

symmetrical federalism

A model of federalism in which provincial governments are entitled to equal powers.

asymmetrical federalism

A model of federalism in which jurisdictional powers are distributed unequally among provinces.

treaty federalism

A system of governance recognizing the equal-order relationship between First Nations and the Crown.

social safety net

Government-funded social-welfare programs designed to assist citizens in their time of need.

as consisting of a compact of 10 equal units. All came together as equal partners to form a common union; therefore, each province is deserving of the same powers and authorities under the constitution. All jurisdictions should have the same autonomy when it comes to establishing their healthcare and education systems, for instance. This sets up a form of **symmetrical federalism**, wherein the powers granted to one province must be available to all provinces. The symmetrical perspective treats all provinces as equals, irrespective of their geographic size, population, economic capacity, history, or political identity.

Others view Canada from a two-nations perspective, also known as the concept of *deux nations*. This view considers Confederation as an agreement between French Canada (represented by Quebec) and English Canada (represented by Ottawa and/or all other provinces). Two-nations proponents view Quebec as possessing a unique constitutional status among all provinces (see Chapter 4). They advocate an **asymmetrical** distribution of powers that favours La Belle Province. Quebec has more control over immigration than any other province, for instance. The province enjoys enhanced powers to select and integrate newcomers compared to other jurisdictions. Typically, then, an asymmetrical style of federalism refers to Canada treating Quebec as a founding partner, rather than just one of 10 equal provinces. More broadly, this approach to federalism suggests that some provinces in some situations deserve unique treatment or status. Indeed, provinces other than Quebec at times argue that their own situation is unique and that a particular policy matter warrants special treatment. This produces a competitive dynamic and inevitable conflict as other provinces jostle for more power and resources.⁵

Others reject both the symmetrical and two-nations views, preferring to recognize the sovereignty of Indigenous peoples. Known as **treaty federalism**, this model treats Indigenous sovereignty on par with the Canadian Crown, such that there are not simply two orders of government in Canada (federal and provincial), but three. This approach corresponds with the principles embodied in the two-row wampum model and the Royal Proclamation of 1763, discussed in Chapter 2. It is also part of a growing literature on multilevel governance in settler colonial states like Canada. Just as federal and provincial governments continue to negotiate the terms of self-rule and shared rule, so, too, do Indigenous governments engage with their federal and provincial counterparts to honour the terms of historical treaties. They seek to establish new systems of governance that respect Indigenous peoples' inherent right to self-government.

As we observed in Chapter 2, the ambiguities of the constitution allow all of these views to co-exist in Canada. Indeed, somewhat ironically, the strength of the federal culture in Canada may contribute to the development of these diverging perspectives.

The Politics of Fiscal Federalism

The regional tensions mentioned in the last section are acute when it comes to funding government programs and services. The importance that Canadians attach to social-welfare programs means that provincial governments are more powerful than Confederation anticipated. This growth is largely attributable to the lead role that provincial governments play in maintaining Canada's **social safety net**. The term "social safety net" suggests that the government will catch people before they fall on hard times, through publicly funded programs that help those in need and improve society. Government is able to encourage citizens to take the risks necessary to advance their well-being and that of their community without fear of becoming destitute, such as taking family leave, going back to

school, or starting a small business. Of the various support networks the social safety net comprises, some are exclusively the federal government's responsibility (e.g., employment insurance, old age security, family allowance), some are exclusively the provincial government's domain (e.g., healthcare, childcare services, social assistance), and some are intergovernmental (e.g., pensions).

The federal government helps to finance some of these provincial programs and services, such as health insurance, student loans, social assistance, and housing subsidies. There are financing agreements in place between federal, provincial, and municipal levels of government, as well as not-for-profit organizations, to provide services such as food banks and emergency shelters. Establishing which level of government should pay and be accountable for what type of service is a constant source of dispute.

Gaps in the System

The constitutional division of powers is only one component of Canadian federalism. Fiscal resources are just as relevant in determining the shape of Canadian politics. **Fiscal federalism** refers to the system of funding transfers that redistribute revenue between the two orders of government and reduce disparities among jurisdictions. Normally this involves the federal government distributing funds to provincial and territorial governments. It may include federal–municipal or federal–citizen grants as well. Fiscal transfers are designed to balance the capacities of the various governments to deliver programs and services to all Canadians, regardless of where they live. In this vein, federalism has two dimensions: one horizontal (among provinces) and one vertical (between the federal and provincial orders).

Every federation has fiscal gaps among their various governments. That is, some governments have more revenue at their disposal than others do. Horizontal fiscal gaps exist when certain regional governments enjoy greater revenue-generating capacities than others. In Canada, regional disparities stem almost entirely from differential access to natural resources like oil and gas. Those provinces that enjoy bountiful resource bases—like BC, Alberta, Saskatchewan, and Newfoundland and Labrador—are deemed to be more affluent than their counterparts in other parts of the country. This fiscal calculation is problematic when we consider that the economic value of natural resources is subject to profound fluctuation.

In and of themselves, these horizontal fiscal gaps do not automatically create problems in Confederation. If the distribution of population aligned with these revenues—such that provinces with greater wealth also had larger populations, and those provinces with less wealth faced fewer demands in terms of spending—there would be little cause for concern. Likewise, there would be few to no gaps if programs and services cost the same amount to deliver in all parts of the country, and if average incomes and business performance was uniform from province to province. This ideal alignment does not exist, however. Instead, Canada has a **horizontal fiscal imbalance**, whereby provinces have varying abilities to raise revenues, affecting their ability to deliver comparable public services. Take, for example, Alberta compared with Newfoundland and Labrador. Alberta is home to over 4.3 million residents; Newfoundland and Labrador's population is approximately 525,000. Alberta's oil and gas wealth spans decades, such that the province was debt-free from 2004 to 2013, and it consistently spent more per capita on programs and services while maintaining Canada's lowest rates of taxation. Conversely, Newfoundland and Labrador has accumulated substantial debt, reflecting the fact the province has some of Canada's highest rates of unemployment and underemployment, some of the country's

fiscal federalism

The manner in which revenues and responsibilities are distributed among various orders and governments.

horizontal fiscal imbalance

A situation in which some provinces have greater capacity to fund their constitutional responsibilities than others.

lowest income levels, and significant reliance on government assistance. Its offshore oil and gas revenues are a recent phenomenon. Governments in both of those provinces enjoy a windfall of revenues that are envied by others, but they must respond to different local circumstances. The value of these resources is subject to the ups and downs of prices set on international commodity markets. Once these natural resources are exhausted, the non-renewable revenue streams will dry up without considerable investment in other sectors. Indeed, faced with massive revenue declines due to the low price of oil, both provinces have been grappling with spending restraint and have registered significant budget shortfalls. Thus, even provinces with generous resource bases have dissimilar policy priorities and spending pressures.

At the same time, vertical fiscal gaps exist wherever the revenue-generating abilities of the central government are different from the (collective) fiscal capacities of the regional governments. In other words, one order of government is able to generate more revenue than another. We might assume that the federal government is at a significant fiscal advantage because of the federal spending power. However, Canada is the only federation in the world in which the vertical fiscal gap favours the provinces. That is, as a group, the provincial governments enjoy more “own-source” revenue than the federal government. This gap exists even before federal transfers are counted, and is once again attributable to the fact that the provinces have exclusive access to natural resource revenues.

At first blush, this vertical fiscal gap suggests the Canadian provinces should be contributing money to the federal government, and not vice versa. Revenues are only one half of the fiscal equation. On the expenditure side, provinces are collectively responsible for a larger proportion of public programs and services than the federal government—and increasingly so. Since the advent of the modern welfare state in the aftermath of World War II, the provinces have inherited responsibility for the fastest-growing areas of government spending, most notably healthcare and education. Under these circumstances, the provinces may enjoy a higher level of revenue, collectively, than the federal government, yet they remain challenged to provide the scope and quality of public services that Canadians demand. This gives rise to the **vertical fiscal imbalance**—a situation in which the federal government has more revenue than it can spend in its own areas of jurisdiction, while the provincial governments have more constitutional responsibilities than they can afford. In many instances, the vertical fiscal imbalance forces provincial governments to raise taxes, cut services, and/or run budget deficits and accumulate debt (see Chapter 8).

vertical fiscal imbalance

The federal government has an excess of revenue, and the provinces an excess of responsibilities, with respect to their constitutional obligations and fiscal capacities.

Addressing Imbalances

Different federal transfer programs exist to address the horizontal and vertical imbalances in Canada’s system of fiscal federalism. Three of these deserve the bulk of attention, as they are by far the largest and most contested: equalization, the Canada Health Transfer (CHT), and the Canada Social Transfer (CST).

equalization

A federal transfer program that is designed to lessen the fiscal disparities among provinces.

Equalization

Equalization is the primary transfer program designed to address the horizontal imbalance in Canada. It operates alongside regional development initiatives and differential formulas built into other federal programs, like employment insurance. The equalization

program was established in 1957 as a mechanism of distributing federal funds to those provinces deemed to be in greatest need. The program's principles were enshrined in section 36(2) of the Constitution Act, 1982, to ensure that "provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation." This means full elimination of the program would require a formal constitutional amendment, including Parliament and the legislatures of several recipient provinces. Equalization payments are paid to the most disadvantaged provinces out of the federal government's general revenues, and the formula by which the funds are distributed has varied over time. The most recent set of changes to the equalization formula came between 2007 and 2009, when the federal government moved to simplify and, at least initially, enrich the size of the program. A separate program, Territorial Formula Financing, sends annual unconditional transfers from the federal government to the three territorial governments to ensure they are in a position to offer Northern residents comparable services at comparable rates of taxation to their provincial neighbours.

The federal government typically consults with provinces every five years regarding the funding formula for the program. The distribution of equalization funds is determined by Ottawa and, as the Trudeau government demonstrated in 2018, they are under no obligation to negotiate with provincial governments when it comes to renewing or revising the formula. Since 2007, the equalization formula has been based on a 10-province standard, meaning that all jurisdictions are included in the calculation of the country's average revenue-generating capacity. Provinces that fall below the national average receive equalization payments based on their population size, while those above that average do not. Not all revenue sources are included in this calculation. Four tax-base indicators are incorporated—personal income taxes, corporate taxes, sales taxes, and property taxes—and provinces are assessed according to how much they could generate if all provinces had the same tax rate. A fifth indicator—50 per cent of natural resource revenues—is included in the calculation of each province's fiscal capacity.

Some premiers attempt to use media pressure to persuade the federal government to devise a formula that will benefit their province the most.⁶ This can lead to divisive politicking, pitting so-called "have" provinces (the wealthier provinces who are ineligible for equalization) against so-called "have-not" provinces (those whose financial capacity is below the national average, qualifying them for equalization), or fomenting dissent among recipients over who receives how much. The term "have-not" is so pejorative in Canadian politics that some now use the nomenclature "have-less" and "have-more" to distinguish the provinces that do and do not receive equalization funding.

There are a number of persistent myths about Canada's equalization program. For instance, there are no perennial "takers" and "makers" in Canada. It is sometimes believed that certain provinces are always dependent on transfers from Ottawa while others never benefit. In fact, every province has received equalization at one point or another in Canadian history. Alberta was among the first set of "have-not" or "have-less" provinces, even though it has not received payments from the program since 1962. Ontario received equalization payments for the first time in 2009, the same year that Newfoundland and Labrador moved into the "have" or "have-more" category for the first time. Quebec and the three Maritime provinces have received equalization payments for decades, while other provinces, notably BC and Saskatchewan, have rotated in and out of the "have-more" category several times.

Another misunderstanding is that equalization payments do not flow directly from have-more provinces to have-less provinces. Critics promote a misconception that equalization funds flow from more affluent to less affluent provinces. Rather, the transfers flow from the general revenues of the federal government to provincial governments with lower-than-average fiscal capacities. That said, compared to their counterparts in have-less provinces, individuals and corporations in Canada's richer provinces contribute more to the federal government in terms of tax dollars than their provinces receive in federal transfers or program spending.

It is not possible to trace, and judge, how provinces spend equalization funds. Some critics of the equalization program argue that recipient provinces squander their transfers, using their equalization funds to lower taxes, depress electricity prices, or create lavish public-service programs. Such judgements are speculation. Equalization is an unconditional transfer that flows into the general revenues of each recipient province. It exists alongside own-source revenues like personal and corporate income taxes, rates for which tend to be higher among have-less governments. As such, it is not possible to determine how each province spends its equalization allotment. Determining whether seemingly generous government programs in have-less provinces are due to equalization or higher taxes is futile.

Vertical Transfers: The CHT and CST

In contrast to equalization, the other two major funding mechanisms—the Canada Health Transfer (CHT) and Canada Social Transfer (CST)—serve to diminish the vertical fiscal imbalance. As its name suggests, the CHT flows from Ottawa to all provinces to help cover the costs of healthcare. Conversely, the CST is intended to assist with the costs of maintaining a host of other social programs, ranging from education to welfare. All provinces receive both the CHT and CST, with each transfer being distributed based on each province's population (per capita).

Initially, Ottawa transferred funds to the provinces on a shared-cost basis for health, post-secondary education, and welfare programs (Figure 3.3). In some instances, Ottawa provided matching funds as a means of facilitating the growth of provincial welfare states.

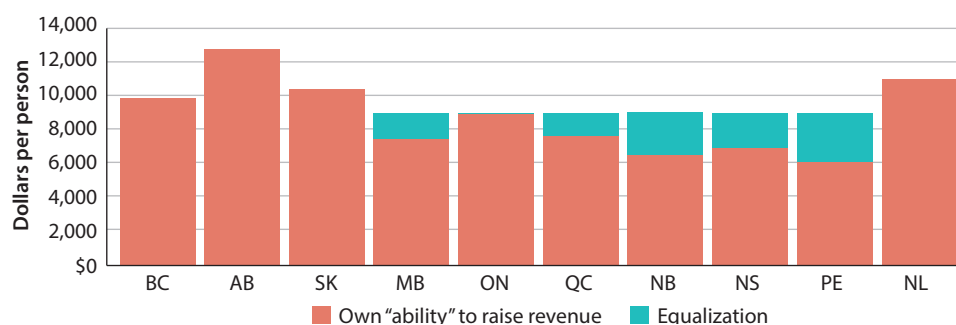


Figure 3.2 | Fiscal Capacity and Equalization, by Province (Fiscal Year 2018–19)

Federal equalization payments bring have-less provinces up to the national average in terms of revenue-generating capacity. But have-more provinces still generate far more revenue per capita, due largely to health natural resource endowments that translate into greater government revenues (royalties and personal and corporate income taxes).

Note: Displays each province's own fiscal capacity, the equalization payment required to bring it up to an "average" level, and the "adjustment payment" to fix the pool of equalization paid. In 2018/19, adjustments totalled \$1.76 billion.

Source: Federal Equalization Workbooks, Table 1, Graph by Trevor@trevortombe

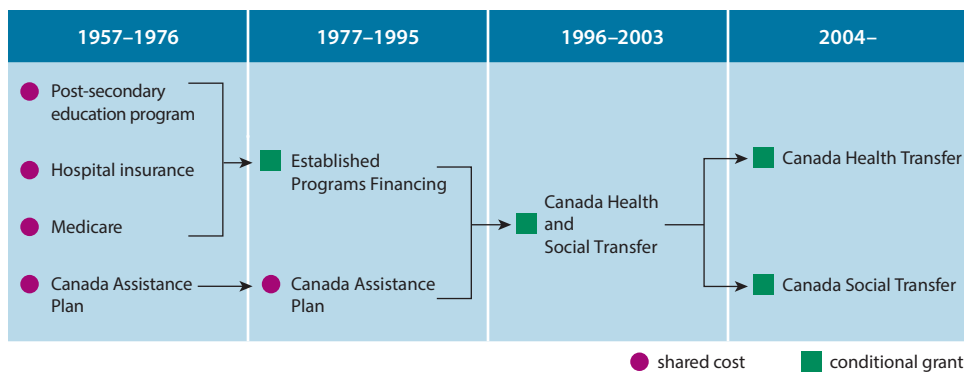


Figure 3.3 | The Evolution of Vertical Transfers

These came to be known as “50-cent dollars” because they came with the stipulation that a province must pay half. Popular if not sustainable in the immediate post-war period, these shared-cost models strained federal and provincial budgets.

In the late 1970s, the federal government began transitioning from the use of unconditional (or block) transfers toward an increased reliance on **conditional grants**. If a province accepted these funds, it was obliged to spend them as per the conditions set by the federal government. For example, the Canada Health and Social Transfer (CHST), in place from 1996 until 2003, prohibited provinces from imposing residency requirements on Canadians receiving welfare services. This meant that a provincial government could not turn away clients based on the fact they had lived outside the province for a specified period of time, ensuring that all Canadians had access to services across the country. It forced provinces to abide by the five conditions of the **Canada Health Act**, namely that provincial health services be:

1. publicly administered,
2. portable across the country,
3. comprehensive in terms of medically necessary services,
4. universally available, and
5. accessible to all.

Provinces that failed to live up to these five conditions—for instance, by allowing certain types of private health services for insurance—were subject to reductions in federal transfers. These mobility conditions continue to apply to the CST and CHT, just as the Canada Health Act continues to apply to the latter. Ottawa imposes similar conditions on dozens of other federal–provincial transfer programs related to justice, infrastructure, labour market development, immigration, environmental sustainability, cultural development, and many other sectors.

Recent developments have challenged the foundations of Canada’s system of federal–provincial fiscal transfers. As of 2014, both the CHT and CST involve **per capita transfers**. This means that these federal funds are distributed to provinces based on the size of their populations rather than on needs-based factors, as they had been previously. In an effort to prevent less affluent provinces from losing out as a result of this shift to per capita funding, the federal government promised that no province would lose CHT or CST

conditional grants

Federal transfers to the provinces that may only be used for a specific purpose, and are subject to federal government restrictions or standards.

Canada Health Act

Federal legislation imposing conditions on provincial governments for the expenditure of funds from health transfers.

For more on medicare and the Canada Health Act see pages 278–9 of Chapter 8.

per capita transfers

Federal funds distributed to provinces based on how many people live in their jurisdictions.

funding year-over-year. In establishing a series of so-called “escalators,” Ottawa guaranteed that all three major transfers would grow at a predictable rate, eventually in line with the growth in Canada’s gross domestic product (GDP) or three per cent, whichever is higher. These federal reforms were designed to encourage provincial governments to rationalize their spending over time, but they may result in adverse policy implications for areas with declining populations.

The sudden, unforeseen economic downturn in the fall of 2008 prompted a second look at this fiscal framework. While retaining its commitment to move the CHT and CST to per capita formulas, the federal government placed a ceiling on the growth of the equalization program. The so-called “GDP cap” made any increase in Ottawa’s contribution to equalization contingent upon Canada’s economic growth. Critics in have-less provinces claimed the federal government reneged on the earlier CHT/CST/equalization deal, eroding the principles of adequacy, stability, and predictability upon which it was based. The change came at an inopportune time, pushing equalization-receiving provinces into even more difficult fiscal positions during an economic recession.

Making matters worse, for the first time in history, the recession pushed Ontario into have-less status. Canada’s largest province drawing funds from equalization left less revenue for the remaining recipients, further challenging them to provide comparable services at comparable rates of taxation. While Ontario became a have-more province in 2018, future federal governments will continue to face pressure to reform the equalization formula and perhaps the entire interconnected transfer system.

Other Transfers

In addition to the big three (equalization, CHT, and CST), the federal government provides a series of other transfers to the provinces. Among them are the following:

- infrastructure funds (to build roads and bridges, for example);
- devolved services agreements (e.g., to provide services on behalf of the federal government, such as education or policing services in First Nations communities);
- one-off grants to provincially run universities and hospitals;
- shared-cost programs like legal aid; and
- fiscal stabilization and disaster financial assistance funds to cushion provincial governments against sudden, drastic drops in revenue and increases in expenditures.

Every year, the federal government enters into hundreds of these sorts of fiscal arrangements with each province. Federal funding to the three territorial governments is covered under an entirely separate set of arrangements, with the block Territorial Formula Financing grants making up a large proportion of each territory’s budget.

Fiscal Federalism: Is It Working?

Critics of Canada’s system of fiscal federalism allege that it disrupts market forces. They argue that it keeps weaker provincial economies alive, provides incentives for Canadians to remain in slow-growth regions, dampens inter-provincial economic competition, and fosters a sense of dependency on federal funding. This prompts calls for the reform, if not abolition, of the equalization program in particular. Some disparage vertical transfers like

the CST and CHT for blurring the lines of democratic accountability: with federal dollars flowing into provincial programs and services, critics find it challenging to assign credit or blame for policy outcomes.

Others see advantages in Canada's system of fiscal federalism. Some view equalization as akin to a national system of revenue sharing, not unlike models in use in professional sports leagues. For instance, the National Hockey League redistributes some of its revenues to the smallest markets for the good of the league as a whole. Wealthy teams that contribute the most to the league's success, like the Toronto Maple Leafs, do not qualify for revenue sharing. Less profitable teams operating in small markets receive funds. The analogy points to the advantages of creating a stronger national economy (or league) by contributing to the growth of smaller provincial economies (or teams). Just as sports leagues generate more revenue and build their market shares by building their brand in smaller markets, federations, too, are stronger when their weaker members are more economically viable. This economic union is stronger both internally by creating domestic markets for Canadian goods and services and externally in the eyes of international investors.

Proponents of Canada's fiscal federalism look at the equalization program as a sort of governmental safety net, allowing provinces to take risks in developing their own-source revenue streams without fear of insolvency. As evidence of this success, they point to the experience of formerly have-less provinces that became have-more, notably Saskatchewan, which achieved marked success in developing its potash industry. Proponents argue that the equalization program and CST/CHT strengthen Canada's social union by fostering the equality of all Canadians regardless of where they live, and by helping long-term communities of interest to survive and thrive.

Inter-state and Intra-state Federalism in Canada

When it comes to negotiations over Canada's social and economic union, Canadian politics has been dominated by **executive federalism**. The term refers to instances where intergovernmental bargaining, deal-brokering, and policy decisions take place among leaders of the various federal, provincial, and territorial governments. Executive federalism was prevalent during the so-called mega-constitutional period discussed in Chapter 2.

executive federalism

A system in which the elected leaders of federal and provincial governments make public-policy decisions.



THE CANADIAN PRESS/Jonathan Hayward

The development of offshore oil and gas reserves moved Newfoundland and Labrador into have-more status. But the province still struggles to balance its budget due to turbulent resource prices, persistently high unemployment, and the relatively high costs of delivering programs and services to its aging and rural and remote residents. What can be done to prevent the province from slipping back into have-less status?