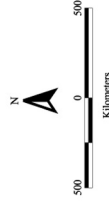
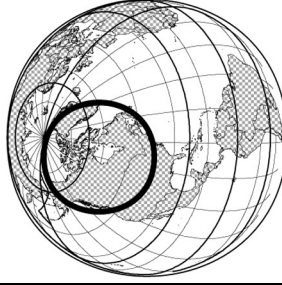


Canada

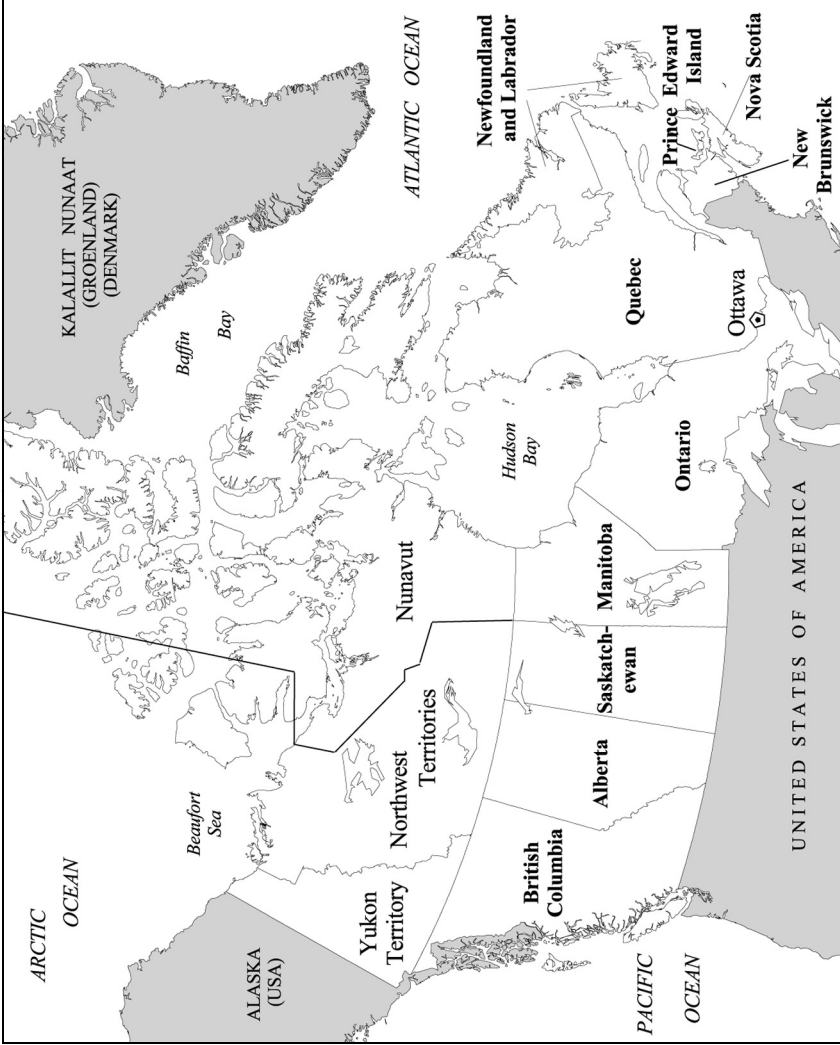
Capital: Ottawa
Population: 31.5 Million

Boundaries and place names are representative only and do not imply official endorsement.

The three northern territories, while administrative divisions, are not provinces.



Sources: ESRI Ltd.; National Atlas of Canada;
Times Atlas of the World



Canada

ROBIN BOADWAY

The Canadian federal system represents the textbook best-practice system of fiscal federalism. Autonomous provincial and municipal governments are responsible for the provision of many important public services. They share with the federal government unrestricted access to all the major tax sources and are responsible for raising a high proportion of their own revenues. Federal transfers to the provinces are only as intrusive as is necessary to achieve national objectives. The two main forms of transfers – unconditional equalization transfers and equal per capita bloc transfers to support provincial social programs – facilitate effective decentralized decision making by ensuring that provinces have comparable fiscal capacities for delivering important public services and by encouraging them to provide health, welfare, and postsecondary education programs that meet minimal nationwide standards. Federal-provincial agreements have led to enviable forms of income tax and sales tax harmonization that provinces are free to adopt, and have established the rules of the game for an efficient internal economic union and for a fair and equitable social union. This chapter reviews the main features of the Canadian federal system and recounts some of the pressures that have arisen recently.

Table 1 summarizes the basic features of Canada. It is the second largest country in the world, covering 9,984,670 square kilometres, but with a population of just 32.3 million. A high proportion of the population lives within 100 kilometres of the border with the United States in an east-west direction. There are ten provinces that run from east to west, and three sparsely populated territories located north of these provinces. The largest province, Ontario, with a population of 12.5 million, covers 1,076,395 square kilometres and has a per capita GDP of US\$35,400. The smallest province, Prince Edward Island, with a population of 138,100, covers only 5,660 square kilometres and has a per capita GDP of US\$24,994. The nationwide per capita GDP is US\$34,710. Roughly speaking, per capita incomes are highest in the west and lowest in the east.

Table 1
Basic political and geographic indicators

Official name: Canada
Population: 32,270,000
Area (square kilometres):9,984,670
GDP per capita in US\$ (year): \$34,710
Constitution: 1867, Constitutional monarchy
Orders of government: federal, provincial and territorial, and local
Constitutional status of local government: subservient to provinces
Official languages: English and French
Number and types of constituent units: ten provinces, three territories
Population, area and per capita GDP in US\$ of the largest constituent unit Ontario:
12,541,400 people
1,076,395 square kilometres
GDP per capita \$35,400
Population, area, and per capita GDP in US\$ of the smallest constituent unit. PEI:
138,100 people
5,660 square kilometres
GDP per capita \$24,994
Exchange rate = .90

Historically, Canada was formed as a confederation of four provinces, one of which was largely French-speaking and the rest English-speaking. French and English remain the official languages of the country, although the francophone population remains largely concentrated in one province (Quebec) and, to some extent, New Brunswick. Most other provinces have a francophone minority. Immigration has been relatively high in Canada (up to 1 percent of the population annually) and has increased the ethnic diversity of the country. There are particularly large Chinese, South Asian, and European populations concentrated in certain areas, and there is a large population of French-speaking immigrants in Quebec.

There is also a sizable population of Aboriginal peoples, consisting of a large number of different ethnic and linguistic groups ranging from the various First Nations (mostly in the provinces) to the Inuit (in the territories). The federal government retains fiduciary responsibility for Aboriginal peoples and is responsible for providing them with public services and protecting various rights that they have acquired through treaties signed with the British Crown.

Canada is a constitutional monarchy in which the monarch is the British queen or king. A federal governor general and provincial lieutenant-governors are appointed by the relevant governments to be the monarch’s representatives in Canada. There is a federal parliament and a legislature

in each province and territory that is elected by a first-past-the-post voting system. This results in a parliamentary democracy in which a small number of main parties vie for election. Typically, there is a majority party whose leader becomes the federal prime minister or a provincial premier, and whose policies are enacted by majority voting in the relevant legislature. Occasionally, the government is a minority one that has to rely on second or third party support to pass legislation. In practice, one party (the Liberal Party) has dominated the federal Parliament, while often a different party is in power in many of the provinces. The result is a reasonably stable government with elections every four to five years as chosen by the party in power. Local governments are also elected by majority voting, although the party system does not apply there.

All federal laws are passed by Parliament and must also be passed by the Senate, whose members are appointed by the prime minister and serve until age seventy-five. The Senate can hold up most legislation, but only temporarily. Provincial laws are passed by their legislatures and municipal laws by their elected councils, although there is no second chamber in the provinces or municipalities. The executive branch consists of a permanent civil service, organized mainly into line departments whose heads are usually ministers drawn from the elected representatives of the party in power. There is also a supreme court, which is appointed by the prime minister. It is the highest appeal court and rules on the constitutionality of legislation as well as on matters arising from the Charter of Rights and Freedoms, which is a component part of the Constitution.

The legal system is based on a common law system inherited from the United Kingdom, except in Quebec, where civil law is used, reflecting that province's French heritage. There are also many quasi-judicial bodies that serve regulatory functions delegated to them by the federal and provincial governments.

Accountability is achieved largely by periodic elections in all spheres of government. This is aided by a free press and by a tradition of freedom of speech and association that, along with other rights, are codified in the Charter of Rights and Freedoms, which was incorporated into the Constitution in 1982. The federal government and the provinces also have auditors-general, who audit government programs and report to Parliament and the legislatures on whether funds have been lawfully spent and value for money has been obtained. All governments also have financial management and accountability systems. Citizens are protected by the Charter of Rights and Freedoms as well as by human rights tribunals that oversee human rights legislation, freedom of information legislation, privacy commissioners, and ombudsmen. There is also a federal language commissioner responsible for reporting on the enforcement of official language requirements.

THE STRUCTURE OF GOVERNMENT AND DIVISION OF FISCAL POWERS

The Constitution sets out fundamental obligations with which governments must abide and imposes limits on legislation. Obligations include those imposed jointly on the federal government and the provinces to provide minimum levels of basic public services, to pursue equality of opportunity, and to foster economic development. In addition, the federal government is committed to providing equalization payments to the provinces so that they can provide “reasonably comparable levels of public services at reasonably comparable levels of taxation.”¹ Limits on legislation include the requirement that laws satisfy the Charter of Rights and Freedoms and some minimal requirement not to interfere with interprovincial trade.

Federal and provincial legislation is restricted by the division of powers set out in the Constitution. The latter lists a number of powers that are exclusively federal, such as defence, international trade, criminal justice, money and banking, international waterways, unemployment insurance, bankruptcy, and divorce. The federal government can also use any form of taxation it chooses, and it is free to spend as it sees fit and to borrow and lend. Other areas are shared between the federal and provincial governments, including immigration, agriculture, and pensions, although only in the former two is the federal government paramount. More generally, the federal government is allowed to legislate as required for “peace, order and good government,”² and it has the power to disallow provincial legislation, although this has rarely been used. The provinces have the residual powers (i.e., those not assigned to either government). Exclusive provincial powers listed in the Constitution include health, education, social services, civil and property rights, administration of justice, highways, and matters of a local nature. There are two areas of formally shared jurisdiction (agriculture and immigration) and several others that, in practice, are also shared (e.g., environmental protection and higher education). Table 2 summarizes the expenditure responsibilities of the orders of government, and Table 3 indicates the breakdown of spending by function and order of government.

Provinces can raise revenues for their own purposes using “indirect taxes,” although in practice this has been widely interpreted to include virtually any tax, except that aimed at taxing non-residents. The provinces also own the natural resources within their borders and can manage and tax them as they see fit. This has turned out to be a very important feature of the Canadian federation and one that has led to intergovernmental conflicts. Provinces have unfettered control over their own budgets, including the ability to borrow and lend.

Table 2
Legislative responsibility and actual provision of services by different orders of government

<i>Legislative responsibility (de jure)</i>	<i>Public service</i>	<i>Actual allocation of function (de facto)</i>
Federal	Trade and commerce	Federal
Federal	Unemployment insurance	Federal
Federal	Banking and currency	Federal
Federal	Postal service	Federal
Federal	Census and statistics	Federal
Federal	Defense and foreign affairs	Federal
Federal	Shipping and offshore	Federal
Federal	Bankruptcy	Federal
Federal	Patents, copyrights	Federal
Federal	Indians	Federal
Federal	Citizenship	Federal
Federal	Marriage and divorce	Federal
Federal	Criminal law and penitentiaries	Federal
Federal and provincial	Pensions	Federal and provincial
Federal and provincial	Immigration	Federal
Federal and provincial	Agriculture	Federal and provincial
Provincial	Administration of justice	Provincial
Provincial	Civil and property rights	Provincial
Provincial	Public lands and natural resources	Provincial
Provincial	Health	Provincial
Provincial	Licensing	Provincial
Provincial	Municipal institutions	Provincial
Provincial	Incorporation of companies	Provincial
Provincial	Local services	Local
Provincial	Education	Provincial and local
Provincial	Social welfare	Provincial and local

Table 3
Direct expenditures by function and level of government

<i>Function</i>	<i>Federal (%)</i>	<i>State or provincial (%)</i>	<i>Local (%)</i>	<i>All (%)</i>
Defence	100	0	0	100
Debt servicing	53.2	42.1	4.7	100
General administration	44.0	27.3	28.7	100
Law and order	55.4	23.1	21.5	100
Economic services	26.9	47.7	25.4	100
Social services	57.6	37.1	5.3	100
Health	21.0	77.7	1.3	100
Education	5.3	52.6	42.1	100
Subsidies				100
Total	37.4	45.1	17.5	100
Local public services ¹	0.0	0.0	100.0	100

1. Local public services include: primary and preschool education, secondary education, public health, hospitals, urban highways, urban transportation, drinking water and sewerage, waste collection, electric power supply, fire protection, public order and safety, police.

Municipal governments are entities of provincial governments, and their powers flow from provincial legislation. They are responsible for local matters, such as local policing, water, sewage and garbage, local roads, and recreation. They often participate in the delivery of provincial services, such as welfare and education. Local governments rely on property taxes and user fees and have the freedom to set their own tax rates. They are also able to borrow and lend, although there may be some restrictions on infrastructure investments and on their ability to borrow to finance them. Table 4 shows the sources of revenue by source and order of government.

The division of powers accords well with best-practice principles.³ National public goods are assigned to the federal government; local public goods are decentralized. The provinces are responsible for public services and targeted transfers delivered to citizens, while the federal government retains responsibility for major social insurance transfers. Both orders of government have access to the main taxes so that a degree of revenue-raising autonomy can be achieved. Expenditure programs that affect provincial residents but have some spillover effects are shared responsibilities. The federal government has the ability to make transfers to the provinces to close any vertical fiscal gap between expenditure responsibilities and revenue raising, and the same applies to the provinces with respect to their municipalities.

Table 4
Tax assignment for various orders of government

	Determination of			Shares in revenue (%)			
	Base	Rate	Tax collection and administration	Federal	State/province	Local	All orders
Federal							
Income tax	Federal	Federal	Federal	64.7	35.3	0	100
Consumption tax	Federal	Federal	Federal	45.3	54.7	0	
Payroll tax	Federal	Federal	Federal	68.6	31.4	0	
User fees	Federal	Federal	Federal	24.4	23.3	52.3	
State or provincial							
Income tax	Federal	Provincial	Federal	64.7	35.3	0	100
Consumption tax	Provincial	Provincial	Fed & prov	45.3	54.7	0	
Payroll tax	Federal	Provincial	Federal	68.6	31.4	0	
Resource tax	Provincial	Provincial	Provincial	0	100	0	
Health premium	Provincial	Provincial	Provincial	0	100	0	
Property tax	Provincial	Provincial	Provincial	0	2.2	97.8	
User fees	Provincial	Provincial	Provincial	24.4	23.3	52.3	
Local							
Property tax	Provincial	Local	Provincial	0	2.2	97.8	100
User fees	Local	Local	Local	24.4	23.2	52.3	

Table 5 indicates the size of the vertical fiscal gap between the federal-provincial and provincial-municipal governments. There are, however, some anomalies. Provincial ownership of natural resources leads to significant horizontal imbalances. Provinces also have the authority to tax business income and capital, despite the fact that these are mobile tax bases. They also have the right to levy taxes on inheritances, but these have disappeared, in part due to interprovincial tax competition. In addition, provinces have the authority to regulate both securities markets and labour markets, and this has the potential to create inefficiencies in internal markets.

While this assignment of responsibilities contributes to the efficient delivery of public services, it also has the potential to create inefficiencies and inequities within the federation. Both can occur if decentralized fiscal responsibilities leave provinces with large disparities in their ability to provide public services and if provinces exercise their fiscal responsibilities in a way that leads to very different levels of public services and different degrees of social protection. Indeed, both spheres of government share responsibility for equity, although some of the major policy instruments for achieving equity are in the hands of the provinces. Moreover, there is a

Table 5
Vertical fiscal gaps

	<i>Total revenue collected (in current US\$ million – 2005)</i>	<i>Total revenue available, including net transfers for that level of government (in current US\$ million – 2005)</i>	<i>Expenditures (in current US\$ million– 2005)</i>
National	181,466	182,044	142,764
Subnational			
State/provincial	172,087	211,367	203,988
Local	38,464	45,737	47,595
All orders	392,018	439,148	394,347

fairly strong national consensus that common levels of social programs should be provided across the country.⁴ Indeed, social citizenship in the form of minimum standards of social services like health, education, and welfare are regarded as one of the more important functions of governments, even more so than the progressivity of the tax system. As a result, the role of government as a vehicle for social protection is given much more emphasis than are other government roles, such as defence and infrastructure spending, and the majority of government spending can be interpreted as contributing to redistributive objectives.

The fact that both spheres of government share responsibilities for national equity and efficiency, while the provinces control many of the important policy instruments, leads to the federal government’s exercising some influence over provincial program design. This is largely done using spending power – that is, federal grants to the provinces and territories.⁵ This is a powerful way for the federal government to influence provincial policies, notwithstanding the fact that provinces enjoy exclusive legislative jurisdiction in such areas as health, education, and social services. The federal government uses transfers to equalize the capacity of the provinces and territories to provide public services and to influence the design of some services so as to achieve basic national standards.⁶ A by-product of this is that the federal government occupies relatively more of the tax room than do the provinces, and this contributes to its ability to induce tax harmonization among governments in income and sales taxation.

The federal government is also able to influence provincial decisions through moral suasion, given that federal and provincial officials are in constant negotiations. As well, there are federal-provincial agreements in various areas that contribute to policy harmonization. Some of these are

multilateral, such as the Agreement on Internal Trade and the Social Union Framework Agreement. Others are bilateral, such as agreements on immigration and child tax credits between the federal government and individual provinces. The tax harmonization agreements covering corporate, personal, and sales taxes are also bilateral in nature, although common templates apply to all provinces that choose to participate.

Naturally, conflicts and situations of disharmony arise between the federal government and the provinces regarding fiscal issues. This is inevitable in a setting in which (1) both spheres of government share some common goals, (2) both have access to similar broad tax bases, and (3) both act independently. Three main sources of fiscal conflict arise. The first results from the fact that the federal government uses its spending power to influence provincial government program design by putting conditions on federal-provincial transfers. The federal government argues that it needs to use its spending power in this way to ensure that provincial social programs take account of national equity and efficiency objectives. The provinces argue that the imposition of conditions violates the spirit of the Constitution, which assigns exclusive legislative authority to the provinces in such areas as health, education, and welfare. There can be no clear resolution of this conflict, although it can be minimized by the federal government attaching only broad, general conditions to its grants, which in recent years has been the case. The Social Union Framework Agreement was negotiated between the federal and provincial ministers to manage the use of the federal spending power, requiring, among other things, that the federal government give advance notice before it is used.

The second source of fiscal conflict concerns the appropriate balance between the revenue and expenditure responsibilities of the federal and provincial governments. The provinces have argued that there is a vertical imbalance in the sense that the level of federal-provincial transfers is too low given the amount of tax room that the federal government has pre-empted relative to its expenditure responsibilities.⁷ To the extent that such an imbalance exists – and the federal government has disputed that it does – there are two types of remedies. One is to turn more tax room over to the provinces by reducing federal tax rates and allowing the provinces to increase their rates. The other is to increase the size of transfers. The provinces disagree as to which remedy is preferable. Some, like Quebec and Alberta, favour turning over tax room; others, such as the Atlantic provinces, favour more transfers. In 2003, the provincial and territorial governments joined together as the formal Council of the Federation to promote intergovernmental cooperation. In 2005, the council established the Advisory Panel on Fiscal Imbalance to recommend ways to restore fiscal balance. Its recommendations included an enhanced equalization system and further transfers from the federal government

for social programs.⁸ However, the provinces were unable to achieve a consensus on the recommendations of the panel.

The third source of conflict involves horizontal fiscal imbalances. As the federation has become more decentralized, fiscal disparities among provinces have increased. This has traditionally been addressed by equalization transfers, but these have come under increasing strain in recent years. The rapid rise in oil and gas prices resulted in large disparities between provinces that have significant oil and gas deposits and those that do not. This increased the cost and the volatility of the equalization program, and the federal government responded by fixing the total transfer and its rate of growth over time. To address the issue, the federal government established the Expert Panel on Equalization and Territorial Formula Financing to advise it on the future design of the equalization program, including whether an arm's-length advisory commission should be established. The panel reported in June 2006 and recommended that a ten-province equalization standard be used that includes one-half of resource revenues.⁹ The federal government is expected to announce its preferred resolution to the fiscal imbalance in its 2007 budget.

Another issue is that of the asymmetric treatment of different subnational governments. Various forms of asymmetry have evolved. The fiscal transfer arrangements with the territories differ considerably from those applying to the provinces. Because of their sparse populations and harsh northern conditions, the territories incur a much greater cost with regard to delivering public services than do the provinces. This is recognized by levels of transfers that are significantly higher on a per capita basis than are those made to the provinces. Unlike with provincial transfers, which are based on revenue-raising capacity, transfers to the territories are based on expenditure requirements. Another area of asymmetry occurs between Quebec and the other provinces. Quebec chose to opt out of certain federal-provincial transfers in return for differential tax room. In addition, Quebec chose not to join the federal public pension scheme but to run its own; and it chose not to join the tax harmonization arrangements for the personal and corporate income taxes but to administer its own. In the case of the value-added tax (VAT), Quebec has a special agreement with the federal government whereby the province administers the tax both for itself and for the federal government. Quebec also has special arrangements for immigration. These asymmetries do not constitute special treatment for Quebec because virtually all of the special arrangements that apply to Quebec are available to the other provinces as well, but they have chosen not to adopt them. These asymmetries reflect the unique nature of Quebec relative to the rest of Canada, it being the historical home of the French language, culture, and institutions.

Local governments have considerable independence over public services of a local nature, and they have the authority to determine their own levels of revenue. They are, however, subject to varying degrees of provincial oversight with regard to some of their operations. They must abide by provincial planning rules, and, in some cases, they are involved in administering provincial spending programs. They also face some borrowing restrictions. They rely on provincial transfers for a significant proportion of their spending, and these transfers are typically provided on an equalizing basis. As do the provinces, local governments sometimes argue that they face an imbalance between their spending responsibilities and their revenue-raising capacity. This has led to concern about the fiscal plight of the cities, inducing the federal government to make some direct fiscal transfers to them, bypassing the provinces.

Particular issues of accountability arise where large cities rival provinces in population and economic size. These issues have been magnified by the fact that some provinces have unilaterally amalgamated neighbouring cities into larger units and, in some cases, have created an additional tier of metropolitan governments responsible for region-wide policies such as transportation and policing (e.g., Toronto and Montreal). These amalgamations were intended to improve the efficiency and equity of local service provision but were often controversial. In the case of Montreal, in 2003 a change in provincial government enacted a law that enabled localities to separate from the amalgamated city.

Finally, while issues of national equity have played an important role in guiding the design of Canadian intergovernmental fiscal arrangements, the efficiency of the national economy has been a consideration as well. Efficiency in the internal economic union has been addressed in four main ways. First, the Constitution contains a provision that precludes provinces from interfering with interprovincial trade in goods and restricts them to using direct taxes on their residents. These are relatively weak provisions. The interprovincial trade article does not apply to services or factors of production. Furthermore, the courts have interpreted the restriction on direct taxation in a generous way, with the result that provinces can levy almost any kind of tax. Second, the federal government has used its spending power to induce provinces not to impose mobility restrictions on entitlements for social programs. This has been quite effective in the cases of social welfare and health. Third, federal-provincial tax harmonization agreements have been relatively effective in harmonizing federal and provincial income tax bases and, to a lesser extent, sales tax systems. Experience indicates that, in order to be effective, the federal government needs to retain a significant share of the tax room in these areas. Finally, and potentially most important, the federal and provincial governments have

negotiated the extensive and detailed Agreement on Internal Trade, which covers a wide variety of areas, including procurement, labour market regulation, investment, and policies that affect the flow of goods and services across provinces. On paper, this agreement appears to be very comprehensive and should facilitate efficiency in the internal economic union. In practice, however, it has been relatively ineffective, largely owing to a weak dispute-settlement mechanism. Nonetheless, it represents an agreement that could be strengthened in the future. There remain some significant barriers to interprovincial transactions in areas such as regulation of the professions, workplace rules, capital market regulation, and procurement.

FISCAL FEDERALISM AND MACROECONOMIC MANAGEMENT

Fiscal decision making is highly decentralized, with the federal and provincial governments exercising independent legislative discretion with respect to their own fiscal policies. The aggregate size of provincial budgets is comparable to that of the federal government, so responsibility for fiscal policy is inevitably shared. Given the nature of budgetary decision making – especially its norms of secrecy – federal and provincial fiscal policies are not coordinated. Nonetheless, they are interdependent in the sense that the tax bases are common, and federal transfers to the provinces can affect provincial budgets. Indeed, a common complaint of the provinces is that federal changes to provincial transfers sometimes occur unexpectedly, which makes provincial budgetary planning difficult. A problem that arises in this context is that, because budgetary objectives are often relatively short-term and because federal-provincial transfers are budgetary items, changes in federal-provincial fiscal relations may not always take longer-term consequences for the federation into account.

Despite this, the federal government does pursue an active fiscal policy, using taxation, expenditures, and transfers to pursue macroeconomic goals, including employment, growth, and debt control. The larger provinces, which perceive that they have some influence over economic activity within their borders, also use fiscal policy instruments for that purpose. But to the extent that provincial governments are reluctant to use deficits to stimulate activity, the possibility exists that provincial fiscal policies can be pro-cyclical rather than anti-cyclical.

The extent of independence of decision making in all the orders of government leads to a high degree of accountability to their electorates. Moreover, this fiscal independence has precluded soft-budget constraint problems, which arise when fiscal transfers respond to the financial needs of recipient governments.¹⁰ This problem is averted because the bulk of transfers are formula-driven and are based on factors that are independent

of government control. Fiscal discipline applies to federal, provincial, and local governments through a combination of political accountability and capital market discipline. Some provinces have enacted legislation that restricts the use of deficit financing. Such legislation is self-imposed rather than enacted by the federal government or embedded in the Constitution.

Monetary policy is the constitutional responsibility of the federal government and is delegated to the central bank – the Bank of Canada. The bank enjoys virtual independence in its policies, although there is constant contact between the minister of finance and the governor of the bank. The bank takes its primary goal to be price stability and uses inflation targeting to determine its policies. It takes as given the debt and borrowing choices of federal and provincial governments, which are chosen independently. There is no Canadian equivalent of the European Union's Growth and Stability Pact limits on member-country deficit finance. No doubt this has the potential for complicating the conduct of monetary policy, and concern has sometimes been expressed about the consequences for some regions of a single national monetary policy, when different regions might be experiencing very different rates of inflation and unemployment. However, there have been no attempts to decentralize decision making and advice over monetary policy, such as is the case in the United States, with its system of twelve federal reserve banks.

ISSUES IN REVENUE-RAISING RESPONSIBILITIES

All spheres of government collect significant amounts of own-source revenues and are responsible for the size of their budgets. The proportion of provincial expenditures financed by own-source revenues has been gradually increasing for several decades, both because provinces have been occupying more and more of the tax room and because their expenditure responsibilities have been rising more rapidly than has the level of federal-provincial transfers.

The federal government has the constitutional right to raise tax revenues by any mode of taxation. It obtains most of its revenues from three broad-based tax sources: personal income taxation, sales taxation, and payroll taxation. The income tax is progressive, although the capital income of various assets is sheltered (e.g., pensions and housing), and is complemented by a corporate income tax that is partly integrated with it. The sales tax is a very comprehensive VAT called the Goods and Services Tax (GST). Payroll taxes are earmarked for social insurance programs (pensions and unemployment insurance). The federal government obtains lesser revenues from excise taxes, trade duties, lotteries, and user fees. Notably, there is no tax on inheritances, although capital gains are deemed to be realized on death. Inheritance taxation was turned over to

the provinces decades ago, and it was gradually competed out of existence – a classic case of tax competition. Moreover, there are no direct taxes on resource revenues, although these generate income and sales tax revenues.

The provinces also use the same three broad-based taxes. Their income taxes are similar in structure to the federal one, but sales tax structures vary widely from province to province. Some have adopted a VAT, others have retail sales taxes on goods, and one has no sales tax. Payroll taxes are sometimes used for funding specific social insurance programs and sometimes for supplementing general revenues. Provinces also levy corporation income taxes and capital taxes. Like the federal government, they obtain revenues from specific excise taxes, gambling, user fees, and other lesser sources. A significant source of their revenues comes from taxes and charges imposed on natural resources. Royalties and the sale of licences are used in the case of oil and gas, and mining income taxes apply to minerals of various sorts. Fees are also obtained from renewable resources such as timber. In some cases, especially hydroelectricity, provincial Crown corporations are used to generate profits for general revenues.

Tax harmonization arrangements exist with respect to some tax types that are shared by the federal and provincial governments. In the case of the income tax, harmonization is achieved by tax-collection agreements negotiated between the federal government and individual provinces. These agreements follow a common template and are open to all provinces. In the case of the personal income tax, the provinces must abide by the federal tax base but are allowed considerable discretion with respect to choosing their rate structures, including both the size of tax brackets and the use of tax credits. They have full discretion over the level of provincial tax rates and, therefore, over the amount of revenue they will raise. The provinces have used this discretion fully, so that different tax rates apply in different provinces, as do different rate structures. Indeed, Alberta has opted for a flat-tax system. The provinces must also abide by a common allocation formula, which, in the case of the personal income tax, allocates income to the provinces on the basis of a taxpayer's province of residence on 31 December of each tax year. In return for agreeing to join the tax-collection agreements, a single tax-collection authority – the Canada Revenue Agency – applies for both the federal and provincial income tax. Only one province (Quebec) has not joined the personal income tax collection agreements, choosing to operate its own personal income tax system.

A parallel tax-collection agreement system applies for the corporation income tax. Those provinces that participate agree to accept the federal tax base, but they are allowed full discretion to determine the provincial tax rate. A common allocation formula applies based on an average of a

corporation's revenues and payrolls in each province. For participating provinces, the federal government acts as the tax-collecting authority and bears the costs. Three provinces do not participate in corporate tax collection agreements (Alberta, Ontario, and Quebec). Together, they account for over three-quarters of corporate income, which would seem to restrict the usefulness of corporate tax harmonization. However, these provinces have in fact designed their corporate tax bases to be similar to the federal base, and they abide by the same allocation formula.

Two comments should be made on the income tax harmonization system. The first is that the tax collection agreements are a federal government initiative, and it seems clear that, in order to sustain them, the federal government needs to maintain some minimum share of the income tax room. As the share of federal personal income tax room gradually dwindled over the post-Second World War period, the provinces brought increasing pressure to bear to loosen the conditions that applied to them. Indeed, some threatened to leave the agreements. In response to this pressure, the system was changed significantly in the 1990s, from one in which the provinces had to abide by the federal rate structure and could only choose a surtax rate to apply to federal tax liabilities to one in which they could choose their own rate structures (within some limits).

The second point concerns the possibilities of tax competition. Despite the predictions of economic reasoning, there seems to have been little tax competition in the income tax area, apart from the mentioned tendency to reduce income tax progressivity. For example, there appears to have been little competition driving provincial corporate tax rates down. There may be various reasons for this, including implicit cooperation among provincial governments. Some observers have also argued that the existence of a strong equalization system that has put provinces on a more equal fiscal footing may have reduced the impetus for tax competition, especially since the consequences of a competitive reduction in tax rates to attract larger tax bases would, to a great extent, be offset by reduced equalization payments.¹¹ Despite the wide discretion that provinces have to set tax rates, relative tax rates across provinces do not deviate from the average by significant amounts, with the exception of Alberta, whose tax capacity is well above average due to its oil and gas wealth.

Harmonization of sales taxes is much less complete, and this no doubt partly reflects the difficulty that exists in both operating and harmonizing a VAT in a decentralized setting with no border controls. Two such arrangements exist. The first involves a federal sales tax harmonization agreement with New Brunswick, Nova Scotia, and Newfoundland and Labrador. Under this agreement, there is a single federal and provincial VAT with one rate, called the Harmonized Sales Tax (HST), which replaces both the

federal GST and provincial sales taxes. Revenues raised on behalf of the three provinces are allocated to them in accordance with estimates of their aggregate consumption. This arrangement can be seen as essentially a revenue-sharing agreement, although the three provinces together can influence the rate of revenue sharing (i.e., that component of the HST tax rate that reflects the provinces' common rate).

The second such agreement involves the federal government and Quebec, whereby the provincial sales tax – the Quebec sales tax (QST) – is harmonized with the federal GST. In this case, the tax is collected by the Quebec government both for itself and for the federal government. The main problem with administering such arrangements concerns properly accounting for cross-border transactions using the standard VAT invoice-and-credit approach. This is handled by using the so-called deferred payment method, whereby imports of intermediate goods into the province are not initially subject to the QST but become liable once the first sale occurs within the province. This method seems workable when only one province is involved, but it remains to be seen how easily such a system would work if several provinces set up VATs with different tax rates. At the very least, compliance would be complicated.¹²

Other provinces have been reluctant to abandon their retail sales taxes in favour of VATs despite the economic arguments for doing so. Partly, this is because VATs are unpopular, given that they include services in their bases. The provinces also seem to fear that they would lose considerable discretion over sales-tax policy if the most feasible method of harmonization was the HST version, whereby individual provincial tax rates could not be chosen.

It is significant to note that, for those taxes that provinces alone collect, especially resource taxes, there is no harmonization. Indeed, resource taxes come in very different types, depending both on the resource and on the province. This can be taken as a reflection of how difficult it is to coordinate policies horizontally without the federal government acting as facilitator or initiator.

Local governments rely on two main sources of own revenues – property taxes and user charges – with the latter increasing in importance. They have discretion for setting their own tax rates. Sometimes the province also uses the property tax by applying a province-wide tax that is used to finance services like education. Alternatively, a portion of property taxes may be earmarked for education, with the rate being set by the province or by a special education authority. Where metropolitan or regional governments exist, they may also be allowed to set their own property tax rate alongside that of local governments.

Property taxes are harmonized within all provinces. The property tax base is the market value of properties (including both land and buildings),

and it is assessed using standard assessment principles in all provinces. Local governments are then able to apply their own property tax rates to this common base. Separate tax rates typically apply to residential and commercial properties. Most provinces have a system of equalizing the fiscal capacities of local governments, with ability to raise property tax revenues being an important determinant of equalization. Moreover, the federal-provincial equalization scheme includes property taxes as one of the bases subject to equalization, including both provincial and local components.

Conflicts similar to those between provinces and the federal government arise between local governments and the province. There may be discontent over the extent of horizontal equalization – for example, between high-fiscal capacity urban areas and low-fiscal capacity areas – with the former resenting the relatively high property tax rates that result from such equalization of, say, education financing. Equally important is the allegation of vertical imbalances between the province and the local governments. Just as the provinces complain that the federal government does not provide sufficient transfers, given the division of tax room and the relative expenditure responsibilities, so the local governments claim that their transfers from the province are insufficient. In fact, property tax levels are high in Canada compared with what they are in other OECD countries, and cities argue that this tax burden makes it difficult for them to attract and retain businesses.

The financing of services to First Nations falls outside the normal federal structure. There are more than six hundred First Nations communities, most of which are quite small, located in remote areas, and have little revenue-raising capacity. The federal government is responsible for providing public services for them, including those that would otherwise fall into provincial jurisdiction. Many Aboriginals choose to live away from their reserve communities, typically in urban areas. They, too, tend to be relatively poor and dependent on the state for income and services, which are provided by the provinces. Members of First Nations on reserves are exempt from paying federal or provincial taxes as a result of past agreements that have become federal acts of Parliament. Federal financing of First Nations is much more hands-on than are transfers to the provinces, which tend to be in blocs and with only general conditions attached. In the case of First Nations financing, transfers are highly discretionary and specific to particular uses, such as schools, health care, housing, and welfare. Even where the First Nations assume some administrative responsibility for delivering the programs, they remain accountable to the federal government for how the funds are spent. The amount that they receive depends on local circumstances, including costs and the ability to raise own-source revenues. This gives rise to potential incentive problems. In the past, commentators have argued that local accountability, good governance, and quality of

services could all be enhanced if the transfer system for First Nations were similar to those that apply to the provinces and/or municipalities and if local Aboriginal communities were given more discretion in providing services for themselves. The problem is how to build up the capacity for self-administration and self-government – goals that are widely accepted. It is a typical chicken-and-egg problem, not unlike what one encounters in considering the case for decentralization in developing countries.

FISCAL EQUITY AND EFFICIENCY CONCERNS AND INTERGOVERNMENTAL FISCAL TRANSFERS

Canada is a large, diverse nation with provinces that differ in their geography, their natural endowments, and the extent of their economic development. The decentralization of public service provision and revenue-raising responsibilities inevitably gives rise to disparities in fiscal capacity. Decentralization also affects, as well as reflects, differences in the extent of commitment to national equity objectives, including those that are written into the Constitution. Managing decentralization has been a challenge to the Canadian federation – one that has become increasingly important as the provinces have become more and more self-sufficient.¹³

There are two main sources of significant fiscal disparities in the Canadian federation, one independent of decentralization and the other an integral part. The first results from the fact that the provinces own the natural resources within their borders and have the right to tax them as they see fit. The provinces differ considerably in their ability to raise revenues from natural resources. The most important source of resource-based fiscal disparity is that arising from oil and gas deposits, which are highly concentrated in Alberta and, to a lesser extent, British Columbia and Saskatchewan. There are also oil and gas reserves on federal lands in the territories and off the east coast. In both cases, the resources are rightfully owned by the federal government. However, the federal government has essentially turned over the offshore resources to the provinces of Nova Scotia and Newfoundland and Labrador, and there is a possibility that it will turn them over to the territories as well.

The disparities generated by oil and gas revenues are enormous. Alberta's per capita revenue-raising capacity is over 50 percent higher than that of the next highest province. This poses a conundrum for the federal government. By the Constitution, it is committed to making equalization payments to the provinces to overcome these fiscal disparities; however, in the case of resource revenues, it does not have direct access to them, so affordability is an issue. As a result, oil and gas revenues have never been fully equalized. This is anomalous because other types of resource revenues that give rise to fiscal disparities are equalized, including provincial

mining taxes and timber revenues. However, in the case of hydroelectricity rents, which can also create large disparities, equalization is minimal. This is because provinces with significant resources of this type (i.e., Quebec and Manitoba) have tended to exploit them through provincial Crown corporations that dissipate at least part of the rents as lower prices to provincial users.

The second main source of disparities comes from differences in per capita incomes among provinces. These have been fairly persistent, with the large province of Ontario, located in the manufacturing heartland, leading the way, and the five most eastern provinces lagging behind. The sizes of fiscal disparities arising from this source depend on the extent of fiscal decentralization: the more provinces rely on their own revenues, the greater the fiscal disparities. The federal government, unlike in the case of natural resources, has the potential to equalize fiscal disparities arising from differences in per capita income across provinces because it has access to taxes on income or their equivalent. Nonetheless, decentralization makes it more difficult for the federal government to fulfill its equalization objectives because disparities become larger while its own tax room decreases.

Fiscal disparities can also arise on the expenditure side because of differences in the need for public services and differences in the cost of delivering them. There is limited evidence about the magnitude of such differences, although there is reason to believe that they are not as large as they are on the revenue-raising side. That is because differences in costs and need tend to offset each other. Provinces that have the highest need because of the demographic structure of their populations or the number of long-term unemployed also tend to be the ones that have the lowest cost of service delivery. Perhaps the most significant differences in need apply between urban and rural areas. However, there is not a systematic difference among provinces with regard to the extent to which they are urbanized.

There remains a significant vertical fiscal gap, despite the extent of decentralization of revenue raising to the provinces. This fiscal gap serves three purposes. First, it enables the federal government to retain a large share of tax room in the income and sales tax fields, thereby facilitating tax harmonization. Second, a vertical gap is needed to finance the equalization transfers that are the cornerstone of federal-provincial fiscal arrangements. Moreover, as I have mentioned, the larger the vertical fiscal gap, the smaller the need for equalization. Finally, the vertical gap enables the federal government to use conditional transfers to influence provincial social program design. Whatever the validity of these arguments for a vertical fiscal gap, there still remains a conflict over whether there is a vertical imbalance – that is, whether the size of transfers is appropriate, given the revenue raised by the federal government relative to its own expenditure responsibilities.

The form of the system of fiscal transfers is relatively simple. There are two main federal-provincial transfers, comprising about one-quarter of the federal budget. One is the equalization system; the other is the system of social transfers. Equalization payments are unconditional transfers from the federal government to those provinces whose revenue-raising capacity is below a national norm. A representative tax system (RTS) approach is used. For each of the many revenue sources used by the provinces (thirty-three in number), each province's per capita equalization entitlement is calculated using a simple formula: $E = t(B - b)$, where t is a national average of all provincial tax rates used for this revenue source, b is the province's per capita tax base, and B is the per capita tax base used for five representative provinces. This is repeated for each province and each revenue source. Then each province's aggregate equalization entitlements are obtained by summing up its entitlements from all revenues sources. Those provinces with positive aggregate entitlements receive a transfer equal to their entitlements. Those with negative aggregate entitlements receive nothing. Thus, equalization brings the revenue-raising capacity, using standard tax bases, up to the five-province standard by ensuring that, if they applied the national average tax rate, their revenues would be comparable to the five-province standard.

This formula-based RTS system has come under heavy criticism in recent years. The provinces argue that a ten-province standard (which would include all provinces) should be used. This would bring Alberta into the standard and increase all equalization entitlements considerably. The federal government, however, worries about the fact that it will have no discretion over the total equalization payments it must make or how it will change over time. As a result of this conflict, in 2005 the federal government froze the total entitlement and fixed its rate of growth. It then set up the Expert Panel on Equalization and Territorial Formula Financing (hereafter the Expert Panel) to advise it on an appropriate formula in the future as well as on whether to set up a permanent arm's-length advisory body comparable to the Commonwealth Grants Commission in Australia. The panel's report rejected a permanent commission but did recommend a return to a formula-driven, principles-based equalization system, specifically a ten-province RTS system with partial inclusion of natural resources. Until the federal government decides how to proceed, the existing RTS system applies, but with a fixed limit on total equalization payments.

The second major form of transfers consists of equal per capita transfers to help finance provincial spending on health, welfare, and postsecondary education. The transfer is nominally divided into two components – the Canada Health Transfer (CHT) and the Canada Social Transfer (CST), which encompasses welfare and postsecondary education. This equal per capita transfer system evolved from a system of transfers that was initially

based on fifty-fifty cost sharing in health and welfare, along with bloc transfers for postsecondary education. These transfers were initially introduced to induce the provinces to introduce public health insurance and welfare programs. Once they were established, the matching component was deemed not to be necessary.

These transfers have minimal conditions attached. To be eligible for the full amount, provinces cannot impose residency programs on their welfare systems, and their health insurance programs must abide by a series of quite general criteria, including such things as accessibility, affordability, and comprehensiveness. Some of the provinces object to the federal government imposing such conditions on its transfers, arguing that these are areas of provincial competence and that the extent of the transfer as a proportion of provincial spending requirements is not enough to be able to insist on federal conditions. As it stands, there are no institutional arrangements for dealing with such disputes. Of course, federal and provincial officials are in constant contact and negotiation, and they exchange views frequently. But in the end, the spending power is a federal legislative prerogative, and any quasi-autonomous body could only be advisory in nature. Nonetheless, such a body might increase the transparency of decision making by subjecting federal policy to ongoing public scrutiny.

There are various smaller transfers from the federal government to the provinces for specific purposes. These are typically highly conditional and may or may not be matching. Examples include cost-sharing transfers for national highway financing, transfers to enable the provinces to provide services to immigrants, and transfers for worker training and health care reform. These transfers are small compared with equalization and social transfers.

The territories are also eligible for the CHT and CST. However, given the high costs of delivering their public services, they receive special transfers in lieu of equalization. These transfers are based on the historical costs of delivering public services, and they escalate annually. The Expert Panel recommended a formula-driven approach, involving a move to an RTS system similar to that used for equalization but excluding resource revenues.

Provincial-local transfer systems are similar to federal-provincial ones. Many provinces have equalization systems and base them on revenue equalization. Effectively, this means property tax equalization as it is the main source of local revenues. RTS-like formulas are used, except that a distinction is often made among communities of different types (large-small, urban-rural, etc.). There are also other transfers to close the vertical fiscal gap, and these are often conditional bloc grants for areas such as education and welfare, to the extent that these are delivered locally.

The Canadian federal system has generally been regarded as exemplary. There is a high degree of autonomous, decentralized decision making.

This has been supported by effective equalization systems that, taken together with social transfers, enable the provinces to provide comparable levels of services at comparable tax rates. Moreover, the federal government's use of its spending power has been relatively non-intrusive compared with that of other federations, although it remains controversial in Quebec. Yet national standards in program design have been achieved, while at the same time leaving provinces open to choosing program design aspects to suit their own needs and to experiment with new approaches. There remains much debate about the extent of decentralization and the role of federal spending power in provincial jurisdictions. Yet this can be regarded more as healthy debate than as devastating criticism. Fiscal equity is achieved to a considerable degree across Canada, with the outstanding exception of Alberta, with its vast oil and gas wealth. It is probably not feasible to go further in that direction.

The main structural problem that needs to be resolved is the issue of vertical imbalance.¹⁴ The provinces are convinced that, for the past decade, the federal government has cut its transfers to the provinces excessively. While the federal government has succeeded in turning budget deficits into large surpluses, some provinces still face fiscal struggles, especially given the very rapid growth of their expenditure requirements in health care and other areas. The issue is whether to resolve that perceived imbalance by turning over tax room to the provinces or by increasing federal transfers. Those who favour the former approach argue that accountability will be enhanced and that the federal government will no longer be able to interfere with provincial spending priorities and to impose unilateral transfer changes. Those who argue for the latter say that a sizeable vertical fiscal gap is necessary for fiscal equity, for ensuring national standards in social programs, and for maintaining a harmonized tax system.

FINANCING CAPITAL INVESTMENT

Capital investment decisions, like other budgeting decisions, are independently taken by the relevant sphere of government. The federal government is responsible for national infrastructure (e.g., small airports, seaports, and railways) as well as capital expenditures involved in providing services (e.g., defence equipment, buildings, and machines). Capital expenditures are budgetary items that exist alongside current expenditures. There is no separate capital budgeting procedure. Capital financing comes from general revenues or borrowing, although borrowing is not typically earmarked to capital purchases. Large capital purchases are subject to tendering rules that ensure accountability and transparency. There are no restrictions on access to capital markets, whether domestic or foreign. Control comes from the discipline of capital markets themselves as well as from standard political and financial management accountability techniques.

Provinces are free to determine their own capital expenditures and to finance them as they choose. There are no restrictions imposed by the federal government, and it does not provide financial incentives for provincial borrowing. (Unlike in the United States, interest on provincial or municipal debt is not tax deductible in Canada.) The normal forms of accountability apply to provincial capital financing decisions, and there is no pressure to change that.

Local governments have somewhat less independence than do the provinces with regard to their capital purchases and financing. Typically, they have to restrict their borrowing to approved capital purchases rather than being able to borrow freely for current spending purposes. In practice, this system has worked well. There have been no major soft-budget constraint problems in local governments, and accountability for capital purchases is effective for both financial markets and electorates.

In recent years, there has been concern that an "infrastructure deficit" has developed, especially in the cities. New mechanisms have been explored for finding the finance to address these infrastructure needs. One innovation has been the use of private-public partnerships to finance and operate new infrastructure, especially in the transportation area. Moreover, the federal government has been looked to as a possible source of finance for provincial and municipal infrastructure.

FISCAL FEDERALISM DIMENSIONS OF THE PUBLIC MANAGEMENT FRAMEWORK

All orders of government enjoy autonomy in their public administration. The federal government has a permanent civil service in which members are career civil servants. Political appointments are restricted to political positions, such as ministerial advisors and staff. The federal government does, however, have considerable authority of appointment to quasi-judicial and judicial bodies. Federal judges are appointed by the federal government, and Supreme Court judges are appointed by the prime minister. The heads of administrative tribunals and Crown corporations are also appointed.

Provincial governments have dedicated civil services, completely independent of the federal civil service. The federal government plays no role in provincial administration. Provincial governments also appoint all provincial judges and all heads of provincial Crown corporations, tribunals, and the like. The local governments also have their own public employees, hired by them and quite independent of the federal or provincial civil service. The provincial government does not interfere in municipal hiring and firing. The result is a set of independent civil services in all spheres of government. It is generally the case that civil servants are very competent and behave with a high level of integrity. Corruption is not regarded as being a problem.

THE WAY FORWARD

As the Canadian federation evolves, demands are being placed on the system to adapt. Fiscal decentralization combined with the rapid growth in demand for the public services provided by provinces has brought with it the prospect of fiscal imbalance, both vertical and horizontal. This prospect also extends to municipal governments and to self-governing First Nations communities, where the need is often greatest. Relations among governments have become strained as each sphere of government seeks to define its own role in the federation. Such soul-searching is not new and, in the past, has always been met by revised fiscal arrangements and tough but amicable negotiations. The question is whether such accommodation will be reached as readily in the future, given the relatively rapid changes now being encountered.

Strains in the federal system frequently stem from two fundamental conflicts that characterize the Canadian federation. The first arises because, while the Constitution gives provinces exclusive legislative responsibility in the important areas of health, education, and welfare, the federal government shares a constitutional commitment to providing essential public services of reasonable quality and to promoting equal opportunities for all Canadians. Given that the public services most critical for fulfilling this commitment are provincial legislative responsibilities, the only feasible policy instrument available to the federal government is its spending power.

The second conflict arises because provinces own the natural resources within their borders and have the right to tax them as they see fit, while, at the same time, the federal government has a constitutional commitment to making equalization transfers so that all provinces have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation. Given that a substantial source of fiscal disparity among provinces comes from natural resource endowments, fulfillment of the equalization commitment would seem to require violation of the provincial ownership of revenues from these natural resources. Many sources of dispute revolve around the appropriate compromise between these fundamental conflicts.

Recent events and trends have put considerable strain on the system. First and foremost, the federal government, faced with an unsustainable debt situation, reduced its expenditures precipitously. Federal program expenditures fell from 15.7 percent of GDP in 1993–94 to 11 percent in 2000–01 (although they rose subsequently to 12.6 percent in 2004–05). Particularly hard hit were cash transfers to the provinces for social programs. These were cut dramatically and were consolidated into a single bloc transfer. This cut occurred with little prior consultation, and the provinces argued that it effectively transferred part of the federal debt onto the

provinces. The provinces argue that this has created a fiscal imbalance – that is, that the federal government collects a share of tax revenues that, relative to its expenditures, is too high, especially given the expected high rate of growth of provincial spending responsibilities (e.g., for health care).

The problem of vertical imbalance is exacerbated by a growing horizontal imbalance, which is partly a natural consequence of decentralizing revenue raising to the provinces, but it is made more immediate by soaring oil and gas prices, which have created unprecedented fiscal disparities among the provinces. The federal response to this has been a series of ad hoc measures, including freezing total equalization entitlements, accompanied by the formation of the Expert Panel to advise the government on future equalization arrangements. Some provinces were stung by what they perceived to be unilateral decisions on the part of the federal government, albeit ones made in the shadow of a fiscal crisis. This is especially a concern given the need to deal with rapidly escalating health care costs as well as the imperative to ensure that education and other human capital policies are in place to deal with the challenges posed by globalization.

These same concerns affect municipal governments and First Nations communities. As the country becomes more urbanized, and cities become the focus of economic growth, there is a need to address the fiscal imbalance that is felt by municipal governments so that they can provide the necessary public services to ensure that their citizens are cared for and their businesses are competitive. The financial problems facing Aboriginal communities are even more immediate. These are communities whose residents are among the poorest in the country and which, in many cases, lack basic public services. The challenge here is a matter not just of financing but also of service delivery as the transition is made from a system in which the federal government had a very hands-on approach to one in which the communities themselves are taking on more and more responsibility.

NOTES

- 1 Section 36 (2), Constitution Act, 1982.
- 2 Section 91, Constitution Act, 1982.
- 3 See Teresa Ter-Minassian, ed., *Fiscal Federalism in Theory and Practice* (Washington: International Monetary Fund, 1997); and Ehtisham Ahmed and Giorgio Brosio, eds., *Handbook of Fiscal Federalism* (Cheltenham: Edward Elgar, 2006).
- 4 See Keith Banting and Robin Boadway, “Defining the Sharing Community: The Federal Role in Health Care,” in *Money, Politics and Health Care*, ed. Harvey Lazar and France St-Hilaire, 1–77 (Montreal: Institute for Research on Public Policy, 2004).

- 5 See Ronald Watts, *The Spending Power in Federal Systems: A Comparative Study* (Kingston, ON: Institute of Intergovernmental Relations, 1999).
- 6 See Robin Boadway, "The Theory and Practice of Equalization," *CESIFO Economic Studies* 50, 1 (2004): 211–54.
- 7 Séguin Committee, *A New Division of Canada's Financial Resources* (Québec: Department of Finance, 2002).
- 8 Advisory Panel on Fiscal Imbalance, *Reconciling the Irreconcilable* (Ottawa: The Council of the Federation, 2006).
- 9 Expert Panel on Equalization and Territorial Formula Financing, *Achieving a National Purpose* (Ottawa: Finance Canada, 2006).
- 10 See Jonathan Rodden, Gunnar S. Eskeland, and Jennie Litvack, eds., *Fiscal Decentralization and the Challenge of Hard Budget Constraints* (Cambridge, MA: MIT Press, 2002).
- 11 See Michael Smart, "Taxation and Deadweight Loss in a System of Intergovernmental Transfers," *Canadian Journal of Economics* 31 (1998): 189–206.
- 12 See Richard M. Bird and Pierre-Pascal Gendron, "VATs in Federal Countries: International Experience and Emerging Possibilities," *Bulletin for International Fiscal Documentation* 55 (2001): 293–309.
- 13 See Robin Boadway, "Inter-Governmental Fiscal Relations: The Facilitator of Fiscal Decentralization," *Constitutional Political Economy* 12, 2 (2001): 93–121.
- 14 Budget 2006, *Restoring Fiscal Balance: Focusing on Priorities* (Ottawa: Finance Canada, 2006).