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Equalization and territorial integration in Canada: a nation building instrument?*

by

Francisco Javier Romero Caro[I]

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Abstract

The accommodation of territorial diversity is one of the biggest challenges that modern societies must face nowadays, especially in a context where secessionist movements are on the rise. Multilevel government plays a key role in managing diversity and reducing the risk of secession. The fiscal dimension is a vital component of any system of shared government as the lack of financial resources to finance constitutionally assigned competences would render them inoperable, reducing autonomy to an empty vessel. However, the use of fiscal instruments to accommodate diversity and reduce the risk of secession has barely been explored. Against this background, this article explores, from a legal perspective, the internal architecture of the Canadian equalization program with the aim of investigating its integrative and disintegrative effects in relation to Quebec (and to a lesser extent also to other provinces). This is done on the hypothesis that equalization mechanisms: raise the cost of secession in sub-units that are net receivers of funds; have an integrating function as they promote economic development and cohesion and tend to enhance a sense of belonging and solidarity among constituent units by fostering national unity. The study focuses on arrangements at constitutional and legal level, including also secondary legislation with the final aim of evaluating if and to what extent the Canadian equalization program can be conceived as an instrument of nation building that contributes to reducing territorial tensions and accommodating diversity, in the end reversing disintegrative trends. This is done through the evaluation of the integrative and disintegrative effects of each of the elements of the internal architecture of equalization mechanisms.

Key-words

Equalization, Canada, accommodation, fiscal federalism, multilevel governance

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1. Introduction

The accommodation of territorial diversity is one of the biggest challenges that modern societies must face nowadays, especially in a context where secessionist movements are on the rise. Multilevel government plays a key role in managing diversity and reducing the risk of secession (Lijphart 1977; Kymlicka 2001). The fiscal dimension is a vital component of any system of shared government as the lack of financial resources to finance constitutionally assigned competences would render them inoperable, reducing autonomy to an empty vessel. However, the use of fiscal instruments to accommodate diversity and reduce the risk of secession has barely been explored. These instruments are almost never mentioned in the literature on territorial accommodation as this has focused on other aspects such as the recognition of national identities (Gagnon and Iacovino 2007). Along the same line, fiscal federalism has been analyzed paying attention to matters such as the allocation of financial resources (Anderson 2010) or the functioning of the financial relations among different levels of government (Boadway and Shah 2009; Schnabel 2020) but without drawing much interest from the literature on nationalism and minority accommodation. This is in part due to fiscal federalism being a rather neglected topic of federalism, especially among public lawyers, due the complexity and polyhedral form of this phenomenon. Thus, the relation between fiscal federalism and secession has also not been covered sufficiently by the literature[II].

The case for decentralization to accommodate diversity is well established in the literature (Duchacek 1997; Keating 2001; Gagnon and Tully 2001; Burgess 2006). However, decentralization sometimes has a cost in terms of economic efficiency as divergences among subunits lead to different financial capacities -e.g. some regions are richer than others, have natural resources, etc.- and different costs when providing public services -due to geography, demographics or any other circumstances-. Equalization mechanisms are envisaged to bridge this gap and reduce disparities among subunits to achieve a certain degree of horizontal equity. Equalization can, thus, be described as a transfer of fiscal resources across jurisdictions with the aim of offsetting differences in revenue raising capacity or public service cost (Blöchliger et al. 2007, 5). Therefore, the main objective of equalization is to -theoretically- allow subunits to provide a comparable level of services at similar levels of

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taxation. Consequently, as Boadway (2004, 212) puts it, equalization can be seen as a necessary counterpart to decentralization and unsurprisingly, equalization mechanisms can be found in most federal systems with the notable exceptions of the USA and Mexico (Watts 2008, 108-109).

Behind equalization lies an idea of inter-territorial solidarity, i.e., the need to achieve a certain degree of horizontal redistribution among territorial subunits in a multilevel state. This is, of course, connected with the value that each society gives to horizontal equity, not only in terms of equality among all citizens but also among the subunits that integrate the country. At a first glance, one could tend to think that homogeneous societies would value solidarity more than those that are divided (Choudhry 2008), but, on the other hand, solidarity and horizontal equity could be used as a tool to hold the country together and foster unity in the case of fragmented societies

Against this background, the article explores, from a legal perspective, the internal architecture of the Canadian equalization program with the aim of investigating its integrative and disintegrative effects in relation to Quebec (and to a lesser extent also to other provinces). This is done following the hypothesis that equalization mechanisms:

- raise the cost of secession in sub-units that are net receivers of funds
- have an integrating function as they promote economic development and cohesion
- tend to enhance a sense of belonging and solidarity among constituent units by fostering national unity.

The analysis will be of a preeminent legal nature, focusing on arrangements at constitutional and legal level, including secondary legislation but also soft law and political agreements. The final aim is to evaluate if and to what extent the Canadian equalization program can be conceived as an instrument of nation building that contributes to reducing territorial tensions and accommodating diversity, reversing disintegrative trends. This is done through the evaluation of the integrative and disintegrative potentials of each of the elements of the internal architecture of equalization mechanisms.

The choice of Canada as a case study is not trivial. First, among federal countries, Canada has one of the longest standing equalization programs dating back to 1957. This is relevant as the need for solidarity among territories is a value that needs to be constructed over time and sometimes is difficult to inoculate (Watts 2015, 21). Second, it has experience in dealing with the side effects of decentralization which could stimulate nationalist or even secessionist

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movements. Finally, Canada has emerged as a successful example of territorial integration, resolving a secessionist crisis like the one that occurred at the end of the 20th century in the province of Quebec, where the unity of the federation was on the verge of collapsing.

The concepts of integration and disintegration used in this analysis are borrowed from the literature of European integration and applied to the internal dynamics that occur within multilevel systems between the central level and the territorial subunits, as well as among the latter themselves.

One of the most influential definitions of integration was coined by Wallace (1990, 9), who characterizes this phenomenon as "the creation and maintenance of intense and diversified patterns of interaction among previously autonomous units". This definition, although intended for sovereign states that join together in a supranational organization, is useful for studying the dynamics that affect the relationship between center and periphery in a multilevel state. Following this, an aspect of equalization -e.g., the territorial participation in the governance of the compact- that contributes to strengthen the ties between the national state and the territorial subunit by promoting dialogue and cooperation while respecting and protecting the political autonomy of the latter will be described as an integrative force.

Moreover, as seen above, the political dimension is a relevant factor when it comes to the study or the internal architecture of equalization mechanisms. For this reason, the role of political actors must be considered following Haas' (1968, 16) vision of integration as a process "whereby political actors in several, distinct national settings are persuaded to shift their loyalties, expectations and political activities toward a new political centre". Although this concept alludes to a new political center -that of the European institutions- in this case the political center in question is that represented by the central institutions and, therefore, the parent state itself. Thus, those elements of equalization that contribute to reinforce the loyalty of the territorial subunits towards the center are considered a step towards further integration.

In contrast to integration, disintegration has not attracted as much interest and the elaboration of a definition has not been pursued in depth. Only Scheller and Eppler (2014, 26) have attempted to fill the vacuum, conceptualizing this phenomenon by defining disintegration as those "erosion processes promoted by individual or collective actors […] which lower the legal, economic, territorial, socio-cultural and/or legitimating integration

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level" undermining "the unity of the internal market, the Monetary Union and the European legal area". In the case at hand, this erosion process lowers territorial integration, undermining the unity of the state, fueling internal tensions and encouraging opportunistic and divisive behaviors that hinder cooperation between the different parts of a multilevel state. On this basis, those aspects of equalization that weaken the ties between a territorial subunit and the national level, hindering dialogue and cooperation will be considered as disintegrative. In the same vein, lack of participation by the territorial subunits that may result in isolation or opportunistic behavior that undermines the principle of horizontal solidarity will also be understood as promoting disintegration.

In sum, integration and disintegration are dynamic processes that can happen at the same time on various dimensions -institutional, territorial, economic or even socio-cultural- (Scheller and Eppler 2014, 26). The following section will focus on the territorial dimension of integration, although the other dimensions as far as they are instrumental for territorial (dis)integration will also be taken into account, analyzing the integrative and disintegrative potential of the different elements of equalization mechanisms. To this end, the aim is to identify those aspects that may increase the allegiance to the state by promoting dialogue and cooperation among the different components of a multilevel state, reducing tensions and appeasing conflicts as well as those that may hinder these values fostering disintegration and increasing the rejection of the current political settlement which could fuel secessionist movements.

2. Exploring the features of the Canadian equalization program

As the analysis will be framed following a legal perspective, it will focus on those components whose nature is connected to the notion of fiscal constitution in the broader sense, hence not only paying attention to those elements "formally incorporated in some legally binding and explicitly constitutional document", but also "customary, traditional, and widely accepted precepts" (Buchanan and Wagner 1977, 24) including sources of law without formal constitutional status and political facts that impact the interpretation and implementation of the rules and determine the way in which a system functions and evolves as in this aspect theory cannot be separated from practice. Thus, the components that made up the internal architecture of equalization mechanisms will be investigated with the aim of

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identifying the integrative and disintegrative effects that these elements have in the territorial accommodation of national minorities in multilevel systems. A brief description of them is presented here below, before delving into the analysis of their (dis) integrative potential in relation to subunits facing secessionist challenges. These include:

The legal entrenchment of the program, i.e., the legal foundations of equalization programs that can be classified into three main models: constitutional entrenchment, legal enactment and an informal consensus on the goals of fiscal equalization via intergovernmental cooperation (Shah 2007a, 294).

The nature of the redistribution that refers to the determination of the overall funding of equalization with a particular emphasis on the origin of the funds (vertical and/or horizontal dimension). Additionally, it is also possible to draw a distinction between open-ended systems, i.e., there is no upper limit to the total pool of equalization, and close-end models wherein the total pool of money is exogenous as is generally linked to the revenue raised by a certain tax which depend on the economic cycle (Ahmad and Brosio 2018, 179-180). Lastly, one can find integrated programs in which all subunits receive transfers, or stand-alone programs that only envisage transfers to those subunits that qualify for equalization as they are below the standard.

The level and components of equalization. In this regard, it is possible to distinguish between the level of equalization and the components that the system would try to equalize. The level of equalization alludes to how much equalization would be pursued, taking into consideration the potential tradeoffs with respect to economic growth, financial stability or political incentives (Ahmad and Brosio 2018, 171-174). Additionally, equalization can be on gross or net terms. Gross equalization is directed towards bringing relatively poorer subunits to the national average or to another standard, leaving the fiscal capacity of the richer subunits unaffected. In contrast, a net equalization program aims to elevate the fiscal capacity of the relatively poorer subunits at the expense of the fiscal capacity of the richer. Whereas the components of equalization refer to the economic magnitude that the mechanism aims to equalize: revenue capacities or expenditure needs.

The degree of conditionality. Conditional or earmarked transfers are a common feature in multilevel states with the national government imposing a series of requirements upon the transferred funds which must be satisfied by the territorial subunits in order to receive them (Shah 2007b, 5-6). In most of the cases, these conditions are input-based with the national

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level conditioning the transfers to a specific and exclusive type of expenditures (e.g., health, education, infrastructure, social services etc.). A second possibility is to establish output-based transfers, by conditioning the funds on the accomplishment of a certain result but without imposing any obligation on how to achieve that goal. Furthermore, conditionality can vary in scope resulting in either soft or hard conditionality. The strings attached to a transfer can be classified as soft when they only imply the mere adherence to broad and generally not disputed principles, such as accessibility to public services or the prohibition of interterritorial discrimination. On the contrary, hard conditionality is prescriptive, as the territorial subunits need to meet specific criteria like balanced budgets, a given degree of spending allocated to a program, or a minimum level of taxation.

The institutional administering of the program. Equalization compacts are complex financial schemes that require an institutional framework to manage its implementation and functioning. Although different institutional arrangements can be used, such as a central government agency or the delegation of this function to the national parliament, the dominant pattern in comparative perspective is to allocate this function either to an independent arm's length agency or to an intergovernmental forum.

The length of the program. Equalization mechanisms can include sunset clauses. These establish the maximum length of the program in place, which is set to expire after its completion if it is not renewed. Such renewal can either extend the program in its current form, or in a revised fashion. Another possibility is to let the program expire and then establish a new one, although this would be similar in nature if the main principles governing equalization are entrenched in a norm such as the constitution or a national law.

Dispute resolution. In this regard, a distinction must be made between mere political criticism and legal disputes. While political criticism of the equalization compact can be channeled through the institutional (frequently also intergovernmental or technical in nature) framework responsible for managing the program, legal disputes may end in court. Since the latter may require the interpretation of constitutional and legal provisions as the result of an inter-governmental conflict that generally involves one or several territorial subunits and the national level, the issue is normally adjudicated to the highest court in the land.

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a) Legal entrenchment of the program

The idea of territorial solidarity is as old as the Confederation with the constitutional design of 1867 (sections 118 and 119) including a federal per capita subsidy with the objective of providing financial resources to the provinces in the early years of the newly formed Dominion. The first formal proposal calling for the implementation of equalization in Canada came from the Rowell-Sirois Commission in 1940, whose final report urged the creation of the National Adjustment Grants to ensure the financial sufficiency of the provinces, allowing them to fulfill their constitutional duties (Milne 1998, 181). This program was characterized by two main features: it would be administered by an independent agency and reviewed every five years, and equalization would not only be carried out according to the fiscal capacity of the provinces but would have also taken into account the needs of each province, creating an emergency fund for those whose financial situation would continue to be precarious after the implementation of the solidarity mechanism (Royal Commission on Dominion–Provincial Relations 1940, 83-85).

Finally, equalization was introduced as a federal program in 1957 under the Tax Rental Agreements, although in different fashion to the one proposed by the Rowell-Sirois Commission as none of their guidelines were adopted. Consequently, the Canadian equalization program was first enacted in a legal statute, the *Federal-Provincial Tax-Sharing Arrangements Act, 1956*, 4 & 5 Eliz. 2, ch. 29. This law was the result of cooperation between the federal government and the provinces as its full implementation required provincial legislation although this was not related to equalization[III]. Equalization was designed as a guarantee of the financial stability for the provinces in the post-war period with its aim being to provide unconditional payments to each province equal to the amounts needed to bring the per capita proceeds of rental payments (or of the allowed abatement) to the average per capita yield of the two provinces with the highest direct tax yield (Bird and Vaillancourt 2009, 212-213). In a certain way, the system was conceived as a sort of compensation for the centralization of most tax sources and social programs such as the unemployment insurance. Likewise, this new program was also aimed at integrating Quebec -although it was not its main purpose- breaking its fiscal isolation as the province declined to participate in any of the tax rental or tax collecting agreements concluded between the federal government and the provinces after World War II (Béland and Lecours 2014, 342).

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The importance of the equalization program and the tensions that its design and effects caused led Nova Scotia in 1967 to advocate for the entrenching of a specific equalization formula in the Constitution (Smiley 1976, 115). Constitutional entrenchment was sought by the province to reduce fiscal tensions and avoid unilateral modifications of the calculations by the federal government that would be unfavorable to their interests as the compact was solely regulated in a federal law that could be modified without provincial consent. However, this claim will not materialize during the patriation process, with the formula being kept in ordinary legislation.

Equalization was constitutionalized in 1982 as part of what P.E. Trudeau called "the People's Package" in reference to the ambitious process of patriating the Constitution form the United Kingdom. Equalization was another piece of Trudeau's project of nation-building aimed at developing and strengthening a pan-Canadian identity. Including equalization into the Constitution highlighted the importance that was given to territorial solidarity during patriation as a process towards building a common social citizenship. Equalization embeds an idea of fraternity and solidarity that promotes integration and national unity, two of the values promoted by Trudeau during patriation. Finally, equalization was entrenched into section 36.2 of the 1982 Constitution in the following terms:

"Parliament and the government of Canada are committed to the principle of making equalization payments to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation".

As can be seen, equalization was framed in a more vague and abstract manner than defended by Nova Scotia in 1967, with section 36.2 limited to the outlining the main goal of the program which is none other than to assure sufficient revenues to provincial governments so they can provide reasonably comparable levels of public services at reasonably comparable levels of taxation. In fact, what was given constitutional status in 1982 was not the equalization compact itself, but rather the principle of equalization or inter-territorial solidarity. Consequently, the federal government enjoys almost full freedom of choice to develop it, even in alternative ways to the program created in 1957, being theoretically possible to reduce equalization to its minimum expression. This is because section 36.2 only commits both Parliament and the federal government to the principle of making equalization payments, but it does not establish any formal obligation to make those transfers. Provincial governments tried to broaden the scope of equalization in the

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Constitution during the Charlottetown constitutional round, strengthening the wording of section 36 to commit the federal government to making payments and not just to the principle of equalization (Béland et al. 2017, 25)[IV]. However, although the bid was initially successful as the federal government agreed, the agreement was never enacted as it was rejected in referendum in 1992.

Despite the narrow scope given to the constitutional provision on equalization, this has not prevented the general acceptance of inter-territorial solidarity by means of an equalization program by all political actors, although they frequently disagree on its nature and extent. The mere presence of the principle in the Constitution seems to have been enough to strengthen the legal foundations of the program and ensure its permanence over time despite occasional political criticism. The rigidity of the Canadian Constitution -one of the most in comparative perspective which makes it almost non-reformable (Albert 2015, 112-113)- has also contributed to the consolidation of equalization in Canada. The difficulty to amend the Constitution makes it virtually impossible to modify or eliminate the principle of making equalization payments as it would require the consent of both chambers of Parliament and of seven of the ten provinces, comprising at least 50% of the population. This effectively safeguards section 36.2 against any threat of unilateral repeal or substantial alteration by the national level as the approval of most of the provinces is required to proceed (Pelletier 1996, 326-327). Additionally, this guarantee was reinforced with the *Constitutional Amendments Act*[V] which grants a veto right to Ontario, Quebec, British Columbia and, by effect of its population, Alberta[VI] (Woehrling 1998, 339) as the federal government must obtain the consent of these provinces before introducing in Parliament a motion to authorize an amendment to the Constitution of Canada. Paradoxically, it has been a province, Alberta, who has called to repeal equalization from the Constitution, holding a non-binding referendum on the issue with the aim of pressing the federal government to change the calculation formula as it considers it unfair and a privilege towards Quebec as if it were a reward in exchange for remaining with the federation (Béland and Lecours 2014b, 347-348)[VII].

In spite of the importance of incorporating the principle of equalization into the Constitution, it did not have a significant impact in the functioning of the program in practice due to the vagueness and reduced scope of section 36.2 as equalization continued to be governed by an act of Parliament. The core of the legal regulation of the equalization

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compact is contained in the *Federal-Provincial Fiscal Arrangements Act, 1985*, which regulates the technicalities and operational aspects of the program such as the timing (art. 3.94) or the method of calculation of the payments (art. 3.2). Thus, the principle of equalization anchored in section 36.2 of the Constitution does not constitute a substantial constrain for the federal legislator, who has full discretion to establish, modify, and terminate the terms of equalization transfers as long as it remains committed to the principle of equalization somehow. Therefore, equalization is entirely a federal program without any provincial participation in the passing or amendment of the *Federal-Provincial Fiscal Arrangements Act*, not even indirectly, given the Canadian Senate's inability to act as a territorial Second Chamber (Verney 1995, 94). A proposal that would have forced the federal government to consult with the provinces prior to any change of the method of calculation of the fiscal equalization payments was tabled in Parliament following Alberta's referendum bid, although it was voted down[VIII].

The integrative nature of equalization was recognized since its first enactment in 1957 as the program was quickly presented as a benefit of the union (Davenport 1982, 116). The constitutional entrenchment of equalization strengthened the legal foundations of the compact, increasing the integrative potential if compared with the previous situation where it was limited to sole legal enactment, an aspect of importance for Quebec given its status as a receiving province since it guarantees the continuity of the compact in time. However, the reduced scope of section 36.2 of the Constitution, which commits the federal level to the principle of equalization but falls short of imposing a legal duty on the national government to make those transfers, conditions the margin of appreciation of the courts when interpreting the compact. In fact, this can be considered as a political question and thus non justiciable, diminishing the integrative potential that results from the inclusion of equalization in the Constitution. Although this issue could be addressed by a redrafting of section 36 to commit the federal government to making equalization payments as was envisaged in the Charlottetown Accord, Canada's chronic difficulty in reforming the Constitution makes this very unlikely in the foreseeable future[IX].

As most models, Canada combines a general framework of equalization enshrined in the Constitution with a national law that sets the operational and technical aspects of the program. This formula combines the stability and predictability of a constitutionally entrenched provision with the flexibility of a legal statute to adapt to a changing reality.

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Nevertheless, the vagueness of the constitutional provision does not impose any substantive limit to the legal regulation of the program and therefore its backbone can be unilaterally altered by the federal government without any territorial participation as it resides in a federal law, the *Federal-Provincial Fiscal Arrangements Act*. This deficit of territorial participation has also not been corrected through other mechanisms because the *Federal-Provincial Fiscal Arrangements Act* only requires a simple majority for its amendment and the Canadian Senate does not effectively channel provincial participation at the federal level. As a result, the equalization compact has been regularly modified to adapt to the financial needs of the federal government rather than those of the provinces -establishing caps or modifying the formula to avoid the financial burden that would result of Ontario becoming a recipient-, weakening the integrative potential of equalization (Courchene 2007).

b) Nature of the redistribution

Equalization has been a federal program since it was created in 1957 and, therefore, it is financed solely by the federal government from its own source revenue. Thus, equalization in Canada is of vertical nature being the federal government in charge of its design and administration via the Department of Finance with provincial participation limited to some sporadic discussions at the First Ministers' Conference. In spite of this, it is not uncommon for the political class and the media to present equalization as if it were a fraternal program in which the flow of money is horizontal, ie. from the richest provinces to the less favored ones (Béland, Lecours and Tombe 2022, 227).

Vertical equalization constitutes an integrative force towards those subunits such as Quebec that are net receivers of funds, a condition that the French speaking province has held since the program was first implemented in 1957. Thus, the Canadian equalization program raises Quebec's cost of secession as cutting the ties with Canada would mean a significant reduction of financial resources. In particular, this would have resulted in the province losing more than 13 billion dollars in equalization, about 11% of its budget in fiscal year 2019-20[X]. So it should not come as a surprise that economic factors have traditionally been the Achilles heel of the sovereigntist movement. The importance of equalization for Quebec has been recognized by the province's Premier François Legault who considers it part of the "original deal" of Confederation - although the term equalization was not coined until the 1940s- and thus it is considered as a right for Quebec, highlighting its contribution

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to maintaining the province within the federation (Authier 2019)[XI]. Additionally, vertical equalization also promotes national unity as the federal government can present itself as the benevolent benefactor whose financial support contributes to reduce horizontal imbalances and achieve economic convergence with the rest of the country. Thus, the federal government can display equalization as a benefit of the union to foster a sense of belonging to the Canadian common project and to persuade Quebeckers into luring their allegiance to the existing constitutional framework increasing their loyalties towards the center. An argument that seems to have had some success, as Legault himself has alluded to equalization as one of the reasons to be a proud Canadian. The inclusion of equalization in the Constitution in 1982 reinforces this idea with equalization being a tool to promote the federal government's image and show its commitment to the province interests with the program acting as glue to hold the country together (Courchene 1984, 406)[XII].

The total pool of funds allocated to equalization has traditionally been determined on an ad-hoc basis by the central level, according to its financial situation and not to that of the provinces. Unlike in Australia, where GST revenue is earmarked for the program, in Canada the funding of equalization does not depend on any specific tax, and a pool of money is constituted with the federal government's own resources regardless of their origin. In 2009, the *Federal-Provincial Fiscal Arrangements Act* was amended so equalization would grow by the moving three-year average of the growth rate of the GDP as mandated by article 3.4 (5) with the total pool of 14,18 billion $ distributed in 2009 as basis. Although this was aimed at preserving the finances of the federal government, especially when gas and oil prices are high and the fiscal capacities of resource rich provinces soar, this decision also had the effect of reducing the uncertainty of subnational governments in respect of the size of the program. Therefore, provinces now have a legal guarantee that the total funds allocated to the program will not be drastically reduced, increasing the predictability and stability of the equalization compact[XIII]. The capping of the total amount of funds dedicated to equalization established in 2009 - as this will not exceed the previous year's amount increased by the moving average of GDP - means that the Canadian equalization system is close-ended. Further, it is conceived as a stand-alone program where only those provinces whose fiscal capacity falls short of the standard qualify for equalization payments as revenue sharing is materialized through others transfers such as the CHT for health and the CST for social services and post-secondary education (Boadway 2012, 307). Consequently, Canada's equalization

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program works as a zero-sum game in which for one province to get higher entitlements, other(s) will receive less funds. This is more pronounced when a province that was not a recipient becomes one of them since the new distribution will result in a significant reduction of the amounts to be received by the rest of the entitled provinces. Also, as Ontario, the most populated province in the federation with nearly 40% the population, tends to be the province with the lower fiscal capacity above the equalization standard, becoming a recipient would significantly alter the distribution of funds as they are calculated on a per capita basis as happened in fiscal year 2009-10.

Although vertical equalization mechanisms are thought to be neutral in integrative terms for not receiving subunits as Béland and Lecours (2014, 340) suggest, this is not the case in Canada due to the fact that any change in the distribution of the funds results in winners and losers as the system works in practice as a zero-sum game. This has crystalized into a disintegrative force that fuels intergovernmental conflicts between receiving and not receiving provinces[XIV], with Quebec often being the scapegoat[XV]. Resource rich provinces such as Alberta or Saskatchewan, also denominated "have provinces", that are not eligible to receive funds from the program as their fiscal capacities are above the average frequently portrait equalization as if it were of horizontal nature (Lecours and Béland 2010, 586-587). These provinces tend to argue that the program is funded by the taxes that the federal government collects in rich provinces and that, as a result, they are subsidizing other parts of the country without getting anything in return. This claim has increased recently as most of the "have provinces" were running deficits while those that were receiving equalization, such as Quebec, had sizeable budgetary surpluses (Feehan 2020, 12). As a response, Saskatchewan has called for a 50/50 solution, a reform of the system in which half of the funds would be distributed per capita without any consideration of territorial equity. This solution would denaturalize the system, undermining the principle enshrined in article 36.2 of the Constitution (Baxter 2018). Alberta, for its part, has repeatedly demanded for the system to be reformed complaining of a lack of financing and deeming the federal refusal to change the nature of the system to be "a slap in face", subsequently claiming for equalization to be abolished from the Constitution (Toy 2018).

The positive effects of equalization for Canadian national unity with respect to Quebec have been used to support criticism of the program, depicting it as an example of the "*fédéralisme rentable*" advocated by Bourassa that results in a privilege for this province to

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contain the rise of nationalism[XVI]. These critics are based on the fact that Quebec has been the largest recipient of funds since the program's inception, an aspect that is interpreted as a quid pro quo for maintaining national unity. While it is true that Quebec receives about two-thirds of the total amount of funds allocated to equalization, this is due to Quebec accounting for 23% of the federation's population. However, in per capita terms, provinces such as Manitoba or Prince Edward Island receive comparatively more funds, which also constitute a higher share of their own GDP than in the case of Quebec[XVII]. Likewise, "have provinces" do not subsidize Quebec's more generous social state because funds come from the federal budget with no wealth being drained away from provincial governments.

This misperception that politicians transmit about equalization, together with its nature as a zero-sum game, has resulted in high disintegrative regional tensions with Quebec at the epicenter since it receives the biggest share of the program in absolute terms. In the end, it is paradoxical that a system that has at its genesis the values of cohesion and territorial integration, also by avoiding Quebec's isolation, an internal exile as characterized by Laforest (2014), is used to promote a fallacious discourse towards that province that only helps to feed that very same feeling of rejection that gave so much profit to the sovereigntist movement in the 1980s and 1990s.

c) Level and component of equalization

The level of equalization pursued in a certain system is intrinsically linked to the goal of the program. In Canada, this was set in stone after the principle of equalization was included in article 36 of the 1982 Constitution, outlining the commitment of "Parliament and the government of Canada" to provide provinces with "sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation".

In this constitutional provision one can observe three basic features of the system. First, like most systems in comparative perspective, Canada's equalization program targets revenue equalization in order to ensure that all provinces can generate income at "reasonably comparable levels of taxation" to provide public services to their citizens. Put differently, equalization must prevent fiscal disparities between provinces from being of such a magnitude that they penalize citizens depending on their place of residence with inferior public services (Stevenson 2009, 27-29). Secondly, the program features partial equalization as it intends to reduce disparities in the provision of public services among the provinces but

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not its complete elimination. This is because the aforementioned notion of reasonableness does not mean that public services levels must be identical throughout the federation, but rather comparable as to reduce horizontal imbalances. Finally, article 36 also hints that the program is based on gross equalization as it attributes to the federal government the task of making equalization payments to shorten the horizontal imbalance, thus increasing the revenues of the poorer provinces but leaving the richer unaffected.

Revenue equalization attempts to bridge the gap in the provinces' per capita revenue raising capacity. Succinctly, the fiscal capacities of the provinces are defined as the amount of per capita revenue that a province could raise if it imposed the national average tax rates plus 50% of the actual per capita revenues from natural resources[XVIII]. These theoretical fiscal capacities are compared with the national average and those below are entitled to equalization payments. This process, simple in theory at first sight, involves certain complications in practice as the actual payment will depend on other corrective measures such as the fiscal capacity cap or the need of adjustment payments to avoid that a province that receives equalization payments ends with a higher fiscal capacity that one that does not (Feehan 2020, 5). Thus, after equalization transfers are made the program achieves its constitutional goal of horizontal equity taking the fiscal capacity of the poorer provinces to the national average.

As briefly described, equalization in Canada only focuses on the revenue side, not including any degree of needs compensation. Although needs-based models entail a higher integrative potential than those strictly based on equalizing fiscal capacities -as they compensate for higher costs when providing public services to all territorial subunits, including those that have high fiscal capacities-, their complexity is also superior due to the hurdles to estimate cost of service provision and the political controversy that surround the process. The possibility of including needs compensation within the equalization compact has traditionally been rejected by the provincial governments considering it a federal interference in provincial matters[XIX]. In fact, Quebec under the government of Maurice Duplessis strongly opposed to any scheme that would involve needs compensation when equalization was first discussed in the 50s considering that it would encroach provincial competences (Pickersgill 1975, 309). Thus, considering the Canadian political landscape it is not adventurous to think that including needs compensation in the equalization compact would lead to an increase in intergovernmental tensions fostering disintegration in lieu of integration.

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The chosen level of equalization -full or partial- takes into consideration the potential tradeoffs with respect to economic growth, financial stability or political incentives (Ahmad and Brosio 2018, 171-174). There are several factors that explain why the Canadian equalization program has opted for partial equalization instead of full equalization. The first one is the competitive nature of Canadian federalism. The provinces have experienced a significant gain of financial autonomy since the end of the Tax Rental Agreements era which has fostered economic competition among them. Furthermore, Canada is a diverse federation where important cleavages exist between the provinces in terms of size, population and economic structure. This has led to the development of strong local markets with little economic cooperation between provinces until a few years ago (Dymond and Moreau 2012, 74). In this regard, full equalization of provincial fiscal capacities would be a disincentive to economic growth and natural resource development hindering the economic competitiveness of the provinces[XX]. The significant weight that natural resources carry in the fiscal capacities of some provinces -mostly due to revenues generated from oil and gas royalties- is another factor that makes full equalization difficult as it would require a significant increase of the pool of funds dedicated to the program compromising the sustainability of the federal finances. The sustainability of the federal government's finances has marked the evolution of the program since the 70s as it has been reformed several times to prevent sudden increases in oil prices in international markets resulting increase in the fiscal capacity of resource rich provinces from destabilizing the system (Feehan 2005, 187-188). In 2004, Paul Martin's government decided to change the approach towards the allocation of the funds devoted to equalization. As stated above, this decision was intended to limit the federal contribution to equalization in the long-term anticipating a rise in energy prices that could threaten the financial situation of the federal government. The formula-driven system, where the total amount of funds was determined by the fiscal capacities of the provinces, was replaced by a fix-pool system. This path towards reducing the federal contribution to equalization was continued by Harper with the introduction of two new features: the fiscal capacity cap and the GDP growth ceiling. The fiscal capacity cap was designed to limit the payments to eligible provinces because of the exclusion of 50% of revenues from natural resources from the formula. This cap is aimed at avoiding that, after equalization, a recipient province would have a higher fiscal capacity than a non-recipient if the whole revenue from natural resources is taken into account. As, at the time, the total of

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funds was formula-driven, it effectively reduced the federal contribution to equalization[XXI], preventing provinces with high revenue from natural resources such as Newfoundland of Saskatchewan from receiving payments[XXII]. In turn, the GDP growth ceiling limited the increase of the total amount of equalization payments in accordance with the three-year moving average rate of growth of the GDP. This measure was intended to reduce the payments to Ontario which had just become a recipient province for the first time as its large population meant that the federal government had to make an additional effort to prevent the rest of the receiving provinces from seeing their payments drastically reduced (Smart 2009, 2-3). These changes perfectly illustrate the existing tradeoff between the level of equalization and the sustainability of public finances, with the latter being prioritized by consolidating the partial nature of the Canadian equalization system.

Equalization transfers are paid to those provinces whose ability to raise revenue is below the national average. This ability is determined according to the Representative Tax System (RTS) which uses a set of representative tax bases -mainly personal income, business, consumption and property taxes- at national average tax rates (Bird and Slack 1990, 919-926). Although the number of provinces taken as benchmark to calculate the standard has varied over time, equalization in Canada has been performed in gross terms since the creation of the program[XXIII]. Therefore, equalization payments are aimed at increasing the fiscal capacity of poorer provinces to the national average as defined by the standard without affecting the fiscal capacity of the richer subunits (Dahlby 2014, 8-10). Despite the fact that the fiscal capacity of richer provinces is unaffected by equalization, this has not prevented the compact from becoming a disintegrative force towards these territorial subunits with Alberta being the loudest critic of the system. In fact, the integrative results of the Canadian equalization system resemble more those of a net system with richer subunits such as Alberta or Saskatchewan complaining that their wealth coming from their natural resources is drained away to subside poorer provinces, reducing the level of mutual trust within the federation. The explanation to this disintegrative force is political as in public discourse, especially by the wealthier provinces, the compact tends to be described as a horizontal model -which are net by definition- in contrast to its real nature as a pure vertical mechanism. Thus, as pointed out by Béland and Lecours (2011, 208-209) equalization has become increasingly politicized in Canada. Successive federal governments have used the program as an instrument to court certain provincial electorates, either offering special arrangements

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along the line of those agreed with Newfoundland and Labrador and Nova Scotia, or implementing tweaks to the formula to avoid sudden losses in equalization revenue in the case that Ontario becomes a receiver (Feehan 2020, 9). For their part, some provincial governments, particularly those in resource-rich provinces that do not receive payments -although they did in the past as all ten provinces have received equalization payments at some point the history of the program-, have also targeted equalization to rally public support when demanding more transfers from the federal government. Such politicization has often been based on misleading assertions, such as presenting the compact as horizontal net equalization, that are far from the reality of the system, and has fueled intergovernmental conflict over the compact turning it into a disintegrative force in relation to richer subunits. The politization of equalization and the intergovernmental tensions that it causes also reduce the integrative potential that it is expected from the compact in the case of those provinces that are below the average and that, consequently, receive equalization payments. This is particularly clear in the case of Quebec whose entitlement to equalization is frequently criticized, being presented as unfair by the richer provinces (Béland and Lecours 2014, 347). Criticism of Quebec's status as a recipient province implies a weakening of the ties between the different units that integrate the Canadian federation reducing the level of mutual trust. Alberta's decision to hold a referendum to call for the elimination of equalization from the Constitution only deepens this lack of trust reducing the integrative potential of equalization also towards Quebec. In fact, behind this referendum, the impact of which at the federal level has been minimal, lies a desire on the part of Alberta to penalize Quebec for its refusal to allow new pipeline projects to pass through the province's territory[XXIV].

The politicization of the compact has proven to be a decisive determining factor in the future of equalization, discouraging any debate about the convenience of incorporating needs compensation or aiming at a higher level of equalization. While the lesser integrative potential of revenue equalization has been compensated with separated grants targeting needs-compensation such as the Canada Health Transfer (CHT) and the Canada Social Transfer (CST), full equalization seems a nonstarter as it would increase the political confrontation to levels that could destabilize the political system. Thus, the politicization of the compact, undermines the performance of the compact in relation to both richer -fostering disintegration- and poorer provinces -reducing the integrative potential- being the later especially clear in Quebec.

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d) Conditionality

Unlike the other two major federal transfers (CHT and CST), equalization has been characterized since its first implementation by the absence of conditionality either input or output based (Bird 2018, 858-965). This means that funds coming from equalization do not have any strings attached regarding their expenditure and thus provinces enjoy full discretion in their use. In the same vein, there is no obligation for the recipient provinces to implement measures to accomplish a certain result such as providing better services to their residents. Accordingly, the funds can also be used to lower taxes or reduce debt (Béland et al 2017, 24). This lack of conditionality is not limited to the transfer itself but also covers the operability of the compact. As the calculation of the fiscal capacities of the provinces is not based on real revenue but rather on theoretical revenue at national standards, the equalization program does not penalize provinces that use their fiscal autonomy to pursue policies of low taxation or low level of public services. This is in contrast to other federal transfers such as the CHT which is subject to compliance with a series of principles, although they are rarely enforced because checking the compliance would entail a big political cost (Cameron 2008, 265-268)[XXV]. Consequently, equalization in Canada is designed as a general-purpose block grant that substitutes own revenue in line with the academic prescriptions for these programs (Boadway 2006; Martinez-Vazquez and Boex 2004; Shah 2007a).

The unconditional nature of equalization is an integrative force not only towards provinces that get equalization payments but also in relation to those that have expectations to qualify in the near future as they have the safeguard that in case that their fiscal capacity ends up below the national average, they will get payments without any loss of autonomy. Thus, unconditional equalization is integrative in relation to Quebec, strengthening the ties between the province and the federation while reducing the potential benefits of secession. There are two reasons that support this idea. First, unconditional equalization raises the cost of secession for those subunits that are net receivers of funds (Béland and Lecours 2014, 340). This is because in the event of secession Quebec would not only loose the more than 13 billion dollars that receives in equalization payments but also would not experience any gain in autonomy due to the absence of conditionality attached to those payments. Therefore, as far as it remains unconditional there is no tradeoff between equalization and autonomy in the case of Quebec or any other province that would like to cease to form part of the federation. Conversely, a conditional equalization program would increase the benefits of

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secession, lowering its cost, as it will create a trade-off between the extra funding and a higher degree of self-government. Second, equalization can be used as a nation-building instrument to improve the image of the federal government, fostering allegiance to the federation. The federal government can display the program as one of the benefits of the union as this transfer improves the financial situation of the recipient government without imposing any obligations. Otherwise, imposing conditionality would reduce this benefit as equalization would turn into a tool to constrain provincial autonomy.

Notwithstanding the integrative potential of unconditional equalization, this characteristic can also lead to perverse economic incentives with some disintegrative potential. The absence of conditionality coupled with the formula used in the calculations -that results in equalization being a zero-sum game- can lead to "beggar-thy-neighbour" policies that could weaken the ties between the provinces hindering national unity. An example of this practice was the closure of the province-owned nuclear plant of Gentilly-2 in Quebec. This decision reduced the revenue that Quebec gets from natural resources lowering its fiscal capacity and increasing its equalization entitlements by 270 million as the province further diverged from the average. In addition, due to the zero-sum nature of the compact, the closure also had an impact in other recipient provinces that saw their payments reduced. This was the case of Ontario -a recipient province at the time- that had its equalization entitlement reduced of around 160 million dollars (PBO 2014, 8-9)[XXVI]. This example perfectly illustrates how the combination of the ceiling on the total payments and the lack of conditionality give room for "beggar-thy-neighbour" policies, discouraging recipient provinces from developing their natural resources -or increasing taxes- as this will reduce their equalization payments[XXVII]. For this reason, conditionality could be used as a soft budget constraint to discourage strategic behavior by territorial governments aimed at getting a higher share out of the program avoiding negative externalities on other constituent subunits and therefore reducing potential for disintegration and reinforcing mutual trust.

Despite these possible negative externalities that could be countered with some conditionality, the unconditional nature of the Canadian equalization program must be considered overall an integrative force in respect of Quebec as it raises the cost of secession and strengthens the bond between the province and federal government increasing the allegiance to Canada as a common project while respecting its autonomy to establish its own tax and service provision levels. The potential side effects mentioned above can be solved

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through adjustments in the calculation formula as Tombe (2018, 906-917) proposes and hence do not require the inclusion of conditionality which would turn the compact into a strong disintegrative force.

e) Institutional administering of the program

Canada's federal system has followed its own path in the management of equalization. Despite intergovernmental forums and independent agencies being the dominant trend in comparative perspective, the Canadian program is solely administered by the center with provincial participation being marginal. This has consolidated a model that represents the paradigm of federal-provincial diplomacy where the provinces lobby the federal government to influence its decision-making in setting and managing the main federal transfers, including equalization.

The federal government has been in charge of administering the compact since its creation in 1957, being the Department of Finance the responsible administrative body. Consequently, the management of equalization is in the hands of the Executive with Parliament also playing its role as changes to the compact are enacted as part of the federal budget, as they represent federal spending programs (Boadway 2008, 132)[XXVIII]. Thus, the federal executive enjoys full discretion to establish, modify, and terminate the terms of equalization transfers as long as it remains committed to the constitutional principle of equalization. However, the federal government's management of the program is characterized by opacity and lack of transparency. Beyond the constitutional principle of equalization and some provisions of the Federal-Provincial Fiscal Arrangements Act, there are no further legal provisions about the management of the equalization program by the Department of Finance. Further, the technical information relating to core aspects such as the formula is not publicly disclosed and it is not easily accessible to the public due to the limitations imposed by the 1982 Access to Information Act (Béland et al 2017, 43). The lack of transparency combined with limited public knowledge about how the program works in practice pave the way for the politization of the program and its instrumentalization.

Another factor that contributes to the politization of equalization is the low degree of territorial participation in the administration of the compact. Provincial participation is not legally required and, although provinces are sometimes consulted, the federal government may unilaterally alter the compact or extend it in its present form without any intervention

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from the former. This was the case in 2018 when the federal government decided to extend the current program until 2024 without changes, despite the numerous complaints of several provincial leaders calling for the overhaul of the distribution of the transfer payments. In this case, provincial participation was limited to some consultation during a Finance Ministers' meeting in December 2017 in which equalization was not even the main point of discussion as the meeting was dominated by discussions on cannabis taxation.

Although the administration of equalization is dominated by the central institutions, intergovernmental cooperation also plays a -small- role as the previous example illustrates. The Federal-Provincial-Territorial Meeting of Ministers of Finance is an intergovernmental body composed by the federal Minister of Finance and its provincial and territorial counterparts that generally meets twice a year to discuss economic and fiscal issues. Within this forum there is a specific committee -the Fiscal Arrangements Committee- that conducts consultations on fiscal transfer issues, including the equalization program. This forum serves as a venue where the provinces can express their views and concerns about equalization in order to demand changes to the compact from the federal government. However, these meetings are consultative and therefore any agreement that may be reached is a mere recommendation to the federal government.

Provinces have also recurred to horizontal cooperation to assert their positions and try to influence the federal government during the periodic renewal processes of the equalization compact. The Council of the Federation (COF), an intergovernmental body created in 2003 grouping the provinces and territories, has adopted a proactive role on this regard. After Paul Martin's decision to implement a "new funding formula framework" in 2004, the COF decided to commission a group of experts to form an independent advisory panel with a mandate to examine the vertical and horizontal fiscal balances among Canada's federal, provincial, and territorial governments and to make recommendations as to how any fiscal imbalances should be addressed[XXIX]. Although some of these proposals were later accepted by the federal government – which appointed its own panel, the Expert Panel on Equalization and Territorial Formula Financing, to expressly deal with equalization – horizontal cooperation has not been very effective when it comes to establishing a common position on equalization due to the diversity of viewpoints among the provinces.

The centralized management of the program with very limited provincial input results in a centrifugal force with disintegrative effects. The lack of effective mechanisms of territorial

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participation in the management of the program – the Fiscal Arrangements Committee deals with all federal transfers not being equalization its primary objective – has fostered the development of a model of federal-provincial diplomacy where the provinces compete with one another to influence the federal government's decision-making in the design and daily management of equalization. This intergovernmental bargaining with the aim of lobbing the federal government to introduce changes in the compact that are advantageous to a given province increases the politicization of the compact and fosters disintegration. The side deals signed by the federal government with Newfoundland and Nova Scotia in 2004 were the result of this as the federal government tends to be keener on certain provincial interests depending on its reelection needs. This circumstance also explains why proposals that would be negative for Quebec's interests – such as changing how revenue from hydroelectricity is computed in the formula – are a nonstarter due to the significant weight that Quebec's seats have in a federal election. Thus, this circumstance plays in the province's favor when lobbing the federal government also in respect of equalization. Although this factor could be considered integrative towards the center, it also entails disintegration in respect of other provinces that come out as "losers" because they are unable to exert sufficient pressure on the center government to take their demands into account.

As an alternative to intergovernmental bargaining and with the aim of reducing the existing politization of the system, Béland and Lecours (2016, 12-13) have proposed the creation an independent body following the example of the Australian Commonwealth Grants Commission to advise the federal government and provinces on equalization. The Australian model, much in vogue among economic experts, has been replicated in other Westminster style systems of government, although with little success (Ahmad and Searle 2006, 397-398)[XXX]. However, the creation of an independent agency was rejected by most of the provinces when asked by the Advisory Panel on Fiscal Imbalance in 2006[XXXI]. Although establishing an independent agency in charge of the program would put an end to the federal government dominance in the management of equalization and potentially depoliticize equalization fostering integration, this would also eliminate the provincial capacity to influence the federal government through intergovernmental diplomacy. Thus, despite the flaws of the current system and the disintegrative effects that it may entail due to the dominance of federal unilateralism and limited intergovernmental cooperation -which is generally held behind closed doors and mostly informally-, provincial governments seem to

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prefer to maintain their capacity to lobby the federal government to influence decision making over equalization policy with the aim to get a better share of the deal. Put differently, provinces are not willing to renounce the influence that partisan politics can have over equalization by relinquishing the administering of the program to an independent agency. This is particularly evident in the case of Quebec, as the creation of an independent agency may result in changes to the formula that could penalize the province' interests. Quebec has greatly benefited in the past from the federal government's need to gain votes in the province. This was the case of the 2007 reform, which resulted in a significant increase of funds for Quebec, and that for many was aimed at boosting support for the Conservative Party in 2007 in an upcoming federal election (Béland et al. 2017, 44). For this reason, the creation of an independent agency does not appear to be a better outcome in integrative terms than the status-quo as provinces would lose the possibility to influence the federal government through federal-provincial diplomacy, being this a salient element of Canadian federalism when it comes to financial relations.

f) Length of the program

Interterritorial solidarity programs are aimed at achieving the long-term goal of horizontal equity. However, the economic reality of the provinces changes over time and the system cannot be indifferent to those changes. The development of natural resources in the West, the decline in the manufacture sector in Ontario during the economic crisis or the revenues from offshore oil and gas in Newfoundland are factors that had an important impact in the fiscal capacities of the provinces and that, as a consequence, have conditioned the federal government's policy in respect of the program.

Equalization was conceived as a permanent program when it was first designed as it was part of a larger scheme of federal-provincial fiscal arrangements. This long-term vocation was reinforced in 1982 when the principle of equalization was included in the Constitution. However, although the essence of the program has remained, change has been a constant throughout the program's history with the technical aspects varying greatly over time. These changes have been necessary not just because of variations in provincial needs but also to implement ad-hoc political solutions to commitments of the federal government with certain provinces, or to meet the financial needs of the center and avoid a sharp increase in the resources devoted to the program. For instance, the initial version of the program did not

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last for long, and less than five years after its enactment Prime Minister Diefenbaker proposed some amendments to include natural resources into the formula. This new formula was changed after just two years to fulfill Pearson's electoral promise of going back to the two-province standard (Davenport 1982, 118). Even major reforms such as the one conducted in 1967, when the program went from equalizing three sources of revenue (individual and corporate taxes and succession duties) to a much more complex formula based on the Representative Tax System that included several revenue sources, only lasted for about five years until further changes were needed to adapt to the rise in oil and gas prices.

Despite the long-term vocation of equalization, reinforced with its constitutional inclusion, the different programs in place have often featured sunset clauses establishing the time upon which they needed to be renewed. This has not been always the case as after Martin's major overhaul of equalization in 2004, the program did not feature any kind of sunset clause neither there was a legal requirement for a periodic evaluation of the performance of the program. A sunset clause was reintroduced in 2007 when Harper reformed the compact following most of the recommendations of the Expert Panel on Equalization. The clause was included in article 3 of the Federal-Provincial Fiscal Arrangements Act, with the duration of the program set for the "period beginning on April 1, 2007 and ending on March 31, 2014". In 2013, that article was amended to extend the program until 2019 and the same happened in 2018 with the current program in force until 2024. Sunset clauses have also been applied to limit in time the scope of several ad-hoc agreements compensating certain provinces for a loss of equalization entitlements. For example, the side deal concluded with Nova Scotia expired at the end of March 2020 as mandated by article 3.71 (2) b of the Federal-Provincial Fiscal Arrangements Act.

A sunset clause establishes the maximum length of the program under the current conditions. This means that the compact will expire after that date unless renewed. The renewal can be under the same conditions, as was the case in 2018, or implement changes to the compact as the Harper government did in 2006. The existence of a sunset clause can be considered as an integrative force as it offers some certainty to the provinces about the duration of the program, although it can be unilaterally changed by the federal government at any time. The sunset clause included in Federal-Provincial Fiscal Arrangements Act also allow provinces to anticipate the termination of the current program and lobby the federal

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government for changes that would be advantageous to them. In Canada, the risk of intergovernmental conflicts during renewal processes that would result in disintegration is rather low as the federal government can unilaterally proceed without involving the provinces in the process. However, the example of 2018, when the federal government quietly renewed the compact for five more years, shows that it was aware of this risk and wanted to avoid clashes with the provincial executives that could undermine its popularity in the next federal election.

Another factor that deserves to be mentioned is the absence of ultra-activity clauses to assure that the expired program continues to be applied on a temporary basis until it is renewed. Such mechanism is not necessary in Canada as the federal government can amend the Federal-Provincial Fiscal Arrangements Act at any time to extend the program and there is no risk of opportunistic behavior by other actors to influence the decision-making process. In the unlikely event that the federal government does not, the compact will expire and equalization payments to the provinces will cease as there will not be a budget provision to finance them. This will create a political conflict and the provinces will likely go to court alleging a violation of section 36 of the 1982. In that case, it will be for the Supreme Court to decide about the scope of the commitment "to the principle of making equalization payments", circumstance that will certainly determine the outcome of the judgment.

Despite the need to renew the compact before it expires, the law does not call for a formal process of review of the program. This feature is common in countries with an independent agency in charge of administering the compact, which is not the case in Canada. Despite this, one of the recommendations of the Expert Panel on Equalization and Territorial Formula Financing called for the federal government to report annually to Parliament on key measures related to equalization[XXXII]. In particular, the federal government should inform Parliament of any "major changes made in the program" as well of "issues raised by the provinces and territories, and how those issues were addressed". In addition to this annual reporting, the experts also recommended the publication of a public discussion paper before every renewal that would serve as basis "for a Parliamentary review process in which provinces, academics, and interested parties would be able to express their views"[XXXIII]. The panel also asked for the publication of this paper in the event of changes being made to the compact before the period set by the sunset clause. Although these measures would have reinforced the integrative potential of the compact, establishing a

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formal mechanism to review the effectiveness of the program while involving all stakeholders in the renewal process, they were not put in place by the federal government, which decided to establish the length of the program on an ad-hoc basis in the Federal-Provincial Fiscal Arrangements Act without imposing any duty of carrying a formal review process or informing Parliament.

g) Dispute resolution

The strong political dimension that equalization mechanisms embed often leads to the coexistence of conflicting visions of the program that may result in intergovernmental conflicts. This phenomenon can be clearly observed in Canada, where the provinces and the federal government frequently clash due to their diverging views of the essence and operation of the program. The political controversy that surrounds the program, which has increased in recent years, should, in principle, be solved politically through intergovernmental cooperation. However, the unilateral management of equalization by the federal government makes this difficult as there is no legal obligation to involve the provinces in the process. If, on the contrary, the dissatisfaction of a province with the compact goes further than political criticism, this may result in a legal dispute that must be resolved in court.

Given the constitutional entrenchment of equalization, it would be theoretically possible to bring a case before the Supreme Court alleging that some aspects of the program violate section 36. However, despite the controversy that the program causes in some provinces, the compact has never reached the Supreme Court. In 2007, the government of Saskatchewan asked for a reference to the provincial Court of Appeal -that later could be appealed to the Supreme Court- claiming that some parts of the formula violated the constitution as they were not "fair and equitable", but the appeal was eventually dropped after a government change in the province (Béland et al 2017, 45-6).

Despite the centralized management of the program, the provinces have opted to pursue the intergovernmental path through federal-provincial diplomacy to settle disputes over equalization instead of initiating legal challenges, reducing the risk of disintegration and avoiding the judicialization of equalization. The absence of litigation on equalization is explained by the unwillingness of the provinces to challenge the program in court. There are several reasons for this. First, it is not guaranteed that the court will accept the case as there is a high possibility that the compact would be deemed as a political question and then non-

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justiciable (Hogg 2000, 156). This is due to the narrow scope of section 36, that only commits the federal level to the principle of equalization, which reduces the Court's margin of interpretation when analyzing the particular elements of the compact. Because of this, Kellock and Leroy (2009, 27-9) argue that most elements of the program cannot be challenged in court on grounds of constitutionality, since only the principle of equalization or inter-territorial solidarity enjoys constitutional status. Secondly, challenging equalization in court may be counterproductive for provincial interests as this would hinder any negotiation attempts with the federal government. Provincial governments recur to federal-provincial diplomacy to influence the federal decision making over equalization. If a legal challenge is launched, negotiations will probably be suspended until the court makes a decision. In fact, this was one of the main arguments put forward by the government of Saskatchewan to drop the case before the Court of Appeal as it argued that the challenge deteriorated the relations with the federal level not just on equalization but also over other issues, hindering provincial interests (CBC 2008). Additionally, political bargaining reduces the risk of an adverse outcome as it could be reversed through political negotiations while this would be more difficult in the event of an unfavorable court ruling that can hardly be changed. This is of particular importance as the Canadian Supreme Court tends to favor the federal government over the provinces (Brouillet 2007, 152), an aspect that further disincentivizes launching a legal challenge on equalization.

This perception of the Supreme Court as more favorable to federal interests than to provincial ones constitutes a disintegrative force and explains why launching a legal challenge over equalization has not been used in Canada as a tool to force the federal government to negotiate some aspects of the compact, as it happens on the contrary in Germany. As a result, provinces that would like to see some changes in the compact have had to find alternative ways to influence the federal government to implement them. An example of this is the decision taken by Alberta to call a referendum on equalization. Instead of directly confronting the federal government in court, the province decided to put a question to the people over the future of the program with the intention of persuading the federal government to revise the compact to introduce new elements that would favor the province. In the end, the referendum was conceived as a political statement to increase the province's bargaining power in the next renewal process and "force the federal government to

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negotiate", as Alberta's Premier Jason Kenney reckoned, to gain some concessions from the federal government (CBC 2021).

The likely non-justiciability of the compact due to the ambiguity of the constitutional provision on equalization and the perceived tendency of the Supreme Court in favor of the center have discouraged provincial governments from litigating over equalization, forcing them to pursue dispute resolution through intergovernmental cooperation. This predominance of conflict resolution through intergovernmental negotiations over court litigation delivers a better outcome in integrative terms. Although conflicts are always divisive, intergovernmental cooperation entails the lowest risk of disintegration whereas the judicializing of equalization would increase territorial tensions weakening the existing patterns of interaction among governments.

3. Concluding remarks

In Canada's origins are intricately linked to the idea of territorial solidarity. The Fathers of the Confederation were immediately aware that any long-lasting union depended on guaranteeing sufficient financial resources to the provincial governments so that they could freely exercise their powers. Thus, the idea of nation building has gone hand in hand with the Canadian equalization program since its creation in 1957. The inclusion of the program into the Constitution highlighted the importance that was given to territorial solidarity during patriation as a process towards building a common social citizenship. It is not by chance that the program embeds an idea of fraternity and solidarity that promotes integration and national unity. The table below provides a graphic summary of the analysis carried on in the article.

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Component			(Dis)Integrative potential*	Factors to consider
Legal entrenchment of the program	Principle enshrined in the Constitution with the program developed in a federal law		Integrative ↑↑	Narrow scope of the constitutional provision High constitutional rigidity prevents its reform
Nature of the redistribution	Vertical funded with federal taxes	Receiving province	Integrative ↑↑	
		Not receiving province	Disintegrative ↓↓	Fuels intergovernmental tensions with Quebec
	Close-ended system		Disintegrative ↓↓	Zero-sum game where any change results in winners and losers
	Stand-alone program with revenue sharing performed through others federal transfers		Disintegrative ↓	
Level and component of equalization	Partial equalization	Richer subunits	Disintegrative ↓	Treatment of natural resources
		Poorer subunits	Integrative ↑	
	Gross equalization	Receiving province	Integrative ↑	Lower in the case of Quebec because of politicization
		Not receiving province	Disintegrative ↓	Compact is presented as net in political discourse
	Revenue		Integrative ↑	Needs-compensation via CHT and CST
Conditionality	No		Integrative ↑↑↑	
Institutional administering of the program	Central agency with minor role for national parliament		Disintegrative ↓↓	Intergovernmental bargaining through federal-provincial diplomacy
Length of the program	Sunset clause (5 years) in federal law		Neutral	Unilateral renewal by the center
Dispute resolution	Supreme Court	Perceived as favorable to the center	Disintegrative ↓	Not used in practice
	Intergovernmental cooperation	High levels of mutual trust and cooperation	Integrative ↑	Consolidated model of federal-provincial diplomacy

*The number of arrows (from 1 to 3) refers to the intensity of the (dis)integrative potential of each component.

Constitutional entrenchment has led to the general acceptance of inter-territorial solidarity by all political actors, although they frequently disagree on its nature and extent. In fact, equalization can be considered as a benefit of the union with the program being aimed at ensuring that all provinces can generate income at "reasonably comparable levels of taxation" to prevent fiscal disparities between provinces from being of such a magnitude that they penalize citizens depending on their place of residence and that would result in inferior public services. Equalization has become a nation building instrument that not only raises the cost of secession of those subunits -such as Quebec- that are net receivers of funds, but that also promotes national unity and increases the allegiance to the center. In other words, equalization has been used by the federal government as an instrument to foster a sense of belonging to the Canadian common project and to persuade Quebeckers into luring their allegiance to the existing constitutional framework. The impact of equalization in the

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evolution of the Canadian federation has been such that the nationalist Premier of Quebec, François Legault, has recognized the contribution of the program to maintaining the province within the federation. Further, equalization has always been a tricky issue for Quebec's nationalists as secession would imply losing a large amount of funds without gaining much autonomy because of the unconditional nature of equalization.

The Canadian experience also features some disintegrative trends, that not only hinder the integrative potential in relation to Quebec but that also threaten to create tensions in the resource-rich provinces like Alberta. Equalization has become increasingly politicized in recent years, by both the federal government and some non-recipient provinces. At the same time that the federal government used it to court certain provinces and defuse the appeal of the secessionist option in Quebec, some non-recipient provinces had difficulties to accept the use of equalization as an accommodation or nation building tool. In fact, Quebec has been sometimes used as the scapegoat, presenting the program as a sort of reward to Quebec for staying in the federation. In the end, the fact that it is construed as a close-ended system in which any change results in winners and losers has further poisoned the political discourse over equalization, fostering disintegration. Another factor that contributes to the politization of the compact is the lack of territorial participation in the decision-making processes over equalization. When participation is non-existent or ineffective, it may be difficult to channel contestation within the constitutional framework, with the risk of resulting in pathological behaviors that spread instability to the federal system as a whole. The referendum held in Alberta is one example of these pathological behaviors, illustrating that the risk disintegration is not limited to Quebec.

Despite these disintegrative trends, the Canadian equalization program has been able to channel contestation within the system, keeping conflicts over equalization 'under control' notwithstanding the matter as such is becoming a major source of intergovernmental conflict -both vertical and horizontal- due to enhanced politicization: both federal and provincial politicians have articulated claims and threats around the program with these increasing during periods of economic recession. The program has also proven to be a tool of territorial integration that has contributed to the accommodation of Quebec, by reinforcing the loyalty toward the center. Additionally, most of the disintegrative elements -such as the controversy about the share of natural resources that should be included in the formula, or the recent politicization of the program- could be countered with reforms. In particular, it would be

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advisable to consider implementing effective mechanisms for channeling territorial participation in the governance of the compact or relinquishing this task to an independent agency to end with the federal government unilateralism that characterizes the governance of equalization in Canada and that seems to be one of the main causes of intergovernmental conflicts between receiving and not receiving provinces, with Quebec often at the center of the debate.

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I Senior Researcher, Institute for Comparative Federalism - Eurac research (Bolzano/Bozen, Italy)

II Sorens (2015) and Rode, Pitlik and Borrella Mas (2017) have addressed this subject from the point of view of political science and economic theory, respectively, leaving aside an important facet of this phenomenon as is the legal perspective.

III The provincial governments had to pass legislation authorizing the rental of the provincial taxes to the federal level to give effect to the Tax Rental Agreements. For example, the *Federal-Provincial Agreement Act, 1957*, ch. 142 in British Columbia or *The Tax Rental Agreement Act, 1957*, ch. 22 in Saskatchewan.

IV The new wording of the article would have been the following: *Parliament and the government of Canada are committed to making equalization payments to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation.*

V *An Act respecting constitutional amendments* S.C. 1996, c. 1.

VI Formally, the federal government must seek the consent of two or more of the Prairie provinces that have, according to the then latest general census, combined populations of at least fifty per cent of the population of all the Prairie provinces but as the population of Alberta exceeds that of Manitoba and Saskatchewan combined, the practical effect of this provision is a veto right for Alberta at the same level as that granted to British Columbia, Ontario and Quebec.

VII The referendum was held on October 18, 2021, with 60% of voters supporting the removal of equalization from the Constitution with a turnout of just 38%.

VIII BILL C-263 *An Act to amend the Federal-Provincial Fiscal Arrangements Act (equalization)*, 2nd Session, 43rd Parliament, 69 Elizabeth II, 2020-2021.

IX The Charlottetown Accord 1992 would have reworded section 36.2 in the following terms: "*Parliament and the Government of Canada are commited to making equalization payments so that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation.*"

X For fiscal year 2019-20 equalization payments to Quebec were 13,124.4 while the total revenue amounted to 117,374 (figures in $ millions). Source: Ministère des Finances du Québec.

XI In the same vein, in a Twitter exchange with the then Quebec's Minister of International Relations, the Francophonie and External Trade, Jean-François Lisée, Legault alleged that equalization made secession less likely as it was not in the interest of Quebec.

XII This idea was behind the side deals that the Martin government signed with Newfoundland and Nova Scotia to compensate these provinces after they become "have provinces" due to the income from their offshore natural resources which were also aimed at making political by improving the federal government's image in those provinces.

XIII The use of the moving average as index instrument mitigates possible fluctuations resulting from extreme episodes such as the acute recession caused by the pandemic.

XIV As an example, the dialectical confrontation between the Premiers of Alberta and Quebec, Kenney and Leagult, respectively, about the history and practice of equalization. See Pilon-Larose 2019.

XV Quebec's strong opposition to the construction of new pipelines, vital to the economy of western provinces, has also helped to increase the fuss about the unfairness of the program as the province is thought to benefit too much from equalization.

XVI Bourassa used the expression *fédéralisme rentable* as an electoral slogan in the 1970 provincial election campaign, highlighting the benefits of Quebec's membership in the Canadian federation as opposed to the sovereigntist discourse of the *Parti québécois*.

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[xvii] In fact, Quebec is typically the province that receives the least funds per capita, except in those years when Ontario was entitled to receive equalization payments.
[xviii] In this step of the calculations, according to article 3.2 (2) of the Federal-Provincial Fiscal Arrangements Act any province may elect either to include 50% of the revenue from natural resources or none, depending on what is most beneficial.
[xix] See Achieving A National Purpose: Putting Equalization Back on Track, Expert Panel on Equalization and Territorial Formula Financing, 2006, 39.
[xx] In fact, one of the most common criticisms from the "have provinces" towards the program is that it discourages receiving provinces from the developing their natural resources as doing so will result in a reduction of their entitlements.
[xxi] The fiscal capacity cap was maintained after the reform of 2009. As the system is no longer formula driven it does not affect the federal contribution to the program but only the distribution of those funds among the provinces.
[xxii] Newfoundland was partially compensated with a payment of two thirds of its previous entitlement to equalization the first year that the province was not eligible and another one of one third the following year as provided by article 28 of the *Nova Scotia and Newfoundland and Labrador Additional Fiscal Equalization Offset Payments Act* (S.C. 2005, c. 30, s. 85).
[xxiii] See Courchene (1984) for a brief history explanation of the different standards used during the history of equalization in Canada.
[xxiv] Quebec's repeated refusal to allow new pipelines to pass through its territory has aggravated tensions with Alberta, whose oil industry needs them to increase its export capacity amid the severe recession that has hit the province in recent years.
[xxv] The eligibility for the CHT is subject to compliance with the principles enshrined in article 7 of the *Canada Health Act R.S.C., 1985*, those being public administration, comprehensiveness, universality, portability and accessibility.
[xxvi] Ontario's 2014 budget reflected the province's unease with this result, claiming that the reduction in equalization payments to the province was due "to factors that have no relation to Ontario's economic performance" but that as a result Ontarians will "subsidize programs and services that themselves may not enjoy".
[xxvii] The lack of soft budget constrains to discourage strategic behavior has been studied by Tombe (2017) who suggest that provinces can implement policies that would increase their equalization payments. For instance, if the provinces with the lowest fiscal capacity, Prince Edward Island, were to increase its income or personal tax rate by one per cent, this would result in an increase of the payments to that province at the expense of the others due to its effect in the standard and the zero-sum nature of the compact. He has also developed a tool where one can simulate how equalization payments would change in the event that the provinces adopt certain policies: https://financesofthenation.ca/equalization/
[xxviii] The minor influence of Parliament is due to the de facto fusion between the legislative and the executive that characterizes the Westminster system of government, a feature that has led Monahan and Shaw (2013, 103) to affirm that there is no real separation of powers between the legislative and the executive functions in Canada.
[xxix] Reconciling the Irreconcilable. Addressing Canada's Fiscal Imbalance, Council of the Federation, 2006.
[xxx] See Watts (2003) and Boex and Martinez-Vazquez (2004).
[xxxi] Reconciling the Irreconcilable. Addressing Canada's Fiscal Imbalance, Council of the Federation, 2006, p. 39.
[xxxii] Achieving a National Purpose: Putting Equalization Back on Track - Expert Panel on Equalization and Territorial Formula Financing, p. 66.
[xxxiii] Ibid, p. 67.

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