

Fiscal Federalism in Canada

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The Basic Features of Fiscal Federalism in Canada

- Structured and circumscribed by the principles of solidarity and provincial autonomy.
- Features federal and provincial governments having access to similar income sources, but with provinces bearing responsibility for large social programs (namely health care and education).
- Involves two major federal per-capita transfers (CHT and CST) to mitigate vertical fiscal imbalance.
- Features a federal equalization program that provides payments to provinces with a fiscal capacity falling below a national average to take them to that average.
- Is based largely on unconditionality in transfers, and provincial governments are ultimately accountable to their residents rather than to the federal government for the use of the transferred money.

Constitutional Framework

- Large federal power to spend outside of its constitutionally-allocated jurisdiction, so long as the spending is not an attempt to regulate.
- Also a broad power to impose conditions regarding the modalities, terms and conditions of spending, including to encourage provincial compliance with federal objectives.
- Concerns about the scope of this power have at times been raised by Québec.
- Courts have acknowledged existence of the federal spending power but are very reluctant to police its boundaries, given concerns about the political nature of spending decisions.
- Use of this power thus largely regulated politically.
- Use of the federal spending power during the COVID-19 pandemic was extensive.

Strengths and Weaknesses of Canadian Fiscal Federalism.

- Strengths:

- Well-suited for a large, multinational country with regional economies with its virtual absence of conditionality in major transfers.
- Ensures public services of comparable quality at comparable rates of taxation across the provinces.

- Weaknesses:

- Health transfers to the provinces do not reflect/meet provincial needs, and the rising cost of health care leaves most provincial governments in challenging fiscal situations.
- Equalization is contested by some non-receiving provinces.

Canadian Fiscal Federalism and Covid-19

- Additional stress on health care systems and increased demands for greater (unconditional) federal transfers for health care (CHT).
- Reduction of horizontal territorial disparities, resulting from greater economic contraction in oil producing provinces, contributing to more pressures to adjust the equalization program (i.e. to reduce its overall pool and therefore payments to recipient provinces).
- Reform of the Fiscal Stabilization program.
- Purchase of provincial bonds by the Bank of Canada.

Lessons for the EU

- Design transfers based on transparent and predictable formulas.
- Consider the use of tools of asymmetric federalism, such as opt outs, to manage difference and for greater autonomy by regional units.
- Allow for broad discretion over the specific disposition of those funds.
- For redistributive programs designed to tackle territorial economic disparities, three principles have considerable value: 1) simplicity and transparency 2) collaborative approaches on program design and reforms based on independent expert commissions/advice 3) non-conditionality.
- Design predictable and formula-based fiscal policies like the Fiscal Stabilization program to support jurisdictions experiencing sharp declines in public revenues.
- Embed the further development of fiscal federalism in an intergovernmental network such as Ecofin.