Canada, like all other federations, must function despite the complex nature of fiscal relations between the country’s multiple levels of government. The Conservative government, under Prime Minister Stephen Harper, has acknowledged that a fiscal imbalance exists in the Canadian federation. Through a number of recent measures, the government has strived to reconcile the country by trying to achieve a state of fiscal equilibrium. This paper will explain how Canada came to be in a state of imbalance, what that means, and how it relates to Alain Noël’s three conditions for fiscal balance. In particular, this paper will focus on the perceived imbalances or disadvantageous financial situations in large Canadian cities like Toronto and in the provinces of Ontario and Saskatchewan. Though many opposition members refused to believe that a fiscal imbalance was applicable to the Canadian situation, Harper vowed to fix these imbalances as part of his 2006 election platform of open
federalism. Lastly, this paper will consider how the 2007 federal budget attempts to return the federation to a state of fiscal equilibrium and whether or not these measures have been successful in allowing the federation to meet the conditions for fiscal balance.

To better understand the complexity of fiscal relations in Canada, it is necessary to define various concepts relating to fiscal imbalance and the programs created to address these issues. Fiscal imbalance was most recently made a public issue with the creation of the Canada Health and Social Transfers (CHST) in 1995 (Brown 2007, 74). The CHST maintained many of the imbalanced policies of its forerunners, Established Programs Financing (EPF) and the Canada Assistance Plan (CAP). The establishment of this lump sum transfer explains why fiscal inequality has become such a prominent issue. Instead of measures based on equality, the legacy of these two programs meant that the distribution of the CHST was based largely on outdated formulas and convention, instigating much controversy because each province received a different share of the transfers per capita. The government at that time, however, refused to believe that this situation constituted fiscal imbalance. Instead, it was up to the recently elected Conservative government to address the issues of imbalance parlayed by voters (Ibid., 75). Stéphane Dion, in his previous role as Federal Minister of Intergovernmental Affairs, was quoted as saying that “there can be no imbalance to the detriment of one order of government when it has access to all revenue sources and even has a monopoly on such major sources as lotteries and natural resource royalties” (Laurent 2002, 2).

Obviously, Harper disagreed. If the current government continues to make fiscal balance a priority, what will it look like? Alain Noël identifies three conditions for fiscal balance, stating that, ideally

1. “...own-source revenues are sufficient to allow each order of government to be autonomous and
accountable in its fields of jurisdiction:”

2. “own-source revenues plus transfers are adequate and enable governments to cover necessary expenditures; and”

3. “transfers are unconditional, unless there is a valid agreement to that effect” (Noël 2005, 129-130).

In other words, a fiscal imbalance exists when any of these three indicators are found to be lacking.

Complexities arise as well because there are two types of imbalance to be considered — vertical and horizontal. A vertical fiscal imbalance, the type of imbalance which has garnered recent attention, occurs when one level of government raises more revenue than is necessary for implementation of public programs and the other level of government raises less than is necessary, after transfers (Advisory Panel 2006, 12). According to the Advisory Panel on Fiscal Imbalance, this type of imbalance developed in the 1990s as a result of large-scale cuts to provincial funding from the federal government. The Panel also notes that the fiscal imbalance is perceivable in the lives of all Canadians, given the federal government’s increasing presence in areas of provincial jurisdiction. This situation is difficult for the different levels of government to resolve because it would be widely unpopular for provinces to increase taxes significantly or decrease the amount of social programs in an attempt to remedy the imbalance (Ibid., 67).

The horizontal fiscal imbalance addresses the disparities in wealth between different provinces and “the difference in the ability of individual provinces and territories to raise revenues” (Ibid., 13-14). Oil-rich provinces like Alberta have far more resources to spend on public programs than provinces which are “economically disadvantaged ... [and] less able to raise the necessary revenues” (Ibid., 77). The situation is equally disadvantageous for the territories, who perceive an even greater imbalance in their ability to raise revenues. In Ontario or Quebec,
increasing income tax rates by 3% would achieve a 1% increase in total revenues. In Nunavut, on the other hand, a 30% increase in income tax rates would be required in order to achieve the same 1% increase in revenues (Ibid., 49). This inequality in fiscal capacity is the reason why the government needed to create “some form of program designed to help the less prosperous provinces provide adequate public services to their residents” (Ibid., 77).

The program created to address the issue of unequal fiscal capacity is called Equalization or, in the case of the territories, Territorial Formula Financing. These programs are intended to uphold the ideal that all Canadians should have access to equivalent levels of service no matter where they live. In order to accomplish this goal, the government distributes tax revenues to less well-off provinces (Ibid.). By averaging the fiscal capacity or “ability to raise revenue” of all 10 provinces, the government discerns which provinces have below average fiscal capacity and grants these ‘have-not’ provinces Equalization payments (Department of Finance, “Equalization Program” 2008). Because of the horizontal and vertical fiscal imbalances which exist in the Canadian federation, Stephen Harper has made it the objective of his government to resolve these issues.

In the past decade or so, there has been evidence of a fiscal imbalance in nearly every interaction between the separate levels of government. Cities, Ontario, and Saskatchewan, have complained of imbalance or unfair treatment, and they will be the focus of the remainder of this paper.

In large municipalities, there exists a valid contention that they do not receive an adequate share of government revenue and are therefore unable to cover the considerable expenses associated with providing services to their citizens (Slack 2004, 4). Cities require an exceptional amount of resources if they are to provide “police and fire protection, roads and transit, water and sewers, garbage collection and disposal, recreation and culture, public health, housing, planning and development,
and in some municipalities, social services” for over a million people (Ibid.). However, because Canada’s cities are only allowed access to “property taxes, user fees, and intergovernmental transfers,” large municipalities such as Toronto, Montreal, and Vancouver, find themselves unable to keep up with the increasing levels of demand for public services (Ibid., 19). Enid Slack addresses this often overlooked issue of the imbalance faced by municipal levels of government and outlines ways in which revenue sharing between provincial or federal governments and large cities might be improved. One possibility is that a portion of the revenues from other levels of government could be transferred to municipalities according to a set formula (Ibid., 8). There is also the possibility that this uniform portion of the provincial or federal tax rate could be returned either partially or entirely to the municipalities of origin. Slack’s other options for revenue sharing suggest a focus on greater municipal autonomy. With more autonomy, cities would be permitted to set their own tax rate from government revenues or could even go so far as to create a municipal tax (Ibid., 9). All of these are valid options which must be considered by the Conservative government if they are to resolve the fiscal imbalance between higher levels of government and large municipal governments.

The province of Ontario must not only deal with the city of Toronto’s inability to meet demands for public services, they must also address provincial fiscal issues. In the past few decades, citizens of Ontario claim to have suffered from cuts in federal funding and the creation of disadvantageous federal programs. For example, “the 5% growth limit to Canada Assistance Program for the three have provinces” likely cost Ontario $7 billion between 1990 and 1994 (Courchene 2005, 5). Ontario also contends that the province should be compensated more generously by the federal government because they receive such a large portion of Canada’s immigrants. More resources to fund the settlement of immigrants and Labour Market Development
Agreements have been demanded from the federal government, but to no avail (Ibid.). The government of Ontario complains that the lack of Labour Market Development Agreements cost the province “$900 million in the three years ending 1993-94” (Ibid.). Until very recent changes in Ontario’s fiscal capacity, most other provinces felt that these contentions made by Ontario were unsubstantiated and unmerited.

As one of the richer provinces in the federation for a long period of time, Ontario has often been looked upon with jealousy and resentment by other provinces who felt, “just as high-income people may complain that they pay more in taxes than they get in services, so do high-income provinces” (Lee 2006, 19). Ontario was often viewed as a rich province complaining that they were forced to contribute more to the federal government in taxes than they received in federal transfers and that poorer provinces were the recipients of Ontario’s tax revenues (Ibid.). As of November 2008, this situation has undergone a significant change as Ontario, for the first time ever, will receive an Equalization payment worth $347,000,000 (Maurino & Leslie 2008, A1). Still, it is important to consider how, prior to this change in economic status, Ontario’s complaints were often viewed as inappropriate and unconstitutional. Section 36 of the Canadian Constitution commits both provincial and federal levels of government “to (a) promoting equal opportunities for the well-being of Canadians; (b) furthering economic development to reduce disparity in opportunities; and (c) providing essential public services of reasonable quality to all Canadians” (Department of Justice 1982). Furthermore, the Constitution commits the federal government to making equalization transfers so that all provinces can have relative equality in public services at similar levels of taxation. This legislation significantly weakens the arguments of rich provinces such as Ontario, that have often felt as though they were receiving unequal treatment by contributing a large portion of their tax revenues to programs in other provinces (Ibid.).
In stark contrast to the situation of Ontario, Saskatchewan is now considered a ‘have’ province after a lifetime of receiving Equalization payments. However, contentions of fiscal inequality persist. In particular, the federal government’s confiscation of Saskatchewan’s oil revenues is cause for unrest in the province, as the people of Saskatchewan are relatively poor without non-renewable resources and feel that they are being mishandled by the federal government. In the “fiscal year 2000-01 Saskatchewan’s energy revenues totalled $1.04 billion...[but] these energy revenues triggered even larger decreases in Saskatchewan’s equalization entitlements, over $1.13 billion” (Courchene 2004, 4). In fact, the province’s “non-energy equalization entitlements are rising” far more quickly than any other province (Ibid., 9). Despite its status as a wealthy province, Saskatchewan is actually one of the least well-off provinces in the federation, finding itself at “the bottom rank in terms of per capita disposable income” (Ibid.). Regardless of massive energy revenues, the majority of wealth is not accrued by the provincial government; citizens are penalized for the wealth derived from energy revenues and prevented from receiving additional and much needed federal transfers. Employment Insurance transfers are another matter for concern in Saskatchewan as the province receives a mere $36 per person. This is in contrast to provinces such as Newfoundland and Prince Edward Island, who receive in excess of $1000 per person in Employment Insurance (Ibid.). These discrepancies in government transfers ignore the fact that Saskatchewan, despite its vast energy resources, is incapable of providing for its own citizens without assistance from the federal government. This case, as well as those of the province of Ontario and large municipalities, provides some insight into the issues raised across the country in relation to fiscal imbalance.

When Stephen Harper was elected Prime Minister in 2006, it was partially due to his criticisms of the fiscal imbalance and his vow to return
Canada to a state of fiscal equilibrium. The Prime Minister’s official website outlines his plans for open federalism as of 21 April, 2006. At that time, he vowed to Canadians that he would “tackle the fiscal imbalance as part of his open approach to federalism” (Office of the Prime Minister 2006).

This concept of open federalism provides provinces with more autonomy and responsibility and, at the same time, constrains the spending of the federal government in areas of provincial jurisdiction (Ibid.). By improving the relationship between federal and provincial levels of government, he believes that fiscal imbalance can be resolved. The Prime Minister also states that the fiscal imbalance is no longer just a financial issue because, “while a lot of money is involved, the functioning and the very spirit of the Canadian federation are at stake” (Advisory Panel, 98). Given such bold statements regarding the issue of fiscal imbalance, it is necessary to consider how he has chosen to act upon these assertions.

Is Canada, thanks to the government of Stephen Harper, now in a state of fiscal equilibrium? The 2006 and 2007 budgets drafted by the Conservative government claim to restore balance, but do they reconcile the disparities in the aforementioned cases of large municipalities, Ontario, and Saskatchewan? Does the current state of the federation meet Alain Noël’s three criteria for fiscal balance? The 2007 federal budget focuses significantly on resolving fiscal imbalance and makes the lofty claim that the Conservative government “follows through on every commitment of the [2006 budget] plan and goes further” (Department of Finance 2007, 3). Budget 2007 allegedly “restores fiscal balance with provinces and territories” and “takes another step towards restoring fiscal balance with Canadian taxpayers” (Ibid.). This restoration process will be implemented over the next seven years and will equate to $39 billion in additional transfers. These transfers are intended to improve Equalization and Territorial Formula Financing programs and support provincial and territorial “healthcare, post-secondary education, child-care spaces, labour
market training and infrastructure” (Ibid., 45). The 2007 budget plan also aims to create a more fiscally transparent federation and to clarify fiscal responsibilities for each level of government (Ibid., 46).

Some of the concerns expressed earlier by municipalities are addressed in part by the 2007 budget. The budget grants municipalities a part in the Gas Tax Fund and an increase in their GST rebate from 57.1 percent to 100 percent (Ibid., 34-35). To the benefit of Ontario, as well as Alberta and the Northwest Territories, the budget claims that the cash support for these provinces and this territory will be increased to the same level as all other provinces and territories (Ibid., 22). For Saskatchewan, the benefits are less certain since the budget hardly mentions the province except to say that it is not receiving Equalization payments due “to strong growth” and that Saskatchewan will receive $15 million in “new labour market training funding” (Ibid. 71). The improvements promised to Saskatchewan, Ontario, and major cities, appear to be quite minimal overall and it is questionable whether these measures will be enough to resolve the fiscal imbalance.

As outlined earlier, the three conditions for fiscal balance according Alain Noël are that:

1. “...own-source revenues are sufficient to allow each order of government to be autonomous and accountable in its fields of jurisdiction.”

2. “...own-source revenues plus transfers are adequate and enable governments to cover necessary expenditures; and”

3. “transfers are unconditional, unless there is a valid agreement to that effect” (Noël 2005, 129-130).

To deal with his first criteria, are the revenues of each level of government sufficient in allowing autonomy and responsibility in areas of jurisdiction (Ibid., 129)? Though this condition is met in a number of provinces, several provinces ran deficits in 2007, which suffices to say that they were unable to provide for the needs of their
citizens with provincial revenues. Newfoundland and Labrador, the Northwest Territories, Nova Scotia, and Quebec ran deficits, while every other provincial government and the federal government ran a surplus or had a balanced budget in this same period (Statistics Canada 2007). In the case of Ontario, prospects of fiscal balance have been hopeful, as the provincial government ran a surplus of $300,000,000 for the fiscal year 2005-2006, a significant improvement over the deficit of $5,500,000,000 that the province incurred in the fiscal year 2003-2004 (Ministry of Finance 2007, 5). In Saskatchewan, the province is forecasting another surplus for the year 2008-2009 at $250,000,000 (Gantefoer 2008, 72).

These two examples, as well as the other nine provinces and territories who avoided deficits, provide some hope of strides being made towards a state of fiscal balance and reliance on own-source revenues. However, municipalities have little hope of seeing the same type of progress any time soon and Toronto’s 2007 budget concedes this point, admitting that the city’s “challenge of matching its spending needs to its ability to raise revenues...is a permanent or ‘structural’ mismatch” (City of Toronto 2007, 35). In terms of the federal government, other issues of imbalance may arise as there is increasing speculation that the federal government will find itself in deficit in 2008 or 2009. A deficit in the federal level of government would complicate the issue of imbalance further, as it would cause several orders of government at once to be unable to provide necessary services through own-source revenues (Martin 2008).

In response to Noël’s second criteria, are own-source revenues and transfers sufficient for the governments to be able to cover their expenses (2005, 129)? Because federal transfers have been adequate in covering the costs incurred by every province and territory, this second criteria has been fulfilled in certain respects. In the four cases of provinces or territories with deficits, federal transfers in the form of Equalization payments have overly compensated for their lack of funding
(Department of Finance, “Federal Support” 2008). However, in the case of a municipal government like that of Toronto, and the potential federal deficit in the coming year, transfers are insufficient to resolve the imbalance. Cities, as mentioned earlier, do not receive Equalization payments. Furthermore, it is unlikely that the federal government would compensate for a possible federal deficit with revenues from lower levels of government. So, though own-source revenues and transfers may be sufficient in covering the costs of the provinces and territories, they are as of yet insufficient in addressing the situation at the municipal and federal levels of government.

Lastly, it must be considered whether intergovernmental transfers are unconditional, or if there is an agreement in place on conditional transfers (Noël, 130). This stipulation, it would appear, has been fulfilled since Equalization payments and Territorial Formula Financing are, indeed, unconditional transfers. The other major federal transfer, the Canadian Health and Social Transfer, is not unconditional, but its conditions have been agreed upon by both levels of government. As the title of this latter transfer might imply, the provinces receive these transfers under the condition that they must be spent on healthcare and social services (Brown, 68). Therefore, this third stipulation of fiscal balance would seem to be the only one adequately fulfilled, as provincial deficits and problems in large municipalities and potentially in the federal government do not allow the Canadian federation to meet the conditions for fiscal balance.

Alas, it would appear that any previous discrepancies in the vertical fiscal imbalance have been resolved in terms of most of the provincial levels of government, but imbalance persists in other areas of the federation. Even in the provinces and territories that meet the requirements for fiscal balance, dissatisfaction with public services and complaints of disadvantageous federal programs still exist. As well, municipalities and the federal government continue to feel the effects of an imbalance.
Therefore, it must be concluded that government has chosen to address and Canada is not yet in a state of fiscal therefore requires critical balance, despite Prime Minister examination. Though cases of fiscal Stephen Harper’s best efforts. Though some would argue that the issue of fiscal imbalance persist in the Canadian context, the current Conservative government has made significant progress towards the goal of fiscal equilibrium.

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**Works Cited**


