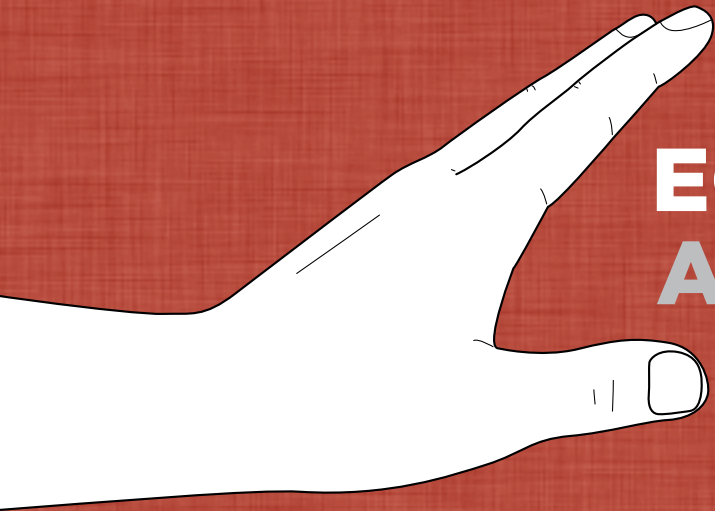




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# EQUALIZATION AT ARM'S LENGTH

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# EXECUTIVE SUMMARY

In the last decade, equalization has attracted significant attention from politicians, commentators, and think tanks. Federal and provincial government commissions have shed considerable political light on the program. Elected officials across the country have been quick to voice their concerns about the impact of equalization on their respective provinces. In doing so, they have ratcheted up the conflict surrounding the program.

Equalization became highly politicized in the mid-2000s and it has subsequently proven difficult to tone down the rhetoric and bickering. Although vigorous national debates on equalization are necessary from a policy standpoint, the political showdowns that took place during the Martin and Harper minority governments only exacerbated regional tensions.

These tensions stymie attempts at calm, neutral discussions of the future of equalization. Claims and counter-claims abound—often with little or misleading evidence.

Tensions over wealth redistribution *may* be unavoidable, but they *can* be mitigated. Other federations have made concerted efforts to de-politicize their equalization programs through arm's length governance agencies.

In Australia, for example, an arm's length body called the Commonwealth Grants Commission (CGC) administers equalization. The CGC is comprised of respected, non-partisan experts, operates under broad terms of reference set by the Commonwealth government, and makes recommendations for the appropriate redistribution of wealth. The Commonwealth government retains final decision-making power but the CGC's recommendations are generally adopted because they come with a seal of neutral fiscal expertise.

As a direct consequence of this institutional setting, the Commonwealth government plays a minimal role in equalization. In other words, equalization in Australia is as de-politicized a program of territorial redistribution as can be found in any federation. As a result, conflict over equalization is rare and, when it occurs at all, generates little political traction.

The Australian model served as the template for the development of both the South African and Indian approaches to equalization. In practice, the differences of these countries' federal systems influence the operation of their arm's length governance agencies.

These experiences are instructive for Canada, but it would be naïve to assume we could replicate the effects exactly. Because Canadian provinces have more politically salient identities than Australian states, we have to be realistic about how this model would translate to the Canadian context. Given the level of existing regional tension, keeping provincial perspectives out of the arm's length agency's work would be tricky.

But as it happens, Canada has a history of using the arm's length agency model with considerable success. For example, the CPP Investment Board was established during the last major reform of the Canada Pension Plan in the mid- to late-1990s. It has since invested over \$140 billion on behalf of Canadian pensioners with little political interference. The Canadian Institute for Health Information (CIHI) has similarly been providing expert and neutral healthcare information and guidance to Canadian governments since 1994. Arm's length governance *is* compatible with the Canadian policy context.

Trusting expert, independent third parties with information gathering and governance responsibilities could improve the current program in a number of ways. It could provide expert legitimacy to policy decisions, reduce territorial conflict, increase the transparency of equalization, and clarify accountability.

Equalization plays a unique role in redistributing wealth across the country. Each and every province has a vested interest in the outcomes of the program—precisely the reason why a neutral arbiter could help cut through the conflicts and the politics that make the program so confusing and misunderstood. Although we can't take the politics out of equalization entirely, we can do a better job reducing the level of territorial conflict surrounding it.

Canada needs a new approach to governing equalization. The experiences of other federations warrant serious consideration. There is no guarantee that Australia's arm's length model will work. But what is guaranteed is that the conflict over equalization will only continue if we let it. Let's not let it.

# EQUALIZATION AT ARM'S LENGTH

**DANIEL BÉLAND AND ANDRÉ LECOIRS**

## INTRODUCTION

**S**ince its creation in 1957, the federal equalization program has only sporadically entered the political agenda and, even less often, triggered federal-provincial conflict. However, in the last decade, equalization has attracted a lot of attention from politicians, commentators, and think tanks—from Quebec's 2002 Séguin Report on fiscal imbalance, to the various and sometimes colourful reactions to the recommendations of the Expert Panel on Equalization and Territorial Formula Financing (O'Brien Report 2006), and most recently, to the Ontario government's suggestion that the program should be revised. Elected officials throughout the country have frequently voiced their concern about the program, which seeks to mitigate the consequences of provincial fiscal disparities on the delivery of public services as stipulated in subsection 36(2) of the *Constitution Act, 1982*.

Aided by the promise-making and side deals of the Martin government, the equalization program became highly politicized in the mid-2000s. It has subsequently proven difficult to put the genie completely back into the bottle. Although vigorous national debates on equalization are both normal and necessary from a policy standpoint, political showdowns like the ones witnessed during the Martin and Harper minority governments unnecessarily exacerbate regional tensions while making detached policy discussions regarding the future of equalization harder to put forward. The O'Brien Report made specific mention of this challenge, noting the tendency of equalization to be negotiated "behind closed doors" and communicated to the public through "squabbles between governments." The report suggested that more transparency was necessary (2006, 39).

In light of this reality, it seems pertinent to think about potential changes in governance structure, namely the creation of an arm's length agency similar to Australia's Commonwealth Grants Commission (CGC) to administer the

program and, perhaps, help de-politicize it—thereby reducing intergovernmental conflict. Although we have to be cautious in evaluating to what extent an Australian-style agency could serve to de-politicize equalization in Canada, this is an option that should be seriously examined, despite the existence of political obstacles to the adoption of this type of governance structure. With an eye on reform, it is instructive to see how arm's length agencies in Australia, South Africa, and India have varied in their decision-making authority.

## **POLITICIZATION AND THE GOVERNANCE OF EQUALIZATION IN CANADA**

Beginning in 2001, the equalization program moved to the centre of policy and political debates in Canada. Since then, Premiers have complained, often loudly, about how the workings of the formula are slighting their respective provinces. The level of intergovernmental conflict over equalization reached its climax during the minority government of Paul Martin (2004-2006) and the first Stephen Harper minority government (2006-2008), when the federal program became a highly contested issue used as an electoral tool by both provincial and federal politicians (Lecours and Béland 2010).

Despite important tensions and some calls for structural reforms (e.g. Joannis 2010), no attempt has been made to transform the program's mode of governance in ways that could reduce future intergovernmental conflict. In other words, successive federal governments have not sought to de-politicize equalization policy through comprehensive institutional reform, for example, by creating an arm's length agency similar to Australia's CGC or, in a different policy area, the Canada Pension Plan Investment Board, whose explicit goal in the context of the 1997 reform of CPP was to de-politicize public pension investment (Béland, 2006). Considering that major intergovernmental tensions have not triggered even a meaningful public debate about the administrative governance of equalization, one can wonder if such a reform is even possible and, if so, under what political conditions it could materialize.

Before tackling these questions, we must keep one historical reality in mind: equalization, like any government program, is the product of past political decisions that still shape the current policy landscape.<sup>1</sup> Therefore, introducing a new governance structure for the program, while not impossible, would

be difficult. When the federal government created the equalization program in 1957, the Australian model formulated more than two decades earlier—based on the idea of arm's length, expert management—was rejected (Béland and Lecours 2011). Instead, equalization became subject to federal executive discretion, meaning that provinces would have the opportunity to voice complaints about the program to, and debate its future with, a governing body concerned with politics as much as policy. Although equalization was rarely a major source of intergovernmental conflict before 2001, the political nature of its governance structure has always allowed Premiers to challenge the federal government publicly over how their province is being treated by the program in any given year.

Beginning in 2004, this pattern of behaviour from Premiers was aided by a change in political landscape. In the context of the Liberal Party of Canada facing a serious threat to its dominant position for the first time in a decade, Prime Minister Paul Martin promised to “fix healthcare for a generation” and, after having escaped the election with a minority government, was keen to reach a “healthcare deal” with the provinces that would see the federal government transfer larger sums of money for better healthcare financing.<sup>2</sup> For Quebec, however, no healthcare deal was going to happen without a revision of the equalization formula. Indeed, the Quebec government, along with other receiving provinces, pressed hard for a reform that would increase federal spending on the program.

Prime Minister Martin's promise to fix healthcare meant that he needed to act on equalization, opening the program to more interprovincial conflict. In December 2004, when Newfoundland and Labrador Premier Danny Williams was unsatisfied by the federal government's failure to meet his demands on equalization—provincial retention of 100 per cent of off-shore oil revenues, free from clawbacks—he removed the Canadian flag from all provincial buildings. This move demonstrates the provincial capacity to heighten the political conflict around equalization under current governance arrangements.

Martin's successor, Stephen Harper, also became a target of Danny Williams and various other Premiers when he implemented most of the recommendations of the O'Brien Commission, including the 50 per cent inclusion of natural resource revenues in the calculation of provincial fiscal capacity and a fiscal capacity cap on payments.<sup>3</sup> In 2008 the status of Ontario in the equalization program became a source of contention, as Premier Dalton McGuinty attacked both the federal government and the program when the province faced a hard economic downturn while remaining a non-recipient province. More recently, a report prepared for the Ontario Chamber of Commerce questioned the logic of equalization by suggesting it has enabled the traditional recipient provinces to offer better services than traditionally non-recipient provinces (MacKinnon 2011). This report, like others that previously developed similar argu-

ments (Eisen and Milke 2010), have fed political challenges to the equalization program. Thus, since 2004, it has been a major source of intergovernmental conflict in Canada, a situation clearly facilitated by the politicization allowed by the governance structure of the program resting on federal executive discretion (Lecours and Béland 2010).

There is no doubt that equalization is here to stay—it is enshrined in the Constitution. Indeed, the *Constitution Act, 1982* states:

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 (Subsection 36(2)).

This constitutional reference means that doing away with it would require provincial approval. It also means that equalization is tied to Canadian citizenship insofar as it operationalizes the idea that all Canadians should have access to public services of comparable quality no matter where they live. From this perspective, equalization as a fiscal and citizenship-related policy is closely associated with national integration and unity.

Even if other major federal programs, such as Employment Insurance, feature regional redistribution, the political meaning of equalization as a large source of horizontal fiscal redistribution gives it special status. The program is also central to the budgeting of several provinces. In 2007-2008, equalization accounted for 19 per cent of Prince Edward Island's total revenues; 17 per cent of New Brunswick's; 14 per cent of Nova Scotia's; 13 per cent of Manitoba's; and 7 per cent of Quebec's.

Of course, the constitutionalization of equalization and its importance for many provinces does not preclude reform of its governance structures. In the last decade, federal executive discretion over the program has meant that governments and opposition parties at both the federal and provincial levels have all contributed to politicizing the program by making various denunciations and promises about its workings and consequences. In the context of minority governments looking to please the electorate of specific provinces, federal politicians have found it hard to resist offering “guarantees” or “special deals” on equalization and fiscal federalism more broadly. For example, after announcing the “New Framework” reform in 2004, the Martin government quickly moved to strike Offshore Accords with Newfoundland and Nova Scotia, which provided full compensation for any reduction in equalization payments resulting from increased revenue linked to offshore resources. In 2006, Stephen Harper promised he would not include revenues from non-renewable resources in a revised equalization formula if his party formed the



government. This overtly political approach stood in sharp contrast with the ten previous years of majority Liberal government, when equalization seldom entered the political debate as its management was mostly left in the hands of Department of Finance experts.

However, Canada's political landscape and economy has changed, which means that an 'organic' de-politicization of the program might be an overly optimistic hope. Because of the very design of equalization governance in Canada, the temptation to, and the possibility for, explicitly politicizing the program remains strong (Lecours and Béland, 2010).

There are alternative modes of governance available that may help reduce intergovernmental conflict over equalization policy. A quick look at the arm's length agency model, used in many other federal states to manage redistribution, as well as in Canada to make decisions on CPP investments, suggests that it presents potential for de-politicizing the program. We do, however, need to be cautious about extrapolating the exact dynamic that such a structure could yield if applied to federal equalization policy.

## **ALTERNATIVE MODES OF GOVERNANCE: COMPARATIVE PERSPECTIVES**

Governance structures for equalization vary from one federal system to another (Watts 2008, 110-11). Across federations, two governance models are most common. The first, which corresponds to Canada's, is characterized by federal executive discretion over equalization policy, specifying the formula for determining fiscal capacity (and expenditure needs, if they are considered), the total sum of money available for equalization, and the amounts transferred to each constituent unit. The second features an arm's length agency that typically makes recommendations on transfers to the constituent units and sometimes also on the formula used to determine fiscal capacity (and expenditure needs, if they are considered). Australia, South Africa, and India are three federal states where an independent agency plays a role in the governance of equalization.

## AUSTRALIA

In Australia, equalization is administered by the CGC, an agency operating at arm's length from the Commonwealth government created in 1933 (CGC 1995; CGC 2008). Although the Commonwealth government retains final decision-making power over equalization, in practice it generally adopts the CGC's recommendations. As a direct consequence of this institutional setting, the Commonwealth government plays a minimal role when it comes to equalization policy (Warren 2008). The Commonwealth Treasury tasks the CGC, through "terms of reference," to determine the most appropriate per capita relativities to be used to divide the pool of GST money between the states.<sup>4</sup>

Because the CGC is composed of respected experts, widely seen as non-partisan, and is at arm's length from the government, its recommendations come with the veneer of neutral fiscal expertise. In other words, equalization in Australia is as de-politicized a program of territorial redistribution as can be found in any federation. Governments and citizens alike believe in the neutral expertise of the CGC. As a result, intergovernmental conflict over equalization is rare and, when it occurs at all, consists primarily of states sniping at each other in a way that generates little political traction (Lecours and Béland, 2011).

## SOUTH AFRICA

When developing their arm's length expert body, South Africa drew from the Australian model. In South Africa, the Financial and Fiscal Commission (FFC), an independent body whose existence is founded in chapter 13 of the *Constitution of South Africa, 1996*, is tasked with making "recommendations on the equitable division of nationally raised revenue among the three spheres of government" after consultation with the national and provincial parliaments as well as local governments (Khumalo and Mokate 2007, 277). The Minister of Finance is constitutionally obligated to explain how the Commission's recommendations were taken into account when devising the "equitable shares."

Formally speaking, the South African FFC is quite similar to its model, the Australian CGC. In practice, however, it has worked quite differently. The FFC "has steered clear of making recommendations on actual allocations" (Khumalo and Mokate 2007, 277). The South African case shows that importing governance structures from a different national context is no guarantee that they will function in the same manner in the new setting.

## INDIA

In India, a Finance Commission also inspired by the Australian model deals with the allocation of fiscal resources to the states, including in matters of horizontal redistribution. The first Finance Commission was created in 1951. It functions as follows:

[The Finance Commission has] the duty of making recommendations to the President as to (a) the distribution between the Union and the States of the net proceeds of taxes which are to be, or may be divided between them under the provisions of the Constitution and the allocation between the States of the respective shares of such proceeds, (b) the principles which should govern the grants-in-aid of the revenues of the States out of the Consolidated Fund of India, (c) any other matter referred to the Commission by the President in the interest of sound finance (Sury 2010, 197).

As this quote suggests, Indian Finance Commissions, which have taken place on a regular basis since the early 1950s, typically have a broad mission, which includes equalization as part of a set of issues related to fiscal federalism.

Alongside the Planning Commission, the Finance Commission is an influential and autonomous expert body that plays a crucial role in the allocation of fiscal resources in the increasingly decentralized Indian federal system (Rao and Singh 2007). More concretely, appointed by the President of India, the Finance Commission is tasked with reporting on fiscal arrangements every five years, or more frequently when needed.

Like in Australia, with a few exceptions, the federal government adopts the Finance Commission's recommendations (Singh and Srinivasan 2004, 14). Yet, more so than in Australia, the Finance Commission is a source of political controversy. It has been subject to the following criticisms:

(i) the scope of the Finance Commissions through the Presidential terms of reference has been too restricted; and (ii) the design of their transfer schemes has reduced state government incentives for fiscal discipline (through 'gap-filling' transfers), while doing relatively little to reduce inter-state inequities (Singh and Srinivasan 2004, 14).

Again, the above quote demonstrates that the operation of any governance structure is dependent, to a certain degree, on national context.

## DOMESTIC EXPERIENCE

The South African and Indian cases show that importing governance structures from another political, institutional, and cultural context does not come with any guarantee of similar outcomes. That being said, it is plausible that placing the responsibility for managing the Canadian equalization program with an arm's length agency could de-politicize equalization and, therefore, reduce the intergovernmental conflict around it.

Outside the field of equalization policy, arm's length agencies are not new to Canada. For instance, the federal government has already created an arm's length agency, the CPP Investment Board, which was set up as a consequence of the last major reform of the Canada Pension Plan, enacted by the House of Commons in December 1997 (CPP Investment Board, 2011). The federal government has also been accepting expert healthcare guidance from the Canadian Institute for Health Information (CIHI) since 1994.

In operation since the late 1990s,<sup>5</sup> the CPP Investment Board was designed with a major political goal in mind: avoiding political interference and de-politicizing financial investment for the CPP (Béland 2006; Weaver 2003). Modeled on private pension funds, symbolically located in Toronto rather than in Ottawa, and staffed by financial experts from Bay Street, the CPP Investment Board is politically independent and protected from direct partisan and government pressure. In fact, when creating the CPP Investment Board, federal officials made sure that no government official would sit on it, a decision meant to increase its autonomy, both real and perceived. Additionally, complex appointment procedures reinforced its autonomy from the federal government while allowing each of the nine provinces participating in CPP to have a stake in the nomination process (Béland 2006; Weaver 2003).

As of 2011, the CPP Investment Board has invested more than 140 billion dollars on behalf of Canadian pensioners and, although some of its investment choices have been criticized, few have called into question its political independence. Overall, largely for this reason, it is possible to argue that the creation of the CPP investment Board has been successful in avoiding the widespread political conflicts over public pension investment that have been periodically witnessed in other jurisdictions. For instance, in Quebec, which has operated its own earnings-related pension program since the mid-1960s (Quebec Pension Plan), the political autonomy of the *Caisse de dépôt et placement* in charge of investing pension money has long been a contentious issue (Béland 2006; Weaver 2003).

Managing a pension fund is a different business than governing the territorially-contentious equalization program and we do not suggest that the apparent success of the CPP Investment Board means that the creation of an arm's

length expert body in the field of equalization governance would necessary lead to the same political outcome.<sup>6</sup> However, as far as issues like the nomination process are concerned, we could learn from the CPP investment Board in ways that could be beneficial to the establishment of an arm's length equalization agency in Canada.

A more modest option would be the creation of a body charged with the neutral dissemination of information on the program. The Canadian Institute for Health Information (CIHI) is a domestic example of an arm's length structure that could be relevant to the reform of equalization governance. Established in 1994 with a mandate to provide "essential information on Canada's health system and the health of Canadians" (CIHI 2012), this independent non-profit takes its strategic direction from health leaders,<sup>7</sup> not politicians. Funded by the federal and provincial-territorial governments, CIHI strives to provide unbiased evidence to policy- and decision-makers. Information is the goal, not political influence.

The organization has no formal decision-making power, but its information gathering/dissemination role helps to guide the negotiations between Canadian healthcare's major players—the federal government, provinces-territories, and organized medicine (Tuohy 2003, 2006). The creation of an information-first agency for the equalization program could, thus, narrow the scope for politicization. If it operated similarly to CIHI, it could, at the very least, help reduce the potential level of information distortion and perhaps reduce political manipulation in equalization debates.

## **OBSTACLES AND OPPORTUNITIES FOR REFORM**

In the short-term, a reform in the governance structures of equalization is unlikely because no federal or provincial leader seems to want an arm's length agency. For example, a few years ago provincial officials speaking to the O'Brien Commission opposed the arm's length agency model practiced in Australia. Provincial leaders typically feel that they can exert direct influence on equalization policy and, as a consequence, they are not willing to give that up for a more technocratic system where they would have much less of a chance to tweak the program in their favour using bargaining and political leverage. This provincial position is fairly easy to understand because, within the Canadian federal system, provinces seek to retain or increase their political influence.

The position of federal politicians is a bit more puzzling. To be fair, nobody has rejected the notion of an arm's length agency, but this model certainly has not been promoted, or even suggested. Because equalization has been a political nightmare for federal governments over the last few years (from Danny Williams' all out attacks to then Saskatchewan Premier Lorne Calvert's threat to go to court over equalization's treatment of his province), we could expect that at least one federal party would seriously consider the creation of an expert body similar to Australia's CGC. Despite much evidence to the contrary, however, federal politicians seem to think that they can make political gains with equalization and do not appear willing to relinquish any control over the program. Or perhaps they are concerned with what it would mean in the long term for the federal government to relinquish much control over a program viewed as central to Canadian citizenship and national unity. Of course, if an arm's length agency were set up to manage equalization in Canada, the federal government would still set the "terms of reference" and formally make payment decisions.

Yet, comparative perspectives on equalization governance suggest that terms of reference are generally very broad and that going against a commission's recommendation is politically difficult since the arm's length agency is established in the first place for the very purpose of being a "fair and neutral" decision-maker. Because of provincial opposition to an arm's length agency model, any reform going in that direction would mean some type of confrontation with the provinces. Of course, the federal government does not need provincial consent to change the governance structures of equalization. But since the political costs of waging a battle over this type of issue with the provinces are hard to assess, the institutional status quo on equalization might appear as the safest option for federal politicians.

The majority government produced by the May 2011 election represents a political change that can facilitate movement towards reforming equalization governance. In the context of a minority government, the party in power was constantly preoccupied by the prospect of an election and was, therefore, unlikely to take on provinces for fear of facing a negative campaign of the type staged by Danny Williams against Stephen Harper in 2008. For a reform in the governance structures of equalization to occur, however, the Conservative government still has to come to the conclusion that the program presents too much potential for being a political hot potato and that unloading some decision-making aspects on the allotment of the equalization pool to an arm's length agency made up of non-partisan policy experts will provide it with useful political coverage.

In the absence of a clear political desire to change the governance structures of equalization in Canada, the path towards this type of reform would probably need to start with an expert recommendation of the type that came out

of the O'Brien Report. Yet, governance issues often take a back seat to other dimensions of the program when equalization is placed under expert scrutiny. A first step would be to position the governance issue at the centre of any expert discussion.

## CONCLUSION

While a reform in the management structures of equalization is not yet on the radar, the federal government should seriously consider the adoption of an arm's length expert body that could deal with some of the equalization decision-making. Simply put, with an arm's length agency set-up, provincial governments would probably be in a weaker position than they are now to make claims about the unfairness of equalization. However, in assessing the potential impact of an arm's length agency on the equalization process, the key question is: to what extent could such an agency acquire the veneer of neutral technocratic expertise possessed by the Australian CGC? For example, could the "commissioners" be accepted as neutral experts or would they unavoidably be linked to a province and suspected of having an agenda?

The very nature of Canadian federalism (a competitive system where provincial identities are strong) stands in sharp contrast to Australian federalism and casts some doubts as to the possibility of replicating the CGC effectively in Canada. The South African and Indian examples prove that replicating the Australian model identically is unlikely. Equalization in Canada cannot be completely de-politicized, and there is an argument to be made that vigorous debate about a program is typically a good thing, at least from a policy standpoint. Yet, reducing toxic political dramas like the ones witnessed over the past decade is most certainly a good thing for the country and its unity. As suggested above, different governance structures present some potential to make equalization less overtly political than it was in the past decade. At the very least, more neutral information dissemination, in the form of a CIHI-like body, could reduce some of the politicization that has emerged.

Meanwhile, regardless of what the current federal government decides to do regarding this vital issue, much more comparative and international research is needed on the politics of equalization and, more specifically, on the role of governance institutions in shaping it over time. As suggested in this paper, governance institutions can matter a great deal, something that both scholars and policy-makers should pay closer attention to. MC

# ENDNOTES

1. For a general discussion about this issue see Pierson 2004.
2. The following discussion draws on Lecours and Béland 2010.
3. The fiscal capacity cap was designed to prevent a recipient province having an after-equalization fiscal capacity greater than that of any non-recipient province.
4. “Relativities” refer to the proportion of the GST pool going to each state.
5. The CPP Investment Board’s first investment was made in 1999.
6. A federal equalization board would necessarily operate differently from the CPP Investment Board, as it would involve a federal decision on payments. Thus, the CPP Investment Board is not a direct model for equalization reform.
7. CIHI’s 16 member Board of Directors is subdivided into regions and is comprised of Deans of faculties of medicine and nursing, Deputy Ministers of Ministries of Health (and related portfolios), and doctors and senior administrators in the healthcare sector.



# APPENDIX 1

## PROS AND CONS OF ARM'S LENGTH GOVERNANCE STRUCTURES IN EQUALIZATION POLICY

PROS	CONS
<ul style="list-style-type: none"><li>• Provides direct expert legitimacy to policy decisions</li><li>• Likely to reduce territorial conflict over the equalization program through de-politicization</li><li>• Transparency and accountability between governments and citizens would improve</li><li>• Allows for better assessment of the downstream impacts of transfer reforms</li></ul>	<ul style="list-style-type: none"><li>• Weakens the federalism dimension of the equalization program</li><li>• Transfers authority to nonelected experts</li><li>• Likely unable to enforce recommendations without political support</li></ul>

# APPENDIX 2

## COMPARISON OF EQUALIZATION GOVERNANCE STRUCTURES

	<b>AUSTRALIA</b>	<b>INDIA</b>	<b>SOUTH AFRICA</b>
<b>Name</b>	Commonwealth Grants Commission	Finance Commission	Financial and Fiscal Commission
<b>Membership</b>	Chair plus five members	Chair plus four members	Chair plus eight members
<b>Method of Selection</b>	All members appointed on advice of federal government (which consults state governments closely)	All members appointed by President of India	All members appointed by President and federal government; three members recommended by provincial governments; two members recommended by local (municipal) governments
<b>Criteria for Selection</b>	All members appointed on the basis of significant fiscal expertise, with no categorization by geography or sector	Chair must have experience in public affairs; members appointed based on: special knowledge of government finances; significant financial and administrative expertise; special knowledge of economics; or experience as current/former judge of a high court	All members appointed on the basis of significant fiscal expertise, with no categorization by geography or sector
<b>Term</b>	Permanent; rotating membership appointed for five-year terms	Appointed every five years (or sooner if needed) under specific terms of reference, and must disband upon submission of a report consistent with these terms	Permanent; rotating membership appointed for five-year terms
<b>Staff</b>	Permanent secretariat (approximately 50 full-time staff)	Temporary secretariat (86 full-time staff in the most recent Commission)	Permanent secretariat (approximately 20 full-time staff)

	<b>AUSTRALIA</b>	<b>INDIA</b>	<b>SOUTH AFRICA</b>
<b>Mandate</b>	Inquire into the relative fiscal capacities and expenditure needs of the states under the Commission's terms of reference; make recommendations on the distribution of federal tax revenues (primarily GST) among states to achieve horizontal fiscal equalization (HFE); refine the methodology for determining the equalization formula every five years	Make recommendations to the President regarding: distribution and allocation of tax revenues between the federal government and the states; principles that should govern grants to states out of the consolidated fund of India; measures needed to augment the consolidated fund of a state to supplement the resources of municipalities and rural governments (based on the recommendations made by the Finance Commission of the state); and any other matter referred to the Commission by the President that can be achieved through revenue sharing and special grants	Provide advice on the equitable allocation of central revenue sharing to provincial and local governments, provincial taxation, municipal fiscal powers and function, sub-national borrowing and debt management issues, and central government guarantees
<b>Authority</b>	Non-binding Commission report is submitted to Treasurer (i.e. federal Finance Minister) and disseminated to state governments, then debated in open proceedings in advance of annual treasurers' conference (at which decisions on equalization are made); Treasurer defines terms of reference and Commission may not initiate inquiries outside its terms of reference; within its terms, Commission has legal powers of a civil court	President must submit non-binding Commission report to both houses of parliament along with government responses to recommendations; President defines terms of reference and Commission may not initiate inquiries outside its terms of reference	Federal Division of Revenue Bill must include responses to the Commission's non-binding recommendations (made at least 10 months before commencement of fiscal year)
<b>Limitations and Flaws</b>	Although transparent in process, the methodology and data used in calculating "relativities" is extremely complex and virtually incomprehensible to outsiders	Terms of reference can be extremely restrictive and contrived (e.g. the population counts used in calculating per capita grants must be derived from 1971 census figures) in accordance with political objectives of the sitting President	Focused on establishing clear principles of formulation, rather than recommending actual allocations

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