

FAIR-SHARES FEDERALISM AND THE 1999 FEDERAL BUDGET

The \$11.5 billion that Mr. Martin added to the CHST over the next five years doubtless will be good for the health care system, but it has also helped to finesse a potentially difficult zero-sum interprovincial redistribution as all provinces are moved to equal per capita CHST grants. The unexpected increase in equalization payments probably helped provide political cover for this sensible, inevitable but also difficult transition

Les 11,5 milliards de dollars que Paul Martin a ajouté au TCSPS pour les cinq prochaines années seront sans doute bénéfiques au système de santé; toutefois, ils ont aussi servi à faire passer en douce une redistribution interprovinciale à somme nulle potentiellement difficile puisque toutes les provinces recevront dorénavant un financement égal basé sur le nombre d'habitants. L'augmentation inattendue des paiements de péréquation a probablement contribué à camoufler cette délicate et inévitable, mais combien difficile, transition.

Thomas J. Courchene

February, 1999, will be remembered as a watershed month in the evolution of Canadian fiscal federalism and governance. On Feb. 4, the governments of Canada and the provinces/territories (absent Quebec) put their signatures to A Framework to Improve the Social Union for Canadians (henceforth "SUF"). And on Feb. 16 Finance Minister Paul Martin's seventh budget delivered on one of the long-standing issues in federal-provincial fiscal relations — fair-shares federalism. This near-fortnight could well be dubbed "Rae Days" (although Ontarians refer to this in quite another context) since former Premier Bob Rae can lay claim to initiating both the social union, in the form of the "Social Charter" in the ill-fated Charlottetown Accord, and the pursuit of "fair-shares federalism," in the wake of the cap on CAP and Paul Martin's rolling-in of the cap on CAP into the CHST in his 1995 federal budget.

The two initiatives were closely related. First, the "side deal" to the SUF, which all parties signed, paved the way for the budget infusion of the \$11.5 billion equal-per-capita CHST cash transfer for health. Second, the social-policy principle which held pride of place in the SUF was "treat all Canadians with fairness and equity." This has long been "code," among the have-provinces at least, for CHST equality in per capita terms. This is precisely what the 1999 budget delivered — a move to equal-per-capita entitlements under the CHST. It is probably a safe guess that the federal SUF negotiators would not have agreed to highlight this principle unless they were sure that the budget would deliver on fair-shares federalism. And it did.

Dollar-wise, the most significant new federal initiative in the 1999 budget was the \$11.5 billion increase in cash transfers related to health, the details

of which are contained in Table 1. As the second row in this table indicates, the proposed increases in CHST cash were \$1 billion in 2000/01, \$2 billion in 2001/02 and \$2.5 billion each in 2003/04 and 2004/05. In addition, there was a \$3.5 billion “CHST supplement,” accounted for in the fiscal year 1998-99, but to be allocated over the next three years. Table 1 allocates this supplement as follows — \$2.0 billion, \$1.0 billion and \$0.5 billion over the three years 1999/00 through 2001/02. However, the provinces will have some flexibility in terms of when they draw down their portion of this supplement. The sum of the CHST cash plus the supplement equals the \$11.5 billion CHST cash infusion. The net result of this is that the pre-budget status quo in terms of CHST cash transfers, namely \$12.5 billion per year through to 2003/04, will now be \$14.5 billion over the next two years and \$15 billion from 2001/02 to 2003/04 (see the fifth row in Table 1).

These monies will be distributed to the provinces on an equal per capita basis. This is clear from the line “CHST-New Funding” in Table 2, reproduced from background budget data. Focussing only on this entry for the moment, over the next 5 years, provinces will receive per capita cash increments of \$65, \$65, \$80, \$79 and \$78, respectively, from what the status quo would have delivered. In dollar terms these increments, when multiplied by the estimated population figures, sum to the \$11.5 billion CHST cash infusion (see Table 3).

This component of the changes to the CHST represents good news for all provinces. Moreover, as noted, it was this equal-per-capita CHST cash that was incorporated into the so-called “side deal” to the SUF (although the precise dollar total was either secret or

not made public prior to the budget). The *quid quo pro* on the provinces’ part was that these additional monies had to be spent on health, which was agreed to by all provinces, including Quebec.

But there was a second component to the 1999 budget’s CHST changes — the surprise move to ensure that from 2001/02 onward provincial entitlements under the CHST would be equal per capita. Note that this equality in per capita terms relates to CHST entitlements — that is, cash plus equalized tax-point transfers — and not CHST cash, an issue dealt with later. Since the move from the differential per capita entitlements under the status quo to equal per capita entitlements is, in effect, a zero-sum interprovincial redistribution of CHST dollars, there were winners and losers. The big winners, as we shall see, were Alberta and Ontario, while the big loser was Quebec.

Since this policy change has now taken on overtones of a serious national unity issue, it is important that it be documented in some detail. As an indication of the nature of the monetary stakes involved here, the entry “CHST Reallocated” in the “5-Year Total” panel of Table 3 indicates that Ontario gains \$962 million while Quebec loses \$1.653 million. How did this come about? The story begins with the 1990 cap on the Canada Assistance Plan (CAP).

For reasons I noted in *From Heartland to North American Region State: Social, Fiscal and Federal Evolution of Ontario*, co-authored with Colin Telmer and published last year, in its 1990 budget Ottawa limited increases in Canada Assistance Plan (CAP) trans-

Table 1
Canada Health and Social Transfer

	1999-00	2000-01	2001-02	2002-03	2003-04	5 years
	<i>(billions of dollars)</i>					
Increased funding						
for health care	2.0	2.0	2.5	2.5	2.5	11.5
Of which:						
CHST		1.0	2.0	2.5	2.5	8.0
CHST supplement ¹	2.0	1.0	0.5			3.5
Existing CHST cash	12.5	12.5	12.5	12.5	12.5	62.5
Total CHST cash	14.5	14.5	15.0	15.0	15.0	74.0
CHST tax transfers	13.9	14.4	15.0	15.6	16.4	75.3
Total CHST	28.4	28.9	30.0	30.6	31.4	149.3

Source: *The Budget Plan 1999*, p. 84, Table 4.3.

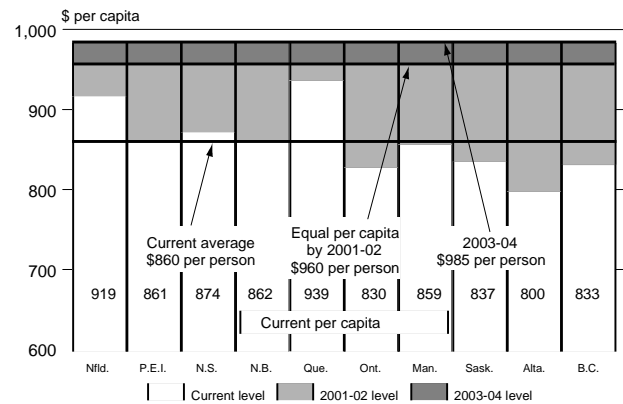
Table 2
CHST Entitlements and Equalization
\$ per capita

		PEI	NS	NB	QUE	ONT	MAN	SASK	ALTA	BC	AVG.
STATUS QUO CHST	915	864	876	865	933	836	862	842	809	839	862
CHST REALLOCATED	-33	-1	-8	-1	-44	16	0	13	33	14	0
CHST - NEW FUNDING	65	65	65	65	65	65	65	65	65	65	65
TOTAL CHST	948	928	933	929	954	918	928	920	908	919	928
EQUALIZATION	1 860	1 619	1 318	1 398	606		811	367			304
TOTAL TRANSFER	2 626	2 385	2 130	2 185	1 495	918	1 679	1 177	908	919	1 199
2000-01											
STATUS QUO CHST	916	871	881	871	932	846	869	852	822	849	869
CHST REALLOCATED	-30	-1	-8	-1	-40	15	0	11	30	13	0
CHST - NEW FUNDING	65	65	65	65	65	65	65	65	65	65	65
TOTAL CHST	951	934	938	935	956	926	934	928	917	927	934
EQUALIZATION	1 916	1 658	1 383	1 448	633		830	387			314
TOTAL TRANSFER	2 677	2 419	2 191	2 231	1 517	926	1 697	1 197	917	927	1 212
2001-02											
STATUS QUO CHST	921	882	890	882	934	860	880	865	839	862	880
CHST REALLOCATED	-41	-2	-10	-2	-54	20	0	15	41	17	0
CHST - NEW FUNDING	80	80	80	80	80	80	80	80	80	80	80
TOTAL CHST	960	960	960	960	960	960	960	960	960	960	960
EQUALIZATION	1 977	1 734	1 434	1 494	663		835	407			323
TOTAL TRANSFER	2 744	2 513	2 260	2 299	1 547	960	1 726	1 245	960	960	1 247
2002-03											
STATUS QUO CHST	926	893	901	894	938	875	892	879	858	877	892
CHST REALLOCATED	-34	-1	-9	-2	-46	17	0	13	34	15	0
CHST - NEW FUNDING	79	79	79	79	79	79	79	79	79	79	79
TOTAL CHST	971	971	971	971	971	971	971	971	971	971	971
EQUALIZATION	2 045	1 795	1 488	1 544	690		840	430			333
TOTAL TRANSFER	2 819	2 586	2 320	2 354	1 584	971	1 741	1 276	971	971	1 266
2003-04											
STATUS QUO CHST	934	907	914	908	944	893	907	896	879	894	906
CHST REALLOCATED	-28	-1	-7	-2	-38	13	0	10	28	12	0
CHST - NEW FUNDING	78	78	78	78	78	78	78	78	78	78	78
TOTAL CHST	985	985	985	985	985	985	985	985	985	985	985
EQUALIZATION	2 117	1 836	1 545	1 587	715		867	461			342
TOTAL TRANSFER	2 899	2 625	2 386	2 407	1 618	985	1 778	1 317	985	985	1 288
Note: Equalization associated with the CHST tax transfer is included in both CHST and Equalization.											
Totals have been adjusted to avoid double counting.											
Total column includes CHST entitlements of Territories.											

fers to the “have provinces” (Ontario, BC and Alberta) to five per cent per year. According to Ottawa’s initial assessment, the cost of this cap on CAP for the three provinces was only going to be \$155 million a year over the first two years and \$365 million in the third year. But then the 1990s recession appeared. The cost to Ontario alone was \$400 million in 1990/91 and roughly two billion dollars annually thereafter until, in the 1995 budget, the cap on CAP was rolled into the CHST, which incorporated both the former Established Programs Financing (EPF) and CAP programs. EPF was always defined in terms of equal-per-capita entitlements, so that this portion of the CHST maintained the concept of per capita equality. However, in rolling CAP into the CHST, Ottawa took the *existing* CAP payments as the benchmark. But since these *existing* CAP payments reflected the operations of the cap on CAP, this inequity became, from the vantage point of the 1995 budget, a permanent feature of the CHST.

It is important to note that the cap on CAP is not the only source of the per capita differences in CAP transfers. For example, Quebec has always been a high per capita spender on welfare, in part because of its extensive and creative programs, some of which qualified under CAP, while Saskatchewan has, for various reasons, traditionally been a low spender. Thus, the differentials for these two provinces have little or nothing to do with the cap on CAP. On the other hand, in the early 1990s Ontario emerged both as the most generous province for welfare benefits and the one with the highest per capita number of welfare recipients. Had there been no cap on CAP, Ontario would have received the highest per capita CAP payments. In any event, the result was that CHST entitlements became quite unequal in terms of per capita entitlements. This is clear from Chart 1, in which the current per-capita CHST entitlements by province appear in the lower portion of the chart. The current average is \$860 per capita, but the provincial entitlements vary from as high as \$939 for Quebec and \$919 for Newfoundland to as low as \$800 for Alberta. Other “low” provinces include Ontario, Saskatchewan and BC. With some analysts — myself in a 1995 C.D. Howe Institute book and Ken Boessenkool in a 1996 Howe *Commentary* — having called for equal per capita *cash* (let alone equal per capita entitlements) and with Mike Harris and Ralph Klein and co. arguing for “fair-shares federalism,” this situation progressively became untenable. Even Paul Martin recognized the inequity in his 1995 budget when he noted that for fiscal years 1997/98 and beyond these provincial allocations would be subject to “negotiations.” At the time, one provincial official noted that the inherent zero-sum nature of any such

Chart 1
Provincial CHST entitlements



Source: *Budget Plan 1999*, Chart 4.3, p. 89

“negotiation” would be equivalent to tossing an un-cut hunk of meat to ten hungry sled dogs and expecting them to divide it fairly.

Nevertheless, the 1996 budget addressed the inequities in per-capita entitlements by announcing that the differentials would be reduced by one-half by fiscal year 2002/03. It also announced that the \$12.5 billion CHST cash transfer floor for 1997/98 would fall further to \$11.1 billion by the end of the century. As it turned out, this programmed decrease in the cash floor was never implemented — during the 1997 federal election the Liberals promised to maintain the cash floor at \$12.5 billion, where it currently stands.

In 1997/98, Quebec’s per capita CHST entitlement was \$944 and the national average level was \$857. Hence the 1996 budget meant that by 2002/03, Quebec’s \$87 excess per capita entitlements would be halved, for a net loss in year 2001/02 of roughly \$350 million, and a cumulative loss several times this amount. Thus, as of 1996 Quebec and Newfoundland were already destined to see significant declines in their CHST entitlements, with corresponding increases for the below-average CHST provinces (see Chart 1). Indeed, one of the rationales for Ottawa’s retaining the \$12.5 CHST cash floor in 1997 may have been to lessen the absolute (but not the relative) impact of these already programmed CHST decreases. Which brings us to the 1999 budget.

The startling aspect of the 1999 federal budget is that instead of following on with the 50 per cent reduction in CHST entitlement disparities by 2002/03, it opted for full equality by 2001/02. The Department of Finance must have judged that, with the \$11.5 infusion of new CHST cash, with equalization underestimated by \$2 billion over the last two years (which

would cushion Quebec and Newfoundland) and with the SUF in hand (including the provision “treat all Canadians with fairness and equity”), there was an unprecedented window of opportunity that would allow full closing of the CHST entitlement disparities without the high-CHST provinces suffering any absolute decline in cash or overall entitlements. Rather, they would just gain less than the other provinces.

The details are as follows. From Chart 2, which presents the all-province overview of the CHST, the increases to CHST cash (the white blocks on the last five bars) represent the \$11.5 billion cash infusion. Overall CHST entitlements are the sum of the regular cash transfers (the dark parts of the bars), these increases to CHST cash and the estimated value of the tax transfer (the grey portion of the annual bars). These aggregate CHST entitlements appear at the top of the annual bars. For example, the total CHST entitlement for 2001/02 is \$30.0 billion, which corresponds to the total column of the “CHST” line entry for 2001/02 in Table 3, namely \$29.988 billion.

Continuing with fiscal year 2001/02 but focussing on per capita data (see Table 2), Quebec’s status quo CHST is \$934 and Alberta’s is \$839. Note that these status quo CHST’s are calculated on the assumption that the cash transfer is \$12.5 billion throughout (the dark portion of the bars in Chart 2) and taking account of the 1996 budget requirement that overall CHST differentials from the average would be cut in half by 2002/03. (Readers wanting details on how the actual calculations are derived can read my 1998 C.D. Howe Institute *Commentary*.) In addition to this, both provinces receive \$79 per capita as a result of the new CHST cash (the “CHST-New Funding” line in Table 2). But then

Alberta gains \$41 per person as a result of the CHST redistribution toward equality while Quebec loses \$54 per capita in this process (the “CHST reallocated” line in Table 2). When one sums these three entries (status quo CHST, CHST reallocated and CHST new funding), both Alberta and Quebec receive \$960 in per capita entitlements for 2001/02, the first year of full equality.

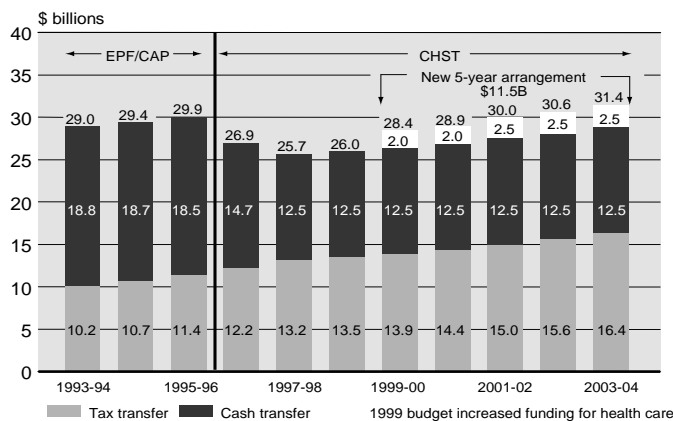
Even though Quebec and Newfoundland are levelled down to the national average, their per capita CHST entitlements remain above what the status quo would have generated, and from 2001/02 and beyond they move with the overall per capita average — \$960 to \$971 and then to \$985 in 2003/04.

The bottom panel of Table 3 presents the cumulative five-year totals. Here a Quebec-Ontario comparison shows the impact of CHST conversion in its starkest form. These two provinces both get their population shares of the new CHST monies — \$2.738 billion for Quebec and \$4.370 billion for Ontario. But then Ontario garners an extra \$962 million from the move to per capita equality, whereas Quebec loses \$1.653 billion in this process. The “net” amounts are \$5.332 billion for Ontario and \$1.085 billion for Quebec. Comparable “net” totals from Table 2 are \$145 per capita for Quebec and \$448 for Ontario, where the latter is 3.09 times the former. And Alberta’s net total is even larger, at \$533 per capita. Small wonder these numbers are not going down well in Quebec.

Initially, I wondered why the budget continued with the gains and losses from CHST reallocations *after 2001/02* when in fact the CHST is then equal per capita. In other words, why continue with the fiction of a *status quo ante* for the CHST once equality per capita is achieved? The answer, I think, has to be that this way of doing things preserves an even more important fiction, namely that Quebec and Newfoundland are receiving an equal per capita share of the \$11.5 billion over the full five years. In other words, the per capita equality in the “CHST-New Funding” for 2002/03 and 2003/04 fulfils the health “side-deal” to the SUF, namely that the new CHST cash will be distributed as an equal per capita basis. Having decided on this, one then needs the status quo CHST data and the CHST reallocation to generate the overall per capita entitlement equality.

The downside to this approach is that it carries the convergence losses through to 2003/04, and even beyond, when in reality full convergence has already occurred. To balance these apparently anomalous gains for the have provinces, perhaps the budget ought to have shown the CHST *losses* for the have provinces from the 1990 “cap” on CAP through to full convergence in 2001/02. Ontario’s loss from the cap on CAP for 1994/95 alone was greater than the \$1.653 billion

Chart 2
CHST: 1993-94 to 2003-04



Source: Budget 1999, *Federal Financial Support for the Provinces and Territories*, Chart 3, p. 15.

Table 3
CHST Entitlements and Equalization
\$ Millions

	NFLD	PEI	NS	NB	QUE	ONT	MAN	SASK	ALTA	BC	TOTAL
1999-00											
STATUS QUO CHST	494	118	823	652	6 878	9 656	988	866	2 379	3 438	26 391
CHST REALLOCATED	-18	0	-8	-1	-326	189	0	13	98	59	0
CHST - NEW FUNDING	35	9	61	49	482	755	75	67	192	268	2 000
TOTAL CHST	511	127	877	700	7 035	10 600	1 063	946	2 669	3 765	28 391
EQUALIZATION	1 003	222	1 239	1 054	4 464		929	377			9 288
TOTAL TRANSFER	1 416	327	2 002	1 648	11 020	10 600	1 924	1 210	2 669	3 765	36 678
2000-01											
STATUS QUO CHST	490	120	832	658	6 902	9 906	1 001	877	2 445	3 548	26 879
CHST REALLOCATED	-16	0	-7	-1	-298	173	0	12	90	54	0
CHST - NEW FUNDING	35	9	61	49	479	757	74	67	192	270	2 000
TOTAL CHST	509	129	885	706	7 084	10 836	1 075	956	2 727	3 873	28 879
EQUALIZATION	1 025	229	1 305	1 094	4 690		955	399			9 696
TOTAL TRANSFER	1 432	334	2 068	1 686	11 236	10 836	1 953	1 233	2 727	3 873	37 478
2001-02											
STATUS QUO CHST	489	123	843	667	6 953	10 204	1 017	892	2 523	3 675	27 488
CHST REALLOCATED	-22	0	-10	-1	-405	235	0	16	122	74	0
CHST - NEW FUNDING	42	11	76	61	596	949	92	83	241	341	2 500
TOTAL CHST	510	133	909	726	7 145	11 389	1 109	991	2 885	4 090	29 988
EQUALIZATION	1 050	241	1 358	1 130	4 931		965	420			10 094
TOTAL TRANSFER	1 457	349	2 141	1 739	11 517	11 389	1 994	1 285	2 885	4 090	38 946
2002-03											
STATUS QUO CHST	488	125	856	677	7 012	10 521	1 034	908	2 606	3 809	28 139
CHST REALLOCATED	-18	0	-9	-1	-344	200	0	13	104	64	0
CHST - NEW FUNDING	42	11	75	60	592	953	92	82	241	344	2 500
TOTAL CHST	512	136	923	735	7 260	11 674	1 126	1 003	2 951	4 216	30 639
EQUALIZATION	1 078	251	1 414	1 169	5 162		974	444			10 492
TOTAL TRANSFER	1 486	361	2 205	1 783	11 839	11 674	2 018	1 318	2 951	4 216	39 953
2003-04											
STATUS QUO CHST	489	128	871	688	7 085	10 872	1 054	926	2 697	3 953	28 867
CHST REALLOCATED	-15	0	-7	-1	-282	164	0	11	85	52	0
CHST - NEW FUNDING	41	11	75	59	589	956	91	81	241	347	2 500
TOTAL CHST	515	138	939	746	7 392	11 991	1 145	1 018	3 023	4 352	31 367
EQUALIZATION	1 108	258	1 473	1 202	5 365		1 008	477			10 892
TOTAL TRANSFER	1 518	369	2 275	1 823	12 148	11 991	2 068	1 362	3 023	4 352	41 035
5 YEAR TOTAL											
STATUS QUO CHST	2 450	614	4 226	3 342	34 831	51 159	5 095	4 470	12 650	18 423	137 764
CHST REALLOCATED	-88	-1	-41	-6	-1 653	962	-2	64	498	304	0
CHST - NEW FUNDING	195	51	348	278	2 738	4 370	425	379	1 107	1 570	11 500
TOTAL CHST	2 557	664	4 534	3 614	35 916	56 490	5 518	4 913	14 255	20 297	149 264
EQUALIZATION	5 264	1 201	6 789	5 649	24 612		4 831	2 117			50 462
TOTAL TRANSFER	7 309	1 741	10 692	8 679	57 761	56 490	9 957	6 407	14 255	20 297	194 092
Note: Equalization associated with the CHST tax transfer is included in both CHST and Equalization.											
Totals have been adjusted to avoid double counting.											
"Total" column includes CHST entitlements of Territories.											

cumulative loss for Quebec in Table 2. Or, better still, why not view this Quebec loss as only a small part of its cumulative CHST gain since 1990, if equality is the benchmark.

All of the above analysis relates to per capita equality in terms of entitlements, that is the sum of the tax point and cash transfers. In 2001/02, the value of the per capita equalized tax points (i.e., 14.865 personal income tax points and one corporate income tax point) for the have-not provinces is \$462.00 (calculated from Tables 2 and 3). This means that the cash transfers for these several provinces equal \$498 per capita. Ontario's tax-point and cash transfers are \$513 and \$447 respectively, while Alberta's are \$510 and \$450. (The BC data are too complicated to explain, and fortunately are not needed for the intended comparisons). Thus, while there is equality in terms of per capita entitlements, per capita cash differentials remain — \$447 for Ontario, \$450 for Alberta and \$498 for the equalization-receiving provinces.

Presumably in anticipation that the richer provinces might now shift the argument for "fair-shares" federalism to the cash side of the CHST, the budget comments as follows: In the federal-provincial discussions leading up to enactment of the 1977 EPF arrangements, the provinces presented a joint position paper to the federal government, which stated: *The provinces propose that the federal contribution be determined as follows: "...one half of the federal contribution would be in cash and the other half in tax room..."* Chart 2 shows that this 50-50 share remains today — the tax transfer share for 2001/02 is \$15 billion and so is the cash transfer share (after including the \$2.5 billion new CHST money).

This budget statement is obviously correct as far as it goes. But it does not go far enough. Specifically, under the 1977 arrangements, the tax point and cash transfers were separate entities, each with its own growth formula. All of this was altered in the 1982/83 negotiations, when an overall entitlement ceiling was placed on CHST entitlements and cash became a residual. Rather than falling back on the 1977 agreements, which Ottawa obviously reneged on, the finance minister should probably have attempted to justify per capita entitlement equality in terms of some or another version of equity. My view is that it is going to be progressively more difficult to explain, let alone "sell," per capita equality of entitlements, given that the cash floor is what is driving the CHST calculations. Better, it seems to me, to revert to equal per capita cash and, if need be, make compensating increases to the equalization program. Nonetheless, the fundamental inequity in the existing CHST relates to the allocation

of entitlements. And this has now been rectified, to which the only appropriate response is: "Well done!"

As already noted, recent estimates of equalization payments for 1997/98 and 1998/99 were significantly underestimated, presumably because of the continuing Ontario boom (since Ontario has close to a 50 per cent weight in the five-province standard for equalization). In any event, the original estimates of \$8.6 billion for 1997/98 and \$8.5 billion for 1998/99 have each been increased by \$1.1 billion, of which only \$0.6 billion had been paid out by budget time. Hence, the remaining \$1.6 billion will be paid prior to the end of the current (1998/99) fiscal year. The projected equalization flow over the next five years is expected to be \$5 billion more than in the previous five years.

Beyond this, several changes were made in the way equalization-formula tax bases are calculated. Specifically:

- *The sales tax base:* The new approach will take into account both the value-added sales tax systems of Quebec, New Brunswick, Nova Scotia, and Newfoundland, and the traditional retail sales tax system.
- *The gaming base:* To account accurately for differences in fiscal capacity from games of chance, a video lottery terminal (VLT) and casino base will be added to the existing lottery ticket base.
- *The resource base:* The new approach will include the value of production of forestry and natural gas as measures of fiscal capacity, rather than their volume as is currently the case.

The changes to the sales tax base are especially important. Under some provincial sales tax systems, intermediate goods are taxed. This is not the case under the GST. On the other hand, services are taxed under the GST, which is not always the case under the PST's. Hence the sales tax base has been adjusted on a commodity basis, as it were, to find some middle-of-the-road compromise. This is not a perfect approach, but it does reduce some of the problems that exist.

As a result of these changes to the base, or "technical improvements," to use the budget terminology, equalization will increase by \$722 million over the next five years, with \$566 million of this going to Quebec. As hinted earlier, these increases in equalization, although not directly related to the CHST, probably helped tilt the federal government in the direction of pursuing full CHST entitlements equality.

One final comment is in order. As a result of the late 1980s boom, especially in Ontario, the "ceiling" provisions for equalization became binding, with the result that equalization payments fell considerably below what the formula would have delivered absent the ceil-

ing. (This even led me to suggest at the time that one might view the cap on CAP as a *quid quo pro* ceiling for the “have” provinces). In the past, the equalization formula was not constrained in the first year of any five-year fiscal arrangement agreement. For the remaining four years, the cumulative growth in equalization from this base year could not exceed the cumulative growth in GDP, also from the base year. Just prior to the 1999 budget, the mechanics of the ceiling calculations were altered. Specifically, the base year value for equalization has been arbitrarily set at \$10 billion for 1998/99. This is well above the actual equalization for this year of \$8.5 billion. In turn, this reduces the likelihood that the ceiling would become binding over the next four years. This was probably another important element in the overall package that facilitated the move toward equal per capita CHST entitlements.

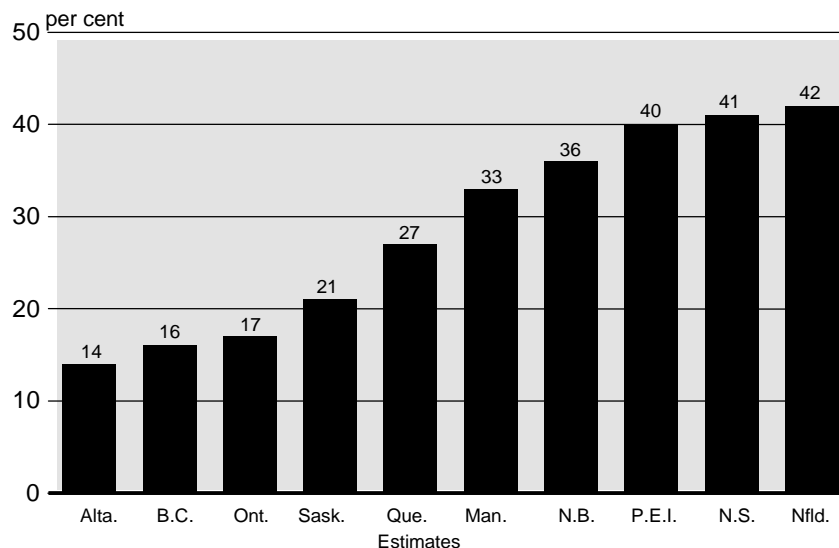
Zero-sum redistributive games can be politically explosive. Perhaps in time the move toward equal per capita CHST entitlements will blow up in

Ottawa’s face. But, so far at least, the federal government has finessed the transition quite well. First of all, it has put enough new CHST cash on the table to buy a role in the future evolution of the country’s health system. Second, and simultaneously, it has addressed a long-standing fairness issue that was driving a significant wedge between the have and have-not provinces and, indeed, was complicating Canada’s entire system of interregional redistribution. If I were to hazard a guess, the degree of freedom that made all of this possible was the larger-than-expected infusion of new CHST cash. And in the final analysis this excess cash probably had more to do with finessing the equal-per-capita-CHST-entitlements goal than with “saving the health system.”

Thomas J. Courchene is Jarislowsky-Deutsch Professor and Director of Economic and Financial Policy at Queen’s University. Tables 2 and 3 are Department of Finance compilations.

Provinces and protectorates

Major federal transfers as a share of provincial revenues



Source: *Federal Financial Support for the Provinces and Territories*, February 1999, Chart 1, p. 10. Figures are for 1998-99.