

by Robin Boadway

DELIVERING THE SOCIAL UNION: SOME THOUGHTS ON THE FEDERAL ROLE

L'auteur affirme que nous devrions faire preuve d'extrême prudence avant d'affaiblir le pouvoir fédéral de dépenser. Le pouvoir de dépenser est en effet un instrument indispensable du gouvernement fédéral pour assumer ses obligations légitimes aux plans économique, social et constitutionnel. Ce sont du reste des obligations que seul le gouvernement fédéral est habilité à satisfaire. Utilisé judicieusement, le pouvoir de dépenser est un instrument incontournable d'une fédération décentralisée qui fonctionne avec efficacité et équité. Le véritable enjeu réside dans le contrôle de son utilisation.

It has become accepted wisdom that the federal government should refrain from interfering with the rightful provincial role in the formulation and delivery of social policy. Providing money is fine, but using that to lever provincial policies is not. Not only is federal involvement in areas like education, health, labour market policy and welfare said to lead to unnecessary over-

lap and duplication, it is also said to constitute unacceptable intrusion into what ought to be exclusive provincial responsibility. It is perhaps not surprising to hear this point of view espoused by provincial governments and their spokespersons; they, after all, have something to gain from acquiring unfettered decision-making responsibilities in areas they covet or perceive to be theirs alone. But, the chorus is joined by an increasing number of influential policy specialists as well.

Undoubtedly, sound reasons exist for the assault on the federal government. There has been no shortage of errant federal policies in the recent past. Unemployment insurance, regional development subsidies, and agricultural and energy policies are often cited. And the federal mode of dealing with the provinces has been sometimes precipitous, and even contemptuous. The history of Canadian fiscal arrangements is strewn with examples of unilateralism and unwelcomed surprises, the most recent of which, the Canada Health and Social Transfer (CHST), was sprung on the provinces and the electorate in a way that could be described without exaggeration as duplicitous. Not surprisingly, the provinces have turned confrontational. In response to the federal government's invitation to participate in framing the new social union, they have called for reining in the main instrument the federal government has at its disposal — the spending power.

The position taken here is that we should be extremely cautious about emasculating the federal government's use of the spending power: doing so would amount to throwing the baby out with the bath water. The spending power is an indispensable policy instrument for the federal government to pursue its legitimate economic, social and constitutional obligations, obligations which only it can fulfill. If properly used, the spending power is a *sine qua non* of an efficiently and equitably functioning decentralized federation. The real issue is how to harness its use.

Social policy is at the heart of what governments do through their budgetary policies. Almost all transfers and a substantial part of goods and services expenditures at the federal and provincial levels of government address social policy concerns in one or more of its three main dimensions — the *ex post* redressing of income inequality, the enhancement of equality of opportunity, and the mitigation of economic insecurity through social insurance. Pursuing these objectives entails a bewildering variety of policy instruments, including the tax-transfer system, the provision of public services, various forms of social insurance, and mandated behaviour such as minimum wages and compulsory saving for retirement. These various policies often contribute to more than one of the above dimensions of social policy and they necessarily overlap and complement one another.

Given that varying degrees of decentralization of these various policy instruments are possible, what principles should guide the extent of federal *versus*

provincial participation in social policies? Let me focus on economic and constitutional ones, leaving those based on political and/or historical considerations for those better qualified.

There is no scientific way to settle how much (de)centralization there ought to be. By its nature, federalism is a compromise, trading off the perceived advantages and disadvantages of decentralization, and many of these are based on untested and untestable premises as well as value judgments. An economist's gut reaction, drawing on the analogy of the virtues of competitive markets, is to attach primacy to decentralization for its ability to deliver cost-effective and innovative programs that best meet the needs of local constituents, and to assign the burden of proof on centralization.

Various arguments can be made in favour of centralization. It allows the implementation of larger scale programs, which may bring economies of size. And federal programs reach the broader national constituency, and so are able to balance competing interests in various regions and to treat citizens comparably no matter where they reside. Moreover, federal policies are able to overcome the adverse spillover effects that might otherwise occur from decentralized decision making.

Put more concisely, the federal role is directed to the enhancement of efficiency and equity of the internal economic union. Efficiency in the economic union requires not only that inter-provincial product and factor markets be unfettered, but also that persons and businesses not be induced to move for purely fiscal reasons. The equalization program is a key policy for enhancing efficiency, but so too are such things as the harmonization of tax and transfer systems, and the portability and accessibility of program benefits. Equity, or fairness, is necessarily a more value-laden concept, but it is nonetheless absolutely critical in the decentralization debate. What economists refer to as horizontal equity translates simply into the idea that all citizens ought to be treated reasonably comparably by the fiscal regime regardless of their province of residence: opportunities or social insurance provided in one province ought to be available, within reason, in another. And — though this is more debatable — standards of redistributive fairness should be reasonably comparable, and should not be whittled away by competition among provinces.

These norms for (de)centralization seem clearly to be reflected in the constitution as written and interpreted. The provinces are given wide-ranging responsibilities for the provision of public *services*, whose efficient

delivery, most economists would agree, is enhanced by decentralization. (The italics are to emphasize the under-appreciated fact that the provinces have no apparent exclusivity in *transfers to individuals*, such as social assistance for the poor.) On the other hand, although efficiency and equity in the internal economic union are nowhere mentioned in the constitution, a clear expectation is created, and the policy tools are made available, for the federal government to pursue these objectives. Section 36 of the *Constitution Act* of 1982 speaks directly to this. One part commits the federal government to pursuing effective equalization (the horizontal fairness dimension); the other gives the federal government joint responsibility with the provinces to ensure that adequate public services are in place to reduce disparities and produce equalities of opportunity (the vertical fairness or social policy dimension). The policy instruments are sparse, yet powerful, consisting mainly of the power to tax and the power to

transfer or spend. (There is some limited ability to regulate or mandate, but not nearly enough to constitute a serious means of addressing social policy issues.)

The power to tax is not an issue; the power to spend is. The spending power has become one of the

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policy instruments most reviled among those espousing provincial rights. Yet it is an indispensable component of the federal policy arsenal. It alone allows the federal government to pursue efficiency and equity in the internal economic union and the principles enunciated in Section 36. Moreover, it is a policy instrument which has been vindicated in constitutional law. It is the basis for the substantial portion of the federal budget that goes for transfers, including transfers to the elderly (OAS/GIS), transfers to families and children (refundable tax credits), various subsidy programs, and transfers to the provinces and territories, whether for equalization, the CHST or other conditional grants. From the point of view of the principles of fiscal federalism, the spending power is a uniquely appropriate policy instrument, one which is critical for the functioning of federations around the world. It is what allows a federation to obtain the substantial benefits of decentralized fiscal responsibility without at the same time compromising national equity and efficiency.

In Canada, the spending power has facilitated some of the most important developments in the social union — the achievement of an astonishing degree of fiscal equity and efficiency across provinces and territories, a system of public health insurance administered by the provinces but satisfying widely accepted national norms, a series of provincial welfare programs reach-

ing those truly in need, tax harmonization, and various direct transfers to individuals across Canada.

There are three main criticisms aimed at the use of the federal spending power. First, it is claimed that it has sometimes been too intrusive in areas of provincial jurisdiction. The case of the *Canada Health Act* is often cited, though not so much for the five general criteria inherited from the old Medicare program as for the prescriptions on extra-billing and user fees. Other examples are surprisingly hard to find. Some would say that the Canada Assistance Plan also invaded provincial jurisdiction. But that ignores the fact that the provinces do not have exclusive jurisdiction in social assistance, and that the federal government has a legitimate and compelling interest in seeing that the needs of the poor are addressed.

The second objection is that the spending power is not a prerequisite to ensuring inter-provincial coordination or harmonization. Critics argue that in the area of post-secondary education, portability or mobility has been the norm, and there has until recently been no attempt by provinces to distinguish between their own residents and those of other provinces. In other words, some harmonization has occurred voluntarily. But a good case can be made that this was not so much a matter of voluntary compliance as a consequence of the fact that significant funding for post-secondary education was forthcoming from federal transfers.

The third criticism, and undoubtedly the most serious one, is that the process by which the spending power is exercised is unduly secretive and unilateral, and has led to many unwelcomed surprises for the provinces. Thus, the provinces were bribed into implementing large health and welfare programs, only to be left with the financial burden as the federal government gradually retracted support. At the same time, these unilateral actions have eroded the moral and political authority of the federal government to impose national standards. The problem seems to be that major changes in the fiscal arrangements are introduced as part of the annual budget cycle, not unnaturally with short-term fiscal objectives in mind. Budget decision making is necessarily secretive, but major structural changes in other areas, such as tax reform, are usually studied more deliberately before being introduced. While it is conceivable that the provinces were fully consulted in advance, the process was not an open one. It is this matter of process that seems to be largely responsible for the disdain with which the federal spending power has come to be seen.

As a result, the spending power is now once again under intense scrutiny. Various options are being con-

sidered:

- *Gut or limit.* Some would argue that the use of the spending power in areas of provincial jurisdiction ought to be eliminated, or clearly circumscribed by requiring provincial assent. This would have several adverse consequences. First, it would remove from the federal government its main instrument for achieving the legitimate economic and constitutional objectives of a fair and efficient internal economic union. Second, if unanimity were required to use the spending power,

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the federal government could be precluded from using it for purposes which implicitly redistribute among provinces. Third, by eliminating the use of the spending power, the federal government might be induced to search for other policy instru-

ments, such as direct transfers to individuals and institutions, which indirectly achieve similar national objectives. This would inevitably introduce inefficiencies into the system. The Millennium Scholarship Fund might be a foretaste of this.

- *Opting out.* Short of gutting the spending power, some form of opting out by the provinces could be considered. The effect of this depends on the criteria used. It has been argued that the Meech Lake opting-out formula was innocuous in its effect, since it required provinces to implement programs with similar objectives. But more extreme forms of opting out would obviously have the same effect as gutting the spending power, and so would be subject to the same objections just expressed.

- *Securing provincial agreement.* The current debate on the CHST and the fiscal arrangements puts emphasis on a new partnership in which the federal government and the provinces agree on the ground rules. There are various aspects to this. One is that agreement should be sought on the national standards governing the use of the spending power. Reaching such an agreement may prove difficult. Securing agreement among the federal government and the provinces and territories is an arduous process, and one which has not proven to be very successful in other areas. Moreover, why should such an agreement be necessary? After all, the national objectives of the federal government are legitimate, and so is its national electoral authority. The second aspect of federal-provincial agreements concerns enforcement and dispute resolution. Setting up a mechanism for resolving disputes would take the issue out of the political sphere and put it into the hands of a quasi-judicial body. It is not clear that this would be appropriate. Not only would it take spending decisions away from the Parliament, it would also either require setting out guidelines for the use of the spending power

in some detail, or affording considerable discretion to tribunals to interpret general guidelines. Given the political nature of the policies, this seems to be inappropriate. The third area where provincial agreement might be sought (and is being sought in the case of the CHST) might be on the funding formula itself. This could be counterproductive, given the redistributive and zero-sum game nature of spending power programs. It is instructive that the main selling point of the recent proposal the provinces and territories concocted for revising the fiscal arrangements was precisely that none of them would lose. This seems hardly a sensible principle on which to base federal fiscal arrangements aimed partly at goals of fairness.

Those who wish to harness the role of the federal spending power can offer two suggestions:

- *Regaining vertical imbalance.* The first suggestion is to re-establish the moral and political authority necessary to using the spending power by increasing the level of transfers to the provinces, transfers which took a highly disproportionate hit as part of the deficit reduction program. This will not only serve to recoup the legitimacy of the federal government's role in maintaining national standards in areas like health care, it will also have the secondary effect of halting the erosion that might otherwise occur in the income tax room that the federal government occupies, an erosion which can potentially threaten the integrity of the Tax Collection Agreements.

- *More transparent institutional decision making.* While requiring the assent of the provinces for the use of the spending power may be excessive, it must be recognized that its unfettered use by the federal government is subject to abuse. Much of the problem seems to stem from process, in particular, the enactment of changes of long-run importance through the secretive procedures of the budgetary process, which seem to leave little room for public consultation. Since the spending power involves spending, it is obvious that the budget will be involved. But it should be possible to put in place arm's-length consultative processes which serve both to open the decision-making process up and allow for the long-run interests of the federation to be given due weight. Other federations have institutions which serve an advisory and consultative role, and allow real input from the public and the provinces. The Australian Commonwealth Grants Commission comes to mind. We might do well to look to such examples as a model to help address shortcomings in the process currently used to determine fiscal arrangements.

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by John Richards

THE "UNHOLY ALLIANCE" VERSUS "SECURING OUR FUTURE TOGETHER"

Il est à-propos d'imposer de sérieuses limites au pouvoir de dépenser du gouvernement fédéral dans le domaine des programmes sociaux. La mise en place d'un mécanisme de règlement des litiges fédéraux-provinciaux est aussi une bonne idée. Il faudrait consacrer plus d'efforts à l'élimination des obstacles à la mobilité inter-provinciale et accorder plus d'importance à l'évaluation des politiques sociales, une transparence accrue pouvant conduire à de meilleurs résultats. L'auteur considère qu'Ottawa devrait résister aux revendications des provinces pour rétablir la générosité antérieure à 1995 en matière de transferts intergouvernementaux et utiliser davantage le programme de péréquation pour aider les provinces à offrir des services publics à un niveau de qualité et de fiscalité sensiblement comparables.

As their opening gambit in negotiating new rules for the conduct of social policy in Canada, the provinces have produced a "consensus document" to which all — Quebec included — subscribe, albeit with varying