

# REIMBURSEMENT FEDERALISM: DEMOCRATIZING COOPERATIVE FEDERALISM FOR THE 21<sup>ST</sup> CENTURY

Tom Kent

In the discussion of what to do with the federal surplus, our Founding Editor proposes “reimbursement federalism,” transferring funds directly to citizens rather than passing them through provincial treasuries. Reimbursement federalism, he points out, is permitted by the Constitution and exists in practice. “From family allowances and old age security onward,” he writes, “that has been the way federal taxes have supplemented personal incomes.” As he notes, “the first social program that changed the lives of millions of Canadians was not provincial. It was family allowances — federal cheques paid directly to all mothers. Today the guaranteed income supplement, child tax benefit and GST credits are income tested but equally direct, personal payments to those who qualify.” Child care and children’s health are two issues he identifies as important investments in the future.

Dans le débat entourant l’usage des surplus fédéraux, notre rédacteur en chef fondateur propose une « fédéralisme de remboursement » qui consisterait à transférer des fonds directement aux citoyens plutôt qu’aux Trésors des provinces. Une formule autorisée par la Constitution, précise-t-il, et qui est déjà utilisée dans les faits. « Des allocations familiales à la Sécurité de la vieillesse, l’impôt fédéral a toujours suppléé aux revenus des particuliers », observe-t-il, rappelant que « le premier programme social qui a changé la vie de millions de Canadiens n’avait rien de provincial ; il s’agissait des allocations familiales. Aujourd’hui, le Supplément de revenu garanti, la prestation fiscale pour enfant et les crédits pour TPS sont fondés sur les revenus mais constituent de la même façon des paiements directement versés aux citoyens admissibles ». Les investissements de demain devront privilégier les services de garde et la santé des enfants, conclut l’auteur.



**T**he government that results from the promised 2006 election — majority or minority, Liberal or Conservative — will face a decision more significant than any politicians have made since 1867. It is a decision crucial to the continuation of Canada as an effective nation state. But it is not about constitutional words. It is about money. It is about how much of the money Canadians pay in taxes goes to Ottawa, and how much to provincial governments.

This is not an issue that will feature much, if at all, in the TV spots of the campaign. It may be little affected by how Canadians vote. On the present evidence, the difference between a Conservative and a Liberal government next year is that one would be likely to make the wrong decision and the other likely to drift into it. Either way,

Canada will be enfeebled unless thoughtful opinion recognizes the danger in time and arrests either the decision or the drift.

Unless, in other words, we reverse the thinking that has developed since the federal government began continually to enjoy bigger budget surpluses than were supposedly needed and planned. They have given impetus to the rising talk, among business economists and academics, in the media and in the clubs, of “fiscal imbalance.” Ottawa appears to have more money than its responsibilities require, and the provinces (Alberta apart) too little. So federal taxes should be reduced; then needy provinces can raise theirs. The argument is attractive. It would also make sense, if we were living in the Canada that passed away 70 years ago.

Today the imbalance that needs correction is political, not fiscal. Our federalism has become incoherent and undemocratic. It will deteriorate further if Ottawa does less by taxing less. It will deteriorate further if Ottawa keeps its taxes but yields to using them for increasing donations to provincial treasuries.

Federalism will again serve Canada well if Ottawa instead returns its revenues directly and democratically to people, in the ways that will create a more just society in a stronger economy.

Canadian federalism was well made for its first half-century or so. Ottawa was given the instruments for what were then seen as the national purposes. "Matters of a merely local or private nature" were provincial business. Though its politics were never easy, this classical model of federalism worked well enough as long as government in total was small, taxation light, and different living standards from province to province of no great account. Each order of government could look after its own without interfering, in administration or in finance, with the other.

Public responses to the depression of the 1930s ended small government and thereby destroyed classical federalism. Active jurisdictions collided. The "merely local or private matters" became basic public services for health and education, for social security and welfare. And with pan-Canadian awareness greatly strengthened in the war, such services were expected to be much the same for people everywhere across the land. Matters in provincial jurisdiction became major concerns of federal politics because public attitudes were stronger than the Constitution.

This revolution could have been easy if our provinces had been more alike. It was difficult because their resources are greatly unlike. Ontario is too different from Newfoundland,

Prince Edward Island from Alberta, for their provincial taxes to finance similar public sectors. The demand for coherence, in a democracy of equal rights, can be satisfied only if much of the finance for the public sector, for provincial services as well as for direct federal responsibilities, is provided nationally, by federal taxes.

The problem of Canadian federalism is that our politics have still not come fully to terms with that necessity.

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fare state. The revolution in information technology, creating the new world society of close connections, has made it equally essential to the economy. An economy strong enough for an affluent society now rests on the advanced knowledge and skills of its people. The public services that enhance people, their health and education and their opportunities, are as crucial to wealth as to equity. They are provincial services but national necessities. There cannot be an efficient Canadian economy, making the most of our human capital, unless the necessary public services are much the same throughout the country.

The political adjustment that created the welfare state was executive federalism. Provincial programs that had become federal concerns were remade or developed in negotiations among governments, to become shared-cost programs delivered by provinces but half financed by committed transfers of money from Ottawa to provincial treasuries. The contrivance worked well for a time, but it confused responsibility and weakened representative democracy. Legislators could only rubber-stamp what first ministers had agreed. Nevertheless the outcomes were nationally popular. Executive federalism blossomed into the cooperative federalism of the 1960s and early 1970s.

That honeymoon depended, however, on a politics very different from today's, on federal parties and politicians enjoying a degree of confidence, relative to the provinces, that has been destroyed. Committed transfers of pre-determined sums quickly became non-events in the media and public opinion. Federal politicians then resented levying taxes that provincial politicians spent to popular acclaim. Progressively, they reneged on the promised amount of their transfers and in 1995 cancelled all commitment to fixed sharing of provincial costs.

It has been replaced by bargained donations, the changing outcomes from the fights of governments. Our federalism is more than ever executive, less than ever either democratic or cooperative. As Harvey Lazar puts it: "Federalism in Canada today is too much about government and fiscal jockeying and not enough about people and policy." Increasingly, the provincial combatants are the better jockeys. Federal leadership in national policy is shrinking. A series of expedients without guiding principle is churning our once proud federalism to a morass. It must be restored to firm

ground. If it is not, there will be no way to fit public policies to the competitive pressures of the contemporary world. The economy will not do well. Social tensions will then mount and federal politics will be unlikely to bridge the divide between Quebec and Alberta. We will risk going down in history as one of the many nation states that have failed.

The risk is readily avoidable. Firm ground for federalism — firm constitutionally, politically, administratively — is not far away. We can move to it if we overcome two misconceptions. One is that transferring money to provincial treasuries is the only way Ottawa can support provincial programs. That way fitted the past but does not fit the present. Canadian federalism is in disarray because we are slow to turn to the more democratic alternative that the Constitution has always made available. Federal payments can be made directly to people. From family allowances and old age security onward, that has been the way federal taxes have supplemented personal incomes. It is now also the fair and efficient way in which Ottawa can contribute to the costs of the basic services most important for all Canadians.

The other misconception is about Quebec. It is still widely seen as the awkward partner hampering, if not inhibiting, progressive policies. The view is 45 years out of date. In the early postwar years the Quebec of Duplessis' Union Nationale stood apart from the development of the welfare state; Ottawa was therefore seen to be engaged in baseless aggression against provincial rights. Then, however, came the Quiet Revolution after the election of Jean Lesage in 1960. It was too quiet for ready understanding in the rest of Canada. There is still a widespread prejudice

that difficulties in the operation of federalism centre on Quebec, that its governments still want to stick to classical, stand-apart federalism.

The reality has been more complex from the day the Lesage government took office. Public policy in Quebec has been more activist than in any other province except, at times, Saskatchewan. Since 1960 Quebec federalists have recognized, quite as clearly as others, that con-

Public policy in Quebec has been more activist than in any other province except, at times, Saskatchewan. Since 1960 Quebec federalists have recognized, quite as clearly as others, that contemporary economic and social programs are inevitably intertwined, that jurisdictions cannot be exercised in isolation. In particular, Quebec cannot prosper within a national economy if its major programs and tax rates are greatly divergent from those in the rest of Canada.

temporary economic and social programs are inevitably intertwined, that jurisdictions cannot be exercised in isolation. In particular, Quebec cannot prosper within a national economy if its major programs and tax rates are greatly divergent from those in the rest of Canada. Certainly Quebec wants to do things its way. But its federalists want to succeed in their way not so much by being, in practice, different, as by influencing the rest of Canada to move the same way. It is an influence exercised both by Quebec federalists in Ottawa and by the government of Quebec in its collaboration with fellow provinces. Both the annual gatherings of provincial premiers and now the more formal Council of the Federation were initiated by Quebec — by Jean Lesage in 1960 and Jean Charest in 2003.

Few politicians elsewhere admit to the leadership role that Quebec began in 1960. Its modernization of bureaucracies and procedures was soon copied in other provincial capitals. All were then opposed to more "joint programs" in the 1950s style, where joint meant provincial programs subject to federal prescription

and monitoring as the condition for financial support. The new Quebec, however, went beyond saying no. It was the leader of the provinces in devising with the federal government ways to introduce major new programs that could be effectively consistent across Canada without overriding provincial responsibilities. Hence the identical Canada and Quebec pension plans, hence programs of health insurance, postsec-

ondary education, social assistance and services, that could be cost-shared on the basis of agreed principles instead of federal prescription and monitoring.

Hence, in short, the cooperative federalism of the 1960s and early 1970s. Its later disruption came not from Quebec but from Ottawa.

True, Quebec has had an undesignated special status since in 1982 a new Canadian Constitution was adopted without the consent of its federalists as well as separatists. The attempts at correction — the Meech Lake and Charlottetown Accords — having failed, all Quebec governments must enter formal reservations to other federal-provincial agreements. But the formality does not prevent them from participating in working arrangements and accepting federal finance. The rhetoric is different, but practicality rules when the government is PQ as well as when it is federalist.

This is in no way to make light of the danger that a sovereignist Quebec government may one day succeed in breaking up Canada. It is to say that

the possibility need not affect the working of the federalism we now have. Indeed, to let it be a distraction from fair and efficient operation, in the interest of all of Canada, is to increase the danger of secession.

**T**his understanding is crucial to the modernization of federalism. The fundamental reform is greater use of the spending power for payments to people that can be used to defray the costs of provincial services. The detail and delivery of those services varies among provinces. So, therefore, must Ottawa's arrangements with them. The principles must be consistent, the rest flexible.

This is, in the language lately becoming fashionable, asymmetrical federalism. It is open to suspicion as cover for deals special to Quebec. It is not. All provinces are different. Federalism requires that Ottawa's relations with them all are the same in most respects but not in all respects. The politics of federalism call for a basic symmetry within which meaningful exceptions fit varying circumstances. That was so from the beginning. As government has grown, so has the need for flexibility. There will be more asymmetry. The challenge to Canadian federalism today is to accept it in necessary measure without undermining the national base, in programs and taxes, for a strong economy and a coherent society.

Canada cannot live with the federal-provincial strife of the past ten years. It confuses responsibilities. Its uncertainties frustrate sound planning and administration for health and education and much else. And where it is leading has become all too probable. Present politics make the provinces strong, Ottawa weak. The existing government does not as yet admit to the existence of fiscal imbalance but its actions put it on the road toward capitulation before the business and provincial pressures to diminish the role of national government.

Two generations ago, a shift of emphasis, from federal to provincial taxes, was the necessary correction to



Photo: Chantal Létourneau

Increasing the Canada Child Tax benefit from its current ceiling of \$2,950 to around \$5,000 is one possible example of "reimbursement federalism" proposed by Tom Kent. Early childhood education is another. Here is one candidate for daycare — two-year old Benjamin Therrien, at a Montreal playground.

wartime centralization. But that time is long gone. In the contemporary world the strength of Canada depends on public services adequately provided nationwide from taxes that are much the same nationwide. A government that agreed at this time to re-balance taxation, shifting from federal to provincial, would be

betraying its responsibility for the well-being of all Canadians. The true imbalance is political, caused by Ottawa's failure to develop a sound way to support provincial services by federal taxes. The Constitution provides such a way. It is not in the Constitution but in our politics that we are stumbling.

The Constitution in fact allows for three ways. Transfers to provincial governments need not be directed to particular programs. However big the fiscal disparities among provinces, in theory they could be overcome by sufficiently large equalization payments, providing all provinces but (at present) Alberta with block grants graduated to bring their revenues per capita up to the standard that the richest can get from provincial sources alone.

**E**qualization on such a scale is, however, the stuff of academic dreams. It has no political substance. It would drive Albertans mad enough to seek another country to

The last defence of federal inertia is usually that “the provinces will never agree,” but in this case it ignores the Social Union Framework Agreement (SUFA), which the provinces pushed Ottawa into signing in 1999. (Quebec of course stood formally aside, but in this as in many other matters it was not an awkward dissident.) SUFA originated in a constructive attempt by the provinces to undo the worst of the damage to federal-provincial relations wrought by Ottawa’s 1995 budget.

be part of. It is unsupportable by federal politicians of any stripe. They have put cost-sharing behind them. To think that they will devote even more tax dollars to the even more amorphous process of equalization is to hallucinate.

The inhibition to new policy is that cost-sharing, supplemented by a modest measure of equalization, worked so well for a time that the federal spending power has become identified with such transfers to the provinces. In fact, of course, it is a general authority. Just as Parliament has the power to raise money by any kind of taxation, it has the legal authority to spend the money for any purpose. What provincial jurisdiction does is to define services that only provincial officials can perform, federal officials cannot. For example, Ottawa cannot set up and operate schools (for people in general, as distinct from status Indians and its soldiers and police).

But it can and does subsidize students, pay professors, finance research.

The spending power gives federal authority to provide money to institutions, communities, corporations. Direct and indirect subsidies to corporations have been major instruments of public policy from the CPR onward. Most important, however, is the authority to make payments directly to people. The first social program that changed the lives of millions of Canadians was not provincial. It was family allowances, federal cheques paid directly to all mothers. Today the guaranteed income supplement, child tax benefit and GST credits are income tested but

are equally direct, personal payments to those who qualify.

The federal government may also buy services for people from private institutions or from the provinces. That was the technique of procurement federalism used when Ottawa recognized the importance of occupational training. Alternatively, Ottawa can reimburse people for fees paid to obtain services, again from private institutions or from provinces. In that way it can subsidize people in myriads of activities, from performing arts and sports to living in low-rental housing.

The merit of reimbursement, compared with procurement, is that the payment can then be universally available but be made as socially just as a refundable tax credit: the extent of the reimbursement can be graduated from full to zero according to income. To distinguish them from the fiscal federalism of transfers to the provinces, such payments to people

may be summarized as “reimbursement federalism.” It is cooperative federalism made more democratic for the 21<sup>st</sup> century.

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For “intergovernmental transfers, whether block-funded or cost-shared” the agreement stipulates conditions that would make them even less politically rewarding for Ottawa than it had come to regard the old programs.

**T**he agreement’s treatment of “direct federal spending” stands in stark contrast. “Another use of

the federal spending power is making transfers to individuals and to organizations in order to promote equality of opportunity, mobility and other Canada-wide objectives. When the federal government introduces new Canada-wide incentives funded through direct transfers to individuals or organizations...it will, prior to implementation, give at least three months notice and offer to consult.” That is the only condition.

What is proposed here gives the provinces a far larger say. Each government has its clearly accountable responsibility and working together is a clear political advantage to both. In the world as it has been for sixty years, any national policy requires such federal-provincial collaboration. But collaboration is a labyrinth in which politicians and officials are easily lost. They become absorbed in the process, the deal-making of executive federalism. They lose sight of what is

most fundamental. Our federation is also a democracy. The politics and procedures of federalism have to be reconciled with the politics and procedures of democracy. That will not be done as long as the main process is a swapping of money and power between governments.

**S**hifting money to people locks competing federal and provincial politicians into a common interest to serve their voters. This is not to suggest that all will suddenly be sweetness and light. Reimbursement federalism will require negotiations on terms that involve practical but principled asymmetries. It will not end the natural tensions between two sets of politicians. But they will have compelling incentives to come to agreements and stick with them. Blame-the-other-guys will no longer be the credible technique that it has been, at different times, for one side or the other.

The key to democratic federalism today is to stop moving money around among governments and instead use it, whether it comes from provincial or from federal taxes, equally for direct services to people. For services that the provinces deliver, the federal role is to finance people's access to them across Canada. The key to collaboration is moderation in that role.

Neither promoters of interests nor pursuers of causes pay much attention to jurisdictions. Sound federalism requires Ottawa politicians to reject the constant pressure to spread their money widely. It means concentrating on basic services whose nation-wide consistency is most important.

Federal moderation has a second dimension. It is to finance access to essential services in ways that secure necessary consistency but not unnecessary uniformity; it is, in other words, to stick to the main purpose and live with considerable asymmetries.

Such methodology for a new cooperative federalism could be used for whatever public services are

thought most important. Rarely, however, have the priorities been so clear as they are today. They are services special to childhood and youth, the investments in human capital crucial to Canada's future. Those are, even though they can be only cursorily summarized here, the natural illustration of modernized federalism.

The first two measures are direct income supports. The Canada Child Tax Benefit is excellent in principle but was begun as a pittance and has only crawled upward. It remains way below the minimum cost of raising a child. Increasing it from its current annual ceiling of \$2,950 to, say, \$5,000 a year would do more good than any of the lavish expenditures made and promised in recent years. It would not, however, end the deprivations of children in poor households. Present taxation combines with provincial welfare systems to help low-income families to

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stay poor. The minimum reform is to change the basic allowance, before income tax begins, to a refundable credit. Subsequent increases in the amount would then be, in conjunction with the child benefit, steps toward a family income guarantee for all Canadians. It would save the provinces money by replacing most of the welfare that is now so varied and everywhere so clumsy.

This is, however, an expensive reform for Ottawa. It will proceed only gradually, at least until we have a better tax system; which again will take time. In contrast, a third change in transfers to people would reduce the demand on current revenue. It is an improvement that could be fully made now.

Improvisations have made finance of post-secondary education a jumble of provincial operating grants, student loans, research grants, scholarships. The subsidization most bene-

fits those who need it least without making access easy for others. Post-secondary education is valuable to the nation but also a material benefit to the individual. Subsidization is unnecessary. The federal government could replace it by fully adequate advances to qualified students. Repayment would be by a surtax beginning when income exceeds, say, average full-time earnings.

Such advances would be unusual among government programs; they could be appropriately financed by borrowing. Surtax recovery of principal and interest would make the money a revolving fund, with margin enough to cover its low administrative costs. The call on tax revenue would be no more than the leakage from the fund caused by former students who fail to get more than the average earnings of Canadians. Financial constraint is no excuse for

the present inadequacy of post-secondary education.

Though some academics would object to the upset, the eventual result would be a healthy reshaping of postsecondary facilities. Taxable advances could also transform our greatly inadequate adult education and occupational training by empowering people to purchase the services, from provinces or from accredited private organizations.

**T**wo other investments in the human capital of Canada are even more important than better post-secondary education. They require, however, much more budgetary expenditure and their delivery depends on more increase in trained personnel. One is early childhood care and education. The other takes health care beyond treating sickness to promoting good health in youth.

The federal government is already involved in financing childcare for the well-to-do people who are its most effective lobbyists. The tax system provides, for the offspring of working parents, an expense allowance deductible from income. The subsidy is generous for people with good incomes, of little or no benefit to others.

**A** government concerned for all children would replace the tax deduction by reimbursement of a proportion of the fees paid for care, the proportion varying from high to zero on a scale graduated to family income. For pre-school children, the maximum reimbursement would cover most of the fees required for care of good educational quality.

The government is at present dabbling its toes into early education. The proffered donation is small in relation to the need. The style is reminiscent of joint programs fifty years ago, when Ottawa prescribed and monitored provincial administration. The donation is supposed to be used only for new child care places conforming to set standards. The standards are desirable aims. But most provinces are far short of the facilities required. It is not for Ottawa to dictate that its very limited subsidy will be used to provide excellent care for just a few children. The effect is to force discriminatory distribution of a public benefit in provincial jurisdiction. It will lead to more of the tensions — and failures — of interference from Ottawa.

**T**he firm base for good childhood care and education is not regulation. It is public opinion. The role of the federal government is to make the opinion into an effective demand by financing that is fair in relation to income. If on this basis the federal government stands ready to reimburse realistic fees, good educational care is what increasing numbers of parents will insist on. Staff and facilities will require development, but it will not be too long before educational care is widely available for children from as early an age as their parents, working or not, think desirable.

However, in addition to parents who choose to keep their children at home, there will be others — particularly in rural areas where attending a centre would require long bus journeys — who prefer more informal care. Rigidity is undemocratic. Ottawa's arrangements with provinces can be fair without being identical, setting reimbursable fees appropriate for various kinds of service. Democracy requires a policy plain in its principles. Federalism requires it to be practised with realistic asymmetries.

**T**he most important program of all is investment in the health of children. It is also the most difficult because it has to be done despite the problems and controversies of medicare. Continually more sophisticated treatments of illness are sustainable only if we become better at preventing it, at promoting good health. Caring for the elderly is a social obligation. So is the health of kids, but it is also crucial to the economy, to investment in our human capital. It is therefore the part of health care of most concern for national government.

It is past time to adopt a sixth principle of health policy, a principle for which Ottawa takes responsibility: to make preventive health care for young people fully comprehensive. The most constructive of all policy initiatives open to the federal government is an undertaking to defray all the extra costs of such enrichment of the health services provided to age eighteen. It would be an offer to the youth who are Canada's future. It could be fulfilled in one of two ways.

The federal government could organize and deliver the services. The provinces in 2004 unanimously proposed such a delegation of function for pharmacare. The Martin government, set on its campaign promise to "fix" medicare as a whole, refused to consider the responsibility, but such unwisdom does not have to be a precedent.

There is, however, an alternative, better for services closely allied with

existing medicare. Ottawa could contract with provincial governments to finance their delivery of the additional services. Provinces might make different choices between contracts and having Ottawa provide some or all of the additional services. In any event, flexibility will be needed to accommodate existing federal promises about medicare with the new undertaking for youthful health. Again, good federalism requires similar outcomes for people nationwide; it does not require uniformity in how the outcomes are achieved.

These cursory outlines of a federal policy for youth are necessarily mere indications of a long-term purpose. What is crucial in government is coherence of purpose. The tensions of a closer world make coherence of purpose more than ever critical to the success of a small population across a continent-wide economy. Coherence requires strength at the centre. Canada has weakened at the centre. It will go on weakening as long as Ottawa persists in executive federalism by donating to provinces, which will increasingly lead to transfers of taxes as well. The urgent need is to change course. It is to move to a democratic federalism that corrects the imbalance of our politics, that relates federal taxes to services to people, that makes the government in Ottawa clearly responsible for the finance of programs basic to the economic and social union of Canada.

The main obstacle is not in our provinces, in their diversities or even in the parochialism of some of their politics. It is not in the structure of our federalism or in the distinctiveness of Quebec. The obstacle is the fading of purpose and of public trust in our national politics.

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