

**REVISITING EQUALIZATION
AGAIN: RTS VS MACRO
APPROACHES***

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INTRODUCTION

Equalization is a very common policy instrument around the world. Virtually all federations have formal equalization systems, with the notable exception of the USA. Many unitary states with multi-level governments have sophisticated equalization systems, such as Japan, the Scandinavian countries, and South

fiscal federalism community, and which provides one cogent set of principles that are relevant for equalization policy. This literature goes back to the 1950s in the United States, and was developed in Canada first by John Graham in 1964, and in more detail by the work of the Economic Council of Canada culminating in their report entitled *Financing Confederation* in 1982. These principles are completely consistent with the commitment to equalization that is set out in Section 36 of the *Constitution Act*. This literature can and should also inform the debate on the RTS versus macro approaches to equalization. For whatever reason, it has been completely neglected in the background documentation provided for this conference, as well as by many of the recent commentators in

PRINCIPLES

It seems self-evident that a prerequisite to

based on the economic objectives, it would look very similar to Section 36(2).

The literature on equalization is reasonably large, and parts of it can be both technical and

fiscally induced migration will result

the best interests of their citizens. While there may be some advantages to having a degree of harmonization of certain types of services and

benchmark case, full equalization of per capita differences in tax revenues is called for under the following circumstances:

under benefit taxation, economic inequality still persists in society: there will be high-average-income and low-average-income provinces. But, it is not the task of equalization to deal with that

prescribed by the federal government, and the federal government provides the bulk of the financing for them. However, in the Canadian case, the degree of decentralization is such that it

the extent of fiscal decentralization of the federation.

Fifth, equalization should apply in principle to both the have and the have-not provinces. Indeed, in some countries (e.g. Germany, Sweden) this is the practice. This does not literally require that the equalization system be a net one. As long as there is enough vertical fiscal imbalance in the system with the federal government transferring sufficient funds to all provinces, it could always structure them so that it effectively equalizes down the three have provinces, though it currently chooses not to do so. In assessing the performance of the system with respect to the constitutional principle, this should be borne in mind. As an aside, this also has implications for proposals to turn over tax

have provinces. However, that is beside the point. Their purpose is not to redistribute among governments so as to enable governments to provide comparable public services. Rather, they are intended to provide higher incomes or more economic security to low-income persons regardless of where they reside. Second, some non-equalization transfers that favour one province over another can be interpreted as capturing an element of need that is missing in the equalization system. For example, the defunct Canada Assistance Plan was a transfer based on actual provincial expenditures on social assistance and services. Third, it is sometimes argued that equalization historically was a *quid pro quo* to the have-not provinces for the industrial policy benefits enjoyed by

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case for equalization is independent of...

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argument. One is that the system is difficult for

the number of

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common valuation procedure. Larger urban
centers have relatively high per capita

not suitable for equalization purposes. There are

NFBs created by actual tax practices. The fact that the latter may be difficult to measure precisely does not justify searching for an alternative that is based on the wrong principles

on their real income. There is a growing literature on equality of opportunity that takes precisely that position. But this point is not relevant for equalization, and again reflects a



