

# STRIPPED DOWN FEDERALISM

## Questions for Al O'Brien

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*As chair of the Expert Panel on Equalization and Territorial Formula Financing, Al O'Brien spent eighteen months unpacking and repacking Canada's most complex national program. Al O'Brien is a fellow of the Institute for Public Economics, University of Alberta, and a Senior Fellow of the C.D. Howe Institute. He was Alberta's Deputy Treasurer until 1999.*

**You've said Canadians have become confused about Equalization's purpose.**

I think over time, with some of the one-off arrangements made between the federal government and individual provinces, people lost track of the basic notion of Equalization and began to confuse it with economic development objectives. Certainly, we heard comments that Equalization isn't working because the recipient provinces' economies aren't as robust as Ontario and Alberta's. Well, that isn't the point.

**What is the point?**

To ensure that, given the inevitable disparities in a large federation like Canada, we can still have a decentralized form of government in which provinces have the capacity to deliver important public services for which they're constitutionally responsible.

**Did the emotion typically surrounding this topic present a challenge for the panel?**

I certainly was surprised at how strongly held the views were, and how narrowly focused they were. People were examining it from a parochial perspective, looking not to the underlying principles but simply to the financial results in their own jurisdiction. Having said that, we also heard very thoughtful, helpful presentations.

**Was there support for the concept?**

We heard very few arguments that Equalization should be abandoned, that it was broken and couldn't be fixed and served no useful national purpose. We were struck by how important this program is to the country.

**Did that surprise you?**

I'd spent 35 years in the Alberta public service and during that period Alberta hadn't qualified for Equalization—so it was probably less at the front of our planning than in many provinces. After eighteen months talking with people, my understanding of the role Equalization plays—and how important it is to achieving quality public services throughout Canada—was expanded. I came to a much deeper appreciation of the program's importance.

**You were created by one government, and reported to another. Did that present challenges?**

No. We were appointed by Ralph Goodale in 2005 and reported to Jim Flaherty in 2006. Both ministers seemed exclusively concerned with finding the best solution to get this program back on track. Our only mandate was to examine the program and consult Canadians, and develop the best recommendations we could.

**Coordinating cross-country input and sifting through all the presentations must have been a huge undertaking.**

It was difficult. We were fortunately supported by an experienced secretariat in Ottawa, and the officials of all governments were very willing to provide information. We also received support from the academic community. I think—and SIPP is an example—Canada has quite a strong public policy focus in its academic institutions. That was helpful. But there's no question the issues are complex.

QUESTION PERIOD

**What was your starting point?**

We needed to start from the basic constitutional provision from 1982 and think about what it meant. Then we set out what we thought the key principles were. Clearly the most important thing is how fiscal capacity and disparities should be measured, and what the standard for receiving payments should be. The program had become in our view excessively complex. It was a challenge to find a handle for addressing it.

**So what became your handle?**

We concluded the most intuitive, sensible standard was a national average that included all ten provinces. Then we recommended five measuring tools, instead of thirty-three. We thought this would simplify the program without any meaningful sacrifice of accuracy and fairness.

**Can you explain the panel's thinking on resource revenues?**

We concluded fifty per cent of resource revenue should be considered rather than one hundred per cent. This recognizes provincial ownership of resources and a principle we thought important: provinces that own resources should receive a net fiscal benefit from their development.

**But you recommended capping that net benefit?**

While only fifty per cent of revenue should be included, that shouldn't result in a province receiving entitlements to the point where they'd end up with greater fiscal capacity than non-receiving provinces. That would defeat the basic purpose of the program.

**What other recommendations strike you as key?**

We made other recommendations that I think address historic Saskatchewan concerns. First, we recommended using actual resource revenues rather than the very elaborate proxy measures that had historically been used. The cost of exploration and development is very different in each province, so this will improve the program's fairness.

Second, we included hydro profits for the first time. We felt hydro revenues were indeed resource revenues, although historically their profits had been treated as though they were simply corporate profits like any private company generates.

**Did you look at how the program would be overseen?**

One of the questions we were asked to examine was whether the government of Canada should create an independent advisory body. We concluded that that wouldn't be helpful and wasn't necessary. We felt it was more useful to try to strengthen the historic intergovernmental mechanisms for consultations about the program, and to encourage continuing research in the academic community and so on. We came to the conclusion that a permanent independent commission wouldn't in fact add a lot to the robustness of the program.

**How do you feel the federal budget reflected your recommendations?**

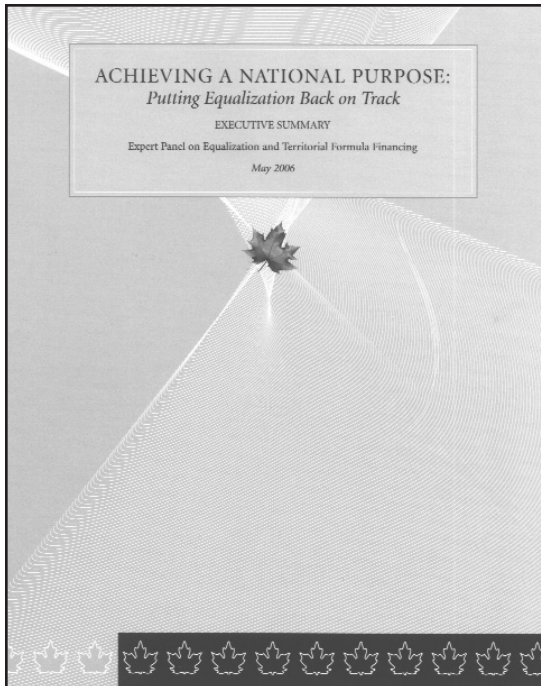
The budget accepted the notion that the program must be based on clear principles and put back on a formula-driven basis. That was our first and most important recommendation. In general, the budget accepted our recommendations in their entirety.

**Including the sticky issue of resource revenues?**

They developed a variation: they said there would be a dual calculation of resource revenue entitlements, one based on our fifty per cent recommendation, and the other on zero per cent, as had been advocated. We concluded fifty per cent was the best balance, but I think the alternative—where no resource revenues are included either in the determination of the standard or in the measurement of an individual province's capacity—is consistent, and doesn't violate the key principles in any way.



*Mr. Al O'Brien, Chair of the Expert Panel on Equalization and Territorial Formula Financing*



*Executive Summary of the Expert Panel on Equalization and Territorial Formula Financing*

**Since the budget, there's been a call for a Saskatchewan Accord.**

This is part of what's developed over time. Some people call it "treaty federalism". I know Saskatchewan will claim they're basing their arguments on principle. We acknowledged in our report that one principle is that provinces should receive the entire benefit of their resource development. The other principle, though, says if you're going to have a program that's critical to delivering services on a decentralized model, to ignore resource revenues just isn't realistic.

**The issue seems quite inflamed. What are the key problems to avoid from a policy perspective?**

I don't think Canada can function on a centralized basis, and I don't think a federation with the kind of fiscal disparities we have in Canada can function without an Equalization program. So I'm very hopeful the government sticks with principles and clearly enunciates how the payments are determined and doesn't try to do one-off deals that are inconsistent.

**Do you foresee that happening?**

I would hope the program will get back onto some clear rules and away from individual bargaining and what has almost become a win-lose attitude. The measure of whether the program is doing a good job or not seems to have become: Does my province get more or get less? In my mind, that's a

poisonous approach to assessing the success of an important national program. Clearly this program, which is meant to deal with fiscal disparities that vary over time, cannot always give everyone more.

**What do you hear back in Alberta?**

I think one of the things this kind of very strident bargaining has done is undermine the confidence of Canadians in the program. Certainly we hear voices in Alberta that say: Why do we have this program at all? Albertans need to understand that if we don't find ways of supporting the delivery of social programs by provinces, then inevitably Canadians are going to demand that Ottawa intervene more directly to ensure quality services for all Canadians. And I don't think that's a formula for success in a large, geographically disparate country like Canada.

**In Saskatchewan, we are given very different messages from our federal and our provincial representatives. How can the public make sense of it?**

Coming from Alberta, I understand the historic sensitivity about resource revenues, but I think Saskatchewan people need to kind of look at what the basic nature of this program is. They shouldn't judge the program's effectiveness on whether it sends money to Regina or not. Over the years, Saskatchewan has been a strong supporter of a national Equalization program, and has historically recognized that in good times they would get less or no Equalization payments, and in bad times they would get greater payments.

**Are you satisfied the panel's thinking will prevail?**

At the end of the day all five panel members were in complete agreement, which surprised us—being five economists. We felt confident we'd come to the best recommendations we could based on all the input we'd received. Our hope was to get to a formula that stuck to some basic principles and could be applied nationally. I'm really hopeful that will be the result.

I'm not a political scientist by any means. I think this program is important. I think the governments are committed to trying to make the program work fairly for all Canadians. And I'm confident they'll be successful over time. ➤