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Abstract: Since the last one decade or so equalization transfer programme has been a principal source of dispute between federal and provincial governments and among provinces. It has become politically controversial given the lack of predictability, accountability and adhoc change in the formula and use of transfer for electoral purpose, among others. Resource federalism has become another major challenge as provinces are now strongly divided between those that possess natural resources and those that do not. Unlike earlier, the major proportion of Canadian population today resides in equalization receiving have-not provinces. This has had profound consequence on fiscal federalism. The very nature of equalization programme and institution of executive federalism through which transfer is operated are highly politicized. The idea of having a non-partisan and independent body responsible for determining and allocating equalization transfers is resisted by both orders of government. The paper examines these challenges.

1. Introduction:

Canada has one of the most developed federal-provincial transfer systems in the world. Equalization transfer programme is its major element. According to Joe Clark (Former Prime Minister of Canada) equalization along with pensions and medicare as programmes, "confirmed that we are a society as well as geography" (as cited by Cowan, 2014). Formula through which equalization transfer is made is quite complex. Commenting on its complexity expert panel on Equalization and Territorial Formula Financing stated: "….Equalization has been largely ignored by the vast majority of Canadians and it is understood by only a select few academics, experts, and finance officials across the country" (Expert Panel on Equalization and Territorial Formula Financing, 2006). Since the last one decade or so equalization transfer programme remains a principal source of dispute between federal and provincial governments and among provinces. Although equalization transfer became key political issue, yet few scholars have paid systematic attention to the political dimensions of Canada's federal equalization programme (Lecours and Be'land, 2012, 569). This is so because most of the scholars examined equalization transfers from the perspectives of the first generation theory (FGT) of fiscal federalism. Being mostly public finance economists they also confine themselves to economic aspects and analyses most of the problems of fiscal federalism in near isolation from political dynamics of federalism. They assume governments (both federal and provincial) as benevolent and maximiser of public welfare functions. The second generation scholars of fiscal federalism, on the other hand, contend that if given opportunity, government may involve in ‘rent-seeking activities’. The second generation theory (SGT) has emphasised on the incentives created by political process and institution. Second generation theorists have studied two different effects of inter-governmental transfers: incentive of federal government to make transfers of funds; and the incentives these funds create for sub-national governments (Weingast, 1995, Rodden 2002, Wibbels, 2001; 2002). Simply put, government being political actor acts according to incentive or disincentive created by political process and institution. For example a minority government at federal level would tend to make more transfers to provinces that help it to survive. Similarly, provincial governments being political actors would like to extract as much transfers as possible from the federal government. Second generation scholars of fiscal federalism therefore focus on designing institution for making transfers in such a manner that incentivises both order of government (Jha, 2007).

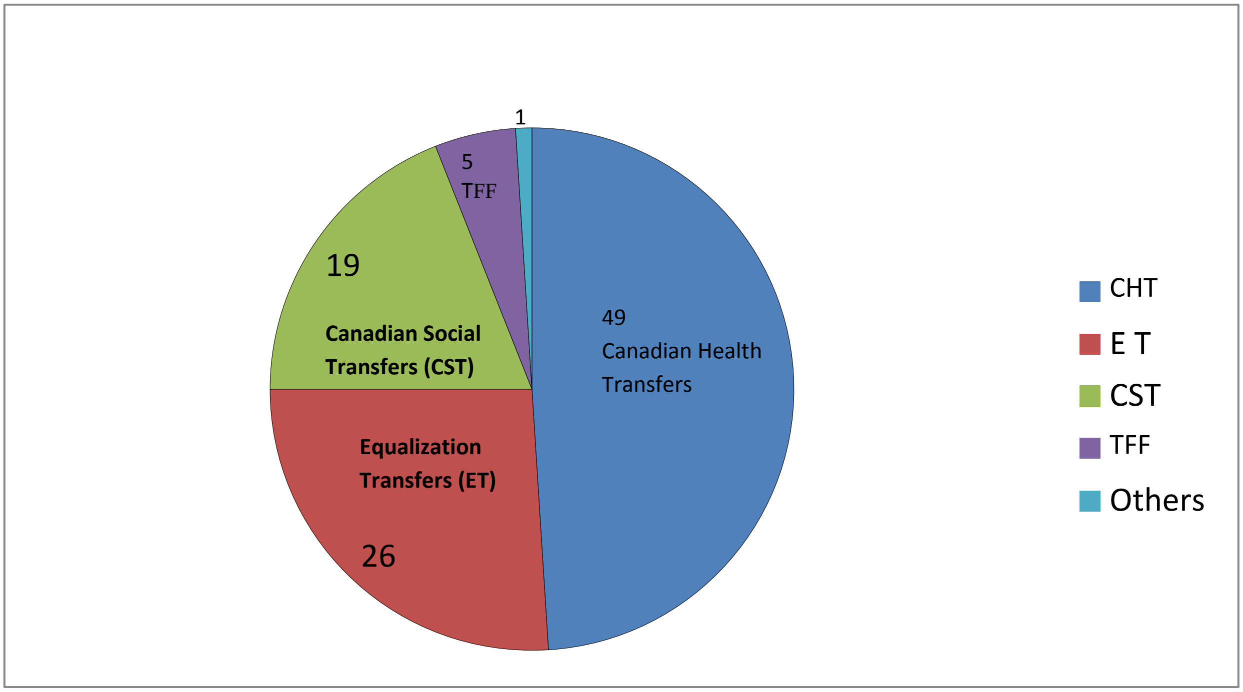
The equalisation transfer programme has historically played a major role in the development of low income provinces in Canada. Out of the four major inter-governmental transfers, equalisation transfer is constitutional while rest of them are non-constitutional transfers.[1] Equalization transfer is unconditional transfer as it is made unconditionally to the low-income provinces based on their tax capacities and are aimed at making all provinces capable of financing some minimum national standard of public services (See Chart 1). Equalisation transfer is determined by federal government on the basis of a formula decided by the federal government with extensive consultation with provinces. Arguably rich provinces, also known as ‘the haves’, contribute to equalization transfer whereas poor provinces (‘the have-not’) receive the transfer. There has been a great deal of consensus among provinces and citizen over equalization (Mendelsohn, 2002, 41). It is also evident from its continuance over five decades.

[1] They include Canadian Social Transfers (CST), Canadian Health Transfers (HST), Territorial Formula Financing (TFF) and Equalisation Transfers

However, of late, the divide between the resource-rich ‘haves’ and the resource-poor ‘haves-not’ provinces has become intense. Most of the studies/researches on equalisation transfers have been done by economists from the perspectives of first generation theory of fiscal federalism (FGT) which advocates determination and allocation of equalization and other intergovernmental transfers across jurisdictions on the basis of formula. But even formula-based programme as Canadian equalization illustrates, is susceptible to political influences, through adhoc changes in the formula. It is important for scholars of fiscal federalism to understand how political forces influence the design and evolution of transfer programme. First generation theorists however fail to capture the political motivation behind transfers, incentive etc. The paper argues that second generation theory (SGT) of Fiscal federalism-- that had contributions also from political scientists-- is much more useful to the understanding of challenges emanating from equalization transfer system in Canada (Weingast, 1995, Rodden 2002, Wibbels, 2001; 2002)[2]. One leading scholar on federalism has observed: “Intergovernmental financial arrangements are therefore not simply technical adjustments but inevitably the result of political compromise. Thus, understanding of intergovernmental financial relations requires an understanding of the political context within which they occur” (Watts, 2003, 2). Second generation scholars apart from dealing with political dimension and political motivation of transfer have also focused upon re-designing the intergovernmental transfers in ways that can safeguard them against political interference. Protection against the influence of politics is considered vital in maximizing the efficiency and retaining credibility of the transfers. The motivation for the study is scarcity of work in Canada on equalization programme from the perspectives of the second generation theory of fiscal federalism (Jha, 2007; Lecours and Beland, 2010, 569; Jaonai, 2014b).

[2] Political Scientists like Weingast, Rodden, Wibbels etc. have contributed to the second generation scholarship of fiscal federalism.

Chart 1: Federal Transfers to Provinces and Territories, 2014-15



Sources: Finance Canada (2014), Government of Canada, URL: http://www.fin.gc.ca/fedprov/mtp-eng.asp

2. Overview of Equalisation Transfers

There is a great deal of literature on economic basis of equalization. Economic justification of the programme is based on the problem of inter-jurisdictional spillover. Economists working in the area of fiscal federalism argue that without equalization, economically stronger provinces/states would be able to offer significantly lower taxes, thus would entice skilled workers and businesses from economically disadvantaged provinces with higher taxes. Weaker provinces would feel the need to compete by lowering taxes. Further weaker province would be inclined to under-invest in the development of skilled workers because such workers might be lured away by the higher wages and/or lower taxes of a economically stronger province. Consequently, the quality of life in the financially weak provinces would decline (Oates, 1999; Ahmad, 1997). Other rationales for equalization are constitutional, political, social and moral.

There are certain public goods and services to which all Canadians, no matter where they may live, are equally entitled as a right of citizenship. Equalization transfers are necessary to enable all provinces, especially the less affluent, to offer such services (Milne, 1998, 185). Canada is distinct from other federal countries given the fact that equalization transfers are included in the Constitution. Thus the federal government is under constitutional obligation to make equalization transfers to provinces. Another very important basis for the equalization transfers is the nation-building or holding federation together (Black and Silver, 2004, 5-7). According to David Milne "equalization should also be justified on moral grounds, as a question of decency and social justice" (Milne, 1998, 186). A survey research found very strong support for the equalization programme nationwide, even in the 'have provinces' that do not receive transfers (Mendelsohn, 2002, 41). Above mentioned rationales and objectives of transfers may be held hostage by political forces. Before discussing these and related issues, let us make an overview of equalization transfers in Canada.

The equalization programme has undergone several changes since its inception in 1957. While there is equalization of provincial fiscal capacity, expenditure needs of provinces are not equalised. Given its importance, equalization transfer programme has also been incorporated in the constitutional Act of 1982 which proclaims: (i) that the national government and Parliament and the provincial governments and legislatures "are committed to promoting equal opportunities for the well-being of Canadians, furthering economic development to reduce disparities in opportunities, and providing essential public services of reasonable quality to all Canadians"; and (ii) that the government and Parliament of Canada "are committed to the principle of making equalization payments to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation" (Subsection 36 (2) of the Constitution Act of 1982 as cited in Boadway, 2005, 1).

Right from its institutionalization in 1957, the programme has been subject to debates as to how equalization transfer should be calculated. Two issues that have been central to this debate include calculation of the national standard and calculation of individual provincial fiscal capacities. The number of provinces forming the national standard has undergone several changes. A province’s fiscal capacity was measured against the average taxing capacity of Ontario and British Columbia (Canada’s two richest provinces at the time) in 1957. In the 1960s, the federal government changed the calculation to include all 10 provinces. Since 1967 Canada has adopted representative tax system (RTS) approach in determining amount of equalization transfers. Under RTS, the amount of equalization that a province receives is determined by reference to (i) that province’s own-source per capita revenue capacity and (ii) a standard level of per capita revenue capacity. In 1982, the federal government removed both Alberta and the poorer provinces from the calculation. The national standard was thus based on the average taxing capacity of five middle-income provinces – British Columbia, Ontario, Saskatchewan, Manitoba and Quebec**.** In 2007, the Conservative government under Prime Minister Harper introduced significant reforms to the equalization programme. Under new system, national standard was based on the average fiscal capacities of all 10 provinces. In order to deal with problems emanating from resource rich provinces, the new system includes only 50 per cent of provincial resource revenues in calculations of the national standard. The new equalization arrangement significantly reduced the number of items used to determine a province’s fiscal capacity. Instead of taking into account 33 different types of provincial revenues, the equalization system was based on only five types of provincial revenues: personal income tax, business income tax, consumption tax, property tax and natural resources. The federal government reintroduced a formula-based approach to equalization, replacing the fixed-sum programme that had been in place since 2004. Further, the fiscal capacity cap was introduced in 2007 in order to limit eligible provinces’ per capita transfers. The cap was introduced because of the impact that partial exclusion of natural resource revenues can have on provincial fiscal capacities (Chassin 2012).

Further in 2009, the federal government changed the equalization formula by adding a ‘ceiling’ in order to limit the total amount of equalization transfers. At that time, Ontario – Canada’s most populous province – was about to become an equalization-receiving province. With the adoption of ceiling, the total amount of equalization transfers is no longer formula-driven and does not vary in accordance with changes in fiscal disparities among the provinces. Since 2009, the total amount of equalization transfers has grown annually in accordance with a three year moving average rate of growth in Canada's nominal gross domestic product (GDP). A province's equalization in any given year is based on a weighted three year moving average, lagged by two years. For example, the actual payment for a province in 2013–2014 is the sum of 50 per cent of its payment for 2011–2012, 25 per cent of its payment for 2010–2011 and 25 per cent of its payment for 2009–2010. This weighted moving average was introduced in 2007 to stabilize year-to-year fluctuations in provincial equalization transfers, and thus to address the volatility and uncertainty that was a feature of the pre-2004 formula. Under the pre-2004 formula, the frequent revision of equalization transfers made it difficult for provincial governments to plan their budget (Parliament of Canada, 2013).

Table 1 shows equalization transfers from the federal government to provinces from 2000-2001 to 2014-2015. Alberta is the only province that has not got any amount during this period, while Prince Edward Island (PEI), Nova Scotia, New Brunswick, Manitoba and Québec have received the transfers every year. On average Québec has received about 55 per cent of the federal equalization transfers. The Saskatchewan and British Columbia have received the transfers from 2001-02 to 2006-07. From 2010-11 to 2013-14, the amounts received by Québec have declined, while Ontario's have increased. Recent data of 2014-15, however, shows decline in amount received by Ontario and significant rise of equalization payment of Quebec. This happened because of change in the equalization formula. In 2014-15, C$16.7 billion in equalization transfers were made to six provinces -- Prince Edward Island, Nova Scotia, New Brunswick, Quebec, Ontario and Manitoba.

Table 1: Equalization Transfers from 2000-01 to 2014-15
(C$ Million)

YEAR	NL	PEI	NS	NB	QC	ON	MB	SK	AB	BC	TOTAL
2000-01	1,112	269	1,404	1,260	5,380	0	1,314	208	0	0	10,948
2001-02	1,055	256	1,315	1,202	4,679	0	1,362	200	0	240	10,310
2002-03	875	235	1,122	1,143	4,004	0	1,303	106	0	71	8,859
2003-04	766	232	1,130	1,142	3,764	0	1,336	0	0	320	8,690
2004-05	762	277	1,313	1,326	4,155	0	1,607	652	0	682	10,774
2005-06	861	277	1,344	1,348	4,798	0	1,601	89	0	590	10,907
2006-07	687	291	1,386	1,451	5,539	0	1,709	13	0	459	11,535
2007-08	477	294	1,465	1,477	7,160	0	1,826	226	0	0	12,925
2008-09	0	322	1,465	1,584	8,028	0	2,063	0	0	0	13,462
2009-10	0	340	1,391	1,689	8,355	347	2,063	0	0	0	14,185
2010-11	0	330	1,110	1,581	8,552	972	1,826	0	0	0	14,372
2011-12	0	329	1,167	1,483	7,815	2,200	1,666	0	0	0	14,659

2012-13	0	337	1,268	1,495	7,391	3,261	1,671	0	0	0	15,423
2013-14	0	340	1,458	1,513	7,833	3,169	1,792	0	0	0	16,105
2014-15	0	360	1,619	1,666	9,286	1,988	1,750	0	0	0	16,669

Source: Finance Canada, Government of Canada, URL: http://www.fin.gc.ca/fedprov/mtp-eng.asp

Table 2 shows that with the change in formula in 2014, Quebec's share of equalization has increased significantly. Ontario's equalization share considerably declined in 2014-15 due to change in formula.

Table 2: Changes in Equalization Transfers since 2013-14 Onwards (C$ Millions)

Provinces	2013-14	2014-15	% Change
NL	0.0	0.0	0
PEI	339.5	359.8	6.0%
NS	1457.9	1619.5	11.1%
NB	1513.1	1666.0	10.1%
QC	7833.0	9285.7	18.5%
ON	3169.4	1988.4	-37.3%
MB	1792.3	1749.9	-2.4%
SK	0.0	0.0	-
AL	0.0	0.0	-
BC	0.0	0.0	-

Source: Parliament Budget Officer (2014, 4), "2014-15 Federal Transfers to Provinces and Territories", Ottawa: Government of Canada, 19 June, URL: http://www.pbo-dpb.gc.ca/files/files/TransferPayments_EN.pdf

Table 3 shows the amounts received by provinces on per capita basis. While Québec received the largest amount, this is not so on a per capita basis; Ontario has received very less in 2014-15 compared to previous year. In per capita terms, the three Maritime Provinces are the principal beneficiaries because they are the least wealthy.

Table 3: Changes in Equalization on per capita basis from 2013-14 onwards (C$ Millions)

Provinces	2013-14	2014-15	% Change
NL	0.0	0.0	-
PEI	2339.3	2477.6	5.9%
NS	1549.2	1728.1	11.5%
NB	2001.4	2205.8	10.2%
QC	961.5	1129.7	17.5%
ON	234.4	145.7	-37.8%
MB	1418.2	1367.4	-3.6%

SK	0.0	0.0	-
AL	0.0	0.0	-
BC	0.0	0.0	-

Source: Parliament Budget Officer (2014, 4), “2014-15 Federal Transfers to Provinces and Territories”, Ottawa: Government of Canada, 19 June, URL: http://www.pbo-dpb.gc.ca/files/files/TransferPayments_EN.pdf

Equalization transfers have played significant role in the reduction of regional economic disparities in Canada. Canada is also known for having “maintained one of the simplest, most elegant, principled, and purpose-driven intergovernmental finance systems in the world” (as cited in Leuprecht, 2007, 259). Equalisation programme has also been subject to numerous criticisms. Some of the criticisms have been longstanding ones; some are politically controversial and recent ones. A major longstanding shortcoming of the transfers is that only differences in tax capacity of provinces are equalised. It does not give any consideration to differences in expenditures of provinces that arise due to differences in needs or costs. For example, differences in need may arise due to demographic features of a province (Brown, 1996). Similarly, costs of providing services may differ from one province to other due to geographic features. Equalisation transfers, not based on expenditure needs of provinces, are not constitutional. Clark (1998, 104) points out that constitutional commitment to equalisation suggests not only equalisation of ‘fiscal capacities’ of provinces but also ’expenditure needs’ in determining their equalisation entitlements. The cost of service delivery in poorer regions is usually cheaper than in more affluent ones, since wages and the cost of social and educational services tend to be lower, as the incentive for immigrants to settle in such areas is lower (Gusen, 2012).

Equalisation programme has also been attacked for creating perverse incentive, i.e., ‘tax back effect’. It has been observed that an increase in economic activity in a province results in a more or less significant reduction in equalization transfers to the province. Interestingly, this is consistent with the programme’s objective: a decrease in a province’s relative poverty should result in a decrease in transfers under the programme designed to offset poverty. This is called the ‘tax back effect’. The so-called ‘tax back effect’ can potentially make it less interesting for provinces receiving equalization to implement measures to stimulate their economic development. For example, Newfoundland and Nova Scotia have, in the past, clearly expressed their concerns that development of their offshore oil and natural gas resources would generate little net benefit for their provinces because of so called 'tax back effect' of the equalization (Boadway, 2005). Similarly, Saskatchewan, a have-not province, had argued that the equalization programme overstates the province's wealth, or fiscal capacity, from the production of non-renewable resources. Courchene (2004, 2) argues that "Canada's equalization programme has more than fully confiscated Saskatchewan's energy revenues".

Mackinnon (2011) has come up with some astonishing evidence of the negative implication of equalization transfer programme. According to him on average Alberta, Ontario and British Columbia have 24 per cent fewer registered nurses for every 100000 people than the equalizing receiving provinces of New Brunswick, PEA, Nova Scotia and Manitoba. Known as economic engines that drive the Canadian economy, Alberta, Ontario and British Columbia have lowest number of nursing home beds per capita. Mackinnon further states that Quebec the largest recipient of equalization transfers (over 50 per cent of the total equalization transfers) subsidises day care at the rate of C$7 per day and has the lowest university tuition fees among all provinces. On the other hand Ontario has the least accessible public sector of all Canadian provinces. He further argues that equalization transfer programme has created the culture of dependency for the have-not provinces.

Another major longstanding problem associated with equalisation transfers, is that transfers provide lack of predictability to the provinces. Though provinces are consulted on regular basis, however, it is Ottawa which has the final word. It has been observed that several times in Canadian history federal government had unilaterally reduced the transfers inviting provincial rebuke and in the process causing over politicization of equalization programme--an issues discussed at length in other section. Since 2004, equalisation transfers are also plagued with adhoc approach, introduction to new framework, ceiling, fiscal capacity cap, change in weightage given to revenue from provincial natural resources and side deal with some provinces departing thereby from principled approach. In fact, of all the issues involved in equalization programme, the treatment of resource revenues in the equalization formula is the most controversial.

3. Resources Federalism and Equalization Transfers

Provinces in Canada own, manage and tax their natural resources, and raise most of their own revenues. This leads to large differences in provincial fiscal capacities. As has been discussed earlier, the federal government is constitutionally bound to address fiscal disparities among the provinces. The federal equalization programme is the main instrument to deal with these disparities. The natural resources of provinces have arguably been the major source of difficulty in the proper implementation of Canadian equalization programme. At present, natural resources have come to occupy an important place in Canadian economy. The difference in the availability of natural resources among the provinces and the instable nature of their prices remain the major concern. The big challenge before Canadian transfer system, therefore, is how to transform these unstable revenues into more stable revenues for the purpose of equalization.

There are two schools, i.e., province-centric and citizen-centric in Canada. The former subscribes to the view that since natural resources belong to the provinces and therefore they should alone benefit from these resources on the behalf of their citizens. The latter posits that revenues from the natural resources are like any other revenues that serve to finance services to the citizens; therefore there is no reason to treat them differently. The degree of inclusion of natural resources in equalization formula has varied with the weight given to these two opposing schools of thought. It is truism to say that the degree of inclusion of revenue from natural resources influence the provinces in developing their resources. Differences in the availability of natural resources among the provinces propel the need for redistribution on the part of federal government. Because resource revenues are concentrated in three provinces namely Newfoundland and Labrador, Saskatchewan and Alberta, the inclusion rate for resource revenues in the equalization formula has a major impact on total equalization entitlements. For example in 2011-12, total equalization entitlements would have been C$24.2 billion with a 100 per cent inclusion rate, instead of C$17.8 billion with the 50 per cent inclusion rate that was used. Thus inclusion rate of natural resources in equalization formula is perennial issue (Dahlby, 2014). "In the past, there has been an effort to include 100 per cent of resource revenues in the equalization calculation formula, as opposed to 50 per cent at present. It would be little surprising to see such attempts occur again in the future, especially as Ontario is now in the 'have-not' category" (Mike, 2014, 7).

Another major issue is increasing the size of equalization receiving provinces. Since 2008-09 the share in population of the 'have-not' provinces requiring transfers is relatively large compared to the share in population of the 'have' provinces. Hence, it can be argued that in such scenario the task of redistribution is difficult. Before 2008-09 the population of the have provinces are quite large, compared to have-not provinces, the task of redistribution can be more easily handled (See Table 4).

Table 4: Have and Have-not Provinces

Before 2008-2009		
Have Provinces	British Columbia, Alberta, Saskatchewan, Ontario, and Newfoundland & Labrador	68% of the population
Have-not Provinces or equalizing receiving	Prince Edward Island, Nova Scotia, New Brunswick, Quebec, and Manitoba	32% of the population
After 2009-2000		
Have Provinces	British Columbia, Alberta, Saskatchewan, and Newfoundland & Labrador	30 % of population
Have-not Provinces or equalizing receiving	Ontario, Prince Edward Island, Nova Scotia, New Brunswick, Quebec, and Manitoba	70 % of population

Source: Adapted from Milke, Mark, *(*2014, 4), "Equalization, Ontario, and the Politics of Division", *Fraser Institute Bulletin*, URL: http://www.fraserinstitute.org/uploadedFiles/fraser-ca/Content/research-news/research/publications/equalization-ontario-and-the-politics-of-division.pdf

Being over-politicized, federal equalization transfer programme in recent time has come to be understood as a programme that transfers income from taxpayers in 'the have' provinces to the 'the have-not' provinces. The resource-rich provinces would always prefer non-inclusion of revenue from their natural resources or less weightage given to it in the equalization formula. 'The have-not' provinces favour inclusion of natural resources because this would give them more equalization transfers. The treatment of provincial governments' resource revenues thus is a never-ending issue in the design of the equalization programme. Before 2009 when Ontario was not an equalization receiving province, it was a stabilizing factor for the Canadian equalization programme due to the size of its economy and the lesser role that natural resources play in this province's economy. With the increase in the size of equalization receiving provinces with inclusion of Ontario --having 40 per cent of the total population of Canada and 40 per cent of GDP -- political importance as well as visibility of programme have increased.

According to Bernard (2012) the revenue of western provinces is more variable given their dependency in natural resources. This in turn leads to a greater variability in equalization transfers. Further, Ottawa's revenues are also subject to the variability of resource prices. "This new era of increased dependence on natural resources will be a source of tension between the federal government and the receiving provinces; also between the 'have' provinces and the 'have-not' provinces. As owners of the natural resources, the provinces that draw revenues from them are not inclined to share their rents with the other members of the federation which are less well off" (Bernard 2012, 16).There is thus growing realisation among provinces with non-renewal resources that including their resources into the calculation of provincial fiscal capacity was highly unfair. Aside from controversies surrounding resource federalism, equalization transfers are highly politicized thanks to Canada's executive federalism.

4. Executive Federalism and Equalization Transfers

While there is strong executive federalism, legislative federalism in Canada is very weak. The combination of strong executive federalism and weak legislative federalism gives political and electoral incentives to federal and provincial executive to negotiate any change in equalization transfer programme. Therefore, the programme becomes highly politicized. Further, first-past-the- post electoral system and confederal nature of political parties strengthen executives at both levels.[3] Therefore, equalization transfers are highly politicized and are seen as a tool to reward some provinces or punish others.

[3] In Canada, senators are not elected; they are appointed by the federal executive for life time. This, in the opinion of Cameron and Simeon, has two consequences for Canadian federalism. First, these unelected senators are not in a position to compete with the provincial premiers as spokespersons for their provinces. Second, since senators are appointed by the federal executive branch, rather than executive branches or legislatures of the constituent entities.

Furthermore, very low level of citizen's participation in public affairs is attributed to executive federalism. This adds to undue secrecy in the conduct of the public business and weakens the accountability of governments to their legislatures and to the people. This is further compounded by the low level of public understanding of equalization programme due to its complex formula. Thus central characteristic of intergovernmental relations in Canada is its executive dominated character (Cameron and Simeon, 2002, 292). A leading authority on Canadian federalism argued:

> The regionalisation of the party system is reinforced by the effects of the electoral system, which exaggerates the seats won by narrow regionally-based parties, and weakens parties whose support is spread more nationally. The result is that major parts of the country feel frozen out of power at the federal level: they are not represented in the governing party, where authority is concentrated; and the opposition parties they do support are virtually powerless in the parliamentary system. It is not surprising, then, that citizens turn to their provincial governments as the ones that better represent them, and support their efforts to defend provincial interests in the arena of executive federalism (Simeon, 2001).

Thus the executive dominated character of intergovernmental relations in Canada explains the highly politicized nature of equalization transfers (Cameron and Simeon, 2002, 292). Following second generation scholarship on fiscal federalism, one can argue that over politicization of equalization transfers helps both orders of government. Provinces and federal government act rationally as they have their own political objectives. They seek to maximize their own political gain first instead of thinking the welfare of society as a whole. Politicization of programme can be understood in the context of institutional structure within which the programme operates as well as the dynamics of Canadian federalism. As has been discussed, Canada's federal

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Inter-governmental relations in Canada consequently take place between executives that are clearly distinct and that are not institutionally linked to Parliament. In Canada, political parties are 'confederal' in nature. Federal and provincial parties, even of the same name, are distinct from each other. The pressures for party discipline within each government have created separate federal and provincial branch of parties into more autonomous layers of party organization (Cameron and Simeon, 2002, 292).

institutional arrangements support politicization of equalization policy because provincial leaders can exert pressure on the federal government to amend the programme to their advantage. Provinces are quite aware of their potential to exert influence on the design of equalization. This awareness is reflected by the provincial opposition to have an independent non-partisan institution. According to Lecours and Beland (2010), reform in equalization formula is seen in terms of federal government choosing provincial ‘winners’ and ‘losers’. Provinces whose leaders think that their provinces are losers vehemently attack federal government. As far as the federal government is concerned, its promises, or decisions on equalization transfers, are often guided less by economics and more by political considerations. It is evident from the fact that reform in equalization formula in 2007, leading to significant rise in transfers of Quebec, was announced a week before election there. This was clearly seen as a move by the minority Conservative government, not only to help a federalist ally in Quebec, but also to get the Quebec ‘soft’ nationalist vote that could help the Conservatives form a majority government at the next election (Stevenson 2007; Lecours and Beland, 2010).

In October 2004, the Martin government introduced the ‘New Framework to Equalization’ reform that set the fixed-pool sum for equalization at a minimum of C$10 billion. It became a source of political problems for the Martin government as the resource-rich provinces did not like the inclusion of non-renewable resources into the calculation of provincial fiscal capacity for equalization. Martin had to sign Offshore Accords with Newfoundland and Nova Scotia providing full compensation to them for any reduction in equalization transfers resulting from increased revenue linked to offshore resources.[4] As a result Newfoundland, an equalization receiving province, had a higher fiscal capacity after equalization transfer than Ontario, a non-recipient province at that time.

[4] During the 2004 First Ministers Conference, then Prime Minister Paul Martin met with the provincial Premiers as part of his election promise to negotiate changes to the equalization programme, Newfoundland & Labrador Premier, attacked the PM for not keeping his election promise to allow Newfoundland & Labrador to retain 100 per cent of their oil and gas revenues – without decreasing their equalization payments in any way. Premier of Newfoundland & Labrador even had gone to the extent of ordering the removal of Canadian flags from buildings of province in protest. In early 2005, federal government made peace by making a lucrative side deal that entitled the province to keep 100 per cent of their resource revenue for eight years. Another Atlantic province, Nova Scotia, managed to have a similar eight year agreement with Ottawa. What followed was demand by Canada’s Northwest Territories for the similar preferential treatment, followed shortly by Saskatchewan, Quebec, and even Ontario.

In 2006, Stephen Harper a conservative prime ministerial candidate decided to make equalization a political issue during his election campaign in order to gain electoral support in resource rich provinces such as Newfoundland, Nova Scotia, and Saskatchewan. He promised not to include revenues from non-renewable resources and adopt a 10 province standard in a revised equalization formula. But after coming to power, when he chose not do so, resource rich provinces forcefully attacked federal government. Newfoundland & Labrador warned the federal government of “dire consequences”. Nova Scotia strongly objected to change in formula; British Columbia voiced concerns in fear of losing eligibility. Alberta and Saskatchewan condemned Harper for not fulfilling his promise to exclude all revenue resources from the equalization formula. (Stevenson 2007, 12-13).

As has been discussed earlier, federal government added in 2009 a ceiling to the equalization programme in order to ensure that growth in the total amount of equalization transfers remains sustainable in the future. Premier of Ontario argued that ceiling was introduced to reduce the transfer of Ontario that was eligible to become equalization receiving province for the first time. Smart (2009) argues: “The entry of Ontario to the program and its simultaneous restraint are obviously no coincidence: without changes to the formula, paying Equalization to a province as large as Ontario has the potential to be very expensive for the federal government.” Although in Canada’s executives led intergovernmental framework, there has been a great deal of consultation between federal government and provinces yet it is the former who has the last word. This apart, the federal government has other mechanisms at its disposal. It can control the cost of the equalization programme both by changing the resource revenue inclusion rate and by imposing a ceiling on the total cost of the equalization programme. According to a report, the ceiling contained in current equalization policy effectively reduces equalization transfers to the provinces by C$1.3 billion in 2014-15, and limits future increases to the annual GDP growth rate. This effectively turns the equalization grant system into a zero-sum game. When one province’s equalization entitlement goes up because of a decline in its tax bases or revenue sources, the other provinces’ equalization payments are reduced. For example, a recent report from the Parliamentary Budget Officer indicates that, because of the ceiling on total equalization payments, the Quebec government's decision to shut down its Gentilly-2 nuclear power plant reduced Ontario's equalization payments by C$161.7 million (Parliamentary Budget Officer's Report, 2014).

Change in equalization transfers formula in 2014 is seen in terms of federal government choosing 'losers' and 'winners'. 'The have' provinces led by Alberta remains extremely critical of inclusion of revenue from natural resources. Ontario a 'have-not' province vehemently attacked federal government for loosing transfers. During her election speech in 2014, Ontario's premier, Ms. Wynne argued that "Mr. Harper deserves some of the blame for this turn of events. He first adopted an equalization formula that favoured Quebec in the (unrealized) hope of winning votes there. He then capped the rate of growth in the equalization kitty, creating a zero-sum game that means Quebec's gains become Ontario's losses" (Yakabuski, 2014). Ironically, in 2008, while Ontario was a 'have' province, McGuinty argued it was time to kill the equalization programme. "The way the federal government spreads money around this country - all the formulas, the calculations, the transfers - all have one core assumption: Ontario's rich and the others are not. Well that just isn't the case anymore. Ontario is strong and others are strong, too," McGuinty further argued. "To speak of 'have' and 'have-not' provinces in 2008 makes no sense. We're a nation of haves these days" (Shuffelt, 2008).

What follows from the discussion is that the executive federalism in Canada concentrates power in the hand of federal executives and provincial executives. Both orders of government have advantages to over-politicize equalization transfers for political or electoral gain. Federal government by changing formula can create 'losers' and 'winners' and later enter into side deal with 'losers'. Provinces can shift the blame for poor service delivery to less equalization transfers from federal government. Garth Stevenson (2007, 2) argues:

> …..it is far easier and more convenient to attribute the deficiencies of one's highways, hospitals, universities or schools to the distant federal government, which is generally inhibited by constitutional propriety and self respect from responding to the verbal abuse that is thrown in its direction, than it is to repair the deficiencies. Blaming other provincial governments is more hazardous, since they are more likely to take offence, and since their cooperation may be required subsequently in the endless battle to win concessions from "Ottawa".

Stevenson (2007, 2-3) further argues: "However, even that may be more convenient than admitting that the source of the province's problems might lie within its own borders, or even within the walls of its legislature. Thus it is unlikely that provincial grumbling over fiscal federalism would ever cease, even if the system were to approach perfection".

An independent institution like Australian Commonwealth grant Commission or Indian Finance Commission would be quite useful but neither federal government nor provinces are interested because that will be disadvantageous to them. An independent body can prevent political deal-making, can address issues in a transparent manner. In fact, the majority of provinces reject the idea of replacing the intergovernmental process with an independent, arms-length agency. Federal governments too do not support the idea of having an arms-length body. Provincial premiers believe such independent and non-political body would prevent them from negotiating equalization with federal government directly and would pose threat to provincial autonomy. "A strong nationalist movement in Quebec and 'regionalism' (or 'provincialism') in Alberta, Newfoundland and Labrador, and other provinces however, means that the idea of provincial autonomy in Canada is understood to involve provincial agency that can negotiate deal with federal government" (Be´land and Lecours, 2011, 208-09). Provinces feel that they can exert direct influence on equalization policy in current form and are, for that reason is not willing to surrender that for a non-partisan, independent and more technocratic system where they would have little scope to influence the programme in their favour by means of political bargaining. Federal leaders appear to subscribe to the idea that the current equalization policy is advantageous to them and they can make political gains during election. Consequently, federal politicians do not find in their interest to abandon any direct institutional control over the equalization programme by handing it over to another institution. Be´land and Lecours (2011, 209) argue: "As long as equalization remains subject to federal executive discretion, provinces have the opportunity to voice complaints about equalization decisions to a governing body concerned with politics as much as policy. Therefore, provincial governments have criticized the idea of an arms-length agency whenever it has been proposed."

5. Concluding Observation

Equalization programme -- considered as one of pillars of Canadian fiscal federalism -- has not only played an important role in reducing provincial economic disparities but also acted like the glue that holds Canadian federation together. Since the last one decade or so the glue appears to have become weaker**.** Despite massive literature on economic aspects of equalization transfer programme, literature on its political dimension in Canada is few and far between. The article has examined the challenges of equalization from the perspectives of second generation theory of fiscal federalism that focuses upon examining political motivation behind transfers and designing the institution to depoliticize it. Four factors makes Canadian equalization highly politicized: First provincial ownership of non-renewable resources and inclusion of revenue from these sources in the equalization formula; second is executive federalism that strengthens the hands of federal and provincial executives, i.e., Prime Minister and provincial Premiers; third is constitutional basis of equalization; fourth is very low level of understanding about this programme among the people.

The current equalization arrangement, that encourages extensive consultation between federal and provincial executives for determining formula for allocation of provincial transfers, appears to be advantageous to both federal and provincial governments but not to the Canadian society as whole. Federal executive can use it to its political and electoral advantage as it has the last word on design and implementation of equalization formula. Provincial executives think that the current arrangement is favourable to them as they can exert direct influence over equalization transfer. Further, they can use equalization as an excuse for poor service delivery, blame the federal government responsible for shortfall in transfers and make it an election issue. Provinces hence support reform within the excisting institutional framework. An independent and non-political body like Australian Commonwealth Grant commission or Finance Commission of India, in line with second generation scholarship of fiscal federalism that may depoliticize, eliminate the perverse incentives and increase accountability of the equalization transfer, has failed to find favour with federal and provincial governments.

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