



Ottawa should consider simplifying transfer payments and give provinces more autonomy

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VANCOUVER, BC—Canada’s system of transfer payments to the provinces should be simplified and allow increased flexibility on how revenues are used, concludes a new report published today by the Fraser Institute, an independent, non-partisan Canadian public policy think-tank.

[Federalism and Fiscal Transfers](#), is a series of essays examining the experience of four other federalist countries: Australia, Germany, Switzerland, and the United States, and how they transfer revenues from the federal government to subnational levels of government. The report aims to identify ways Canada could improve its own program of transfers to the provinces.

“Surprisingly very little attention has been given in Canada to the ways other federalist countries manage programs similar to Canada’s equalization program,” said Sean Speer, Fraser Institute associate director of fiscal studies.

One common finding was that poorer jurisdictions come to rely on the infusion of federal cash from senior governments. Consequently, they have little incentive to take action to improve their economic position through better policies, something which has also been observed in Canada.

Possible solutions the authors identify are to simplify the transfer programs and give receiving jurisdiction more autonomy in how they use federal transfers, either through block grants or untied transfers.

“Heavy-handed regulation coupled with narrowly-defined earmarked funding by senior levels of government time and again has proven to be generally ineffective by impeding innovation and slowing responsiveness,” said Jason Clemens, Fraser Institute executive vice-president and co-

editor of the study.

Specific observations from the four nations studied include:

Australia

Australia's economy is similarly structured to Canada's. However, unlike Canada, both the spending and taxing of Australian states are considered in determining equalization. Canada only assesses the taxing or revenue capacity of the provinces in calculating equalization even though the aim of equalization is to allow comparable services at comparable tax rates across the country.

"There are lessons for Canada in Australia's experience. Consideration should be given to both expenditure requirements and revenue-raising abilities when setting equalization payments," writes Stephen Kirchner, a Research Fellow with Sydney's Centre for Independent Studies and Fraser Institute senior fellow.

Germany

The German tax system incorporates transfers from well-off states to the less well-off states. This system is similar to Canada's system of equalization, although it is less complicated and receiving states are able to use the transferred revenue as they see fit. However, the German system lacks incentives for states to improve their economies.

When a state receives benefits because it is underperforming and risks losing such benefits through improvement, there are clear disincentives to improve, and that is an approach worth examining in order to avoid it," said Professor Charles Blankart of Humboldt University (Berlin) and the University of Lucerne (Switzerland), author of the essay on Germany.

Switzerland

Early evaluations of Switzerland's overhauled system of equalization have identified positive results. Fiscal capacity equalization, the main redistribution mechanism, is now based on the tax potential of the individual cantons, defined by standardized tax revenues on income, wealth, and profit in relation to taxable income and wealth.

"The reforms have improved the system of fiscal transfers in Switzerland, particularly with respect to cantonal financial autonomy," said Pierre Bessard, president and executive trustee of the Liberal Institute, Switzerland's oldest independent educational foundation.

The takeaways for Canada from the Swiss model are a clear delineation of the roles and responsibilities of the federal and cantonal governments and assessing both spending and revenue needs in calculating transfers.

United States

The United States has no formal system like equalization to transfer resources from prosperous states to less prosperous ones. Instead, the financial relationship between the federal government and the states is provided through the Grants-in-Aid system.

Many aid programs required states to match federal funds inducing excessive state spending and prompting growth in state bureaucracies.

“The ad-hoc system is made up of many federal aid programs for the states, each with their own rules and regulations, all designed to micromanage state and local activities in funded areas,” said Canadian-born Chris Edwards, Director of Tax Policy Studies at the Cato Institute and author of the U.S. essay.

“The lessons from the United States seem largely to be what to avoid. In fact, Canada can serve as something of a model for the U.S., showing ways of simplifying and improving their system of transfers to the states.”

While Canada can learn clear lessons from the experience of other nations, the report’s authors agree that more study is required to determine how best to structure any system of federal transfers to less economically-developed regions.