

Reassignment of Tax Fields and the Changing Federal Role

G.C. Ruggeri
Alberta Treasury and
University of Alberta
Edmonton, AB T6G 2H4

D. Van Wart
Alberta Treasury
Edmonton, AB

R. Howard
Alberta Treasury
Edmonton, AB

The allocation of spending responsibilities and taxing powers between orders of government is a fundamental issue in a federation. Usually cast within a constitutional framework, it is subject to periodic stresses as the federation evolves. Even when there is initial balance between revenues and expenditures for each order of government, economic forces are likely to disrupt it, so that through time a divergence between the net fiscal position of federal and provincial governments arise. Called vertical fiscal imbalance (VFI), this divergence, which is built into the fiscal structure, requires periodic correction if both orders of government are to perform effectively their constitutionally-mandated functions.

Large and increasing VFI undermine the stability of a federation. This was argued forcibly, for example, by the British Royal Commission on the Constitution, 1969-1973 (see, Government of Great Britain):

"One of the chief obstacles to the proper working of federalism in modern conditions is the impracticality of arranging a division of finance between

This paper reflects the personal views of the authors and should not be construed as representative of the position of the Alberta Treasury.

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the federal and state governments that will for any length of time satisfactorily match their respective functions under the constitution".

Traditionally, in Canada, VFI has been addressed through intergovernmental transfers. Before the 1995 federal budget, the two major instruments used for balancing purposes were the cash component of the federal block grant for health and post-secondary education under the Established Programs Financing (EPF) scheme and the matching grant under the Canada Assistance Plan (CAP). In 1994-95 those grants were estimated at \$17.5 billion, which represents 15% of federal program spending. These have been replaced by a single block transfer, the Canada Health and Social Transfer (CHST), which is allocated on the EPF funding formula.

Recent history of unilateral federal adjustments to formulas determining EPF and CAP payments indicates that federal transfers do not represent a stable and effective tool for correcting VFI which are large in magnitude and increasing over time. Eventually, conditions develop which require a realignment of taxing powers and changes to the delivery of spending programs. In our view, these conditions exist today in Canada. A timely opportunity for changing the existing approach to the correction of VFI is provided by three federal policy initiatives: the social policy review, the review of health care financing and the GST replacement.

In this paper, we concentrate on the opportunity to restore fiscal balance to the Canadian federation by a reassignment of tax fields to produce a closer dynamic match between the revenue raising capacity and spending demands of each order of government. Such a reassignment would involve an important shift in the federal role. The federal government would exercise less control and more coordination. This role is consistent with the position of Canada as a mature federation operating as a small open economy within a global market.

The Traditional Approach to the Assignment of Tax Fields

The traditional approach to the assignment of taxing powers in a federation involves the selection of a number of criteria, and the allocation of tax fields to different orders of government in accordance with these criteria. The criteria may be economic, political or legal. Well known examples of this approach are in work by Musgrave, Boadway and Bird. A recent example is provided by Ip and Mintz (1992). They evaluated the division of tax fields for each major component of the tax system with respect to five principles: efficiency, simplicity, accountability, equity and flexibility.

Under the Ip and Mintz proposal the personal income tax (PIT) would continue to be shared by the two orders of government. Taxes on corporate income and capital, currently levied by both orders of government, would

become exclusively federal. Sales tax would become the exclusive domain of the provinces, while excise taxes and duties on liquor, tobacco and motive fuels would be exclusively provincial. Specific social insurance taxes, such as the federal Unemployment Insurance and the provincial Workers' Compensation Board premiums, would remain under their current jurisdictions as self-financing funds. However, general payroll taxes and health care premiums imposed by provinces would be eliminated or limited. Ip and Mintz recommend that resource taxes be reallocated to the federal government, but concede that such a reallocation of an exclusively provincial base is unlikely. They also suggest that provinces co-occupy the industrial portion of the real property tax with municipalities, while the federal government would remain excluded. This proposed reallocation of tax fields allows the federal government to phase out all transfers to provinces under EPF and CAP.

The main shortcoming of the Ip and Mintz proposal, as well as the earlier studies, is its static framework. While recognizing the current fiscal imbalance in the Canadian federation, Ip and Mintz fail to acknowledge the built-in tendency of the existing fiscal arrangements towards a widening VFI through time. Although a certain degree of VFI may be inevitable, and even desirable, in a federation, persistent, large and widening VFI are symptoms of excessive strains in the fiscal structure of the federation. This may create economic inefficiencies and become a source of political instability. In the next two sections we provide estimates of dynamic VFI in the Canadian federal system and suggest a reassignment of tax fields which is capable of restoring vertical fiscal balance.

Dimension and Effects of VFI

Estimates of the degree of dynamic VFI for Canada are found in Ruggeri, Howard and Van Wart (1993a, 1993b). The reader is referred to those sources for methodological details. Here we summarize the main findings.

Our measure of VFI compares, for each order of government, the growth rate of expenditures that is built into the structure of existing programs in the base year with the growth rate of revenues built into the existing tax structure. Growth ratios for the detailed components of expenditures and revenues were selected from theoretical and empirical sources. Our simulations used 1993-94 as the base year and adopted assumptions consistent with consensus medium-term economic forecasts. The assumptions were 2% annual inflation, 2% annual employment growth and 1% annual productivity growth, for a nominal growth rate of 5.08% per year and a nominal interest rate of 6.58% (1.5 percentage points above the growth of nominal GDP).

As shown in Figure 1, under that scenario, the federal deficit/GDP ratio falls continuously and rapidly, generating a surplus following a balanced budget

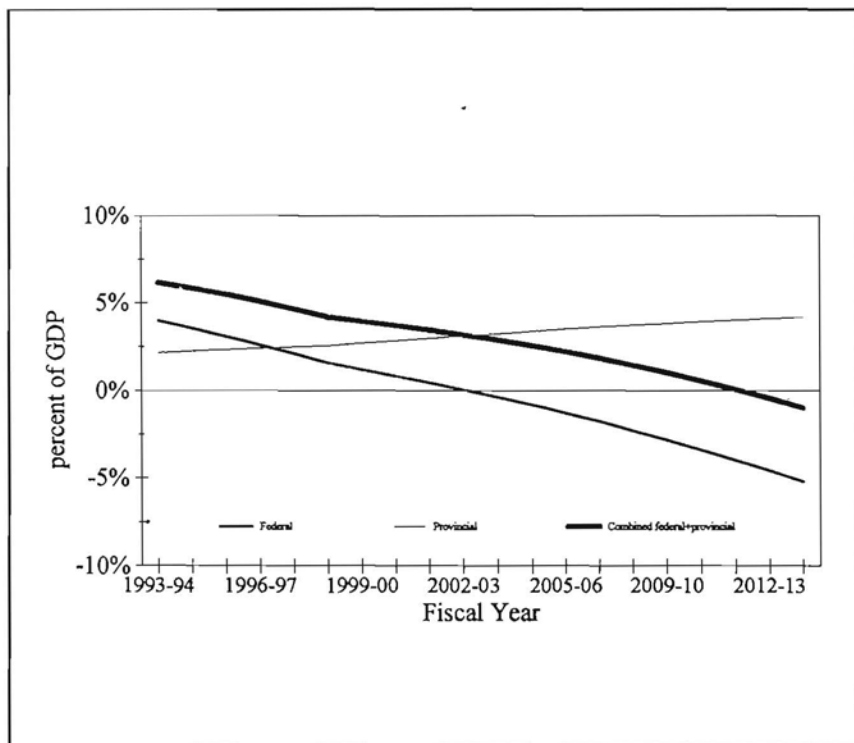


FIGURE 1 Deficit as a Percent of GDP

in 2002-03. As in Figure 2, the federal debt/GDP ratio rises for the first two years before beginning to fall at a gradually increasing rate. For the provinces, in the absence of major policy changes such as drastic spending cuts, the deficit/GDP and debt/GDP ratios will continue their current path of steady increase. The provincial deficit/GDP ratio will rise gradually and the debt/GDP ratio will more than double to almost 50% of GDP in twenty years.

Our results show that the combined federal and provincial fiscal system is structurally balanced: the combined deficit/GDP ratio continuously falls, leading to growing surpluses, while the debt/GDP ratio declines after rising slightly for 5 more years. In Canada, it is not the national fiscal structure that is dynamically unbalanced, but the relationship between the federal and provincial fiscal structures. The recent spending cuts by the provinces, and their success (with some exceptions) at balancing their budgets have temporarily masked the VFI built into the Canadian fiscal system. These changes have reduced the level of provincial spending, but have not necessarily reduced the structural growth of spending relative to the growth of revenue.

The rapidly growing VFI in the Canadian fiscal structure is driven by two

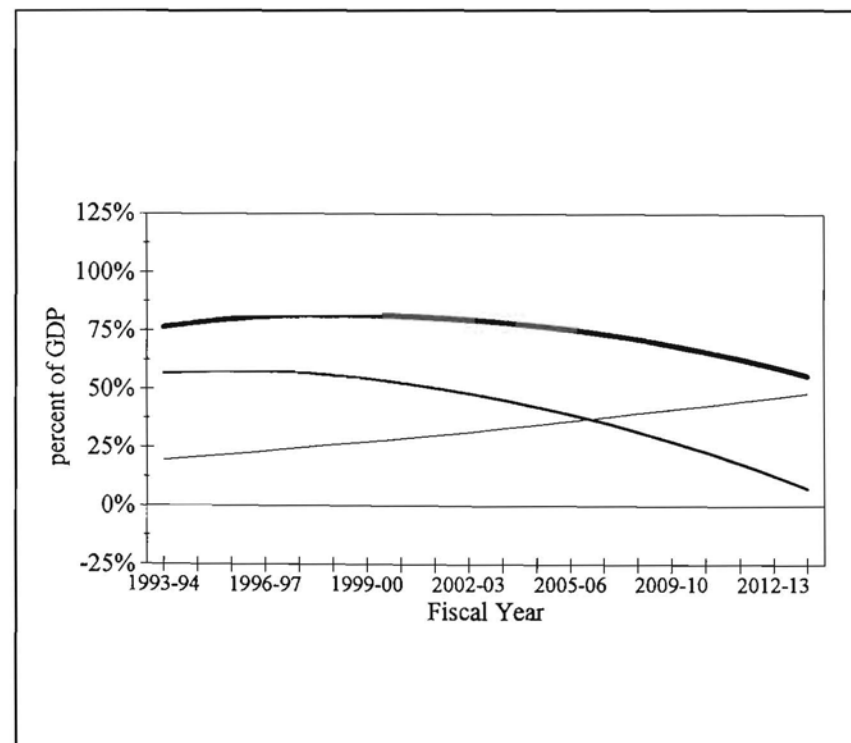


FIGURE 2 Debt as a Percent of GDP

major factors. First, the federal government dominates the only revenue source that automatically grows at a significantly faster rate than GDP, the personal income tax. Second, the provinces are responsible for spending on social programs that have a high built-in growth rate due to economic and social trends. In particular, health care is a large component of provincial expenditures and has the highest projected rate of growth of all expenditure programs because of the aging population.

Dynamic VFI may have important economic consequences. It may lead to a misallocation of resources by distorting spending priorities, and increasing federal-provincial conflicts, which impedes the coordination of desirable policy outcomes. Similar concerns have been expressed by many authors. One line of analysis has focused on the distortions in spending priorities (Gramlich 1977). A second has stressed the incentive to fiscal irresponsibility (Walsh 1993). A third has underlined the promotion and bureaucratic manipulation of fiscal illusion (Winer 1983).

Since the constitution assigns responsibility for social programs to the provinces, the provision of core social goods, such as health, education and

social services, may be unnecessarily reduced by the absence of adequate taxing power. Such pressures will not be felt at the federal level because of the built-in growth of revenue. Large and increasing VFI, therefore, will exert differential pressures on provincial and federal spending. Since spending decisions by each order of government are made separately and within the constraints of each jurisdiction's budget, the net result is likely to be a misallocation of national spending priorities.

Consider the following example. A federal proposal to increase spending for physical infrastructure must compete with proposals for spending in other federal areas, for transfers to provinces or for federal tax cuts. Viewed within the framework of federal fiscal responsibilities and accountability, provincial expenditures on social programs do not enter seriously in the deliberations. At the provincial level, proposals for reducing spending on health care and other social programs are evaluated against provincial budget items, not against federal spending on infrastructure. Because of the VFI, the federal government can afford to approve additional spending on physical infrastructure without raising taxes while provinces cannot afford to maintain current standards of health care without substantial tax increases.

The dynamics of the adjustments to widening VFI have the potential to alter the structure of the federal system in a manner which may be neither predictable nor desirable. For the provinces, the built-in mismatch of expenditure and revenue growth will generate continuous pressure for both tax increases and spending reductions. These pressures will intensify if the federal government, attempting to speed up the process of deficit elimination, reduces spending on social programs and intergovernmental transfers. For example, additional tightening of the unemployment insurance program, in the absence of stronger employment growth, would tend to increase provincial spending on social assistance. The effects of the UI reform would likely differ among regions, especially if the adjustments are made to seasonal unemployment or extended regional benefits.

Negative effects on provincial revenue will also occur if the federal Canada Health and Social Transfer (CHST), which replaced the EPF and CAP programs with a single block transfer, is allocated on a formula similar to the EPF, which leads automatically to the gradual elimination of the transfer. Such a consolidation would lead to a structure of federal transfers to provinces which includes only equalization payments.

The federal government will not face such pressures. There are three major fiscal choices after the deficit is eliminated: maintain budget surpluses to reduce the debt, reduce taxes, or increase spending. The first fiscal option may be unsustainable as the adverse effects of the imbalance in the distribution of taxing powers become apparent; it may be difficult to justify the use of federal surpluses to reduce federal debt while the provinces are forced to maintain strict spending restraint.

The pressure for transfers of funds or tax room to the provinces may be

released by reducing federal taxes. The federal government may be reluctant to follow this course because it cannot prevent provinces from occupying the tax room made available by the federal tax cut. In this case there would be an uncoordinated ad hoc transfer of tax room.

Finally, the federal surplus could be spent. The federal government may not have access to direct social spending because the federal presence in health and education spending is being reduced by reductions in transfer payments. If additional federal spending were channelled to other areas, there would be a major shift in spending priorities for the combined governments. In addition there would be an increase in the relative size of the federal government, as measured by its share of total government spending.

This potentially haphazard response to widening VFI is not the most efficient way to restore fiscal balance within the Canadian federation. Unbalanced fiscal structures should not be allowed to radically alter public spending priorities and, indirectly, to restructure the federal system. We suggest that a major change in spending priorities should be made openly through the political process, not as an unintended consequence of unbalanced fiscal structures. The potential welfare loss from the misallocation of resources that arises from misplaced spending priorities and uncoordinated policies may be particularly severe in a global economy which stresses competitiveness. Unintended consequences of unbalanced fiscal structures will also have differential regional impacts. Therefore, they affect not only spending priorities and resource allocation at a national level, but may also alter regional economic disparities. Canadians should address the existing VFI in a direct and coordinated manner, so that economic efficiency, political accountability and horizontal equity among regions can be faced openly and solved cooperatively.

Dynamically Balanced Reassignment of Tax Fields

A fundamental criterion for the rearrangement of tax fields is dynamic stability, which ensures that vertical fiscal balance is roughly maintained over the long term. Achieving dynamic stability has significant benefits for the performance of a federal system. It allows both orders of government to meet independently their constitutional spending responsibilities and it allows provinces to tailor their fiscal systems to the preferences of their residents. It also minimizes federal-provincial disputes which arise when intergovernmental transfers are largely controlled by the federal government as a result of its excessive taxing powers.

We have developed an alternative allocation of tax fields which restores fiscal balance and yields a dynamically stable division of tax fields between the federal and provincial governments. Under this alternative, the federal government would have sole occupancy of corporate, sales and excise taxes. The

provinces would retain revenues from payroll taxes and health levies, natural resources, property taxes and fees and charges, and would have sole occupancy of the PIT. With this switch of major tax fields, both the federal and provincial governments would have adequate revenue to meet their constitutionally-mandated spending responsibilities and eliminate their deficits over the medium term without increasing taxes.

By rebalancing the Canadian fiscal structure, our proposal eliminates VFI. It promotes more harmonious intergovernmental relations and supports a stronger union, as it reduces fiscally induced pressures on political institutions. Our proposal also meets the main criteria traditionally employed to determine the assignment of tax fields.

Efficiency. A single national corporate income tax, by eliminating provincial corporate tax competition, could reduce tax-induced distortions that lower both investment and national income. Sole federal control of retail sales taxes would eliminate the problems of two sales tax systems and allow the federal government to collect the full sales tax at border points. Our proposal also improves allocative efficiency within a balanced budget. It removes the distortion in public service provision created by the mismatch between taxation powers and spending responsibility.

Accountability. A clear separation of tax fields between governments enhances the visibility and accountability of a tax, increasing the public sector responsiveness to local concerns. Our proposal enhances accountability by clearly separating control over the corporate income tax, PIT and retail sales taxes and by eliminating major federal transfers.

Flexibility and Equity. Our proposal will result in increased flexibility for provincial governments and somewhat reduced flexibility for the federal government. Equity will be enhanced within the federal system by allowing the use of the important income redistributive tool of the PIT to be more closely related to the provincial distributions of income.

Simplicity. Exclusive federal control of retail sales taxation will standardize the base, allowing uniform treatment of exemptions and business inputs. Exclusive provincial control of the PIT will allow the elimination of cumbersome provincial surtaxes, flat taxes and low-income reductions that are required to meet provincial objectives under the current tax arrangements. Harmonization could be maintained by a binding agreement among provinces to use a common tax base and the establishment of a national collection agency.

Stepwise Implementation

The rebalancing proposal for tax field reassignment, outlined above, may be viewed as the polar case to the traditional view. Since it involves a major shift of tax fields between the federal and provincial governments and a dramatic

change in intergovernmental fiscal relations, it may be impractical to implement this proposal in one step. In our view, it would be more practical and prudent to implement the rebalancing proposal in stages, with the federal government ceding an increasing share of the PIT to the provinces in exchange for an increasing share of the corporate income tax and sales taxes. Intergovernmental transfers would continue to be used as an additional, though temporary, rebalancing tool.

The federal-provincial discussions on GST replacement and the financing of health care afford an excellent opportunity for implementing the first major step towards rebalancing the Canadian fiscal system. Four proposals on GST replacement have been presented by the federal and provincial Finance Ministers. They will be briefly evaluated in terms of their impact on VFI.

The proposal suggested by the Quebec government is a variant of the traditional assignment of tax fields. The federal government would vacate the general sales tax field; however, instead of acquiring additional PIT room, it would reduce its transfers to provinces. Given the magnitude of the net revenue loss to the federal government (approximately \$16 billion), the offset would involve the elimination of cash payments under CAP and EPF. This proposal has the potential to moderately reduce VFI. The provinces would gain tax room which grows approximately at the same rate as GDP; in exchange they would give up federal transfers that grow at a slower rate, primarily because of the built-in decline in the cash component of EPF. Unlike the cash transfers, whose growth rate is at the discretion of federal policy, sales tax room would be independent of federal actions. However, the modest reduction in VFI would be achieved only if provinces fully occupied the sales tax room vacated by the federal government, a condition which may require a substantial expansion of their sales tax bases. Moreover, since the growth of the tax points component of EPF is likely to be lower for the "have-not" provinces, they would gain less under the Quebec proposal than the "have" provinces.

The federal proposal, viewed from a fiscal rebalancing perspective, involves minor changes to the status quo. Under the federal proposal there would be a 12% national value added tax, with the same base as the GST, collected by the federal government. Provinces would eliminate their provincial retail sales taxes (PST) and would receive in return 7 of the 12 national sales tax points. This arrangement is equivalent to a tax rental agreement where the federal government collects the entire amount and then remits 58.3% of the revenue to the provinces to be shared according to their relative sales tax bases.

The 12% national rate would result in a revenue shortfall for the federal and provincial governments. The federal shortfall would be offset by a PIT flat tax of 1% and various adjustments to excise taxes. The provincial shortfall would be offset by any combination of increases in personal income, excise, payroll and capital taxes. Provinces would lose most of their flexibility on sales taxes, but would gain some flexibility on the PIT by having full access to flat taxes, currently confined to Alberta, Saskatchewan and Manitoba under tempor-

ary and very restrictive conditions. The federal government would also lose some policy flexibility because changes to the common base and rate would require provincial agreement. The federal proposal would have minimal effect on VFI. It effectively offers provinces cash payments which will grow at the same rate as the PST revenue they give up.

The Ontario proposal is fully consistent with the rebalancing solution discussed in this paper. Suggested only for Ontario, with the option for other provinces to join, it involves a clean switch of tax fields. Ontario would give up its retail sales tax in exchange for equivalent PIT points. The federal government would reduce its PIT in Ontario by the proportion needed to offset the newly acquired sales tax room; in turn, Ontario would raise its PIT rate to offset the lost PST revenue without raising the total PIT burden on Ontarians.

If applied to all provinces, the Ontario proposal would have the potential to reduce VFI considerably. The provinces would exchange sales tax points, which generate revenue growth approximately equal to that of GDP, for equivalent income tax points with a substantially greater revenue growth potential.

The Manitoba proposal is also consistent with the rebalancing approach, and was presented as a national scheme. As in the case of the Ontario proposal, the provinces would vacate the PST field; in return they would receive a special federal transfer instead of PIT points. Specifically, the federal government would assign approximately 30% of federal PIT before surtaxes to a national health care fund. Each province would receive a share of this fund through equal per capita payments (approximately \$700 per person in the first year). The use of equal per capita entitlements would fully equalize the PIT points implicitly transferred to provinces and the revenue they generate would be independent of provincial tax changes. The Manitoba proposal explicitly links the two major sources of VFI: the federal predominance of the fast-growing PIT and the provincial responsibility for fast-growing health care expenditures.

In conclusion, of the four proposals under consideration, only the Ontario and Manitoba proposals offer a potential for substantial reductions in VFI. The federal proposal effectively maintains the status quo, while the Quebec proposal offers the opportunity for a small improvement in VFI. Such improvement, however, would require a substantial increase in PST rates and/or a considerable expansion of the PST base. The Ontario and Manitoba proposals differ in two major aspects. First, the Ontario proposal involves an explicit transfer of PIT points to the provinces, while the Manitoba proposal involves an implicit transfer of PIT points in the form of cash transfers that grow at the same rate as the Basic Federal Tax (BFT). To be an effective tool of fiscal rebalancing, this cash transfer should be structured in a manner that would prevent unilateral federal changes. Second, the Manitoba proposal also addresses the issue of horizontal equity through the use of fully equalized tax points. As such, it addresses simultaneously the problem of VFI between the two senior orders of government and the problem of differences in fiscal requirements among

provinces.

Let us now turn to federal cash transfers under the CHST and evaluate their potential for redressing VFI. When the block funding formula for federal transfers related to health care financing, EPF, was introduced in 1977, its two components -- tax points and cash -- were not linked and therefore grew independently. Through a series of unilateral federal decisions, the cash component of EPF was transformed into a residual element designed to automatically decline to zero within ten to fifteen years. At that time provinces would have taken over full financial responsibility for health care financing without any additional tax room. The CHST for 1996-97 will be based on the share of total CAP plus EPF received by a province in 1995-96; no formula for the amount or allocation of future transfers has been decided on by the federal government. If future cash transfers under the CHST are linked to the value of the PIT points component of EPF, they will follow the same path to liquidation.

Hobson and St-Hilaire (1993) have presented compelling arguments for replacing the health care component of EPF cash transfers with a shift of PIT points to the provinces. Under their proposal, the transfer of PIT points would be distributed on an equal per capita basis, thus involving full equalization. If their proposal was combined with a clean swap of PST for PIT points under the GST replacement scheme, the result would be a federal PIT abatement of about 40% of BFT. With this transfer, the federal government would no longer dominate the PIT field, but would continue to maintain a significant presence with 40% of the combined PIT revenue.

In our view, this intergovernmental fiscal package would move toward a more balanced fiscal federalism, greater political stability, a simpler tax system and more political accountability at both senior orders of government. A single national sales tax, collected and controlled by the federal government, would greatly reduce administration and compliance costs. The clearer separation of tax fields and full provincial responsibility for health care financing would enhance political accountability. As well, the transfer of PIT points to the provinces would substantially reduce VFI and temper federal-provincial conflict.

The above proposal raises three major issues, which require solutions acceptable to all involved parties.

The first issue relates to the need for special arrangements in the case of Alberta. Alberta has no retail sales tax to trade for PIT points. Moreover, the Alberta government has frequently reiterated its position that it has no plans to introduce a provincial sales tax independently or as part of a national scheme. Therefore, in Alberta, the GST replacement component of the partial rebalancing option would have to be confined to a shift of taxes within the federal tax system. Albertans, as a whole, would pay the national GST rate, thus experiencing an increase in federal sales taxes, but would receive an offsetting reduction of federal personal income taxes.

The second issue relates to the horizontal equity aspects of the rebalancing

program. The value of one point of federal PIT abatement in the initial year and its growth through time differs among provinces because of interprovincial disparities in income levels and income distribution. One may argue, on grounds of horizontal equity among provinces, that the PIT points transferred should be subject to some form of equalization. Evaluation of the merits of whether PIT points should be equalized and whether equalization should be full or partial is beyond the scope of this paper. However, there are feasible mechanisms for delivering equalized tax points if an agreement is reached. A benefit of the rebalancing program is that it would bring to the fore the issues of regional fiscal disparities and necessitate an explicit solution.

One solution to the equalization issue is offered by the Manitoba proposal. Under that proposal, a certain share of federal BFT would be placed in a separate fund and allocated to provinces on an equal per capita basis, thus ensuring full equalization. Federal control of this fund is not necessary to ensure equalization of PIT points. The same result would be achieved directly through a provincially funded and administered fund. As an example, the PIT could be collected by an independent national tax collection agency, whose activities are supervised by a board of directors composed of federal and provincial representatives. The agency could set up a special equalization fund where a portion of provincial PIT revenue, equivalent to the uniform federal PIT abatement in each province, would be deposited. This revenue would then be distributed to provinces on an equal or unequal per capita basis, depending on whether PIT points are fully or partially equalized.

The final issue relates to the maintenance of national standards in health care. Enforcement of national standards does not require federal control or continued intergovernmental transfers. For example, the transfer of federal PIT points to replace cash transfers under EPF for health care could be made conditional upon an agreement among provinces to maintain satisfactory standards of health care. Since our proposal reduces the current fiscal bias against health care funding, this may result in improved and more uniform national standards.

The partial rebalancing option discussed in this paper would not affect significantly the federal government's fiscal capacity. The federal government would retain a large presence in the PIT field, receiving 40% of total PIT revenue. Its spending power would be unaffected in the initial year, and would just grow at a slower rate through time. It is the additional spending power, generated by the PIT transferred to provinces, which is curtailed. Our analysis indicates that such additional spending power is not needed by the federal government to perform its constitutionally-mandated functions.

Changing the Federal Role

Our evaluation of the assignment of tax fields differs from the traditional approach in principle on the need for dynamic balance and in the importance of accountability. Our dynamically balanced assignment of tax fields differs on one major element: we propose a substantial increase in the occupancy of the PIT by provinces.

Supporters of the traditional view argue that this shift would lead to excessive fiscal decentralization and, thus, undermine the federal government's ability to effectively carry out its economic stabilization and income redistribution functions. This view is based on conditions which, in our view, no longer exist. With respect to economic stabilization, federal stabilization policies over the past two decades have become increasingly reliant on monetary policy and less reliant on fiscal policy. Moreover, federal stabilization policies are not necessarily desirable. As Boothe and Davidson (1993) have shown, national stabilization policy may actually be destabilizing because provincial business cycles are not synchronized.

With respect to redistribution, the view that the federal government is the major source of income redistribution may not be valid. Ruggeri, Van Wart and Howard (1995) show that the federal and provincial governments produce similar degrees of income redistribution. Moreover, the concern that the transfer of PIT room to the provinces will reduce redistribution from the tax system may be unfounded. The transfer of PIT points to the provinces in 1976 as part of the EPF program did not reduce redistribution. As shown by Howard, Ruggeri and Van Wart (1991), the provincial PIT systems are more progressive than the federal PIT system. Hence, they have become relatively more progressive, compared to the federal structure, than they were in 1976.

Broad federal fiscal control may be efficient and, perhaps, necessary only under certain conditions. For example, during the early stages of a federation the development of a domestic market generally requires greater emphasis on defence, national infrastructure and the justice system. Alternatively, central taxing and spending control is consistent with a mature federation operating as a closed economy, where fiscal stabilization policy can be independently pursued.

These conditions do not apply to Canada. Canada is better characterized as a mature federation operating as a small open economy in an increasingly competitive world market. Economic rents can be maximized by increased regional specialization and foreign trade. Strengthening the federation requires flexible fiscal arrangements which allow each province to take full advantage of these opportunities. It may involve greater diversity among provinces in both economic structures and fiscal systems. To the extent that a more flexible federation generates increasing regional disparities, the equalization system can be used to address the associated horizontal equity issues. The economic gain

from greater regional specialization should facilitate these financial adjustments.

We believe the issue is not whether the federal government should be bigger or smaller. Instead, it is to define a role for the federal government consistent with the new global economic reality. We suggest that this new role involves more coordination and less control. The central function of the federal government should be to facilitate the efficient coordination of provincial and federal policies, rather than imposing centralist solutions which may hinder the economic potential of some regions. Examples of this changed role are our suggestions for the PIT transfer, equalization and health care standards. Policy discussion would become more fruitful if our focus shifts away from the centralization-decentralization dichotomy and toward a combination of federal control and coordination leading to a sustainable federation in a global economy.

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