Amend the Equalization Formula to Incent Less Spending and More Saving

Issue

The current formula of Canada's equalization transfer program includes a number of disincentives that result in inefficient levels of taxation and government spending.

Background

The equalization transfer program was first introduced in 1957 and was designed to reduce the differences in revenue generating capacity across the provinces by compensating provinces with weaker tax bases or resource endowments.[1]

At present, the equalization formula works by calculating each province's ability to generate revenues on a per-capita basis with several exceptions that distort transfers such as under-reporting of revenues by crown corporations as well as excess government spending and employment.

Quebec, by far the largest recipient of equalization payments is home to crown corporation, Quebec Hydro. On average citizens of Quebec pay among the lowest electricity rates in North America that are far below comparable market rates. Exports by Quebec Hydro comprised nearly 30% of the utilities net profits in 2018 and are sold at a substantial premium to those paid by Quebec residents.[2] If Quebecers paid market rates for power their fiscal capacity would be calculated much higher than it is presently.

PEI is the largest per-capita beneficiary of equalization has two-thirds of its workforce in the public sector.[3] With a large portion of these jobs supported by transfer payments, there is little incentive for PEI to reduce the size and cost of its public service. Macroeconomic theory maintains that increases in government expenditure may result in crowding-out effects, displacing private sector spending.[4]

Another issue is that of natural resource revenue. Some provinces our rich in natural resources yet choose to disallow or discourage their extraction. An example of this would be Quebec with its vast energy reserves in the St. Lawrence Lowlands and other areas. Rather than allow for the development of these reserves, Quebec chose to ban fracking and instead imports massive quantities of natural gas from the United States.[5] This political decision is a self-imposed economic handicap greatly affecting Quebec's fiscal capacity - but unlike Alberta's decision to not charge a provincial or harmonized sales tax, is not reflected in the formula.

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[1] https://lop.parl.ca/sites/PublicWebsite/default/en_CA/ResearchPublications/200820E
[2] https://montrealgazette.com/business/hydro-quebec-poised-to-profit-from-u-s-thirst-for-green-energy
[3] https://www.fraserinstitute.org/sites/default/files/analysis-of-public-and-private-sector-employment-trends-in-canada.pdf
[4] ibid
[5] https://montrealgazette.com/opinion/opinion-quebec-is-making-a-mistake-on-fracking-and-natural-gas

Canada would be well served by having an equalization formula that incentivizes the provinces to be thrifty with their spending, save for a rainy day, and fully recognize their economic and financial potential.

The Alberta Chambers of Commerce recommends the Government of Canada:

1. Amend the equalization formula such that it equalizes for both fiscal capacity and government spending while also allowing provincial fiscal surpluses to be exempt from the transfer calculation.