Equalization Payments

First made in 1957, equalization payments are monetary transfers from the federal government to provincial governments.[1] Equalization payments are encapsulated in the Constitution, and section 36(2) reads:

Parliament and the government 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.[2]

Their inclusion in the Constitution received bi-partisan support from the likes of Conservative premiers William Davis and Peter Lougheed, and Liberal Jean Chretien.[3] By 1982, when it was enshrined in the *Constitution Act, 1982,* the principle of equalization had become so accepted by provinces, that its inclusion in the constitution was largely without controversy.[4] Section 36(2) imposes a burden specifically on the federal government, and it is responsible for deciding how the equalization program is carried out.[5] Equalization payments are highly-politicized, and some have argued that the constitutional obligation is too vague to be justiciable.[6] Nevertheless, it is a distinct feature of Canadian federalism which would require constitutional amendment to remove.

The money for payments comes entirely from federal funds; provinces do not transfer money to each other or the federal government as a result of this program.[7] There are no conditions attached to the receipt of an equalization payment; provinces can use the money as they see fit.[8]

How provincial governments spend their money is closely linked to the misconception that whether a province is running a surplus or a deficit affects equalization payments. Because provinces choose how they spend their money, they determine whether they are in a surplus or deficit. “Deficit is a choice, not something caused by equalization.”[9] Eligibility for a payment is determined by a province’s ability to generate tax revenue, not how much they actually generate.[10]

Eligibility is determined, on a per capita basis, by how a province’s fiscal capacity (ability to raise tax revenue) compares to the average fiscal capacity of all ten provinces.[11] If a province’s capacity is below the average, it receives an equalization payment. The payment only brings the province up to the average.[12]

There are five revenue sources used to determine fiscal capacity:

1. Personal income;
2. Business income;
3. Consumption;
4. Property taxes and miscellaneous revenues; and

5. Natural resources.[13]

There are two differences when calculating natural resources. First, actual revenues are used rather than a calculated fiscal capacity.[14] This is because resources and royalty structures are so different from province to province that it would be impossible to determine an average (ex. comparing oil to lumber).[15] Second, only 50% of natural resource revenue is included in the final calculation.[16] Provinces can opt out of having natural resources included in the calculation if doing so increases the amount of their equalization payment.[17]

The federal government typically renews or amends equalization payments and the formula every five years after consultation with the provinces.[18] The current formula was set in 2007.[19] It has been renewed until 2024 and can be found in the *Federal-Provincial Fiscal Arrangements Act*.[20]

Example Illustrating the Principle of Equalization Payments

Suppose a country has two provinces, A and B. Now imagine that province A and B have the same population, 1,000 people, and (for simplicity) that the only taxable revenue source is personal income.

In province A, the average personal income is $10,000, the tax rate is 10%, and so the province collects $1,000,000 in personal income taxes. Province A's fiscal capacity is $1,000,000.

But in Province B the average personal income is $7,500, and with a tax rate of 10% collects only $750,000 in personal income taxes. Province B's fiscal capacity is $750,000.

Even though they have the same number of people and the same tax rates, through the fault of no one, the provinces' revenues are different. Province B has a weaker fiscal capacity than province A. Equalization payments step in to ensure that province B has a similar amount of money as province A to provide government services to its citizens.

The federal government determines the average fiscal capacity across the provinces:

($1,000,000 + $750,000) / 2 = $875,000.

Next, they determine how a province's fiscal capacity compares to the national average:

Province A = $875,000 – $1,000,000 = – $125,000

Province B = $875,000 – $750,000 = $125,000

If the amount is less than $0, then the province does not receive an equalization payment. If it is above $0, the province will receive that amount.

$125,000 is the amount that the federal government will give in equalization payments to province B, to bring it up to the average. Province A still has a larger total revenue than province B, even after equalization payments.

[1] Jim Feehan, “Canada’s Equalization Formula: Peering Inside the Black Box, and Beyond” (2014) 7:24 School of Public Policy 1 at 2.

[2] *Constitution Act, 1982*, s 36(2), being Schedule B to the Canada Act 1982 (UK), 1982, c11.

[3] Mirja Trilsch & Jessica Leblanc, “Well-being Matters Under the Constitution – Why Section 36 is About More Than Money and What It Should Mean for Canadians” (2019) 39:2 NJCL 159 at 180-181.

[4] Thomas J Courchene, “A Short History of Equalization” (1 March 2007) at 26, online (pdf): *Options Politiques* <http://irpp.org/wp-content/uploads/sites/2/assets/po/equalization-and-the-federal-spending-power/courchene.pdf>.

[5] Peter W Hogg & Wade Wright, *Constitutional Law of Canada*, 5th ed (date accessed 1 January 2022), (Toronto: Thomson Reuters Canada), ch. 6, § 6:6. Thomson Reuters ProView.

[6] *Ibid.*

[7] Economics, Resources and International Affairs Division & Parliamentary Information and Research Service, *Canada’s Equalization Formula*, by Edison Roy-Cesar, (In Brief), Publication No. 2008-20-E (Ottawa: Library of Parliament, 10 November 2008, revised 4 September 2013) at 1.

[8] *Ibid*.

[9] “Q&A: The wonky world of equalization payments”, *CBC News* (22 November 2016) <https://www.cbc.ca/news/canada/calgary/equalization-payments-frequent-questions-answers-1.3862482>.

[10] *Ibid*.

[11] Economics, Resources and International Affairs Division, *supra* note 7 at 2.

[12] *Ibid* at 4.

[13] *Federal-Provincial Fiscal Arrangements Act*, RSC 1985, c F-8, ss 3.2(1), 3.5(1) .

[14] Economics, Resources and International Affairs Division, *supra* note 4 at 2.

[15] *Ibid*.

[16] *Fiscal Arrangements Act*, *supra* note 10, s 3.2(1)(a).

[17] *Fiscal Arrangements Act*, *supra* note 10, s 3.2(1)(b).

[18] Feehan, *supra* note 1 at 1.

[19] *Ibid*.

[20] *Fiscal Arrangements Act*, *supra* note 13, s 3 (for the 2019 renewal see *Budget Implementation Act, 2018, No. 1.*, SC 2018, c 12, s 215; but the budget is not where the *Fiscal Arrangements Act* is always renewed, for the 2014 renewal see *Economic Action Plan 2013 Act, No1.*, SC 2013, c 33, s 110).