
The Practice of Equalization in Federal Countries

**International Conference on Federalism
St-Gallen (Switzerland), August 29, 2002**

**Intergovernmental Affairs
Privy Council Office (Canada)**



Key Issues

1

Why equalize?

2

What should be equalized?

3

How to equalize?

4

How much?

5

What results?

1

Why equalize?

- **To reduce disparities among governments of federated entities:**
 - **for equity among citizens**: to ensure reasonably comparable public services at reasonably comparable tax levels in all federated entities;
 - **for the economy**: to enhance economic efficiency by reducing distortions (e.g., fiscally induced migration).
- **The need for equalization increases with the magnitude of responsibilities of governments of federated entities and the degree of disparities among them.**

2

What should be equalized?

- What kinds of disparities need to be equalized?
 - revenue disparities? expenditure disparities? both?
- Answer will likely depend on:
 - the relative size of revenue and expenditure disparities;
 - the balance between simplicity and exhaustiveness.

What is equalized	Canada	Switzerland	Australia
<u>Revenue</u> disparities reduced	extensively	moderately	extensively
<u>Expenditure</u> disparities reduced	none	moderately	extensively

3

How to equalize?

	Formal equalization program?	Entrenched in Constitution?	Who finances equalization ?		
			Federal to governments of federated entities	Governments of federated entities to federal	Governments of federated entities among themselves
U.S.					
Canada	√	√	√		
Australia	√		√		
Switzerland	√	√	√	√	
Germany	√	√	√		√
Belgium	√		√		

Sources: IMF, *Fiscal Federalism in Theory and Practice* (1997); Ronald Watts, *Comparing Federal Systems in the 1990s* (1998); Belgian Constitutio: www.uni-wuerzburg.de/law; German Basic Law: www.jura.uni-sb/law; Swiss Constitution: www.admin.ch

4

How much?

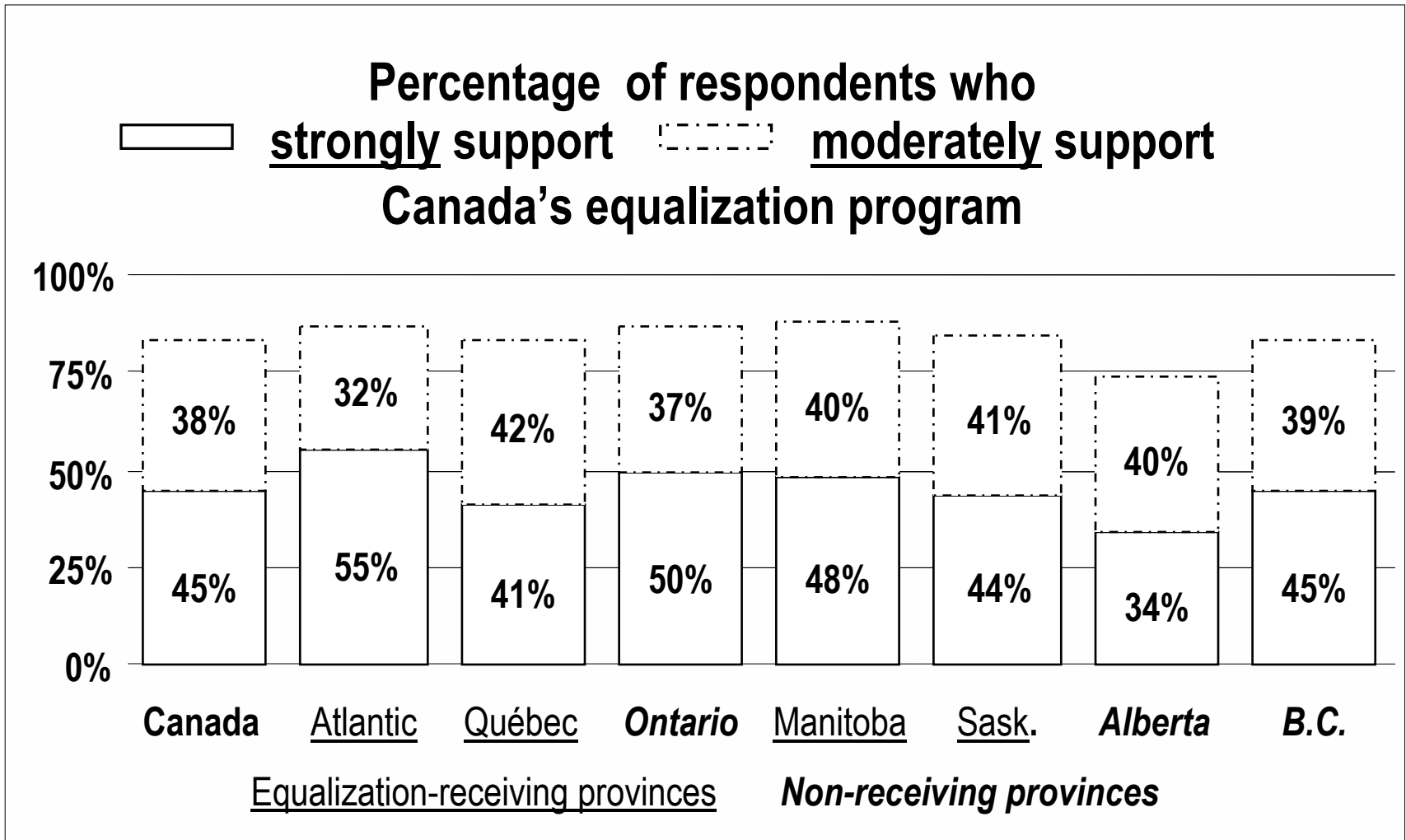
- **Can / should disparities be eliminated or be (only partly) reduced ?**
- **Answer will likely depend on:**
 - the magnitude of responsibilities of governments of federated entities;
 - the extent of disparities in revenue capacity and expenditure needs across federated entities.
- **Should equalization transfers be conditional?**
 - Generally, no conditions attached since goal is to reduce disparities not to create a national program.

5

What results?

- **There is a debate about the efficiency of the equalization program.**
- **Some commentators in Canada have argued that equalization increases dependency of some provinces and contributes to increased economic disparities.**
 - **However, the evolution of provincial per capita real GDP and income shows that disparities between provinces have diminished since 1981 in Canada.**

In Canada, equalization is strongly supported



Qualitative comparison of equalization systems

Different contexts:	Canada	Switzerland	Australia
Degree of decentralization	high	high	moderate
Revenue disparities	large	large	relatively small
Expenditure need disparities	small	small	relatively large
Resulting design choices:			
Degree of equalization	not full	not full	full
<u>Revenue</u> disparities reduced	extensively	moderately	extensively
<u>Expenditure</u> disparities reduced	none	moderately	extensively

Summary

Why equalize?

- To reduce disparities (revenue and expenditure) across governments (equity and efficiency reasons).

What should be equalized?

- It depends on the relative size of revenue and expenditure disparities and the balance between simplicity and exhaustiveness.

How to equalize and by how much?

- It all depends on the magnitude of responsibilities of governments of federated entities and the size of disparities (revenue and expenditure) across them.

Summary

- **What results ?**
 - **No empirical evidence that equalization is inefficient.**
 - **In Canada, disparities between provinces have diminished over the past 20 years.**

ANNEXES

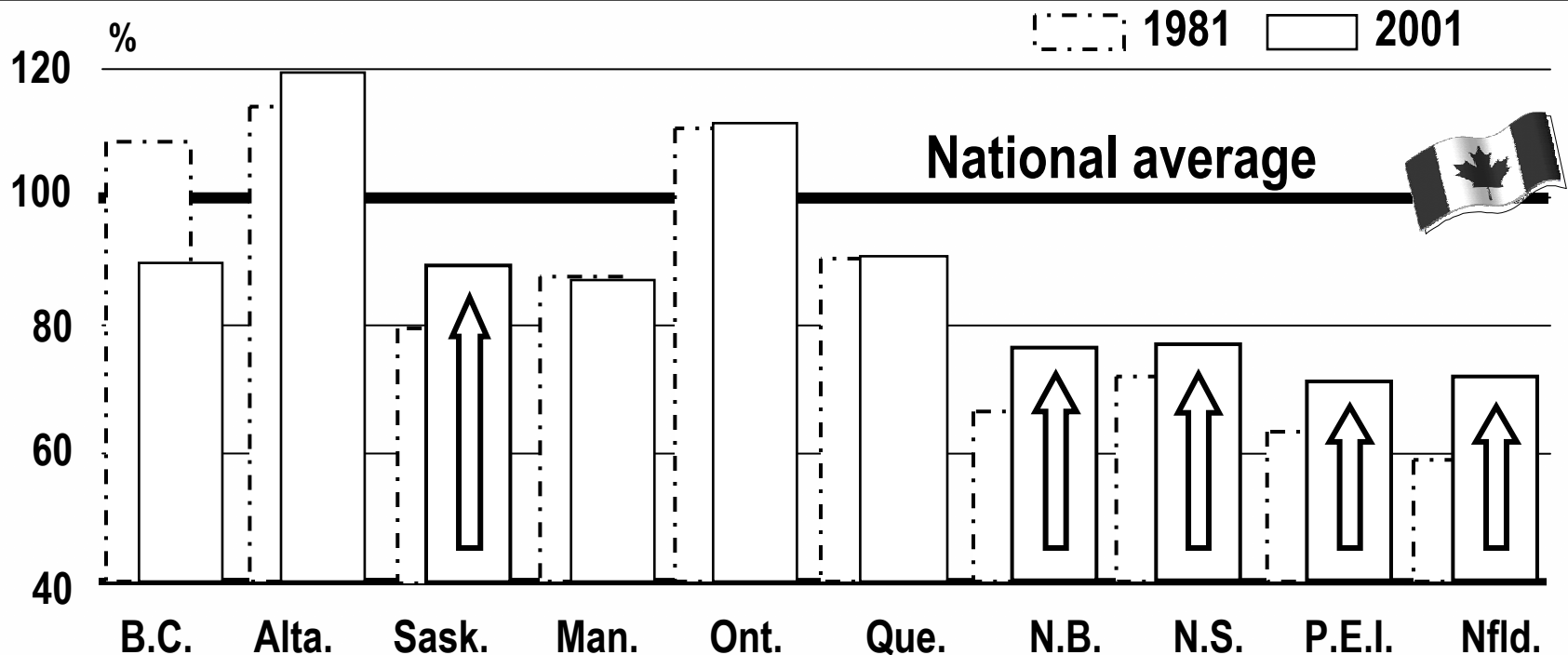
Indices of fiscal capacity national average = 100

	1980-81		2000-01	
PROVINCES	Pre-	Post-	Pre-	Post-
	Equalization	Equalization	Equalization	Equalization
Newfoundland	56.8	90.2	65.1	96.9
Prince Edward Island	53.4	90.2	66.7	96.9
New Brunswick	64.4	90.2	70.7	96.9
Nova Scotia	63.4	90.2	73.7	96.9
Quebec	76.6	90.2	86.4	96.9
Ontario	91	91	105.9	105.9
Manitoba	75.7	90.2	79.6	96.9
Saskatchewan	113.4	113.4	90.5	96.9
Alberta	229.7	229.7	148.4	148.4
British Columbia	117.6	117.6	96.4	96.9
Canada	100	100	100	100
Receiving provinces	76.6	90.2	86.4	96.9
Equalization standard	-	90.2	-	96.9
National average	100	100	100	100

Source: Department of Finance, Canada

The economic disparities have decreased over the last 20 years in Canada

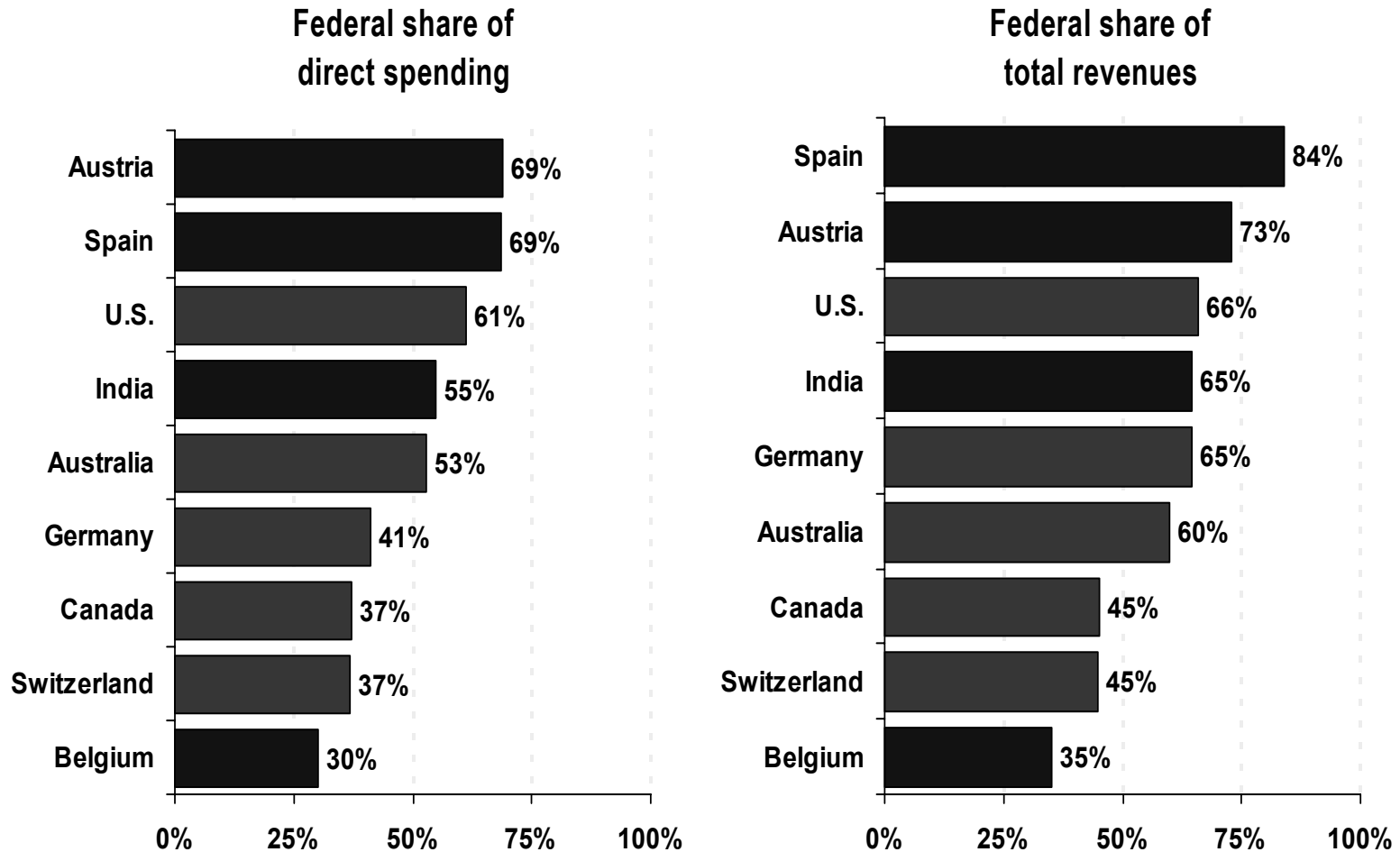
Real GDP per capita compared with national average, 1981-2001



Source: Department of Finance, Canada

Most of the less well-off provinces have moved closer to the national average over the past 20 years.

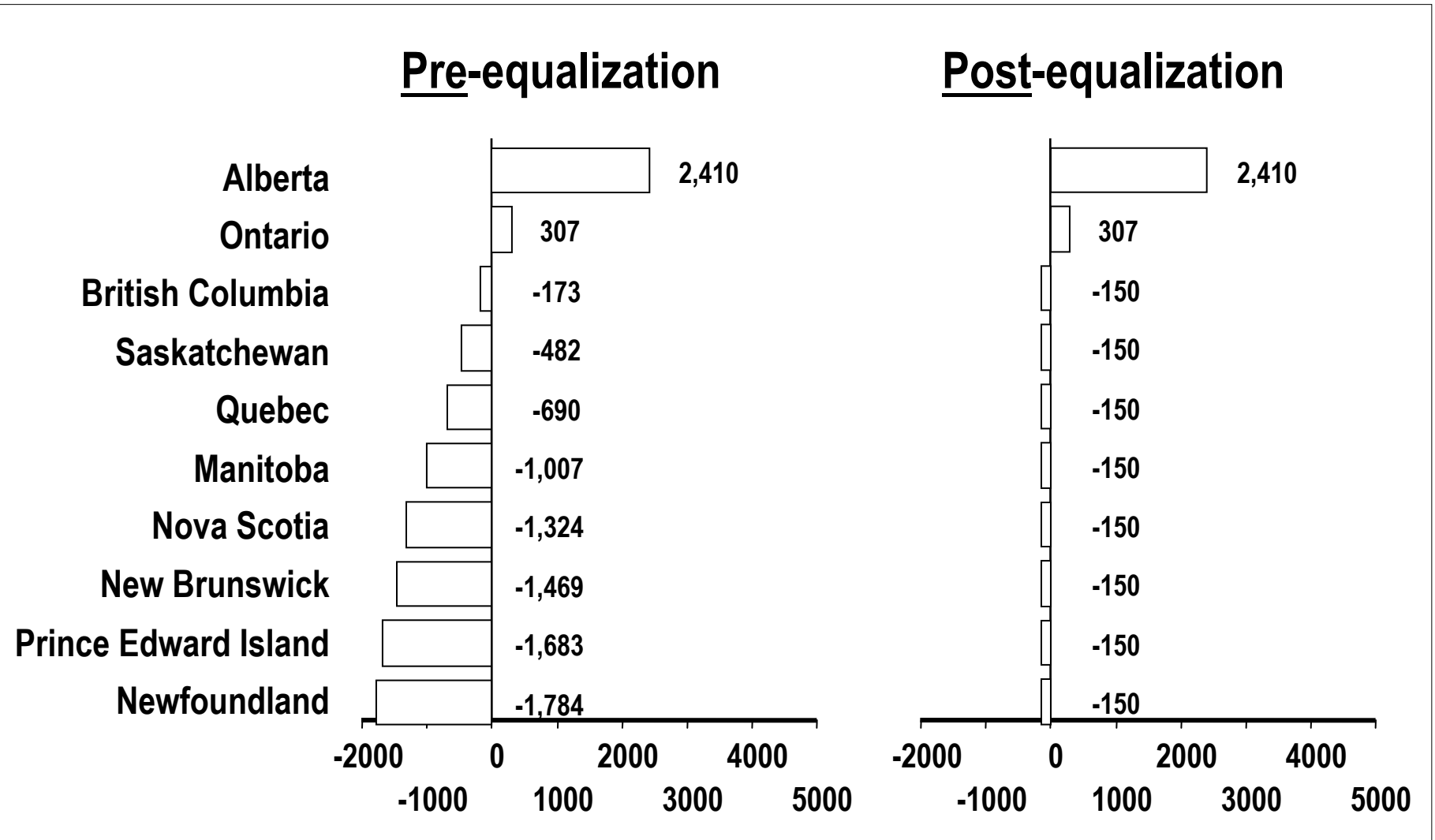
Indicators of fiscal decentralization in selected federal countries



Sources: Ronald Watts, *Comparing Federal Systems in the 1990s* (1998); National Bank of Belgium; Statistics Canada

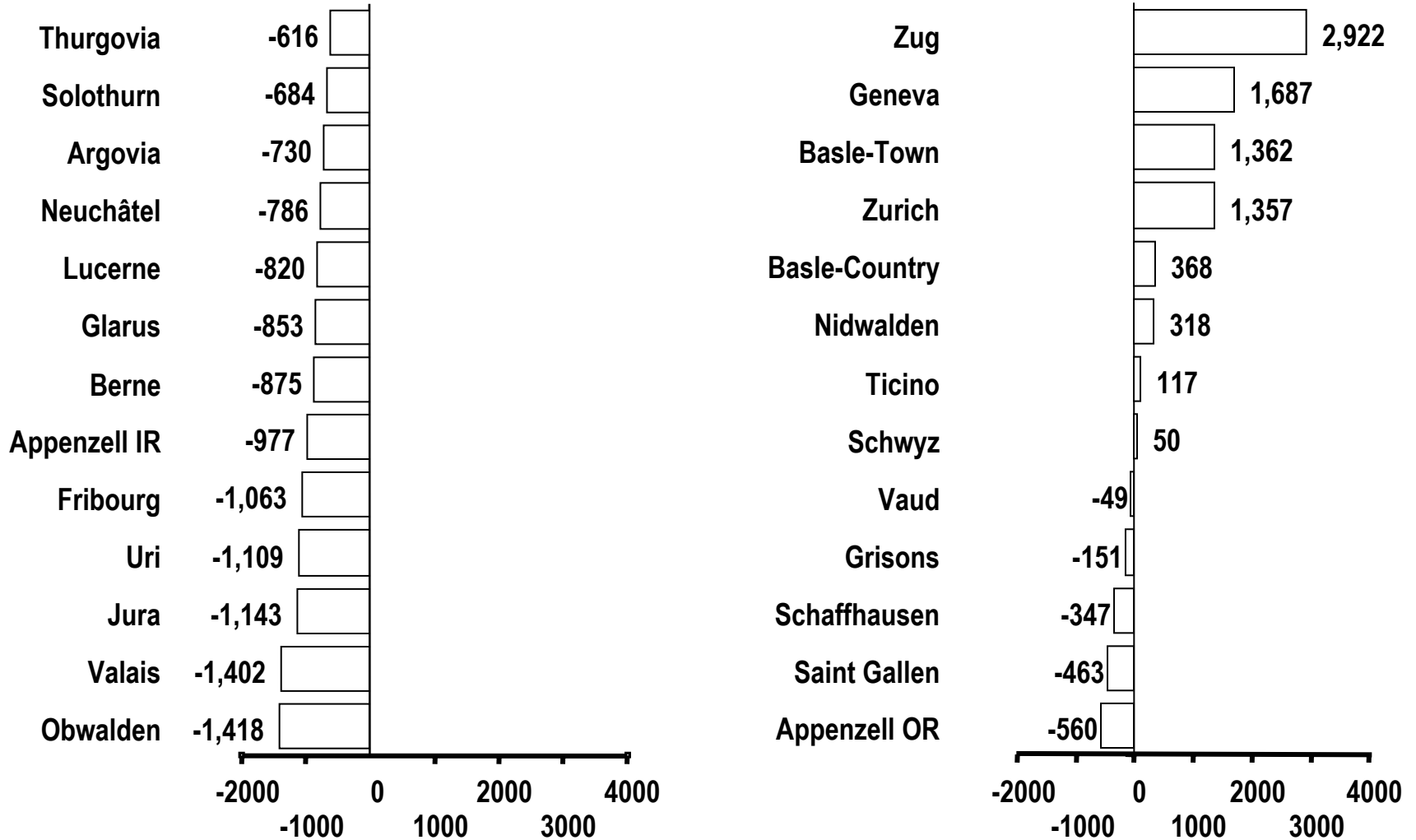
Canada has very large revenue disparities ...

(in US\$ per capita)



Annex 5

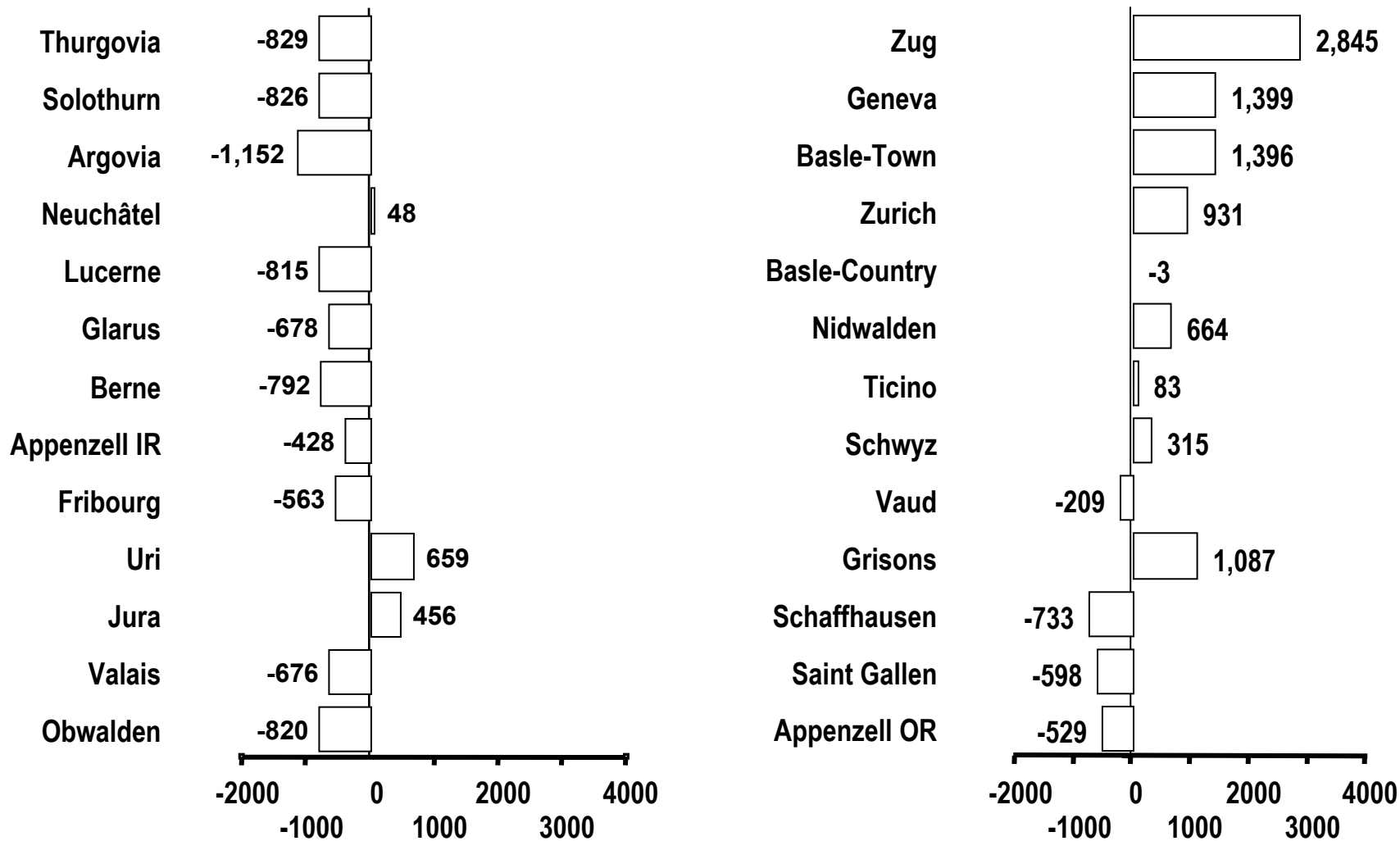
... as does Switzerland, both pre-equalization... (in US\$ per capita)



Annex 6

... and post-equalization

(in US\$ per capita)

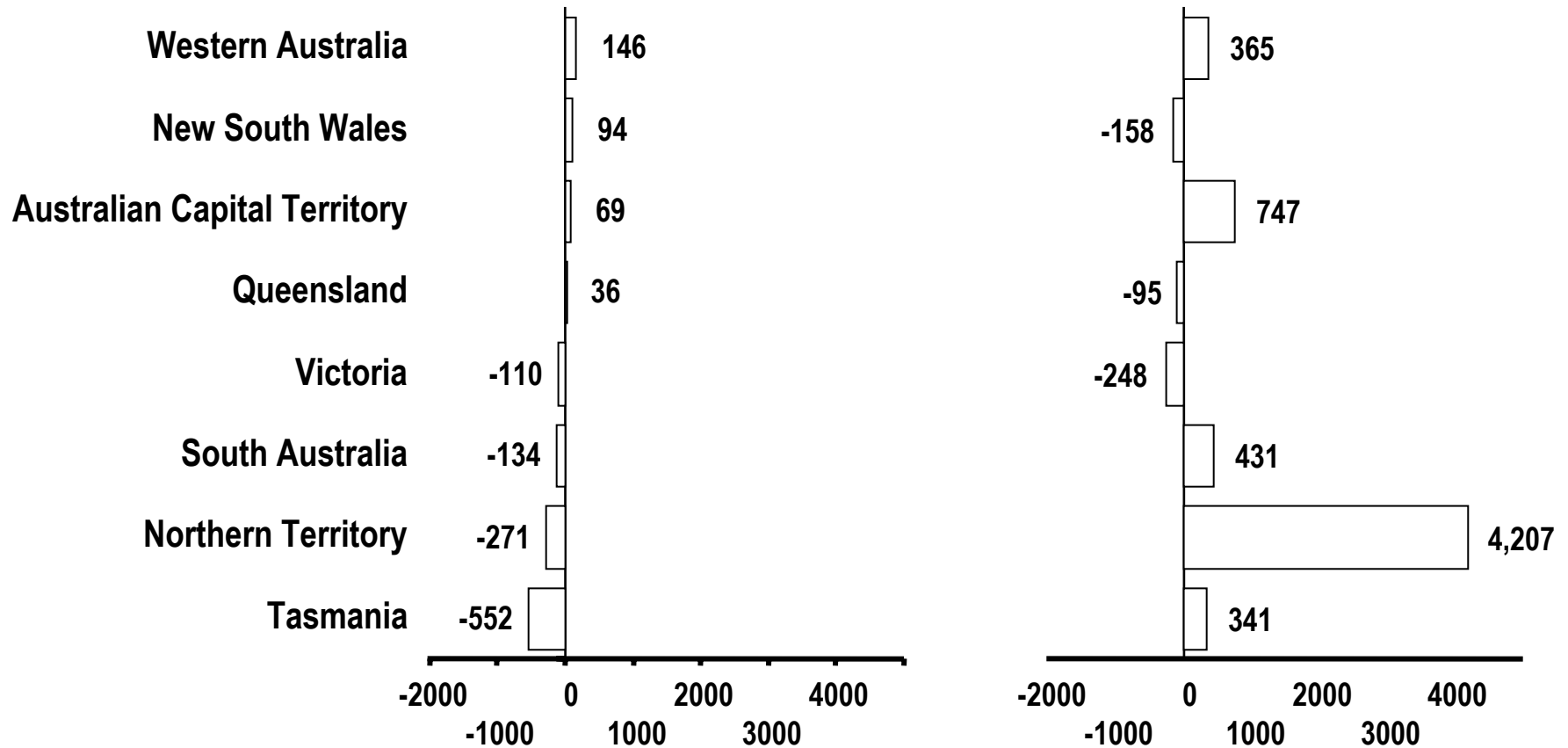


Whereas Australia's disparities are generally small, both pre-equalization...

(in US\$ per capita)

Revenue disparities

Expenditure disparities



... and post-equalization

(in US\$ per capita)

Revenue disparities

Expenditure disparities

