ABSTRACT

Equalization payments in Canada take the form of unconditional transfers made to the have-not provinces by the federal government. These transfers are designed to raise the fiscal capacities of the recipient provinces to a standardized level. Historical, constitutional and economic rationales for such a scheme are first reviewed. Equity and efficiency considerations suggest an optimal scheme under which all provincial revenue sources would be fully equalized to a national average standard. In effect, such a scheme would involve direct transfers from the have provinces to the have-not provinces at no net cost to the federal government. The extent of interprovincial redistribution under existing arrangements is compared with the optimum. The major beneficiary under existing arrangements - with reference to the optimal levels of redistribution - is Alberta at the expense of Quebec. For 1980-81, interprovincial redistribution resulting from both equalization and policies affecting provincial revenues from natural resources - especially the NEP - is shown to have caused both Quebec and Ontario to receive positive net transfers and Alberta a negative net transfer that were

more than double their optimal levels. This provides one incentive argument for Alberta to voluntarily participate in national sharing of its vast resource revenues.