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Communiqué

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Social union agreement could lead to better, more predictable, more accessible social policies, says C.D. Howe Institute study

If successful, the negotiations now under way between Ottawa and the provinces on a "framework" agreement that would underpin future intergovernmental talks on specific social programs would help provide services that are better adapted to Canadians' priorities, more predictable, and more accessible to Canadians wherever they live than is now the case, says a C.D. Howe Institute Commentary released today.

Because many social programs are largely a provincial responsibility, however, this positive result hinges on the provinces' having the right to approve national initiatives in areas that are substantially under their jurisdiction, as well as a general right to opt out if they choose not to take part in a national consensus in these areas. In return, all governments would agree to respect certain key obligations towards Canadians.

The study, *More Than the Sum of Our Parts: Improving the Mechanisms of Canada's Social Union*, was written by Daniel Schwanen, a Senior Policy Analyst at the C.D. Howe Institute. Schwanen explains that the delivery of good social policies must exploit the advantages, and minimize the disadvantages, of Canada's federal system. He notes that recent attempts to enhance the social union provide a foundation for discussions that are relevant to today's social union agenda.

Schwanen identifies a number of areas for reform and offers specific recommendations on the key elements of a successful "framework" accord on the social union:

- A social union framework should respect existing jurisdictions. Thus, substantial provincial approval should be required before national initiatives are launched in areas substantially the responsibility of the provinces. This would apply not only to cost-shared initiatives, as the federal government has already signaled, but also to federal tax credits when these are contingent on provincial companion measures and, in some areas clearly specified in the social union framework pact, to direct federal transfers to individuals.
- A province that does not support the national consensus should be able to opt out of a national program, with cash compensation (on the same per capita basis as participating

provinces) if it chooses to run a compatible program or with a transfer of (equalized) tax points if it runs one that is noncompatible.

- Provinces should agree to conditions that would apply even to programs from which they decide to opt out. Key among them would be to accord "provincial treatment" in their social programs to all Canadians (that is, they would agree not discriminate on the basis of province of origin); to mutually recognize certain standards or programs (such as education credentials or pensions) that are "portable" with the individual; to participate in a compensation mechanism that ensures that they take account of the costs (and benefits) of their actions to other provinces; and to take part in a national "benchmarking" exercise that allows Canadians to better compare programs and outcomes across jurisdictions. The federal government should similarly agree to make its program expenditures, other than equalization or programs of an unavoidably regional nature (such as the fisheries), fairer across regions on a per capita basis.
- Mutual undertakings between governments on specific programs should last for fixed, renewable periods, and sufficient advance notice should be given before a withdrawal from or renegotiation of the conditions of specific programs can take effect.
- An impartial dispute-settlement mechanism should adjudicate contentious issues concerning governments' obligations under the agreement and accords reached under it about specific programs. Individuals should also have access to the dispute-settlement mechanism with respect to their mobility rights and the portability of programs.

Schwanen stresses that, initially, an accord on the social union would be an essentially political agreement on how governments use their powers to determine social programs (for example, the federal spending power), without yielding on the substance of those powers. A justiciable accord could follow if the model is successful and acceptable to Canadians. In the meantime, Schwanen says, giving the provinces a greater role in managing the emergence of national programs in areas under their jurisdiction, under stringent conditions of nondiscrimination and cooperation, is an experiment worth attempting, given the need for social programs better suited to the priorities of Canadians across the country.

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Une entente sur l'union sociale permettrait de fournir des politiques sociales améliorées, plus prévisibles, et plus accessibles, soutient une étude de l'Institut C.D. Howe

La réussite des négociations présentement en cours entre le gouvernement fédéral et les provinces sur un accord cadre, qui baliserait les relations intergouvernementales futures concernant les programmes sociaux, aiderait à fournir des services mieux adaptés aux priorités des Canadiens, plus prévisibles, et aussi plus accessibles à tous au travers du pays, que ce n'est actuellement le cas, soutient un Commentaire de l'Institut C.D. Howe publié aujourd'hui.

Toutefois, puisque plusieurs programmes couverts par les discussions sur l'union sociale sont largement la responsabilité des provinces, ce résultat positif pour les Canadiens dépend de l'existence d'un droit des provinces d'approuver les initiatives pan-canadiennes dans ces domaines qui relèvent surtout de leurs compétences, ainsi qu'un droit général de retrait pour toute province ne participant pas à un consensus national. En retour, les provinces s'entendraient pour respecter certaines obligations clés envers les Canadiens.

L'auteur de l'étude, intitulée *More Than the Sum of Our Parts: Improving the Mechanisms of Canada's Social Union* (Plus que la somme de nos composantes: améliorer les mécanismes de l'union sociale canadienne), est Daniel Schwanen, analyste de politique principal à l'Institut. Il y explique que la livraison de bonnes politiques sociales au Canada doit exploiter les avantages du système fédéral Canadien, et en minimiser les désavantages, et fait remarquer que les tentatives récentes de changements de l'union sociale canadienne fournissent des éléments pertinents à l'ordre du jour actuel des discussions sur l'union sociale.

M. Schwanen identifie ensuite un certain nombre de réformes nécessaires, menant à plusieurs recommandations sur ce que devrait contenir une entente-cadre sur l'union sociale:

- Un accord-cadre sur l'union sociale devrait respecter les champs de compétence existants. Un accord provincial substantiel devrait donc être requis avant de lancer des initiatives pan-canadiennes dans des domaines qui sont surtout de compétence provinciale. Cette règle s'appliquerait à tout programme à frais partagés, tel que déjà annoncé par le gouvernement fédéral, mais aussi aux crédits d'impôt lorsque ceux-ci dépendent de l'introduc-

tion de mesures accompagnatrices au niveau provincial, et même à certains transferts directs du gouvernement fédéral aux particuliers, lorsqu'ils ont lieu dans des secteurs spécifiés par l'accord-cadre.

- De plus une province qui n'aurait pas appuyé le consensus national en faveur d'un programme, aurait le droit de se retirer de ce programme, avec transfert en argent (sur la même base per capita que celui reçu par les provinces participantes) si elle choisit d'établir un programme comparable, ou un transfert de points d'impôt, si elle établit un programme non comparable.
- Toutefois, les provinces devraient aussi accepter certaines conditions qui devraient faire partie d'une entente sur l'union sociale. Ces conditions devraient être respectées même en regard des programmes dont une province aurait exercé un droit de retrait. Entre autres, les Canadiens devraient avoir droit au "traitement provincial" en ce qui a trait à la livraison des programmes sociaux dans chaque province (c.a.d. non-discrimination sur la base de leur province d'origine). Les provinces devraient aussi accélérer la reconnaissance mutuelle de certaines normes ou programmes qui sont "attachés" aux individus, ou portatifs (tels les diplômes ou les pensions), prendre part à un mécanisme de compensation pour les coûts (ou les avantages) que leurs programmes pourraient faire subir aux autres provinces, le cas échéant, et participer à un exercice de "calibrage" des programmes qui permettrait aux Canadiens de mieux comparer les programmes et résultats au travers du pays. De même, le gouvernement fédéral s'engagerait à répartir ses dépenses, autres que la péréquation et les programmes dont la nature régionale est incontournable (par exemple, les pêches), de façon équitable entre les différentes régions du Canada.
- Les ententes entre gouvernements sur des programmes particuliers devraient être signées pour des périodes fixes, mais renouvelables, et un préavis suffisant devrait être donné avant que tout retrait ou renégociation d'un programme puisse prendre effet.
- Un mécanisme impartial devrait résoudre les différends concernant les obligations des gouvernements selon l'accord-cadre et toute entente s'y référant concernant des programmes particuliers. Les Canadiens devraient aussi avoir accès à ce mécanisme de règlement des différends, en ce qui concerne leurs droits à la mobilité et à la reconnaissance des programmes ou normes portatifs.

M. Schwanen souligne que, dans un premier temps, un accord-cadre sur l'union sociale serait essentiellement un accord politique sur la façon dont les gouvernements exercent leurs pouvoirs (par exemple, le pouvoir fédéral de dépenser) au chapitre des programmes sociaux, sans toutefois modifier la substance de ces pouvoirs. Un accord juridique pourrait être adopté par la suite si l'expérience est concluante et acceptable pour les Canadiens. Entre temps, soutient M. Schwanen, permettre un plus grand rôle aux provinces dans l'élaboration de programmes nationaux dans des domaines relevant de leur compétence, compte tenu de conditions strictes de non-discrimination et de coopération, est une expérience qu'il vaut de tenter, étant donné les besoins au travers du pays pour des programmes sociaux mieux adaptés aux priorités des Canadiens.

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More Than the Sum of Our Parts:

Improving the Mechanisms of Canada's Social Union

by

Daniel Schwanen

Successful negotiations between Ottawa and the provinces on how to generate national social policies could lead to programs that are better adapted to Canadians' priorities, more predictable, and more accessible to Canadians across the country than is now the case.

A successful social union framework would respect existing jurisdictions in that substantial provincial approval would be required before national initiatives were launched in areas of provincial responsibility — even, in some cases, where direct federal transfers to individuals are concerned. Moreover, a province should be able to "opt out" of a national consensus on a program, with cash compensation if it chooses to run a compatible program or with tax-point transfers if it runs one that is noncompatible.

Even if a province opts out, it should still have to live up to certain obligations: to treat all Canadians the same; to participate in a compensation mechanism that ensures that it takes account of the costs (and benefits) of its actions to other provinces; to ensure that standards and programs that attach to individuals are portable or mutually recognized across Canada; to participate in a benchmarking exercise that allows Canadians to better compare programs across the country; and to allow an impartial dispute-settlement mechanism to adjudicate contentious issues.

Under this framework, a government would have to give advance notice before withdrawing from or renegotiating the conditions of specific programs. The accord initially would be an essentially political agreement on how governments use their powers, without modifying the substance of those powers. If this phase is successful, a justiciable accord could then follow.

Main Findings of the Commentary

- Negotiations on a social union "framework" agreement between Ottawa and the provinces, under way since December 1997, could lead to social programs that are better adapted to Canadians' priorities, more predictable, and more accessible to Canadians across the country than is now the case.
- To be successful, a social union framework must exploit the advantages, and minimize the disadvantages, of Canada's federal system by respecting existing government jurisdictions. It also means that provinces would have to live up to obligations toward the union as a whole, even in areas under their jurisdiction.
- Since many social programs are largely a provincial responsibility, substantial approval of the provinces should be required before national initiatives whose costs exceed a minimal threshold are launched in those areas. In some cases, provincial approval should be required even where direct federal transfers to individuals are concerned.
- A province that chooses not to take part in a national program should be able to "opt out," with cash compensation if it decides to run a compatible program or with (equalized) tax-point transfers if its program is noncompatible. In certain areas, a province should even be able to claim, through a supermajority in its legislature, jurisdiction over a direct federal transfer to individuals, in which case it would also receive a tax-point transfer.
- An agreement on a social union should also specify obligations that a government would have to meet, even with respect to programs from which it had opted out. Key among these obligations would be: nondiscrimination toward all citizens, regardless of their province of origin; participation in a compensation mechanism that ensures that provinces take account of the costs (and benefits) of their actions to other provinces; ensuring the "portability" or mutual recognition across Canada of standards and programs, such as education credentials or pensions, that attach to the individual; and partaking in an ongoing "benchmarking" exercise that allows Canadians to better compare programs across the country.
- An impartial dispute-settlement mechanism should adjudicate contentious issues concerning governments' obligations under the agreement and accords reached under it about specific programs. Individuals should also have access to the dispute-settlement mechanism on issues with respect to their mobility rights and the portability of programs.
- Mutual undertakings between governments on specific programs should last for fixed, renewable periods, and sufficient advance notice should be given before a withdrawal from or renegotiation of the conditions of specific programs can take effect.
- Following the model of the 1994 Agreement on Internal Trade, a social union accord initially would be an essentially political agreement on how governments use their powers (for example, the federal spending power) without modifying the substance of those powers. If the initial phase is successful, however, a justiciable accord could then follow.

The Canadian welfare state has gone through several periods of substantial change, including its inception beginning around World War II, expansion through the late 1960s and early 1970s, and the burgeoning of costs relative to the country's resources in the 1980s and early 1990s. The most recent period of change has been marked by efforts to restrain these costs and to adapt social programs to rapidly evolving needs, leading in many cases to review of their modes of delivery and overall effectiveness in reaching their stated objectives.

Throughout, the welfare state has been the product of actions by both Ottawa and the provinces, with local governments also playing a role. The relationship between the different levels of government and their respective roles in providing social programs has been an important features of the welfare state. It has also been a source of sometimes costly conflicts and uncertainties that arguably have resulted in a less-than-adequate correspondence between the wants and needs of Canadians and the programs designed to meet them.

The dialogue on the social union between Ottawa and the provinces,[1] which by December 1997 had evolved into formal negotiations, has been directed at reducing the causes of conflicts and uncertainties and their attendant costs. The provinces, which deliver and administer the majority of programs, have been increasingly uneasy with the way Ottawa — traditionally a key source of financing and sometimes the standards setter through its spending and other powers — has reacted to soaring costs by pulling back on funding meant to support provincial expenditures on health care, welfare, and education. With "social policy undergoing substantial, indeed unprecedented, decentralization" (Courchene 1996, 2), Ottawa can no longer be considered the sole "standards setter and enforcer" of the Canadian welfare state.

In the past year, however, Ottawa has either announced or publicly mulled over new initiatives in the social arena. These include the Millennium Scholarship Fund announced in the 1998 budget and a home care strategy that, if implemented, would affect policies in areas already well thought through at the provincial level. This has prompted the provinces — which risk being left holding the bag financially and politically if national policies are at odds with their residents' needs or if federal funding is cut back — to call for a more formal say in how these policies are set and for the right to withdraw from national programs under certain conditions. The dialogue on the social union is thus in large measure about how such a new balance of responsibilities can be managed.

In turn, a successful overarching "framework" agreement on responsibilities for social programs would determine the process for negotiating the content and financing of a wide range of specific proposals now on the agenda — from vocational rehabilitation for disabled persons to a comprehensive youth employment strategy to developing a national children's agenda to reviewing the Canada Student Loans Program — for which one level of government wishes to secure the other's cooperation.

This *Commentary* is about such a process, rather than about specific social policy outcomes, although it is written in the belief that a good process will lead to social programs that Canadians value. It takes as a point of departure the fact that social policy in Canada is enmeshed in the country's federal structure.

Accordingly, I begin by exploring some basic elements of federalism that facilitate or hinder the ability of the political apparatus to respond to Canadians' needs and objectives with respect to social policies. I then dwell on some major, earlier proposals or actions for reform of the federation on matters now encompassed by or relevant to the social union talks. Next I use this review of earlier reform at-

tempts as a platform for presenting key elements of the reform of the federal framework underpinning the social union.

In the following section of the paper, I formulate specific recommendations pertaining to the current discussions toward a social union agreement. A last substantive section addresses some concerns that the social union negotiations have raised.

My key recommendations are that

- Substantial approval of the provinces should be required before Ottawa launches, in areas of provincial or joint jurisdiction, new policy initiatives that involve shared-cost programs or block grants to the provinces and, in some specific areas, direct transfers from Ottawa to individuals.
- Federal tax credits should not require such approval unless their existence depended on the putting in place of companion provincial measures.
- Provinces should have the right to opt out of a national social policy that involves shared-cost programs or federal block grants.
- Provinces should be able to opt their residents out of federal transfers to individuals in areas explicitly agreed on. Any province that does so should have to gain the approval of a "supermajority" in its legislature.
- A province that opted out of a national program should receive either payments on the same per capita basis as participating provinces or equalized tax points that reflect what the province would have received in the first year of the program had it participated. Which of these two options applied would depend on the type of program and on whether the opting-out province chose to run a comparable program on its own.
- A province that opted out of a national consensus should have to compensate other provinces for any burden its opting out added to their social programs.
- Ongoing "benchmarking" of the accounting for, modes of delivery, and outcomes of social programs should be established to increase the transparency and comparability of such programs across Canada.
- Provinces should undertake to mutually recognize or harmonize programs having small differences that impede personal mobility, and to maintain the portability of programs that attach to individuals.
- The provinces should be required to enhance and uphold the nondiscrimination rights that accrue to the residents of other provinces by virtue of their Canadian citizenship. Similarly, Ottawa should stop discriminating between residents of different regions in its expenditures unless regional redistribution is a program's explicit purpose or natural outcome (as in the case of the fisheries).
- A mechanism, open to citizens, should be established to deal with disputes about the rights and obligations of Ottawa and the provinces under a social union agreement.
- No province should be able to opt out of the benchmarking, portability, mobility, nondiscrimination, or dispute-settlement provisions of a social union agreement, even with respect to a program or standard from which it had opted out.

Federalism and the Social Union

My proposals stem from an attempt to better harness Canada's federal structure for the benefit of its citizens, and are inspired by earlier debates relevant to Canada's social union. Accordingly, the next two sections of this paper review key concepts of federalism and significant earlier attempts at reform as they pertain to today's social union discussions.

Canada's federal system of government is a "logical response to the diversity of preferences" within it (Robson 1992, 17). Federalism acknowledges that citizens living in different regions may disagree about specific social, economic, and even political arrangements, and provides a system of government in which such differences can be expressed. As the Supreme Court of Canada unanimously stated in its decision on the *Referendum re Secession of Quebec:*

> The principle of federalism recognizes the diversity of the component parts of Confederation and the autonomy of provincial governments to develop their societies within their respective spheres of jurisdiction. (Para. 58.)

Thus, the very existence of the Canadian federation implies that, in areas under their jurisdiction, provinces may refuse to go along with an initiative they consider damaging; just as important, they may institute on their own a range of policies they consider beneficial. More specifically, provinces may, in their areas of jurisdiction, pursue policies that lack the approval — and perhaps even incur the disapproval — of a majority of Canadians as expressed, for example, through the federal government.

Yet it would be impractical, indeed nonfederalist, to take this principle as meaning that provincial governments should always be able to do exactly what they want, even in areas under their jurisdiction. This qualification has three principal rationales.

First, one province's actions may run up against constitutional or other obligations it has undertaken toward the union as a whole (to the federal government, to other provinces, or to citizens in other provinces). For example, section 121 of the Constitution precludes provinces from erecting barriers against goods produced in other provinces; section 6 of the Charter of Rights and Freedoms and, more recently, Chapter 7 of the Agreement on Internal Trade (AIT) proscribe barriers to entry against residents from other provinces.

Second, the lines between areas under different jurisdictions can be unclear, even when the jurisdictions appear to be formally separate or, *a fortiori*, are concurrent. Examples include potentially conflicting trade (federal) and labor (provincial) regulations, the overlap between environment regulation (concurrent) and property rights (provincial), or the impact of unemployment insurance rules (federal) on welfare policies (provincial).

Third, because Canadians are potentially highly mobile, a policy adopted in one province may create significant spillovers that either cost or benefit taxpayers in another. (A simple example of such a spillover is when residents of one province receive publicly funded health care another.)

I return to these problems — with more examples — below. Here it seems sufficient to note that, if a province had to internalize the spillover costs its policy created for other provinces, it might well not have adopted it in the first place. Conversely, if a province could internalize the benefits its policy provided taxpayers in other provinces, it would likely provide more of it.

In short, while the will of the majority of Canadians should, of course, prevail on the many issues of undivided national interest under the Constitution, it should not override differences in areas under the jurisdiction of, and of particular importance to, individual provinces. But neither should any province's exercise of its powers trump the rights of or impose direct costs on Canadians in other provinces.

How can one best assess the use by Ottawa and the provinces of their respective powers in a federal context? That is, what rights and obligations do the two levels of government have toward each other and toward each other's constituencies?

Making the Most of Federalism

The choices Canadians make with respect to a social union agreement should encourage the best possible use of their constitutionally given federal structure. Compared with a unitary state, a federal state with its multiple autonomous governments allows a country to reap a number of benefits. But a federal arrangement also has costs. The architectural goal of any federal state and, by extension, of the social union exercise is to ensure that the resulting structure — the web of constraints and obligations that ciizens and the various levels of government should observe toward each other — works in such a way that the benefits for citizens tend to exceed the costs.

Benefits

The benefits of a federal state include at least five items. First, federalism accommodates diversity in countries that have underlying regional or cultural differences. In Canada, this variation is most obviously the case with Quebec's majority French language and culture, as well as its civil law.

Federalism also accommodates other differences that, on the surface at least, do not look as radical. Provinces often pursue quite different strategies in response to divergent views about optimal social and economic arrangements (as when Alberta and British Columbia take quite different paths in welfare programs) or simply in response to different objective socioeconomic circumstances. In this country, the provincial governments are the principal avenue through which this diversity can be expressed in policy terms.

This ability to adopt different policies produces a second benefit of federalism: policy successes can easily be copied across provinces (with, for example, Ottawa's encouragement), while obvious policy failures can be prevented from spreading beyond their province of origin. Given Canadians' ease of movement, stemming from their common citizenship, a dynamic process can emerge that encourages experimentation to find an optimum set of policies for citizens in each province.

In a market, the best correspondence between public preferences and costs tends to occur where decisionmaking is decentralized. Similarly, a number of goods and services that governments produce can be delivered and administered most efficiently (that is, more in line with the public's preferences given a certain cost) when they are decentralized.

Thus, a third benefit of a federal system is that it allows the exercise of more administrative decisionmaking closer to the ground, which increases citizens' well-being by allowing a closer correspondence between the needs of the taxpaying public and the services offered — in other words, by avoiding diseconomies of scale in the aggregation of preferences that arise when administrative functions are not close enough to the public. Thus, ideally, local interests are preserved on local issues, not *against* the common interest but as a counterweight to the potential tyranny of the majority at a higher level of government that could actually reduce the overall welfare of Canadians by denying the capacity for local choice.

A fourth benefit of a federal system is that, while it allows local governments to achieve closer correspondence between the needs of the public and the services offered, it also allows the central government to deliver the agreed-on features of common nationality — rights of citizenship, national defense, redistribution to poorer regions, a customs union, rules of competition, and a common currency, among many others. Individual citizens, businesses, and other entities can thus count on the greater whole for issues of common interest, not *against* regional or local interests *per se* but against those measures that would hurt the union as a whole.

Finally, a federal system offers obvious opportunities to exploit economies of scale when these are available, as in delivering certain types of benefits (such as public pensions), raising revenues (most provinces currently use the common federal tax base in raising their own personal income taxes), overseeing crossborder endeavors, and spreading economic and other risks across disparate regions (for a Canadian analysis of the latter, see Goldberg and Levi 1994).

Costs

Significant differences in public services and taxes can emerge in a federation as a result not of different preferences or types of administration but of differences in the constituent regions' ability to pay. These disparities can lead individuals or businesses to move in response to different levels of public services offered relative to the taxes they pay in ways that hurt economic efficiency.

The literature on fiscal federalism often refers to public services received relative to taxes paid as the net fiscal benefit (NFB) (Boadway and Flatters 1982, especially 15–22). When movers are spurred by differences in NFBs across provinces, rather than by market signals that indicate where skills and capital are most gainfully employed in the economy, the result may be an inefficient allocation of resources. NFBs are notoriously difficult to measure, but some commentators invoke the potential for them to diverge across the country as the basis for some offsetting interregional redistribution, in the belief that this would ensure that individuals' choice of residence was based only on a combination of individual preferences and market signals.

Courchene describes the crux of this literature (1998, 14–21). He also, however, questions the use of the concept as an underpinning for transfers to provincial governments. Among other criticisms of the view that NFBs should be fully compensated across regions, he notes that its holders do not take account of "provincial priorities relating to taxation and expenditure policies" (ibid., 17) — in particular, with regard to competition with jurisdictions across the Canadian border (ibid., 21–22) — and unrealistically assume that the NFBs for residents of a province are not "capitalized" into the wages, rents, and prices in that province. Courchene notes that "full capitalization," if it occurs, may equalize NFBs without any redistribution between governments.

Second, a federal system holds the potential for costly duplication of activities between the federal and provincial levels and for unclear lines of accountability, which can distort voters' choices of public policy. The duplication of programs — provincial and federal training programs, for example — negatively affect citizens both as taxpayers and as potential users if the duplication results in less efficient services.

Note that it is not the overlap of jurisdictions itself that is the problem, since such an overlap can also provide citizens with more choices and comparisons. Nor are unitary states devoid of problems of overlapping jurisdictions that lead to turf wars between ministries of the same government (Dion 1995). Rather, the problem is the inherent potential for both unnecessary duplication and lack of accountability when, for example, two levels of government operate in the same area and one finances services delivered by the other.[2]

Third, governments in a federation can work at cross purposes or in an uncoordinated way, leaving their citizens with a suboptimal level of services. This problem is conceptually distinct from that of overlap and duplication. It arises from programs in different areas of jurisdiction that potentially have effects (either positive or negative) on other jurisdictions that are not taken into account when the programs are implemented or that even have contradictory outcomes, thus frustrating the legitimate

policy goals of one or the other level of government. This is the problem of externalities (spillovers), which I mentioned above.

Externalities

The question of externalities — of governments tending to account only for a policy's benefit or cost to themselves and their constituents and to ignore the possible benefits or costs to other jurisdictions — bears special examination.

Because of externalities, governments that act autonomously may offer a level of services that is lower than it would be in their citizens' collective interests to provide. They may end up underproviding programs that, because of mobility, end up benefiting other jurisdictions or overproviding programs services in ways that spell costs for other jurisdictions.

Consider two provinces that dispense significantly different welfare benefits; if this difference attracts citizens from the less-generous province into the more-generous one, the latter's costs go up. Or consider a province that finds a significant proportion of its postsecondary graduates end up living — and paying taxes — in other provinces. It may be tempted to underfund its investment in education, atleast in certain programs.

The existence of such horizontal (interprovincial) externalities requires, at minimum, an implicit understanding of how they are to be accounted for when common citizenship makes it easy for individuals to move from one region to another. Indeed, in health care, for example, some accounting between provinces already explicitly exists. Another relevant example is the net transfer of funds that occurs between Maritime provinces, based on the enrolment of their residents in higher education programs that are unavailable in the student's home province.

Some externalities are vertical (between a province and the federal government). Examples include federal training or scholarship programs that do not fit well with provincial educational or welfare programs; provincial regulations that hamper the negotiation of international treaties by Ottawa; or the potential for the provinces' overall fiscal stance to frustrate the intent of monetary policy. Vertical externalities call for better coordination mechanisms so that each level of government can internalize the impact of its decisions on the other's policies.

For horizontal externalities, the key question is whether and how provinces that are subject to negative externalities or that create positive externalities should be compensated for them. The answer must respect the rights of common citizenship, including mobility rights, and the right not to be discriminated against on the basis of provincial origin. Therefore, provinces may not throw up barriers to out-of-province citizens in order to capture more of the benefits of their policies internally (in the case of positive externalities) or to avoid the negative consequences of others' policies (in the case of negative externalities).

Finding the Right Process: The Challenge

Often advanced as a way of resolving the externality question is a system of common national standards combined with federal funding to support provincially administered programs that generate positive externalities across the country (for example, postsecondary education) and compensation for negative externalities when out-of-province citizens use the programs (for example, health care and welfare).

Yet imposing common standards on governments, taxpayers, and service recipients in regions where preferences truly diverge from any national consensus would negate much of the benefit of coexisting in a federal system in the first place. And just as federal transfers can be too blunt an instrument to prevent inefficient mobility across the country in search of NFBs,[3] it may also be difficult to target or justify federal transfers simply as a tool to en-

hance positive externalities or reduce negative ones within the federation. Part of the social policy challenge, therefore, is to see if one can find more targeted mechanisms to deal with externalities, both vertical and horizontal, as they arise.

A persuasive case can be made that Canadians could benefit from a better process to deal with social union issues. Currently, federal programs can be implemented without much thought about or consultation on their effects on provincial programs (and vice-versa for provincial programs that may affect federal prerogatives). Federal funding that affects provincial programs can be given and then withdrawn without explicit consideration of the impact. Moreover, although rigorous and ongoing comparison of interprovincial differences in social and other standards would allow Canadians to judge the results of their provincial or local governments' policies, too little of it exists.

In general, Canadians are still searching for a formula — constitutional or otherwise — that would allow greater flexibility within the federation without sacrificing the rights and obligations inherent in common citizenship. Because they have not yet found one, they risk getting short shrift from governments: they do not have as much control over local institutions that serve local needs as they should, and they are not as exposed to the benefits of the wider union as they could be.

The Search for a Better Union

Since 1940, the combination of the rights of the provinces to devise their own policies in their areas of jurisdiction and the use of the federal spending power to back a national consensus on certain programs has delivered Canada's modern social policy apparatus, the objectives of which are, on the whole, widely supported (Banting 1998, 40–59). But Canada, like all federations, is a dynamic country: changing conditions require administrative shifts and sometimes deeper mutations in its governance and institutions. Parts of the social policy infrastructure and the respective roles of the federal and provincial governments within it have been subjected to many modifications over time, and it is natural that they continue to be so in the future. Just as naturally, proposals for reform of Canadian federalism are as old as the federation itself.

Here is a brief look at some recent institutional changes, proposed and actual, that are relevant to current talks on the social union, although many dealt with an even broader agenda when they were formulated.

The Macdonald Commission

I begin my brief and selective survey with the work of the Macdonald Commission, completed in 1985, because it has clearly provided a great deal of the intellectual fodder for much of the activity since that date. Even though the ideas in the commission's report led to two stillborn efforts at "mega-constitutional change" (Russell 1993), many of them have also informed more successful developments and recent promising proposals.

The Macdonald Commission was impressive in both its breadth and the specificity of its recommendations. Although it did not use the term *social union*, it was very concerned with institutional issues surrounding policymaking, both economic and social. It made specific recommendations on reforming Parliament as well as on improving intergovernmental relations.

The commission was particularly harsh about the lack of regional representation in policymaking in Ottawa:

> [I]n recent years, by any measure of regional representation, our national institutions have been seriously flawed. It is not an exaggeration to speak of an institutional failure...Despite the importance of regional differences in Canada, the present design

> of our national institutions gives remarkably little attention to regional interests. (Canada 1985, 72.)

The commission therefore recommended reform of the Senate, including the election of senators, in order to "implement the federalist principle in our national institutions" (ibid.).

On intergovernmental relations, the commission noted that, although there was "considerable communication among governments, it is often sporadic and *ad hoc*" (ibid., 262). To remedy this situation and to improve the various levels of intergovernmental interaction — consultation, coordination, and joint decisionmaking — it proposed to constitutionalize and annualize the first ministers' conference as the "capstone of the intergovernmental structure" (ibid., 265). The body it proposed would have no powers to legislate but would oversee and receive reports from ministerial councils made up of provincial and federal ministers overseeing similar portfolios, including a council of ministers on social policy that would "consider all facets of" federal-provincial transfers and manage policy overlaps both horizontal (in, for example, provincial education) and vertical (in, for example, federal unemployment insurance and provincial welfare).

The commissioners also recommended the development of a nonconstitutional "Code of Economic Conduct" (ibid., 137), which can be seen as one of the precursors to the AIT. The commissioners envisaged that this code would also cover areas relevant to the conduct of social policy; for example, it would include a commitment "to minimizing the costs of provincial programs that might fall on residents of other jurisdictions," as well as to promoting "non-discrimination against persons (individuals and organizations) based on province of residence" (ibid., 138).

In summary, the Macdonald Commission sought to increase regional input into centralized decisionmaking, to formalize intergovernmental institutions such as the first ministers' conference and under it various councils of ministers responsible for overseeing specific areas requiring better policy coordination, and to strengthen Canadians' rights of citizenship.

Attempts at Constitutional Reform

Two key building blocks of Canada's current social union were put firmly in place with the *Constitution Act, 1982*. Section 6 (part of the new Canadian Charter of Rights and Freedoms) considerably strengthened the rights of Canadian citizens and permanent residents to take up residence and pursue a livelihood in any province, while section 36 entrenched the concept of equalization. Unfortunately, however, although the act accomplished the patriation of the Constitution from the Parliament of the United Kingdom, formally making constitutional change a matter for Canadians alone to decide, it did little to bring peace to the country's constitutional politics, since Quebec's National Assembly overwhelmingly rejected the move.

Two subsequent major attempts at constitutional reform resulted in the Meech Lake and Charlottetown Accords, both of which contemplated further modifications to the social union. Indeed, the overall concept of a Canadian "social union" came to the fore during the negotiations that led to the Charlottetown Accord (Meekison 1996).

Although the deals themselves failed as packages, some of their elements could muster a broad consensus in a context other than that of blockbuster constitutional change. It is, therefore, worth reviewing here some of the components of these accords relating to the social union, many of which hark back in some form to the work of the Macdonald Commission.

The Meech Lake Accord, reached unanimously by Ottawa and the provinces in 1987, was short and explicitly directed at reintegrating the Quebec government within the willing constitutional family. Of particular relevance

to the social union were proposed constitutional amendments that would have provided "reasonable" compensation to the government of a province that chose not to participate in a new national shared-cost program in an area of exclusive provincial jurisdiction, on condition that the province carried on an initiative compatible with the national objectives.

In addition, the Meech Lake amendments would have ensured that appointments to the Senate were acceptable both to Ottawa and to the provinces in which the vacancies were to be filled, and mandated a yearly first ministers' conference.

A more elaborate deal, the 1992 Charlottetown Accord emerged from new federal constitutional proposals in 1991 and from the recommendations of a major parliamentary joint committee (the Beaudoin-Dobbie Committee). Negotiated between Ottawa and the provinces with the participation of aboriginal leaders and after consultation with representatives of many social and business groups, the accord attempted to deal with a wide series of outstanding issues within the federation, some of which were, in retrospect at least, not suited to constitutional negotiations.

The draft legal text of the Charlottetown Accord also included provisions for "reasonable" compensation for any province that chose not to participate in a new national shared-cost program, on condition that it carried out an initiative of its own that was compatible with the national objectives. Along these lines, negotiations on the devolution of Ottawa's existing labor market development and training activities were to take place with any province that wished to do so.

Other provisions would have prevented a government from unilaterally altering the terms of an intergovernmental agreement before its expiry, required that Ottawa treat provinces with similar needs and circumstances equally under such agreements, and given the Senate a role "parallel" to that of the House of Commons (with the two voting jointly in case both proved unable to pass a similar legislation) in approving these agreements on the federal side. The accord would also have opened the door to the election of senators, and it contemplated that, in certain cases, the Senate could (and would, in the case of the head of the central bank) review federal appointments.

Moreover, the accord would have committed governments to "the principle of the preservation and development of the Canadian social and economic union." Although not justiciable, this commitment to the social union went beyond framework questions such as those just described and required the execution of certain specific policies. For example, section 36(2) of the accord would have constitutionally committed governments to maintain a publicly administered health care system. As well, the "integrity of the environment" would have been entrenched as a defining component of the social union.[4]

Finally, as a general matter, the accord also included a commitment from the federal government to "respect and not distort provincial priorities" and to "ensure equality of treatment of provinces" when spending money in areas of exclusive provincial jurisdiction; it would also have entrenched an annual first ministers' conference at which progress on these and other commitments would have been reviewed.

Nonconstitutional Renewal

One can reasonably say that the failure of these two mega-accords resulted in governments' shifting their emphasis toward addressing the causes of stress within the federation through nonconstitutional means. In part, this approach has involved building on specific aspects of the wider negotiations that had shown the promise of garnering consensus, now that these could be separated from some of the particu-

larly contentious issues the accords sought to address.

Some significant changes, previously included in constitutional proposals and discussions, were made without constitutional fanfare. A prominent one was the commitment not to institute new shared-cost programs in areas of exclusive provincial jurisdiction without the approval of a majority of the provinces — a pledge made in the 1996 federal Throne Speech, soon after the near-defeat of the federalist forces in the October 1995 referendum in Quebec.

The prime examples of intergovernmental cooperation were the negotiations on the AIT, launched in March 1993 and concluded the following year (see Box 1), and the beginning in 1998 of a renewed National Child Benefit (NCB), described below.

The National Child Benefit

In recent years, much of the impetus for and work on restructuring the federation has come from the provinces. Spurred by unilateral federal actions in the 1990s, such as the cap on payments to rich provinces under the Canada Assistance Plan — a shared-cost precursor to the current Canada Health and Social Transfer (CHST) — and the cuts in transfers to all provinces contained in the 1995 federal budget, the provinces (without, initially, the participation of Quebec) have taken the lead, via the annual premiers' conference, in shaping the Canadian social union.

At their annual meeting in 1995, the premiers and territorial leaders asked a ministerial council to examine the need for reform of social programs. The group submitted an issues paper and, following its adoption at the August 1996 premiers' conference, the Provincial/Territorial Council on Social Policy Renewal was established with a specific mandate to move the social policy renewal agenda forward in conjunction with Ottawa and to coordinate an approach to overarching social policy issues of national importance. Under the council, the social services ministers were asked to prepare a report on a new integrated national child benefit by January 1997.

Meanwhile, the federal government had indicated, in a green paper, its interest in reform of the child benefit (Lazar 1998b, 122). Thus, in November 1996, a new Federal/Provincial/Territorial Council on Social Policy Reform and Renewal held its first meeting to discuss its mandate, ground rules for working together, and the gathering of public input. When the social service ministers' report on a new national child benefit was completed in January 1997, it was received by both the Provincial/Territorial and the Federal/Provincial/Territorial Councils as well as by the premiers.

This joint approach to policymaking resulted in the development of a renewed National Child Benefit (NCB), which provides a particularly promising example of what a cooperative approach can deliver. The NCB is a joint, interlocking approach to child benefits. Briefly, Ottawa is increasing the Canada Child Tax benefit for low-income families, thereby allowing provinces to recover funds they can then use for a variety of programs — such as child care, an employment income supplement, or help with school or training initiatives — provided the initiatives promote attachment to the workforce or otherwise assist low-income families with children (Canada 1998).

Increased Provincial Involvement

In addition to its work on child benefits, the Provincial/Territorial Council released, in April 1997, a paper entitled *New Approaches to Canada's Social Union* (1997). It clearly expresses the view that both orders of government have a role in developing the social union, and it lays out some options on a number of fronts of interest to the premiers.

Box 1: ***The Example of Internal Trade***

A good example of an experimental cooperative approach is the Agreement on Internal Trade (AIT), signed in 1994. The signatories to the AIT — all the provinces and the federal government — agree to work more cooperatively toward reducing discriminatory barriers to trade, enhancing the transparency of various trade-related measures, and harmonizing standards. The AIT provides a balance, through various tests and reporting requirements, between acknowledging the right of governments to take measures to achieve legitimate objectives within their spheres of competence and ensuring that these measures do not constitute unnecessary obstacles to trade within Canada.

Although in many cases progress on implementing the AIT has not been as quick as initially promised (Schwanen 1998) and the agreement's coverage is not as extensive as it could have been, it should be kept in mind that the AIT is a non-justiciable agreement. Thus, it should not be confused with the law of the land, let alone with a constitutional amendment. In particular, it does not prevent the federal government from passing legislation toward removing barriers, using its constitutional trade and commerce powers (Howse 1996, 13–14).

Yet despite its being essentially a political accord, the agreement's framework is a useful experiment for all Canadian governments, not the least because it represents an equilibrium whereby all governments agree to refrain from using their powers to set their own objectives in a way that is damaging to Canadians, and because it contains new mechanisms to improve consultation, cooperation, and dispute resolution within the existing legal and constitutional structure. In the words of the members of a dispute-settlement panel established under the agreement, the AIT "has in fact changed the policy context facing governments by requiring a greater level of consultation or 'process' when introducing measures affecting internal trade" (Agreement on Internal Trade, 5).

The relevance of this exercise to the current debate over the social union is clear. It suggests that it is possible to envisage a meaningful political agreement to better define and harmonize governments' *exercise* of their constitutional powers without their having to yield on the *substance* of these powers. If, over time, wide support can be maintained for the AIT or for a similarly political agreement on the social union, these agreements could be given a more solid legal basis.

In particular, the paper suggests moving toward a cooperative process to "develop, review and interpret principles and standards" as well as to "develop, monitor and report on program outcomes" (ibid., 5). It points to increased cooperation in areas of shared jurisdiction and in areas where policy in one jurisdiction affects another. It also suggests that any agreement between Ottawa and one province ought to be communicated and made available to all other provinces.

The paper then considers the prevention of conflicts and the reconciliation of disputes through a variety of methods: consultation at the ministerial or first minister levels, public discussion and consultation on items of dispute, a formal advisory or adjudication process, or some combination of these approaches. It suggests that the work of promoting adherence to principles and standards necessitates agreement on goals, outcomes, and the public reporting of results, as well as a "joint mechanism for assessing and imposing sanctions, including financial penalties" to ensure adherence to principles and standards (ibid., 7).

Another key aspect of the options paper concerns the development of a new approach to the federal spending power. The paper points to Ottawa's commitment in the 1996 Throne Speech not to implement shared-cost programs without the consent of a majority of

provinces and to allow provinces to opt out so long as they commit themselves to implementing comparable initiatives.

In this respect the paper then discusses a number of provincial "consent alternatives," ranging from a simple majority to unanimity. It suggests two forms of opting out: either a province commits itself to implementing a similar program (conditional compensation), or it simply opts out with compensation without such a commitment (unconditional compensation). It expands Ottawa's list of programs potentially subject to opting out beyond merely future shared-cost programs to include existing shared-cost programs and any program Ottawa delivers in an area of exclusive provincial jurisdiction.

Finally, the paper proposes to limit governments' ability to unilaterally change intergovernmental financial arrangements. To do this, it suggests, all governments could pass legislation with notice provisions, or all intergovernmental agreements could include multiyear funding commitments with high levels of consent required to effect change and with compensation for early termination.

The proposals in the options paper are unsurprisingly decentralist, given that it was written by a provincial council without Ottawa's participation. They also reflects the slow withdrawal of federal influence in social programs, giving *de facto* legitimacy to provincial demands for more control. (One result was the August 1998 opting into the negotiating process of Quebec, a province that has long demanded more autonomy in policy development.)

Yet overall, the provincial/territorial paper shows a great deal of interest and willingness on the part of the provinces to assume a national outlook on programs for which they bear the most constitutional and financial responsibility. Ottawa has a unique opportunity here to work in concert with the council on a better, more predictable yet flexible, social policy framework for the country.

The ACCESS Model

As noted, this provincial assertion is the result of Ottawa's slow but steady withdrawal from social policy over the past 15 years, but it also received a noted intellectual push by a widely circulated paper written by Courchene for the Ontario government. One of its "key operating assumptions [is] that an effective internal socio-economic union must require the combined efforts of all levels of government" (1996, 4).

Courchene proposes two institutional models for implementing his assumptions: a "workable interim model" that could be implemented with minimal changes to existing practices and institutions, and a full-blown version that takes the framework principles to their "logical and constitutional limit" (ibid., 11).

The interim model would include the enforcement of existing national standards (the five principles of the *Canada Health Act* and the prohibition of residency requirements for welfare), the 1996 Throne Speech commitments on the federal spending power, and a

> revitalized version of the First Ministers' Conference. Challenges could be brought by citizens or governments which would be adjudicated by a panel of experts, and if upheld, remedies could be applied by consent of all governments. The accord would be signed for five-year periods. (Ibid., 13.)

Courchene sees two problems with the interim model. First, it would not bind the federal government in the area of federal cash transfers to the provinces when federal unilateralism has been an issue. Second, he regards the current principles, such as those of the *Canada Health Act*, as unsuited to the coming challenges and evolution of social policy.

These two weaknesses, plus the key operating assumption of the paper, lead Courchene to prefer the full-blown model, which implies a wide range of policies embodying

> a highly decentralized approach to securing the internal common market, with any attendant externalities/spillovers to be sorted out largely via interprovincial accords rather than federal intervention. (Ibid., 16.)

The provinces would assume full responsibility for financing, designing, and delivering health care, welfare, and education, with standards set by interprovincial agreement, rather than by adherence to federally imposed models.

Labor market policies would also devolve to the provinces, with the unemployment insurance program being run jointly or, alternatively, at the provincial level (premiums would be brought into the equalization formula to ensure that all provinces had sufficient access to revenues). Accompanying this shift would be mutual recognition in the areas of training and certification.

Courchene then proceeds to the difficult issues of compliance, enforcement, and remedies. Since social policy would be moved into the provincial sphere, the overriding question would be how to bind the provinces to an interprovincial agreement. Courchene builds on Swinton's analysis (1995) to recommend that all provincial legislatures "design an accord or convention that they would then initial. Template legislation would then be drafted and passed in the legislatures of all signing parties" (Courchene 1996, 27). While such "manner and form" legislation would not be as strong as constitutionalized provisions, Courchene argues that, in the area of social policy, the political pressures to abide by the agreements "would be intense, if not overwhelming" (ibid., 28).

Courchene thinks that monitoring and dispute resolution under the full-blown version could be modeled on the AIT provisions (see Box 2). Enforcement of any rulings would rest on the political difficulty of pulling out of an agreement that gives citizens, personal and corporate, rights that governments would be very wary of abrogating.

Box 2: *Dispute Settlement under the AIT*

The AIT's dispute-settlement mechanism is available to both governments and citizens. (The latter must go through a screening stage to ensure that their case has a substantial basis.) The agreement places considerable emphasis on the need to settle disputes without recourse to an independent panel, including requiring the disputants to go through consultation, mediation, and conciliation before the Committee on Internal Trade, which is composed of all Canadian ministers responsible for internal trade, can intervene in a dispute. Only if that intervention fails does a dispute go to an independent panel, formed from a standing roster of persons named by each government and from which each disputant selects panelists from among those they did not name to the roster.

Governments are expected to conform with panel findings, although in practice enforcement relies far more on moral suasion than on the ability of governments to retaliate (see Schwanen 1998, 189–191).

Critiques of Increased Integovernmental Cooperation

Cooperative federalism as embodied, for example, in the recent provincial approach and the ACCESS model, is not without its critics. Some commentators believe the idea is not in Canadians' best interests. Others simply doubt that the models proposed can achieve the desired cooperation.

In this subsection, I examine examples of both critiques.

Cooperation Would Limit Choice

A powerful criticism of the types of cooperative models for reform reviewed above is

based on the idea that competition between the federal government and the provinces is healthier, from the point of view of the consumer (in this case, the voter) than cooperation, which can lead to collusion between governments and fewer policy choices for the public. This criticism was expounded in a classic supplementary statement to the Macdonald Commission report written by one of its commissioners, Albert Breton (1985).

Breton's rich argumentation is difficult to summarize, but it is based on the idea that, regardless of the *de jure* division of powers, policy interdependencies are pervasive in a federation. Relevant to the question of whether competition or cooperation should prevail between the two levels of government are two kinds of interdependencies: one in which the policy choices of one level of government affect how another is able to respond to citizens' preferences, and the other involving the carrying out of policy, which Breton calls the "production and implementation" process of policy (ibid., 503).

The latter, says Breton, is the "limited case for Executive Federalism" — cooperation between governments when policies have been decided on by their respective political arms — and it is acceptable (ibid.). But cooperation should not extend to the first interdependency because it concerns the elaboration, formulation, and design of policies; here, one level of government should have the choice of "complementing" another's policy when it agrees with it or countervailing it with another if it does not. Thus, Breton sees this cooperative federalism as a form of collusion that limits the voter's choice.

The response to Breton's argument hinges on understanding what constitutes fair competition and what limits to competition are efficiency inducing and hence acceptable. Here, it is useful to recall Breton's views on the conditions for efficient horizontal (interprovincial) policy competition:

> To be sure, efficient horizontal competition does not require that all competing units be of equal size….But it must be that the large units are not in a position to continually dominate, coerce, and in other ways prevent the smaller units from making independent autonomous decisions; nor are they in a position to inflict "disproportionate" damage on them. (Ibid., 506–507.)

Is it not, however, also important to avoid *vertical* imbalances? When Ottawa has gradually appropriated parts of the common (federal-provincial) tax room while staving off transfers to the provincial level (St-Hilaire 1998), is competition fair? Is it efficient?

A case can be made that the market for citizens' preferences can be distorted by Ottawa's use of its amorphous spending and taxing powers, blurring the *de jure* responsibility for government activity in a particular field, which Breton acknowledges must ultimately be borne by some elected government if the political market is to function. Breton acknowledges that checks and balances on the federal government are missing in our parliamentary system, and he proposes a renewed Senate to remedy the situation. But in the absence of such reform, which body will review the federal government's interventions in areas of provincial responsibility and provide clear lines of accountability?

Furthermore, as Breton acknowledged at the time, the study of competition between governments, a form of nonprice competition, is not complete. But the evolution of the theory of competition in the private realm has shown that cooperation between firms does not always equal collusion; it may yield, for example, significant economies of scale that deliver benefits to the consumer in terms of lower prices or a more accessible service. As well, the Chicago School theorists of competition policy argue that the vertical contractual relations frowned on by traditional competition policy can actually constitute an efficient — welfare-

enhancing — business practice (Anderson and Khola 1995, 8, 83–90).

The general point that vertical cooperation is not necessarily at the public's expense suggests that the policy walls between the federal and provincial governments need not be as high as suggested by adherents to a strict view of competitive federalism. There is indeed room for more cooperation.

Cooperation Will Not Happen

Other commentators raise a problem about the results of the reduced threat of unilateral federal action explicit or implicit in proposals such as Courchene's ACCESS model:

> Courchene's proposal is thus a double-edged sword: the promise of decentralization that he offers the provinces is premised on a commitment to "positive integration," which implies greater harmonization (i.e., uniformity). To make this approach work, some of what provinces receive in the form of greater powers will have to be sacrificed on the altar of harmonization. The key question is thus whether Courchene's interprovincial model for building social Canada can reconcile these conflicting approaches, or whether centrifugal forces unleashed by decentralization will gain the upper hand in the absence of a strong federal presence. (Kennett 1998, 12.)

The criticism stems from the view that the provinces alone do not have sufficient incentives to cooperate on devising national social policies or to submit to the disciplines of a social union.

This argument appears, however, to be based on an assumption that in the voters' minds, the issues on which they vote provincially are completely divorced from the issues on which they vote nationally — in other words, when voters in a province wish to deal with a national issue, they do so through national rather than provincial politicians. On that assumption, of course, provincial politicians are ready to cooperate among themselves and with the federal government only in the narrow interest of their province and rarely in the interest of the country as a whole.

But what if, as seems quite natural to me, provincial governments are also judged on how well they have performed in *national* negotiations on issues of interest to their citizens? What if provincial governments are rewarded for their successful efforts on a national scale when these accord with their voters' preferences? This situation would actually explain the everyday experience in Canadian politics of provincial governments' actively engaging in a wide range of cooperative behavior (for numerous recent examples, including the AIT, see Lazar 1998a). Although one can find examples of provincial politicians who "got burned" by playing national politics, one can certainly also find examples of those whose fortunes declined as they played their regions against "the feds." The reverse, of course, can also happen with federal politicians.

In short, there is little evidence that provinces have insufficient incentives to cooperate on issues of national importance. Of course, the federal government should think twice before giving up its ability to act within its powers — alone if need be — on issues of national importance, but neither should it assume that only this power will induce federal-provincial or interprovincial cooperation on national issues when that is what the voter wants from both levels of government.

Key Elements of Reform

A wide range of options can be used to implement social policy within a federation. At the two extremes are centrally enforced harmonization, which would come close to replicating the unitary state, and pure devolution, which would result in a neutered central government

and a confederation of powerful states. Both would be unsuitable for Canada: the former would encroach on the flexibility provinces need in order to develop and deliver policy in their areas of jurisdiction; the latter would ignore the predicate of common citizenship and the strong interdependencies that continue to exist in these same policy areas and that require a minimum degree of coordination within the federation. Thus, in my view, a permanent strengthening of the Canadian social union must be accomplished through a form of direct cooperation between Ottawa and the provinces.

In this section, I describe five elements of reform that, if applied in the social policy areas substantially under the control or administration of the provinces, would make the most of Canada's federal structure by ensuring the required degree of cooperation. These elements are rooted in the above discussion on federalism and the social union and often echo some of the earlier proposals for improving the functioning of the federation in the field of social policies.

Respect for and Cooperation between Jurisdictions

In Canada, members of the federal Parliament are elected using the first-past-the-post system in each constituency and senators, though apportioned by region, are neither elected nor chosen by provincial legislatures, making this country a peculiarity among federations (see Watts 1996, 84–89). With such a system, Ottawa is able to articulate policies in areas of substantial provincial jurisdiction without having to win broad-based popular and/or regional support. This situation has probably contributed to the periodic perception of the federal spending power — a potentially key tool of the federation when it comes to implementing a genuine national consensus that requires federal intervention — as a means of running roughshod over areas legitimately under provincial jurisdiction.

The Millennium Scholarship Fund, which the federal government announced unilaterally in its 1998 budget, provides an example of the flaw. Although postsecondary education is the exclusive domain of the provinces, Ottawa is proceeding with a program that will fund students and overlap with provincial programs in the same area. Even if the program is exemplary on its own terms, the provinces are well within their rights to complain about potential inefficiencies due to their lack of input into the announcement of a program that will operate in an exclusively provincial area of jurisdiction and will likely affect their own budgets and priorities and student loan programs. Tension in this case, as with most examples of federal unilateralism in areas of provincial jurisdiction, shows the absence of bridges between the federal and provincial governments in areas of mutual concern.

It is imperative to build permanent bridges between national and provincial concerns so as to obtain the proper balance between the two at a time when so many initiatives at one level affect the other.

Ottawa may, of course, hesitate to relinquish its current ability to design and implement programs without bothering, at least formally, with provincial or regional concerns. Yet this view overlooks the fact that involving the provinces in federal initiatives increases the likelihood of their making greater commitment to national programs that are funded by Ottawa but that substantially affect provincial policies. Provinces could truly opt into various national programs and initiatives, as they did with the NCB.

Ottawa has, in fact, stated its desire to move in this direction. As mentioned, in its 1996 Throne Speech, it pledged not to initiate any "new shared-cost programs in areas of exclusive provincial jurisdiction without the consent of a majority of the provinces" (Canada

1996, 9) and to compensate provinces that stay outside a new program but implement a comparable one of their own. No formal mechanism to that effect has yet been established, however. Moreover, Ottawa left itself free to act unilaterally on programs that are not cost shared (hence, it could, for example, institute the Millennium Scholarship Fund, which will be entirely federally funded).

The Right to Opt Out under Certain Conditions

Even if a national program exits in an area of provincial jurisdiction, that should not mean all provinces must subscribe to it if, for example, it is incompatible with the needs of the population as perceived by a particular province. If the program is in an area where the provinces have primary responsibility for delivering the service, the right to opt out should prevail over the national consensus.

Furthermore, as a practical matter, if a province exercises its right to opt out, its residents should not suffer direct adverse financial consequences from that decision when other provinces receive money paid from the common federal coffers (which include taxes from the residents of the province that opts out).

If a province decides to opt out of a program supported by cost sharing or block grants but to maintain a program that exhibits substantially the same features as the national program or is otherwise considered compatible, the question of compensation is relatively straightforward: the province should be entitled to payments from Ottawa on the same basis as those made to participating provinces. (This would be the most easily understood and defensible way to divide transfers, since the equalization program is already designed to compensate for any weaknesses in provincial economies relative to the national average.) Furthermore, so long as programs are comparable or compatible, the question of policy spillovers between provinces does not arise.[5]

Provinces should also have the right to opt out of a national consensus in areas under their jurisdiction without committing themselves to maintaining programs that are similar or comparable to those in other provinces. In this case, however, compensation from Ottawa should be crafted so as to avoid creating new financial incentives for any province to opt out and conduct alternative policies, especially at the rest of the country's expense. An impartial dispute-settlement mechanism should also be available in case of disagreement on whether a province is in sufficient conformity with the national standard. (I explore these questions further in the section on recommendations.)

Furthermore, as I have already discussed, large differences in social programs between provinces are likely to have drawbacks for Canadians living inside or outside an outlier jurisdiction. In particular, differences in one province may impose burdens (negative externalities) on the purses of other provinces or indeed on the federal budget if they result in the dumping of local expenditures on national programs or on any program in place in a neighboring province. On the other hand, the benefits of a provincial program may accrue to other provinces or to the federal coffer (a positive externality), causing the province to underprovide the program relative to its benefits for the country as a whole or to restrict its provisions to *bona fide* provincial residents, which may impede economically and socially useful mobility.

As mentioned, positive externalities have been invoked as the basis for federal intervention in the funding of higher education and other programs — although intervention is rarely, if ever, tied to any measured estimate of the size of the externality. Negative externalities have been invoked by provinces that have considered raising barriers against nonresidents attracted by, for example, generous welfare rates, a lower cost of higher education, or even the availability of certain kinds of health care

services. Given that the problem is not of epidemic proportion, however, attempting to resolve it with cross-country federal transfers or standards or with barriers to mobility is likely to lead to overkill: either too much federal intervention or, at the other end, "not in my backyard" provincial attitudes. Neither is healthy in a federation.

As an alternative to these extreme solutions to the externality issues, one of the conditions for opting out of a national program should be reference to its impact on other provinces and, indeed, on other federal programs. In other words, maintaining the social union would require that citizens in other provinces not suffer an undue fiscal burden when a province deviates from an otherwise agreed-on national norm. Before exercising its right to opt out, therefore, a province should secure the agreement of other provincial governments that it has adequately dealt with any costs the exercise of that right may impose on them. (Indeed, a province that maintained a richer program than its neighbors and showed that this created positive externalities for other governments could, in principle, claim compensation to that effect.)

Transparent and Standardized National Reporting

A major virtue of a province's having the right to engage in social policymaking is simply that Canadians in other provinces can learn what works and does not work, at a very practical level, and adapt that knowledge to their own circumstances.

Of course, in the long run, provinces with effective policies will be more successful socioeconomically even given an equitable sharing across the country of fiscal resources (as is attempted through equalization), and this success will encourage other provinces to adopt similar policies for fear of lowering the relative living standards of their residents. Nevertheless, citizens and officials across the country would be better off if some benchmarking exercise informed them, in timely fashion, of the policies in place in other provinces, their objectives, and their modes of delivery, costs, and outcomes.

As Robson (1996) argues, a positive result of such a comparative exercise from the bottom up would be the voluntary adoption of proven "best practices" across the country. The exercise could also facilitate the adoption of a national consensus. Either way, the result would probably be better than counting on citizens to vote with their feet toward jurisdictions with more successful policies, when these policies really should also be adopted in their home province. Furthermore, such a benchmarking exercise could make it easier to assess which areas are good candidates for policy experimentation and help all governments evaluate whether policy differences among provinces genuinely correspond to their citizens' differing priorities.

Facilitation of Harmonization and Mutual Recognition

Local administrations naturally tend to protect their turf. And the lack of any body to provide standardized reporting of provincial services has virtually guaranteed the existence of small differences between provincial programs that are difficult to justify by differences in policy objectives. Just as Ottawa often isolates its policy process from the provinces, so may provinces also have too few formal reviews of their different practices.

Thus, a natural outgrowth of the benchmarking exercise described above would be for small differences in social policy standards to be subjected to a more formal harmonization exercise, similar to the one undertaken under the AIT. The point here is that, while large differences often reflect legitimate differences in underlying policy objectives, small differ-

ences may have more harmful effects, as they are often administratively burdensome (for example, for firms needing to transfer employees across the country and for the movers themselves) without the countervailing potential benefit of responding to different priorities.

With respect to standards attaching to individuals, a useful substitute for complete harmonization might be the mutual recognition of standards across the country, principally those that would ensure the portability of occupational qualifications. (Another example is the portability of public pensions, even though the Canada Pension Plan and the Quebec Pension Plan are two different schemes.)

In this respect, the AIT introduced an ingenious mechanism by which provincial occupational standards conferred in one province are to be mutually recognized in the others, provided a test showed that the relevant qualifications are substantially the same across the provinces (except in the case of justifiable overriding requirements — for example, engineers must have a knowledge of permafrost conditions in order to practice in the Northwest Territories). Another possible application to the social union would be to ease the mutual recognition or equivalence of school programs when these are mostly similar across provinces.

Enhanced Rights of Mobility and Nondiscrimination

Citizenship in a democracy entitles the individual to a *droit de cité* within its boundaries, encompassing the right to live anywhere in the country with a strict minimum of formal requirements when moving and, when in a province from which he or she does not originate, to be treated there on par with other citizens under provincial and local laws. Hence, the right of citizens to be mobile across the country and to be treated everywhere in a nondiscriminatory fashion ought also to be a cornerstone of Canada's union, social or otherwise. To put the point another way, without such fundamental rights of citizenship, no political union exists and, hence, it can have no functioning social or economic component.

There is, however, a distinction between the right to be treated elsewhere as a local resident in local matters and the right to be treated the *same* way everywhere the individual goes. To claim the latter right as an absolute treatment would be a fundamental denial of the purpose of the federation. This being said, it is important to realize that rights of mobility and nondiscrimination discourage, rather than encourage, differences within a country and are thus key to Canada's ability to foster as close a social union as possible while respecting the provincial jurisdictions mandated by the Constitution. The reason is that mobility encourages not only competition but also governments' adoption of some of their neighbors' most successful economic and social policies. Therefore, as a general rule, banning all barriers to mobility and discriminatory practices that are based on a citizen's province of origin would enhance the social union.

In addition, the benefits of federalism cannot be fully captured if Ottawa does not treat individual Canadians on the same footing regardless of where they are located. To begin treating individuals facing similar circumstances differently only because their province of residence differs is to invite a fracture in the sense of common citizenship that would particularly affect citizens of provinces that are discriminated against. This is at the heart of the principle of fiscal neutrality that many observers have promoted (see, for example, Group of 22; Courchene 1996).

The principle of fiscal neutrality is not meant to replace the federal government's power to redistribute across regions. It simply applies to programs that do not have redistribution as their explicit purpose. The chief interregional redistributive program in Canada, equalization, has been outside the purview of the social union negotiations because of the widespread

approval of its principle: that all provincial governments should have the wherewithal to provide reasonably comparable public services at reasonably comparable tax rates (in the words of section 36(2) of the *Constitution Act, 1982*).

At any given time, the sharing of resources through equalization allows for differences in services, standards, and taxes between provinces to be less the result of differences in the resources available to them and more simply the result of different policy choices or other nonpecuniary factors (such as lack of standardized reporting across provinces).

Equalization can thus be seen as a *quid pro quo* for provincial jurisdiction over a wide range of programs, particularly in the area of social policy (Bird 1986). Equalization payments, therefore, should be (and are) unconditional payments that allow provinces taking different approaches to reap the benefits of federalism but to have access to similar levels of revenues in order to minimize the costs of federalism — or to maximize the sense of common citizenship.

However, once the equalization program provides revenues sufficient to ensure that provinces can provide reasonably comparable public services at reasonably comparable tax rates, the principle of fiscal neutrality requires that other federal programs not treat Canadians differently because of their place of residence. Today, this principle is far from being met.

Federal transfers to provinces in the form of CHST payments for health care, education, and social services distribute widely varying amounts of cash across provinces, and current proposals to reduce these disparities will do little to improve the matter (Boessenkool 1996). Per capita payments under recently announced federal transfers for labor force training, funded by employment insurance (EI) payroll taxes, also vary widely across provinces, as do a myriad other shared-cost programs (in, for example, agriculture, culture, the environment, human resources, regional development, justice, housing, and transportation) where no obvious justification exists for regional differences (idem 1998, appendix A). Finally, variable eligibility requirements for the EI program, which are based on regional unemployment rates, mean that Canadians in different parts of the country in effect face vastly different public insurance regimes against unemployment.

Recommendations for Reform

In this section, I return to the five elements of reform on the social union agenda formulated above in order to devise a menu of rules and tools that would help governments to implement them. I liberally pillage from some of the earlier ideas for reform described above, but I also introduce some new ideas for change to ensure the coherence of the package or to supplement earlier ideas that seem inadequate to implement reform across the spectrum I have envisaged.

Respect for and Cooperation between Jurisdictions

The development of the NCB, described above, illustrates that Ottawa and the provinces can take a cooperative approach to developing policy in an area of provincial jurisdiction where the national dimension is also compelling — a sign of progress toward my first element of reform. However, the cooperation process in that case was largely *ad hoc*, and the precedent did not stop Ottawa from taking unilateral action on the Millennium Scholarship Fund.

The first step needed here to secure useful reform is a political commitment to a genuine intergovernmental process for national decisionmaking in policy fields substantially under provincial jurisdiction. The purpose of the process would be to more firmly establish

national support for such a policy, as well as to inject greater predictability in any financial arrangement supporting it. Hence:

Recommendation: Ottawa should undertake to seek substantial provincial approval before launching any new national initiative in the social policy arena.

This undertaking should be conditional on the provinces' having accepted a broader political agreement on the social union along the lines of the other recommendations below. The agreement would not be justiciable, and it should explicitly not abolish Ottawa's constitutional option to use its spending power until such time as a constitutional amendment entrenching such limits can be contemplated.

Ottawa has already pledged not to initiate any new shared-cost programs in areas of exclusive provincial jurisdiction without the consent of a majority of the provinces. In order to effect a fuller reform, I propose that this pledge be expanded both vertically and horizontally to require substantial provincial approval not only for shared-cost programs and block grants but also for any federal tax benefits requiring matching provincial actions and even for some direct federal transfers to individuals that could significantly affect provincial policies. (The sectors affected in the last instance would have to be narrowly defined and negotiated; they would likely include education, training, and health care.) On the other hand, for practical reasons, the requirement should probably apply only to initiatives costing in excess of a given financial threshold.

Thus, any government in Canada wishing to bring forward a new or substantially modified national program in an area of provincial or concurrent jurisdiction would need to secure the assent of both a substantial majority of the provinces and of the federal Parliament before implementing that program.

Any such agreement on new national programs and their financing should include an understanding that all parties will adhere to it until a predetermined expiry date or consensual renegotiation. Sufficient advance notice would have to be given before a withdrawal or renegotiation of conditions could take effect.

Recommendation: The determination of "substantial provincial approval" within a formal agreement should go beyond the current* ad hoc *practice.

The particular voting formula adopted would, of course, be a sticky point. The recent options paper prepared by the Provincial / Territorial Council on Social Policy Renewal considered nine ways to tally provincial consent. However, one option that it did not consider but that seems to me particularly attractive is that of a European-style "qualified majority" vote for a predetermined range of national social policy issues.

Elsewhere (Schwanen 1992, 36), I propose requiring that such a decision be made by a qualified two-thirds majority of 28 votes, distributed as follows: Quebec and Ontario, four votes each; Alberta and British Columbia, three each; Newfoundland, Nova Scotia, New Brunswick, Manitoba and Saskatchewan, two each; and Prince Edward Island and each of the three territories, one vote each. Note that, although such a system would avoid having to rely on the approval of either Quebec or Ontario for the establishment of a national program (which is the case under the 7 / 50 mechanism of constitutional amendments), a very substantial consensus in the rest of the country would be required to carry the day without the assent of these two most populous provinces.

Overall and not necessarily alternatively, an attractive forum for molding substantial consensus (and avoiding current "*ad hoc*ery") would be a formal decisionmaking body, of the

European Council type, mandated to deal with federal-provincial and interprovincial issues. Indeed, although I am suggesting the creation of such a body for national social policy formulation under a framework agreement, it could also direct the implementation of some existing agreements and processes, such as the AIT, since each government could be represented on the council by whichever minister was responsible for the issue under consideration at a particular meeting.

The Right to Opt Out under Certain Conditions

Although the process I recommend should ultimately promote the widest possible consensus on national social programs and standards that involve areas substantially under provincial jurisdiction and administration, a province should still have the right to withdraw from such a consensus if its government believed that a program did not accord with the needs of its citizens or that it could better deliver the program directly.

As mentioned above, the citizens of a province that opts out out should not be financially penalized through the withdrawal of federal transfers or tax expenditures (to which they would have contributed through their taxes). In order to maintain the integrity of the union, however, neither should Canadians in other provinces suffer from the opting out of one or more provinces. This means that conditions for opting out should vary according to the type of program or standard involved and how the province exercises that right (see Box 3). Specifically, I envisage the following rules.

Recommendation: With respect to shared-cost programs or block grants, a province that opts out should receive "full" compensation — that is, federal transfers on the same basis as those granted to participating provinces for the purpose of that program — only if it runs a program judged equivalent. If the province does not intend to run such a program, it could still opt out, but compensation would be a once-and-for-all transfer of equalized tax points whose yield would be equivalent to what the program would have cost in the opting-out province in its initial year.

The purpose of establishing this difference between the two types of opting out is that, in the second case, the majority of the country participating in the program should be made fiscally immune from the vagaries of any alternative program or lack thereof in a province that has opted out. If the social needs that resulted in the establishment of a national program actually diminished in the province that opted out, its treasury would become the sole beneficiary, whereas if the needs worsen, its treasury, not that of Ottawa, would bear the burden.

Furthermore, a province could opt out of a consensus without establishing a similar or equivalent program only if it had not initially voted in favor of the consensus. (Otherwise, the formation of a consensus could be skewed; a national policy could be established with the crucial support of a province that subsequently opted out without adopting a comparable program.)[6]

Recommendation: In certain areas explicitly agreed on, a province should also be able to choose to opt its residents out of direct federal transfers by claiming jurisdiction over such transfers.

This right would not be as automatic as in the previous recommendation. In particular, the areas agreed on would be more narrowly defined than the general social union rubric. Moreover, no province should have the oppor-

Box 3: ***Opting Out of National Programs in Areas of Provincial Responsibility***

Even if one or more provinces opt out of a national program in an area of provincial responsibility, they would still need to agree to maintain the following conditions of the social union:

- no discrimination within a province between Canadians on the basis of province of origin;
- enhanced mutual recognition of programs and standards (for example, pensions or educational credentials) that are portable with the individual;
- participation in a national benchmarking exercise;
- agreement to be subject to the dispute settlement mechanism, which may be called on to determine whether the province has respected the conditions for opting out.

The following table describes specific conditions for opting out of programs involving federal money, and the compensation that should be available to a province that does so.

	Conditions and Compensation if a Province Opts Out:	
Type of Federal Program	**But Maintains a Comparable* Program**	**But Does Not Maintain a Comparable Program**
Block grants	No other condition. Transfers available from federal government on exactly the same basis per capita as that given to participating provinces.	Transfer in the form of equalized personal income tax points, yielding what the cash transfer would have been in the first year had the program been comparable. The opting-out province would have to cover other provinces for any negative externality through the compensation mechanism (see Box 4).
Shared-cost programs	Same as above	Same as above
Direct transfers to individuals	Opting out possibly limited to specific areas, such as education, training, and health care. A province could claim jurisdiction only over the transfer with support of two-thirds of its legislature. Compensation would be available only in the form of equalized tax points.	Same sectoral and "super-majority" conditions as when maintaining a comparable program, plus the same compensation scheme and accounting of externalities as above.
Personal income tax credits	No opting out or jurisdictional claim would be permitted. Provinces with their own personal income tax system would have leeway to offset federal action if they chose.	*A fortiori*, no opting out or jurisdictional claim would be permitted.

* The distinction between "comparable" and "noncomparable" programs is an analytical one. In practice, the lines may be blurred if the definition of a comparable program is fairly loose (for example, if the money must be spent in one area and not another). In that case, programs may be sufficiently comparable to qualify for federal cash transfers, but standards would still differ enough across provinces that the compensation mechanism I describe could be called into play.

tunity to disrupt the federal government's direct relation with its citizens, even in an area understood to be under provincial jurisdiction, unless there is a clear consensus within the province for such a move and unless it is evident that the move is not being made for short-term, partisan purposes.

I recommend that a province be able to opt out its residents from such transfers only if it obtains consent to do so from two-thirds of its legislature.[7]

If a province's residents choose to opt out under such a rule, Ottawa should also vacate the equalized tax room that represents what the program's cost would have been in its initial year in that province.[8]

Recommendation: All governments should participate in a process to examine what compensation, if any, provinces — and in some cases the federal government — are entitled to because of the services they provide to citizens in other jurisdictions as a result of significant policy differences in a context of high mobility.

The goal here is to maintain the integrity of the federation in the face of potential spillovers by providing an important *quid pro quo* for provinces that situate themselves outside a national program or, even more generally, a norm. The process would operate at an impartial, technical level, under instructions from governments to identify plausible and actual costs or benefits to their treasuries resulting from any significant differences in social policies.

This idea, which I take up in an earlier paper (Schwanen 1996, 15) is inspired by the formulas in place to apportion corporate income tax between provinces that levy it and the existing reciprocal billing agreements (adhered to though not legally binding) between provinces and territories for hospital and medical services; it is compatible with Vaillancourt's (1998) proposal for sharing the cost of higher education between provinces and the existing arrangement between Maritime provinces referred to earlier. Box 4 sets out, for illustrative purposes only and at the risk of glossing over important technical considerations, how this process could deal with some externalities.

Thus, if a province did not wish to follow the objectives of a national program, it could still withdraw with compensation. However, it would have to negotiate with the other provinces (and the federal government) arrangements that would ensure that taxpayers in other provinces did not lose out and, at the same time, that mobility was not impeded.

This compensation process would not affect individuals' choice to move or not to move or to seek services in one province or another for their perceived best advantage. It would raise no barriers to mobility or encourage discrimination against out-of-province residents in the provincial delivery of key social services, yet it could accommodate large, legitimate differences in publicly subsidized services across provinces, should such emerge.

With such a mechanism in place, provinces would be more fully compensated for the externalities they create for residents of other provinces. Indeed, its existence would finally put flesh on the skeletal evidence on the actual size of such externalities.

The possibility that net positive and negative externalities are small means that the compensation system initially might operate without any actual payments or receipts of money. Indeed, an initial run might suggest that the idea be dropped altogether or be kept up only between provinces that registered large differences in their level of services. But collecting the data on an ongoing basis, even if the net results were insignificant, would put to rest charges of dumping as a reason for mounting barriers to mobility or, at the other extreme, for unnecessarily imposing uniform social standards across provinces.

Box 4: ***A Canadian Compensation Mechanism***

The system that I envisage for compensating Canadian jurisdictions for the costs (and benefits) of spillovers from the programs of another jurisdiction is essentially a mechanism for tracking and netting out those costs and benefits.

The system would operate at an impartial, technical level, with a mandate from Canadian governments to ensure that, in general, when a public service funded by taxpayers of one signatory province (the "source province") benefits either an individual or the general taxpaying public residing in or immediately originating from another province (the "destination province"), the source province is compensated while the destination province is debited.

In the case of postsecondary education, the procedure could be straightforward. If individuals attend university in New Brunswick but now reside in Toronto, part of the tax collected from them in Ontario would be paid into a compensation fund up to an amount reflecting some agreed-on fraction of the cost of the public subsidy in New Brunswick, which would be credited with it.

Where differences exist in provincial health care plans and individuals "border shop" for services inadequately covered at home, the compensation system could debit the home province for the amount of public subsidy given for the service in the destination province. If the home province does not publicly pay for the service, pays less, or otherwise does not provide a service of comparable quality, it could, at its option, bill the border shopper for the amount debited. This way all residents in the province would have access to similar services at the same cost, while the service-providing province would maintain the integrity of its public service. Indeed, this arrangement would simply be an extension of existing gentlemen's agreements between the provinces.

Welfare programs would present the difficulty of measuring not only the size of the spillover but also its sign. In the extreme case of one province having no welfare program and a neighboring province a generous one, some individuals would move to take advantage of this fact. On the other hand, individuals may also move because of increased job prospects but may require a temporary period on welfare, in which case the relative level of assistance would end up benefiting the source province. A further complication is the continual flow of individuals between provinces and also into and out of provincial welfare programs, seemingly unrelated to the widening or narrowing differences in welfare benefits. Consider, for example, the two-way flow between British Columbia and Alberta, even after Alberta cut its welfare rates and tightened eligibility in 1993 (Boessenkool 1997, figure 3).

A possible formula here would be for the compensation system to debit the destination and credit the source (of the service) province for the welfare bills of all migrating recipients for a period of time that could depend on the size of the difference in welfare and unemployment rates between the two provinces. The interprovincial payments could be based on national average benefit levels, adjusted for differences in the cost of living across the country. (Unavoidably, the externality would be overstated in individual cases and understated in others.)

Clearly, even with a compensation process in place, disputes could arise about whether a province was living up to its obligations under a social union agreement. Such charges could also arise against the federal government (for example, if it implemented a policy unilaterally that it claimed was excluded under the agreement). This potential leads to another important recommendation.

Recommendation: A dispute-settlement mechanism should be established that is open to citizens with respect to issues regarding mobility or the portability of benefits and modeled after the dispute-settlement provisions of the AIT.

It would deal with disputes about the respective rights and obligations of Ottawa and the

provinces under a social union agreement. In particular, it could be used to determine what type of compensation and what obligations an opting-out province was entitled or subject to and whether a province was running a program compatible with the national consensus. (The standards and policies benchmarking exercise described below would help any panel struck under such a dispute-settlement process.)

Recommendation: No province should be able to opt out of the dispute-settlement provisions of a social union agreement or from its benchmarking process and nondiscrimination and mobility provisions, even with respect to a program or standard from which it had opted out.

The point here is that opting out should not shield a province's policies from scrutiny or challenge by others for their effects on the social union as a whole or be used to deny other Canadians the right to live as citizens in any province they choose.

Transparent and Standardized National Reporting

The federation would gain much from merely establishing a formal benchmarking exercise by an interprovincial standards council that provided standardized information on provincial programs. Commitment on the part of the provinces to such an exercise would be a substantial step toward the social union, particularly if the information were made public. Substantially improved and available information on choices, tradeoffs, and results across provinces would likely reduce differences of outcomes. Thus, I make a straightforward proposition:

Recommendation: A permanent national benchmarking exercise of the accounting for, modes of delivery, and outcomes of social programs should be established with a view to increasing the transparency and comparability of social programs across Canada.

Easing Mutual Recognition and Harmonization

Along with the results from the standards and policy benchmarking exercise just described, Canada needs procedures for spurring mutual recognition and harmonization of standards where differences do little to achieve legitimate policy objectives and particularly where they impede the portability of programs attaching directly to individuals.

This leads to:

Recommendation: Provinces, with Ottawa's assistance, should try to mutually recognize or harmonize programs in areas where small differences exist between them.

This process could take the form of a rigorous examination of small variations that exist not because of differences in policy objectives. The immediate goals could include harmonization of the type of information required of welfare applicants, as well as mutual recognition of roughly comparable training or education programs. Large differences, including those in the mode of delivering services, would continue to be recognized as representing legitimate different preferences of residents of the various provinces.

More formal commitments to harmonize or mutually recognize certain types of standards could also be made part of the process when an agreed-on degree of convergence was observed between the provinces. In addition, of course, national initiatives decided under a social union framework agreement would, by their nature, likely involve some standardization.

Enhanced Rights of Mobility and Nondiscrimination

Recall that an important concern is securing the right — beneficial for the social union — of citizens to be treated in every province as a resident, with a minimum of formality, and of Canadians in similar circumstances to be treated equally by the federal government, regardless of their province of residence. This immediately leads to:

Recommendation: Ottawa and the provinces should agree to enhance and uphold the mobility and nondiscrimination rights that accrue to all provinces' residents by virtue of their Canadian citizenship.

To that effect, they should step up the application of Chapter 7 of the AIT on labor mobility. Similarly, federal expenditures should no longer discriminate between residents of different regions when regional redistribution is not the explicit purpose or an unavoidable outcome of the nature of the program or obligation — for example, where spending is naturally concentrated in a particular area.

In particular, steps should be taken to increase public and business awareness of the AIT and strengthen its institutions, as recommended by a number of observers (Howse 1996; Schwanen 1996; 1998; Chaitoo and Hart 1998). Also:

Recommendation: Ottawa should undertake to make its transfers to Canadians regionally neutral (other than equalization payments, constitutionally mandated transfers to specific areas, and expenditures that, by their nature, are regionally concentrated, such as spending on fisheries).

Barring this change, the reform of the equalization program could take account of the problem of regionally discriminating transfers. One possibility here would be to make the equalization program an interprovincial revenue-sharing pool that factored in any regional discrepancies in other programs from Ottawa (Boothe and Hermanutz, forthcoming). The total amount of federal transfers flowing to the recipient provinces would in no way be affected by such a move, if equalization payments themselves were adjusted to deal with the financial consequences of making other programs more regionally neutral.

This being said, the best way to secure a sense of regional fairness in the administration of federal programs, as well as to strengthen their appeal to all Canadians, is probably to better represent regional interests in central decisionmaking and to give regional representatives a formal way *at the federal level* of objecting to programs that disadvantage their constituencies. What appears to be missing from current proposals is a way to improve regional input into the policy machinery in Ottawa (Gibbins and Harmsworth 1997), extending it not only into areas of federal-provincial overlap but also measures that would ensure regional fairness in federal programs more generally.

As noted, the push for renewal of the federation has recently been on a nonconstitutional track, as a result of two factors. First, Ottawa's presence in social policy has been dwindling with reduction in the size of both its transfers and its direct programs. Second, in the wake of the failed Meech Lake and Charlottetown Accords, the general distaste for constitutional matters has precluded formal changes to federal institutions such as the Senate (ibid.).

This reluctance to consider constitutional change highlights a weakness of the intergovernmental approach: it fails to acknowledge that Ottawa holds, and most likely will continue to hold, a number of important policy levers that influence social policy. For exam-

ple, so long as Ottawa is constitutionally responsible for providing insurance against unemployment, pensions, and aboriginal affairs, it is likely to continue to design and deliver programs that overlap with those in provincial areas of jurisdiction. Furthermore, the equalization program, which is constitutionally an all-government responsibility, continues to be run by the federal government.

What are needed in these areas are changes designed to ensure greater regional fairness and transparency in policymaking at the national level, not only at the intergovernmental level. I find it difficult to believe that progress on this question can be made without a revitalized Senate.

Many thoughtful proposals consider better regional representation at the federal level as key to improving the workings of the federation. In other federations, such as Germany, Australia, and the United States, the upper chamber represents an important locus of regional input into national policy. Such a central "chamber of the provinces," if elected and effective, could provide invaluable regional input into Ottawa's policymaking apparatus, while also fostering national coherence in overlapping federal-provincial matters.

Senate reform has remained on the back burner during nonconstitutional discussions, but it is remembered, as the appointment of an elected senator from Alberta in 1992 and the fall 1998 "senator-in-waiting" election in that province seem to indicate. The difficulties of such a reform should not make us forget about its potential in the management of the social union. Hence:

Recommendation: In addition to a social union pact, reforms to federal institutions, particularly the Senate, should be seen as a way to strengthen Canadians' sense of ownership of and fairness in their national programs.

In the meantime, decisionmakers should consider some earlier interim reform proposals, such as ensuring that appointments to the Senate are acceptable to both the federal government and the province in which vacancies are to be filled.

In Defense of Experimentation

Over the past few months, the social union negotiations have gradually come to the fore of public discussions, including those in the media. Although it is perhaps understandable that many Canadians express skepticism about attempts to improve the way the federation works, some public commentaries have displayed a strong nay-saying attitude toward the talks. Thus, it is fitting to conclude this *Commentary* with some observations on the nature of the social union exercise and, more specifically, on the negative comments about it.

The Centralist View

Most of those who oppose or are highly skeptical of the substance of the social union negotiations accept the idea of a "strong" federal government in the social arena in the sense not of a government naturally determined to garner or foster a strong national consensus but of one unimpeded by the constraints that the interests and preferences of the provinces might represent. At least implicitly, these commentators believe that only Ottawa can adequately represent citizens' interests in national matters — that provinces, even on issues that are under their jurisdiction but that have a national dimension, ought not to have a formal voice in the determination of national policies in these areas.

This centralizing view is made up of two distinct strands. The first comes from those who believe that having to bother garnering a provincial consensus on any issue would strip

the federal government of its ability to act on questions of national importance. For example, one of Canada's leading columnists asserts that Canadians should welcome tensions between Ottawa and the provinces on social policy because the former is able to articulate a national vision shared by all Canadians, while the latter are no more than the sum of their parts (Gwyn 1998). Others warn against a surrender of Ottawa's ability to use its spending power to impose minimal conditions on provincial social programs or to enter provincial fields of jurisdiction (Coyne 1998).

A second centralizing group comprises those who perceive Ottawa as the guardian of a more interventionist social agenda against a provincial agenda "that leaves the people out" (Barlow, quoted in Fraser 1998).

From both viewpoints, tensions between Ottawa and the provinces can be a welcome sign that recalcitrant provinces will be met by a government that represents some underlying national interest or an overwhelming desire for Canadians to maintain a uniform network of social programs.

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Underlying Forces for Change

In response to these substantive critiques, I defend the need to experiment on social policy coordination in today's federation. The reality is that the world has changed in the past 20 years — something all analysts recognize but from which they are sometimes reluctant to draw conclusions.

As already alluded to, the provinces, by virtue of their direct involvement in the administration of ballooning social programs, now have an inescapable primary role in the delivery of social benefits to Canadians. A world characterized by rapid technological change, globalization, and an aging population presents genuine questions about the effectiveness of traditional modes of delivery of social programs, even (or perhaps especially) for a strong defender of the idea of the welfare state (Richards 1998). Furthermore, the importance of east-west ties in trade and investment, though remaining far greater than they are sometimes made out to be, has qualitatively diminished with the rapid opening of north-south trade links, arguably increasing the need for regional flexibility.

None of this challenges the idea that many pan-Canadian values and interests remain and need to be expressed through common policies and standards across the country, but the changing nature of the environment in which programs are devised and of the links between the regions of Canada argues in favor of flexible formulas that permit experimentation, comparisons, and consensus building on social programs.

In my view, rather than being the byproduct of a healthy articulation of the national in-

terest, federal-provincial bickering on issues of major national importance reveals a real flaw: Canada has no formal mechanism for involving the provinces in developing a vision for the country, particularly for national programs under provincial or shared jurisdiction. We should not dismiss out of hand attempts to improve the mechanisms of social policymaking. When many indicators point to Canada's underwhelming social and economic performance, it is surely too early to rush to defend the existing way of doing things without carefully considering new options that may emerge.

Indeed, some experimentation is already taking place. As already discussed, the recent NCB is an example of a truly cooperative effort between Ottawa and the provinces. But it was the product of *ad hoc* work rather than a formal consultation mechanism. Should we encourage the adoption of a more widespread cooperative process leading to results such as the NCB? What about the likelihood that a formal social union, involving formal provincial participation in the setting of national priorities, would encourage a wider debate on national social programs and interprovincial comparisons during provincial elections?

Any social union agreement is highly unlikely to be justiciable (or at least should not be), let alone turned overnight into a constitutional amendment. Rather, it would outline politically acceptable rules by which Ottawa and the provinces could discharge their mutual responsibilities in a more transparent, predictable, and coordinated fashion on social policies. Those facts should put new light on the objections of process some have raised that governments' negotiating positions are not fully known or that the negotiators themselves are unrepresentative. It is well within the mandate of duly elected governments to attempt to foster improved relations through an agreement that Canadians would have an open-ended opportunity to examine and see work in practice before it is actually entrenched in law.

On Guard for Thee?

Finally, the notion that the federal government constitutes a bulwark against a slide in social programs at the provincial level must be reconciled with the federal caps and cutbacks in social transfers that have taken place in the 1990s, which at least some political scientists have interpreted as the key driver of a neo-conservative agenda at the provincial level (Rocher and Rouillard 1998). Others less inclined to view these fiscal decisions nefariously have nevertheless concluded that they point to the need for greater stability in federal-provincial relations concerning social programs. Justified though the cutbacks were on other grounds, they suggest that the policy winds do not always blow in the same direction.

It is also useful to remind ourselves of the social policy innovations that took place at the provincial level in the 1960s. In short, federal intergovernmental affairs minister Stéphane Dion surely got it right when he stated, with respect to certain differences of view between the present Ontario and federal governments:

> In aiming to improve a social union, however, we need to take a more long-term approach. You can't rule out the possibility that a very conservative government may one day take power in Ottawa, at the same time as a government very open to social policies is in power at Queen's Park. Many people would then be very happy to count on a provincial government with sufficient jurisdictional clout to counterbalance the neo-conservatism in Ottawa. (Dion 1998, 4.)

In short, I believe that Canadians have good reason to see the social union negotiations in a positive light — or at least to give them a chance.

How Is as Important as What

This paper is about the important issue of *process* within Canada's social union. On the inter-

governmental front, change is taking place, and we are seeing early signs of new institutions taking hold. Consider, for example, the Provincial / Territorial Council on Social Policy Renewal, which reports to the premiers, as well as its cousin, the Federal / Provincial / Territorial Council on Social Policy Renewal, which reports to the first ministers; both have tasted success with the introduction of the NCB. The important question is, where do we go from here in strengthening the management of the union?

Like many analysts, I envision a greater provincial role in managing the emergence of national programs in areas of provincial jurisdiction, to be exercised under transparent and sometimes stringent conditions of cooperation. While various governments might claim to be winners or losers in this process, better management of the social union would ultimately be a winner for Canadians.

Notes

This paper was initiated as a joint project with Kenneth J. Boessenkool, a former colleague at the C.D. Howe Institute. Although his name does not appear here as coauthor, he is more than entitled to a sense of authorship for the ideas, energy, and drafting skills that he brought to earlier versions of this paper. I am also grateful for the detailed and highly stimulating comments received at various stages of the paper from Tom Courchene, Patrick Monahan, Finn Poschmann, John Richards, Bill Robson, François Vaillancourt, and another reviewer who wishes to remain anonymous. I am, however, solely responsible for the views herein and for any remaining error.

1 Throughout, the terms *provinces* and *provincial* implicitly include the territories.

2 Robson (1992, 25–26) points out that federations tend to have relatively smaller governments than unitary states, when size is measured by revenues and expenditures relative to gross domestic product. This fact could be the natural result of some of the structural advantages of federalism identified above and does not invalidate the possibility that the reduction of duplications or clearer lines of accountability could result in further savings.

3 As distinct from the questions of ensuring that provinces have sufficient revenues to exercise their responsibilities and that all have the minimum wherewithal to allow them to provide broadly comparable basic services across the country, which Courchene calls the "federal" and "citizenship" rationales for equalization (1998, 10–12).

4 Since then, environmental issues have usually not been covered by discussions on the social union but pursued as a separate matter on the federal-provincial agenda.

5 The distinction between "comparable" and "noncomparable" programs here is an analytical one. In practice, the lines may be blurred, if the definition of a "comparable" program is fairly loose — for example, if the money must be spent in one area and not another. In that case, programs may be sufficiently comparable to qualify for federal cash transfers, but the standards could still differ enough across provinces that the "compensation mechanism" described below could be required to deal with spillovers.

6 As agreements would be periodically revised, governments that agreed to a national program would not be binding their successors permanently.

7 Another possibility for garnering sufficient approval for opting out could be through a referendum, with the wording agreed to by both the federal government and the province.

8 With respect to this and the previous recommendation, the tax points would be "equalized" so as to make the incentive to opt out depend as little as possible on a province's own relative fiscal capacity.

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