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NEWS RELEASE

IRPP Study Urges New Thinking on the Treatment of Resource Revenues in Equalization

Record-high energy prices are intensifying pressures on equalization program, says Thomas J. Courchene.

Montreal – With oil and natural gas prices at record highs and revenues flowing into the coffers of resource-rich provinces, Canada's equalization program is under increasing stress and urgently needs to be restructured, says a study released today by the Institute for Research on Public Policy (IRPP.org).

Author Thomas J. Courchene (IRPP Senior Scholar and Queen's University Professor) notes that the equalization program is "an essential part of the glue that binds us together east-west," because it ensures that less prosperous provinces can provide public services that are reasonably comparable to those in other provinces at reasonably comparable levels of taxation. But soaring energy prices have distorted the effect that resource revenues have on equalization payments.

The paper presents a quantitative analysis of the mechanics of equalization, with a particular focus on how different treatments of resource revenues affect the amount and geographic distribution of equalization payments. Courchene, one of the country's foremost experts on the program, argues that because resource revenues are utilized in part to provide public goods and services implies that they should be included in the equalization formula at least partially.

The author highlights several serious inequities in the current "five-province standard," which excludes Alberta and the Atlantic provinces from the formula that determines equalization payments. Because Alberta's massive energy revenues are excluded, other provinces such as British Columbia and Saskatchewan appear to be relatively rich in natural resources, and their resource revenues are clawed back, often at "near confiscatory rates," by smaller equalization payments, whereas Newfoundland/Labrador and Nova Scotia have negotiated special accords that refund these clawbacks.

The paper thus considers scenarios based on the national average (or ten-province) standard and shows that equalization payments would increase across the board for all have-not provinces. Courchene notes that if 100 percent of resource revenues were included a ten-province standard, Ontario would likely qualify as a have-not province if current energy prices persist.

A second issue is deciding what portion of resource revenues should be included in the equalization formula. Courchene notes "neither the historical record nor analytical principle can point the way toward the appropriate inclusion rate." He thus raises the "highly speculative" and "controversial" possibility of splitting equalization into two separate tiers.

The first tier would use the entire current federal envelope ($10.9 billion in 2005 and growing at 3.5 percent annually) to equalize provincial non-resource revenues. The second tier would consist of a modest interprovincial revenue-sharing pool for natural resources revenues, managed by the Council of the Federation. The author emphasizes that such a pool would have to be voluntary, and would thus only be feasible if Alberta and other energy-rich provinces agreed.

While Courchene concedes that provincial resource revenue-sharing faces daunting political hurdles, he notes that it would be far more equitable than the status quo. Furthermore, revenue sharing systems are used in other federations (including Germany and Australia).

"Resource Revenues and Equalization: Five-Province vs. National Standards, Alternatives to the Representative Tax System, and Revenue-Sharing Pools" is the latest *IRPP* Working Paper released as part of the Institute's Canadian Federalism research program. It is available on the IRPP Web site, at www.irpp.org.

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