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Policy Solutions for Ontario's Prosperity

Reforming Canadian Fiscal Federalism:

THE CASE FOR INTERGOVERNMENTAL DISENTANGLEMENT

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Issue Statement

The COVID-19 pandemic has renewed calls for major changes to Canadian fiscal federalism. Provincial premiers, for instance, recently called on the federal government to permanently increase the Canada Health Transfer in order to raise the federal share of health-care spending from 22 percent to 35 percent.[1]

There is certainly a good case for fundamentally rethinking fiscal federalism. A combination of factors including aging demographics, a growing service delivery role for cities, and the question of long-term fiscal sustainability was already shaping a nascent conversation about "who does what" and "who pays for it" prior to the pandemic. There was an increasing sense that we could no longer continue to deal with these complex intergovernmental issues through ad hoc or one-off responses. It required a more systematic approach. The pandemic will likely accentuate these discussions and may ultimately lead to fundamental reforms to Canada's system of fiscal federalism.

Yet, as important as possible changes to major transfer payments and the divisions of powers are, the truth is that Canada does not have an historical tradition of systematic reforms to our federalism. Instead, change has tended to come incrementally and on a smaller scale. Notwithstanding growing calls for major reform, it is quite likely that past is prologue when it comes to post-pandemic changes to Canadian federalism.

There is a risk, then, that putting all of our eggs in the basket of fundamental reform becomes an obstacle to other changes that can improve the functioning of Canadian federalism. In particular, there is room for short- and long-term

[1] Rachel Aiello, "Premiers Want Commitment to Increase Health Funding in Trudeau Throne Speech," CTV News, September 18, 2020. https://www.ctvnews.ca/politics/premiers-want-commitment-to-increase-health-funding-in-trudeau-throne-speech-1.5110160.

policy and operational reforms to "disentangle" areas where federal, provincial, and municipal governments are currently overlapping and duplicating programs, policies, and services. Solving for intergovernmental entanglement could improve accountability, permit greater scope for experimentation, reduce burdens on businesses, and ultimately lower costs for taxpayers.

The COVID-19 pandemic may or may not create an opportunity for sweeping reforms to Canada's system of fiscal federalism, but, in the meantime, the Ontario government should champion a "disentanglement agenda" in cooperation with the federal government and the other provinces.

This paper provides a primer on the evolution of Canadian fiscal federalism, the current state of Ontario's transfer payments from Ottawa, and the increasing role of cities in the delivery of programs and services. This analysis may be useful as federal and provincial policymakers consider possible reforms to major transfer programs and the roles and responsibilities of different orders of government in the aftermath of the COVID-19 pandemic.

But it also lays out a more incremental and targeted agenda for reform to Canadian federalism. In particular, it puts forward an iterative plan for disentanglement in areas such as environmental regulation, consumer protection and safety, and immigration settlement. Clarifying which order of government ought to be carrying out these responsibilities through an evidence-based, systematic process could produce considerable benefits for Canadian governments and taxpayers.

This disentanglement agenda is not a substitute for major fundamental reforms to Canada's system of fiscal federalism. But there is opportunity for actionable reforms in the short-term that can possibly build momentum for a broader agenda to reconceptualize Canadian federalism following the COVID-19 pandemic.

Decision Context

Canada's system of fiscal federalism has evolved through a steady yet incremental process of political, legal, and intergovernmental engagement for more than 150 years. It has tended to be the subject of piecemeal rather than systematic change.

Sir John A. Macdonald's vision of a highly centralized federation started to fall apart soon after Confederation commenced. A series of legal decisions by the Judicial Committee of the Privy Council granted the provinces a greater role in policy and governance.[2] The Great Depression and post-World War II expansion of Canada's social safety net exacerbated this trend by placing a new and growing importance on areas of provincial jurisdiction, including education, health, and welfare. Our conception of "who did what" and "who paid for it" started to change.

The Rowell-Sirois Commission, which was struck in 1937 and reported its findings and recommendations in 1940, was one of the rare cases of systematic thinking about Canada's system of fiscal federalism. The Royal Commission was established by the federal government in light of the nation's experience with the Great Depression, when the patchwork of provincial-based unemployment and welfare programs were underfunded and poorly delivered. The goal was to build a consensus around a set of systematic reforms to Canadian fiscal federalism.

As the commission's final report observed, there was a significant imbalance between the revenue-generating capacity and spending responsibilities between the federal and provincial governments. Just consider that, in 1937, the federal government generated revenues amounting to $995.2 million, while all nine provinces combined (Newfoundland and Labrador had not yet joined Confederation) generated revenues of just $464.3 million.[3]

There was a general view that there needed to be adjustments to the intergovernmental architecture that had been established at Confederation. It was essential for each order of government to have the fiscal means to be able to meet its constitutional responsibilities, particularly as the beginnings of

[2] Alan Cairns, "The Judicial Committee and its Critics," Canadian Journal of Political Science, 1971. https://www.cambridge.org/core/services/aop-cambridge-core/content/view/2A6C8440E819414740F7B3C02762E75B/S0008423900026809a.pdf/the-judicial-committee-and-its-critics.pdf.

[3] Newton Wesley Rowell and Joseph Sirois. "Royal Commission on Dominion-Provincial Relations." Government of Canada, 1940, page 186. https://www.solon.org/Constitutions/Canada/English/Committees/Rowell-Sirois/index.html.

the modern welfare state were taking shape. It was clear to the commissioners that the combination of constitutional responsibilities and revenue-generating capacity granted to the provinces in the *British North America Act* could no longer meet the new challenges of the twentieth century.

The Rowell-Sirois Commission made several system-wide recommendations. Only one was acted upon immediately: transferring responsibility for unemployment insurance to the federal level via a constitutional amendment which permitted a national risk pool and better enabled interprovincial mobility for unemployed and underemployed workers. The Commission's other recommendations, however, were, at least temporarily, superseded by World War II. The war effort shifted much of the fiscal burden from the provinces to Ottawa in order to mobilize hundreds of thousands of Canadian troops.

Following the war, some of the commission's other recommendations – including the creation of a federal equalization program – were eventually adopted. But the evolution of fiscal federalism has since been generally incremental and ad hoc. The Rowell-Sirois Commission's vision of systematic reform has never been fully realized.

A complex web of transfer payments from the federal government to the provinces and territories and from the provinces to municipalities has evolved. For example, the Pearson government in 1966 introduced the Canada Assistance Plan, which created a cost-sharing arrangement between the federal government and the provinces for social programs including provincially-administered health care.[4] The Trudeau government altered this arrangement in 1977, removing health care and post-secondary education from the purview of the Canada Assistance Plan, instead introducing the Established Programs Financing arrangement, which gave the provinces tax room and cash transfers but eliminated matching federal dollars in those two policy areas.[5] The Chrétien government, facing a federal fiscal crisis in the mid-1990s, eliminated the Canada Assistance Plan and Established Program Financing and replaced them with a new, block funding transfer for education, health care, social assistance, and other social services.[6]

[4] Rand Dyck, "The Canada Assistance Plan: The Ultimate in Cooperative Federalism," Canadian Public Administration, 1976, page 602. https://onlinelibrary.wiley.com/doi/abs/10.1111/j.1754-7121.1976.tb01877.x.

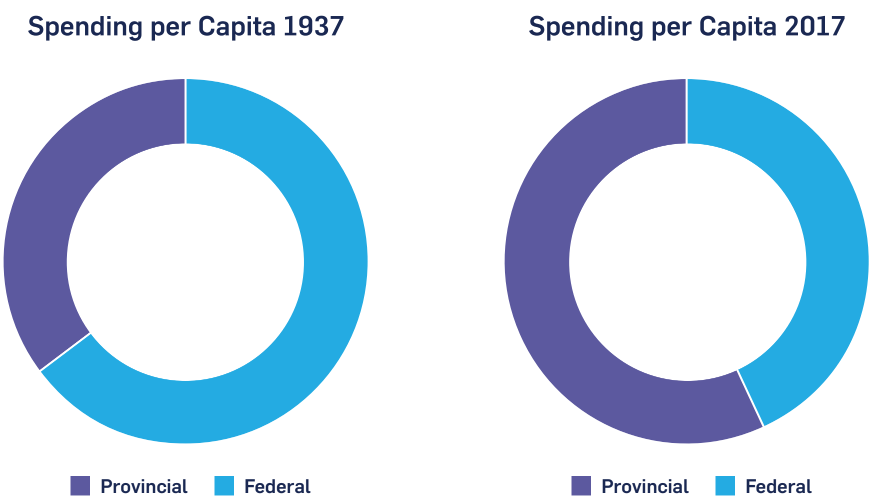
[5] Malcolm C. Brown, "The Implications of Established Program Finance for National Health Insurance," Canadian Public Policy, 1980, page 525. https://www.jstor.org/stable/3550102?seq=1.

[6] Sylvia Bashevkin, "Rethinking Retrenchment: North American Social Policy During the Early Clinton and Chrétien Years," Canadian Journal of Political Science, 2000, page 30.

Subsequent governments have tinkered on the margins of major transfer payments and increased bilateral and trilateral spending – including infrastructure and social housing – but the basic architecture of Canada's system of fiscal federalism has remained, by and large, unchanged.

The same cannot be said for how the relative size of federal and provincial spending has evolved since the Rowell-Sirois Commission was launched. The commission noted that, in 1937, annual federal spending per capita significantly outpaced provincial spending: on average, Canada's provinces were spending $23.25 per person on government services, while the federal government was spending $43.00.[7] In 2017, by contrast, the provinces' spending outpaced their federal counterpart: on average, Canada's provincial governments spent $11,073 per capita,[8] while the federal government spent $8,408, including transfers to other orders of government (see Figure 1).[9] This significant change in relative spending levels reflects the substantial growth in the areas of provincial jurisdiction due in large part to the rise of the modern welfare state.

Figure 1: **Federal and Provincial Spending per Capita in Canada, 1937 and 2017**



Source: Rowell-Sirois Commission Report on Canadian Federalism and Library of Parliament Research Publications.

[7] Rowell and Sirois, 188.

[8] "Comparing Ontario's Fiscal Position with Other Provinces," Financial Accountability Office of Ontario, February 14, 2019. https://www.fao-on.org/en/Blog/Publications/inter-prov-comparisons-feb-2019.

[9] Sirina Kerim-Dikeni, "Distribution of Federal Revenues and Expenditures by Department," Library of Parliament, November 2017. https://lop.parl.ca/sites/PublicWebsite/default/en_CA/ResearchPublications/201701E.
Sirina Kerim-Dikeni, "Distribution of Federal Revenues and Expenditures by Province," Library of Parliament, May 24, 2018. https://lop.parl.ca/staticfiles/PublicWebsite/Home/ResearchPublications/InBriefs/PDF/2017-01-e.pdf.

Canada's intergovernmental spending regime is now one of the most decentralized among federal states in the world. Intergovernmental transfer payments are a crucial part of it. We effectively risk pool revenues at the national level and then distribute them to the provinces based on a combination of fiscal redistribution and funding on a per capita basis.

The federal government manages three major transfer programs: the Canada Health Transfer, the Canada Social Transfer, and Equalization. The first two are distributed on a per capita basis and are notionally responsible for assisting provinces and territories with the costs associated with health care and social services. There are certain conditions – including for instance restrictions on private health insurance – attached to these transfer payments. Equalization is distributed according to a formula based on provincial fiscal capacity. Equalization-receiving provinces are not subject to any conditions.

As of the current fiscal year, the federal government planned to transfer $77.5 billion across these three programs to the provinces.[10] In a normal year, that would represent about one-fifth of total federal program spending.[11] These figures have changed though due to an emergency, one-time increase of $19 billion to federal transfers in response to the pandemic.[12]

It is important to note that, although the major transfer programs represent the bulk of federal transfer payments, there are other programs such as infrastructure, social housing, and skills training that involve federal payments to other orders of government. Federal transfer payments (excluding major transfers) can be difficult to discern because they involve a plethora of programs and services. One estimate is that annual intergovernmental transfers from the federal government is nearly $90 billion.[13] The key, though, is that the overall level of federal transfers to other orders of government is much larger than just the major transfer programs.

[10] CHT is $41.8 billion, CST is $15 billion, and Equalization is $20.5 billion.

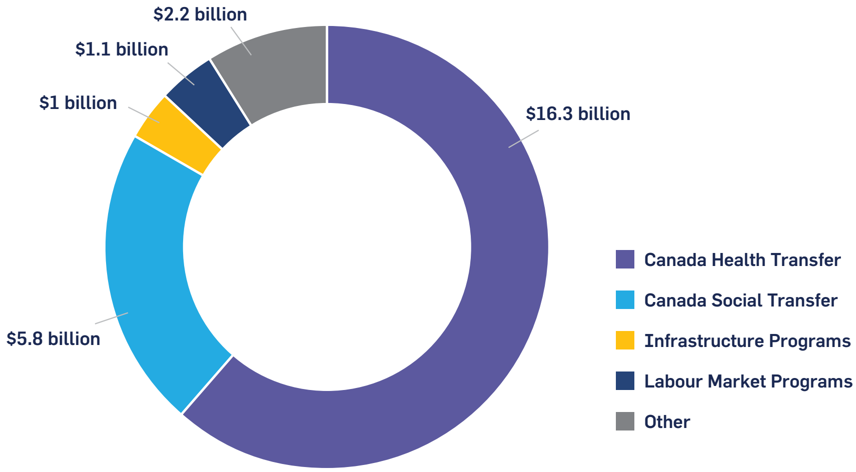
[11] Bill Morneau, "Investing in the Middle Class: Budget 2019," Department of Finance, March 19, 2019, page 289. https://www.budget.gc.ca/2019/docs/plan/budget-2019-en.pdf.

[12] Joan Bryden, "Premiers Seeking at Least $28 Billion Boost to Health Care ahead of Feds' Throne Speech," Global News, September 18, 2020. https://globalnews.ca/news/7343316/premiers-billions-health-care-throne-speech/.

[13] Intergovernmental Fiscal Relations Commission, Draft Proposal: Reforming Canada's Intergovernmental Fiscal Relations in a Post-Pandemic World, Canada West Foundation, August 7, 2020. https://cwf.ca/wp-content/uploads/2020/08/2020-06-25-IFRC-Draft-Proposal-Public.pdf.

The case of Ontario is instructive. In March 2020, the Ontario government projected that federal transfers would comprise 16.8% of its total revenues for fiscal year 2020-2021. Total federal transfers to Ontario for the year were thought to be approximately $26.3 billion: of which, $16.2 billion came in the form of the Canada Health Transfer, $5.8 billion came from the Canada Social Transfer, and the remaining $4.3 billion came from smaller programs, such as infrastructure spending support, labour market programs, and social housing agreements (see Figure 2).[14]

Figure 2: Federal Transfers to Ontario, March 2020-21 Projections



Source: Government of Ontario March 2020 Fiscal Update.

These projected revenues have changed somewhat since March. When the Ontario government updated the province's finances in August, it reported an incremental increase of federal transfers of $6.2 billion due to a one-time payment to help deal with the pandemic.

More generally, the governmental response to the COVID-19 pandemic has tilted in the federal direction. According to estimates from Ontario's Financial Accountability Office, federal measures – including the Canada Emergency Relief Benefit – have totaled $102 billion in the Province of Ontario, while the provincial government's pandemic-related spending has totalled $10.8 billion.[15]

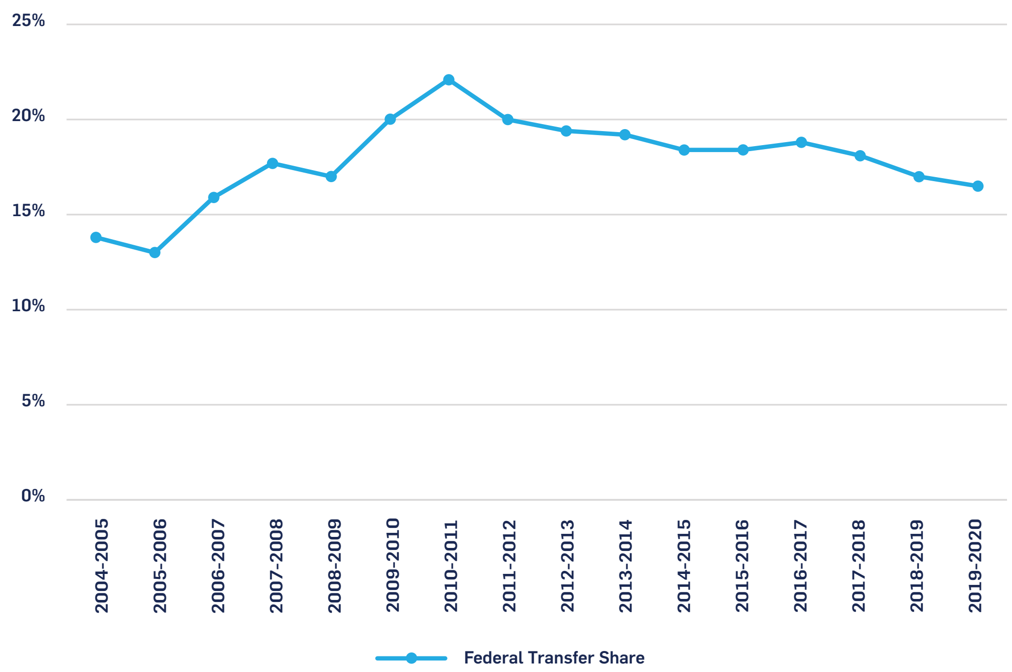
[14] Vic Fedeli, "Protecting What Matters Most," Government of Ontario, April 11, 2019, page 282. https://budget.ontario.ca/pdf/2019/2019-ontario-budget-en.pdf.

[15] Comparing Ontario's Fiscal Position with Other Provinces," Financial Accountability Office of Ontario, February 14, 2019. https://www.fao-on.org/en/Blog/Publications/inter-prov-comparisons-feb-2019.

Over the past decade, though, federal transfers as a share of provincial revenues has been falling in Ontario. The share of Ontario's revenues from federal transfers has declined from a recent high of 22.1% in 2010-2011 to a low of 16.5% in 2019-2020.[16] One of the reasons for this decline is that the province has moved in and out of the federal equalization program, which provides transfers to provinces with below average fiscal capacity. Ontario received equalization payments from 2011-12 to 2018-19. Its equalization payment peaked at $3.3 billion in 2012-2013.

As the chart below demonstrates, the proportion of provincial revenue obtained through federal transfer payments has been on a steady decline since 2010-2011, which was before the equalization payment peaked in 2012-2013 (see Figure 3). Other potential causes of this relative decline could be a reduction in the growth of Canada Health Transfer payments and faster-growing provincial tax revenues.

Figure 3: Federal Transfers as a Share of Ontario Government Revenues, 2004-05 to 2019-20



Source: Ontario Budgets, 2004 to 2019.

[16] According to the government of Ontario's 2019 budget, transfers from the federal government are calculated by combining the value of the Canada Health Transfer, Canada Social Transfer, funding for labour market programs and Canada-Ontario community housing initiatives. Ontario did not receive equalization payments in 2019, so equalization was not included in the overall federal transfer figure.

Federal-provincial fiscal relations only tell part of the story. There is also the relationship between Ontario's cities and the more senior levels of government. It, too, has generally been subject to ad hoc and piecemeal change rather than systematic reform. And the consequences are increasingly clear as cities become responsible for a greater share of programs and service delivery without commensurate revenue-generating capacity.

A 2019 study released by the Mowat Centre examined the need for municipal financing to be re-evaluated. The report, which focused on Peel Region as a case study, noted that municipalities are facing rapidly rising costs with limited revenue options to pay for them. As the authors wrote: "Over the years, municipal expenditure responsibilities have … increased, while revenue growth has not kept pace. Municipalities continue to receive the smallest share of the economic pie – for every household tax dollar paid in Ontario, they collect only 9 cents."[17] Municipalities in Ontario face some of the highest financial burdens of municipalities across the country, as the provincial government has given them among the highest degree of responsibilities when compared to cities in other provinces.

Ontario's municipalities are currently responsible for some fiscal share of a wide range of government services including policing, fire fighting, general regulatory measures, road and street maintenance, public transit, preventative care, other health services, social assistance, other social services, tourism and trade promotion, water purification and supply, sewage collection and disposal, garbage and waste collection, recreation and culture, public housing and regional planning and development.[18] In addition, these tasks are expected to become increasingly burdensome financially, with new demands being placed on social assistance, transit, and affordable housing, to name a few.

There is also a strong argument to be made that municipalities need better funding to avoid regressive taxes. Cities across Ontario are dependent on property taxes to try to meet their budgetary needs, but these taxes are regressive, and hurt seniors and those with fixed incomes the most. Ontario's municipalities continue to rely on property taxes for nearly fifty percent of their overall budgetary revenue. In addition, as the Mowat Institute report notes, there is "limited scope to increase

[17] Sunil Johal, Kiran Alwani, Jordann Thirgood and Peter Spiro, "Rethinking Municipal Finance for the New Economy," Mowat Centre, March 2019, page 1. https://www.peelregion.ca/finance/_media/rethinking-municipal-finance-new-economy.pdf.

[18] Sunil Johal, Kiran Alwani, Jordann Thirgood and Peter Spiro, "Rethinking Municipal Finance for the New Economy," Mowat Centre, March 2019, page 15. https://www.peelregion.ca/finance/_media/rethinking-municipal-finance-new-economy.pdf.

property taxes to meet service expectations and other cost pressures, particularly as wages and income levels fail to keep pace for many families."[19]

With many businesses choosing to have their employees work from home in the midst of COVID-19, some businesses are considering permanent work-from-home measures to keep costs down. This, in turn, will lead to vacancies, lower demand, and potentially very limited revenue growth through property taxes. Families in Ontario likely cannot afford anything greater, particularly in these difficult economic times. Cities may indeed face the greatest financial challenges brought on by the COVID-19 pandemic, as they are not allowed to run deficits in their operating budgets.

While the federal and provincial governments have a diverse set of revenue sources, Ontario's municipalities are forced to rely almost entirely on property tax, specialty taxes (such as taxes on alcohol and tobacco), and user fees. Municipal governments require provincial authority to enact new or different forms of revenue such as a local sales tax or a municipal income tax and such authority has not been forthcoming. The combination of rising expenditures and limited revenue options has led many municipalities to raise property taxes at a rate faster than inflation.

One way to highlight the challenges facing cities in our current system of fiscal federalism is to compare the City of Toronto and the Province of Prince Edward Island. The City of Toronto must provide programs and services for 2.7 million residents. Its operating budget was $13.5 billion in 2020. PEI's population is 142,900. Its operating budget is $2.03 billion.[20]

Yet the latter has a wide range of revenue tools within its capacity, including income taxes, sales taxes, and so forth. It also received $694 million in federal transfers while the City of Toronto received approximately $227 million per year in federal transfer payments.[21] This amounts to $4,320 per person in PEI, but only $77.47 in Toronto. The City of Toronto also receives $2.4 billion from the

[19] Sunil Johal, Kiran Alwani, Jordann Thirgood and Peter Spiro, "Rethinking Municipal Finance for the New Economy," Mowat Centre, March 2019, page 83. https://www.peelregion.ca/finance/_media/rethinking-municipal-finance-new-economy.pdf.

[20] "Prince Edward Island Estimates 2020-2021," Prince Edward Island Department of Finance, 2020. https://www.princeedwardisland.ca/en/publication/2020-2021-estimates-revenue-and-expenditures

[21] "Major Federal Transfers," Government of Canada, February 2, 2017. https://www.canada.ca/en/department-finance/programs/federal-transfers/major-federal-transfers.html#Prince.

government of Ontario.[22] But even if we add transfer payments from both the federal government and the government of Ontario together, Toronto receives just $893 per capita, far short of PEI's federal transfers.

The upshot: Canada's system of fiscal federalism is starting to show its age. The issues and challenges facing our different orders of government probably require systematic change rather than the piecemeal reform that we have seen in the past. This was the case prior to the COVID-19 pandemic. Provincial governments, including Ontario's, were facing long-term fiscal sustainability challenges because of aging demographics and the pressure placed on provincially delivered health care. Health expenditures in Ontario are currently about 40 percent of the province's overall program spending and they are bound to increase as an aging population demands more services and care. And, as mentioned, cities were already becoming increasing vocal about the need to rethink their revenue tools and spending responsibilities.

The pandemic has exacerbated these issues. The Ontario government, for instance, has experienced a significant drop in own-source revenues and the federal government has stepped in with one-time emergency transfer payments. There are also, of course, greater demands on provincial health-care systems and funding challenges for cities which are experiencing drops in public transit revenues and pressures on social services. This confluence of issues could theoretically create an opportunity for fundamental reform to Canada's system of fiscal federalism.

There is some considerable thinking and scholarship occurring on these questions. One nascent initiative with much promise is an Intergovernmental Fiscal Relations Commission modelled on the Ecofiscal Commission. The proposal involving a steering committee of policy experts shepherded by the Institute for Research on Public Policy and the Canada West Foundation would address three interrelated policy areas: fiscal arrangements related to the rising demand for public services, the coordination of public services and income support programs, and the financing of municipal governments in terms of public services and infrastructure. A draft proposal now circulating in public policy circles touches on themes and challenges in this paper.[23]

[22] "Budget TO: City of Toronto 2020 Budget Summary," City of Toronto, February 2020, page 109. https://www.toronto.ca/wp-content/uploads/2020/08/8de8-2020-city-of-toronto-budget-public-book.pdf

[23] Intergovernmental Fiscal Relations Commission, Draft Proposal: Reforming Canada's Intergovernmental Fiscal Relations in a Post-Pandemic World, Canada West Foundation, August 7, 2020. https://cwf.ca/wp-content/uploads/2020/08/2020-06-25-IFRC-Draft-Proposal-Public.pdf.

As part of these efforts, there ought to be a balance between a focus on systematic reforms and more practical yet smaller-scale changes to the functioning of Canadian federalism. The Ontario government should, of course, participate in any intergovernmental discussions about fundamental reform to Canada's fiscal federalism – including changes to major transfers and possible shifts in the divisions of powers – but it should also be realistic about what is possible in light of the inevitable political economy factors that would shape such reforms.

Decision Considerations

A more practical reform agenda might target the problem of intergovernmental disentanglement. What do we mean?

There has been a build up over time of federal, provincial, and municipal programs, policies, and activities that is leading to overlap and duplication, regulatory confusion, and a burden on businesses and households. The list of areas of entanglement is long – including (but hardly limited to): two Species at Risks Acts; duplicative environmental assessment processes; various environmental efficiency and conservation programs; multiple (and sometimes conflicting) health and safety regulatory standards; Indigenous programming and services; a range of disconnected individual tax and transfer policies; tri-level streams of funding for infrastructure, affordable housing, homelessness, occupational training; innovation, and so on; and, of course, the design and funding levels of intergovernmental transfers.[24]

Just consider, for instance, that, according to a recent Ontario 360 paper, there are no fewer than 280 provincial statutes, and countless provincial regulations, policy frameworks, and service standards affecting how municipalities in Ontario deliver services.[25] This number multiples if one tries to account for federal statues and policies that touch on the provinces and municipalities.

The causes of such intergovernmental entanglements are complicated. It is a combination of shared jurisdiction, resource pooling, efforts to realize economies-of-scale or standardization, and of course politics. Sometimes they may be justified. In other cases, the evidence-based rationale might be weaker. But in all cases, the benefits must be weighed against the costs.

Intergovernmental overlap can manifest itself in less accountability, higher costs, and limits on policy and service delivery experimentation. Taxpayers lose out when the system becomes too centralized and duplicative. So do businesses and workers due to the cost burden that the labyrinth of multi-jurisdictional regulations imposes on the economy.[26]

[24] Matthew Mendelsohn, Joshua Hjartarson, and James Pearce, "Saving Dollars and Making Sense: An Agenda for a More Efficient, Effective and Accountable Federation," Mowat Centre, October 2010. https://mowatcentre.ca/saving-dollars-and-making-sense/.

[25] Gabriel Eidelman, Tomas Hachard, and Enid Slack, "In It Together: Clarifying Provincial-Municipal Responsibilities in Ontario," Ontario 360, January 23, 2020. https://on360.ca/policy-papers/in-it-together-clarifying-provincial-municipal-responsibilities-in-ontario/.

[26] Brian Lee Crowley and Sean Speer, A Work and Opportunity for Canada, Macdonald-Laurier Institute, September 2018. https://macdonaldlaurier.ca/files/pdf/MLI_GAI_Labour_FinalWeb.pdf.

One of the key outcomes of such intergovernmental overlap is the redundancy of various programs, services, and regulations. A now dated estimate puts the annual federal cost of intergovernmental overlap at $5 billion alone.[27] There are no similar estimates for provincial or local governments or for businesses and individuals who must navigate the different regimes. But it is fair to say that the cost is substantial and likely growing in light of the increasing entanglement between the provincial government and Ontario municipalities as previous Ontario 360 research has documented.

Another problem is that multiple policies and activities at the various levels of government may not be aligned and can even act at cross-purposes. The interaction between different innovation policies or energy efficiency measures, for instance, demonstrates the risks of layering and an overall lack of coordination. The left hand and right hand may not be in synch. The result can be poorer outcomes and a lack of accountability and transparency that usually are marked by intergovernmental finger-pointing.

There is certainly an argument that democracy functions best when to the extent possible the same level of government responsible for spending is also collecting the associated revenues. Clear lines of revenue collection and spending choices enable greater transparency and, in turn, political accountability. Legal scholar Asher Honickman has referred to this as a federalism of "watertight compartments."[28]

A final challenge involves the limits that intergovernmental entanglement can impose on policy and service delivery experimentation. One of the benefits of federalism is that it permits a degree of familiarity and localism in decision-making and implementation. Centralizing policy choices necessarily precludes this type of policy, and political entrepreneurship and creativity. Policymakers at all levels should create the policy space to enable the expression of local preferences or priorities and policy and service delivery experimentation. One can argue that this may be even more important in light of growing divergence in economic outcomes according to geography, as a recent Ontario 360 paper highlighted.[29]

[27] Michelle Salvail, "Federal-Provincial Program Overlap." Parliamentary Research Branch, December 1992. http://publications.gc.ca/collections/Collection-R/LoPBdP/BP-e/ bp321-e.pdf.

[28] Asher Honickman, "Watertight compartments: Getting back to the constitutional division of powers," Alberta Law Review, 2017. https://www.albertalawreview.com/index.php/ALR/article/view/795.

[29] Weseem Ahmed, Measuring Ontario's Urban-Rural Divide, Ontario 360, November 13, 2019. https://on360.ca/policy-papers/measuring-ontarios-urban-rural-divide/.

The upshot is that there is a need for an evidence-based, systematic effort to think about the functioning of federalism. It must go beyond the usual ad hoc approach to federalism-related reforms and instead involve evidence-based guideposts to judge "who does what" in the name of accountability, efficiency, and local experimentation. This may involve some uploading and downloading. But it will ultimately be guided by evidence and the overriding objective of disentanglement.

There is reason to believe that such an agenda could find political support across the provinces and with the federal government. Every government is running large budgetary deficits due to the pandemic. A "disentanglement" agenda could produce fiscal savings. At minimum, it would reduce the overall cost of government. And, although it is a bit cliché, there is ultimately only one taxpayer. One could envision progress on disentanglement as part of an effort to "right-size" government in a post-pandemic recovery.

If it is to gain broad-based and durable political support, such an agenda must be rooted in clear guiding principles. This cannot be merely about uploading or downloading responsibilities to improve one level of government's public finances at the expense of another. It requires deeper analysis about which level of government is best placed to execute certain functions or deliver certain programming and services based on various considerations – including accountability, efficiency, effectiveness, experimentation, fiscal sustainability, and subsidiarity.

The Mowat Centre produced a major report along these lines in 2010.[30] It was based on extensive consultations with academics, policymakers, and other stakeholders. The Council of the Federation is uniquely positioned to build on this work and further develop the lens that federal and provincial governments can apply to this question of disentanglement. The Ontario government should use its influence with the council to advance this work.

Even without federal "buy-in," Ontario could move forward and perform such disentanglement in its relationship with municipalities. Currently, the Government of Ontario jointly funds several essential local services with municipalities, including (but not limited to): water, solid waste, roads, transit, social housing, ambulance service, long-term care, public health, social assistance, and childcare.

[30] Matthew Mendelsohn, Joshua Hjartarson, and James Pearce, "Saving Dollars and Making Sense: An Agenda for a More Efficient, Effective and Accountable Federation," Mowat Centre, October 2010. https://mowatcentre.ca/saving-dollars-and-making-sense/.

A previous Ontario 360 paper has raised many of the same issues cited above with the growing entanglement between Queen's Park and Ontario's municipalities.[31] As the authors observed, this overlap and duplication (which is often times arbitrary and inconsistent) erodes accountability, government efficiency, and the potential for experimentation. Why, for example, does the government of Ontario fund 71% of the cost of social assistance in municipalities across the province but only 14% of the cost of social housing?[32] It would be productive for the Ontario government to try to answer such questions in conjunction with the province's municipalities, even if there is not support for a broader, national disentanglement agenda following the pandemic.

Policymakers need not fear major fiscal burdens: the provincial government can initiate a process of disentanglement in a cost-neutral manner. That is to say that dollars would follow government functions. Disentanglement simply means that the province chooses to take on full responsibility for certain areas of policy and service delivery areas and vice versa.

Where can Ontario policymakers look for similar experiences? Peer jurisdictions have experimented with different forms of disengagement agendas. These experiences can ostensibly inform and shape such an agenda in Canada.

The most relevant and instructive may be in Australia. Australia's model of federalism is similar to Canada with regard to the division of powers and the overall political system. Similarly, like Canada, Australia's government overlap represented a significant opportunity cost: estimates are that intergovernmental overlap and duplication could cost Australia's economy as much as $20 billion annually.[33]

[31] Gabriel Eidelman, Tomas Hachard, and Enid Slack, "In It Together: Clarifying Provincial-Municipal Responsibilities in Ontario," Ontario 360, January 23, 2020. https://on360.ca/policy-papers/in-it-together-clarifying-provincial-municipal-responsibilities-in-ontario/.

[32] Gabriel Eidelman, Tomas Hachard, and Enid Slack, "In It Together: Clarifying Provincial-Municipal Responsibilities in Ontario," Ontario 360, January 23, 2020. https://on360.ca/policy-papers/in-it-together-clarifying-provincial-municipal-responsibilities-in-ontario/.

[33] Business Council of Australia, "Reshaping Australia's Federation: A New Contract for Federal-State Relations," October 28, 2006. https://d3n8a8pro7vhmx.cloudfront.net/bca/pages/2698/attachments/original/1532661118/combined-full-version-action-plan_28-10-2006.pdf?1532661118.

Australia began to pursue disentanglement reform in the 2010s. The Coalition government under both the Abbott and Turnbull regimes seriously considered it, and even produced a white paper on the topic, but the government backed away due to the controversial nature of certain proposals, including withdrawing national government funding for schools.[34]

If the aborted experience of disentanglement in Australia can teach us anything, it is that reform through disentanglement should be pursued on an issue-by-issue or sector-by-sector basis. The ultimate failure of the Australian reform effort was due to the national government's elusive "grand bargain" posture, potentially trying to achieve every objective in one shot and focusing on fiscal savings rather than better policy and governance.[35]

What does this mean for Ontario policymakers? Given the wide range of issues at play, it makes sense to conceptualize a disentanglement agenda according to a short- and long-term set of reforms. The former are areas of reform that might be carried out with relative ease based on the current funding formula, policy framework, and a sense of political feasibility. The latter are areas of reform that would be more challenging due to these same factors. The process can be incremental to permit consultation and lessons learned. The list below reflects a combination of our own assessment of different priority areas and work done previously by the Mowat Centre.

Short-term reforms

- **Social housing/infrastructure** – the current funding and project selection model (which can involve tripartite approvals) erodes regional and local accountability and assumes too much localized knowledge on the part of the federal government. There is scope to protect the federal role in national or interprovincial projects and also decentralize funding and decision-making for provincial or local projects

- **Skills training and financial support for students (including student aid)** – the federal government is currently involved in various training and education-related programming that is far removed from regional or local labour markets. There may be scope to further devolve funding and decision-

[34] Anne Tiernan, "Reforming Australia's Federal Framework: Priorities and Prospects," Australian Journal of Public Administration, December 15, 2015. https://onlinelibrary.wiley.com/doi/10.1111/1467-8500.12180.

[35] David Donaldson, "Why We Gave Up on Federalism Reform (This Time)," The Mandarin, May 5, 2016. https://www.themandarin.com.au/64341-happened-federalism-white-paper/.

making for training-related initiatives, including possibly the Canada Student Loan and Canada Student Grant programs

- **Payroll deductions/tax collection** – the Canada Revenue Agency is already responsible for collecting income taxes on behalf of the provinces. There is a case that it should also assume responsibility for provincial-based payroll deductions such as WSIB premiums and health taxes

- **Resource projects** – there seems to be a general consensus that there is too much overlap and duplication with regards to environmental regulation and permitting for major resource projects. Delays with major projects such as the Ring of Fire exemplify the uncertainty and lack of accountability stemming from intergovernmental overlap. There is the need to simplify the regulatory process for major projects

- **Environmental regulations** – the federal and provincial governments have various environmental and conservation-related regulations such as Species at Risk Acts. This overlap and duplication carry undue economic costs for businesses and fiscal costs for governments. There is scope for rationalization and disentanglement without eroding environmental and wildlife protection

- **Food inspection** – the federal and provincial governments are each responsible for food inspection depending on where the products are being sold and consumed. This overlap and duplication similarly carries undue economic costs for businesses and fiscal costs for governments. There is scope for rationalization and disentanglement without eroding heath and safety

- **Consumer protection and safety** – the federal and provincial governments are responsible for different aspects of consumer safety such as the federal role in transportation (e.g., car seats) and provincial role in various areas (e.g., motor vehicle repairs). This overlap and duplication creates confusion and a lack of accountability as well as economic and fiscal costs. There is scope for rationalization and disentanglement without eroding consumer protection and safety

- **Immigration settlement** – as provinces assume a greater role in determining their immigration needs, there is scope to rethink how we fund and deliver immigration services

- **First Nations service delivery** – as provinces assume a greater role in delivering services on- and off-reserve, there is a need to rethink how we fund these functions – particularly to simplify the burden on provincial ministries and affected communities

Long-term reforms

- **Tax/transfer system** – there is scope for longer-term judgements about the optimal mix of tax policy levers among the three orders of government and the delivery of different income support programming
- **Financial regulations** – building on the progress of the "passport model" and federal credit union legislation, there is scope to rationalize Canada's regulatory framework for the financial sector to address systemic risk and support efficient capital markets
- **Pensions** – there is room to consolidate the various pension-related laws and regulations to simplify the pension rules for individuals and businesses
- **Economic development/innovation** – the federal government will continue to set out macroeconomic policy, but there may be scope to devolve more regionalized or sectoral initiatives to the provinces to enable experimentation and specialization based on provincial or regional comparative advantages and needs
- **Law enforcement** – the current state of policing and law enforcement involves a panoply of federal, provincial and local organizations and activities. Law enforcement needs are evolving in response to terrorism, complex financial crimes, and other threats. There is scope to streamline federal-provincial law enforcement activities to achieve greater specialization, less duplication and to realize cost savings

This list is not exhaustive. Our purpose here is to spur interest in, and support for, a disentanglement agenda in conceptual terms. But such a discussion comes with some key caveats:

- Other areas will invariably be added as part of an evergreen process of clarifying "who does what." As mentioned earlier, this ought to be seen as an iterative exercise.
- There will be disagreements about whether certain programs or services ought to be uploaded or downloaded if the goal is to achieve clearer accountability and differentiation. Solving for these differences will require a combination of evidence-based decision making and political compromise.
- There will also be disagreements about whether to tackle these subjects on a one-off basis or in their totality. The evidence (including from Canada) seems to be that an all-or-nothing proposition may be an obstacle to progress.
- The range of issues, timing, and ultimate outcomes would necessarily require discussion, debate, and negotiation between Ottawa and the provinces and territories.

In this vein, it is also important to emphasize that a disentanglement agenda involving these policy areas will not necessarily result in a significant reduction in provincial spending. It may, in fact, increase the size of provincial governments, if the judgment is made that these programs and services ought to be concentrated at the provincial level.

The benefits could come in the form of greater accountability, more scope for flexibility, a reduced regulatory burden on businesses, and ultimately, lower overall costs for taxpayers.

Summary and Policy Recommendations

The Government of Ontario can play a key role in building interest in, and support for, a disentanglement agenda as part of post-pandemic recovery planning at the federal, provincial, and municipal levels. The province has a long history of playing a catalytic role on intergovernmental issues. This time should be no different. There is an opportunity for the provincial government to build a consensus with its federal and provincial counterparts in favour of short- and long-term efforts to achieve intergovernmental disengagement.

The Ontario government ought to pursue two steps in this direction. The first is to have the Ontario ministry of finance produce an estimate of the economic and fiscal costs associated with intergovernmental entanglement. Earlier in this paper, we cited a dated estimate that it costs the federal government as much as $5 billion per year. Presumably that figure is multiplied across the provinces and municipalities and has only increased over time. It is important, however, that the calculation not be limited to the fiscal costs for government. The goal should be to also incorporate the costs to businesses and households. An evidence-based estimate of the economic and fiscal impact of intergovernmental entanglement could help to build momentum and support for a disentanglement agenda.

The second is for the Ontario government to encourage the Council of the Federation to expand its focus from reforms to major federal transfers (which is primarily about increasing the Canada Health Transfer) to a broader emphasis on improving the functioning of Canadian federalism. This is not to say that the provinces need to necessarily abandon the goals of systematic reform to transfer payments and the division of powers. But there is, in our view, a good case for not putting all of our eggs in this basket. There is a reason why we have seen so little systematic reform to Canadian federalism over the years. Building broad-based support is highly challenging.

There may be room for greater progress in the realm of intergovernmental disentanglement – particularly given that, according to the Council of the Federation, provincial and territorial premiers have been in regular communication amid the COVID-19 pandemic.[36] This represents an opportunity to build a provincial/territorial consensus and then engage the federal government.

The Ontario government is well-placed with its provincial and territorial counterparts to broaden how they all think about reform to Canadian federalism, so as to enable a short- and long-term focus on disentanglement. This should have greater resonance in light of the fiscal challenges caused by the COVID-19 pandemic.

[36] "Canadian premiers reiterate priorities," Council of the Federation press release, September 24, 2020. https://www.canadaspremiers.ca/canadas-premiers-reiterate-priorities/.

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