Equalization and Escalator ripping off Alberta

A formal equalization system was rolled out in 1957, initially tying payments to the per-capita revenues of Canada's two wealthiest provinces: Ontario and B.C. This was later lowered to the national average among provinces.

The principle of equalization became part of Canada's Constitution in 1982.

What is the 'escalator' and why is it controversial?

With the global financial crisis creating massive uncertainty, the Harper government brought in a new rule in 2009 that linked equalization payments to overall national economic growth. While meant at the time to make equalization costs more predictable and manageable, the so-called "escalator" had some unintended effects once the crisis ended and growth returned to normal.

Trevor Tombe, an economist at the University of Calgary and expert on equalization, says the escalator has disconnected equalization payments from interprovincial inequalities.

"Right now, (equalization) is paying out more than what it's own formula wants to, because inequality is less than the total dollars available," says Tombe.

Tombe noted that, while the mid-2010s oil glut shrunk the gap between Alberta and the rest of the country, payments have only grown since then.

He estimates that, as a result of the escalator, equalization receiving "have-not" provinces have been overpaid by more than $7 billion over the last five years.

Why does Ontario get equalization payments?

The Harper-era escalator is also why Ontario gets equalization payments. The escalator generates excess funds beyond what the equalization formula allocates to true "have-not" provinces. This surplus regularly goes to Ontario, the next worst off province, in the form of adjustment payments. Ontario is scheduled to receive a $406 million payment in 2026-27.

How do you change the equalization formula?

The federal government could, in theory, change the formula unilaterally by amending the Federal-Provincial Fiscal Arrangements Act.

For example, Tombe says that tying federal equalization payments directly to provincial GDP could help ease regional tensions and ensure equalization dollars are spent more efficiently.

The program is formally reviewed by the federal government every five years, in consultation with the provinces. The next mandatory review must take place before March 31, 2029.

Equalization Is Broken: How the Continuous Growth Requirement Inhibits Reform

- In 2009, the federal government altered the equalization formula by creating a rule requiring aggregate payments to grow in line with recent national nominal economic growth. This change is known as the Fixed Growth Rate (FGR) rule.
- The rule was introduced to control program costs, which had risen rapidly in the preceding decade. However, following convergence in provincial fiscal capacity beginning around 2015, it began to require upward adjustments rather than downward ones, functioning as a floor rather than a ceiling.
- We refer to payments generated by the FGR's floor function as constituting "over-equalization." This bulletin estimates their cost since 2018/19 at approximately $10.5 billion, with the rule accounting for more than 10 percent of total program costs in three separate years.

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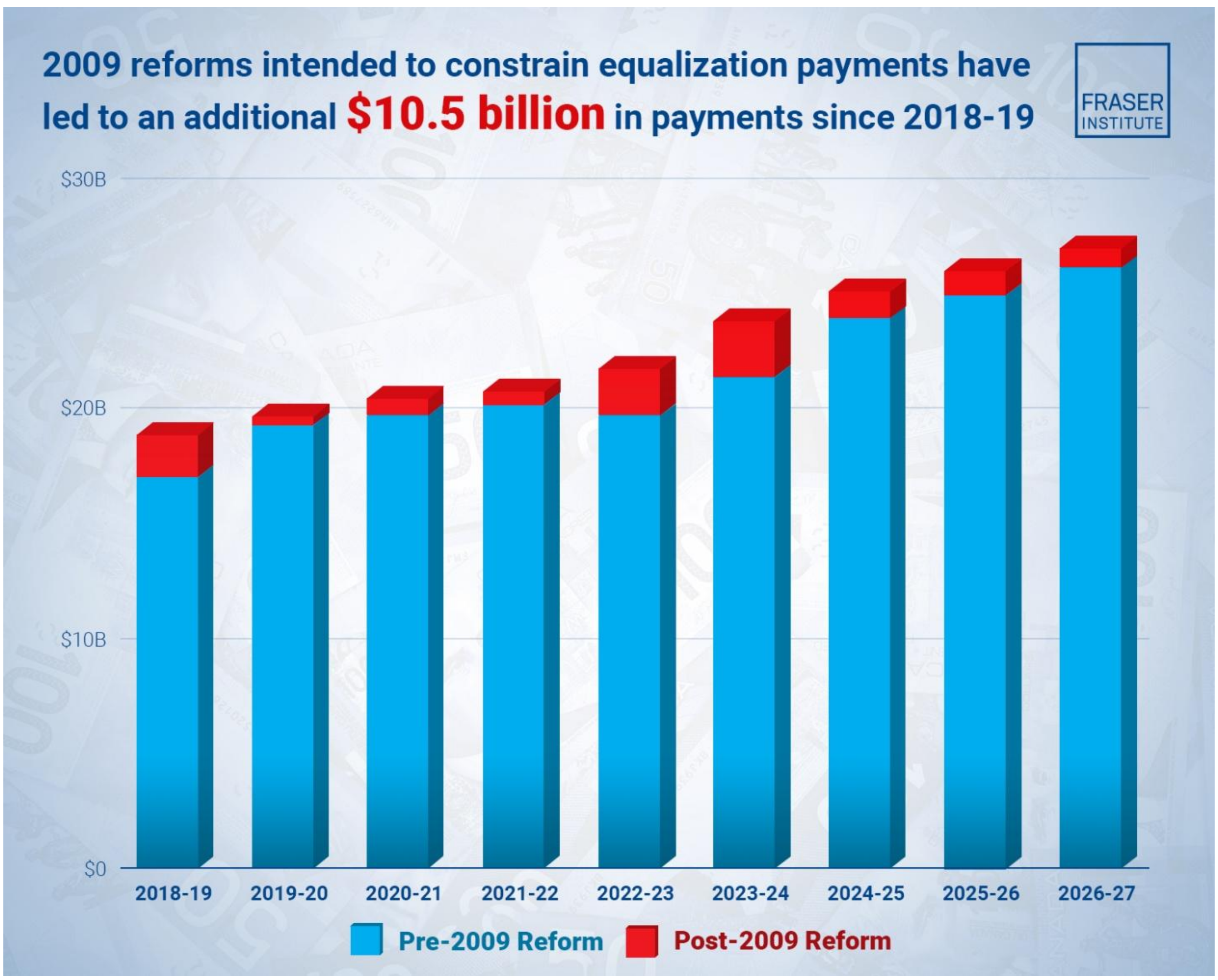
- A more fundamental problem, which we illustrate, is that the FGR severs the link between changes to the equalization formula and changes in total program spending. This limits the potential effectiveness of many reform options.
- We review a range of reform proposals and show that, absent changes to the FGR itself, they would primarily reallocate payments among provinces rather than reduce aggregate spending.
- In this important sense, the program is broken: a rule intended to constrain program costs now prevents the formula from adjusting total spending in line with changes in relative provincial fiscal capacity and limits the effectiveness of many possible policy reforms.



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The Hydro vs. Oil Paradox: Utility vs. Commodity

Hydro = Public Utility: Hydroelectricity is treated as a public utility delivered by Crown corporations. The formula uses *actual revenues* from domestic sales. Since Quebec sells power at below-market regulated rates (7.3¢/kWh vs. 15¢+ elsewhere), the revenue counted is artificially low — even though the resource has enormous market value if exported.

Oil & Gas = Commodity: Oil is treated as a commodity sold on world markets at full market prices. Alberta cannot sell oil to Albertans at a "subsidized" domestic rate — it's sold globally at market value. There's no equivalent way to "hide" revenue capacity the way hydro-rich provinces can.

The Double Standard: Alberta's lack of a PST is treated differently — the formula assumes Alberta *could* have one and calculates hypothetical revenue. But Quebec's choice to forgo billions in potential hydro revenue is not counted. Critics argue this effectively rewards hydro provinces for subsidizing their residents' power bills at the expense of taxpayers elsewhere.