

**Equalization, Regional Development, and Political Trust:  
The Section 36/Atlantic Accords Controversy**

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## **Equalization, Regional Development, and Political Trust: The Section 36/Atlantic Accords Controversy**

The controversy generated by the federal government's unilateral alteration of the Atlantic Accords, and the subsequent bitter political stand-off between the federal government and the provinces of Nova Scotia and Newfoundland and Labrador, was the initial stimulus for this paper. The agreements, the alleged breach of trust involved in their unilateral alteration, and the political fall-out, manoeuvrings and negotiations that followed raise a number of issues about the mechanisms and pathologies of executive federalism in Canada. This episode also provides some insight into a continuing source of misunderstanding and grievance that persists in centre-periphery relations in Canada around the issues of equalization and regional development. The purpose of this paper is to use the controversy as a case study to inquire into these issues, with a view to making an incremental contribution to the critical literature on the institutions of Canadian federalism.

This study begins with an examination of the intergovernmental agreements known as the Atlantic Accords, but expands inevitably beyond this to more broadly inquire into the constitutional, fiscal and political context for the Accords, and in particular Section 36 of the constitution on equalization and regional development.<sup>1</sup> The major commitment to regional equity in Section 36 has proven to be both a powerful mechanism of integration in the Canadian federation and a continuing source of frustration, representing as it does a form of social contract at best imperfectly observed or fulfilled. After examining the problems associated with the implementation of Section 36, and its connection to the controversy surrounding the Atlantic Accords, the paper will conclude with some reflections on the factors affecting trust in intergovernmental relationships, and some strategies for coping with these factors, with a view to avoiding, limiting or better managing politically-destabilizing and regionally-alienating controversies and conflicts within the federation.

It seems clear that a key variable in the Atlantic Accords controversy, as well as the longer term problems associated with the implementation of the commitments embodied in Section 36 of the Constitution, is *political trust*. Trust is an important element in federations, and particularly in intergovernmental negotiations and agreements. As a political variable, trust can be seen to have both a moral and a strategic dimension. Elazar sees federal unions as based on moral covenants which bind the partners together in mutual respect and recognition. LaSelva has inquired into the moral foundations of

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<sup>1</sup> Section 36 reads as follows: "36 (1) Without altering the legislative authority of Parliament or the provincial legislatures, or the rights of any of them with respect to the exercise of their legislative authority, Parliament and the legislatures, together with the government of Canada and the provincial governments are committed to a) promoting equal opportunities for the well-being of Canadians; furthering economic development to reduce disparities in opportunities; c) providing essential public services of reasonable quality to all Canadians. 36 (2) Parliament and the Government of Canada are committed to the principle of making equalization payments to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation."

Canadian federalism. In both cases the morality of federalism, its ethos or ethic, relies heavily on trust ties between the federating partners, whether peoples or distinct regional communities, and that the spirit of federalism – a union based and continually renewed upon the mutual consent and agreement of the partners – will be observed.<sup>2</sup>

Dupré, writing on role of trust as it affects the workability of inter-state or ‘executive’ federalism, stressed the importance of honouring the ‘norms’ of intergovernmental relations, rather than just the strict legalities. These norms are reinforced through the establishment and maintenance of “trust ties” among intergovernmental decision-makers and officials generated over time through the mutual recognition and honouring of negotiated agreements. He also noted that these trust ties were most likely to be the product of ongoing ‘functional relations’ among officials, rather than ‘summit relations’ among political executives, due to the fact that the former generally operate more smoothly and predictably. In particular, Dupré notes that the inherently quantifiable character of fiscal relations in Canada, the common vocabulary and network formation of finance officials, and the fixed maximum five-year term of fiscal arrangements (‘nothing is forever’) make it one area where the mechanisms of executive federalism perhaps have the best chance of generating successful outcomes, in terms of negotiated agreements that address problems and manage or moderate intergovernmental conflict. Yet even here the workability of the model can be rendered inoperable by the intrusion of political factors.<sup>3</sup>

Trust is clearly essential to building and utilizing a form of social capital in federations, which makes possible the more effective and efficient operation of intergovernmental consultative and decision-making processes, in short the functional mechanisms of intergovernmentalism. As well, in a more generic sense, trust is a central factor in the realm of contracts, as a basic prerequisite of good-faith negotiations and agreements between individuals or institutional actors or agents. Contractual relations involve a continuum of measures and mechanisms that can be used to enable and enforce agreements, ranging from the negotiation of trust-based oral agreements to legally-binding contracts with detailed requirements.<sup>4</sup>

An expected political consequence of broken trust ties, especially in the case of repeated occurrences, is the erosion of federal norms and assumptions that underlay a federal culture or ethic, a pronounced contraction in the reservoir of social capital that both relies upon and contributes to cooperation and trust, and lower levels of legitimacy, initially for political authorities, but eventually for the political regime, or even the political community. Such consequences certainly will make future intergovernmental cooperation and negotiation less likely and more difficult, and more prone to negative outcomes, especially where non-justiciable, open-ended or flexible agreements are concerned, since

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<sup>2</sup> Daniel Elazar, *Exploring Federalism*, Tuscaloosa: University of Alabama Press, 1987; Samuel LaSelva, *The Moral Foundations of Canadian Federalism: Paradoxes, Achievements and Tragedies of Nationhood*, Montreal: McGill-Queens University Press, 1996.

<sup>3</sup> J. Stephan Dupré, “The Workability of Executive Federalism in Canada”, in H. Bakvis and W. Chandler, eds, *Federalism and the Role of the State* Toronto: University of Toronto Press, 1987, 236-258. Dupré cites as an example the last Trudeau government’s decision to pursue its counter-offensive against provincialism into the fiscal domain.

<sup>4</sup> OECD, *Linking Regions and Central Governments: Contracts for Regional Development* OECD, 2007.

negotiations in the context of low levels of trust, if they are to be successful, generally require agreements featuring more verifiable commitments, and therefore the inclusion of strict enforcement mechanisms.<sup>5</sup>

In this connection, it has been recognized that institutional development can reduce the need for and the role of political trust. In effect, the fewer institutions you have, the more trust is needed. One reason for this is that routinization (a by-product of institutionalization) makes it less likely that diversions will occur from established understandings and practices. Higher levels of institutionalization also generally involves the greater prevalence of, and accepted recourse to decision rules, dispute resolution mechanisms, procedures for clarifying accountabilities, and other bureaucratic supports, all of which can make trust less central or essential to intergovernmental relations. On the other hand, as noted by Benz, one of the consequences of increased institutionalization in federations can be reduced flexibility and the accumulation of rigidities in intergovernmental relations, with the Courts used more regularly to resolve conflicts and ultimately to act as the arbiter of intergovernmental relationships.<sup>6</sup>

### Section 36 of the Constitution Act 1982

Section 36 of the Constitution entrenches a commitment on the part of Parliament and the government of Canada to the principle of making equalization payments to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services to all Canadians at reasonably comparable levels of taxation (36-2). It also contains a commitment on the part of Parliament and the provincial legislatures, together with their governments, to further economic development to reduce regional disparities (36-1). These constitutional commitments can be understood to embody a trust that the federal spending power will be used to advance regional equity.

Experts in fiscal federalism generally acknowledge that while equalization payments have dramatically reduced the discrepancies between provinces in fiscal capacity, the equalization commitment in Section 36 has never truly been fulfilled, primarily because of the inadequacies of the formula used between 1982 and 2007 to determine payments. A formula based on fiscal capacity rather than actual costs or need, the construction of a national average based on a five-province standard which excluded Alberta and its resource revenues, and later the employment of a cap on equalization payments, all contributed to a federal transfer payment to poorer provinces that was less generous than was necessary if Section 36 commitments were to be fully realized. The inevitable result of this, not surprisingly, was somewhat lower levels of public services at somewhat higher levels of taxation, along with higher levels of public debt in recipient provinces, all of which indicates a greater fiscal effort for services of equal or lesser quality.<sup>7</sup>

<sup>5</sup> OECD, *Linking Regions*, “Executive Summary”, 9-20.

<sup>6</sup> Artur Benz, “Trust and Mistrust in Intergovernmental Relations – The Case of Germany”, a presentation to the 8<sup>th</sup> CREQC Symposium, “La dynamique confiance/méfiance dans les Etats fédéraux ou en voie de fédéralisation”, UQAM, Montreal, Canada, November 23, 2007.

<sup>7</sup> Robin Boadway, “Should the Canadian Federation be Rebalanced?” Working Paper 2004 (1), Institute for Intergovernmental Relations, Queen’s University; Harvey Lazar, “Opening Statement before the Senate Standing Committee on National Finances, March 31, 2004.

As for reducing regional disparities, understood to be the underlying cause of differing provincial fiscal capacities, this federal commitment was downplayed and progressively de-funded after its constitutional entrenchment in 1982, with declining regional development spending arguably a reflection of a fading federal commitment to advancing regional equity.<sup>8</sup>

However, it also should be noted here that it may not be just the federal government which has fallen somewhat short of its constitutional commitments under Section 36. A recent lawsuit involving the Government of Nova Scotia and Cape Breton Regional Municipality (CBRM) raises both the question of whether the commitments in Section 36 (both with regard to equalization and regional development) are legally binding on governments, and also whether provinces have an obligation to distribute equalization funds to municipalities based on a provincial variation of the same fundamental principle that is propounded in Section 36: in this case ensuring reasonably equivalent public services to all Nova Scotians at reasonably equivalent levels of taxation. The Nova Scotia Supreme Court has rendered an initial decision on the case rejecting the CBRM legal action on the basis that the question on which it seeks a judicial ruling is non-justiciable.<sup>9</sup> As of June, 2008, the municipality is mulling over the pros and cons of launching an appeal. Regardless of the final outcome in this matter, the underlying political problem provoking the municipality to seek redress through the courts is basically one of trust, specifically the lack of trust or the perception of a broken trust in terms of the intergovernmental relationship between the province of Nova Scotia and its second largest municipality.<sup>10</sup>

### The Atlantic Accords

The 2005 Atlantic Accords were bilateral agreements negotiated between Prime Minister Paul Martin, Danny Williams, the Premier of Newfoundland and Labrador, and John Hamm, the Premier of Nova Scotia. The negotiations were conducted in the context of an announced “new framework” for equalization that would have resulted in reduced and capped payments, and ongoing provincial discontent over the 70-80% federal claw-back of provincial offshore revenues. Both of these federal initiatives were perceived by the affected provinces as breaches of trust, the first related to the Section 36 equalization commitment and the second related to a federal government undertaking in the original 1985 Atlantic Accords that the two provinces would be the principal beneficiaries of the

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<sup>8</sup> Donald Savoie, *Regional Economic Development: Canada's Search for Solutions* (Second Edition), Toronto: University of Toronto Press, 1992; Donald Savoie, *Visiting Grandchildren: Economic Development in the Maritimes*, Toronto: University of Toronto Press, 2006. Of course, there are a number of factors that contribute to an explanation for this federal failure to fulfill its regional development commitment: the embrace of the neo-liberal paradigm by the federal government, the imposition of stern fiscal discipline on federal spending in the 1990s, the general political weakness of the Atlantic region and the inability of its federal representatives to protect regional interests, and the steadily diminishing political legitimacy for regional development spending after 1982.

<sup>9</sup> Cape Breton Regional Municipality v. A.G.N.S., 2008 NSSC 111.

<sup>10</sup> Laura Fraser, “C.B. lawsuit on hold for 60 days”, *The Chronicle Herald*, May 24, 2008, B1, B2.

development of offshore oil and gas resources. This was recognized at the time as an important step in advancing the goals of regional development and equity.

The political context for bilateral agreements in 2005 was a politically weakened federal government in a precarious minority situation, which re-valued the support and political leverage of the periphery, enabling small provinces to wring concessions from Ottawa that no doubt would not otherwise have been forthcoming. Certainly Department of Finance officials, the guardians of the federal treasury and managers of federal-provincial fiscal arrangements, were unhappy with the deal. The new Atlantic Accords gave the provinces in question 100% of their offshore revenues without any corresponding reduction in (or cap on) their equalization entitlements; indeed, the deal included an automatic 3.5% increase in equalization payments until 2009-10. This effectively de-linked equalization payments to Newfoundland and Nova Scotia from the national formula. If the provinces did not reach the average fiscal capacity standard by 2012, the agreement would be extended for another eight years; should they reach the standard during that period and therefore no longer qualify for equalization, then they would get transitional payments for two years. Furthermore, the two provinces were granted ‘up-front’ advance payment against their future revenue streams. This last concession reflects the provinces’ immediate fiscal need, the limitations of their trust in the federal commitment, and the softening of the federal government’s bargaining position during the course of the negotiation, primarily due to Martin’s personal intervention. This of course spawned the inevitable opposition and resentments outside the region from political and bureaucratic actors who saw the deal as containing a generous “no strings attached” grant component at odds with the basic rationale of the equalization program.<sup>11</sup>

It is worth noting here that both the federal commitments in Section 36 and the federal undertaking in the Atlantic Accords can be understood to involve questions of *trust* rather than *legality* because both ultimately rested on the use of the federal spending power, which placed the federal government in a strong if not unassailable legal position as confirmed by the Supreme Court in 1991. In the *Reference re Canada Assistance Plan (B.C.)* (1991), “the Supreme Court made it clear that the doctrine of parliamentary sovereignty trumps intergovernmental agreements, and that any ‘legitimate expectations’ on the part of the provinces that such agreements could not be altered unilaterally had no legal effect.”<sup>12</sup> In effect, the federal Parliament (and therefore government) has the discretionary power to spend or not to spend, and it can neither be required nor prevented from doing so by an intergovernmental agreement to that effect.<sup>13</sup>

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<sup>11</sup> Jennifer Smith, “Canada: a noisy squabble over offshore oil and equalization” in *Federations*, vol. 4, no. 3, March, 2005, 19-20. Famously, among the bargaining tactics used by Premier Danny Williams to jolt stalled negotiations was the calculated use of rhetorical and symbolic flourishes, through his populist stoking of Newfoundland neo-nationalist sentiment and the dramatic gesture of lowering Canadian flags outside government buildings in the Newfoundland capital.

<sup>12</sup> Richard Simeon and Amy Nugent, “Parliamentary Canada and Intergovernmental Canada: Exploring the Tensions” in Herman Bakvis and Grace Skogstad, eds, *Canadian Federalism: Performance, Effectiveness and Legitimacy Second Edition*, Don Mills, ON: Oxford University Press, 2008, 96.

<sup>13</sup> This probably explains PM Harper’s initial “so sue me” reaction in Parliament to charges from Nova Scotia and Newfoundland that he blatantly had breached the Atlantic Accords.

## Overturing the Accords

Soon after the defeat of the Martin Liberal government by the Harper-led Conservatives in 2006, a number of ongoing government-commissioned and private sector studies on equalization and fiscal federalism reported with their recommendations. Most important of these was the federal government's own O'Brien Report, which recommended changes to the equalization formula that would broaden and enrich the program's fiscal base. This would simultaneously act on the concern that the program should be placed on a principled national basis and also address provincial complaints about a vertical fiscal imbalance that was fattening federal budgetary surpluses while straining provincial finances. O'Brien proposed a ten-province standard in place of the five-province formula in place since 1982, while including 50% of all natural resource revenues in the formula for calculating entitlements. A further recommendation was that equalization payments to any receiving province be capped to ensure that the fiscal capacity of a recipient province did not exceed that of the lowest non-receiving province (Ontario), regardless of its entitlement under the new formula.<sup>14</sup>

In its March, 2007 budget, the Harper government adopted the main recommendations of the O'Brien report, which effectively killed the federal commitment in the Atlantic Accords to de-link the offshore oil and gas revenues of Newfoundland and Nova Scotia from their equalization entitlements. This was heavily criticized by the two provincial governments as a direct and specific breach of trust, and they both embarked on political campaigns to have the Accords reinstated in their original form and intent. In the course of this campaign, the provincial governments, both Conservative, called on Conservative MPs in Ottawa to join them in demanding the reinstatement of the Accords. One Nova Scotia MP did so, and he was promptly expelled from the Conservative caucus. The popularity of his stance put intense political pressure on the two remaining Nova Scotia Conservative MPs, one of whom was Foreign Minister Peter MacKay. Eventually a new alternative deal was negotiated with Nova Scotia which both sides claim repairs the fiscal damage done to the province by the equalization provisions in the 2007 federal budget.<sup>15</sup> However, this new deal was greeted with widespread scepticism from the Nova Scotia public and political commentators.<sup>16</sup> Typical was the observation of the banished Conservative MP Bill Casey, who continued to call for the restoration of the original Accord, claiming the issue was primarily one of "broken trust" rather than dollars and

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<sup>14</sup> Al O'Brien, "Strengthening Canada's Territories and Putting Equalization Back on Track: The Report of the Expert Panel on Equalization and Territorial Formula Financing", *Fiscal Federalism and the Future of Canada – Conference Proceedings*, Institute of Intergovernmental Relations, September 28-29, 2006. A further change to fiscal arrangements announced in the 2007 budget was a switch from variable cash transfers to the provinces under the CST and CHT, with some poorer provinces receiving an additional compensatory component in the transfer, to a system of unalloyed per capita payments, a change demanded by Ontario and highly beneficial to the larger, wealthier provinces.

<sup>15</sup> Though the specifics of this new deal with Nova Scotia are complicated, the key elements are the federal promise of a back-end "insurance payment" in 2020 that will guarantee Nova Scotia suffers no financial penalty as the result of the 2007 budget changes. Stephen Maher, "Accord deal's value shrinking?" *The Chronicle Herald*, May 6, 2008, A1, A2.

<sup>16</sup> Roger Taylor, "Nova Scotia accepts Wimpy deal, hopes for something later" *The Chronicle Herald*, October 12, 2007, C1,C3.

cents.<sup>17</sup> Meanwhile, no negotiations took place with an embittered, truculent and highly popular Newfoundland Premier, who consistently refused to consider anything less than the re-instatement of the 2005 Atlantic Accord.

### Explaining the Trust Involved and the Politics of its Breach

What exactly was the trust broken by this chain of events and developments in fiscal federalism? The most proximate and glaring was the decision to adopt new equalization measures that would effectively overturn the Accords. What two provinces thought were hard-won victories sealed into intergovernmental agreements that would be adhered to by any subsequent federal government very quickly proved to be a mistaken assumption. This sent political shock waves through the affected provinces, and quickly eroded trust and confidence in the honesty and fairness of the federal government in its dealings with the region. Behind the ensuing public and governmental outrage, however, was a longer-term regional grievance over the distribution of the benefits of offshore development. In a set of original Atlantic Accords in the 1980s, Nova Scotia and Newfoundland had been promised that they would be the principal beneficiaries of offshore oil and gas, and yet the federal government had persisted in imposing a claw-back of 70-80% of offshore revenue through the equalization program; furthermore, Ottawa remained the main beneficiary of the profits from offshore oil because of its direct share in offshore oil developments, as well as federal revenue derived from various taxes. For instance, as of 2007, Ottawa had received four times more revenue from Hibernia than the province of Newfoundland and Labrador (\$4.8 vs \$1.2 billion).<sup>18</sup> As well, the offshore agreement with Nova Scotia in the 1980s contained a promise to financially compensate the province for giving up its claim to ownership of the offshore (referred to as the “crown share”), a promise that was never fulfilled.<sup>19</sup> It was this long-simmering dispute that motivated Nova Scotia Premier John Hamm’s “Campaign for Fairness” which he patiently yet persistently flogged at political and business gatherings across the country during Paul Martin’s Prime Ministership.

Fully understanding the anger and resentment in the reaction of Nova Scotians and Newfoundlanders to this particular episode of federal deal-breaking requires going beyond the immediate broken trust argument (essentially, “a deal is a deal”), or even the longer-term broken trust related to the federal commitment in the original Atlantic Accords (in the 1980s) that these provinces would be the “principal beneficiaries” of offshore oil and gas development. Beyond this, it is worth noting that the Atlantic Accords were negotiated in the context of, and partially in response to the long-standing partial or non-fulfillment of the commitments set out in Section 36 of the constitution, whereby the federal government committed itself to furthering economic development to reduce regional disparities and to an equalization program that would provide all

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<sup>17</sup> Reference for Casey response\*

<sup>18</sup> Staff, “The Hibernia Offshore Oil Project” *The Sunday Herald*, November 18, 2007, p. 4 of ‘The NovaScotian’ supplement.

<sup>19</sup> As part of the Harper Government’s negotiated settlement with Nova Scotia in the wake of the Atlantic Accord controversy, a panel was established to adjudicate the dispute over the “crown share” issue arising from federal non-fulfillment of the original Atlantic Accord.



provinces with the fiscal capacity to provide their residents reasonably comparable levels of public services at reasonably comparable levels of taxation. If it is to be understood why the generous provisions of the 2005 Atlantic Accords were not viewed as excessive or unfair by the governments and publics of the two Atlantic provinces involved, in contrast to much of the reaction elsewhere in Canada, at least part of the explanation lay in the continuing perception within these provinces that the Section 36 commitments have never been properly upheld or acted upon, and certainly with regard to regional development that the federal effort had been sorely lacking. This lingering dissatisfaction with past federal performance was fused with a widespread sense that the economic returns to the provinces promised by the rising value of non-renewable offshore resources was perhaps their last, best chance to break out of their perpetual 'have-not' status. If the resource were to be depleted without any discernible gain in economic advantage because of the federal government's policy of clawing back equalization payments, then this would not only be a blatant injustice and inequity, but also a historic opportunity forgone. In this sense, the Atlantic Accords were seen as a belated federal acknowledgement of the need to somehow compensate the region for federal shortcomings over the years in fulfilling its Section 36 equalization commitments and its outright failure in the area of regional development.

The Harper government decided to adopt a new equalization formula that would effectively negate the Atlantic Accords in the face of this strong regional sentiment that the benefits conferred by the Accords were both justifiable and overdue. This decision can be explained by a number of proximate and strategic political and bureaucratic factors. Since Harper had promised to maintain the Accords prior to his elevation to Prime Minister in the federal election of 2006 (as loudly proclaimed by Premier Williams), renegeing on this commitment in effect constituted a double breach of trust (personal and governmental), and so presumably not a decision to be taken lightly or without some foreknowledge of the likely political consequences in the affected provinces. In fact, there were a number of good reasons for doing so, if viewed from the point of view of strategic political calculation or party ideology. To begin, there was the hostility of the federal Department of Finance to Martin's deal on equalization, and the clear recommendation of the O'Brien Report to cap equalization payments at the level of the lowest non-recipient province. Also important was the Government of Ontario's vehement criticism of the Atlantic Accords, and its opposition to any enrichment of the equalization formula.<sup>20</sup> Likely the most important consideration, however, was the political need to craft a response acceptable to Quebec and Ontario on the issue of the fiscal imbalance, the resolution of which was another promise of the Harper Conservatives. This imperative was mostly accomplished with the adoption of the O'Brien formula on equalization, which benefited Quebec more than any other recipient province, and with the adoption of strictly equal per capita social transfers (excluding the

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<sup>20</sup> In fact, the rise of Ontario regionalism which has asserted itself in federal-provincial relations since the 1990s, can itself be traced to unilateral federal cuts to social transfers to the provinces in that decade, beginning with the "cap on CAP" in 1991, which discriminated against the better off provinces and in a recessionary period added to Ontario's rapidly expanding fiscal deficit at that time. Thenceforth, a more "Ontario first" stance has been adopted by the provincial government in the Canadian federation, particularly with regard to fiscal relations.

health transfer, which for the time being will continue to be determined by its own separate accord). “This essentially ended a long-term bias in favour of fiscally-challenged provinces – what the Ontario and others somewhat misleadingly termed equalization outside the equalization program.”<sup>21</sup>

Essentially the Atlantic Accords were sacrificed to accomplish these broader political objectives, a decision made easier by the political isolation of Newfoundland and Nova Scotia. Whereas in the past the Atlantic provinces could count on Quebec’s influence and coincident interests on equalization to augment and reinforce their own weak political situation, in this instance it was in Quebec’s interest to support implementation of the O’Brien Report. Finally, and in a more ideological vein, the Harper Conservatives’ Reform-CA lineage instils in the Government an aversion to differentiated treatment for provinces in the context of its embrace of the idea of equality as the same treatment for all (ergo, one national formula), its long-standing priority of advancing the goal of provincial autonomy over the redistribution required by regional equity, and in this connection its neo-liberal hostility toward regional development spending of the sort traditionally associated with the Section 36 commitment.<sup>22</sup>

These observations on the factors explaining the federal *volte-face* on the Atlantic Accords raises yet again the question of how “inter-party coalition politics” comes into play in the conduct and institutions of intergovernmental relations. In the absence of brokerage parties operating within an integrated national party system, and the aversion in Canada to inter-party legislative coalitions, “the party governments of Canada have of necessity played a game of intergovernmental coalition politics, but it is a game that does not appear to be as effective for managing the federation as either brokerage parties or coalition governments.”<sup>23</sup>

As argued by Carty and Wolinetz, the competitive dynamics of Canadian party politics often works to aggravate rather than ameliorate regional tensions, though this may begin as an attempt to manage federal-provincial issues through bargaining and accommodation. This is generally played out in a number of “under-institutionalized forums which are poorly integrated and seek to obfuscate the partisan face of the interests involved ... Coalition activity emerges around issues, not programs ... ongoing policy making is not governed by consistent partisan orientations or coherent electoral mandates ... The party coalitions are constantly changing ... [with] no guarantee that those who begin a decision-making cycle will be around to see it through.”<sup>24</sup> In fact, this is an apt description of the competitive partisan dynamics, inter-party coalitions, and accommodative intergovernmental bargaining of the Martin-Harper period, as it pertains to the Section 36/Atlantic Accords controversy. And not surprisingly, building alliances

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<sup>21</sup> Douglas Brown, “Integration, Equity and Section 36” *Supreme Court Law Review* (2007), 37 S.C.L.R. (2d), 24.

<sup>22</sup> Brown, “Integration”, 30.

<sup>23</sup> J.P. Meekison, H. Telford, and H. Lazar, “The Institutions of Executive Federalism: Myths and Realities” in Meekison, Telford and Lazar, eds, *Canada: The State of the Federation 2002: Reconsidering the Institutions of Executive Federalism* Montreal and Kingston: McGill-Queen’s University Press, 2004, 12.

<sup>24</sup> R.K. Carty and S.B. Wolinetz, “Political Parties and the Canadian Federation’s Coalition Politics” in Meekison, Telford and Lazar, eds, *Canada: The State of the Federation 2002*, 67.

and creating obligations in the world of federal-provincial accommodation can lead to a competitive outbidding that is corrosive of the national system. This is made even more likely by the fact that federal party-governments are by necessity engaged in a process of ‘big-tent’ aggregation of interests, while provincial party-governments benefit from the articulation of a provincial interest; the two ‘partners’ in the coalition are therefore frequently working at cross-purposes. In short, the “fleeting, shifting, and oversized” coalitions that governing parties build across the federal-provincial divide to manage the federation tend to be “unresponsive, fragile and electorally unaccountable ... Locked into this syndrome, Canadian parties hardly seem the instruments that a democratic citizenry can use for managing its federation.”<sup>25</sup>

### Remedies and ‘Coping Strategies’

This review of the Section 36/Atlantic Accords controversy as a case study of broken trust ties in intergovernmental relations suggests the complexity of the intertwined issues at play, simultaneously rooted in the exigencies, biases, and pathologies of executive federalism, regionalism, regional development, and the national party system. Of course, the inevitable question arises: what can or should be done? There are a range of possible remedies that might be applied, or strategies for coping with the factors that contribute to eroding trust ties in this area of intergovernmental relations. Such considerations are worthwhile because finding ways of limiting negative outcomes or making less likely future instances of trust breaches would avoid the political damage such instances inflict on the capacity of the intergovernmental relations system to effectively manage the federation. As a subset of the proposed reforms to address the systemic deficiencies of executive federalism, these can be seen to fall into the three general categories first identified by Simeon in the late 1970s: disentanglement of the two orders of government; reforming federal institutions to better represent provincial concerns and interests within those institutions; and changes to improve the machinery of intergovernmental relations.<sup>26</sup>

Some of the measures discussed below pertain directly and specifically to the political situation of the federation’s smaller provinces exposed by the Section 36/Atlantic Accords controversy. Other proposed ‘remedies’ are in fact reforms that are more broadly applicable in terms of addressing the shortcomings of executive federalism as practiced in Canada, and the ‘federalism deficit’ that hampers and distorts the regional representativeness, responsiveness, and accountability of the political regime.

#### 1) Disentanglement

“In some ways, the remedy for the dysfunctions of intergovernmentalism is to have less of it.”<sup>27</sup> It can be argued that the disentanglement of federal and provincial governments in Canada has been occurring over the past two decades and is now fairly well advanced, thus reducing the need for intergovernmental coordination. Certainly in the area of fiscal relations, provincial budgets are now far more reliant on own-source revenues than they

<sup>25</sup> Carty and Wolinetz, “Political Parties”, 74.

<sup>26</sup> As cited in Meekison, Telford, and Lazar, “The Institutions of Executive Federalism”, 7.

<sup>27</sup> Simeon and Nugent, “Parliamentary Canada”, 105.

once were, with federal transfers declining in significance and the federal government far more judicious in using its spending power to leverage provincial government expenditures.<sup>28</sup> One idea to further disentangle the federal and provincial orders of government, in the process reducing the need for intergovernmental transfers or agreements, is to follow the reasoning of Quebec's Seguin Report, and agree upon an exchange or redivision of tax jurisdiction and revenues that would simplify tax jurisdiction and provide the provinces with sufficiently ample revenue for their program needs without recourse to federal transfers (for example, give the federal GST to the provinces, in exchange for provincial corporate taxes, and phase out the Canada Social Transfer). This would further remove the federal government and its spending power from provincial jurisdiction.<sup>29</sup>

While a proposal was briefly floated by the Martin government to resolve the equalization-offshore resources conflict that was contrary to this disengagement trend (by sequestering offshore revenues to a federal regional development fund, thereby keeping them out of provincial equalization calculations), this proposed solution, which would have re-instituted a substantial regional development role for the federal government, ran aground on stiff resistance to this kind of intergovernmental re-engagement. For the provinces, their opposition stemmed at least in part from their own bitter past experience with federal failures in fulfilling their Section 36 commitments (once burnt, twice shy). This made the prospect of an expanded federal role in provincial economic development, using what otherwise would have been provincial resource revenues, unsavoury in the extreme, and in the end completely unacceptable as a 'solution'.<sup>30</sup>

For other observers, disentanglement as a strategy for Canadian intergovernmental harmony at a time of growing interdependence globally is not considered a wise course of action. Virtually all important problems cut across jurisdictional lines, creating interdependence and necessitating intergovernmental machinery "to assist in multilevel governance or achieve coordination on matters of common concern."<sup>31</sup> Certainly with regard to fiscal relations, public finance economists like Boadway oppose the cession of further tax room to the provinces as a remedy to intergovernmental conflict, basing his arguments on tax harmonization considerations and the importance of federal transfers as a means of accomplishing national efficiency and equity objectives. In effect, federal dominance in revenue-raising not only leads to a more harmonized tax system with advantages for the efficiency of the national economy, it also "allows for the use of the spending power as an instrument for inducing national standards in provincial programs in accord with the principles set out in Section 36 of the *Constitution Act*. Given the division of legislative responsibilities, the use of the spending power is arguably the *only*

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<sup>28</sup> P. Leslie, R. Neumann and R. Robinson, "Managing Fiscal Federalism" in Meekison, Telford, and Lazar, eds, *Canada: The State of the Federation 2002*, 246.

<sup>29</sup> Garth Stevenson, "Fiscal Federalism and the Burden of History" in *Fiscal Federalism and the Future of Canada: Conference Proceedings, September 28-29, 2006*, Institute of Intergovernmental Relations, Queen's University, 15.

<sup>30</sup> Need reference for this episode.

<sup>31</sup> Simeon and Nugent, "Parliamentary Canada", 94.

effective policy instrument available for the federal government to fulfill these commitments [emphasis added].”<sup>32</sup>

## 2) Reforming Federal Institutions

These solutions would involve institutional reforms aimed at improving the regional representativeness, responsiveness, and accountability of the federal parliament and government. In particular, proposed reforms to the Senate and electoral system could go some way toward accomplishing these ends, by giving more legitimacy to the Senate as a chamber for representing and protecting the interests of the smaller provinces, and through electoral reform, to create a more stable partisan environment and multi-party, coalition governments, which generally results in more consensual and incremental, less precipitate decision-making and policy change. While comprehensive Senate reform or other previously proposed constitutional changes (such as the Section 36 changes included in the 1992 Charlottetown Accord) seems unlikely to happen anytime soon (if ever), and momentum for electoral system change seems once again to have stalled, such fundamental reform remains the best long-term strategy for addressing the democratic and federal deficits of the current Canadian political system.

Despite the formidable political obstacles to institutional reform that goes beyond mere tinkering (such as minor changes in the role of Parliamentary committees), there are still some possibilities for constructive institutional evolution short of constitutional amendment. One example is the Harper Government’s attempt to progressively install elected Senators with limited terms of office through legislation and an altered appointment procedure. If successful, this initiative might well result, over time, in a politically-legitimate and regionally-responsive Senate that could be invaluable for representing and protecting the interests of smaller provinces in the federation. Another possibility is an expanded role for the Supreme Court in intergovernmental relations. As noted by Poirier, if the Court were to begin to make Intergovernmental Agreements “legally more robust” by giving greater weight in their rulings to the federal principle involved in such agreements, the contractual concept of legitimate expectations, and the idea that constitutional conventions have emerged around such agreements, then the Court would begin to place limits on parliamentary sovereignty in recognition of claims flowing from Intergovernmental Agreements.<sup>33</sup>

## 3) Improving IGR Machinery

As noted by Watts, “as long as Canada continues to combine parliamentary and federal institutions, it will be difficult to eliminate ‘executive federalism’ and therefore, the focus should be on harnessing ‘executive federalism’ in order to make it more workable.”<sup>34</sup>

However, the current situation appears to range from poor to abysmal. In its 2006 Report on the Fiscal Imbalance, the Council of the Federation described intergovernmental relationships as ‘corrosive’. The provincial governments interviewed for the Report,

<sup>32</sup> Boadway, “Canadian Federation”, 8-9.

<sup>33</sup> Meekison, Telford and Lazar, “The Institutions of Executive Federalism”, 15. For a fuller elaboration of the arguments, see Johanne Poirier, “Intergovernmental Agreements in Canada: At the Crossroads Between Law and Politics” in Meekison, Telford and Lazar, *Canada: The State of the Federation 2002*, 425-462.

<sup>34</sup> As cited in Meekison, Telford and Lazar, “The Institutions of Executive Federalism”, 7.

“identified an across-the-board ‘decline in trust’ which they attributed to ‘irregular federal-provincial meetings, called on an ad-hoc basis’; ‘last minute negotiations on major issues’; ‘wedge strategies’ used by the federal government to divide and rule; intergovernmental agreements ... ignored at will ... There is little permanence, predictability or consistency when intergovernmental agreements, many of which are achieved only with great difficulty, can be cancelled or altered unilaterally.”<sup>35</sup> Moreover, it seems likely that this pattern of relations is being worsened by the progressive shift from a departmentalized to an institutionalized cabinet, and now to Prime Ministerial government (what Savoie calls ‘Court government’), wherein cabinet has joined Parliament as an institution being by-passed. This “doubtless [has] exacerbated intergovernmental tension and served to weaken Cabinet as a mirror of Canada’s regional diversity.”<sup>36</sup>

One change that could improve the situation is for governments in Canada to agree to use legally-binding contracts, backed up by legislation, in place of loose intergovernmental agreements. This would give the parties greater assurance that an agreement will be judicially enforced and not unilaterally altered or ended. However, this is difficult to do in many cases, due to the complexity of the policy field involved, and therefore a degree of indeterminacy and the need for flexibility. This is often the case, for instance, in regional development agreements, though there are instances where this approach works well. One example is the gas tax transfer agreements that funnel federal tax revenue through the provinces to municipalities. These agreements take the form of highly formalized, legally-binding contracts. Another impediment to this ‘remedy’ is provincial resistance to the level of federal oversight and accountability that would be involved, which sharply circumscribes the conditions under which provinces are likely to agree to these types of intergovernmental agreements.<sup>37</sup>

There are as well some ‘modest proposals’ that have been put forward from time to time to improve the performance of Canada’s intergovernmental machinery. First, a repeated recommendation has been to regularize and properly institutionalize first minister’s conferences, such that they are no longer hostage to the political needs of the incumbent Prime Minister. They should be held annually, at fixed times. As noted by Papillon and Simeon, “a more highly structured FMC might help build trust and cooperation and transform the culture of confrontation.”<sup>38</sup> A corollary of this change would be to develop a formal process for concluding, ratifying, and modifying intergovernmental agreements. Finally, create legislative standing committees on intergovernmental relations at both the federal and provincial level, improving scrutiny and transparency by giving both

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<sup>35</sup> Simeon and Nugent, “Parliamentary Canada”, 99-100.

<sup>36</sup> Meekison, Telford and Lazar, “The Institutions of Executive Federalism”, 13. See Donald Savoie, *Court Government and the Collapse of Accountability in Canada and the United Kingdom*, Toronto: University of Toronto Press, 2008.

<sup>37</sup> OECD, *Linking Regions*, 188-191.

<sup>38</sup> Martin Papillon and Richard Simeon, “The Weakest Link? First Ministers’ Conferences in Canadian Intergovernmental Relations” in Meekison, Telford, and Lazar, *Canada: The State of the Federation 2002*, 132.

legislators and citizens a greater role in the process. Legislatures might also be asked to ratify major intergovernmental agreements, like the SUFA or the Atlantic Accords.<sup>39</sup>

As Dupré argued a quarter-century ago, what is most lacking in Canada's system of intergovernmental relations is mutual trust. Over time, "the extent of distrust seems to have increased as relations moved from line officials, to central agency officials, to ministers, and then to first ministers. Institutional reform cannot create trust if the basic sense of common purpose and federal 'comity' is missing."<sup>40</sup> The Section 36/Atlantic Accords controversy is only the latest confirmation of this, and represents yet another illustration of what is a worsening systemic problem in Canadian federalism.

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<sup>39</sup> Simeon and Nugent, "Parliamentary Canada", 106.

<sup>40</sup> Papillon and Simeon, "The Weakest Link?", 134.