zation payment by the federal government would be necessary to bring such a province's fiscal capacity up to the national average fiscal capacity. If the purpose of equalization is to put the province in the same posture as a province whose fiscal capacity is at a national average, that is, to bring it up to the national average, then the equalization payment in the above case must be equal to the *additional revenue* the province would collect from retail sales (a) if its share of national retail sales were equal to its share of national population and (b) if the rate it was imposing on retail sales were equal to the national average rate. It can be demonstrated that this *additional revenue* is precisely equal to the total of all provincial revenues from the retail sales tax multiplied by the province's fiscal capacity deficiency—that is, the difference between its share of population and its share of retail sales. This is exactly the way the actual dollar amount of equalization payable to a province in respect of the retail sales tax base is calculated. If the province has a fiscal capacity deficiency in respect of sales tax, the amount of equalization arrived at will be positive. If it has a fiscal capacity surplus, the amount will be negative.

This exercise is repeated for each of 29 revenue categories identified under the current equalization formula as sources from which at least some provinces derive revenue. For each province, the total of all positive and negative amounts is determined, and for those provinces where the net total is positive, a payment equal to that total is made by the federal government. It is important to note that although only provincial revenue sources are brought into this formula, no provincial revenues are redistributed. A payment is made by the federal government, financed from federal revenues received from taxpayers across Canada, but no reductions to provincial revenues occur anywhere. Provinces with an overall net fiscal capacity deficiency are brought up to a national average; provinces with an overall net fiscal capacity excess are unaffected and thus remain above the national average. The workings of the present formula are illustrated in some detail in Annex VII-A, where a complete example relating to a single province and a single revenue source is given, and where the 29 revenue sources and tax bases are listed.

There are several important issues associated with the equalization formula that will have to be dealt with in the forthcoming round of fiscal negotiations. The remainder of the chapter is devoted to a more detailed examination of these issues.

The Definition of Population

Because a province's share of the national population is one of the key factors in the equalization equation, the population data used for computing equalization must be as accurate as possible. The population figures used in the past, and at present, are the official population estimates as determined by the Chief Statistician of Canada.

The problem of *census under-enumeration* has considerable financial implications for equalization-receiving provinces. It is caused by the inadvertent failure to enumerate a small portion of the population in a census. Methodologies exist to estimate the extent of under-enumeration. One, known as the reverse record check, has been used in Canada to estimate the number of persons missed in the 1966, 1971 and 1976 censuses, and is being used again for the June 1981 census. The estimate is designed to provide some guidance to users of census data of the likely magnitude of this source of error.

The question raised by census under-enumeration is whether population data used in the equalization formula should be adjusted to take account of census under-enumeration. The question is important because it may involve hundreds of millions of dollars over the 1982-87 period. The reverse record check following the 1976 census indicated that some 477,000 people across the country had not been counted. A relatively high proportion of these people lived in British Columbia and Quebec and a slightly above-average proportion lived in New Brunswick. According to the Chief Statistician, when the interprovincial distribution of population is adjusted for under-enumeration, the distribution obtained is likely to reflect more accurately the unknown true distribution than does the unadjusted distribution. The Chief Statistician has, however, expressed doubt about the use of the adjusted distribution at this time. A number of arguments are advanced in support of this position, including the fact that the results of the estimates of under-enumeration in