

Abstract

Canadian fiscal federalism is a set of complex relations on both federal and interprovincial levels. As each province faces different geographic, economic or demographic situation, federal government runs equalization program that aims to diminish potential economic gaps. Despite vaguely defined purpose, the transfers are unconditional – provinces could use them for any purpose they find appropriate. That could possibly cause distorted incentives such as *flypaper effect* in which politicians tend to adjust spending behavior according to source of income. Equalization payments are distributed based on potential capacity of each province to raise revenue. As Quebec has been the largest recipient of equalization grants with slow, if existent, convergence to the rest of provinces, it is subject of the analysis in the period from the year 1981, which marks breaking points in both Quebec and equalization system history, to 2016. Quebec tends to be blamed for taking advantage of the system by deliberately undervaluing its fiscal capacity through subsidized prices of electricity and by boosting its social expenditures. By incorporating descriptive statistics and discussion, this thesis concludes that Quebec's policymakers likely deliberately implement fiscal policies that in turn undervalue its fiscal capacity. However, their motivation has arguably been the policies' redistributive effects rather than boosting transfers from the central government. Intensive role of provincial government has presumably been a societal preference in Quebec since the Quiet Revolution.