

Today, I am going to talk about major changes that have occurred and are occurring in relation to Ontario's financial relationships with the rest of Canada. Over the past few years, we've had many discussions about fiscal gaps, vertical and horizontal; equalization, subsidies to regions through E.I and so on. Much research has been done on these issues and virtually every think tank in Canada has been engaged on them.

I think it is timely, particularly during current controversies, to try to take stock of all this and to understand the implications of our system of regional subsidies.

I should say that many find the comments I'm going to make surprising. This is not a speech about how great we are because we share and all that. Many of you will even be offended by my message and my language. I'm willing to risk that in the interests of a larger issue to which I'll return later.

I will argue that our system of regional subsidies has hurt everybody and is a fundamental cause of the productivity and competitiveness problems we are experiencing. Equally, rather than being a source of unity, the evidence available to me is that the subsidies divide rather than unite us.

I'd like to first talk more specifically about Ontario's circumstances.

The best way I can approach the problem of the fiscal gap Ontario is experiencing is to slowly review a few facts about Ontario and let you come to your own conclusions. These are:

- In July, 2006, Ontario's unemployment rate was 6.5%. The national rate was 6.1%. Ontario's unemployment rate exceeded the national rate for the first time in 30 years, according to the Deputy Chief Economist at BMO Nesbitt Burns.
- From January 2000 to the present, manufacturing employment in Ontario has been in a steady decline. According to Statistics Canada, manufacturing employment in Ontario in June 2006 was 894,000, a remarkable 66,000 less than in June of 2000. It continues to decline rapidly. Fortunately the job loss has been offset by job gains elsewhere but the crisis in manufacturing has pervasive impact throughout the province.
- Ontario is experiencing significant declines in income relative to the national average. In 1990 personal income per capita was 112% of the national average and in 2003 it was 103% of average. This is largely attributable to Alberta's growth. Ontario will fall below the national average sometime in the next year or two.
- Ontario's contributions to interregional subsidies are nearly double its annual growth, expressed as a share of GPP. In 2005 Ontario's net fiscal gap of \$23 billion was 4.5% of GPP versus growth of 2.3%. This is a much larger burden than defense is for the people of the United States
- Ontario's per capita spending on provincial programs in 2005-06 was \$7,410, according to Statistics Canada. This is the lowest of all provinces. By comparison,

per capita expenditures were \$8,068 in New Brunswick, \$7,751 in Nova Scotia and \$9,025 in P.E.I. Serious revenue issues underpin Ontario's under spending relative to other provinces. These problems are particularly evident if one adjusts the actual figures to reflect differential costs in providing services.

- Professor Tom Courchene of Queen's University concludes that Ontario has the least effective revenue per capita of any province. Ontario's adjusted revenues are \$6,992 per capita compared with \$8,764 for P.E.I., \$7,748 for Nova Scotia, \$7,670 for New Brunswick and \$7,449 for Newfoundland. Professor Courchene states that "phrased simply, Canada over equalizes".
- Ontario operating grants to universities, institutions that are key to competitiveness, in 2003 - 04 were a remarkable 25% below the average of the other provinces. The operating grant per student was approximately \$6,000 compared with an average of \$8,000 for the other provinces.
- Hospital bed capacity at 2.7 per thousand of population in Ontario in 2004 was the lowest of all provinces and far below the national average of 3.6 per thousand citizens. The corresponding figures for 5.3 per thousand in New Brunswick, 4.0 for Nova Scotia and 3.4 per thousand for Prince Edward Island.
- Operating grants per student in community colleges in Ontario were approximately \$6,000 per student in 2003-04 compared with a national average of approximately \$9,000 and \$12,000 in Saskatchewan.
- In 2002, the most recent year for which I have data, there were 65 RNs per 10,000 of population in Ontario and 75 per 10,000 for Alberta. These compared with a national average of 73 per thousand and levels of between 89 per thousand and 102 per thousand for the Atlantic Provinces.
- I can give you some new statistics on physicians. You undoubtedly think there is a physician shortage in Nova Scotia and indeed there probably is. However, you have 416 citizens for every physician. Imagine how much worse this is in Ottawa, where there is one physician for every 504 people. It's 17% more serious there.
- According to the Institute for Competitiveness and Prosperity, marginal tax rates in Ontario (both labour and capital) are approximately double those in adjacent and competing U.S. jurisdictions, a fact which effectively prevents tax increases to cover the issues I've mentioned. In any event, the combination of provincial and local taxation in Ontario is already very slightly above the national average. With Canada indexed at 100, Ontario's tax effort is 101, compared with New Brunswick at 103, Nova Scotia at 101 and P.E. I. at 106.
- Ontario ranks 13th out of 16th in an Institute for Competitiveness and Prosperity study of the competitiveness of large North American jurisdictions.

There is conclusive evidence that much of the transfer has gone to finance bureaucracies that are much larger, relative to population, in the Atlantic Provinces and

Manitoba than corresponding arrangements in Ontario and Alberta – or, indeed, in all other provinces.

In Nova Scotia there is one provincial civil servant in the general government category for every 83 citizens. The corresponding figure for P.E.I. is one for every 43 people.

In Ontario there is one provincial civil servant in the general government category for every 127 people and in Alberta, one for every 111 people.

These figures are paralleled in the federal public service. There is one federal public servant for every 54 persons in New Brunswick, one for every 39 people in Nova Scotia and one for every 38 people in P.E.I. The corresponding figures for Ontario and Alberta are one for every 82 citizens, in Ontario and one for every 127 citizens in Alberta.

Think of it: the federal civil service in Nova Scotia is more than two times the size of its federal public service in Ontario relative to population. Recent studies by the Atlantic Institute for Market Studies explore this in greater detail.

Most federal programs have built in biases against Ontario if you dig deeply enough. E.I. is by far the most serious of these but there are countless others.

The most rapacious of these, to my mind, is Pearson Airport. It accounts for thirty something percent of the traffic volume of Canadian Airports and yet the federal government collects sixty something percent of all the rental revenues associated with the entire system from it. Unfortunately, we do not have a system which assesses comparability of programming across Canada, a considerable deficiency given that the avowed goal of equalization is comparability of programming.

What all this tells me is that Ontario is no promised land of milk and honey in the world of 2007.

Ontario is a jurisdiction trying to maintain our footing in a world where everything, including most key services, is now or soon will be open to international competition. Even while we face this environment, we are locked into a fiscal system which requires us, as I hope I've demonstrated, to support others to a much higher standard of public services than our own and to devote an impossibly large proportion of our resources to do so.

This status quo is not only unaffordable, it is counterproductive.

There is a great deal of evidence, much of it produced by the Atlantic Institute for Market Studies in Halifax that the subsidy system, especially equalization, has greatly damaged the economic development of Atlantic Canada, Manitoba and Quebec. It has impaired their growth by insulating some from change, by creating massive state bureaucracies, by chasing unsubsidized companies out of business because they must compete against those that are subsidized, by gravely damaging labor markets through regional bias in E.I. and by encouraging national wage rates in economies that have no hope of supporting them.

It's easy to see what the alternative path might have been. It is the path that Ireland, Massachusetts, Iceland and virtually every other rapidly growing jurisdiction in Europe and the United States has taken. Low corporate taxes, economical and manageable public services and a determination, in most cases, to avoid direct subsidies to business are three elements in the alternate path.

Change is starting to take place in Ontario. However, in the recipient jurisdictions, there are few signs of this type of fundamental rethinking going on, at least in governments. Most speeches and government documents in recipient jurisdictions are monumental in terms of their sterility, sense of grievance and, especially, a sense of complete entitlement for more. There is, however, a tiny glimmer of hope in recent federal budgets.

Over the past two years, federal budgets have been a bit better for Ontario than the budgets of previous years. The tax reductions announced will have a disproportionate benefit for Ontario as will the government's commitment to provide transfers outside of equalization on a per capita basis. The federal government has also decided to put a cap on equalization payments to ensure they do not bring a receiving province's fiscal capacity above any non receiving province.

However, the bulk of the problem remains and the increases in equalization erase some of the benefits Ontario has won. Probably the best interpretation of the federal government's recent decisions is that the hole being dug for Ontario taxpayers by Canadian federalism is being dug a bit more slowly than in previous years. In total dollar terms, the problems I have summarized remain. The dominant thought many have when I recite the numbers summarized above is: how did we get here?

Unfortunately, the first answer is that some of the problem is self inflicted.

It should be a matter of great concern to citizens of Ontario that even today, the tools of quantitative economics have never been used to provide the public with essential information on the impact of the problem. Nobody knows the impact – with any precision - of the net fiscal deficit on investment, productivity, consumption and savings in Ontario.

Ontario governments over the years have never taken notice of the substantial body of academic research which demonstrates clearly that the funds have been spent, largely on excessively big and very highly paid bureaucracies and on policies in recipient jurisdictions which discourage economic growth.

If Ontario governments had been better informed and participated more effectively during negotiations, the probability is that many of the problems I've mentioned could have been reduced or avoided. One very prominent academic observer who was close to negotiation processes commented on Ontario's apparent lethargy. His assessment is correct. Fortunately, the current government has ended the lethargy but it is very late in the day.

The second part of the answer is studied federal ignorance. To this day, no over arching study of the interregional subsidy system has ever been done or if it has been done, has never been made public.

Let me repeat that again, in different words. Nobody knows because nobody has studied the economic impact of what is probably the world's largest system of regionally based subsidies on the nation as a whole, let alone on each individual provincial and territorial jurisdiction.

At the federal level, it gets worse. The goal of equalization has always been comparability of programming but the federal government has never developed even the roughest measures of program comparability so that we could see if the goal is being achieved.

There are lots of words that could be used to describe these omissions. My choice is simple. They are tragic. They demonstrate fundamental incompetence. Many momentous consequences flow from all this.

First, the regional subsidy system has become a cause of national disunity rather than a solution to it. I earlier mentioned the case of Mr. Williams pulling down the flag and getting rewarded for it with cheques. It should surprise nobody that if the reward for bad behaviour is a cheque, the next time more money is wanted, more stridency will be forthcoming. And we are getting more strident buffoonery and puffery today as several recent editorials in the Globe and Mail have noted.

Second, none of the recipients gives a hoot for the very difficult competitive circumstances Ontario faces and the implications of federal policies which, as two Deans at the University of Toronto noted in the Globe and Mail, are killing the Ontario golden goose. If you think I'm being heavy handed, go through the websites of the other provinces and try to find one paragraph which recognizes that Ontario has the least real fiscal capacity of all and that our ability to provide funds has been greatly threatened by the crisis in manufacturing I mentioned earlier. You won't find one.

All you will see are greedy, grinding and grasping injunctions for more with not the slightest recognition that Ontario taxpayers would be required to provide nearly half of the funds other jurisdictions are seeking. These taxpayers really need a breather – the goose isn't dead but it is getting very short of breath. Let me give you a current example of this.

The Premier of Saskatchewan recently gave a remarkable speech to the Prince Albert Chamber of Commerce. He noted that the economy of the province is "sizzling hot". He reported that Saskatchewan is experiencing "record employment levels for the tenth straight month". He reported that the Fraser Institute considers the province to be "the third best place to invest in all of Canada". He didn't report – but he could have – that Saskatchewan's real GDP growth of 2.2% in 2006 is nearly double the Ontario rate of 1.3% in the same year and that Saskatchewan's growth has been faster than Ontario's for several years. So what does he do?

He might have said that we'll recognize the dramatic changes in Ontario and help that province enjoy a breather from the subsidy system given all that it has contributed in the past during Saskatchewan's lean years. Not on your life. The man wants more equalization, largely from Ontario and Alberta taxpayers. More! The place is booming

and he wants more! This is what I meant by grinding, greedy and grasping and Mr. Calvert is not alone.

Third, we've created a sense of national community that is far too narrowly based and seems to depend greatly on what provinces consider to be in their financial self interest. Some refer to equalization as the glue that holds Canada together. Let me put that in different words.

If one accepts this view, then we are being held together by a program which is, as I mentioned, not measured against its principal goal, which has never been studied to determine its impact on Canada, which has largely been wasted by recipients and which has, as Gordon Gibson recently noted in the *Globe and Mail*, been part of a transfer structure by which "Ontario has been bled like a sacrificial lamb".

We are, as I mentioned earlier, doing all this to provide much higher levels of government service outside of Ontario than are available inside the province. In short the transfer effort lacks any real moral foundation and if that is what is holding us together we had better find something else because the economic base of Ontario cannot take any more of this kind of togetherness. We cannot build a country based on this kind of moral quicksand.

It would be nice to have a country that is held together by something else – common purpose comes to mind - but you will find no trace of that in the greedy, grinding and grasping injunctions for more.

Look, I could go on and on. There is no good news in this file and I'll spare you any further recitation of the evidence which supports that. There are, however, solutions and many feature in the academic literature and the extensive studies carried out by independent policy organizations. These solutions include debt swaps, changes to the tax system, measures to assess program comparability, the elimination of wasteful energy subsidies in Manitoba and Québec and many others. We could move ahead.

I hope, however, that I've shown that unless Ontario really stands up for its interests and gets these transfers and subsidies cut, it has a very darkly shadowed future.

I'd like to conclude with a request to each of you.

This is a society which produced Samuel Cunard and Max Atkin. This is a society that once had economic clout felt around the globe. These were real leaders.

I see few leaders now. I see a political elite which makes its living in steadily more elaborate efforts to extract more from others who have fewer public resources than they have. You really need, as individuals, to bring them back to reality and basic morality before the damage they are doing to the national unity of Canada becomes irreversible.

David MacKinnon
13 June 2007
The Halifax Club
AIMS' Public Policy Briefing