

Canadian regional subsidies: Killing the Golden Goose and Weakening Canada

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I should warn you that this is a difficult speech for me to make and I suspect it will be difficult for you to hear. I will be criticizing a system which goes to the heart of our federation and to which many have an emotional and personal attachment.

I believe I can address our larger national interest from an unusual point of view. I've lived and worked in Western and Eastern Canada and, of course, in Ontario. My family has substantial roots in Alberta and Quebec.

Today I am going to tell you that Canada's crazy quilt of regional subsidies is doing serious harm to this province as well as the economic potential of the provinces to which these subsidies are aimed. And I believe ultimately it will undermine the ability of Canada to compete in the global markets of the 21st century.

What is this system?

The regional subsidy system is very extensive and includes equalization, targeted transfer programs and a very large number of regional biases built into regular federal programming. The principal recipient jurisdictions are Manitoba, Quebec and the

Atlantic Provinces. The principal paying region

is Ontario whose taxpayers each year contribute tens of billions more to the federal government than they get in return in the form of services. On a per capita basis, Albertans contribute even more.

Why is this system so damaging?

I'll begin by talking about public opinion in Ontario and the regional subsidy system. Most Ontarians believe that government programs are less accessible in recipient jurisdictions than in this province and that we should help others for this reason.

Not so.

Accessibility of government programs in recipient jurisdictions, even acknowledging demographic and geographical differences, is better than in Ontario and Alberta, whose taxpayers pay so much of the freight. As an example, in 2005:

- Ontario had 2.8 hospital beds per thousand and Alberta 3.30. Manitoba had 3.82 and Newfoundland and Labrador had 4.35;

- Newfoundland and Manitoba had 10.7 and 9.6 nurses per thousand respectively. Alberta had 8 and Ontario 7.1.
- The student-teacher ratio in elementary and secondary schools are 13.6 for Newfoundland and 14.5 in Manitoba. For Ontario and Alberta, the figures are 16.6 and 16.9.
- Ontario has only half the number of judges, in relation to population, as Newfoundland and has by far the fewest of all provinces;
- Total public sector employment per 1000 population in Ontario is 81, Alberta, 83. Quebec, 92, Newfoundland is 105, and Manitoba, 117.
- The Ontario government has the fewest resources available for public services, in relation to population, of all Canadian provinces.

The numbers don't tell the story in human terms. The old and the very young in Ontario will find greater challenges in accessing hospitals and teachers than most Canadians in other provinces.

The human cost is also reflected in bad policy choices.

Why is it that Manitoba can subsidize electricity prices, even in the world Al Gore describes, by \$1.2 billion even while it collects \$1.8 billion in equalization? Did anybody in this room sign on to that kind of public policy? Do you want to pay for it?

Very little of this is likely to involve economies of scale because the Atlantic Provinces are very compact and because most recipient jurisdictions have sacrificed

possible economies of scale by distributing many small facilities about their landscapes rather than concentrating them.

The second thing most Ontarians believe is that they are assisting economic growth in recipient regions.

They are not.

Very briefly, the tidal waves of funding from Alberta and Ontario taxpayers to recipient jurisdictions impairs economic growth by forcing labour costs to national levels, well beyond what the local real economy can support, by funding excessive public services and, over the years, by forcing unsubsidized enterprises to compete with subsidized ones in the same sector.

And then the gold plated public services are breathtaking.

In Nova Scotia there are 32 hospitals and in Prince Edward Island eight. That's 40 hospitals for a population of one million! In Vaughan, Ontario, there isn't a single hospital for more than 200,000 people. There are 15 universities in Atlantic Canada and four complete provincial public services for a combined population of two million.

Most people in Ontario feel that equalization is the principal means by which regions are subsidized and that there is no equalization outside equalization, to put it simply. That is also not true.

If one takes equalization entirely out of this, federal spending in PEI per capita is about double the level in Ontario and federal spending per capita is approximately 50% higher in all recipient provinces except Quebec.

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Fourth, most Ontarians believe that equalization and other subsidy programs reflect the different needs of each province.

Amazingly, they do not.

Cost drivers do not factor at all in the equalization program. The program focuses entirely on the revenue side of the equation. To put the problem simply, all the factors which make the delivery of programs in Ontario and possibly some other provinces more costly than elsewhere – immigrant support, huge urban areas, unemployment levels, demographics and higher cost levels – are not recognized at all in the calculation of equalization entitlements.

Several observers agree, including the Atlantic Institute for Market Studies, that the per capita funding need for provincial programs in Ontario is probably at least 20% greater than in recipient provinces. This means that the entire analysis I've just gone through significantly understates – understates if you can believe it - the fairness deficit encountered by all who live in this province.

Finally, most Ontarians believe that equalization at present levels is specifically required under the constitution and is firmly grounded in law. It is not.

While equalization is mentioned in the Constitution Act of 1982, legal scholars generally agree that it is too vague to have legal consequences or to require any particular level of equalization expenditures.

I'd now like to talk about how we got into this mess and what Ontario's legislators need to do to get out of it. The causes of the mess, first, are to some extent self inflicted.

Ontario's leaders, with only a few exceptions – Mr. McGuinty and Mr. Rae are two - have been operating in two vacuums: a factual vacuum and a leadership vacuum. The scale of the factual vacuum defies belief in a jurisdiction this size. Ontario governments have never shown any interest in the impact of regional subsidies on recipients and recipient jurisdictions. They did not identify the harm these subsidies do to others and that the money from Ontario taxpayers was being wasted on big bureaucracies and gold plated services far beyond North American standards.

Similarly, there has, even to this day, been no factual description of the complexities of the problem available to the public in Ontario. Most Ontario citizens have never heard of the failure to consider cost issues built into the system and there have been no public studies of the impact of this system on growth, competitiveness, consumption, savings and investment in Ontario.

If you believe that facts are the best place to start in solving any complex problem, then Ontarians have been seriously failed by their provincial governments over decades. The present government in its first term was a refreshing exception.

The leadership issue is more subtle.

If you listen to Ontario political leaders in election debates and other similar forums, you will hear them hark back to a misty, nostalgic era when Ontario, in their view, led the federation. Again, I hate to be the bearer of bad news, but for most of the 1970's and early 1980's, I had the opportunity to watch Ontario delegations at federal provincial meetings from my vantage points in delegations from the federal government and

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two other provinces. I and my colleagues didn't feel that Ontario was leading at all.

We felt that it was simply enabling federal leaders to do whatever they wanted to do. Ontario's leaders got out of the way and willingly agreed to the spending of whatever money from Ontario taxpayers that federal leaders felt was necessary. They had no idea of the financial consequences of these decisions for Ontario.

More seriously, lack of Ontario leadership has led to a sense of entitlement by others that Ontario will find very difficult to manage. Other provinces feel so entitled that they make financial demands regardless of economic circumstances in this province. Because equalization is based on relative fiscal capacity, this system is now largely decoupled from the economic performance of Ontario. If Ontario fell into recession today and its output declined, its citizens would still have to come up with nearly half the annual increases guaranteed for equalization in coming years.

This is a very dark shadow on Ontario's future.

Demands from other provinces are also made in wildly inappropriate ways that are little more than political blackmail – a game more easily played in the last few years of federal minority governments. A few years ago Premier Williams came to this club and noted that Newfoundland came into Confederation with a government surplus and now faces major deficits, with the clear implication that the relationship with Canada was the problem.

Conveniently, he did not mention that when Newfoundland entered Confederation it was under the supervision of the British Government due to disarray in its finances and that the only reason it had surpluses is because Canada, then a foreign country, and

the U.S. had spent the war years building large military bases on the Island. The omission of those two facts was simply disingenuous.

We've recently had similar stuff from Saskatchewan. That province has been growing much faster than Ontario for a decade, but what did its former Premier want? More equalization, of course, half of which would have to come from the hard pressed citizens of Ontario.

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Even more leadership problems are evident at the federal level.

The first problem is ignorance. Ontario's MPs seldom, if ever, express informed concern about the scale of the regional subsidy problem and its impact on Ontario as it has been described by banks and think tanks across the country and by the Organization for Economic Co-operation and Development.

More seriously, the chances of correcting the problems I've mentioned are being reduced by the efforts by the federal government, led by Mr. Van Loan, the Government House Leader, to ensure that Ontario's current under-representation in the House of Commons worsens in future years. One hopes the citizens of Mr. Van Loan's Simcoe riding are noticing. Last time I checked that was in Ontario.

Perhaps we need to borrow an idea from the Americans and have the modern equivalent of a tea party in Toronto Harbour to argue for the principles of representation by population and no taxation without fair representation.

I would now like to talk about the actions Ontario's provincial legislators should take to lift the unreasonable burden I've described.

First, Ontario's leaders need to get real and get tough. Ontario, in population and



financial terms, is a Sweden and a half. It should behave with similar sophistication. The 40 year policy of standing aside and enabling the federal government to do its thing is both unseemly and pathetic from this point of view. Every time I think of Ontario government leaders acquiescing in the financial disaster I've outlined and forcing their successors to crawl back to the federal government any time they want to build a subway line, I cringe.

Getting tough is another thing. Except for the past eight or nine years, Ontario has for decades been the accommodating light weight at federal-provincial financial gatherings. This has let the recipients seize the moral high ground on regional subsidies. To be seen on the moral high ground counts for a great deal in politics. This province needs to take it back. As it gets more real and tougher, the Ontario government could take several specific steps.

It needs to put some specific solutions on the table and explain them publicly to the Ontario electorate and to other Canadians. Several that hold promise are: transferring the GST to the provinces in return for an end to regional subsidies; proposing a cost basis for calculating equalization and, finally, arrangements by which the federal government assumes some or all provincial debt in return for ending transfer payments and regional subsidies.

It also needs a large scale public education on the full dimensions of the problem. The province could do this in two ways: it could compile the comments that banks, domestic think tanks and organizations such as AIMS and the Frontier Center for Public Policy have made about the system and use these as a basis for an extensive advertising and

communications program. Alternatively, it could refer the entire problem to research organizations outside Canada that could offer an entirely independent view and use the result as the basis for public dialogue. The OECD has long been concerned about the impact of Canadian regional subsidies and it might be a good place to start.

A further step Ontario could take is to clarify the legal underpinnings of this system. While arguably such clarifications should take place in the courts – that is what courts and the constitution are for – a preliminary step could be to ask for a formal opinion from a recognized legal expert and make it public. The question that should be put to this person should be aimed at refuting the idea that the present very high level of equalization and other regional subsidies is in any way guaranteed by Section 36 of the Constitution Act. The answer is almost certainly no, an answer which would help Ontarians feel more comfortable about change.

And Ontario should take an historic u-turn and support Mr. Harper's efforts to constrain the federal role to its core responsibilities by limiting its spending power.

This requires recognition of two realities. Every major new national program implemented by the federal government represents an opportunity for legislators in other jurisdictions to argue for especially favourable treatment in relation to Ontario within that program. Second, legislators in other provinces will use these opportunities ruthlessly and will usually succeed because of their focus on it and Ontario's under-representation in the House of Commons.

Another thing the province needs to do is be very aware of the consequences of short term deals. In recent years, the federal

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government has taken some steps to lessen Ontario's fiscal deficit and other steps to increase it. There are few public numbers on the net change. It is certain to be positive but not particularly significant in relation to the scale of the problems I've outlined. Ontario should maintain a public running tab on the scale of these changes and not let small improvements lull us into complacency and stop progress on the large issues.

The final task that should be high on Ontario's priority list is forming an alliance with Alberta. If both provinces developed a common approach to the issues I'm talking about today, their chances of achieving change are much greater than either acting alone. And their basic interests are generally aligned.

I'd like to conclude with a few final thoughts.

Ontario is in significant difficulty today. Toronto is the unemployment capital of Canada. We have lost 64,000 jobs in manufacturing in a year, 6.5% of the total. While we have gained in service employment, there have been major weaknesses in agriculture, natural resources and construction. These have had a serious impact in non metropolitan areas of the province. We have been in a long slow decline since the 1960's.

Our schools, to judge from recent reports by the Toronto Board of Education, are violence prone and many are infested with vermin. This is not a jurisdiction that can carry the burden for others who are, in many respects, better off than it.

Ontario political leaders – federal and provincial - have a strategic choice. They can continue to support federal regional subsidies that have been disastrous for this province, dangerous for others and that both impede Canada's performance and corrode its fabric.

They can continue with the nostalgic and unsupportable references to a long ago era in Canadian politics when Ontario leaders

thought they were leading by enabling the writing of federal cheques.

Alternatively, they can recognize that the problem I've summarized is like an iceberg – a much bigger problem than it appears on the surface, an iceberg that could sink many of our provincial and national dreams.

If they act they can chart a new path of basic change.

They and their federal counterparts can help build a country united by common purpose and shared values rather than divided by unseemly efforts to get others to pay for local services and problems. I hope they will choose the leadership option to help all parts of Canada achieve a better future.

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