

POLICY SERIES



The Real Have-Nots in Confederation: Ontario, Alberta and British Columbia

**How Canada's equalization program creates
generous programs and large governments
in have-not provinces**

**By Ben Eisen, M.P.P.,
and Mark Milke, Ph. D.**

About the Authors



Ben Eisen is a Policy Analyst with the Frontier Centre for Public Policy. His undergraduate degree is from the University of Toronto where he specialized in history and political science. He also holds a Masters Degree in Public Policy from the University of Toronto's School of Public Policy and Governance. Ben completed a public policy internship with the federal government, and he worked as a researcher for the CBC. Ben's policy columns have been published in the *National Post*, the *Winnipeg Free Press*, the *Calgary Herald*, *The Montreal Gazette* and the *Toronto Sun*.



Mark Milke is the Frontier Centre's Director of Research. He lectures in political science at the University of Calgary where he received his doctorate. He is the author of three books on Canadian politics including the 2006 *A Nation of Serfs? How Canada's Political Culture Corrupts Canadian Values*, which was published by John Wiley & Sons. Mark has written policy papers on British Columbia's treaty process, the Canada Pension Plan, Alberta's Heritage Fund, automobile insurance, corporate welfare and the flat tax, and a series of columns on Alberta's future co-authored with Preston Manning. Mark is writing a book on the effects of anti-Americanism on deliberative democracy in Canada. Mark is also a Sunday columnist for the *Calgary Herald*. In addition, his columns on politics, hiking, nature and architecture have been published across Canada including in the *National Post*, *The Globe and Mail*, *Reader's Digest*, *The Vancouver Sun*, *Victoria Times Colonist* and the Washington DC magazine on politics *The Weekly Standard*.

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Date of First Issue: February, 2010.

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ISSN 1491-78

**FRONTIER CENTRE
FOR PUBLIC POLICY**

www.fcpp.org

MB: 203-2727 Portage Avenue,
Winnipeg, Manitoba Canada R3J 0R2
Tel: 204 957-1567

SK: 2353 McIntyre Street,
Regina, Saskatchewan Canada S4P 2S3
Tel: 306 352-2915

AB: Ste. 1280-300, 5th Avenue SW
Calgary, Alberta Canada T2P 3C4
Tel: 403 230-2435

FCPP Policy Series No. 83 • February 2010

The real have-nots in confederation: Ontario, Alberta and British Columbia

**By Ben Eisen
and Mark Milke**

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Executive summary

This policy study analyzes Canada's equalization program to compare government services in the have and have-not provinces to discover if the residents in recipient provinces end up with more-generous public services than those who pay part of the bill, i.e., those in the have provinces whose tax transfers subsidize the former.

For the purposes of a longer-term look at equalization, Ontario is treated as a have province in this analysis despite the fact that it is receiving equalization payments in 2009-2010. This study considers it a have province because these payments are small relative to population and, taken together with other transfers, Ontario still contributes substantially more money to the federation than it receives in transfers and federal services.

Similarly, while Newfoundland has technically not received any equalization payments since the 2007-2008 budget year, it receives payments akin to equalization under a 1985 accord that will total \$465-million in the current fiscal year (2009-2010). In broad terms, over the last three decades, British Columbia, Alberta and Ontario have been the main contributors to equalization (with a further qualification that British Columbia briefly received equalization early in this century). The other provinces have been the recipients.

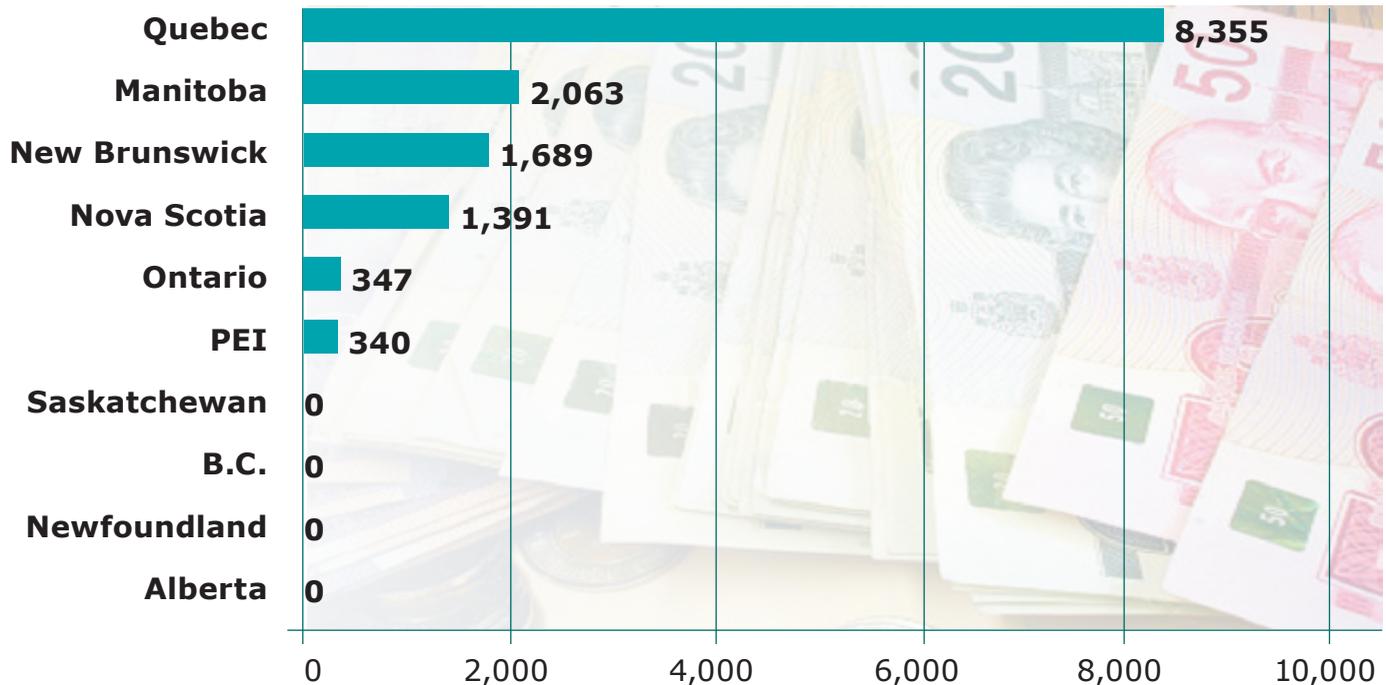
How the have provinces lose out under equalization

The evidence presented in this paper strongly suggests that, in many important areas, levels of government service in the traditional and largest have provinces such as British Columbia, Alberta and Ontario are significantly below those that exist in most recipient provinces. Specifically, the data suggest that large transfers allow recipient provinces to spend more freely on a range of government services including health and education.

A comparison between British Columbia, Alberta and Ontario on the one hand and Quebec on the other in terms of government service levels helps to illustrate this point. Quebec is the largest recipient of equalization money; it will receive almost \$8.4-billion in 2009-2010 out of a total equalization budget of \$14.2-billion for the six receiving provinces, or 59 per cent of all equalization transfers. The billions of dollars in equalization transfers received by Quebec each year from taxpayers in British Columbia, Alberta and Ontario (and as of late, Saskatchewan and Newfoundland) are used to provide service levels far beyond what is provided in the paying provinces. For example:

- There are substantially more doctors and nurses per capita, on average, in the have-not provinces than in the have provinces. Nova Scotia has 228 physicians per 100,000 people and Quebec has 217 physicians per 100,000 people. The comparable ratio in the main have provinces is 176 in Ontario, 197 in Alberta and 198 in British Columbia per 100,000 people.

Chart 1 **Equalization program receipts**
fiscal year 2009-2010 (Millions of \$)



Source: Department of Finance Canada

- In education, undergraduate tuition tends to be lower in the have-nots. Quebec's average tuition is \$2,167, while tuition is \$5,643 in Ontario, \$5,361 in Alberta and \$5,040 in British Columbia.
- Daycare spaces are more readily available in have-not provinces; a regulated space exists for 25 per cent of Quebec children under five years of age. The equivalent measurements in the have provinces are 19.6 per cent in Ontario, 17.4 per cent in Alberta and 18.3 per cent in British Columbia.
- The student-educator ratio is generally smaller in the provinces that receive significant equalization payments. One educator has 13.5 students in Quebec, while the ratio in elementary schools is 14.5 students in Ontario, 16.8 students in Alberta and 16.6 students in British Columbia.

The provision of more government services in the have-not provinces is a predictable consequence of equalization transfers. The equalization program has the effect of subsidizing government spending in poorer provinces to such an extent that more services at a more generous level are available in the have-nots than in the provinces that pay for such transfers.

There are several problems with this: First, when an activity is subsidized, more of it tends to occur. Whereas Albertans know they will pay for every dollar of provincial government services they receive, Quebec's voters face a situation in which voters in other provinces will pay a certain percentage of the cost of any proposed government action. This causes Quebec voters to demand higher levels of government spending than they would support if they had to pay the full cost.

Table 1: Selected government services in Quebec, Ontario, Alberta and British Columbia

(Most generous amounts/ratios in **bold**)

	Quebec	Ontario	Alberta	B.C.
Regulated child-care space for children under 5 years of age	25%	19.6%	17.4%	18.3%
Elementary student-educator ratio	13.5	14.5	16.8	16.6
Average university tuition	\$2,167	\$5,643	\$5,361	\$5,040
Physicians per 100,000 population	217	176	197	199
Nurses per 100,000 population	717	633	715	619
Percentage of residents spending more than 1 per cent of income on prescription drugs	28.7%	13.6%	17.4%	23.3%
Social services spending per capita	\$2,342	\$1,398	\$1,592	\$1,702

Second, services are not equitable between jurisdictions. The intention underlying the equalization program—to ensure Canadians in poor provinces have access to high-quality government services—is a good one. However, the data in this report show that the program has the unintended effect of subsidizing big government spending in the have-not provinces. The result is that the have-not governments tend to spend freely, which leads to inefficient resource use and the development of government service

levels that are far beyond what taxpayers in those provinces would choose if they were forced to bear the entire cost.

Due to the negative effects of the equalization program and the fundamental unfairness of forcing taxpayers in some provinces to subsidize gold-plated government services elsewhere, this report recommends freezing equalization payments at current levels and working toward the long-term goal of eliminating the program.

Table 2: Selected government services in the prairie provinces

(Most generous amounts/ratios in **bold**)

	Manitoba	Saskatchewan	Alberta
Regulated child-care space for children under 5 years of age	20.6%	9.1%	17.4%
Elementary student-educator ratio	14.2	14.6	16.8
Average university tuition	\$3,276	\$5,015	\$5,361
Physicians per 100,000 population	177	163	197
Nurses per 100,000 population	793	778	715
Percentage of residents spending more than 1 per cent of income on prescription drugs	27.8%	30.5%	17.4%
Social services spending per capita	\$1,619	\$1,267	\$1,592

Summary

In our view, it is fundamentally inequitable to force residents of the have provinces to fund government services elsewhere to the point that their own public services are below the level of those they subsidize. This is the net result of a federal transfer system of equalization where federal tax dollars are transferred en masse out of have provinces to have-nots. By comparing a variety of indicators of provincial government services in the 10 provinces, this policy study reveals that donor provinces subsidize levels of government services in the recipient provinces beyond those available to residents in the have provinces.

The real have-nots in Confederation are those provinces that have, through their federal tax dollars, historically contributed massive amounts to equalization—British Columbia, Alberta and Ontario—and now find their benefits from taxation are demonstrably fewer than those which are available in the provinces to which they have contributed so much, the traditionally defined have-nots such as Quebec.

Introduction

This policy study will compare government services in the have and have-not provinces to determine whether donor provinces subsidize government services in recipient provinces that are more generous than what they are able to provide to their own residents.

In 2009-2010, six provinces are scheduled to receive equalization payments. They are PEI, New Brunswick, Manitoba, Nova Scotia, Quebec and Ontario. However, Ontario's per capita equalization payments are minuscule when compared to the other five provinces. Furthermore, whereas the other recipient provinces have received equalization payments throughout recent years, this is the first time in its history that Ontario will receive any equalization payments. Thus, this paper looks at the historical trend, which is that residents in Ontario, British Columbia and Alberta are net contributors to equalization most years with the consequences such transfers entail.

Equalization in Canada: a brief history

Canada's equalization program was introduced in 1957, and it is intended to ensure that residents of all 10 provinces enjoy comparable access to important public services such as education, health and social assistance. The theory behind equalization is that it is easier for governments of more-prosperous provinces to raise tax revenue to finance programs than it is for governments of poorer provinces. The equalization program thus transfers money to poorer provinces (through federal taxes), so the latter can provide comparable government services, which they might not be able to pay for with the funds raised through provincial taxes alone.

Equalization functions by taking federal tax dollars and distributing them to provinces that are determined to have a low per capita fiscal capacity, which is the ability to generate government revenue from the tax base. The formula used to measure fiscal capacity is extremely complicated and takes account of 33 different revenue sources. If the fiscal capacity of a particular province is found to be lower than the average of five chosen provinces (British Columbia, Saskatchewan, Manitoba, Ontario and Quebec), that province will receive equalization payments. Provinces with fiscal capacity above the five-province average do not receive payments, and provinces where fiscal capacity falls below the average receive per capita payments that are determined by the size of the gap between themselves and the five-province average.

The promises and myths of equalization

The intention underlying the equalization program—to ensure Canadians in poor provinces have access to high-quality government services—is a good one. However, economists and political scientists have identified several ways in which this program has adverse, unintended consequences that stifle productivity and undermine democratic accountability in recipient provinces.

One undesirable effect of the equalization program is that it provides a disincentive for poorer provinces to increase their productivity and to promote economic growth. As a province's economy develops and its capacity to raise taxes increases, Ottawa withdraws the equalization payments. In some situations, lost equalization payments can offset increased local tax generation dollar for dollar.¹ This means that provinces that receive large equalization payments can find themselves in a situation where even successful efforts to promote economic growth bring no additional revenue into the provincial treasury. In short, increased tax dollars simply take the place of withdrawn equalization dollars. Clearly, this has the potential to breed complacency about the necessity of promoting growth in poorer provinces.

A second major problem created by large equalization payments is that they undermine democratic accountability by making it impossible for voters to know which politicians to hold accountable for perceived problems with service delivery. Federal transfers, which include equalization, represent a large portion of the overall revenue of several have-not provinces. In Quebec and Manitoba,

approximately one-quarter of the provincial government revenue comes from major federal transfers. In the recipient Maritime provinces, PEI, New Brunswick and Nova Scotia, major federal transfers constitute approximately one-third of total provincial government revenue.

This state of affairs has serious consequences for democratic accountability. When citizens are unhappy with the quality of provincial services, it is often difficult to determine whether federal or provincial authorities are responsible for perceived problems. As Brian Lee Crowley, the founder of the Atlantic Institute for Market Studies, points out, the equalization process creates an incentive for have-not provincial governments to spend freely, since they recognize that taxpayers in other provinces will be forced to cover a significant portion of any new spending programs.

Although these objections to the equalization program are strong ones and are supported by empirical research, this policy study will examine a third criticism of equalization. It is closely linked to the two already described: Equalization overshot its target by transferring huge sums of money to recipient provinces and thus made it more difficult to access government services in wealthy provinces when compared to recipient provinces. To put it another way, the ostensibly wealthier provinces are in some cases subsidizing better (or more available) services in the have-nots than their citizens can access.

This argument was made forcefully by David Mackinnon, who wrote that residents of the two provinces that have

contributed the most money to federal transfer payments in recent history, Ontario and Alberta, have “less access to key public services than most of the recipient provinces.” Mackinnon and others argue that due to being forced to subsidize other provinces through equalization and other programs, Ontario and Alberta residents have access to public services that are, in important respects, significantly worse than what is provided in other provinces.

A closely related problem is that large equalization payments may subsidize government spending to the point that have-not governments do not face the incentives for cost control that lead to the efficient use of government resources. This criticism of equalization holds that large transfers to poorer provinces have the effect of reducing the importance of cost control in government and ultimately promote inefficient government spending.

This paper examines these claims by comparing 10 indicators of government services in the 10 provinces. Specifically, this paper will focus on measures that give a clear indication of the amount of money at the disposal of provincial governments in a range of policy areas. Measurements such as the number of home care beds available, the student-educator ratio in schools and wait times for simple medical procedures are good indicators of the level of financial resources that are available to the provincial ministries. These indicators are tightly linked to the availability of financial resources and are therefore useful for examining the claim that equalization has created an unfair situation in which donor governments face tighter fiscal constraints than do recipient governments.

Findings

The evidence presented in this paper strongly suggests that, in many important areas, levels of government service in donor provinces such as Alberta and Ontario are significantly below those that exist in the major recipient provinces. Specifically, the data presented suggest that large transfers allow recipient provinces to spend more freely on a range of government services including health and education.

It is fundamentally unfair to force residents in the have provinces to fund government services elsewhere to the point that their own public services are below the level of those they are subsidizing. By comparing a variety of indicators of provincial government services in the 10 provinces, this study will show that donor provinces subsidize levels of government services in the recipient provinces beyond what is available to residents in the have provinces.

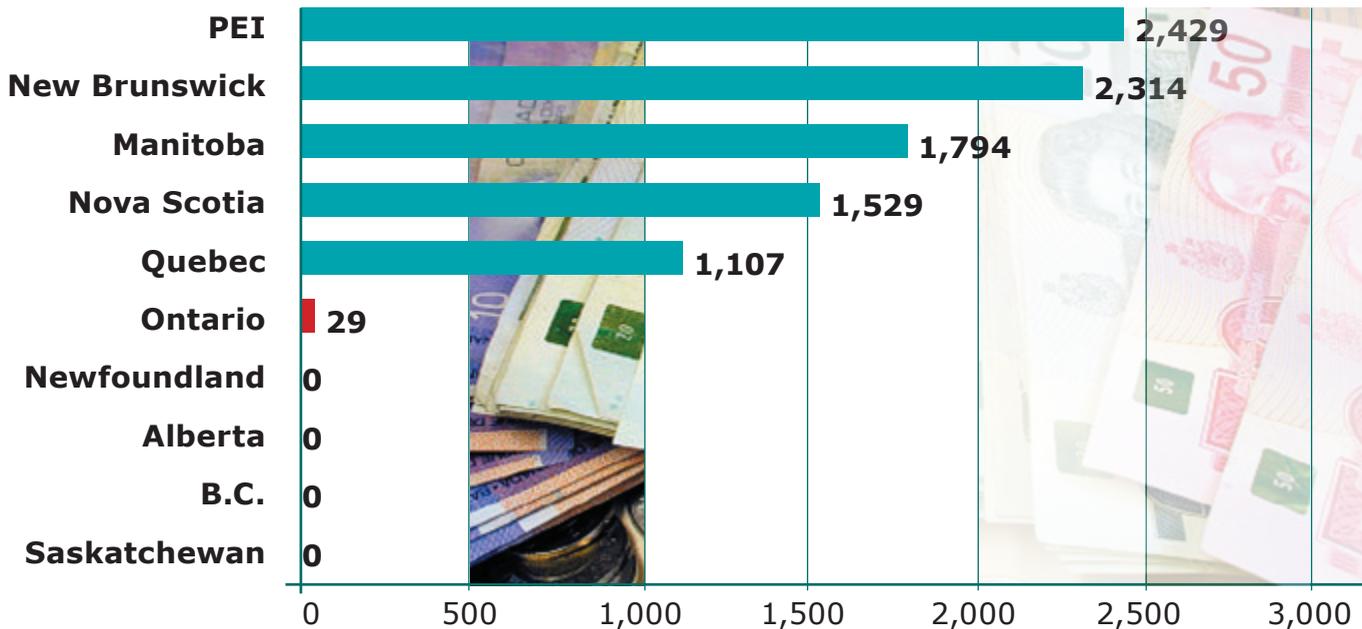
The haves, the have-nots and the anomalous case of Ontario

This policy study compares government services in the have and have-not provinces to determine whether donor provinces subsidize government services in recipient provinces that are more generous than what is available to their own residents. Readers may quibble with whether this or that service should be available to residents of any particular province and so do the authors of this study. For example, Quebec can be criticized for offering subsidized daycare to all parents, millionaires and poverty-level single parents alike—an inefficient, unfocused subsidy. However, such subsidies only highlight the absurdity of federal transfers where the wealthy in one province might be subsidized by middle-income taxpayers in another province or where residents in a province where housing is inexpensive, for example, Prince Edward Island, are subsidized by taxpayers in Calgary or Vancouver where home prices are significantly higher.

Nonetheless, while readers should question whether such programs and transfers ought to exist, this paper focuses on the bizarre result of such transfers: Residents in the have provinces have less in selected services, or pay more (for example, tuition costs) than residents in the provinces that are receiving large equalization transfers.

In 2009-2010, six provinces are scheduled to receive equalization payments: PEI, New Brunswick, Manitoba, Nova Scotia, Quebec and Ontario. As Chart 2 (next page) shows, however, Ontario's per capita equalization payments are minuscule when compared to the other five provinces. Furthermore, whereas the other recipient provinces have received equalization payments throughout recent years, this is the first time in its history that Ontario will receive any equalization payments.

Chart 2 Per capita equalization program receipts 2009-2010 (\$)



Source: Department of Finance Canada

Due to the extremely small size of Ontario’s equalization receipts, the reality is that these payments are a historical anomaly, and the fact that when other federal transfers are taken into account, Ontario is by far the largest net contributor to Confederation. Ontario will be considered a paying province rather than a recipient province for the sake of analysis in this paper. Thus, for the purposes of this study, we assume Ontario’s situation to be temporary.

Among scholars of economic federalism in Canada, the decision to classify Ontario as a paying province would be non-controversial. Ontario’s taxpayers contribute dramatically more to Confederation than they receive, even in 2009-2010 when the province will technically be classified as a have-not and will receive small equalization payments. Economists estimate that Ontario’s taxpayers contribute much more to Confederation than they receive in transfers and federal government services. According to one credible and well-researched estimate,

Ontario’s net contribution to the federation (including all programs in addition to equalization) was \$26-billion in 2007-2008. Alberta, with a population of just over 3.3 million people, was estimated to have a net contribution of \$15-billion dollars during the same fiscal year.² These two provinces clearly constitute a distinct category, and they are the two major subsidizers of government activity in the have-not provinces.

A paper from 2005 helps break down the imbalance per household. When all federal transfers are lumped together and net federal fiscal contributions are calculated per family, the severe imbalance for Canadian families in different provinces becomes even more apparent. A three-decade overview produced in 2005 by the University of Calgary’s Institute for Sustainable Energy, Environment and the Economy showed the average Ontario family of four paid \$3,032 annually to other provinces between 1961 and 2002 while the British Columbia family gave

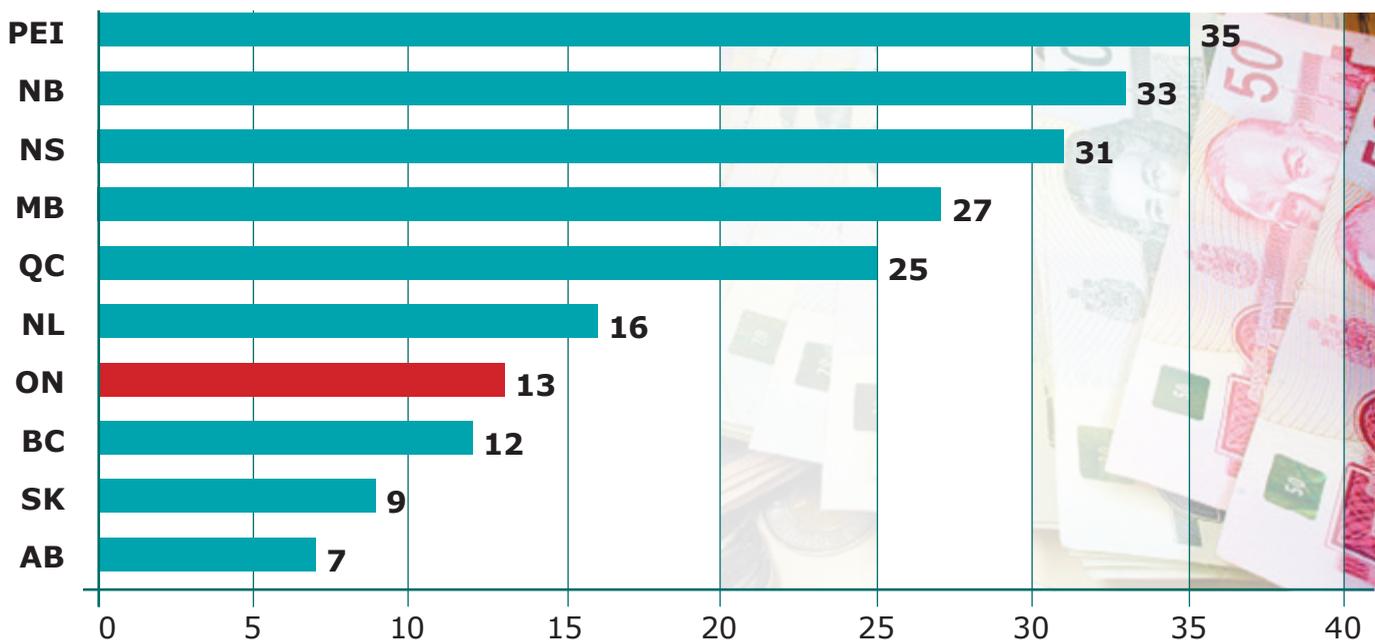
\$1,712 each year. An Alberta family paid out over \$10,000 every year.³ That Ontario should be classified as a paying province rather than a recipient province is further demonstrated by a consideration of the size of federal transfers to each province as a percentage of total government revenue. Chart 2 demonstrates that there is a clear division between major equalization recipient provinces and the paying provinces in terms of the share of provincial government revenue that comes from major federal transfers. In the have-not provinces, federal transfers constitute between 25 per cent and 35 per cent of provincial revenue. In the have provinces, the importance of major federal transfers is much smaller, between seven per cent and 16 per cent. Ontario clearly belongs to the latter category for this measure of fiscal independence, which provides further evidence that Canada's most populous province should be classified as a paying province for an analysis of the impact of equalization and other federal

transfers on government activity.

As Chart 3 shows, PEI, New Brunswick, Manitoba, Nova Scotia and Quebec are the major equalization recipient provinces. The following sections will compare provincial government services in these provinces to the other five provinces, Alberta, Ontario, British Columbia, Newfoundland and Saskatchewan, in order to analyze where there is a systematic relationship between the receipt of equalization payments and government services.

In particular, the five major recipient provinces will be compared to Alberta and Ontario because these are the two provinces that historically have drawn the least money from the equalization program and the two provinces that are the largest net contributors to Confederation when all forms of transfers are considered. The comparisons demonstrate that the major donor provinces do in fact subsidize levels of government service in recipient provinces that those provinces cannot provide.

Chart 3 Percentage of provincial government revenue from major federal transfers



Source: Department of Finance Canada

Childcare and education

The subsidization and direct provision of educational services for children and young adults consumes a major amount of the provincial budgets in Canada. This set of indicators measures government provision of a range of services in this policy area.

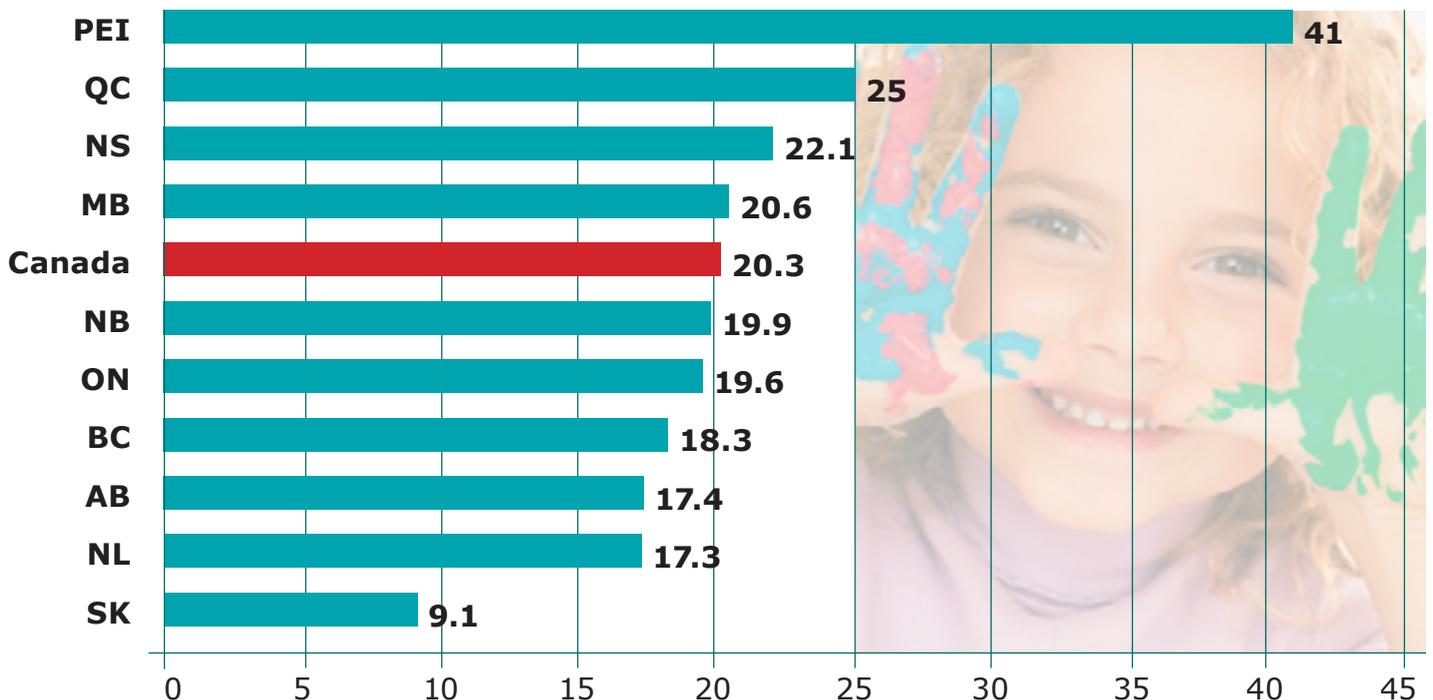
1. Regulated childcare spaces

Across Canada, governments regulate and, to different degrees, subsidize the use of childcare services. The number of regulated childcare spaces that a province can provide is tightly linked to the amount of resources that it is able to allocate to this policy area.

Chart 4 shows the number of regulated childcare spaces in the province as a percentage of the total number of children who are under five years of age.

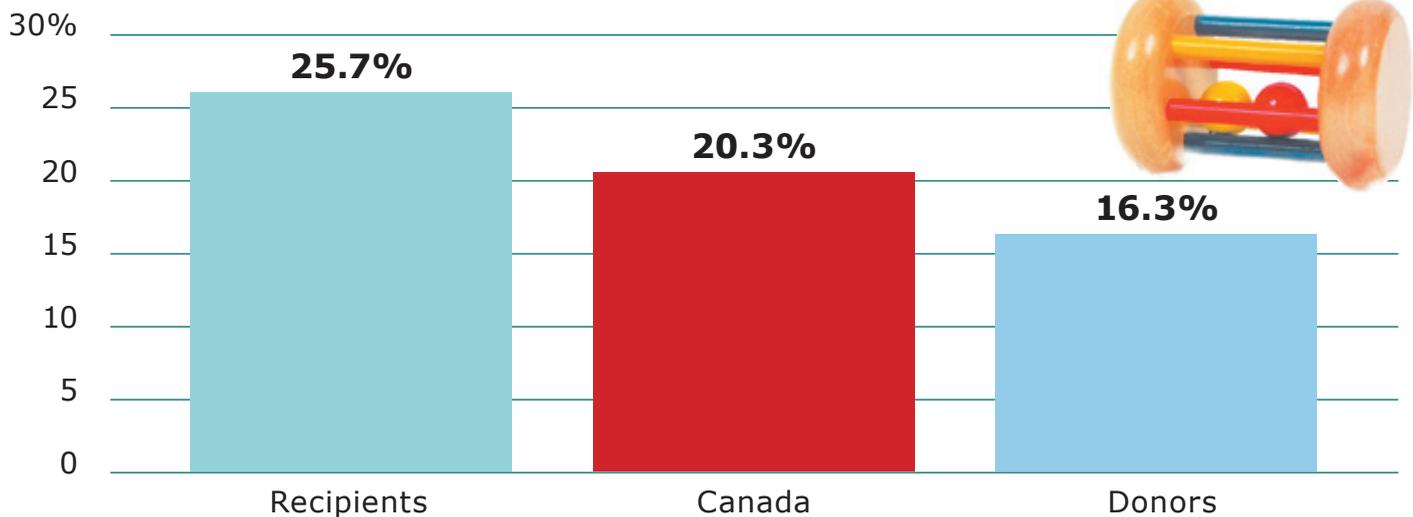
Across Canada, on average, there are 20.3 regulated childcare spaces in existence for every 100 children of pre-school age. As Chart 3 shows, all four of the provinces that have levels of daycare access that exceed the Canadian average are have-not provinces that receive equalization payments. Furthermore, *the five provinces that provide the fewest regulated daycare spaces per capita are the five paying provinces that do not receive substantial equalization payments.*

Chart 4 Percentage of children under 5 for whom there exists a regulated childcare space



Source: Childcare Research and Resource Unit

Chart 5 Percentage of children under 5 for whom there exists a regulated childcare space (provincial average)



Source: Calculations by Author

As Chart 5 shows, the provincial average in the five have-not provinces for this indicator is 25.7 per cent compared to a provincial average of just 16.3 per cent in the five donor provinces.

Conclusion: This indicator clearly shows that the equalization recipients have more regulated daycare spaces available to their residents than the paying provinces have for their residents. For this indicator, Ontario ranks slightly below average, sixth in Canada. Ontario has 19.6 childcare spaces available for every 100 pre-school age children. Alberta, the other major contributor to the federation, is near the bottom of the pack for this indicator. Alberta has among the fewest childcare spaces per pre-school age child in the country at just 17.4 per cent.

2. Student-educator ratio

The operation of public schools falls under the jurisdiction of the provincial governments. Although there is a complex, ongoing debate about the importance of class size to successful elementary school education, most parents believe that smaller classes are better than larger ones, and most provincial governments have proclaimed a commitment to keeping class sizes as small as possible.

At the very least, class size is a useful indicator of the funds available. The elementary school student-educator ratio is therefore a useful indicator of the government resources that are available for public schools. This measurement is broader than class size, as it includes personnel outside the class including principals and counsellors. A low student-educator ratio is a strong indicator that a province has substantial resources available for public school funding. Conversely, a particularly high student-educator ratio suggests funds may be in

short supply, as it means that a province has not staffed its schools at the same levels as other provinces.

Chart 5 shows the recipient provinces tend to have significantly lower student-educator ratios than do the donor provinces. In other words, schools in less wealthy provinces tend to hire more educators than schools in the provinces that pay into the equalization program. Of the five provinces with the fewest students per educator, four are have-not provinces.

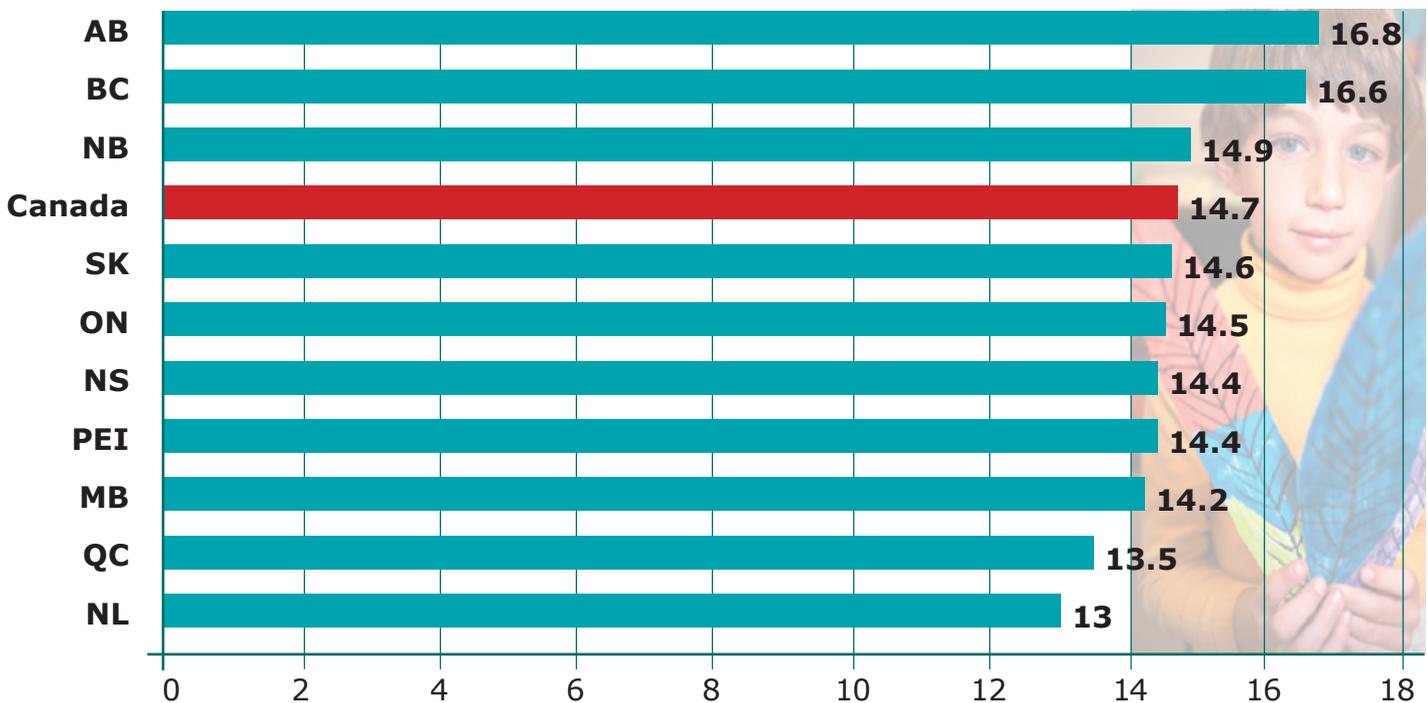
Although have-not provinces generally have smaller student-educator ratios, there are two exceptions to this. First, Newfoundland, an equalization-paying province (albeit through federal taxes and not directly), has the smallest ratio in the country. Second, New Brunswick, a recipient province, has a student-educator ratio that is slightly higher than the national average. Despite these exceptions, ratios in recipient provinces tend to be significantly smaller than the ratios

in donor provinces. The provincial average for this indicator across the five recipient provinces is 14.3 students per educator. In the five donor provinces, the average is 15.1 students per educator. In Alberta, the one province that has not received any equalization payments in the past five years, the ratio is well above the national average and stands at 16.8 students for every educator.

Conclusion

A reduced student-educator ratio generally leads to smaller average class sizes and increased interaction between students and their teachers. The student-educator ratio tends to be significantly smaller in recipient provinces than in donor provinces. This suggests have provinces subsidize public school service levels in the “have-nots beyond what they (the ‘haves’) are able to provide for their own citizens.

Chart 6 Elementary school student-educator ratio



Source: Statistics Canada

3. Average undergraduate tuition

Throughout Canada, undergraduate university education is heavily subsidized. In each province, students and their families bear only a fraction of the total financial costs of a university education, with the remainder being borne by the province.

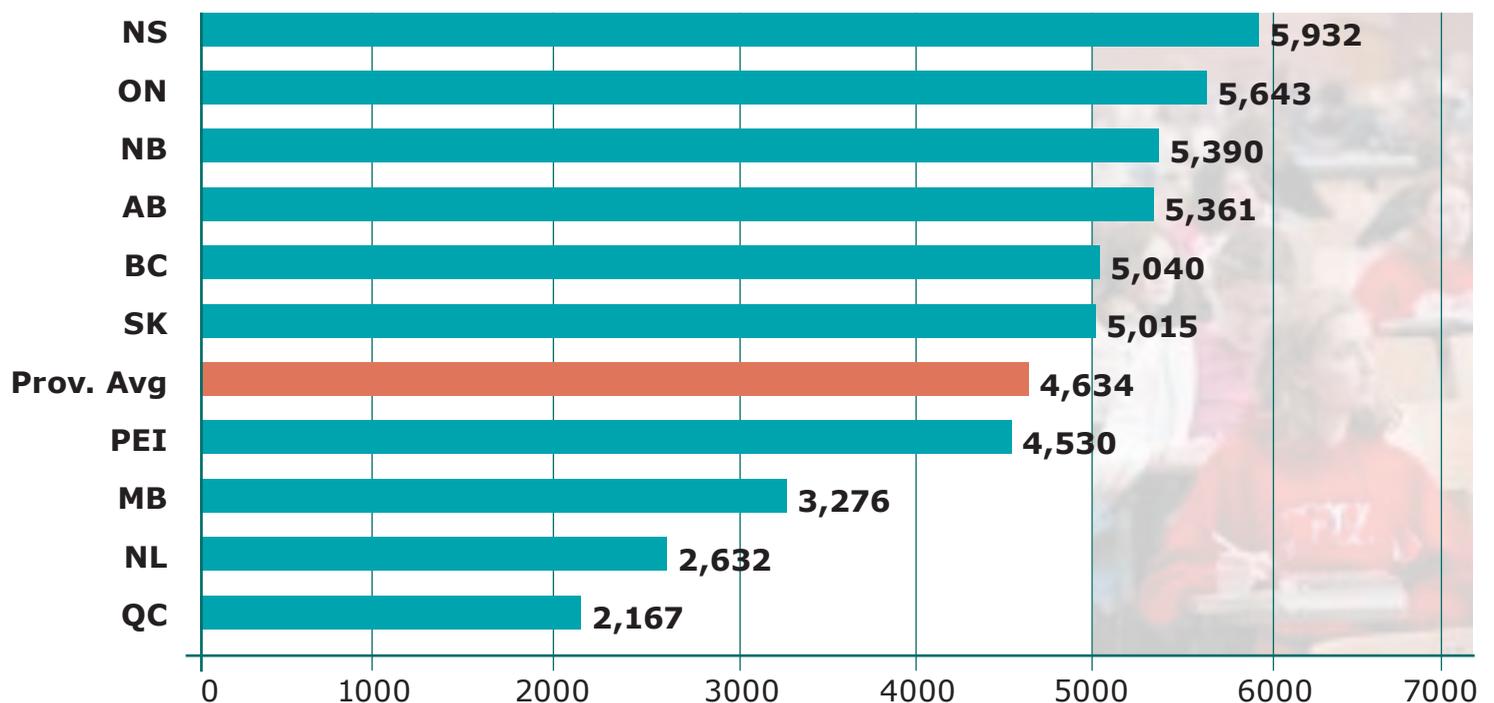
Although a number of factors influence tuition fees, the amount of financial resources that a province is able to dedicate to its system of higher education certainly has an impact on tuition fees. Tuition levels are a politically sensitive issue, and politicians face a strong incentive to keep out-of-pocket expenses as low as possible. Since all provincial governments aim to keep undergraduate tuition levels low relative to the actual cost of a university education, the average tuition payments for full-time undergraduate students in each province is a useful metric with which

we can compare the level of a politically popular government subsidy in the have and have-not provinces.

The relationship to equalization receipts is not as strong for this indicator as it is for the two previous education indicators. Nonetheless, four donor provinces—Saskatchewan, British Columbia, Alberta and Ontario, all have average tuition levels well in excess of the provincial average.

For this indicator, a comparison of Alberta and Ontario to Quebec clearly illustrates the effects of the equalization program. Quebec is the largest recipient of total equalization dollars. The billions in equalization money the province receives enables Quebec to offer undergraduate tuition that is substantially cheaper than what is available to the taxpayers in the have provinces who pay those bills.

Chart 7 Average annual undergraduate tuition (\$)



Source: University of Calgary: Office of Institutional Analysis

In Ontario, the average undergraduate's tuition is 2.6 times larger than it is in Quebec. In Alberta, British Columbia and Saskatchewan, undergraduate tuition is more than twice as expensive as it is in Quebec.

Clearly, the residents of have provinces are subsidizing tuition levels of Quebec residents that are much lower than what they have access to.⁴

Conclusion

The relationship between equalization receipts and average university tuition is significant, but equalization payments are not as strong a predictor of government service levels as is the case for the two other education indicators examined. Nonetheless, in the case of Quebec, the largest recipient of total equalization dollars, it is particularly exceptional for this indicator. Tuition fees in that province are less than one-half the fees charged in Alberta, Ontario, British Columbia and Saskatchewan.

All three education indicators lead to the finding that government service levels and subsidies are greater in the provinces that receive equalization payments than in provinces that do not.

Healthcare

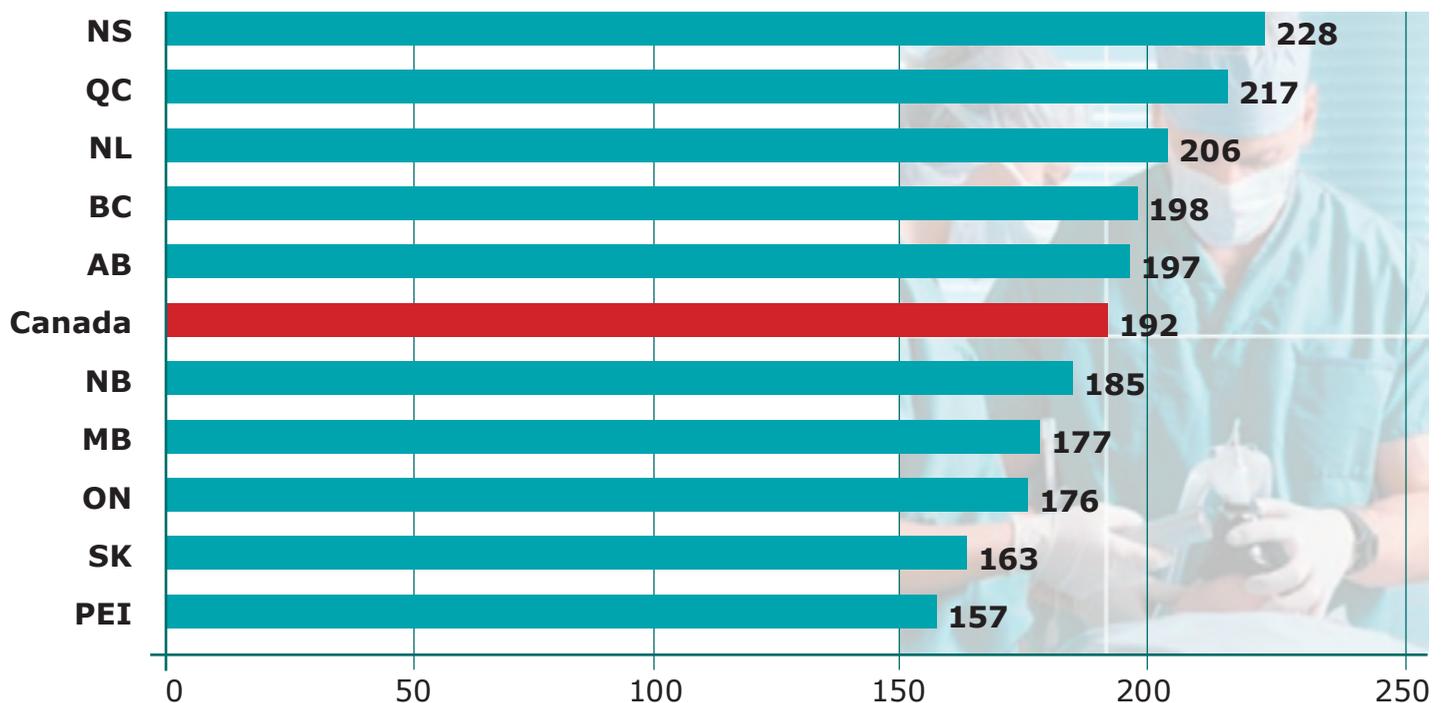
Healthcare expenditures consume a large portion of the provincial budget in all 10 provinces. These indicators compare a number of indicators of healthcare service levels in the have and have-not provinces.

A wide variety of factors influence healthcare quality aside from the availability of financial resources. The efficiency with which resources are used and the competency of healthcare system management vary between jurisdictions and can dramatically affect healthcare quality. The indicators in this report, however, were chosen because they are tightly linked to the availability of funds for healthcare spending. These indicators, taken together, can be used to examine the question of whether the paying provinces face tighter budget constraints than the have-nots in the area of healthcare spending.

4. Physicians per 100,000 population

Provincial governments are responsible for the provision of healthcare services. One of the major expenses associated with the provision of healthcare is the compensation of physicians. The number of physicians per 100,000 population is a useful measure of the availability of healthcare services and hospital capacity,⁵ and it is an indicator of the availability of healthcare resources in a province.

Chart 8 Physicians per 100,000 people



Source: Canadian Medical Association

For this indicator, the equalization recipient provinces generally have slightly more doctors per capita than the paying provinces do. The two provinces with the most doctors as a share of the population—Nova Scotia and Quebec—are recipient provinces. The average of the five have-not provinces on this indicator is 193 physicians per 100,000 population compared to 188 in the have provinces, a gap of 2.6 per cent.

The three major donor provinces, British Columbia, Alberta and Ontario, once again fare between poor and average on this indicator. British Columbia has 198 doctors per 100,000 people, Alberta has 197 and Ontario has just 176 doctors per 100,000, which is well below the national average and ahead of only two provinces.

Once again, for this indicator, a comparison between Quebec and the major paying provinces—Alberta and Ontario—is revealing. Quebec has 217 doctors per 100,000 population, which ranks the province second in Confederation behind another have-not province, Nova Scotia, which has 228 physicians for every 100,000 people.

Comparisons between the major payers and Quebec, the largest recipient of total equalization dollars, are useful because all three are large provinces and this makes direct comparisons easier. Quebec is also the largest overall recipient of equalization dollars. This indicator shows that one of the effects of the multi-billion dollar annual transfer from taxpayers in (mainly) British Columbia, Alberta and Ontario to Quebec is that the latter can afford to maintain significantly more physicians than its benefactors can.

Conclusion

For this indicator of the availability of healthcare services and hospital capacity, the have-not provinces fare, on average, slightly better than the five have provinces. The five-province average on this indicator for the equalization recipient provinces is approximately 2.6 per cent larger than the five-province average for the paying provinces. Alberta has a slightly larger number of doctors as a proportion of the total population than the national average, and Ontario has a significantly smaller number, with about nine per cent fewer doctors per 100,000 people than the national average. The largest recipient of equalization dollars, Quebec, has 217 doctors per 100,000 people, placing it second in Confederation behind another have-not, Nova Scotia. Quebec has 23 per cent more physicians as a proportion of population than does Ontario and 10 per cent more than does Alberta.

5. Registered nurses per 100,000 population

One major expense associated with the provision of healthcare is compensation for nurses. As with the previous indicator, the number of registered nurses per 100,000 population is a useful measure of the availability of healthcare services and hospital capacity,⁶ and it is an indicator of the availability of healthcare resources in the provinces.

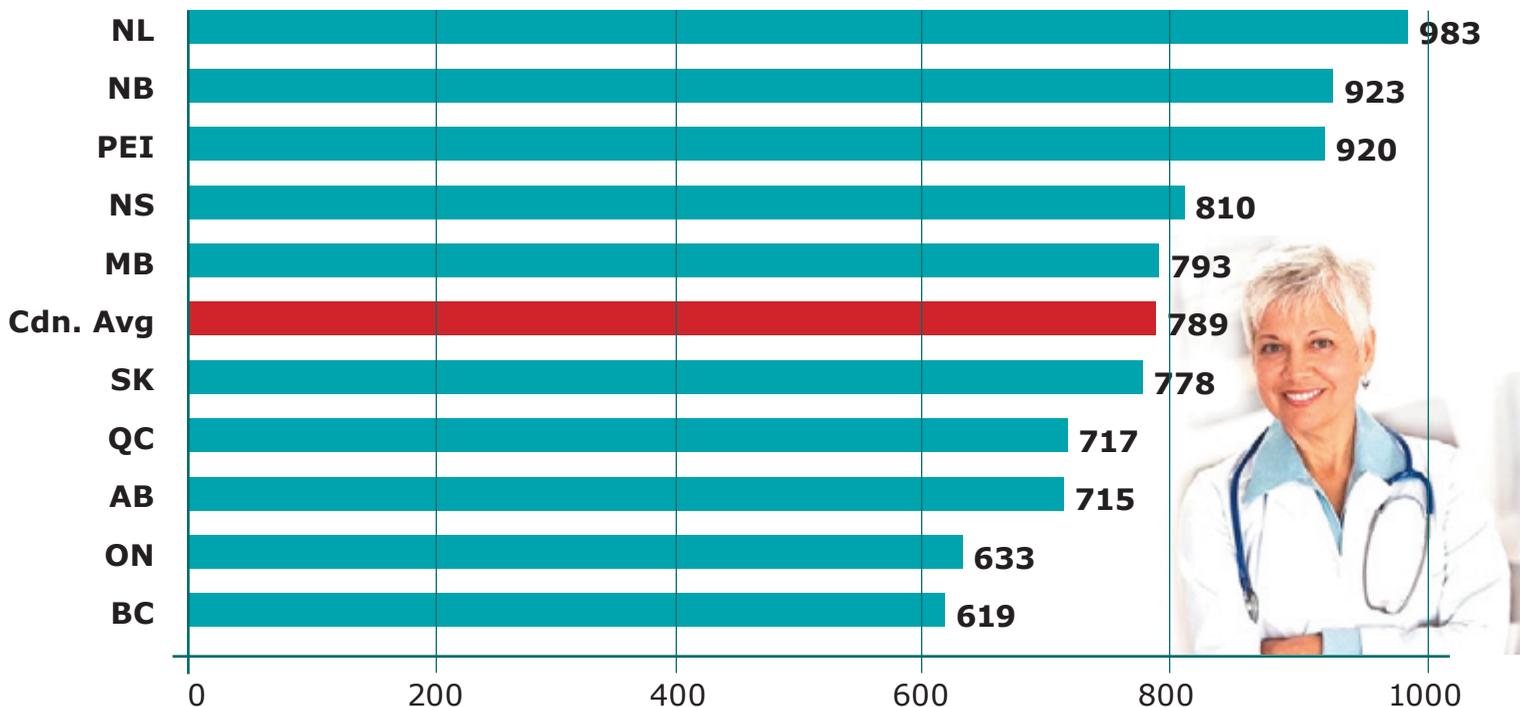
This graph shows there are substantially more nurses as a share of the population in the equalization recipient provinces than in the paying provinces. The three provinces with the fewest nurses as a share of the population are all paying provinces.

The three major paying provinces, British Columbia, Ontario and Alberta, have the lowest, second-lowest and third-lowest number of registered nurses as a proportion of their population in the country.

The major exception to the general pattern for this indicator is Newfoundland, which has the largest number of nurses per 100,000 population in Canada.

When one examines the five-province average for the have and have-not provinces, the gap in this indicator of health-service availability becomes evident. The five have-not provinces have an average of 833 nurses per 100,000 population.

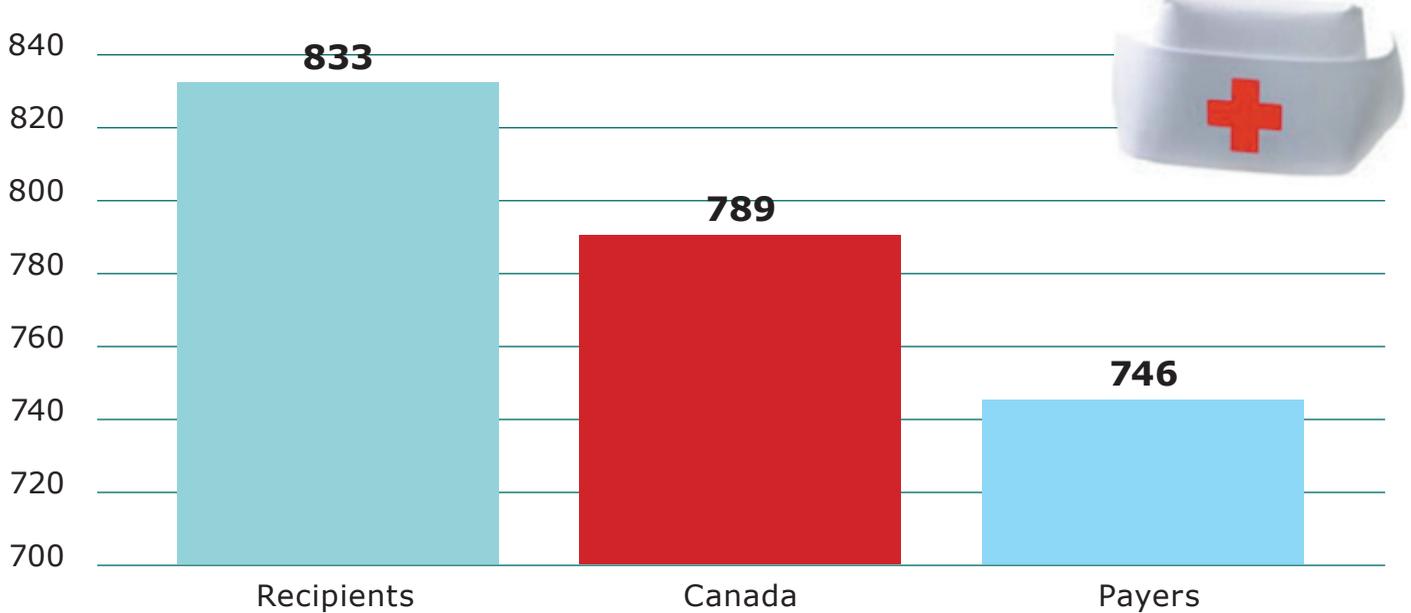
Chart 9 Registered nurses per 100,000 people



Source: Canadian Institute for Health Information



Chart 10 **Nurses per 100,000 people**



Source: Calculations by Author

The average for the five paying provinces is 746 nurses per 100,000 population. This means that the provincial average for this indicator is 12 per cent higher in the have-not provinces than in the haves.

Conclusion

For this indicator, the have-not provinces are, on average, substantially better off than the paying provinces. Of the five provinces with the fewest nurses as a proportion of their population, four are have provinces under equalization.

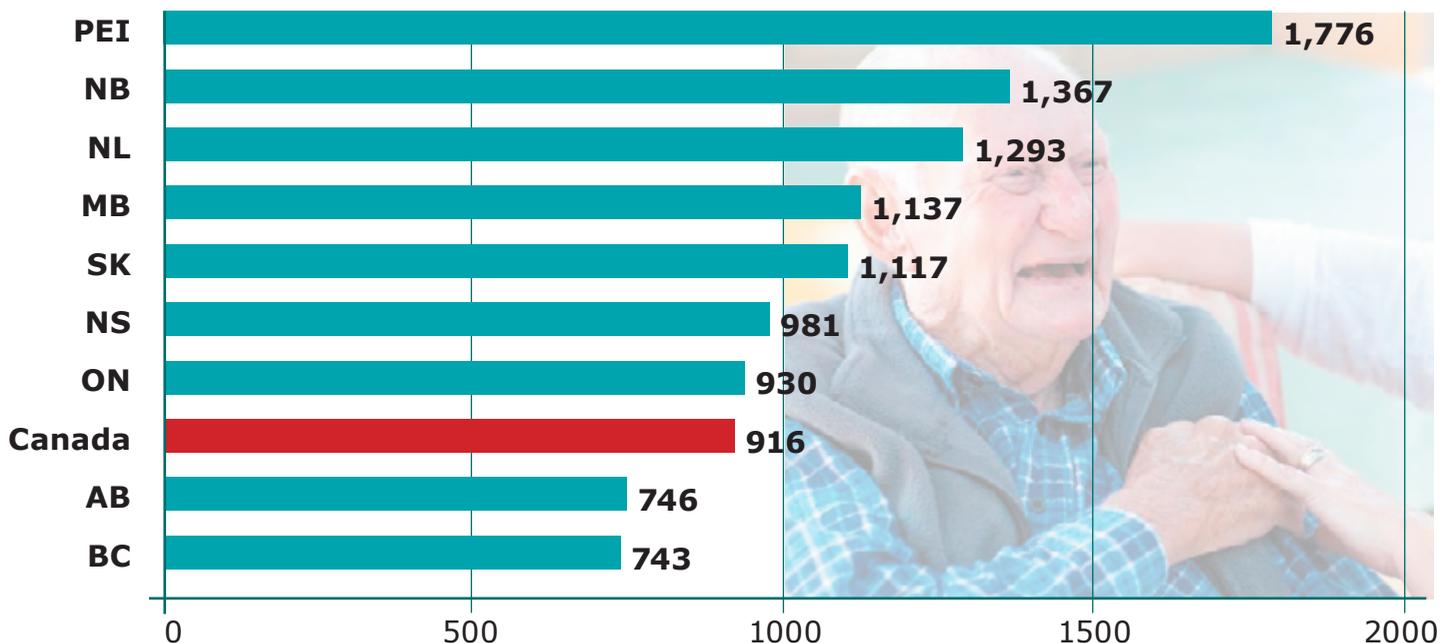
6. Long-term residential-care beds

For elderly Canadians who require care that cannot be provided in the home, long-term institutional care is often necessary. When there are insufficient beds in long-term care homes for chronically ill seniors, patients who would be better off in residential care are diverted to hospitals.

This can be a hardship for seniors, as hospitals are generally not equipped to provide as comfortable an environment as residential-care centres designed for that purpose. Some caution is required in the interpretation of this indicator, as it may be driven in large part by demographic factors. Nonetheless, as with doctors and nurses per capita, the number of long-term residential-care beds available is a useful comparison of government benefits available in each province as is any disparity.

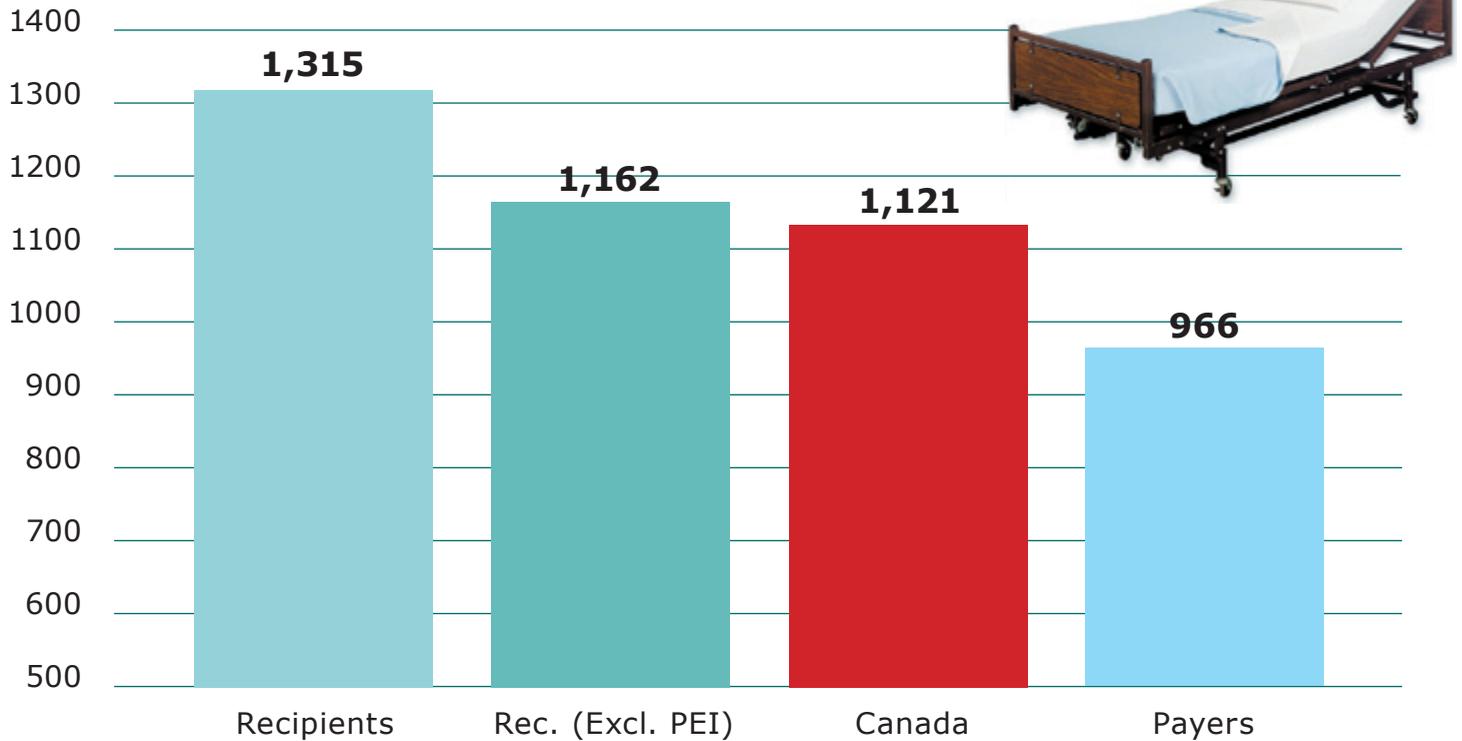
Once again, this indicator suggests the existence of greater financial resources within the healthcare systems of the have-not provinces—provided in large measure by the have provinces of British Columbia, Alberta, Saskatchewan, Newfoundland and Ontario (in most years). The three provinces with the fewest residential-care beds per capita are have provinces under equalization. The two provinces with the *most* residential-care beds per capita are have-not provinces. Unfortunately, Quebec does not report data for this indicator to Statistics Canada. The three major contributing provinces to Confederation, British Columbia, Alberta and Ontario, have the fewest, second-fewest and third-fewest long-term residential-care beds in Canada as a proportion of population.

Chart 11 Residential-care beds per 100,000 people



Source: Statistics Canada

Chart 12 Residential-care beds per 100,000 people (provincial average)



Source: Calculations by Author

As Chart 12 shows, the four-province average for the have-not provinces that do report data is 1,315 residential-care beds per 100,000 population compared to the 966 average in the five paying provinces. The average in the four recipient provinces for which we have data is therefore 36 per cent higher for the recipient provinces than the average in the five paying provinces. If PEI is excluded because of its small population and extremely large number of residential beds per capita, the three remaining have-not provinces still average 20 per cent more residential-care beds per 100,000 population than the five have provinces.

Conclusion

The four have-not provinces that report data for this indicator have, on average, considerably more long-term beds per capita than do the contributing provinces. This indicator suggests more healthcare system capacity in the have-not provinces to meet the needs of their elderly residents than exists in the have provinces.

7. Prescription drug subsidies

The proper use of pharmaceuticals is an important component of efforts to effectively prevent and treat disease. Governments within Canada, and in other countries, use a variety of strategies to subsidize the cost of these medicines.

This indicator measures the percentage of households in each province that diverts a significant share (1 per cent) of their annual income to purchasing prescription drugs. Although this indicator is strongly influenced by other factors—such as demographic variables—it is still a useful measure of the extent to which residents of each province are insulated from heavy out-of-pocket expenses for pharmaceuticals by government subsidies.

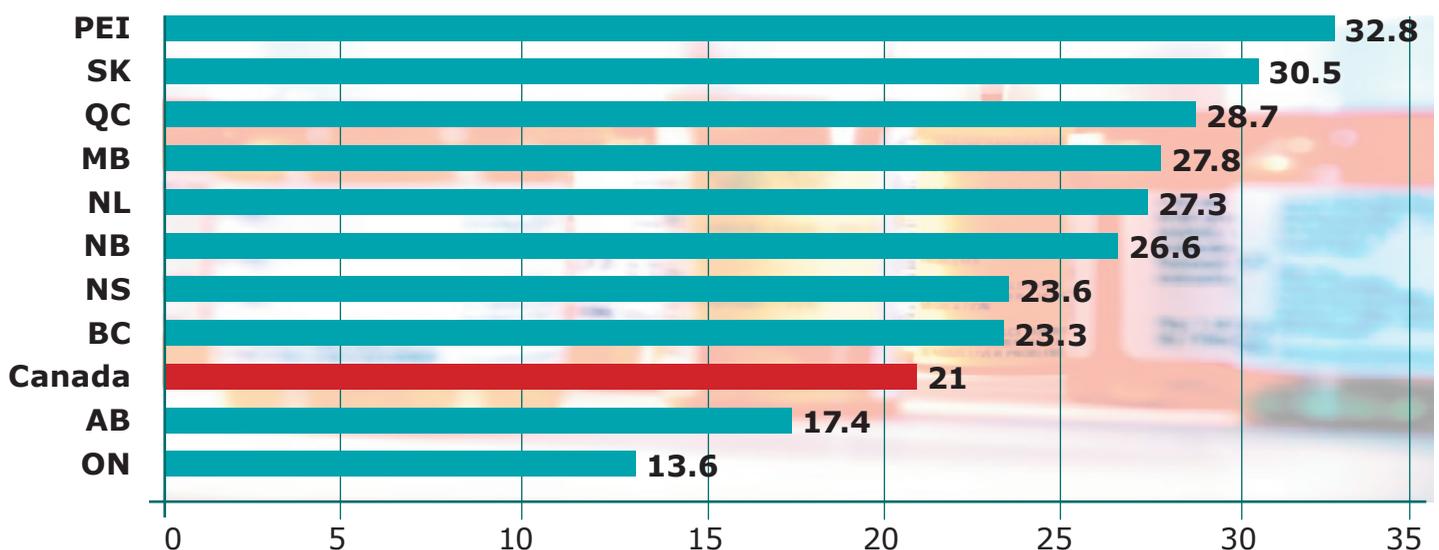
On this indicator, and counter to the trend that has emerged in the indicators examined so far, more residents of have-not provinces incur large out-of-pocket expenses for prescription medication than do residents of the have provinces.

The two large contributors to Confederation, Ontario and Alberta, have the smallest portion of their populations spending more than 1 per cent of their annual income on pharmaceuticals in 2008. Of the three provinces that have the largest proportion of their population incurring substantial out-of-pocket expenses for prescription drugs, four are have-not provinces.

Conclusion

Residents of the have-provinces are better protected by government subsidies from incurring out-of-pocket drug expenses than are residents of the have-not provinces. Unlike the first three healthcare related indicators examined in this study, this indicator provides no evidence of higher levels of government services in the have-not provinces. In fact, on this indicator, residents of the have provinces appear to receive more-extensive government subsidies than do residents of the have-nots.

Chart 13 Percentage of residents spending more than 1% of income on prescription drugs



Source: Statistics Canada

Miscellaneous

Healthcare and education are the two largest categories of government spending at the provincial level. The first two major sections of this report examined indicators of service levels in these two policy areas across the 10 provinces. The indicators in both of these major categories suggest that provinces receiving equalization payments do have access to higher levels of government services than do the paying provinces, particularly Alberta and Ontario.

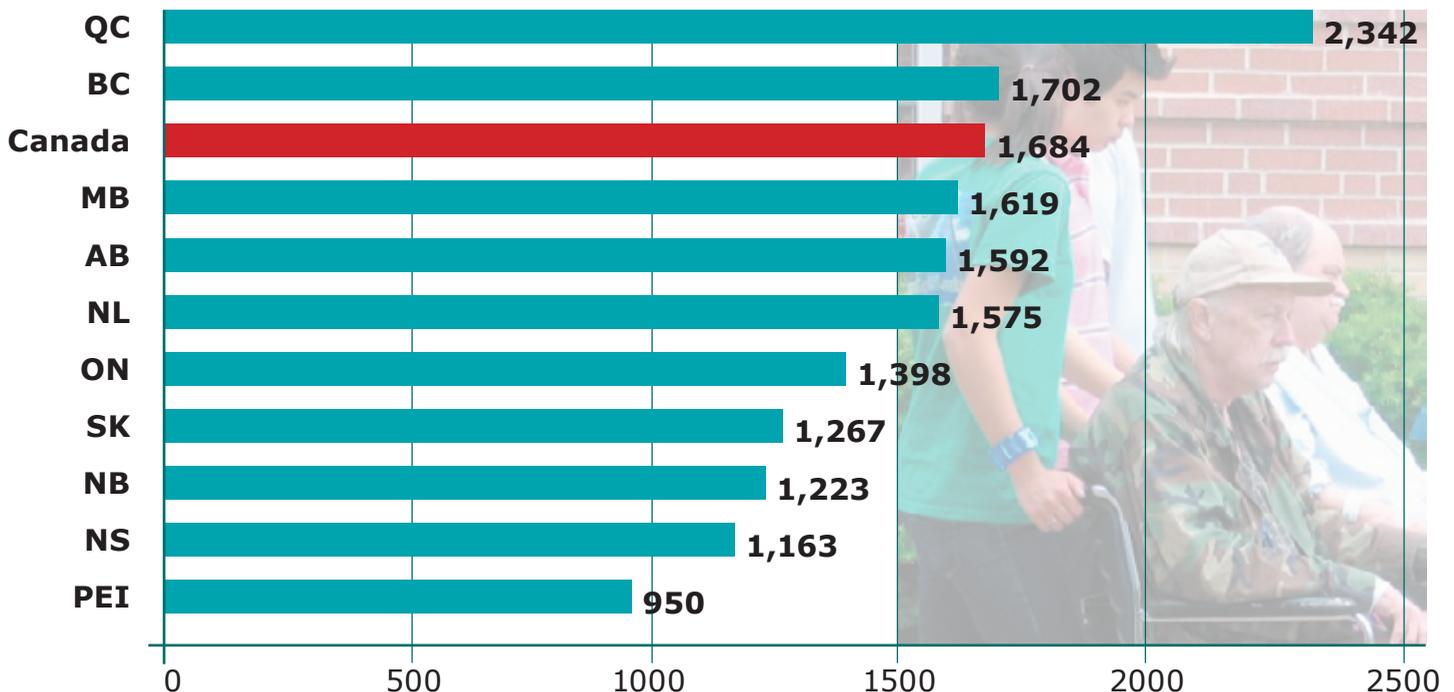
This section considers a variety of indicators drawn from other areas of government activity to assess whether these findings can be generalized across a broader range of public services.

8. Social services spending per capita

Social services spending includes a wide range of government programs, most of which take the form of cash transfers to individuals. Some of the programs in this category of government activity are social assistance, income maintenance and family allowance.

Chart 13 shows that there is not a strong relationship between equalization receipts and government service levels. Although the three provinces with the lowest social services spending per capita are have-not provinces, Quebec, another have-not, has the highest level of spending per capita. The five-province average for this indicator is similar for the have and have-

Chart 14 Social service spending per capita (\$)



Source: Statistics Canada

not provinces: The average spending level for the five have provinces is about three per cent higher than the average in the have-nots.

Although the average for this indicator is slightly higher for have provinces than for have-nots, that gap disappears when an average is taken that weights the provinces according to their populations. This is the case because the largest recipient of equalization dollars, Quebec, is something of an outlier, with far higher levels of spending than any other province. Quebec spends \$2,342 per resident on its social services spending. This is much more than is spent in any other province. Quebec spends 37 per cent more, per capita, on social services than the next biggest spender, British Columbia. Quebec also spends 47 per cent more than the richest province in Confederation, Alberta, and it spends 68 per cent more than its neighbour, Ontario.

As for the three major paying provinces, two of three (Alberta and Ontario) have service levels that are slightly below the Canadian average and are ranked fourth and sixth respectively for this indicator.

Conclusion

The have-provinces and the have-not provinces have similar levels of per capita social services spending. This indicator does not provide general evidence of a link between equalization receipts and the level of government services. Nonetheless, Quebec's exceptionally high level of social services spending is noteworthy. Quebec's per capita spending for this indicator is 37 per cent higher than the next biggest spender in the country, British Columbia. Quebec is an outlier in this indicator, and it is likely that its exceptionally high level of spending in this area is enabled by its receipt of billions of equalization dollars from taxpayers in other provinces.

9. Police officers per 100,000 population

Perhaps the most important responsibility of government is law enforcement. One major expense associated with the provision of law enforcement is the compensation of police officers. They are primarily hired at the provincial and municipal levels. Since municipalities are constitutionally “creatures of the province” and most hiring takes place at these two levels of government, the number of police officers as a proportion of the population is a useful indicator of the availability of fiscal resources for this important government function.

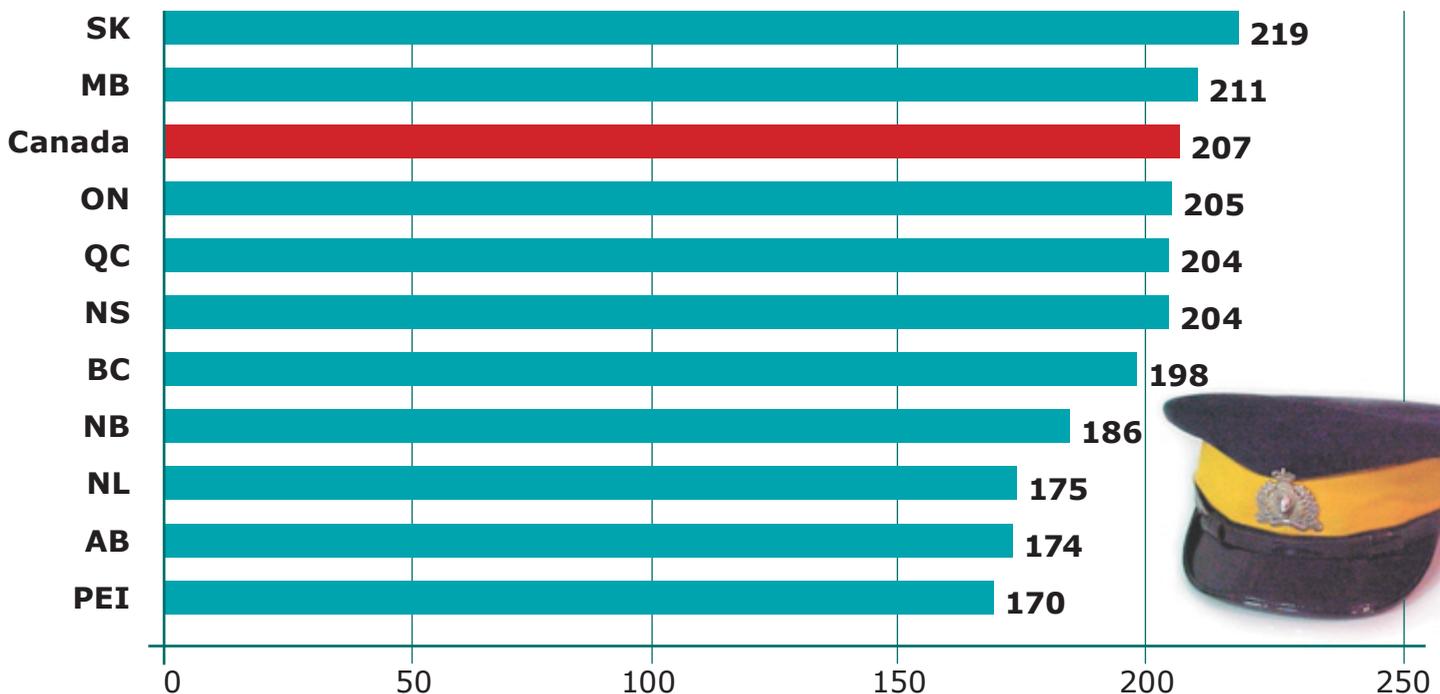
Chart 15 illustrates that there is no clear relationship between equalization receipts and police officer employment across Canada.

The five-province average for the paying provinces and the five-province average for the recipient provinces are nearly identical. Alberta has a below average number of police officers as a proportion of the population and Ontario is very close to the national ratio.

Conclusion

The data show that equalization receipts do not have a clear relationship to the number of police officers hired in each jurisdiction. We have seen that spending for the have-not provinces is significantly greater in many policy areas than it is for the have provinces. There is no correlation, however, between equalization receipts and police officer employment.

Chart 15 Police officers per 100,000 people



Source: Statistics Canada

10. Provincial public administration workers per capita

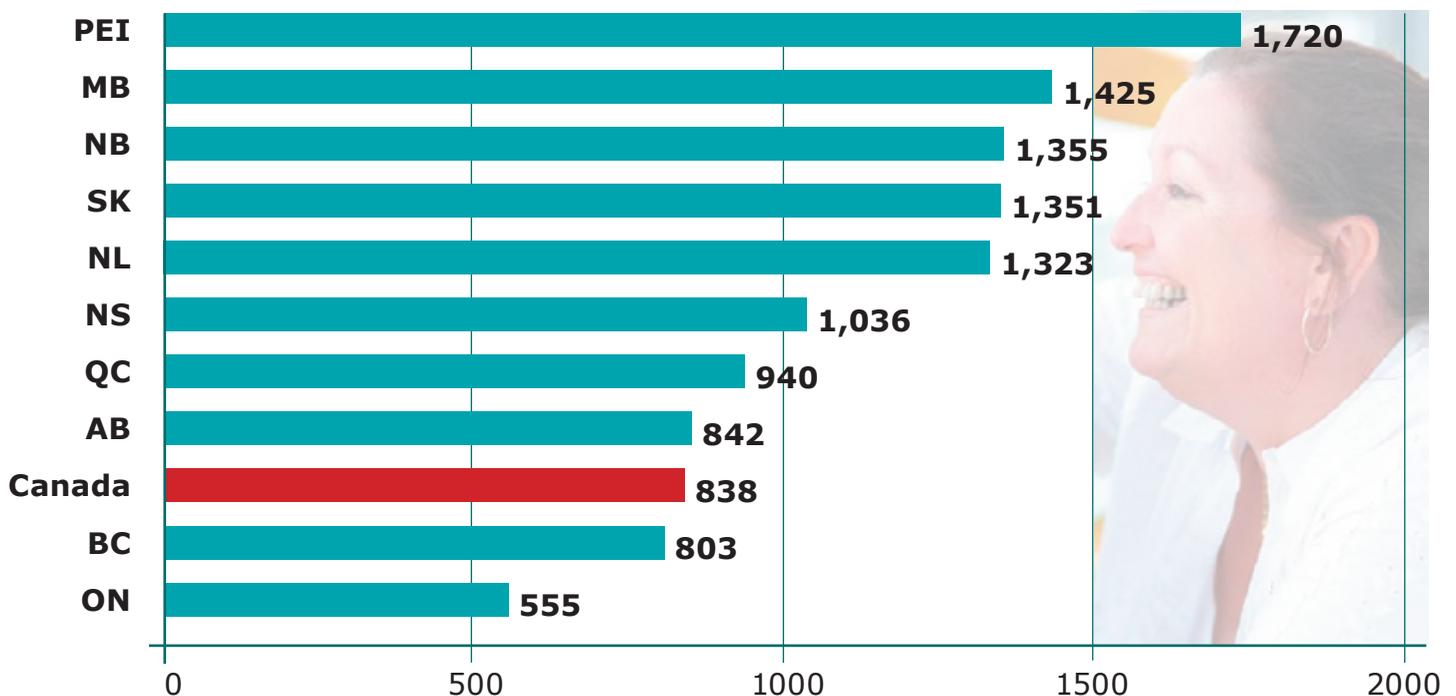
Several of the indicators suggest that recipient provinces are able to provide government services at higher levels than paying provinces, in ways that many voters would value. Most voters would prefer small classes in public schools to large ones and lower tuition to high, assuming these things could be achieved without higher taxes or added debt.

This evidence suggests that some of the money that is transferred through the equalization program is used by have-not governments to provide higher levels of government service to their residents than the governments in the have provinces

can provide. However, there is also evidence that the government bureaucracy absorbs some of the additional funds that are transferred to the have-nots through equalization, sometimes in inefficient ways. If a clear relationship exists between equalization receipts and the size of the public service, this suggests that equalization transfers have the noticeable effect of subsidizing the employment of additional civil servants in the have-not provinces.

Chart 16 shows that the have-not provinces employ significantly more provincial level public servants than the have provinces do.

Chart 16 Provincial public servants per 100,000 people



Source: Statistics Canada

The three provinces that employ the most provincial public servants as a proportion of population—PEI, Manitoba and New Brunswick—are all have-not provinces. The three provinces with the fewest provincial public servants per capita—Ontario, British Columbia and Alberta, are all have provinces.

The three major paying provinces, Ontario, British Columbia and Alberta have, respectively, the fewest, the second-fewest and the third-fewest public servants per capita in Canada.

Conclusion

This data suggests that a significant amount of equalization money received by have-not provinces is absorbed by the bureaucracy itself in the form of higher rates of public administration employment. This may result in better government services in these provinces or it may simply represent an inefficient use of funds that is enabled by the receipt of large equalization transfers. In either event, the data demonstrate that the recipient provinces employ much larger provincial bureaucracies as a proportion of population than the paying provinces. In short, residents in the have provinces and their equalization payments allow for larger bureaucracies in the have-nots than would otherwise be the case absent equalization.

Discussion

The effect of equalization on spending levels in have-not provinces

This paper examined 10 indicators in order to analyze the relationship between equalization receipts and government services. Three of these indicators were related to the area of education policy, four were related to healthcare and the remaining three were drawn from a range of different areas of government activity.

Taken together, these 10 indicators provide strong evidence of a relationship between the receipt of equalization payments and heightened levels of government spending.

For seven out of the 10 indicators, the have-not provinces displayed, on average, markedly higher levels of government spending than did the have provinces. For two of the indicators, no relationship was found. For just one indicator, prescription drug subsidization, the have provinces showed evidence of a higher level of government spending and/or higher levels of government services.

Discussion Table 1: Service levels in have-not versus Have provinces, by indicator

Have-not Provinces	Neutral/No Relationship	Have Provinces
Provincial Public Servants Per Capita	Social Spending Per Capita	Prescription Drug Subsidization
Residential-Care Beds Per Capita	Police Officers Per Capita	
Nurses Per Capita		
Doctors Per Capita		
Student-Educator Ratio		
Avg. Undergraduate Tuition		
Daycare Availability		

The provision of more government services in the have-not provinces is a predictable consequence of equalization transfers. The equalization program has the effect of subsidizing government spending in poorer provinces. When an activity is subsidized, more of it tends to occur. Whereas Albertans know they will pay for every dollar of provincial government services they receive, Manitoba voters face a situation in which voters in other provinces will pay a certain percentage of the cost of any proposed government action. This causes Manitoba voters to demand higher levels of government spending than they would support if they had to pay the full cost of that spending.

To summarize, the data point to two major, closely related consequences of the equalization programs.

- Because they know they will not pay the whole cost of government spending, voters in have-not provinces have an incentive to demand more government spending than they would support if they were bearing the entire cost.
- As a result of the financial strain on taxpayers from making equalization payments to the have-not provinces as well as the phenomenon described above, governments in paying provinces often provide lower levels of government services than governments in have-nots. This means the taxpayers of paying provinces ultimately subsidize higher levels of government spending and services elsewhere than they themselves receive.

The extreme cases: British Columbia, Alberta and Ontario

As mentioned in the introduction to this paper, British Columbia, Alberta and Ontario are the three major contributors to Confederation. Over the past five years, Alberta did not receive any equalization payments and Ontario received payments in only one year. Numerous analyses have shown that taxpayers in both provinces contribute far more money to Confederation than they receive, and that they are, by far, the largest net financial contributors to Confederation.

The pattern examined in this report—have provinces providing lower levels of government services than have-not provinces—is especially pronounced in the case of these two provinces.

Table 2 (next page) describes the provincial ranks for British Columbia, Alberta and Ontario for each of the 10 indicators examined in this report. A rank of 1st represents the highest level of government services and/or spending for each indicator and a rank of 10th represents the lowest.

Discussion Table 2: Ontario and Alberta: provincial ranks for 10 indicators

Indicator	Ontario	Alberta	British Columbia
Regulated Child-care Spaces	6 TH	8 TH	7 TH
Elementary School Student-Educator Ratio	6 TH	10 TH	9 TH
Average Undergraduate Tuition	9 TH	7 TH	6 TH
Physicians per 100,000 population	8 TH	5 TH	4 TH
Nurses per 100,000 population	9 TH	8 TH	10 TH
Residential-care Beds per 100,000 population	8 TH	9 TH	10 TH
Prescription Drug Subsidies	1 ST	2 ND	3 RD
Social Services Spending Per Capita	6 TH	4 TH	2 ND
Police Officers per 100,000 population	3 RD	9 TH	8 TH
Provincial Public Admin. Workers per 100,000 population	10 TH	8 TH	9 TH

As Table 2 shows, Ontario ranks in the top half of the country for just two of the 10 indicators. Furthermore, Ontario is ranked eighth or lower for half of the indicators. In Alberta, the situation is similar. Alberta ranks in the top five for only three of the indicators, and it finishes eighth or lower for six indicators. British Columbia is in the top half of Confederation for four of the indicators, but it is either lowest or next-to-lowest for four others. The indicators we examined suggest that in a number of important respects, government service levels in these three provinces are far below what is provided in the have-not provinces they are subsidizing. A simple comparison between Quebec, the largest

recipient of equalization, and the three major providers of equalization and other transfers helps to clearly illustrate this point. Quebec is scheduled to receive almost \$8.4-billion in equalization transfers in 2009-2010. Its provincial government's activities are heavily subsidized by taxpayers in British Columbia, Alberta and Ontario, as major federal transfers made up 25 per cent of its provincial budget in 2008. As Table 3 shows, these transfers have allowed Quebec's government to provide substantially higher levels of government services to residents than the have provinces receive in a number of important areas of government activity.

Discussion Table 3: Selected government services in Quebec, Ontario, Alberta and British Columbia

(Most generous amounts/ratios in bold)

	Quebec	Ontario	Alberta	B.C.
Regulated child-care space for children under 5 years of age	25%	19.6%	17.4	18.3%
Elementary student-educator ratio	13.5	14.5	16.8	16.6
Average university tuition	\$2,167	\$5,643	\$5,361	\$5,040
Physicians per 100,000 population	217	176	197	199
Nurses per 100,000 population	717	633	715	619
Percentage of residents spending more than 1% of income on prescription drugs	28.7%	13.6%	17.4%	23.3%
Social services spending per capita	\$2,342	\$1,398	\$1,592	\$1,702

Table 3 shows that for six of these seven direct indicators of government service levels, Quebec residents receive substantially higher levels of service than Ontarians, Albertans and British Columbians. The equalization program was intended to ensure that have-not provinces are able to provide public services that are comparable to those of the have provinces. The data show that the result of equalization and other transfers has been to overshoot this objective by a wide margin. The average university tuition in Ontario is 260 per cent higher than it is in Quebec. Spending on social services per capita is 69 per cent higher in Quebec than in Ontario, and Quebec has 23 per cent more physicians as a proportion of population than Ontario does. While ensuring that poorer provinces have adequate public services is a reasonable goal, it is unreasonable to force Ontarians to subsidize levels of government services in Quebec that are far beyond what their own government provides.

Table 4 similarly shows that among the three Prairie provinces, the province that receives large-scale equalization payments—Manitoba—tends to provide more extensive government services than the two Prairie provinces that pay into equalization—Alberta and Saskatchewan. For five of these seven direct indicators of government service levels, Manitoba residents receive higher levels of government services than their neighbours in Saskatchewan and Alberta. This example further demonstrates that the equalization program does not merely allow have-not provinces to provide comparable public services to other provinces, but that the program actively encourages government spending, and results in the subsidization of government services at levels that are beyond what is received by residents of the paying provinces.

Discussion Table 4: Selected government services in the prairie provinces

(Most generous amounts/ratios in **bold**)

	Manitoba	Saskatchewan	Alberta
Regulated child-care space for children under 5 years of age	20.6%	9.1%	17.4
Elementary student-educator ratio	14.2	14.6	16.8
Average university tuition	\$3,276	\$5,015	\$5,361
Physicians per 100,000 population	177	163	197
Nurses per 100,000 population	793	778	715
Percentage of residents spending more than 1% of income on prescription drugs	27.8%	30.5%	17.4%
Social services spending per capita	\$1,619	\$1,267	\$1,592

Recommendations

Freeze equalization spending

The data presented in this report show that, in many important ways, residents of the have provinces of British Columbia, Alberta and Ontario receive lower levels of government services than do taxpayers in the have-not provinces whose government activities they subsidize. This is inequitable for taxpayers in the provinces that are the major financial contributors to Confederation. What makes the situation particularly troubling is that equalization payments to many of the have-not provinces have grown quickly over the past few years. In fact, equalization payments to Quebec have increased by 74 per cent since fiscal year 2005-2006. Equalization payments to Manitoba have increased 29 per cent during this period, and payments to New Brunswick have increased by 25 per cent.

Considering that these provinces are already providing more-extensive government services than British Columbia, Alberta and Ontario in several key areas, continued growth in equalization payments should not be permitted in coming years. This is particularly important because of the severe economic slump in which Ontario is mired.

The long-term objective of government policy should be to eliminate the equalization program altogether. As a short-term measure, provincial equalization receipts should be immediately frozen at the 2009-2010 levels in order to protect taxpayers in paying provinces.

In the medium-term, the government's objective should be to reduce equalization payments to the provinces and, in the long-term, to eliminate such payments. As an immediate first step, however, the federal government should clearly signal that to receiving provinces that there will be no further increases in future years by enacting legislation that prohibits further equalization program growth in coming years.

Long-term, the federal government should end equalization and other transfer programs and in exchange give up tax room to the provinces in order to end transfers between the two levels of government.

The big picture

Equalization is merely one part of a broader problem with the way provincial government activities are funded in Canada. Instead of raising money directly for all of their activities, provincial governments in all provinces rely on several large, annual cash transfers from the federal government to fund a significant portion of their activities. In the have-not provinces, federal transfers make up a huge part of provincial budgets. In Quebec and Manitoba, about 25 per cent of provincial government revenue comes from major federal transfers. In the have-not Maritime provinces, the situation is even more extreme, as federal transfers make up about one-third of provincial revenue. In the have provinces, major federal transfers make up between eight and 16 per cent of provincial revenue.

This situation, particularly in the have-not provinces, is a disaster from the point of view of democratic accountability. With a significant portion of tax revenue collected by the federal government and then redistributed to the provinces according to complicated funding schemes, it is difficult for voters to know who to hold accountable when they are unhappy with provincial government services.

From the perspective of accountability, it is ideal for each level of government to raise the necessary revenue to provide the services for which it is responsible. This makes it easier for voters to monitor the performance of politicians at each level, and it eliminates the incentive for excessive government spending that is created when one province can force taxpayers in other regions to pay for some of the services the province provides.

These problems can be resolved by eliminating or at least dramatically reducing the size of the federal transfer programs. The federal government should accompany the reduction in spending on these programs with a commensurate reduction in federal tax rates. These steps would permit the provinces, if they so choose, to replace the lost revenue from federal transfers by increasing provincial taxes. Since higher provincial taxes would be replacing lower federal taxes, the tax burden on individuals and businesses would not be increased.

This policy would prevent politicians in one province from passing the costs of government spending on to taxpayers elsewhere, while improving the ability of voters to monitor the performance of provincial politicians. This reform would dramatically improve democratic accountability in Canada, particularly at the provincial government level, and it should be the ultimate objective of government policy in this area.

Report conclusion

The equalization program is intended to ensure a comparable level of government services in the 10 Canadian provinces. By transferring money to the governments of poorer provinces, where it is more difficult to raise tax revenue, the program seeks to ensure that every Canadian province is able to provide high-quality government services.

This well-intentioned program has a number of adverse, unintended consequences. It subverts democratic accountability and provides an incentive for have-not provinces to spend more freely on government programs than they would if taxpayers elsewhere were not being forced to pick up part of the tab.

In receipt of huge equalization transfers and facing an incentive toward bigger government, the have-not governments tend to spend freely in a number of areas. This leads to two distinct consequences that are troubling from the perspective of the paying provinces: the inefficient use of funds and the delivery of higher levels of government services than exist in the have provinces.

Significantly higher levels of public administration employment in the have-not provinces suggest that some portion of equalization transfers might be absorbed by the bureaucracy in the form of increased hiring in the public sector.

The data presented in this paper, however, suggest that another consequence of equalization is that have-not provinces use some of the money they receive to provide levels of government services that are actually significantly higher than what is being delivered to residents of have provinces. The have-not provinces have lower university tuitions, smaller student-educator ratios and more regulated daycare spots than do have provinces. In the area of health care, the recipient provinces have more doctors, more nurses and more residential-care beds per capita than do the paying provinces.

The current situation in which taxpayers in the traditional and largest have provinces, especially British Columbia, Alberta and Ontario, subsidize levels of government services that are higher than what they receive is inequitable. It is a direct consequence of an equalization program that allows recipient provinces to not economize—on the size of their bureaucracies or in salaries and benefits or between targeted subsidies and unnecessary, unfocused subsidies (daycare in Quebec being perhaps the prime example).

The current system is broken and the equalization program should be abolished or dramatically reformed to reduce the adverse, unintended consequences that the equalization program creates.

Endnotes

1. Brian Lee Crowley, "Good Intentions are not enough," Atlantic Institute for Market Studies, December 2001. Available online: <http://www.aims.ca/equalization.asp?typeID=3&id=355>
2. David MacKinnon, "Ontario, Alberta and Nine Fiscal Dependencies in a time of Crisis," January 2009. Available online: <http://www.davidmackinnon.ca/westtripjan09.pdf>
3. Institute for Sustainable Energy, Environment and the Economy, "Energy, Fiscal Balances, and National Sharing," November 2005. Available online: http://www.iseee.ca/iseee/whatsnew/nov18_2005
4. It should be noted that Quebec charges out-of-province students substantially higher tuition rates than it does its own residents. This means that prospective students in other provinces cannot simply enrol in Quebec universities and take full advantage of these subsidies.
5. Healthy Development Measurement Tool, "Public Infrastructure/Access to Goods and Services." Available online: <http://www.thehdmtool.org/indicators/view/111>
6. Healthy Development Measurement Tool, "Public Infrastructure/Access to Goods and Services." Available online: <http://www.thehdmtool.org/indicators/view/111>.

Further Reading



July 2006

Frontier Centre for Public Policy and the
Atlantic Institute for Market Studies

Do We Over-Equalize?

<http://www.fcpp.org/publication.php/1452>



July 2006

Frontier Centre for Public Policy and the
Atlantic Institute for Market Studies

The Flypaper Effect

<http://www.fcpp.org/publication.php/1451>

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