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Notes for Speech by Prof. David C. MacKinnon

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1 I'd like to start by warning you that my subject today is a difficult one.

Regional subsidies, including equalization, are portrayed by many as one of the foundations of Confederation.

I will be arguing that they are both counterproductive and unprincipled and that Canada's competitive position in the world and possibly its unity depend on changing them.

2 It is important to note, first, that even though Ontario is receiving equalization payments, its taxpayers are still spending, according to the Drummond Report, about \$12 billion to support other province's programs - programs that are more accessible elsewhere than in this province.

Ontario taxpayers contribute twice as much as they receive from equalization.

They are contributing about \$1 billion a month or about \$50 million every working day toward these programs.

I will return to that theme later.

3 I'd like to deal first with what I will call the myths associated with the current system and then devote the largest part of my remarks to the consequences of these myths for Canadians and the politics of actually changing.

4 The first myth is that equalization, the largest regional subsidy program, is required by the constitution. Federal leaders and Premiers from recipient provinces have often said this.

Put simply, it isn't true.

The constitution requires a commitment in principle to equalization, whatever that means, and I'll leave it to the lawyers in the room to decipher that.

The commitment, whatever it is, can be fulfilled at any significant level of funding rather than the \$15 billion that is currently being spent each year.

5 The second myth is that the federal government is managing the bundle of regional subsidies it offers in a competent way.

It isn't.

At no time has the Government of Canada ever done an analysis of the economic impact of its regional subsidy effort on Canada, recipient provinces or the major contributors, Ontario and Alberta.

This has had tragic consequences and I'll describe them later.

The goal for equalization described in the constitution is comparability of programs among provinces.

The federal government doesn't even bother to measure comparability which means it isn't managing the program.

One can't really manage what one doesn't measure.

6 The third myth is that there is no equalization outside equalization.

This has never been true.

For many years, the Canada Health Transfer and the Canada Social Transfer had strong biases against Ontario and Alberta. While these have been eliminated in the last few years, they were in place for decades.

Today, there are powerful regional biases in the EI program, smaller programs such as airport management and many others that have never been tabulated.

The second biggest equalization activity of the federal government is wildly disproportionate federal employment in recipient jurisdictions. This is worth \$1 billion annually in Nova Scotia alone.

Governments can never get this perfect. The navy, for example, must be in Halifax.

We are, however, far from perfect. Every major city in recipient provinces has wildly disproportionate federal employment compared to Ontario cities.

For example, there are twice as many federal bureaucrats in PEI in relation to population than there are in Ontario, even though PEI is the easiest province in which to deliver programs and Ontario has the national capital.

Equalization outside equalization may be almost as large as equalization but is hidden from the public and indeed from federal legislators themselves.

7 The fourth myth is that recipient jurisdictions need help to bring their programming up to the national average.

This is nonsense.

Ontario has the least accessible provincial programming, as several think tanks and the Ontario Chamber of commerce have noted. These deficiencies are especially evident in post secondary education and health, two areas of vital significance.

The public sector wealth that is apparent in all recipient provinces is especially evident in my native province, Prince Edward Island. PEI has 50% more nurses in relation to population as Ontario, university funding that is 28% higher than in Ontario and twice as many long term care spaces as Ontario in relation to population.

PEI also has, believe it or not, three times as many provincial bureaucrats in relation to population as Ontario

The same issues are evident across all aspects of public administration and in all recipient provinces.

This is robbing Peter to pay Paul so that Paul can live better than Peter and it is tragic that it has gone on for so long.

It has been especially tragic for the people of Ontario.

They have been failed by their federal legislators over decades as they acquiesced in federal subsidy arrangements without any real understanding of them.

I will return to that point later.

8 The last myth I will deal with is population need.

One would naturally expect a program this big would be based on some assessment of the actual needs of the populations in each province.

It isn't.

Demographics, urbanization, the nature of labor markets, price levels, population dispersion and all the other factors that gives reality to everyday life are not considered by the government of Canada in equalization or the other programs that deliver regional subsidies.

Amazing.

10 I'd now like to describe the consequences of this system.

There are many, but I'd summarize them by saying that regional subsidies have produced five Greeces and have ensured a bleak future for Ontario, the home of 37% of all Canadians.

This means that Canada will not be able to compete in the demanding world of the twenty first century.

I'll deal with the provinces that are like Greece first.

In recent years, Greece has become a byword for a bloated public sector.

To some extent, this is not entirely justified but there is no doubt their public sector is bigger than most OECD countries.

According to the OECD, employment in Greece's public sector, including government corporations, is about 20% of that country's labor force.

The corresponding figures (derived from Statistics Canada data) for recipient jurisdictions in Canada are, however, much higher than this. They are:

PEI	23.4%
Nova Scotia	25.5%
New Brunswick	23.1%
Quebec	24.4%
Manitoba	26.1%

In Ontario, 18% of the labor force is employed in the public sector. Fifteen percent of employed Albertans are in the public sector and the corresponding figure for British Columbia is 16.5%.

International comparisons are always difficult but data from local studies supports these observations on the excessive scale of government in recipient provinces.

The Atlantic Institute for Market Studies has demonstrated that much of the subsidy money has been used to fund public services in recipient jurisdictions that are much larger, in relation to population, than in contributing provinces.

The Frontier Centre For Public Policy estimates that Manitoba would have to shed 40,000 jobs, mostly in Winnipeg, if it operated its public sector at Ontario standards.

The problem of disproportionate public sectors is a terrible shadow over our future.

The economies of Manitoba, Quebec, New Brunswick, PEI and Nova Scotia are all driven to a remarkable extent by their public sectors but we live in a market driven world lead by the private sector.

Consequently all these jurisdictions are uncompetitive.

The problem is getting worse.

Over the past decade, all recipient jurisdictions - including Quebec - have become much more dependent on taxpayers in contributing jurisdictions.

11 The impact on Ontario and its citizens of this system is more difficult to judge because, with few exceptions, successive governments in Ontario have neither researched nor understood it.

The Ontario Government has never been and is not now in a position to properly inform citizens of the scale of the problem or its consequences.

However, the Ontario Chamber of Commerce, the Mowat Center at the University of Toronto and the Drummond report have all drawn attention to how serious they are.

I'd like you to go into their websites and inform yourselves.

One could look at the impact on Ontario in another way.

For the past fifty years, Ontarians have been required to contribute about 4% of their Gross Provincial Product to supporting other jurisdictions with much more accessible public services than are available here.

This is roughly the share of output the US has spent on defence, even while it was fighting wars in Afghanistan and Iraq.

Many observers feel that level of defence spending cannot be sustained by the people of the United States.

Viewed from this perspective, the impact of the regional subsidy effort on Ontario is like fighting a fifty year war.

It is exhausting, draining, wearing and discouraging.

Most people my age who remember Ontario as it was fifty years ago will not find those adjectives excessive.

12 Even more seriously, the presence of this system enables recipient jurisdictions to act in very perverse ways.

Quebec and Manitoba, for example, subsidize the consumption of electricity, something they certainly could not afford to do unless other Canadians were paying part of the freight through equalization and other regional subsidies.

Can you imagine?

In a world where energy conservation is very important, you and I and all other Canadians are subsidizing energy consumption because we are writing large cheques to some provinces that pursue such policies.

Nova Scotia has just decided to provide \$156 million to support a paper mill in Port Hawksbury and the 330 people employed in the plant.

Several hundred indirect jobs are also related to this facility

The Globe and Mail notes that this is roughly equivalent to the entire wage bill for the plant for ten years - and this coming from a small province with a \$250 million deficit that depends on Canadians elsewhere to partially fund its activities.

Nova Scotia has a long history of industrial boondoggles going back to the several billion - I said billion - that was spent to keep Sydney Steel alive at time when the only practical policy was to let it die because it couldn't compete.

Each of us in this room is a contributor to this new boondogle and by our silence, we and our provincial government are enablers of it.

Nova Scotia's boondoggles are made much easier by the fact that they are paid for in part by funds coming from other Canadians.

13 The perverse behavior problem may go far deeper.

We need to understand that the regional subsidy system may be an enabler of Quebec separatism rather than a bulwark against it.

Separatist behavior is encouraged by the extent to which Quebec is protected from the financial and economic consequences of the actions it takes.

The province is protected in two ways:

-it has an implicit guarantee on all its debt outstanding because the federal government could never let a provincial government default and market players know this;

-it is very generously funded by the rest of Canada, something most of its citizens know little about.

On the assumption, explained previously, that equalization outside of equalization could be as generous as equalization, Quebec receives an annual subsidy from the rest of Canada that could be as high as \$16 billion or about 5% of its GPP.

This is a huge amount that suggests that the financial and economic consequences of separatist thinking are greatly muted by torrents of money and the implicit debt guarantee.

Successive referendums, for example, can be threatened without riling bond markets.

If economic development is slowed by policies which isolate the province from English, the global language of business, the consequences are lessened by federal subsidies which increase as Quebec's development, relative to the rest of Canada, slows.

If the Quebec government raises income taxes and damages investment, the resulting slower growth will trigger additional federal transfers.

In other words, we reward incompetent policy making in Quebec and elsewhere.



Quebec's dependence on the rest of Canada is likely to grow rapidly in future years unless the province opens itself to the world and implements more growth friendly policies.

Quebec faces the most significant debt and demographic problems of all provinces and its short term outlook is poor.

In the words of the conference Board of Canada in its September outlook, "Quebec faces a hard economic road ahead - much harder than the economic prospects for the Western provinces and even for Ontario".

14 The perverse behavior problem goes even further.

Experience in recipient jurisdictions suggests that federal subsidies are so large in different parts of the country that they discourage work.

Ganong's, a chocolate manufacturer in New Brunswick, has to import workers from Romania because local people choose not to work in the plant.

Prince Edward Island brings people from the Ukraine to work in fish plants, again because locals choose not to work in them.

Similar patterns are evident in the Nova Scotia Christmas tree industry.

In all three provinces, the official unemployment rate often exceeds 10%.

15 The risks associated with the regional subsidy system have been discussed by many commentators.

Most recently, David Dodge commented on them. He said:

"transfers can also play a counterproductive role if they act to mask inexorable structural change, delay necessary adaptation and create the illusion that the unsustainable can somehow be sustained indefinitely. Ultimately, they can destroy unity by creating resentment, disrespect and distrust".

We should pay attention to that comment.

16 So, what is to be done?

I think the most important thing is to recognize that this is not only a public policy problem. It is a leadership and governance issue first.

17 The fact that several hundred billion dollars can be spent over decades without any effort to understand its impact or to measure the effort against its target is outrageously deficient governance.

We probably wouldn't give foreign aid to any country that behaved that way.

At another level, creating dependence is one of the most definitive failures of governments because it disempowers people and makes them less likely to succeed.

We should be really troubled that successive federal governments have created dependent populations in five provinces with nearly one third of our population.

That approach is both unethical and corrosive of the future.

18 The leadership failure is deeper, however.

Successive federal governments have, as I noted earlier, acquiesced in the maintenance of this unsustainable system and have made no effort to understand its consequences.

Moreover, the same governments have made the system opaque and have hidden internal studies that would have helped public understanding of the problem.

19 Modern political leadership can be different.

Dove Sideman, a prominent American commentator, recently noted that:

"nothing inspires people more than the truth. Most leaders think that telling people the truth makes that leader vulnerable - either to the public or their opponents.

They are wrong.

The most important part of telling the truth is that it actually binds you to people...because when you trust people with the truth, they trust you back.

Obfuscation from leaders just gives citizens another problem - more haze - to sort through.

Trusting people with the truth is like giving them a solid floor. It compels action.

When you are anchored in shared truth, you start to solve problems together.

It's the beginning of coming up with a broader path"

20 If you were a Prime Minister or an Ontario Premier, how would you abandon command and control decision-making and apply this more contemporary approach?

What would you do?

- you would study every corner of the regional subsidy system and make the studies publicly available.

-you would throw the redacting pen away and make all past studies relating to the problem available.

-you would assess the many solutions which have been proposed for regional subsidy problems and make the results public also.

-most importantly, you would identify a combination of possible solutions - there is no single magic bullet - and advocate those where win-win solutions are possible. Fortunately there are some.

-you would give a voice to the future. None of our children and grandchildren want to live in a second rate country that tries to compete in the world with beggar-thy-neighbour policies that end up hurting everybody.

-you would stop kicking the problems of competitiveness and productivity down the road by maintaining the regional subsidy system.

The data strongly suggests that Canada cannot compete as long as the system remains in place because it dramatically reduces productivity in all regions.

-you would do all this very quickly.

20 I really hope this can happen but I wouldn't bet the store on it.

Ontario's federal legislators, with very few exceptions, are neither informed nor brave.

21 It is important, however, to be hopeful. All it takes is for one leader to emerge and light a spark to get this problem addressed.

22 I'll conclude with words from Thomas Friedman, one of the world's best known global commentators as he talks about the leadership and leaders that are necessary to solve difficult problems:

"You'd think one of them, just one, would seize the opportunity to enlist their people in the truth: about where they are, what they are capable of, what plan they need to get there and what they each need to contribute to get on that better path".

If that were to happen in relation to this problem, our collective future as Canadians would be immeasurably enhanced.

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