

Rotary Speech – Belleville Rotary Club

By David MacKinnon

February 1, 2010

Belleville, ON

Thank you for inviting me to speak today, and to tackle a taboo subject: how one of Canada's most sacred cows—regional subsidies—is, in fact, chewing up the country's economic foundations, national unity and future prospects.

Imagine for a moment that we could lay a satellite image of Halifax, Nova Scotia over the Belleville and Prince Edward County area and some parts of surrounding counties. We are talking about two roughly equivalent areas in terms of population. But if we compare the two regions in terms of resources funded by taxpayers, the differences are nothing short of amazing.

Halifax is home to no less than five of the eleven universities serving Nova Scotia's population of 850,000.

The lovely campuses of Dalhousie University and St. Mary's University, are both in Halifax. Just a mile apart, these two schools each offer a full MBA program—and this, in a metropolitan area of about 300,000 people. This is preposterous.

Here in Belleville, the closest universities are Trent, in Peterborough, and Queens, in Kingston, and they are very different places with little duplication in programs. They're also a two and a half-hour drive apart.

The same is true for health services: Halifax has seven major hospitals, one of which, IWK, is a university-accredited research centre. The entire region of Belleville, Prince Edward County and Trenton, more geographically spread out, has four hospital sites and one corporate structure.

Incidentally, Nova Scotia has no less than 32 public hospitals and Manitoba, with a population just over a million, has 70. This is both bad medicine and terrible finance. Even worse, my home province has eight hospitals to serve 140,000 people in a very compact geographical area.

So who is paying for the higher standard of services in Halifax and Manitoba and Prince Edward Island? Well—you are. Along with other taxpayers in Ontario, Alberta and other parts of Canada.

Supporting our most vulnerable populations is a long-held value. But there are very serious problems that arise when people are subsidizing a higher standard of services for others than they can afford for themselves. Both recipient and contributor are damaged.

Our system of regional subsidies, which many consider to be a key aspect of the Canadian federation, includes equalization and additional subsidies, embedded in other federal programs, that are as large as equalization. Ontario taxpayers have been subsidizing other Canadians since 1958 by of up to \$25 billion a year.

I have seen the system from both sides.

I grew up in Prince Edward Island. For several years, I served as Director of Planning and Economics for the Nova Scotia Department of Development. There, I saw the harmful effects of the system on receiving provinces.

On the other side, I've worked for many years in the Ontario public sector. The impact on the people of Ontario is nothing less than tragic.

It is very difficult to have an informed public debate on this system. Why? In part because governments in Ottawa and in Ontario have made decisions that are not based on rigorous analysis. To add insult to injury, much of they have said publicly about this is simply wrong.

A good example is the federal assertion that equalization is entrenched in the constitution.

In its present form, it is not.

What is entrenched is a very vague, and probably not legally enforceable commitment to the principle of making equalization payments. That commitment could be met with expenditures far below current levels and with different program designs.

Then there is the problem of understanding the impact of this system.

You may find this hard to believe, but neither the federal nor Ontario government has ever studied the economic impact of regional subsidies—even though taxpayers have spent the most part of a trillion dollars on them.

There has never been a public study of their impact on consumption, investment, productivity, and competitiveness or consumer well-being in contributing jurisdictions, on recipients or on Canada as a whole.

The subsidy system is needlessly incomprehensible.

It is always described in terms of complex formulas, arcane language and bureaucratic mumbo-jumbo.

The federal government never talks about the issue which should be at the heart of the system: what is the actual population need in each province or territory?

This is not mysterious. There are many credible ways to quantify population need to support funding decisions that reflect demographic, labour market, immigration and urbanization issues.

Australia uses just such a system.

But in our system, population need does not figure at all. We are subjected to mindless statistical formulas: the actual financial needs of provinces, given their particular circumstances, don't enter into it.

And to top it all off, our regional subsidy system has another black hole: unlike any reputable business or household budget, no one ever measures its largest component—the huge equalization program—against its stated goal of comparable levels of public services across Canada.

How can this be? The truly amazing simple fact is that there is no system in place to measure and compare programming from one province to another.

I'd like to ask you to reflect on what I've just said.

We have a system that does not reflect population need, is not measured against its principal goal, is provided by governments that have never studied its impact and which is not entrenched in the constitution in the way that the federal and recipient governments say it is.

Disinformation reigns supreme.

This is a major problem because this system is close to the heart of our federal structure.

I'd like to turn to that issue now, starting with the damage to receiving provinces.

As an Ontario audience, you may find my assertion that regional subsidies damage recipient jurisdictions odd. How, you might ask, can it be dangerous to be on the receiving end of tidal waves of money coming from other people?

Let me count the ways.

First, regional subsidies reduce the incentive to work.

Not long ago, I'm embarrassed to say, Prince Edward Island had to bring people from the Ukraine to operate fish plants at a time when the unemployment rate in the province was 11%.

Second, generous regional subsidies encourage people not to move.

The opposite approach – encouraging labour mobility – is one of the main reasons the United States has been more successful than we have in reducing regional economic disparities—even though it has no regional subsidy programs.

Third, as we saw in my earlier comparison between Halifax and your region, these subsidies have financed superior and more accessible services in recipient jurisdictions than in contributing ones. How can this be healthy?

Four, one of the most awful consequences of the system is the dependence it has created in some provinces.

In most recipient jurisdictions, about 60% of all output originates in the public sector. In my native province of P.E.I., it is much higher than that.

Federal transfers now account for about a third of all provincial expenditures in Manitoba and Atlantic Canada and about a quarter of expenditures in Quebec. By contrast, transfers account for about 17% of provincial expenditures in Ontario.

This means that receiving provinces depend on other Canadians for short-term economic stability and that their provincial governments are becoming more and more like large county administrations. This is the exact opposite of what the constitution intends – the clearest possible separation of powers between the provincial and federal levels of government.

This dependence has debased the political culture in recipient provinces—and in federal politics. There is now one dominant discourse: get more and more money from Ottawa—largely out of taxpayers in Ontario and Alberta but also from other Canadians.

A few days ago, Premier Ghiz of Prince Edward Island met with a federal Minister to express concern about static equalization payments.

Think about that: with all that has happened in the Alberta and Ontario economies in the past two years, one of the most heavily subsidized jurisdictions in the world wants more.

Regional subsidies are a slowly-unfolding financial and economic catastrophe. Unless we change them, Canada is marching towards industrial irrelevance.

The system is also toxic to our values.

Since childhood, we have been taught not to covet the property of our neighbours. And yet, one of the biggest federal programs actually encourages beggar-thy-neighbour policies because it takes from a large province with a provincial government with the lowest real income per capita, to support areas with more accessible services and much higher real provincial government incomes.

Surely we can do better than this. Shouldn't we expect more of ourselves? Can't we set a better example to other countries in the world?

This opaque and unfair system also discourages other values we all say we cherish, such as decency, integrity and stewardship.

Here is a tragic example from Quebec.

Decades ago, to maximize the take from other Canadians via the federal government, Quebec designated orphanages as mental care facilities because the federal government was more generous in funding mental health facilities than orphanages.

This meant labelling the children in these facilities as being slow and troubled, something not true in the overwhelming majority of cases.

The Globe and Mail recently reported that of the 4,000 children affected, only one has received a university degree in the years that have passed since.

This system also threatens accountability.

To implement equalization and other regional subsidies, the federal government has taken the position that it can operate in areas assigned to provinces under the constitution. This means that it is very hard to know who can be held to account in key areas of public policy—a huge problem, in my view.

In many of these areas, such as health and mass transit—to cite only two—this leads to confusion, conflict and delay whenever something needs to be done. The feds have the money, the provinces the accountability and the municipalities have to deal with the most intense public expectations. They rarely match up and everybody becomes accountable.

When everybody is responsible, nobody is.

The regional subsidy system also encourages debilitating self-satisfaction and complacency in those who can least afford it.

In Charlottetown, my home town, things look pretty good on the surface.

There are no mass layoffs, public services are much more accessible than in Belleville or Toronto, and a disproportionate number of citizens have gold-plated DB pensions because of the sheer size of government in the province. This acts as a built in stabilizer in economic downturns.

Well-paid civil servants are everywhere, including an entire Ministry of the federal government.

These circumstances obscure the fact that the private sector in PEI and other recipient jurisdictions is astonishingly small. The scale of government and its protective shelter from market realities are actually impeding any potentially enduring economic development but the surface prosperity hides all that.

Finally, we all value productivity, the sense that we are doing everything possible to contribute to our common welfare.

Unfortunately, however, there is evidence that regional subsidies actually contribute to our national productivity problems and may be their principal cause. In general, heavy federal subsidies and low output per person go together.

It is hard to see how Canada can achieve acceptable productivity levels if federal subsidies covering about one third of the population either cause low productivity or are inextricably associated with it.

Our expectations of ourselves should be much higher. We should develop our country on the reasonable values we say we support. There should be very little space between our aspirations and our practices.

The large gap that exists now is downright dangerous.

I'd now like to turn to Quebec because its perceived needs are at the heart of all this.

Is it possible that one reason that regional subsidies are so opaque is that they are not so much instruments of economic policy as they are incentives to keep Quebec in the federation? If so, the other recipient provinces are free riders.

The trouble with this is that easy incentives often lead to demands for more, and free riders are often irresponsible with public funds because they can afford to be.

It is also likely that federal regional subsidies have contributed to making Quebec the weakest large jurisdiction in North America, measured in terms of output per person, according to the Institute for Competitiveness and Prosperity at the University of Toronto.

They have probably damaged Quebec in the same way that they have impaired the economic performance of Manitoba and Atlantic Canada. The system is the same, even though regional subsidies are smaller in relation to the size of the economy in Quebec than in other receiving jurisdictions.

I have painted a very bleak picture here. But I am actually hopeful, because the good news is that there are several promising solutions to these problems. I won't be able to cover them in detail, but briefly, here are some ideas:

We could transfer the GST to provinces in return for an end to regional subsidies.

We could ensure that regional subsidies are removed from regular federal programs such as E.I.

We could follow Australia by adopting an equalization system so that the flow of funds reflects actual population need.

We could measure the comparability of provincial programming to ensure that people in contributing provinces are no longer subsidizing the services of recipients to a higher standard than their own.

There are other possible changes.

The impact of the very serious current recession makes it important that we make major changes soon, however.

In the past 18 months, the absurdity of the subsidy system has been starkly evident. Unemployment is now higher in the industrial cities of Ontario than it is in the cities of Atlantic Canada and Manitoba.

While the federal government has taken steps that are helpful to Ontario in the past year, such as support for the auto sector and the HST incentive, these are for the most part one-shot events. The underlying problem—the basic system I've described—remains intact.

I'd like to conclude with some observations about the politics of change.

Many observers have recently noted problems in the quality of Canadian democracy and the absence of important new ideas at the federal level.

These issues are especially evident in the management of the regional subsidy system.

Federal politicians don't even talk about it. They leave that to banks, distinguished academics, think tanks and even international organizations—who are talking about it.

Federal leaders don't talk about it because they feel they can't. Have you ever heard an Ontario Member of Parliament raise any of the issues I've discussed?

The greatest danger of all is this silence about a key national problem.

Personally, I hope that federal and provincial leaders will emerge who can move us forward.

In the last few days, Alberta's new Minister of Finance has taken this issue on. We can all hope he succeeds and that others emulate his courage on this issue

All Canadians will benefit from change of the type he is advocating for the transfer system.

If we follow a different path, Manitoba and Atlantic Canada will likely resume self-sustaining economic growth, after initial disruptions.

If we adopt approaches more compatible with the original bargain of Confederation, and end the federal intrusion into provincial responsibilities that inevitably comes with regional subsidies, we could begin to have a relationship with Quebec that would be based on common values and actions rather than financial self-interest.

Ontario could thrive, manufacturing new products and delivering new services, if its taxpayers didn't have to fund failed policies that support excess consumption elsewhere.

Western Canada would likely feel much more like a partner in our national dream if it did not need to fear that it will have to support everybody else through the transfer system.

There are directions for change and exciting possibilities for the future. But someone has to make sure they are always on the table, well researched and reflecting the broader national interest.

I hope you will stay tuned because I and several other concerned Ontarians are starting a new organization with these purposes in mind.

We have recently incorporated an organization called the Ontario Institute for Public Policy, and we are just starting our work.

We enjoy the support of the Frontier Centre for Public Policy in Winnipeg in establishing this organization. For now, our new organization is collaborating with the Frontier Centre on research work related to the issues I have spoken about today while we work to become a registered educational charity.

Thank you so much for the opportunity to see so many of the new neighbours my wife and I will have when we come to the **county in April**.