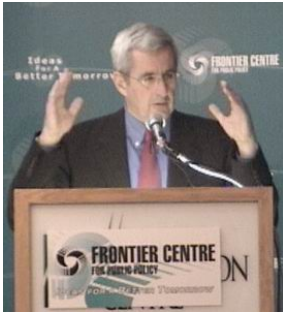


WITH David MacKinnon, Retired Ontario Public Servant and Critic of Regional Subsidies



David MacKinnon, a native of Prince Edward Island, was awarded a Bachelor of Arts degree (honours economics) from Dalhousie University and an MBA from York University. He was awarded a Centennial Fellowship by the Canadian Imperial Bank of Commerce and York University to study at York, Harvard and Oxford Universities as well as the European Institute of Business Studies. Mr. MacKinnon served as Director, Planning and Economics and Executive Director, Development Strategy in the Nova Scotia Department of Economic Development from 1976 to 1981. He later served in several senior capacities in the Ontario Public Service, the Bank of Montreal and as CEO of the Ontario Hospital Association from 1996 to 2003. Mr. MacKinnon is a Public Member of the Council of the Ontario College of Physicians and Surgeons and is the Chair of its Finance Committee and a member of its Executive, Complaints and Outreach committees. He serves on several Boards of Directors, including the West Park Health Centre. He recently finished my five year term on the Standards Council of Canada and was subsequently elected to the board of the Canadian Standards Association. He has advised the Ontario Chamber of Commerce and other Ontario organizations on fiscal federalism issues. David MacKinnon was interviewed prior to his Frontier speech on November 6, 2007.

Frontier Centre: Why do Canadians seem to like equalization as a concept?

David MacKinnon: Well they like equalization because there are some myths about it. The myths are equality and we're all the same and we all have equal rights and access and all those things appeal to people. None of them are true. But they are myths from our past that are associated with the program.

FC: So do Canadians understand the program?

DM: Few really understand equalization or the whole body of regional subsidies in place in Canada. The issue is not just about equalization. The federal government has a variety of regional subsidies that are huge that take place outside of equalization.

FC: Equalization is a federal program. So why do you say it's an Ontario issue?

DM: It's an Ontario issue because about 45 percent of all equalization is paid by Ontario taxpayers. I think they have a perfect right to have some understanding of what its been used for and whether the program is effective and builds regional opportunities. They are generating the money. They are entitled to know how it's being used. There is a reasonable expectation that their provincial government would be on top of and comment publicly on those issues.

FC: Why do you say Ontario can't afford it anymore?

DM: Like any manufacturing jurisdiction, Ontario is facing real challenges. Ontario has to compete with India and China. Its per capita income has been falling relative to the Canadian average for 15 years. It is about to fall below the Canadian average.

Ontario faces a huge challenge just to stay competitive. It would be far better for Canada if it could face that challenge without the burden of having to pay, in part, for government programming in six or seven other Canadian provinces.

It gets more complicated. All the evidence shows that the other jurisdictions have more real effective revenue per capita than Ontario and that the services in recipient provinces are more accessible to consumers than in Ontario. So what the Canadian system is really doing is asking the people of Ontario to pay nearly half the cost of subsidies which are going to people who already have more accessible services than Ontario and more real effective revenue. Not reasonable, not just and not effective.

FC: Why don't we hear about Ontario's challenge or position from Ontario's politicians?

DM: Well you do hear a fair bit. It's important that the rest of Canada understand that there have been two unanimous resolutions in the Ontario legislature expressing concern about the fiscal gap that the province has with the rest of Canada. I can't understand why that has not received more attention in Manitoba

and other recipient jurisdictions. Its as if Premiers Doer, Calvert, Williams and the others have decided to ignore this and hope it goes away. It won't.

FC: When were they passed?

DM: They were passed about two years ago. They have been followed up by quite an aggressive campaign by Mr. McGuinty. He also had a fiscal summit to talk about this issue and there's been extensive discussions with the federal government.

FC: Just to refresh things, what did the resolutions say?

DM: The resolution just expressed significant concern about the fiscal gap of about \$23 billion between what Ontario receives and what it pays.

FC: Places like Manitoba have highly funded services thanks to equalization. What's wrong with that?

DM: The problem is that the public sector in Manitoba is half again as big as it is in Ontario in relation to population.

All the evidence is that most public services are much more accessible to the Manitoba population than similar public services in Ontario to the Ontario population. So the people who already have less access to government programming are being asked - year by year - to provide Manitobans, who already have more effective real revenues per capita than Ontario, with additional funding. I think that is not only unfair but indecent. Nobody should thrive by weakening the neighbors.

FC: We talk in the public policy world about perverse incentives on the equalization file. Several prominent thinkers now say that equalization encourages dependency and policies that don't lend themselves to growth. Do you agree with that?

DM: Yes. I'm a Maritimer and I served as the senior Economist for the Nova Scotia government at the time these programs were being put in place. I and some of my colleagues and even some political leaders – Robert Stanfield comes to mind- were very concerned about it.

I believe that equalization and other regional subsidies have been the silent killers of opportunity in the provinces that received them. The problem is that so much money came in that more creative approaches to job generation were not tried, local wage rates were driven to national levels in economies that couldn't support them and the public sector infrastructure was built is to standards far beyond those in the rest of North America or the developed world.

I'd like to leave you with one example but I could give you ten. In the province I come from, for 140,000 people there are eight hospitals. Next door in Nova Scotia for 900,000 people there are 32 hospitals. That is two or three times the North American standard. In the city of Vaughn north of Toronto, there are no

hospitals to serve the local population of 250,000. This is awful medicine, awful finance and corrosive public policy.

FC: All the “have-not” provinces have comparatively large governments compared to Alberta and Ontario. Do you have some quick stats from Manitoba that suggests equalization just adds to the body count in the civil service?

DM: The body count in the civil service in Manitoba, not just the civil service but the whole broader public sector, is really quite remarkable. I'll give you the actual figures. For the total public sector in Manitoba there are 117 employees per thousand citizens. In Ontario, by contrast, there are 81 and in Alberta there are 83. I think that a province with such heavy overhead is going to have a very difficult time competing. The scale of government in Manitoba is probably 50 percent larger than it needs to be or should be.

FC: But why should they if there's easy money propping it up?

DM: That's the great danger. The Organization for Economic Development, the world's largest economic research organization drew this issue to our attention in its 2006 review. It noted that the tendency is for provinces to seek to negotiate more transfers from the federal government rather than to attack their real problems. Whenever a Maritime jurisdiction comes up against a real problem, the first thought that comes from its political leaders is how can we get more support from Ottawa – read largely Ontario and Alberta – to deal with it? And that is a tragedy.

FC: What is your view on the fiscal imbalance, as it's so called, and the governments ramping up transfers the way they have done?

DM: I think the federal government has still not come to understand that transfer payments destroy more economic opportunity than they create and that's true in all parts of Canada.

What we really have to do is find a way to explain to Canadians just how much harm is done in terms of bloated bureaucracies, lack of creative approaches to new problems and just plain old lack of momentum that regional subsidies such as equalization cause. The federal government has taken the lazy route by simply allocating significant amounts of money through equalization and other subsidies and hoping that the recipients will do something good with it. Well the hope is wrong. What recipient jurisdictions have done is simply build bigger bureaucracies, pay the people in them more and establish gold plated public services. In doing these things, they have rendered themselves uncompetitive.

FC: If you look at the numbers, federal spending has increased faster than the rate of economic growth for several years. Would you be in favour of some kind of law that would limit spending increases to growth in the economy, for example?

DM: With respect to the federal government, I think the most important thing is to stop the federal government from transferring money to it from taxpayers so that they in turn can transfer it back and spend in areas of provincial jurisdiction.

If you were from Mars and came to Canada and looked at our written Constitution, one of the first things you'd see is a division of powers – who does what. And unfortunately, the Government of Canada pays little or no attention to that and is active in a whole variety of areas that are, under the Constitution, provincial responsibilities. What that means for Ontario is that there's more opportunity to establish unfair subsidies.

It also means that no one is accountable. If the province and the federal government are both trashing around in the same area, tax payers have real difficulty of figuring out who really is accountable. And we all know the old adage, when everybody's accountable, nobody's accountable. That is a very serious problem associated with the entire Canadian transfer program.

FC: There have been signals in the recent Throne speech that the federal government is moving to restrict the federal spending power but we don't have any details. If you were to provide details what would they be?

DM: The main purpose for the federal equalization program is supposed to be comparability of programs and yet there's absolutely no system in place to measure the comparability of programs. This means that the tens of billions being spent on regional subsidies is ill informed. This is perhaps the major reason these programs have gone so far astray.

My advice would be either suspend these programs or cut them back until such a system can be put in place so the federal government can finally find out what, if anything, it is achieving through regional subsidies. After fifty years, its time they found this out.

FC: The politics of it are difficult so would you suggest then that they transfer tax points perhaps?

DM: I think the best choice would be to transfer part of the GST or part of some other tax and/or assume some provincial debt burdens and say we're out of the GST, we're going to assume some of the debt but no more transfers is the price and leave provinces to manage their own affairs in areas of provincial jurisdiction. That would be the best policy choice before us.

FC: Manitoba drastically under prices its electricity but still collects over \$1.8 billion in equalization. Some argue that below-market pricing electricity subsidy worth about \$1.2 billion a year should be deducted from Manitoba's equalization. That means it would get a little over \$600 million instead of \$1.8 billion. Do you think that makes sense?

DM: I can't imagine what's in the minds of Manitoba legislators, to be subsidizing electricity consumption in an age where we all know we need to consume less energy, not more. So what's behind this subsidy is completely opaque to me. But I don't think that the people of Ontario should in any respect be paying for it.

So yes, I think Manitoba should either get rid of those subsidies or failing that, they should be deducted from its equalization. And I mean deducted in total so that this totally unreasonable burden of paying for electrical subsidies in Manitoba does not fall, which it now does, on citizens all across Canada but especially those in Ontario. Also, why should Alberta, which charges the real price for its oil, be paying Manitoba to subsidize its price for hydro electricity?

FC: So how do you see things playing out, assuming Ontario says no more?

DM: As I've mentioned there have been two resolutions in the legislature expressing concern about this. The Premier called a summit on the fiscal gap which was held in the summer of 2006.

There are all kinds of reasons why the Government of Manitoba should be thinking very seriously about what it's going to do if and when the day comes when the people of Ontario and Alberta really say they cannot do this anymore or cannot do it to the same extent as at present.

At the moment, the short-term economic health of Manitoba is dependant on these transfers which are coming from one jurisdiction which is facing very serious competitive challenges and another jurisdiction, Alberta, which has to find massive amounts of capital to fund the many challenges stemming from growth.

As a matter of pure risk management, the political leaders of Manitoba should be seeking to reduce the take from those two jurisdictions and other Canadians, not increase it. If they don't seek to reduce it now, the change when it comes later will be all the more difficult and all the more challenging in terms of the short term issues facing the people of this province. In the medium and

long term they will be much better off without the subsidies but there's no doubt that sudden change in the short term would have drastic consequences indeed.

The goal of public policy in Manitoba should be to start shrinking its government and its public sector so that it needs less from others so that when the change comes it's less wrenching.

Also, when Mr. McGuinty discussed this issue with other Premiers, the Premier of Manitoba was quick to make continued subsidies from Ontario a national unity issue. He should avoid that at all costs. No one is questioning the issue of Canadian national unity.

Mr. McGuinty and his colleagues seem to me to be focused citizens of Canada and they have a perfect right to warn that the Canada of the future is going to have to be a Canada that is less dependent on subsidies from Ontario without having someone comment on their commitment to Canada.

FC: Isn't equalization entrenched in the Constitution?

DM: Equalization is entrenched in the Constitution but there's two issues to that. One is that it's not entrenched to any particular level and second, as I mentioned earlier, there is no measurement in place for the comparability of programs, the goal of equalization.

I can't imagine how a court could decide whether equalization is being practiced in accordance with the Constitutional provision without some measurements or metrics attached to its outcomes. And at the moment there are no such methods. Personally, if I were a lawyer I would be happy to walk into any court room to say that this program without measurements of comparability is not an equalization program at all. It's just a bunch of subsidies cobbled together to achieve an unmeasured purpose.

FC: We can see for example Saskatchewan challenging equalization based on the different treatment of oil versus electricity. But do you really think that Ontario would challenge equalization in court?

DM: No, I don't think a challenge is, at present, on the horizon but it is useful to remember that the most important court challenge relating to the federal spending power that is so tied to all this was a challenge from Ontario and it was successful.

I think that those who argue that equalization is constitutionally entrenched need to recognize that it's not entrenched at any particular level and also that since there's no measurement of whether we're achieving comparability of programs or not, the program is vulnerable. It's vulnerable to attack from auditors. It's vulnerable to attack in the courts. It's just unreasonable to have a program of several billion dollars aimed at a goal which isn't even measured.

FC: This is a lonely task, taking on the complexity of equalization. Why do you do this?

DM: I'm unusual in that I have served and worked in both worlds. I managed many of the Nova Scotia government's efforts on funding and I came to Ontario and did the same job there. That's when I became convinced of the profound unfairness of regional subsidies to the people of Alberta and Ontario who pay about 60% of the freight for them.

There's no reason whatsoever why a hard working manager of a retail store in a suburban strip mall in Toronto should be funding people in Manitoba who have access to more services and who benefit from Manitoba's better effective revenue position relative to Ontario.

Building a country on that kind of unfairness is not a sound policy. I do this, and I've done it for the better part of 15 years, because I believe that this system is profoundly unfair and there is a real human cost to the unfairness.

If we are to have a united and competitive Canada in the future we need to reduce and eliminate the corrosive regional subsidies to which more than half of Canadian provinces are addicted.