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## *Equalization, Ontario, and the politics of division*

by Mark Milke

### MAIN CONCLUSIONS

■ In 2008/09, the year before Ontario first received equalization payments from the federal government, “have-not” provinces (those that receive equalization) represented 32% of the ten province population. On the other side, then “have” provinces represented 68% of the population of the ten provinces.

■ A notable shift in the economic balance of the Canadian federation occurred in the fiscal year 2009/10 when Ontario became eligible for equalization. Ever since that year, a minority (29%) of Canadians have lived in provinces that do not receive equalization.

■ By 2011/12, Ontario, at \$39,273 household income per capita, the highest among “have-nots”, did better than the “have” provinces of

British Columbia, where household income per capita was \$38,463, and Newfoundland & Labrador, where household income per capita stood at just \$37,101. That the equalization program is ostensibly designed to “correct” for average lower revenues in poorer provinces (and not to take into account income measurements) does not make the practical real-world result any less odd.

■ By 2011/12, the four “have” provinces were rich in resource revenues relative to the six “have-not” provinces. This has relevance for future equalization debates given that in the past “have-not” provinces have demanded that more resource revenue be included in calculating the relative “richness” or “poorness” of provincial treasuries for the purposes of equalization payments.

## Introduction

Equalization is a federal transfer program that is explicitly designed to subsidize provinces with weak own-source revenues and to be politically unifying. However, the flip in Ontario's status from a "have" to a "have-not" province has had, and will continue to have, profound consequences for the country as a whole.

This essay focuses on three results that have evolved since 2008/09, the year before Ontario became a "have-not" province: First, Ontario's shift means the majority of Canada's population now live in equalization-receiving provinces; second, a "have-not" province (Ontario) has higher average living standards than two "have" provinces (British Columbia and Newfoundland & Labrador); third, all four remaining "have" provinces are relatively rich in resources while no other province is.

As part of an on-going equalization research program, this essay highlights the above three results of Ontario's "have-not" shift.<sup>1</sup>

## Equalization: Origin and description

Federal transfer payments date back to Confederation, though the start of equalization dates from a federal-provincial agreement in 1956 (Holden, 2006: 1) and the program was later entrenched in the 1982 constitution.

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<sup>1</sup> This is particularly important as the federal government has listed renewing equalization as one of its 2014/15 priorities (Canada, 2013e).

Equalization is an unconditional transfer of federal funds to provinces which are deemed eligible (Canada, 2013a and 2013b).<sup>2</sup>

Section 36(2) of the Constitution Act, 1982 states that equalization is meant to "provide reasonably comparable levels of public services at reasonably comparable levels of taxation" (Canada, undated). As the Federal Department of Finance notes, equalization is meant to address "fiscal disparities among provinces." Echoing the constitutional imperative, the department states that equalization exists to "enable less prosperous provincial governments to provide their residents with public services that are reasonably comparable to those in other provinces, at reasonably comparable levels of taxation" (Canada, 2013b).<sup>3</sup>

In addition to equalization payments, other major federal transfers exist—the Canada Health Transfer and the Canada Social Transfer (Canada, 2013a)—though they, unlike equalization, are not apportioned based on the relative strength in

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<sup>2</sup> Equalization payments are calculated based on a formula that measures a province's ability to raise revenues, its "fiscal capacity." Eligibility for equalization results when a province's fiscal capacity falls below the average fiscal capacity of all provinces known as the ten-province standard. Also, provinces eligible for equalization payments can choose to receive whichever amount turns out to be greater: that which results from fully excluding natural resource revenues, or that which results from excluding 50 percent of natural resource revenues (Canada, 2013b).

<sup>3</sup> Equalization's constitutional status leads some to assert the prospect for substantial reform to the program is difficult if not constitutionally out of reach. However, according to a 2006 paper published by the Fraser Institute that surveyed the views of constitutional scholars on this topic, the notion of an equalization program unable to be substantially reformed is severely overstated. See Kellock and LeRoy, 2006, for a full discussion of this topic.

own-source revenues but on a per capita basis. Some provinces also receive extra federal transfers for “offshore accords” and/or transfers from the Total Transfer Protection program, this is to avoid reductions in overall federal transfers (Canada, 2013c and 2013d), though those are not included in equalization calculations.<sup>4</sup>

## The situation in 2008/09 and in 2012/13

A comparison of equalization-receiving provinces (commonly referred to as “have-nots”) with those provinces that do not receive equalization (“haves”)<sup>5</sup> reveals a distinct shift in recent years. In 2008/09, just before Ontario became a “have-not” province, five provinces—Prince Edward Island, Nova Scotia, New Brunswick, Quebec, and Manitoba—all received equalization payments. Collectively, they represented 10.8 million people, or 32% of the population in the ten provinces. In 2008/09, the federal government spent \$13.5 billion in equalization payments to the five eligible provinces (Canada, 2013a).

On the other side, British Columbia, Alberta, Saskatchewan, Ontario, and Newfoundland &

Labrador, the then “have” provinces, represented 22.4 million people or 68% of the population in the ten provinces (Statistics Canada, 2013a; Canada, 2013a).

A notable shift in the economic balance of the Canadian federation occurred in the fiscal year 2009/10 when Ontario, which represented 38% of the Canadian economy and 39% of the Canadian population, became eligible for equalization. Put simply, in 2009/10, Ontario was deemed to be a “have-not” province (Statistics Canada, undated a and b; Canada, 2013a).

The addition of Ontario to equalization-receiving provinces<sup>6</sup> dramatically altered the equalization picture and the impact of this change should not be underestimated. The equalization program has changed from one where supported provinces had a minority of Canadians to the exact opposite: A majority of Canadians (71%) now live in provinces that receive equalization (figure 1).

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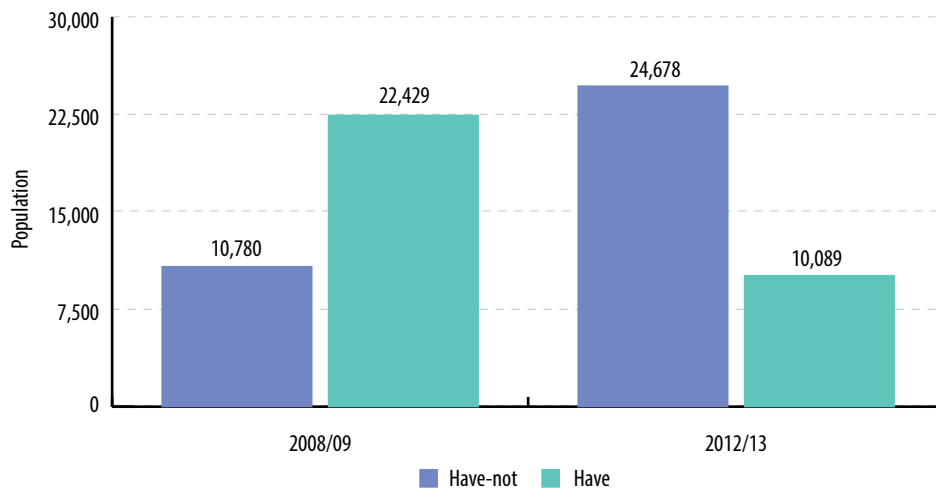
4 Ontario is a “have-not” province at present for the purposes of equalization (Canada, 2013a), but as another paper from this author notes, the province is still a net contributor to Confederation (Milke, 2013). That reality should be kept in mind but is peripheral to the discussion in this paper: Is equalization politically divisive and likely to be more so given Ontario’s status as a recipient of federal equalization funds? As elaborated on in this paper, I suggest the answer is yes.

5 Here “have” is simply shorthand for a province that does not receive federal equalization payments.

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6 Statistics Canada measures Canada’s population and household per capita income by calendar years (January 1 to December 31) while government fiscal years run from April 1 to March 31. To avoid confusing readers, this essay will refer only to fiscal years, even though the “population” count (and income measurements) technically falls into parts of two fiscal years. For example, a reference to 2012/13 will assume the 2012 population year, given that 2012/13 includes nine months of 2012 and just three months of 2013. One could perform calculations to arrive at an estimate of the “actual” 2012/13 population (i.e., the average of April 1, 2012 to March 31, 2013) but the difference would be negligible, and Statistics Canada anyway revises its own population estimates. Such an exercise here would add nothing in terms of additional precision.

**Figure 1: “Have-not” and “have” provinces\* comparisons on population, 2008/09 v. 2012/13 in '000**



Sources: Statistics Canada 2013a; \*Equalization calculation includes offshore agreements and Total Transfer Protection

## Higher-income Ontario as a “have-not”/ lower income BC and Newfoundland as “haves”

This paper does not probe the various reasons for Ontario’s decline instead it looks at the effect of such a decline on equalization.<sup>7</sup>

In 2008/09, equalization performed in the manner one would expect of a program designed to subsidize provincial governments based on fiscal capacity measurements: there were federal transfers to “have-not” provinces where lower per capita incomes<sup>8</sup> existed when contrasted with the “have” provinces.

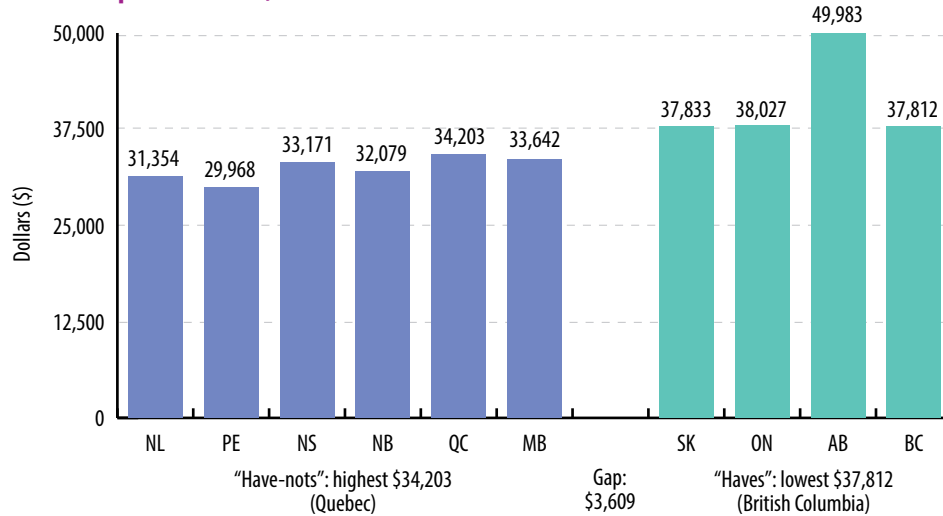
<sup>7</sup> More information on Ontario’s decline can be found in a series of essays on the matter, edited by my colleagues and released earlier this year, *The State of Ontario’s Indebtedness* (Clemens and Veldhuis, editors, 2013).

<sup>8</sup> Measured by household.

In 2008/09, there was a substantial gap between per capita income in the “have-nots” and the “have” provinces (figure 3). In that year, Quebec had a per capita income of \$34,203, the highest per capita income of “have-not” provinces. This income was \$3,609 less than the lowest province among “haves”—British Columbia at \$37,812 (Statistics Canada, 2013a and 2103b). In other words, in 2008/09, no recipient province had a higher per capita (household) income than a “have” province.

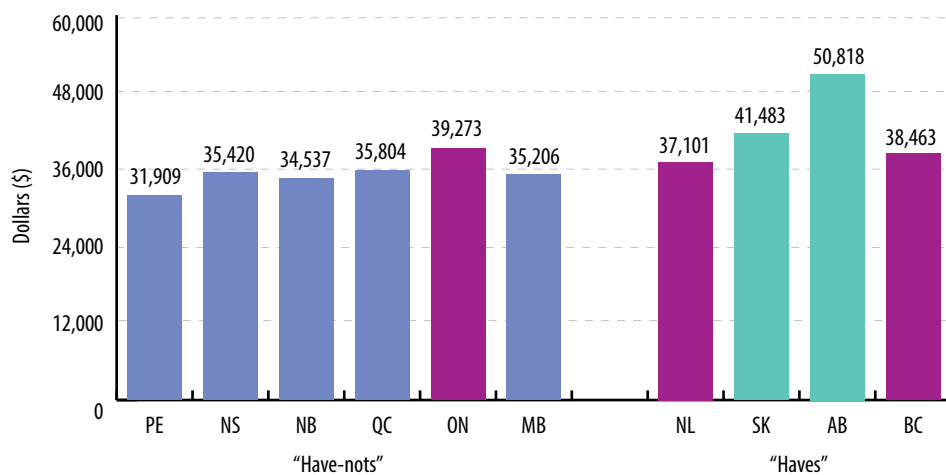
That dynamic has changed. In 2011/12 (the latest year for which this figure is available), Ontario—with the highest income per capita among “have-nots” at \$39,273—did better than British Columbia, the lowest income per capita “have” province, where the figure was \$38,463 (\$810 less than in Ontario). In addition, Ontario was doing better than another “have” province, Newfoundland & Labrador, where income per capita stood at just \$37,101 (\$2,172 less than Ontario) (figure 3) (Statistics Canada, 2013a and 2103b). Thus, by 2011/12, an

**Figure 2: Household income per capita, “have-not” and “have” provinces\*, 2008/09**



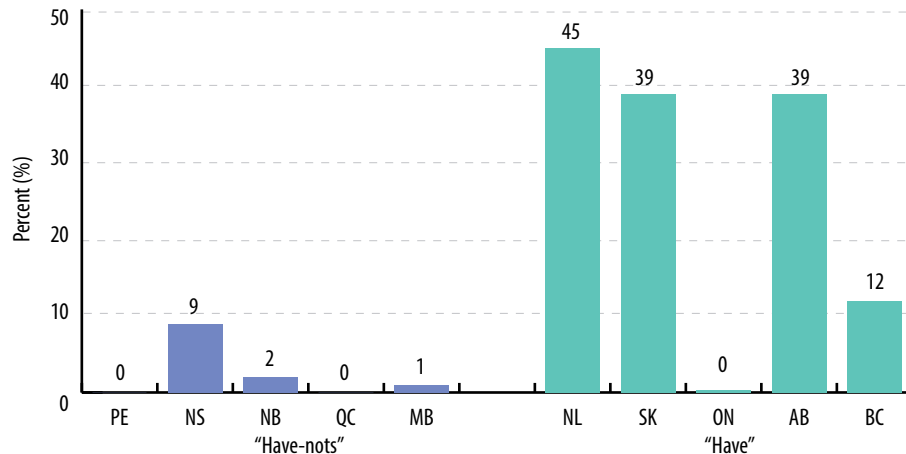
Sources: Statistics Canada 2013a and 2013b; \* Equalization calculations include offshore agreements and Total Transfer Protection.

**Figure 3: Household income per capita, “have-not” and “have” provinces\*, 2011/12**



Sources: Statistics Canada, 2013a and 2013b; \*Equalization calculations here include offshore agreements and Total Transfer Protection.

**Figure 4: Resource revenue as a % of total own-source revenues  
“have-not” versus “have” provinces\*, 2008/09**



Sources: Canada, 2012; Provincial public accounts & budgets; \*Equalization calculations here include offshore transfers and Total Transfer Protection

unusual development had taken place whereby Canada’s most populous province, Ontario, was now an equalization recipient. It was so even though the province was still technically richer in terms of income per capita when compared with British Columbia and Newfoundland & Labrador, two “have” provinces (figure 2 and figure 3).

## Rough seas ahead on equalization politics

The flip in Ontario’s status has led to a situation that has the potential to exacerbate provincial wrangling over equalization.

The exit of Ontario from “have” status means “have” and “have-not” provinces are now strictly divided between those that possess and/or develop their natural resources, and those that

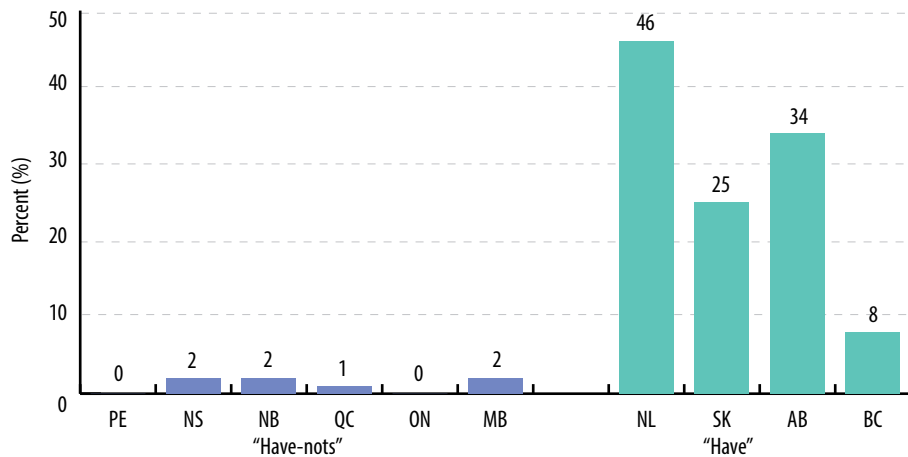
either do not possess much in the way of natural resources and/or choose not to more fully exploit them.<sup>9</sup>

To understand why this might be a problem, consider two final illustrations that highlight the “have-nots” and “haves” on this measurement. These two data sets, one from 2008/09 and the other from 2011/12, highlight how the provinces most likely to be “haves” are resource-rich provinces while equalization recipients are resource-poor, either by accident or choice.

In 2008/09, Prince Edward Island, Nova Scotia, New Brunswick, Quebec, and Manitoba all received equalization payments. On the other side, British Columbia, Alberta, Saskatchewan, Ontario,

<sup>9</sup> Quebec would be an example of a province that has chosen not to exploit its resources. It has been resistant to permit drilling for shale gas and the lucrative provincial revenues that might otherwise result (Quebec, 2013).

**Figure 5: Resource revenue as a % of total own-source revenues  
“have-not” versus “have” provinces\*, 2011/12**



Sources: Canada, 2012; Provincial public accounts & budgets; \*Equalization calculations here include offshore accords and Total Transfer Protection

and Newfoundland & Labrador, did not (Canada, 2012). Even then, a division was apparent: four of the five “have” provinces were rich in resource revenues relative to total own-source revenue (i.e., they—BC, Alberta, Saskatchewan and Newfoundland & Labrador—depended heavily on resource revenues). However, and in addition, such resource riches also set them apart relative to equalization recipients (figure 4).

The same pattern appeared in 2011/12 but with an increasingly stark divide after the disappearance of Ontario from the “have” category (several years previous). By 2011/12, all four remaining “have” provinces—and only those provinces—were rich in resource revenues relative to their respective total own-source revenues. Also, and critically for the purposes of political and public discussion about equalization, the four “have” provinces were also resource revenue-rich relative to the six “have-nots” (figure 5) (Canada, 2012 and 2013a).

In the past, there has been an effort to include 100% of resource revenues in the equalization

calculation formula, as opposed to 50% at present (Council of the Federation, 2006). It would come as little surprise then to see such attempts occur again in the future, especially as Ontario is now in the “have-not” category. That reality may portend future divisive debates over equalization.

Lastly, resource revenues divisions may not be the only factor in future equalization debates. The federal government has “capped” equalization growth, tying increases in program funding to the three-year moving average of gross domestic product (GDP) growth (Canada, 2013b). While desirable from a fiscal prudence point of view, the practical result is that if Ontario grows more slowly than other “have-not” provinces, it may take up an increasingly large share of existing equalization funds.

As it is, Ontario’s share of the federal equalization “pie” has already grown from \$347 million in 2009/10 to almost \$3.3 billion as of 2012/13, or from 2.4% to 21.1% of all equalization payments in those respective years (Canada,

2013a). It is not difficult to surmise that Ontario's crowding out of other provinces in the equalization program might lead to either: a demand to increase equalization funding and thus increase federal spending (de facto already occurring with "Total Transfer Protection" program that ensures provinces do not receive less in transfers from the federal government than in previous years); or political rancour among the provinces over the existing equalization "pie" (Canada, 2013c and 2013d).

## Conclusion

Equalization is a program that was explicitly designed to subsidize provinces with weak own-source revenues and to be politically unifying. However, the change in Ontario's status has had, and will continue to have, profound consequences for the country as a whole, including exacerbating any current divisions that exist. The change in Ontario's status is pregnant with potential for additional divisive debates over equalization; equalization itself is one program that has been materially affected by the relative decline in Ontario's economy.

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