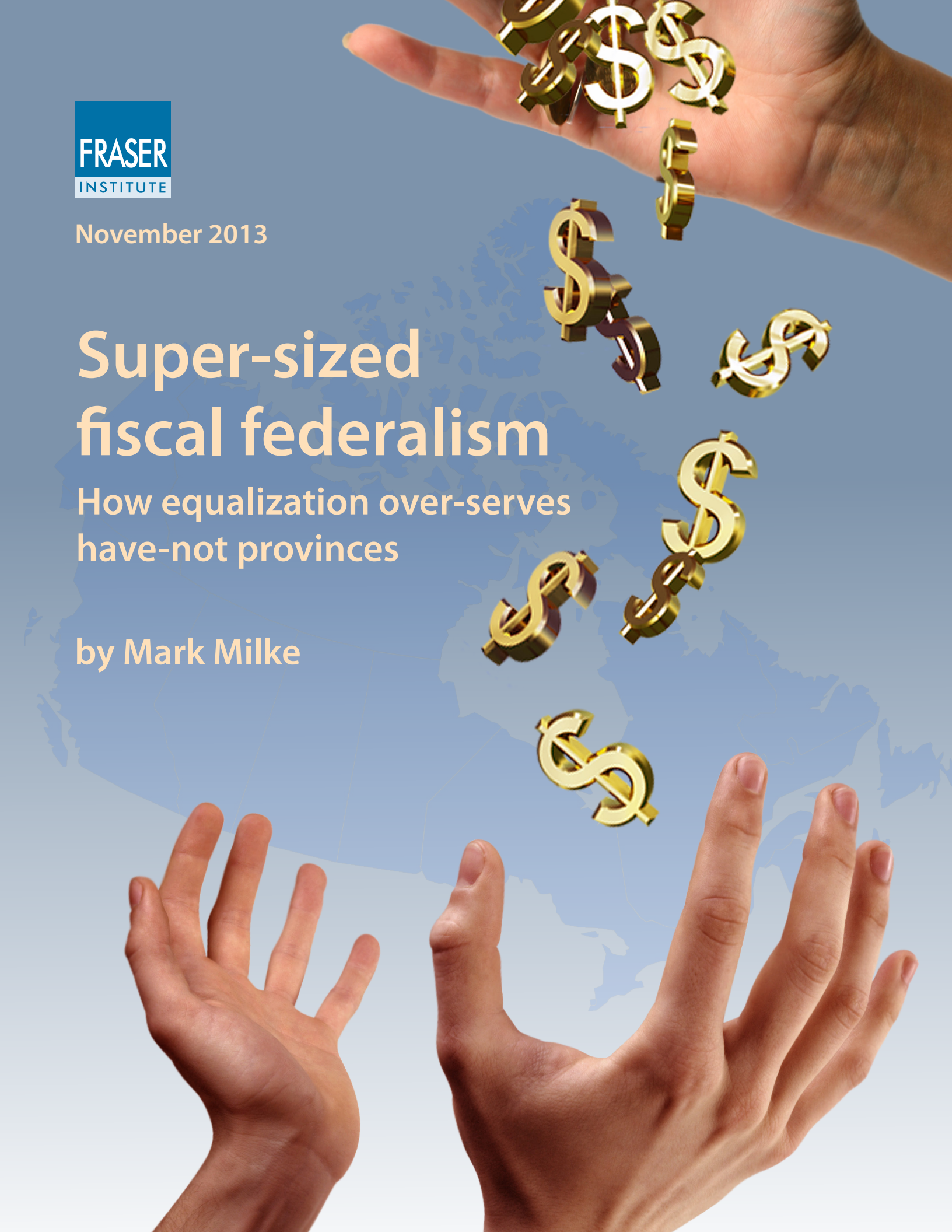


November 2013

Super-sized fiscal federalism

How equalization over-serves
have-not provinces

by Mark Milke



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“It is a sound principle of finance and a still sounder principle of government that those who have the duty of expending the revenue of a country should also be saddled with the responsibility of levying it and providing it.”

— Prime Minister Wilfrid Laurier, House of Commons, 1905, on the problem of transferring revenues between governments (Hamilton and Hutchinson, 1965: 219).

Executive summary

In 2012/13, the federal government's total transfers to the provinces amounted to \$60.1 billion, or \$1,725 per capita. This study examines one of those federal transfer programs, equalization. Equalization is an unconditional transfer of federal funds to provinces eligible for such payments; eligibility is determined based upon calculations of "fiscal capacity" (which is calculated based on a province's ability to raise its own revenues). In total, from 2005/06 to 2012/13 (the period covered by this study), the federal government has transferred \$107.5 billion in equalization, \$4.6 billion in offshore agreement payments, and almost \$2.2 billion in what is known as "total transfer protection" (the latter two are kinds of "equalization-plus" payments) to nine of Canada's ten provinces.

Equalization dollars, the additional payments, and other federal transfers originate in federal tax collections from taxpayers in all provinces and territories. Equalization is normally understood as a program that transfers income from taxpayers in "have" provinces to governments in the "have-not" provinces (though the language of "have" and "have-not" does not appear in the constitutional section on equalization); "have" and "have-not" simply refers to provinces that do not receive equalization or ones that do, respectively. Instead, the Section reads as follows:

Parliament and the government of Canada are committed to the principle of making equalization payments to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation.

In colloquial terms, some might characterize equalization as a federal transfer program that acts as "Robin Hood of redistribution, taking from taxpayers in rich provinces and redistributing such money (through the federal treasury) to provincial governments in poor provinces.

In theory, as Section 36(2) of the Constitution Act, 1982 states, equalization is meant to “provide reasonably comparable levels of public services at reasonably comparable levels of taxation.” To test this theory, this study’s main objective is to examine this question: Does the federal program actually provide “reasonably comparable levels of public services” across the provinces—or is some other outcome occurring?

Finding: Have-not provinces are “over-equalized”

To answer this question, the ten provinces were categorized based on their status as “giver” or “taker”, this based, in essence, on those provinces that received little or no equalization payments on a relative per capita basis in the 2005/06-2012/13 period, and those that received substantial per capita sums. Then, nineteen indicators were surveyed including health and education as well as protection of persons and property and general government functions. While additional indicators are available, the indicators chosen represent service levels in program areas, two of which—health care and education—account for roughly two-thirds of provincial program spending. Thus, this group provides a reasonable reflection of several main provincial government spending priorities.

Also, given that there is always the possibility of statistical or conceptual issues surrounding a particular measurement, a broad range of measurements were used. The results were as follows (table E1):

- ◆ The six “have-not” provinces (Manitoba, Quebec, New Brunswick, Nova Scotia, Prince Edward Island, and Newfoundland & Labrador) possess the advantage in thirteen categories.
- ◆ The four “have” provinces (British Columbia, Alberta, Saskatchewan, and Ontario) have an advantage in just three categories.
- ◆ Three categories are neutral, with no discernible advantage in have or have-not provinces.
- ◆ The data also reveal that: five of six “taking” provinces show a larger government relative to the economy when compared to all “giving” provinces. Quebec has a larger share of government than three of four giving provinces.

Implication and options for reform

In summary, in the have-not provinces, “free” money offers choices to recipient provinces (when compared with the giving provinces) that otherwise would not be possible, from public sector staffing levels to government spending as a larger share of the economy. The receiving provinces have an advantage, at least in part, because of the additional money that flows from equalization.

Table E1: “Advantage” and/or larger size of government

| | “Giving” provinces | “Taking” provinces |
|---|-----------------------|-----------------------|
| 1. Average public sector employment | | YES |
| 2. Average public sector employment, health and social service institutions | | YES |
| 3. Average public sector employment, universities, colleges, vocational, and trade institutions | | YES |
| 4. Average public sector employment, local school boards | | YES |
| 5. Average police employment | NEUTRAL | |
| 6. Number of physicians | | YES |
| 7. Proportion of households who have a regular family physician | | YES |
| 8. Total median patient wait (from referral from a GP to treatment) | YES | |
| 9. Regulated nurses workforce | | YES |
| 10. Difficulties accessing routine or on-going care, any time of day | YES | |
| 11. Hospital beds staffed and in operation | | YES |
| 12. CTs per million people | | YES |
| 13. MRIs per million people | NEUTRAL | |
| 14. Undergraduate tuition fees | | YES |
| 15. Public post-secondary enrollments | | YES |
| 16. Annual expenditures by post-secondary educational institutions | YES | |
| 17. Annual expenditure by K-12 educational institutions | NEUTRAL | |
| 18. Student to educator ratio | | YES |
| 19. Program spending as a % of GDP | | YES |
| Total “advantage” and/or larger size of government | 3 | 13 |

(3 NEUTRAL)

Sources: See citations for items 1 through 19.

Option one: Reduce transfer payments

On the expenditure side, one option is a reduction in the amounts disbursed by the federal government to the provinces as happened in the mid-1990s under Jean Chretien's government. Back then, federal transfers to other levels of government decreased from 3.8% of GDP in 1992/93 to 2.3% in 1997/98, or from \$26.5 billion to \$20.5 billion in nominal terms. A government could, today, enact similar reductions on the fiscal justification that existing transfers are over-equalizing and thus can be frozen or reduced. As noted in the addendum, there is no constitutional barrier to such an action.

Option two: Account for lower costs in have-not provinces

On the "input" side of equalization, for purposes of determining which provinces should be eligible for equalization and, if so, in what amounts, it might be useful to account for the various costs of providing services in one province when compared with another. Economist Dan Usher noted this possibility when he pointed out that if province A has double the income but its average price level is four times that of province B, A's standard of living is lower than that of B. This is a serious omission in most discussions of equalization reform. Absent any other or more dramatic reform of equalization, making allowances for the differing cost of services is worth including in any reform of equalization. It may be that some services are cheaper in have-not provinces, and is a useful question for further study. Of course, if that were found to be the case, it would call into question the practical usefulness of equalization: after all, if a province has a cheaper cost of "doing business," why would it need equalization dollars?

Introduction: Federal transfers

In Canada, federal transfer to the provinces are as old as Confederation, but not because the Fathers of Confederation desired such an outcome. At the time of Confederation, Canada's founders actually wished to avoid providing federal subsidies to the provinces. The conundrum was that the Dominion government did not care to risk the prospect of provincial tariffs on each other's goods (tariffs then being the main source of revenues for governments) and in so doing create trade barriers within the new country. Canada's Fathers of Confederation, thus, agreed on subsidies which at the time amounted to 80 cents for each person in each province. In addition, the provinces were given the power to tax directly (i.e., to tax personal incomes) even though they were not expected to use that option. Given the initial reluctance of the Dominion government to enact such subsidies, and the unlikely possibility provinces would tax personal incomes, the agreed-upon settlement was stated to be the "full and final" settlement of all claims by the provinces upon the new Dominion government (Moore and Perry, 1953: 6).

That hope by the Fathers of Confederation never held and, instead, provincial governments have continually sought ever-more fiscal transfers from the federal government. One hundred and forty-six years later, in 2012/13, the federal government's total transfers to the provinces amounted to \$61 billion, or \$1,725 per capita (Canada, 2013a).

Equalization in the context of fiscal federalism

This study will examine one of those post-Confederation transfer programs, equalization. The federal equalization program is anchored in Section 36(2) of the Constitution Act, 1982, whereby equalization is meant to "provide reasonably comparable levels of public services at reasonably comparable levels

of taxation” (Department of Justice, undated). The assumption inherent in that section is that some provinces are unable to raise sufficient revenues to fund public services to the same degree as other, presumably richer, provinces. As the Federal Department of Finance notes, equalization is meant to address “fiscal disparities among provinces.” Echoing the constitutional imperative, the department notes 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).

However, to examine that claim, this report poses two questions:

- ◆ Does the system of federal transfers “over-equalize” to the extent observable differences exist between provinces with regards to the levels of services provided?
- ◆ Do federal transfers allow for a larger size of government relative to provincial economies?

To answer those two queries, this study is organized in the following manner:

- ◆ First, it will survey the literature on equalization;
- ◆ Second it will explain equalization (and the offshore accords signed with Newfoundland & Labrador and Nova Scotia), including its origin and where equalization dollars end up;
- ◆ Third, it will place equalization in the wider context of fiscal federalism (i.e., when all federal revenues and transfers are considered, where do federal tax collections originate, flow to, and in what proportion in each province?);
- ◆ Fourth, it will investigate whether equalization succeeds in providing “reasonably comparable levels of public services” across the provinces, or whether some other result is occurring;
- ◆ Fifth, it will provide conclusions based on the data and two options for reform;
- ◆ Last, one addendum is provided that describes the constitutional status of equalization and the myth that little can be done to reform the program as a result of such status. As will be noted in more detail, the fact that equalization is mentioned in the constitution is largely irrelevant to

possible reforms. Equalization payments can be frozen or reduced as they were in the 1990s, or the program itself can be significantly changed. In particular, it is critical to know that equalization is likely non-enforceable and non-judicial, this according to some of the most eminent and widely publicized constitutional scholars.

Part 1: Equalization in the literature

Equalization has been widely studied from a variety of angles, some generally or firmly supportive of equalization with others in the opposite “camp.” Paul Boothe and Derek Hermanutz found that equalization hindered economic development in less well-off parts of Canada and that equalization blurred accountability, as Canadians did not know “which level of government to hold responsible for the taxes they pay and the programs they receive” (Boothe and Hermanutz, 1999: 6). Leonard Wilson (2003) found equalization might improve efficiency despite the program’s costs. Robin W. Boadway and Masayoshi Hayashi (2004) found that the equalization system can actually destabilize provincial revenues. Alex MacNevin (2004) examined alternative approaches proposed for measuring a region’s fiscal capacity. In 2006, former Saskatchewan NDP Finance Minister Janice MacKinnon argued that redistributing resources from richer to poorer provinces with the goal of ensuring some comparability in the services was a “noble goal” but that such an end “should not be achieved at the expense of Canada’s two wealthiest provinces, Ontario and Alberta.”

Dan Usher (2007) analyzed the mandate for equalization payments in the constitution and asserted that a proper reading would allow for direct provincial transfers from richer provinces to poorer ones. Jason Clemens and Niels Veldhuis (2007) edited a series of essays on broadening the analyses of federal transfer programs. The various authors considered: the levels of provincial dependence on federal transfers, claims of fiscal imbalances, undermining of rules in the equalization framework, the program’s constitutional status, and principles for reform. Samira Bakhshi and Mohammad Shakeri et al. (2009) assessed federal equalization for effects on interprovincial migration. Daniel Beland and Andre Lecours (2010) noted that relatively few scholars have paid systematic attention to the political dimensions of Canada’s federal equalization program and why equalization policy has provoked interprovincial conflict.

David Albouy (2012) found that Canadian equalization policy appears “neither efficient nor equitable, but exacerbates pre-existing inefficiencies and underfunds minorities.” Benoit Tarrow (2012) compared the distributions of private and public goods before and after equalization payments. He found “for most scenarios, equalization transfers have an ambiguous normative impact on the distribution of well-being among Canadians and that, for some scenarios, equalization transfers actually worsen this distribution of well-being.” Melville McMillan (2012) looked at whether there are unintended consequences to equalization, concluded that there are few and that it is surprising that equalization has attracted criticism as of late. McMillan also asserted that equalization results in both equity and efficiency benefits.

The question of “over-equalization”

Despite the plethora of studies on equalization only a few have asked what should be an obvious question: Given the stated purpose of equalization in the constitution—to “provide reasonably comparable levels of public services at reasonably comparable levels of taxation”—does equalization succeed in the program’s stated endeavour? Or does it fail to meet such an end? Or does equalization produce some other effect?

A few attempts have been made to answer such queries. In 1998, Finn Poschmann analyzed all federal transfers and spending and found that the federal government collects taxes from low-income Canadians in high-income provinces in part to fund transfers to higher-income residents of poorer provinces. “In a nutshell, poor people in richer provinces commonly subsidize the living standard of people who are better off but happen to live in poorer provinces,” wrote Poschmann, one of the first to ask if federal transfers over-equalized provinces or, in this case, over-equalized families (Poschmann, 1998: 4 and 26). In 2000, Fred McMahon examined government transfers to Atlantic Canada and labour market policy and found, in addition to other negative consequences, massive transfers to the region from elsewhere provided “an incentive for provincial governments to keep their spending high (McMahon, 2000: 27). McMahon also noted how the combination of labour market policy and “rapidly increasing government spending” pushed wages higher with no relation to the local economy, thus creating higher unemployment and also a higher cost of government” (2000: 104-106).

In a 2010 co-authored paper Ben Eisen and this author attempted to see if significant, unintended consequences of equalization exist, most notably, if over-equalization exists; we found have-not provinces often had an advantage in terms of services provided ranging from nurses and doctors per capita to the availability of residential care beds. Similarly, and more

recently, in 2011, David MacKinnon, for the Ontario Chamber of Commerce found Ontario lagged in a significant number of indicators vis-à-vis poorer provinces on items mostly paid for by taxpayers. Areas included how, per capita, equalization-receiving provinces generally had more nurses, child-care spaces, and more residential beds. His study also found equalization-receiving provinces such as Nova Scotia and New Brunswick possessed a large number of colleges and universities relative to their population when compared with Ontario. MacKinnon interpreted the latter finding as one sign of a larger-than-necessary public sector in the two noted Atlantic provinces (MacKinnon, 2011: 10-13).¹

1 This report does not delve into the question of whether some provinces have lower fiscal capabilities in part because of anti-prosperity policies. For example, British Columbia and Alberta allow significant natural gas exploration and Quebec does not, which has consequences for the bottom line of all provincial budgets. While I do not explore what is a self-handicapping approach to a province's own fiscal capacity, such actions deserve further study, given the very justification for equalization is that some provinces lack sufficient own-source revenues.

Part 2: What is equalization and how is it calculated?

Equalization is only one of several main federal transfer payment programs to Canada's provinces and territories.² It dates from a 1956 federal-provincial agreement (McMahon, 2000: 13) and only later was entrenched in the constitution, in 1982. Equalization is an unconditional transfer of federal funds to provinces which are eligible for such payments. Thus, unlike the health or social transfers, which in theory must go to such ends (though in practice may in fact be different as such transfers are not “tracked” by the federal government) the provinces are free to allocate equalization dollars in any manner. Since 2005/06 and to 2012/13 (the period covered by this study), the federal government has paid out just under \$107.5 billion in equalization payments alone (Canada, 2013a).

The purpose of equalization

In theory, as Section 36(2) of the Constitution Act, 1982 states, equalization is meant to “provide reasonably comparable levels of public services at reasonably comparable levels of taxation” (Department of Justice, undated). As the Federal Department of Finance notes, equalization is meant to address “fiscal disparities among provinces.” Echoing the constitutional imperative, the department notes 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).

² The other main federal transfers are the Canada Health Transfer, the Canada Social Transfer, Territorial Formula Financing, and “Other” (Canada, 2013a).

Equalization calculations

Equalization payments are calculated based upon a formula that measures a province's ability to raise revenues, its "fiscal capacity." An equalization entitlement results when a province's fiscal capacity falls below the average fiscal capacity of all provinces—known as the "10 province standard" (though this standard has shifted over the years in terms of the number of provinces used to calculate average fiscal capacity).

In addition to equalization payments, some provinces also receive extra federal transfers for "offshore accords" to avoid, for a time, reductions in overall transfers from the federal government; these were worth almost \$4.6 billion between 2005/06 and 2012/13. The federal government has enacted yet another mechanism to "protect" federal transfers to selected provinces, the Transfer Protection Program, which delivered almost \$2.2 billion to selected provinces between 2010/11 and 2012/13 (the duration of the program thus far) (Canada, 2013b; 2013c; 2013d). Thus, the offshore accords and Total Transfer Protection have served to create parallel equalization envelopes outside of the regular equalization system.³

Where do equalization dollars originate?

Such monies have been the subject of occasional misunderstandings and are not transfers between provincial governments. They originate in federal tax collections from taxpayers in all provinces and territories. Annual payments from the federal government for equalization payments increased to over \$16.6 billion in 2012/13⁴ from \$11.1 billion in 2005/06 (Canada, 2013a).

3 Note that further references in this study to equalization include offshore dollars and total transfer protection without explicit mention of the latter in every instance.

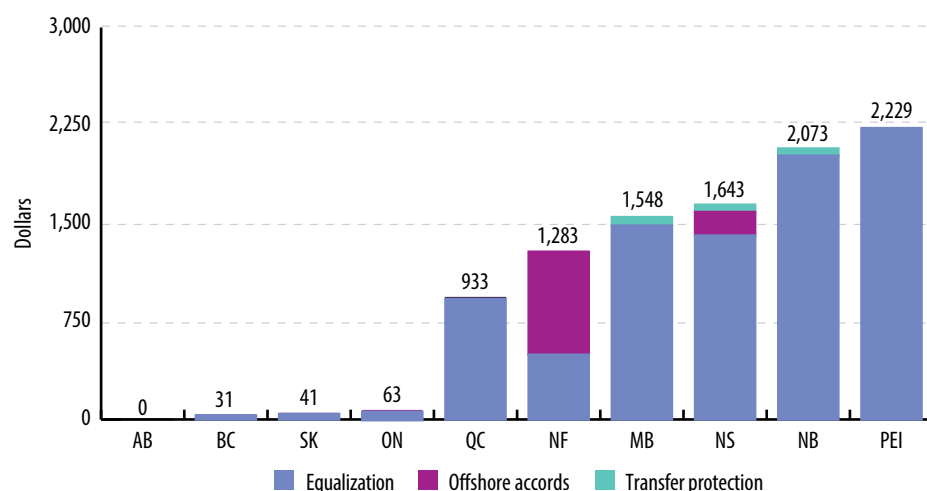
4 To understand how \$16.6 billion is arrived at: \$15.423 billion in equalization plus \$443 million in offshore accord money plus \$679 million in total transfer protection equals \$16.545 billion. For the sake of the reader's attention span to multiple decimal points, this study will round to nearest \$0.1 billion.

Where do equalization dollars end up?

In 2012/13, Quebec received the largest share of federal equalization payments, at almost \$7.8 billion,⁵ with Ontario second at just under \$3.3 billion (Canada, 2013a). Thus, Canada's two most populous provinces received \$11 billion, or 68% of all equalization (and "equalization plus") payments that year.

However, another way in which to look at the value of equalization to a particular government can be calculated using a per capita measurement (figure 1). With a look at the 2005/06 to 2012/13 period and averaging per year, four provinces received little or nil in such payments while the eight-year annual average for the other six provinces were significant: Quebec, \$933; Newfoundland, \$1,283; Manitoba, \$1,548; Nova Scotia, \$1,643; New Brunswick, \$2,073; Prince Edward Island, \$2,229 (Canada, 2013a; calculations by Fraser Institute).

Figure 1:
Equalization (including offshore accords and transfer protection), annual average dollars per capita (2005/06-2012/13)



Source: Canada, 2013c.

5 Note that Quebec's transfers here include not just cash but the value of 1960s-era tax points transferred to the province, this while other provinces accepted cash transfers (Holden, 2007: 17). The form of the transfer—cash or tax points in lieu of cash, or both, in the case of Quebec—is irrelevant; it is the value of the transfer amount that matters for the purposes of comparison.

Part 3: Equalization in greater context

The fact that taxpayers in all provinces and territories contribute to the federal treasury through federal income tax payments (and other taxes) has led some, such as former Quebec Finance Minister Raymond Bachand, to claim that no one part of the country subsidizes another. Thus, in the case of Quebec, in 2012, Bachand claimed that higher provincial taxes, not equalization payments, allow for Quebec's more generous and costly social programs (Duhaime, 2012).

To put the Bachand claim in context, it is important to understand that the first part of the assertion—taxpayers in all provinces pay federal taxes and thus support federal transfer programs such as equalization—is correct; the second part—no one part of the country subsidizes another— is incorrect, as what matters is where federal taxes are collected and in what amounts, the subsequent spending, and the resulting net transfers.

The context for such taxation and spending is as follows: Using Statistics Canada data as a proxy to examine the Bachand argument,⁶ consider the difference between federal revenue and federal spending as a percent of

6 This use of Statistics Canada's Provincial Economic Accounts (PEA) data is not without limitations and criticism. For example, Steve West (2007) notes how, if the federally-funded and Ontario-based RCMP headquarters bought uniforms in Quebec but distributed them to RCMP officers in Manitoba, the federal spending benefit would be attributed to Quebec on a procurement allocation basis but to Ontario on a purchasing basis. West thus argues that the PEAs should not be used "...to determine who benefits from federal activities" because of such limitations. Nonetheless, such different assignments are routine and expected and therefore do not negate the possibility of using such data as a proxy in the absence of more detailed and precise data. Moreover, such assignment of spending does not detract from how larger and more prosperous economies such as Alberta have economies that are significantly larger as a percentage of the national economy vis-à-vis their population (and thus are proportionately higher contributors to federal tax coffers when compared to say, Quebec). To my knowledge, no currently available dataset can conclusively show who benefits from federal

provincial GDP averaged over the 2000 to 2009 period (when the Statistics Canada data ends). In that period, British Columbia, Alberta, and Ontario were net contributors to federal coffers while all other provinces were net recipients:

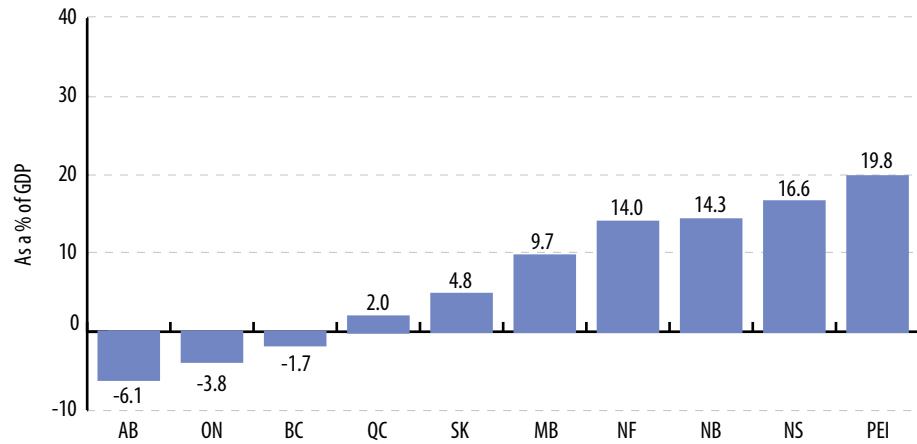
- ◆ Taxpayers in three provinces contribute more than such provinces receive back in federal spending. Albertans contribute more (by 6.1 percentage points), Ontarians contribute more (by 3.8 points), and British Columbians contribute more (by 1.7 points) in federal revenue than they receive in federal spending (figure 2a).
- ◆ Even though Ontario and British Columbia received some equalization in the last eight years it was funded from these same provinces—in that net federal revenues from BC and Ontario exceeded the amounts they received in equalization.
- ◆ Also, federal spending as a percent of GDP is higher than federal revenues as a percent of GDP on average between 2000 and 2009 in the other seven provinces.
- ◆ On average, federal spending was 2.0 percentage points of GDP higher than federal revenue in Quebec; in Prince Edward Island, federal spending was almost 20 percentage points higher (Figure 2a).
- ◆ Based on the 2000 to 2009 average, net federal spending per capita was as high as \$5,838 (in Prince Edward Island) to a net loss of \$3,852 per Albertan, with other provinces between those two extremes (figure 2b).
- ◆ Based on the 2000 to 2009 average, net federal spending per family of four was as high as \$23,352 (in Prince Edward Island) while an Alberta family of four saw a net loss of \$15,407 federal tax dollars with other provinces between those two extremes (figure 2c).⁷

Thus, the Bachand assertion is akin to arguing that in a poker game, because ten players all contribute money to the pool at the beginning of the game, there is no net transfer of money at the end. In fact, if seven people leave the poker table with more money than they contributed while three leave with less, a net transfer has occurred. It is the same with net federal transfers.

activities. Further, when such data was available, the Fraser Institute produced reports using it, such as 1994's *Government Spending Facts Two*.

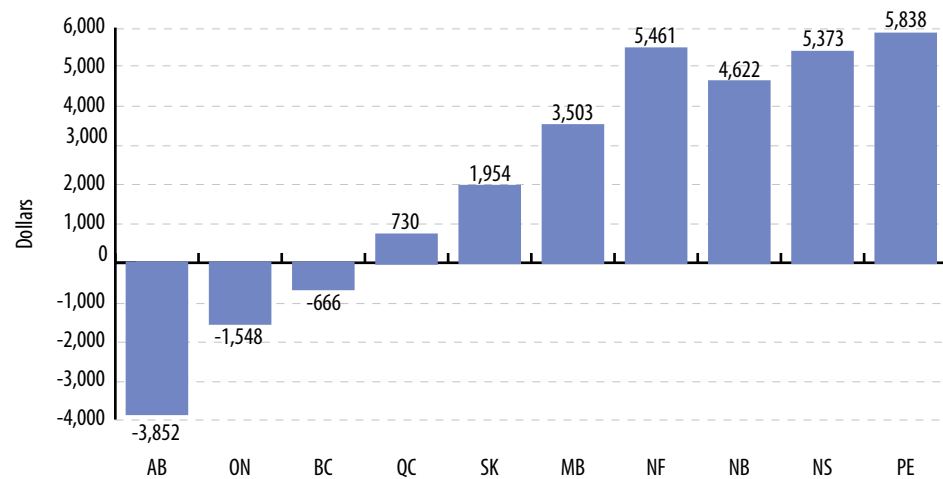
7 Bullet point statistics from Statistics Canada, 2011a.

Figure 2a:
Net difference in federal spending v. federal revenue by province
As a % of GDP
2000-2009



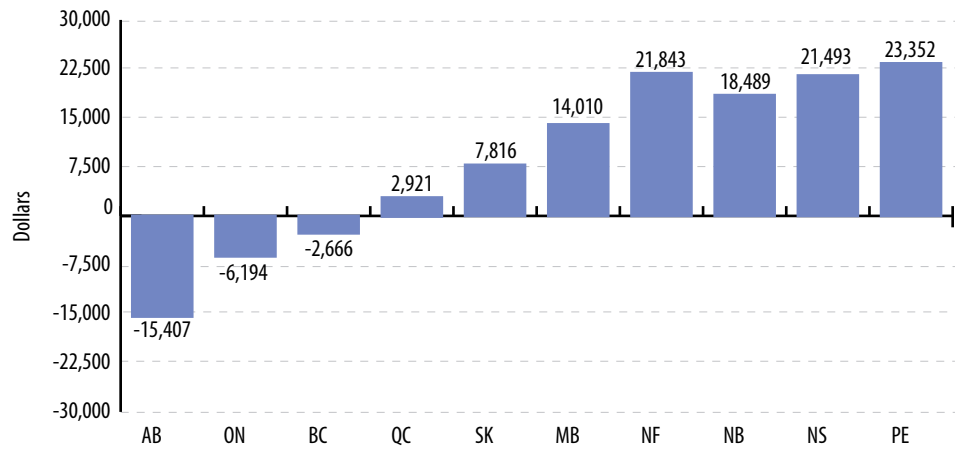
Source: Statistics Canada, 2011a.

Figure 2b:
Net federal spending by province
Annual average dollars, per person
2000-2009 average



Source: Statistics Canada, 2011a.

Figure 2c:
Net federal spending by province
Annual average dollars
Per family of four
2000-2009 average



Source: Statistics Canada, 2011a.

Nevertheless, for this study, “haves” and “have-nots” are characterized according to their position in the 2005/06-2012/13 period as mainly significant recipients of equalization on a per capita basis (Manitoba, Quebec, New Brunswick, Nova Scotia, Prince Edward Island, and Newfoundland & Labrador), or minor recipients (Ontario, BC, and Saskatchewan), or not at all (Alberta).

Part 4: Do transfer programs deliver “equality”?

A further question is pertinent to any empirical analysis of equalization: Is the goal of equalization—to provide “reasonably comparable levels of public services” across the provinces, the result? Or is some other outcome occurring?

To answer this question, this section considers a variety of taxpayer-funded services provided by provincial governments, which allow for a measure of comparability among provinces on spending priorities, the size of the public sector, and the size of government. Many other indicators are available but this group provides a reasonable reflection of several main provincial government spending priorities, including health and education, as well as protection of persons and property and general government functions. Health and education alone make up the lion’s share of provincial budgets. For example, combined, those two budget expenditures constitute 69.5% of Quebec’s total program expenditures, with the equivalent proportion at 64.3% in Ontario, 66.1% in Alberta, and 73.6% in British Columbia (Quebec, 2012: 29; Ontario, 2012: 35; Alberta, 2012: 25; British Columbia, 2012: 113).

Givers and takers

In this section, and based on the figure 1 division (equalization, offshore accords, and total transfer protection), there are four “giving” provinces (British Columbia, Alberta, Saskatchewan, and Ontario) and six “taking” provinces (Manitoba, Quebec, Nova Scotia, New Brunswick, Prince Edward Island, and Newfoundland & Labrador). Comparisons will be made with Alberta, as it was the only province in the eight-year period which did not receive any equalization payments, so it is used as the baseline.

Comparisons which, in the original data were based on ratios (i.e., public sector employment per 1,000 people) are converted to relative percentages vis-à-vis Alberta. In figure 3, for example, Alberta has 79 public sector employees per 1,000 people while Saskatchewan has 112. In percentages, the “42%” atop Saskatchewan’s column indicates that Saskatchewan has 42% more public sector employees per 1,000 people compared with Alberta. The nineteen indicators are as follows:

Public sector employment

- ◆ Average public sector employment
- ◆ Average public sector employment, health and social service institutions
- ◆ Average public sector employment, universities, colleges, vocational, and trade institutions
- ◆ Average public sector employment, local school boards
- ◆ Average police employment

Health care

- ◆ Number of physicians
- ◆ Proportion of households who have a regular family physician
- ◆ Total median patient wait (from referral from a GP to treatment)
- ◆ Regulated nurses workforce
- ◆ Difficulties accessing routine or on-going care, any time of day
- ◆ Hospital beds staffed and in operation
- ◆ Access to medical technology-CTs
- ◆ Access to Medical Technology-MRIs

Education

- ◆ Undergraduate tuition fees
- ◆ Public post-secondary enrolments
- ◆ Annual expenditure by post-secondary educational institutions
- ◆ Annual expenditure by K-12 educational institutions
- ◆ Student to educator ratio

Total program spending

- ◆ Provinces: Program spending as a % of GDP

Each indicator is summarized with the giving or taking provinces marked with the “advantage” (where the advantage is unclear or neutral, that indicator is marked as “neutral”). This mark is based on the preponderance of an advantage as identified in the data. For example, on undergraduate tuition fees (figure 15 and table 1), most of the “have-nots” have an advantage over most of the provinces that are net givers. The result is the “taking” provinces

are marked with an “advantage” in that category and in the summary table (table 2).

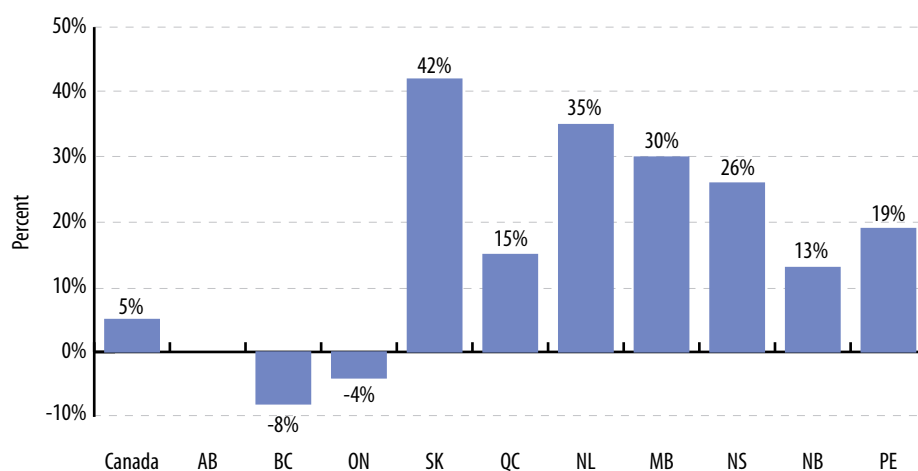
To be clear, the “advantage” signifies merely that the taking or giving cohort has a preponderance of an indicator over another group. The “advantage” is a sign that takers or givers charge users less for some government service (e.g., tuition), or fund some program more lavishly, or have a larger size of government. The “advantage” indicator is not the same as an endorsement of the policy or that said province is effective and efficient. For this reason, the level of effective service can be lower in a high-spending province than in a low-spending province. This study does not address those outcomes, but instead the ability to provide a plethora of some public service or at a reduced cost (e.g., tuition rates).

Critically, it is important to recall that such “advantages” in recipient provinces are made possible in part by transfers from elsewhere, and recall that such transfers are tied directly to federal taxes that on a net basis, originate in British Columbia, Alberta, Saskatchewan, and Ontario (Statistics Canada, 2011a).

Figure 3: Average public sector employment per 1,000 population—Advantage: Takers

This definition of public sector includes all provincial and local government functions except for government business enterprises (GBEs). All recipient provinces employ more people in the public sector than the contributing provinces with the exception of Saskatchewan (Statistics Canada, 2012a & 2012b).

Figure 3:
Average public sector employment (excluding federal)
Employees per 1,000 people
Relative to Alberta
2007-2011

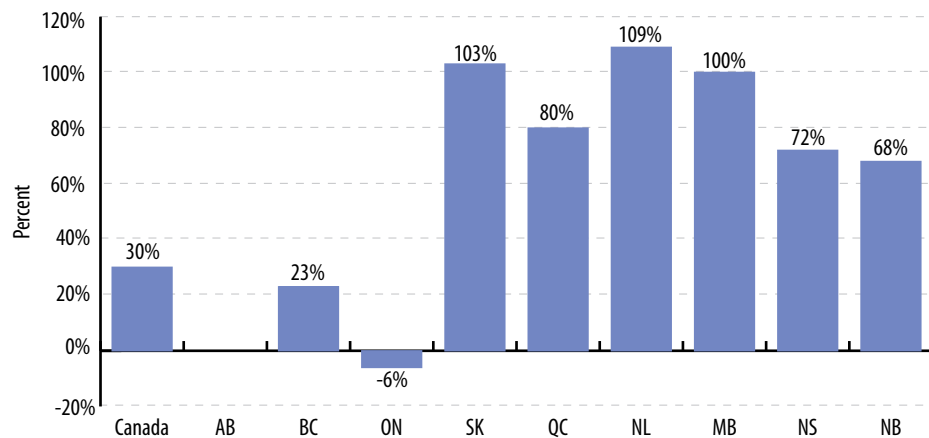


Sources: Statistics Canada, 2012a & 2012b.

Figure 4: Average public sector employment, health and social service institutions—Advantage: Takers

Ontario, Alberta and British Columbia have the lowest ratios of health and social service employees among the provinces. The “taking” provinces have higher staffing ratios per 1,000 people that range from 68% more to 109% more when compared to Alberta. The advantage here is to taking provinces (Statistics Canada, 2012a & 2012b).⁸

Figure 4:
Average public sector employment, health and social service institutions
Employees per 1,000 population
Relative to Alberta, 2007-2011



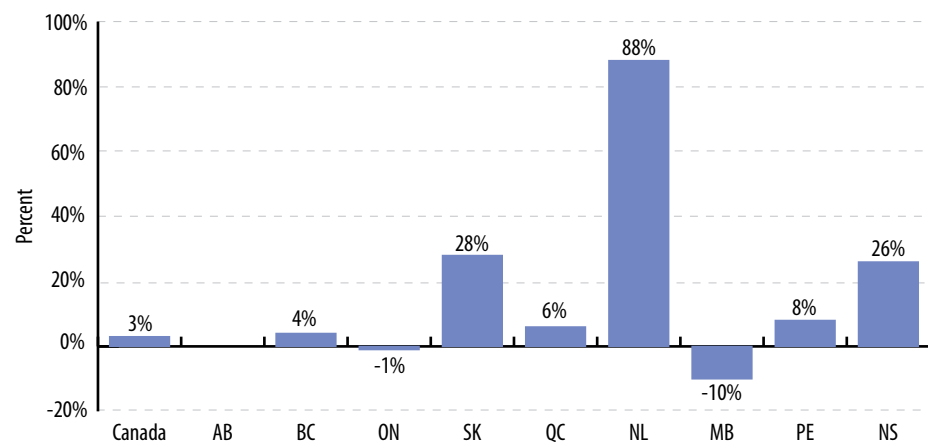
Sources: Statistics Canada, 2012a & 2012b.

⁸ Health and Social Service Institutions have been embedded in general provincial government in Prince Edward Island since 2005 and thus PEI is excluded from this comparison.

Figure 5: Average public sector employment, universities, colleges, vocational, and trade institutions—Advantage: Takers

Excluding New Brunswick*, four of five provinces among the remaining takers have higher employment ratios per 1,000 people when compared with any of the giving provinces. They have public sector employment here that ranges from 8% to 88% higher than Alberta. This measurement is marked “advantage” for the taking provinces (Statistics Canada, 2012a & 2012b).⁹

Figure 5: Average public sector employment, universities, colleges, vocational, and trade institutions
Employees per 1,000 people
Relative to Alberta
2007-2011



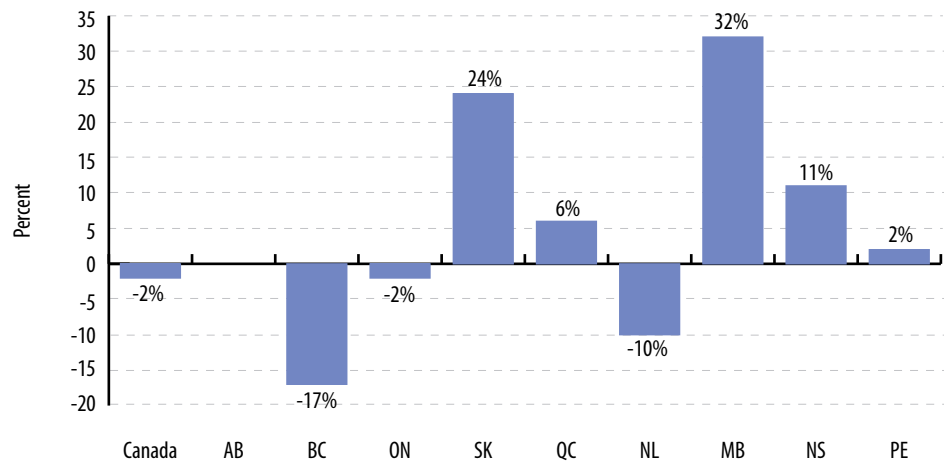
Sources: Statistics Canada, 2012a & 2012b.

⁹ Colleges, vocational, and trade institutions are embedded in provincial and territorial general government in *New Brunswick. New Brunswick's data is thus not directly comparable and has been left out of my analysis here vis-à-vis the other provinces.

Figure 6: Average public sector employment, local school boards— Advantage: Takers

Excluding New Brunswick, four of five remaining “taking” provinces have employment levels in local school boards per 1,000 people that are proportionately higher than in any of the giving provinces. Compared to Alberta, they have public sector employment that ranges from 2% to 32% higher (Statistics Canada, 2012a & 2012b). The advantage in this measurement goes to taking provinces.¹⁰

Figure 6:
Average public sector employment, local school boards
employees per 1,000 people
Relative to Alberta
2007-2011



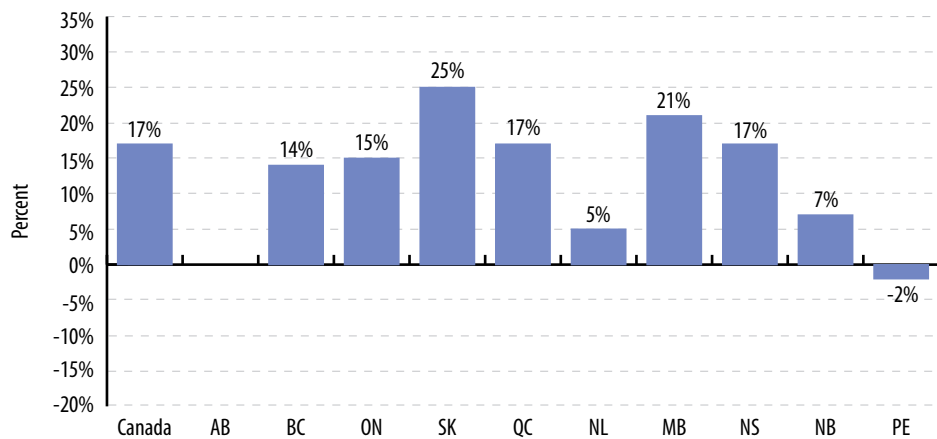
Sources: Statistics Canada, 2012a & 2012b.

¹⁰ In New Brunswick, local school boards are embedded in provincial and territorial general government and thus New Brunswick is not directly comparable and has been left out of this analysis.

Figure 7: Average police employment—Advantage: Neutral

Prince Edward Island has the lowest proportion of police officers for every 100,000 people. All the “giving” provinces have ratios of police employment below the national average, but so too do three of the “taking” provinces (Statistics Canada, 2011b). All the provinces, except Prince Edward Island, have an advantage over Alberta, and by a range of 5% to 25%. This indicator is marked neutral.

Figure 7:
Average police employment
Per 100,000 people
Relative to Alberta,
2007-2011

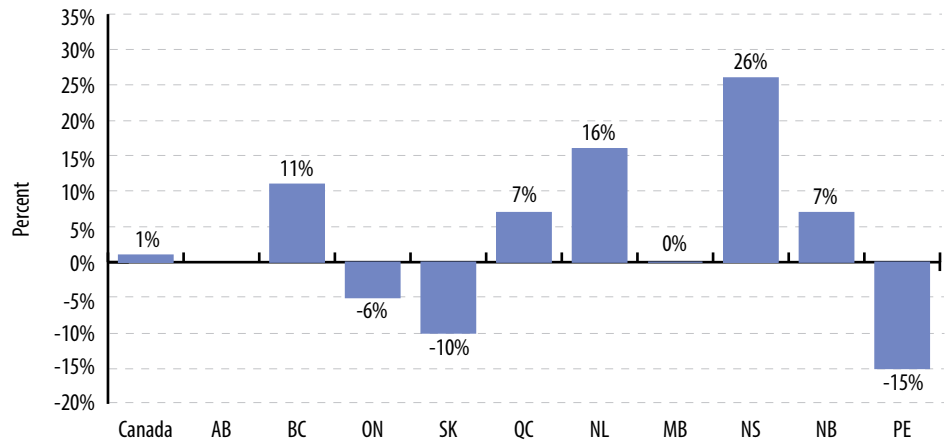


Sources: Statistics Canada, 2011b.

Figure 8: Number of physicians—Advantage: Takers

Prince Edward Island has the lowest ratio of doctors per 100,000 people while Newfoundland & Labrador and Nova Scotia have the highest ratios in the country. Alberta is in the middle of the pack and Ontario and Saskatchewan are below the national average. Four of six “taking” provinces do have more physicians than Alberta, in a range of 7% to 26% more (Canadian Medical Association, 2011; Statistics Canada, 2012b). The advantage here is to the “taking” provinces.

**Figure 8:
Number of physicians
Per 100,000 people
Relative to Alberta
2011**

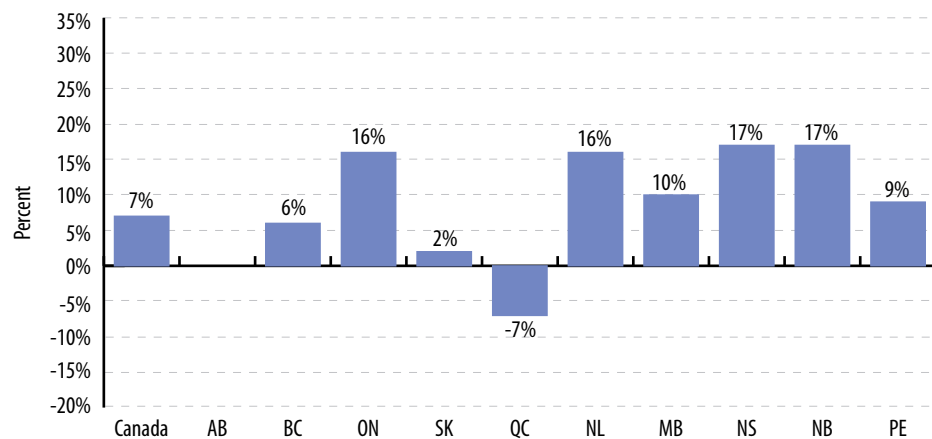


Sources: Canadian Medical Association, 2011; Statistics Canada, 2012b.

Figure 9: Proportion of households who have a regular family physician—Advantage: Takers

Five of the recipient provinces have an advantage here over most of the “giving” provinces (Alberta, British Columbia, and Saskatchewan); Ontario is the lone exception and scores similar to Newfoundland & Labrador, Nova Scotia, and New Brunswick. The measurement is marked as an advantage for the “taking” provinces (Statistics Canada, 2012c; age-standardized rate).

Figure 9:
Proportion of households who have a regular family physician
Relative to Alberta
2011

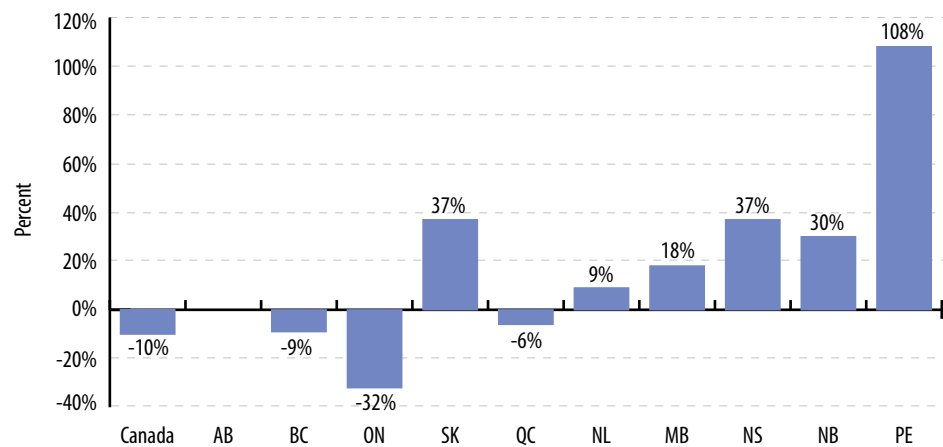


Source: Statistics Canada, 2012c

Figure 10: Total median patient wait (from referral from a GP to treatment)—Advantage: Givers

Three of the four “giving” provinces have an advantage over most taking provinces (Barua, Rovere, and Skinner, 2011). This indicator is marked as an advantage for the “giving” provinces.

Figure 10:
Total median patient wait from referral from a GP to treatment
(based on wait time in weeks)
Relative to Alberta
2011

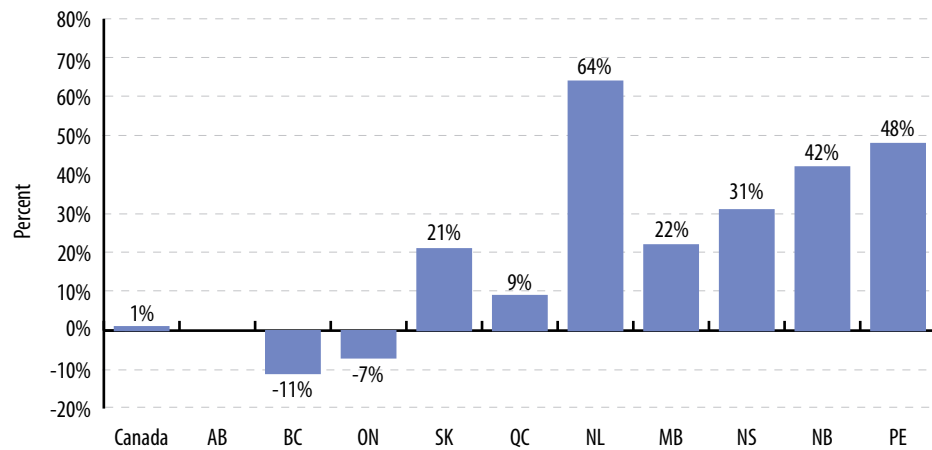


Source: Barua, Rovere, and Skinner, 2011

Figure 11: Regulated nurses workforce—Advantage: Takers

In the category of regulated nurses per 100,000 people, the “taking” provinces have a clear advantage over “giving” provinces (CIHI, 2011a).

Figure 11:
Regulated nurses workforce
(Based on comparisons per 100,000 population)
Relative to Alberta
2006-2010 average

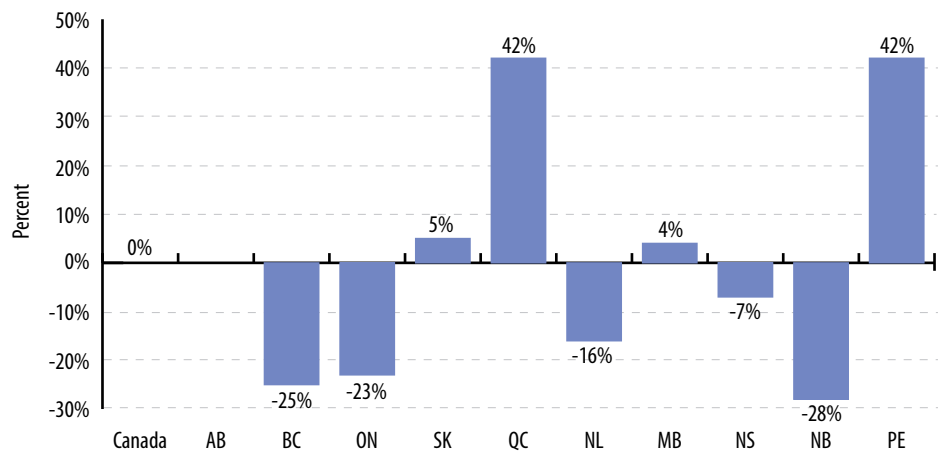


Source: CIHI, 2011a.

Figure 12: Difficulties accessing routine or on-going care, any time of day—Advantage: Givers

In this category, households in the “giving” provinces have the most ease in accessing on-going care though New Brunswick (on the “taking side”) is a notable exception. The advantage lies with the “giving” provinces (Statistics Canada, 2012d; age-standardized rate).

Figure 12:
Difficulties accessing routine or on-going care, any time of day
(Based on proportion of households 15 and over)
Relative to Alberta
2011

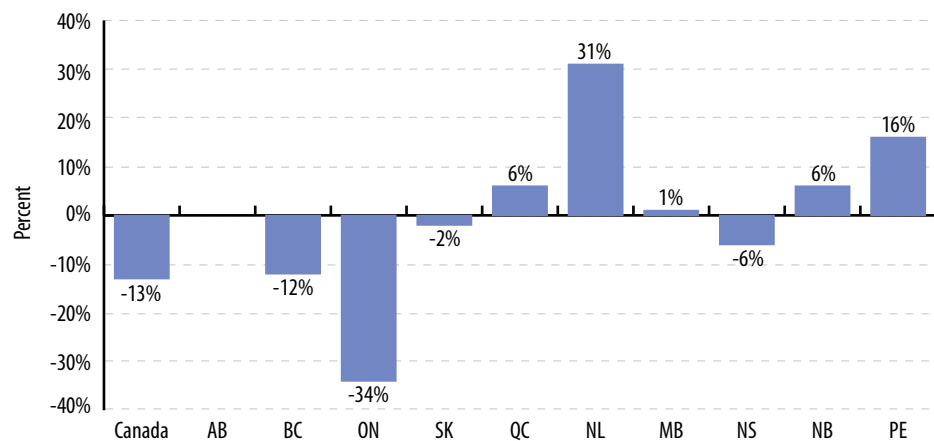


Source: Statistics Canada, 2012d.

Figure 13: Hospital beds staffed and in operation—Advantage: Takers

British Columbia and Ontario are at a significant disadvantage in the number of hospital beds staffed and in operation per 1,000 population while Saskatchewan is also worse off relative to most “taking” provinces (save Nova Scotia). This category is marked in the takers’ favour (CIHI, 2012; Statistics Canada, 2012b).

Figure 13:
Hospital beds staffed and in operation
Based on beds per 1,000 population
Relative to Alberta
2010-2011

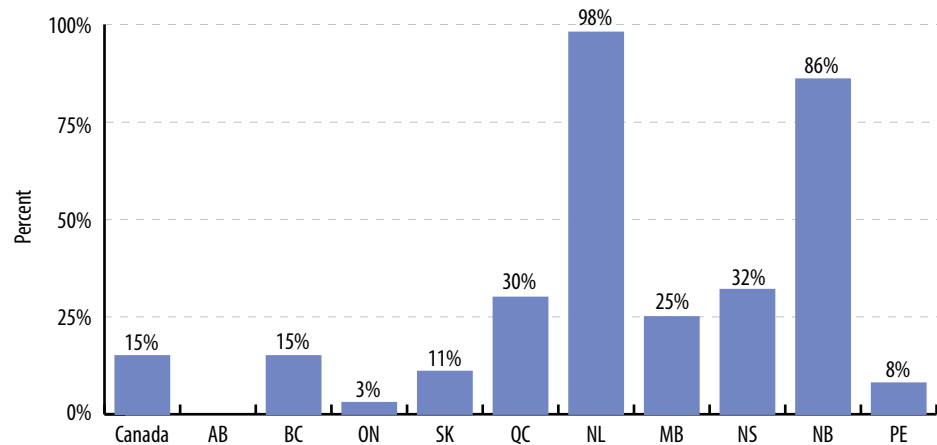


Sources: CIHI, 2012; Statistics Canada, 2012b.

Figures 14a: Access to medical technology, CT scanners—Advantage: Takers

Here, the “taking” provinces possess a clear advantage on CT scanners per million people (CIHI, 2011b).

Figure 14a:
CT scanners per million people
Relative to Alberta
2011

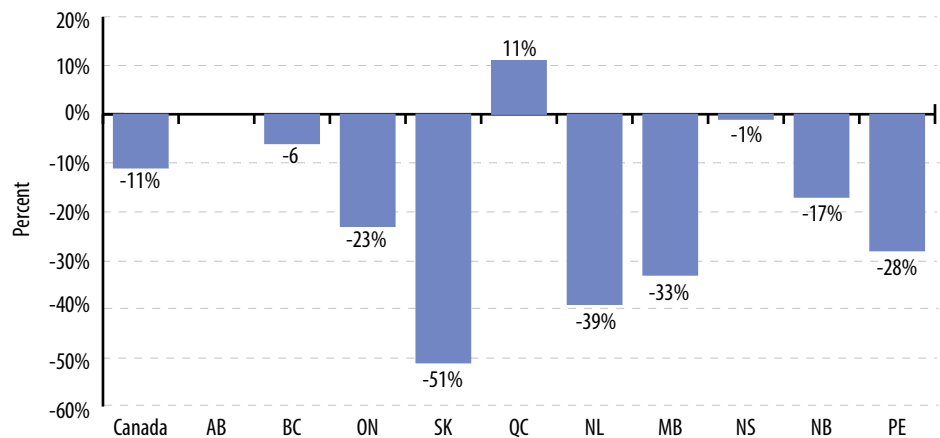


Source: Canadian Institute for Health Information, 2011b.

Figure 14b: Access to medical technology, MRI scanners—Advantage: Neutral

Here, the indicator is neutral given how both “giving” and “taking” provinces have examples of low MRI coverage relative to Alberta and how Saskatchewan is in fact the lowest (CIHI, 2011b.)

Figure 14b:
MRIs per million people
Relative to Alberta
2011



Source: Canadian Institute for Health Information, 2011b.

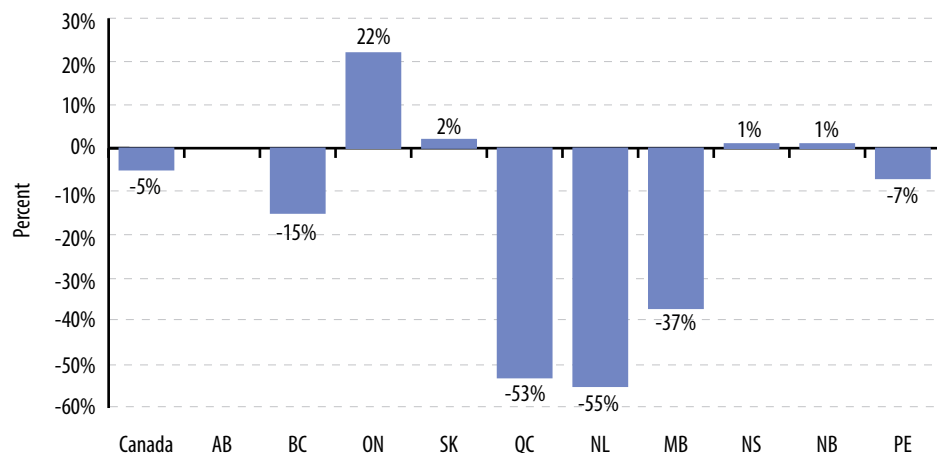
Figure 15 and Table 1: Undergraduate tuition fees—Advantage: Takers

Tuition fees in Canada vary widely (table 1) but Ontario students pay the highest tuition in the country while Manitobans, Newfoundlanders, and Quebecois students pay the lowest tuition rates (Statistics Canada, 2012e). The most dramatic contrast is thus between Ontario and those three provinces:

- ♦ Ontario students, with undergraduate tuition rates at \$7,180 pay almost twice the tuition faced next door in Manitoba, at \$3,729.
- ♦ Ontario students pay more than two-and-half times the \$2,774 paid by Quebec undergraduates.
- ♦ Ontario students pay more than two-and-half times the \$2,649 paid by students in Newfoundland & Labrador.

Six “taking” provinces have tuition rates less than Ontario and Saskatchewan while four of the “taking” provinces have rates less than British Columbia. Thus, the “advantage” is to the “taking” provinces.

Figure 15:
Undergraduate tuition fees, full-time Canadian students
Relative to Alberta
2012/2013



Source: Statistics Canada, 2012e.

Table 1: Undergraduate tuition fees, 2012/13p

| | Tuition for full-time Canadian students, undergraduate, in \$ |
|-------------------------|---|
| Canada | 5,581 |
| Alberta | 5,883 |
| British Columbia | 5,015 |
| Ontario | 7,180 |
| Saskatchewan | 6,017 |
| Quebec | 2,774 |
| Manitoba | 3,729 |
| Newfoundland & Labrador | 2,649 |
| New Brunswick | 5,917 |
| Nova Scotia | 5,934 |
| Prince Edward Island | 5,470 |

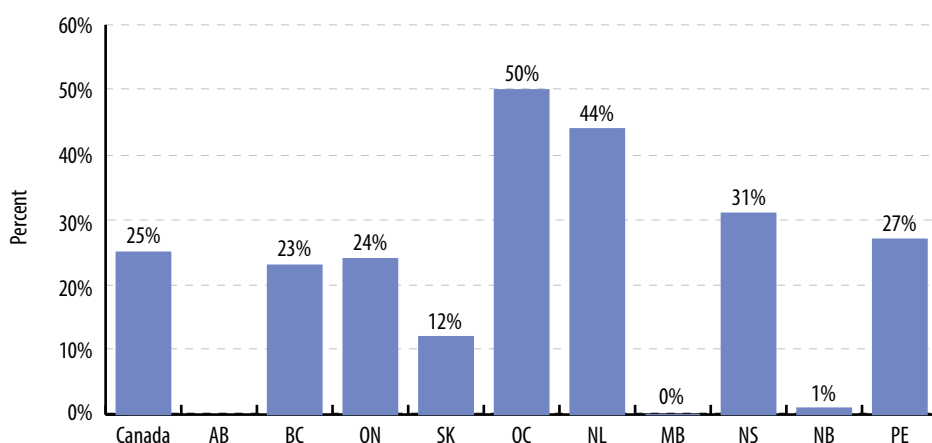
Note: p=preliminary

Source: Statistics Canada (2012e)

Figure 16: Public post-secondary enrolments-Advantage: Takers

Four of six “taking” provinces have an advantage over the four “giving” provinces while only two of the takers show relatively less in enrolment. The advantage is to the takers (Statistics Canada, 2012b & 2012f).¹¹

Figure 16:
Public post-secondary enrolments
Canadian students per 1,000 people
Relative to Alberta
2009/10



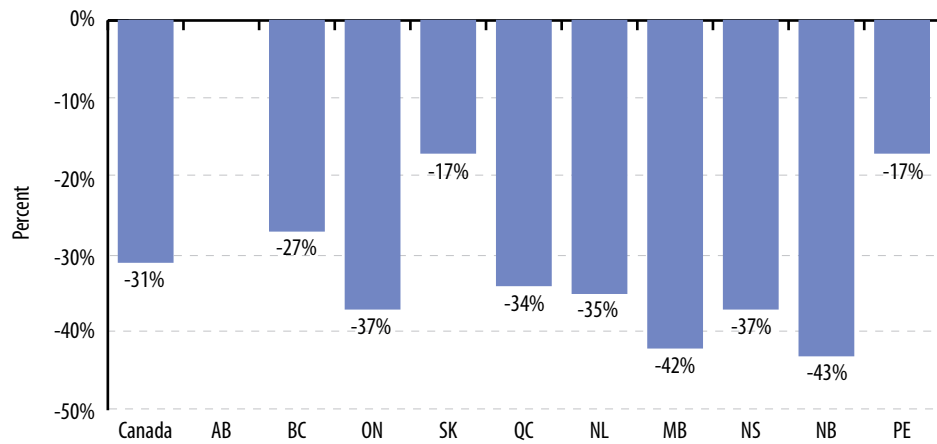
Sources: Statistics Canada, 2012b & 2012f.

- 11 Interestingly the correlation between tuition (figure 15) and student numbers (figure 16) is negative, suggesting at best a complicated relationship between student numbers and spending and thus fiscal federalism. Nonetheless, what figure 15 reveals is how many have-not provinces charge less than, say, Ontario.

Figure 17: Annual expenditure by post-secondary educational institutions—Advantage: Givers

Post-secondary institutions in Alberta spend more per student than in any other province. Most “taking” provinces spend less than BC and Saskatchewan, while some also spend less including Ontario. In other words, the “advantage” here accrues to the giving provinces who are spending more in most cases (Statistics Canada, 2012g).

Figure 17:
Annual expenditure by post-secondary educational institutions
(Based on dollars per student for all services)
Relative to Alberta
2008/2009

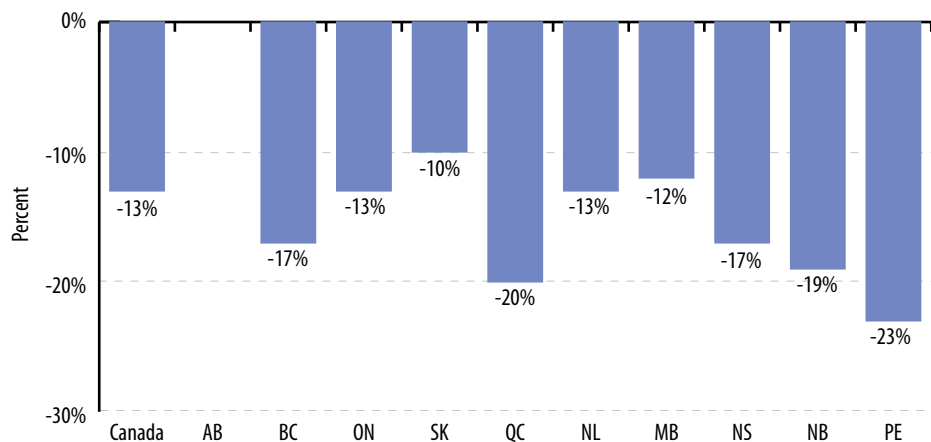


Source: Statistics Canada, 2012g.

Figure 18: Annual expenditure by K-12 educational institutions— Advantage: Neutral

Alberta spends more per student than any other province on pre-primary and K-12 education (Statistics Canada, 2012g). Saskatchewan is the next highest spender, while BC and Ontario fall within a range matched by Newfoundland & Labrador, Manitoba, and Nova Scotia. There is no clear delineation between taking and giving provinces. This measurement is marked neutral.

Figure 18:
Annual expenditure by K-12, educational institutions
(Based on dollars per student for all services)
Relative to Alberta
2008/2009

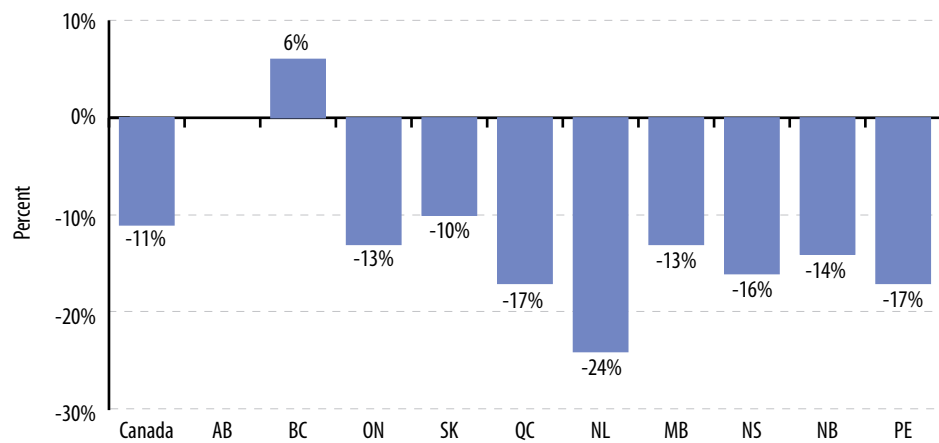


Source: Statistics Canada, 2012g.

Figure 19: Student to educator ratio—Advantage: Takers

All six “taking” provinces have ratios that indicate fewer students per educator than Alberta, Saskatchewan, or BC and five have lower ratios than Ontario. The takers have between 13% and 24% fewer students per educator when compared with Alberta. The “taking” provinces have the advantage (Brockington, 2011; Educational assistants are not included).

Figure 19:
Student to educator ratio, public elementary and
secondary schools
Relative to Alberta
2009/2010



Source: Brockington, 2011.

Figures 20 and 21: Provincial program spending as a % of GDP— Advantage: Takers

While the other indicators indicate a snapshot of selected provincial priorities, provincial program spending as a percent of the economy is a comprehensive measure. This category measures program spending as a percent of GDP.

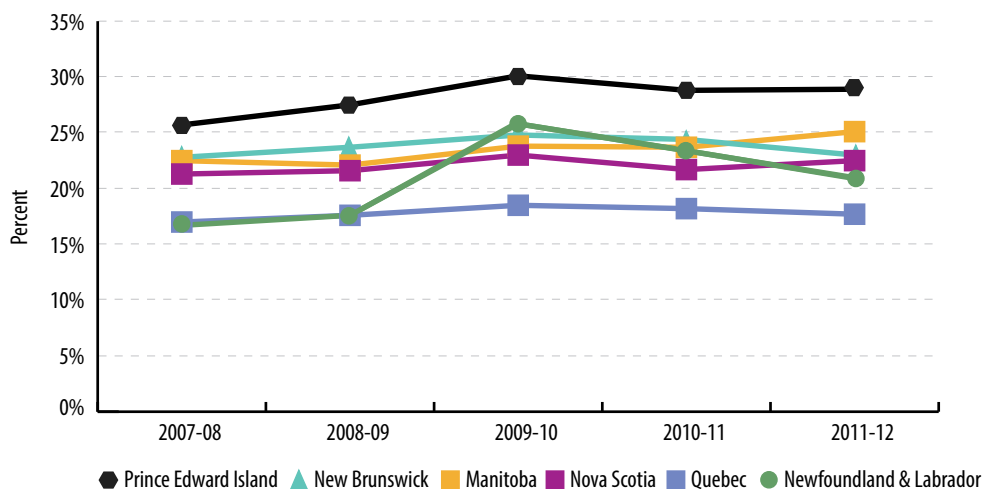
The finding here is that five of the recipient provinces—Manitoba, New Brunswick, Nova Scotia, Prince Edward Island, and Newfoundland & Labrador, show program spending as a percent of GDP that is higher than the have provinces. In the most recent year available (2011/12), government program spending as a share of the economy ranged from 17.7% of GDP in Quebec to 28.9% in the case of Prince Edward Island.

British Columbia, a “giving” province, was notable for having program spending higher than the province of Quebec with respect to the economy of each province [Statistics Canada, 2011a; Canada, 2012; Provincial Public Accounts, 2011/12 (except NL and PEI); various provincial budgets (NL and PEI); Statistics Canada, 2013].

Thus, the general “advantage” accrues to the takers. It is again critical to note such an “advantage” signifies only a preponderance of something—in this case, a preponderance of a large government, of significant government program spending as a share of the economy.¹²

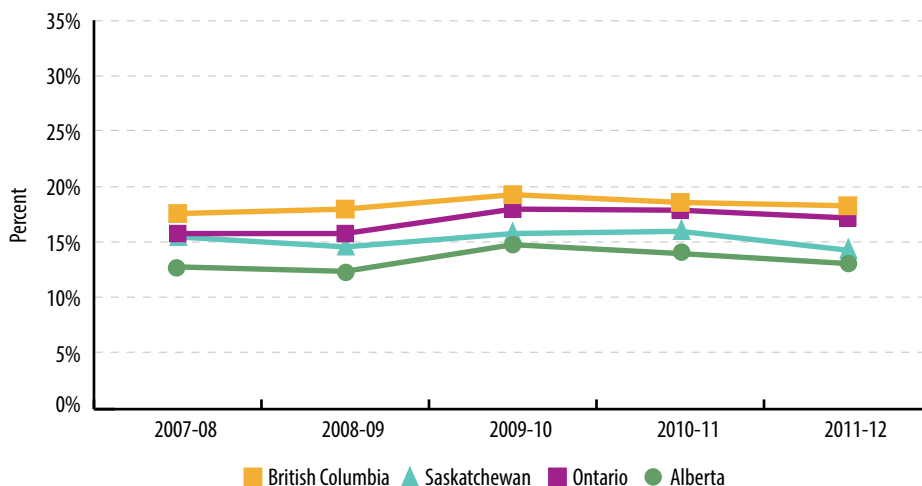
12 One might assert that this is an expected outcome given the point of equalization is to “equalize” public services across the country, and thus insertions of money into one provinces fiscal “coffers” beyond its normal own-source revenues will of course increase the size of government relative to the economy. However, it is not clear that services in “have-nots” could not be (or are not already) provided at a cheaper rates to begin with, given possible lower costs of housing and other cost of living inputs relative to “have” provinces. The issue—“Do ‘have-nots’ have cheaper costs?”—and the possible answer to it might call into question the “need” for equalization. Such a possibility is worth further study. Regardless, in the interim, this study shows the extra money from equalization certainly allows “have-not” provinces in multiple areas to have an advantage.

Figure 20:
"Taking" provinces program spending as a % of GDP,
2007/08 to 2011/12



Sources: Statistics Canada, 2011a; Canada, 2012; Provincial Public Accounts, 2011/12 (except NL and PEI); Various provincial budgets (NL and PEI); Statistics Canada, 2013 (Table 384-0037 - Gross domestic product, income-based, provincial and territorial, annual (dollars); calculations by the Fraser Institute.

Figure 21:
"Giving" provinces program spending as a % of GDP, 2007/08 to
2011/12



Sources: Statistics Canada, 2011a; Canada, 2012; Provincial Public Accounts, 2011/12 (except NL and PEI); Various provincial budgets (NL and PEI); Statistics Canada, 2013 (Table 384-0037 - Gross domestic product, income-based, provincial and territorial, annual (dollars); calculations by the Fraser Institute.

Part 5: Summary of nineteen measurements

The summary of the nineteen measurements is as follows. Those six “taking” provinces (Manitoba, Quebec, New Brunswick, Nova Scotia, Prince Edward Island, and Newfoundland & Labrador) have the advantage in 13 categories:

- ◆ Average public sector employment
- ◆ Average public sector employment, health and social service institutions
- ◆ Average public sector employment universities, colleges, vocational, and trade institutions
- ◆ Average public sector employment, local school boards
- ◆ Number of physicians
- ◆ Proportion of households who have a regular family physician
- ◆ Regulated nurses workforce
- ◆ Hospital beds staffed and in operation
- ◆ CTs per million people
- ◆ Undergraduate tuition fees
- ◆ Public post-secondary enrolments
- ◆ Student to educator ratio
- ◆ Program spending as a percentage of GDP

Those provinces received little or no equalization between 2005/06 and 2012/13 (the “haves”: British Columbia, Alberta, Saskatchewan, and Ontario) have an advantage in three measurements:

- ◆ Total median patient wait time (from GP referral to treatment)
- ◆ Difficulties accessing routine or on-going care, any time of day
- ◆ Annual expenditures by post-secondary educational institutions

Three are neutral, with no discernible advantage in giving or taking provinces:

- ◆ Average police employment
- ◆ MRIs per million people.
- ◆ Annual expenditure by K-12 educational institutions

Table 2: “Advantage” and/or larger size of government

| | “Giving” provinces | “Taking” provinces |
|---|-----------------------|-----------------------|
| 1. Average public sector employment | | YES |
| 2. Average public sector employment, health and social service institutions | | YES |
| 3. Average public sector employment, universities, colleges, vocational, and trade institutions | | YES |
| 4. Average public sector employment, local school boards | | YES |
| 5. Average police employment | NEUTRAL | |
| 6. Number of physicians | | YES |
| 7. Proportion of households who have a regular family physician | | YES |
| 8. Total median patient wait (from referral from a GP to treatment) | YES | |
| 9. Regulated nurses workforce | | YES |
| 10. Difficulties accessing routine or on-going care, any time of day | YES | |
| 11. Hospital beds staffed and in operation | | YES |
| 12. CTs per million people | | YES |
| 13. MRIs per million people | NEUTRAL | |
| 14. Undergraduate tuition fees | | YES |
| 15. Public post-secondary enrollments | | YES |
| 16. Annual expenditures by post-secondary educational institutions | YES | |
| 17. Annual expenditure by K-12 educational institutions | NEUTRAL | |
| 18. Student to educator ratio | | YES |
| 19. Program spending as a % of GDP | | YES |
| Total “advantage” and/or larger size of government | 3 | 13 |

(3 NEUTRAL)

Sources: See citations for items 1 through 19.

Summary

Given that there is always the possibility of statistical or conceptual issues surrounding a particular measurement, a broad range of measurements were used. Expressed in sum, the six “taking” provinces have, on average, a four-to-one advantage over the four “giving” provinces.

Based on the data, spending on government programs in provinces that are net recipients of equalization dollars is, frequently, more lavish than those in giving provinces

- ◆ Out of nineteen measurements, “taking” provinces have an advantage in thirteen categories while the giving provinces have an advantage in three categories (three categories show no advantage either way).
- ◆ The data also reveal that: five of six “taking” provinces show a larger government relative to the economy when compared to all “giving” provinces. Quebec has a larger share of government than three of four giving provinces.

In the have-not provinces, equalization transfers offer choices to recipient provinces (when compared with the giving provinces) that otherwise would not be possible, from public sector staffing levels to government spending as a larger share of the economy. It would not be hard to design a theoretical test to prove this: Remove the \$7.8 billion in equalization and transfer protection transfer available to Quebec in 2012/13, and consider if every existing spending priority would likely remain. Such an outcome is possible, but only if that province taxed or borrowed more.

In a jurisdiction without transfers from outside of its own borders, a provincial government would have a choice between just those three options: higher taxes, pared spending, or more debt. In a system with transfers from outside a particular jurisdiction, a government can choose a fourth option: to use tax dollars from non-residents that then allows a government to avoid answering local voters on their priorities for the first three options. Instead, priorities can be set without regard to the desirability or affordability of a particular program, service, the size of the public sector, and the size of government.¹³

13 As noted elsewhere, but is worth repeating: It may be that some services are cheaper in “have-nots”, and is a useful question for further study. Of course, if that were found to be the case, it would call into question the practical usefulness of equalization: after all, if a province has a cheaper cost of “doing business”, why then the need for equalization dollars?

Part 6: Observations and two options

Given the findings from the data, there are a plethora of possible reforms to equalization or other federal transfers. The various authors cited at the beginning of this report all have recommendations specific to what they assert are problems with fiscal federalism, and which range from allowing the provinces more tax room in place of existing federal tax, to simply increasing federal payments to the provinces. I will not critique such recommendations here given the purpose of this analysis was to examine levels of services in the provinces.

Option one: Reduce transfer payments

Relevant to this work, two options are worth consideration. First, on the expenditure side, one option is a reduction in the amounts disbursed by the federal government to the provinces as happened in the mid-1990s under the government of Jean Chretien. Back then, federal transfers to other levels of government decreased from 3.8% of GDP in 1992/93 to 2.3 % in 1997/98, or from \$26.5 billion to \$20.5 billion in nominal terms (Canada, 2012). A government could, today, enact the same reductions on the fiscal justification that existing transfers are over-equalizing and thus can be frozen or reduced. As noted in the addendum, there is no constitutional barrier to such an action.

Option two: Account for lower costs in have-not provinces

A second option, on the “input” side of equalization might be useful, i.e., where calculations of eligibility and also eventual equalization payments take into account the various cost of providing services in one province when compared with another. Economist Dan Usher noted this possibility when he pointed out that if province A has double the income but its average price level is four times that of province of province B, A’s standard of living is lower than that of B (quoted in Clemens and Veldhuis, 2007: 88). This is a serious omission in most discussions of equalization reform and the cost of providing services in the “haves” and “have-nots” should be further studied. Absent any other or more dramatic reform of equalization, making allowances for the differing cost of services is worth including in reform of equalization.

Addendum A: The myth of equalization's sacred constitutional status

Many people might recognize the flaws in equalization and conclude nothing substantial can be done in pursuit of reform, as equalization is explicitly mentioned in the 1982 Constitution. However, as legal scholar Burton H. Kellock, QC, and former Fraser Institute analyst Sylvia LeRoy found in their 2006 paper, *Questioning the Legality of Equalization*, the legal significance of the Constitution's equalization provisions is misunderstood (Kellock and LeRoy, 2006).

For instance, University of Alberta law professor, Dale Gibson, has observed that "... it could be contended that because s. 36(2) contains no reference to legislative jurisdiction, and employs soft terms like 'committed' and 'principle' rather than power-granting expressions like 'may make laws,' it was not intended to have any direct legal effect" (Gibson, 1996).

Similarly, Professor Peter Hogg, one of Canada's leading constitutional scholars, has described equalization as "statements of economic and social goals that ought to guide government but which are not enforceable in court." He continues by noting that the commitment to equalization in section 36(2) is akin to the "directive principles of state policy" in the Constitution of India, which are also non-justiciable (Hogg, 2000: 156).

Thus, the consensus amongst the above academics and the others cited in the Kellock-Leroy paper is that "the constitutional obligation to make adequate equalization payments to the poorer provinces is probably too vague, and too political, to be justiciable" (Hogg, 2000: ch. 6.6, 156; see also Brown, 2002: 116; Milne, 1998: 176; Sossin, 1998).

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