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Unseen Equalization: Provincial Subsidies in Federal Programs

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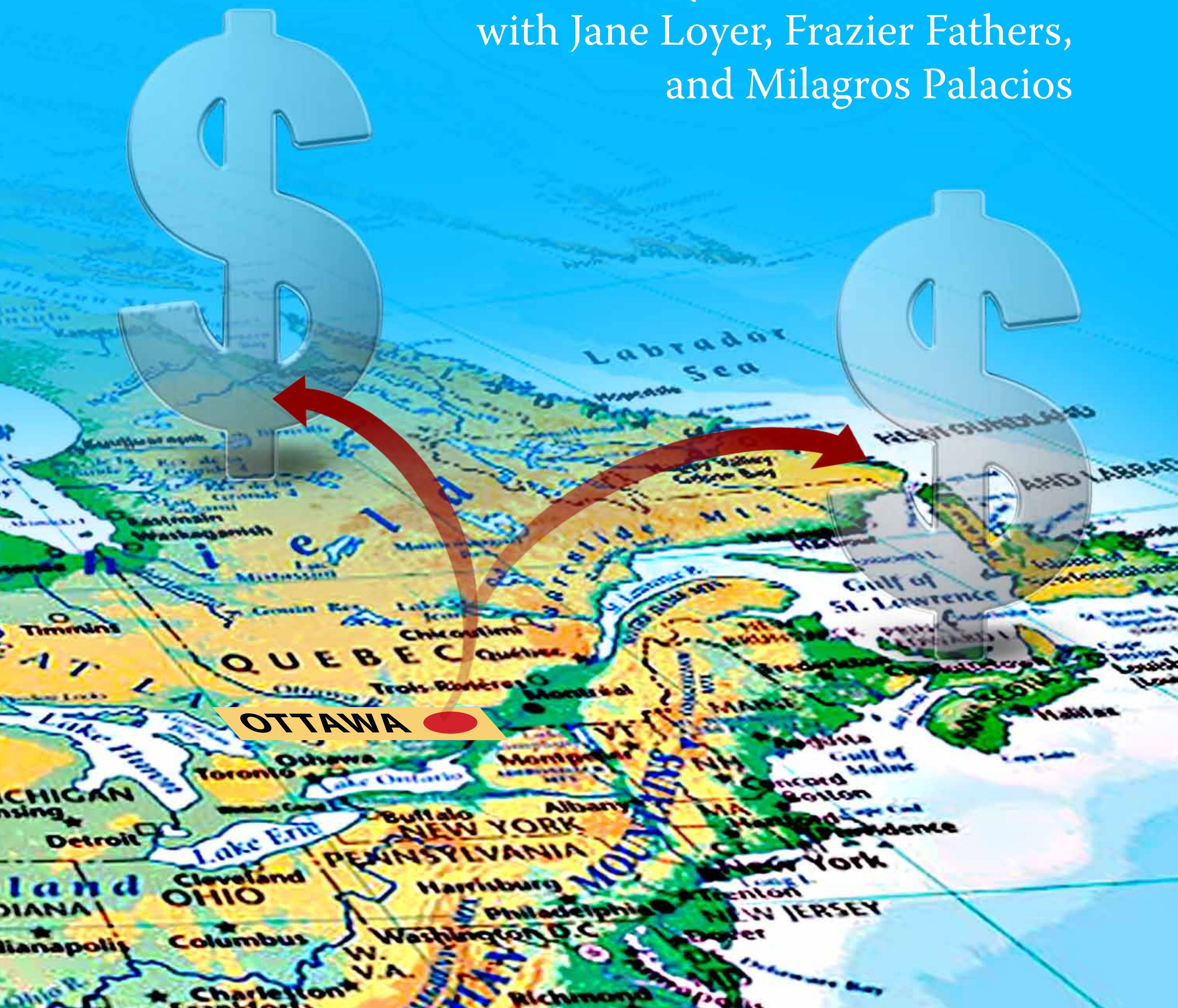

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Executive summary

For many years, debate on Canada's fiscal transfers has focused largely on programs that transfer funds from the federal government to provincial and territorial governments, such as Equalization, the Canada Health Transfer, and the Canada Social Transfer. Academic studies of these programs have been extensive. Expert panels have opined on them. Discussions among officials are constant. These activities have occasionally led to intense public debate, controversy, and conflict. This attention is understandable, as these programs are both large and easily identifiable.

In recent years, however, evidence has accumulated that regional subsidies incorporated in other federal programs are substantial, affect all parts of Canada, and often have a direct impact on everyday life. These arrangements are not well understood, because the funding directed to them is entwined with activities serving other purposes. Consequently, with few exceptions, the resources being devoted to these programs, their impact on the economy, and the results being achieved are not evident to the public, governments, and legislators.

This paper provides an overview of the interprovincial redistributive effects of certain federal programs. How many such arrangements exist? What are the dimensions and characteristics of the most obvious of them? Are unseen regional subsidies large enough to change the way Canadians think about the entire regional subsidy effort?

The paper is organized around six selected areas of federal programming incorporating regional subsidies, rather than attempting a detailed review of all federal programming. These areas have been chosen because of their size, because they are ongoing rather than one-time interventions, and because they represent different types of programming.

Employment Insurance

Regular EI benefits are designed to transfer income from lower-unemployment areas to higher-unemployment areas. The differential calculation of eligibility and benefits based on prevailing unemployment rates amplifies this effect. As a result, higher-unemployment regions such as Atlantic Canada and Quebec receive substantial net contributions, compared to the contributing provinces of Western Canada and Ontario. Alberta is the largest net contributor province on a per capita basis ($390 per person annually). Net contributions from Ontario, Manitoba, Saskatchewan, and British Columbia range from a low of $170 per capita in BC to $304 in Saskatchewan.

Newfoundland and Labrador is unmistakably the largest net recipient province after adjusting for population, with net benefits equivalent to $846 per person in 2010. All four Atlantic Provinces remain net recipients. While Quebec is still a recipient province, it receives the lowest per capita surplus ($32). Despite recent changes to EI, the substantial flow of funds from regions west of the Ottawa River should be expected to continue, largely unabated.

The federal government also operates a program within EI to provide benefits to self-employed Canadians in the fishing industry—the only category of self-employed workers eligible to receive benefits. The value of these benefits ($259.2 million in 2011) is high compared to the value of the fisheries generally. We find that Nova Scotia and Newfoundland and Labrador are the main beneficiaries of this program.

Finally, large cross-provincial variation was also observed with respect to per-unemployed-person funding of EI training. One report has found a per-unemployed-person expenditure of $970 in Ontario compared with $4,040 in Newfoundland and Labrador.

Disproportionate federal employment as a subsidy

Another type of federal activity that can have profound implications on the flow of federal funds is the geographic location of federal employees. While the location of many federal employees is determined by geographic or strategic reasons—those in the Ottawa-Gatineau region, military personnel, and so on—other categories would be expected to be evenly distributed (as weighted for population) across the country, such as those who provide services to citizens.

Adjusting for military personnel and employment in the National Capital region, Prince Edward Island has the highest rate of federal employment relative to population (24 federal employees per 1,000 residents). Ontario, by contrast, maintains federal employment of 3.4 per 1,000 residents—roughly 85 percent lower than in PEI. Such differences in federal employment by province result in large differences in payments to federal employees by province. For example, on a per-resident basis, Nova Scotia receives $1,532 while Ontario receives only $281.

The subsidies received by provinces in the form of larger than expected federal employment for general government functions are equivalent to 39.3 percent of formal equalization in PEI, 44.2 percent in New Brunswick, and a startling 90.1 percent in Nova Scotia. In other words, the value of the transfer from federal employment in Nova Scotia is almost as large as the entire equalization transfer.

Airport ground rental arrangements

During the decade from 1990 to 2000, the federal government transferred responsibility for operating major airports to local not-for-profit organizations. Subsequently, airports have been required to pay ongoing ground rentals to the federal government. There are large disparities between burdens carried by major airports, particularly Pearson in Toronto, and other airports across the country. For instance, Pearson Airport paid almost half of the total airport rental fees in 2011, but accounted for only 28.5 percent of passengers and 32.5 percent of cargo. Similarly, the big four airports (Vancouver, Calgary, Pearson, and Montreal) paid nearly 90 percent of total rental revenues collected by the federal government in 2011, but only had 65 percent of both passengers and cargo. These data strongly suggest that the four largest airports in the country are disproportionately carrying the burden of airport rents, while smaller airports and the regions they serve are disproportionately saving.

Regional economic development agencies

The federal government's regional development agencies are tasked with trying to improve economic performance in their respective regions through direct spending, as well as through indirect measures such as loan guarantees. Considerably more resources are transferred into Atlantic Canada on a per-capita basis ($130.1) than into other regions through this spending. For example, adjusted for population, spending in Quebec is less than one-third the level of spending in Atlantic Canada. Overall, based on 25 years of data, it is clear that the funding pattern for economic development expenditures by federal development agencies have strongly favored both Quebec and Atlantic Canada.

Cultural programs

The federal government spends money on a host of culturally-related activities. This is an area where Canadians might expect a reasonably consistent level of spending, given the nature of the underlying programs. However, there are actually large differences between provinces in per-capita cultural spending. The largest per-capita positive transfer compared to the cross-provincial average occurs in PEI ($191 vs. $115)—two-fifths larger than it would be if the transfer were in line with the average for all provinces. The Atlantic Provinces and Quebec all receive per-capita cultural spending that exceeds the national average, while Ontario and all four western provinces receive less than average. These shortfalls are material. For instance, in British Columbia, per-capita spending on culture is less than half the national average: $53 vs. $115.

Immigration Settlement

According to James McAllister (2010), Ontario's share of settlement spending allocations (45.7 percent) compared to its percentage of new permanent residents from immigration (44.9 percent) are roughly in balance, but significant relative shortfalls are evident in BC, Alberta, and Saskatchewan. BC's funding shortfall is particularly significant: in 2010/2011, that province was allocated 13 percent of settlement funding, while it received 18 percent of Canada's new permanent immigrants. Quebec, by contrast, received 18 percent of new permanent residents but was allocated 28 percent of total funding for immigration settlement programming.

Conclusions

Provincial subsidies incorporated in operating programs are a prominent feature of federal programming, and have an importance that belies the relative lack of attention they receive. Unfortunately, we do not know just how many such arrangements exist in federal programs. However if provincial subsidies can be built into programs as disparate as culture, airport rentals, and regional development, then it is probable that such subsidies are built into many other federal programs.

Overall, the effect of many of the federal programs studied is to disproportionately support provinces east of the Ottawa River, and especially Atlantic Canada, at the expense of provinces west of it.

The significance of these hidden transfers is not just a matter of the expenditures involved. Most people assume that governments treat similarly situated people in similar ways. Unfortunately, it appears that the Government of Canada does not pay enough attention to this fundamental principle of public administration. Similarly situated people seeking EI are treated differently depending on where they live. The same is true of immigrants seeking support after their arrival, or workers seeking access to training programs. The treatment of institutions with similar functions varies widely as well. Airports are just as important to Toronto as they are to

Charlottetown, but ground rental arrangements are much more generous for Charlottetown than Toronto.

The Government of Canada has never conducted a study of the economic impact of Canada's comprehensive regional subsidy system. It is also probable that the federal legislators who countenance regional subsidies other than equalization have little understanding of how many there are, or of their cost. However, the regional subsidy system appears to be so big—much bigger than equalization on its own—that it is not sustainable in anything close to its current form.

The Alberta government, for instance, estimates that its net fiscal deficit with the rest of Canada in 2011 was $19 billion, or about 7 percent of output in a province with a GDP of $275 billion that year. For most of the past fifty years, Ontario's net fiscal deficit with the rest of Canada has been about 4 percent of GDP, although it has gone as high as 6 percent and recently has fallen to about 2 percent. Both provinces face major uncertainties in the global economy. Their capacity to succeed will be greatly impaired because each is carrying a burden—with no financial return—to support other Canadians.

This system is also discouraging growth and development in traditional equalization-receiving provinces. Regional subsidies encourage excessive infrastructure and excessively large provincial public services, and, in the case of EI, they discourage labour mobility. They also enable the growth of public sectors in traditional equalization-receiving provinces that are much larger than in Ontario, Alberta, or British Columbia. These factors all discourage growth and negatively affect the people of these provinces.

Regional subsidies incorporated in programs other than equalization are a substantial but little understood feature of Canadian society, and deserve much greater attention than they have received.

Introduction

Many Canadians are aware of formal transfers of funds from the federal government to the provinces.[1] They are a mainstay of the federalist system, and a frequent source of stress among provinces as well as between the provinces and the federal government.[2] These transfers are substantial—projected to reach $62.3 billion in 2013/2014 (**figure 1**). The Canada Health Transfer is by far the largest, representing almost half of the total.[3] Equalization is the next largest federal transfer to the provinces, although, unlike the other transfers, only provinces deemed to be "have-not" are eligible to receive this funding.[4]

Canadians are probably less familiar with the ways in which many other federal programs tend to transfer resources between different provinces and regions. Canada's equalization system is complex (EPETFF, 2006), but the amount transferred from Ottawa to recipient provinces can be readily discerned. The fact that equalization is a government-to-government arrangement also makes it easier to understand its exact dimensions. Perhaps for these reasons, formal equalization has always received disproportionate attention in academic and government research. A critical component of the federal-provincial transfer debate that is almost always missed—because it is opaque in nature—is the interprovincial redistributive effect of other federal programs (Edwards, forthcoming).

It is important to consider equalization in this broader sense, which incorporates not only direct equalization transfers but also regional biases built into transfer programs for individuals and businesses, and into

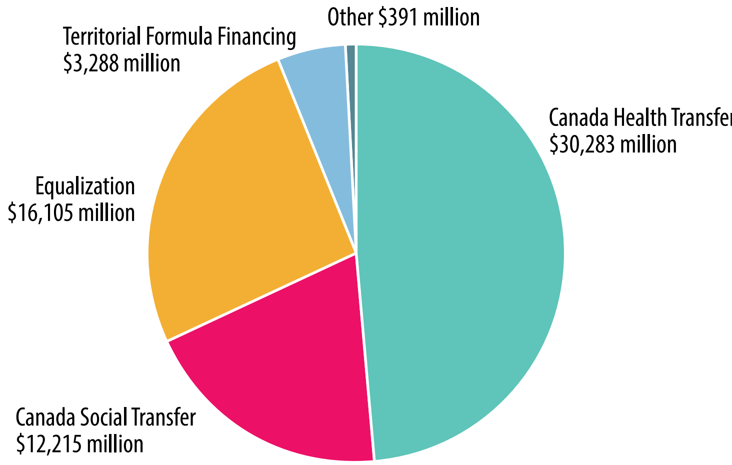
1. Territories, as well as provinces, receive federal transfer payments. However, this paper will focus mainly on transfers to provinces.

2. As Clemens and Veldhuis (eds.) (forthcoming) indicate, federal-provincial stresses are not unique to Canada.

3. The Canada Health Transfer will reach $30,283 billion in 2013/2014, representing 48.6 percent of all equalization (authors' calculation based on Department of Finance (2013).

4. For data on the flows of equalization in Canada for 2013/2014, see http://www.fin.gc.ca/fedprov/eqp-eng.asp. For in-depth analysis of the equalization and transfers system see Clemens and Veldhuis (eds.) (2007).

Figure 1: Federal transfers to provinces and territories, 2013/2014



Source: Department of Finance (2013).

ordinary federal operating programs. Understanding all forms of regional subsidy is essential to gauge the success or failure of Canada's regional subsidy system.[5]

This paper explains the nature of these unseen transfers, and begins to quantify their scale, in order to motivate wider discussion of federal government programs with embedded provincial subsidies. It illuminates important questions relating to subsidies and transfers to provinces and regions, outside of formal transfers like equalization: How many federal programs contain inherent subsidies to provinces and regions? What are some of the most significant and obvious such programs? Are these program-based subsidies large enough to change the way Canadians should think about the entire regional subsidy effort, including equalization?

The study concludes with a brief analysis of the implications of identified subsidies, along with suggestions for future research.

This is a preliminary study, and much additional work is needed to fully describe the extent, effectiveness, and fairness of the subsidies to provinces and regions incorporated in federal programs other than transfer programs. It is particularly important to consider whether economies of scale justify the extensive subsidies smaller provinces receive, as well as the impact of different costs of providing public services in different provinces. These are addressed in a preliminary way in the appendices, but further work is needed in both areas.

5. The Canada Pension Plan, while it doubtless has important regional economic impacts, is not included in this analysis because it is a separate entity.

The study does not attempt to identify all provincial subsidy arrangements built into federal operating programs. Instead, the programs examined were selected because of their size—we attempt to capture the programs with the largest subsidies—and the presence of existing research. A number of major programs—such as loan guarantees for offshore development, and emergency assistance to the automobile industry—are not addressed because they are non-recurring, and because there are provisions for repayments in the case of loans and fixed terms for guarantees.

The programs incorporating subsidies to provinces and regions examined in this study are:

1. Employment Insurance (regular benefits; program to support fishers; training programs)
2. Federal employment
3. Airport ground rental arrangements
4. Regional economic development agencies
5. Cultural programs
6. Immigration settlement

Federal programs with provincial subsidies

A number of federal programs provide clear and material subsidies to particular provinces based on program design or the distribution of federal revenues and spending. It is our contention that such asymmetries—in direct fees, program spending, and transfers to individuals that vary by province—constitute a hidden form of equalization. To truly understand the scale of equalization undertaken in Canada, we need to more thoroughly understand the extent and scale of these unseen transfers.

1. Employment Insurance

Canada's Employment Insurance (EI) program provides temporary financial assistance to Canadians who have lost their jobs through layoffs, are in the process of upgrading their skills, or are on temporary leave for reasons relating to the birth of a child, sickness in the family, and so on.[6] However, there are a number of ways in which the EI program goes beyond these goals and acts to transfer funds between provinces. This analysis looks at three specific components of the EI program with such an effect: regular unemployment benefits, the benefit program for fishers, and EI-funded training programs.

1.1. Regular unemployment benefits

Employment Insurance is the only major federal social program that does not treat similarly situated Canadians in the same way. Canadian workers become eligible for EI payments if they have worked for enough hours to qualify, and *this threshold varies according to the unemployment rates in particular regions.*[7] The maximum number of weeks payable for regular benefits

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6. For a broad overview of Canada's EI system please see http://www.servicecanada.gc.ca/eng/sc/ei/index.shtml. A full analysis of the program can be found in Mowat Center (2011).

7. The range is generally between 420 and 700 hours of insurable employment. See http://www.servicecanada.gc.ca/eng/ei/types/regular.shtml#Labour for more details.

varies by unemployment rate as well. Put simply, Canadian workers who have registered a similar number of eligible work hours during a given period will be eligible for different EI benefits depending on their location and the unemployment rate in the region.

The assumption underlying this mechanism is that people will find it harder to retain or obtain jobs in regions with higher unemployment. This assumption may or may not be true for particular individuals. Many other factors—the nature of their skills, conditions in the specific industry where they work, and technological change—affect the ability of any single person either to hold a job or to find a new one if they become unemployed. Consequently, some people who live in high-unemployment regions will have a much easier time getting and keeping jobs than others who live in low-unemployment areas. Much depends on their specific situations, and the local unemployment rate is only one factor. The disproportionate attention to this one factor is a grave flaw in the EI program (Busby and Gray, 2011).

The provincial transfers embedded in the EI system can be examined in a number of ways. One method is to compare, across provinces, the difference between total EI benefits paid out and employer-employee contributions paid in (Clemens and Veldhuis, 2003: 30–31).

The amount and share of EI premiums paid by employees and employers varies by province (**table 1**). For instance, in 2010, Ontario workers and employers paid 40.2 percent of all EI premiums, while Prince Edward Island contributed 0.4 percent of the total. There is also stark variation in the difference between premiums paid and benefits received in each province. In raw dollar terms, Ontario is the largest net contributor to EI with respect to regular benefits—a pattern traced by Jenness and McCracken (1994a) back to 1982—while Newfoundland and Labrador is the largest net recipient.[8] All four Atlantic provinces, along with Quebec, are net recipients.

More telling, however, is to adjust these figures by population (**figure 2**). Once this is done, it becomes clear that Alberta is the largest net contributor to EI with respect to regular benefits minus premiums paid. On a per-capita basis, Alberta contributes $390 per Albertan (net) into EI. The remaining four contributor provinces, namely Ontario, Manitoba, Saskatchewan, and British Columbia, range from $170 per capita in BC to $304 in Saskatchewan.

Newfoundland and Labrador is unmistakably the largest net recipient province after adjusting for population, receiving $846 (net) per capita in 2010. All four Atlantic provinces remain net recipients. Interestingly, while Quebec is still a recipient province, it is the lowest on a per-capita basis ($32).

8. "[O]ver the decade 2000–2010, Ontario workers and businesses made a net contribution of roughly $20 billion to the EI system. This is a heavy burden for workers and businesses operating in a competitive global economy" (Mowat Center, 2011: 11).

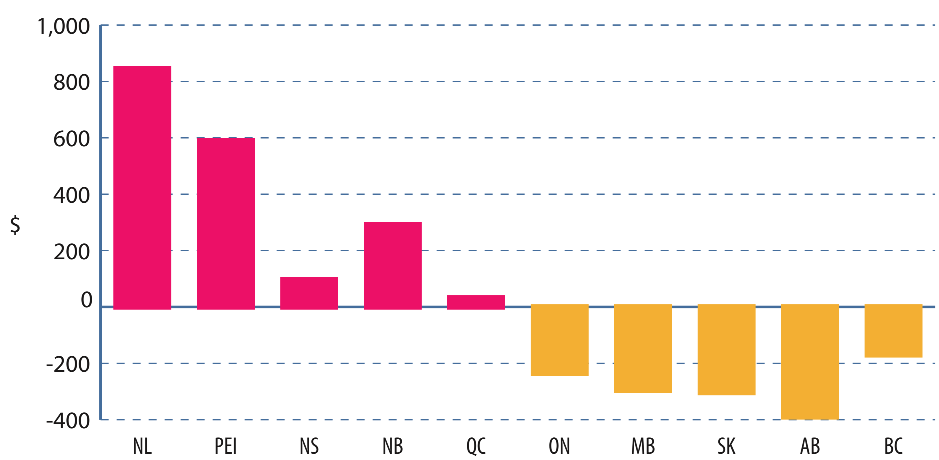
Table 1: EI contributions and benefits, by province, 2010

	EI premiums		Regular benefits		All income benefits		Difference, benefits minus premiums	
							Regular	All income
	$ million	% of total	$ million	% of total	$ million	% of total	$ million	$ million
Newfoundland and Labrador	255.5	1.5	688.8	5.5	892.9	5.0	433.3	637.4
Prince Edward Island	73.7	0.4	158.2	1.3	223.6	1.3	84.5	149.9
Nova Scotia	486.5	2.8	577.6	4.6	793.1	4.5	91.1	306.6
New Brunswick	399.5	2.3	619.6	4.9	829.4	4.7	220.1	429.9
Quebec	3,195.6	18.2	3,448.0	27.5	3,967.9	22.3	252.4	772.3
Ontario	7,048.0	40.2	3,939.5	31.4	6,092.1	34.2	-3,108.5	-955.9
Manitoba	654.3	3.7	288.9	2.3	505.7	2.8	-365.4	-148.6
Saskatchewan	565.0	3.2	247.1	2.0	417.6	2.3	-317.9	-147.4
Alberta	2,473.8	14.1	1,021.6	8.1	1,727.8	9.7	-1,452.2	-746.0
British Columbia	2,279.1	13.0	1,507.5	12.0	2,271.2	12.8	-771.6	-7.9

Notes: As premium payments are administered through the tax system, the most recent data available are for the 2010 taxation year. Province is determined by the location of the employer for premiums and of the claimant for benefits.

Source: Human Resources and Skills Development Canada (2012).

Figure 2: Net EI contribution per capita, by province, 2010



Sources: Human Resources and Skills Development Canada (2012); Statistics Canada (2012a); calculations by authors.

An alternative method by which to gauge the size of these transfers is offered by the Department of Employment and Social Development (formerly Human Resources and Skills Development Canada), which calculates the ratio of benefits received to contributions made, by province. A score of 1.0 indicates that a province contributed taxes to and received benefits from the EI program in proportion to one another. A score greater than 1 indicates net benefits paid to a province in excess of contributions; a score less than 1 indicates contributions in excess of benefits. The results of this method buttress the previous results: the Atlantic Provinces receive pronounced net benefits from EI, with Quebec receiving fewer but nonetheless net positive benefits as well (**table 2**, **figure 3**). British Columbia and Ontario are estimated to be close to break-even. The western provinces are all net contributors.

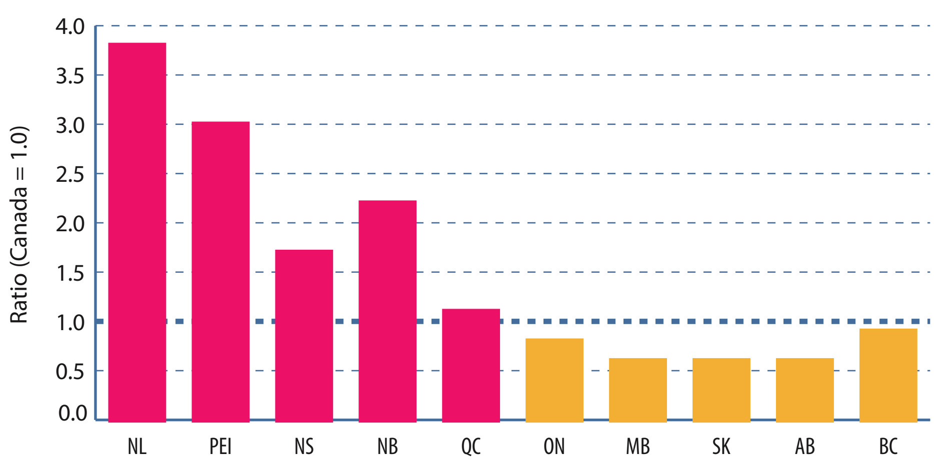
Another way to understand the scale and nature of the provincial transfer through regular unemployment benefits is through the share of the working-age population receiving employment insurance benefits (**table 3**). This follows the pattern observed above. Specifically, higher shares of the working-age population of Atlantic Canada—ranging from 5.3 percent in Nova Scotia to 10.3 percent in Newfoundland and Labrador—received EI benefits in 2012. Quebec recorded the lowest rate of the five net recipient provinces at 2.8 percent, which was only slightly higher than most of the contributing provinces. The share of the population receiving EI benefits in contributing provinces ranged from 2 percent in Alberta to 2.6 percent in Manitoba.

Table 2: EI benefits-to-contributions ratio, 2010

	Adjusted regular benefits-to-contributions ratio Canada = 1	Adjusted total income benefits-to-contributions ratio Canada = 1
Newfoundland and Labrador	3.8	3.4
Prince Edward Island	3.0	3.0
Nova Scotia	1.7	1.6
New Brunswick	2.2	2.0
Quebec	1.1	1.2
Ontario	0.8	0.9
Manitoba	0.6	0.8
Saskatchewan	0.6	0.7
Alberta	0.6	0.7
British Columbia	0.9	1.0
Nunavut	0.7	0.8
Northwest Territories	0.7	0.8
Yukon	1.1	1.1

Notes and sources: See figure 3, below.

Figure 3: EI adjusted regular benefits-to-contributions ratio, 2010



Notes:

For ease of analysis, the benefit-to-contribution ratios have been adjusted so that the national figure equals one.

As premium payments are administered through the tax system, the most recent data available are for the 2010 taxation year.

Province and territory are determined by the location of the employer for premiums and of the claimant for benefits.

The calculation of Quebec's regular benefit-to-contribution ratio takes into consideration that employers and employees in the province do not pay EI premiums for maternity and parental benefits, due to the presence of the Quebec Parental Insurance Plan. To account for this, the EI contributions from Quebec have been modified upward to estimate how much employers and employees in Quebec would pay in EI premiums if they had to contribute for EI maternity and parental benefits.

Source: Human Resources and Skills Development Canada (2012).

Table 3: Share of working-age population receiving regular EI benefits, 2012

	%
Newfoundland and Labrador	10.3
Prince Edward Island	9.6
Nova Scotia	5.3
New Brunswick	7.2
Quebec	2.8
Ontario	2.4
Manitoba	2.6
Saskatchewan	2.4
Alberta	2.0
British Columbia	2.5
Canada	2.8

Sources: CANSIM Table 276-0001: Employment Insurance Program, income beneficiaries by province, type of income benefit, sex and age, annual (persons); CANSIM Table 282-0002: Labour force survey estimates, by sex and detailed age group, annual (persons x 1,000); calculations by authors.

1.2. EI benefits for fishers

The federal government operates a program within EI to provide benefits to self-employed Canadians in the fishing industry.[9] Benefits are calculated based on earnings during a qualifying period, rather than the hours of work calculation employed in regular EI.

The EI Fishing Benefits program is unusual in several respects. Fishers are "the only self-employed workers eligible to receive benefits similar to regular benefits" (Leonard, 2010: 10). Also, the value of benefits paid through the program ($259.2 million) is high relative to the value of the fisheries in general, which in 2011 totalled $2.1 billion (Fisheries and Oceans Canada, 2013; HRSDC, 2012). The federal subsidy to this industry is therefore fairly large at 12.3 percent of the total wage bill.

Nova Scotia and Newfoundland and Labrador capture the lion's share of the sea fisheries in Canada, with a little over 66 percent of the total (**table 4**).[10] British Columbia maintains the third largest sea fisheries sector but is less than one-third the value of either Nova Scotia or Newfoundland and Labrador. Assuming that the distribution of fishing benefits is similar to the distribution of the sea fisheries themselves, Nova Scotia and Newfoundland and Labrador are the main beneficiaries of the EI program.

As with regular EI benefits, Atlantic provinces are the main beneficiaries of this sector-specific benefit program within EI.

Table 4: Canadian sea fishery values and imputed fishing benefits, 2011

	Fishery value ($ millions)	% of total	EI fishing benefits ($ millions)
Newfoundland and Labrador	643.9	30.6	79.2
Prince Edward Island	109.8	5.2	13.5
Nova Scotia	750.1	35.6	92.3
New Brunswick	175.6	8.3	21.6
Quebec	149.2	7.1	18.4
British Columbia	278.7	13.2	34.3
Total	2,107.3		259.2

Note: EI fishing benefits are imputed on the assumption that their distribution reflects the value of the fisheries.

Sources: Fisheries and Oceans Canada (2013); HRSDC (2012: Annex 2.6); calculations by authors.

9. For information on the benefit program for fishermen in EI please see http://www.servicecanada.gc.ca/eng/sc/ei/benefits/fishing.shtml.

10. Freshwater fish landings account for about 4 percent of all fish landings in Canada, and are not considered in this analysis.

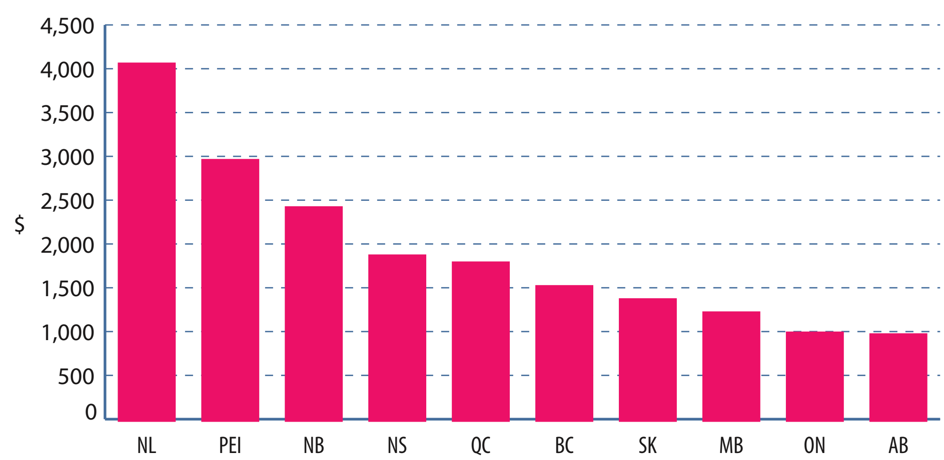
1.3. EI-funded training programs

In order to qualify for EI-funded training programs, workers have to be eligible for EI, so the eligibility differences explained earlier result in varying access to training programs by province. According to Ontario Ministry of Finance calculations (**figure 4**), federal training expenditure per unemployed person in 2011 ranged from "$970 in Ontario compared with $4,040 in Newfoundland and Labrador, $2,940 in Prince Edward Island, $1,770 in Quebec and $1,520 in British Columbia. Overall, Ontario received only 28% of the EI Part 2 training allocation in 2011-12" (Ontario, 2012: 218). Note that Alberta receives the lowest training funding per unemployed worker, according to these calculations.

In 2005, the issue of training expenditures came up during negotiations between the federal government and Ontario on the fiscal gap facing Ontario at the time. The Ontario government noted that Ontario received $1,143 per person in EI-funded training, compared to $1,827 in the rest of Canada—a shortfall of $314 million (Ontario, 2005). In addition, an earlier study reviewed the provincial distribution and impact of training and skill development programs and concluded that, "set against whatever labor market indicators—labour force, employed, unemployed—one wishes to use, the Atlantic Provinces and Quebec are overfunded, and Ontario grossly underfunded" (Jenness and McCracken, 1993a: 15).

In summary, while data is too limited to express federal biases in training expenditures in financial terms, it is reasonable to conclude that provinces east of the Ottawa River are grossly overfunded in relation to training expenditures, while the western provinces and Ontario are underfunded.

Figure 4: EI training allocation per unemployed, by province, 2011/2012



Source: Adapted from Ontario (2012): chart 3.2, p. 218. Figures for Nova Scotia, New Brunswick, Manitoba, Saskatchewan, and Alberta are estimates.

Assessing recent EI reforms

In recent months, the federal government has made some changes to the EI program, including changes to the definition of suitable employment and what constitutes a job search (Service Canada, 2013). While these reforms have much merit, the Mowat Center (2012: 12) recently estimated that they will not change the program significantly.

The review of payment and benefits flows within EI suggests that the provincial transfers within the program amount to several billion dollars annually. Ontario pays a disproportionately high share of the total costs of the program while its workers have reduced access to it relative to other provinces. Alberta is the largest and most significant contributor on a per-capita or per-worker basis and, like Ontario, has limited access to the program relative to other provinces.

EI is a major industry in most recipient provinces, particularly in Atlantic Canada. It is so large in relation to the economies of these provinces that it almost certainly disrupts labour markets and impairs the economic performance of the region (Audas and Murrell, 2000). Despite recent changes, the substantial flow of funds within EI from regions west of the Ottawa River is likely to continue largely unabated.

Conclusion

The key insight emerging from the discussion of regular unemployment benefits, the fishing benefit program, and EI-funded training programs is that substantial regional subsidies are received by some provinces, particularly the Atlantic provinces and to a lesser extent Quebec, that are in practical terms financed by the western provinces along with Ontario. These transfers constitute a hidden type of equalization, whereby resources flow to and from specific provinces due to the design of federal EI programs.

2. Disproportionate federal employment as a subsidy

The geographic location of federal employees can have profound implications for the flow of federal funds (Eisen, 2010).

Some categories of federal employees would not be expected to be evenly distributed across the country. Many if not most federal employees in the Ottawa-Gatineau region perform head office functions which probably cannot be evenly spread across the country, and the location of some other employees is also linked to geography—for example, a large portion of federal employees in the Department of Fisheries and Oceans will by all logic be located in provinces with access to oceans and covered waterways. Defence expenditures may also be determined largely by geographic and strategic considerations, which almost certainly will not result in an even distribution of employees across the country—for example, Canada's most significant naval facilities must be located in Atlantic Canada and British Columbia. In addition, federal employees outside Canada, such as those working at foreign embassies and consulates, could not be evenly distributed across Canada.

However, a portion of the federal public service is designed to provide services (such as Employment Insurance) to citizens. This category of federal employees should be relatively evenly distributed across the country, and any substantial deviations from such a pattern can reasonably be considered a form of subsidy.

After adjusting federal employment to the fullest possible extent—for Ottawa-Gatineau employment, military employment, and federal employees located outside of the country—it appears that there is a fairly large range of population-adjusted federal employment in provinces (**table 5**, **figure 5**). Prince Edward Island enjoys 24 federal employees per 1,000 residents, the highest in the country, although this figure is skewed somewhat by the location of the head office of the Department of Veterans' Affairs in Charlottetown. Ontario, on the other hand, maintains federal employment of 3.4 per 1,000 residents, which is roughly 85 percent lower than PEI.

In general, the Atlantic Provinces dominate other provinces with respect to the level of federal employment for customer service programs in their provinces, relative to population. At the other end of the spectrum, Ontario, Quebec, and Alberta maintain the lowest population-adjusted level of federal public sector employment for customer service programs. It's worth noting that of the three provinces with the lowest rate of federal employment, only Alberta would not have capital-city employment; that is, both Ontario (Ottawa) and Quebec (Gatineau) enjoy high levels of federal employment in the National Capital Region.

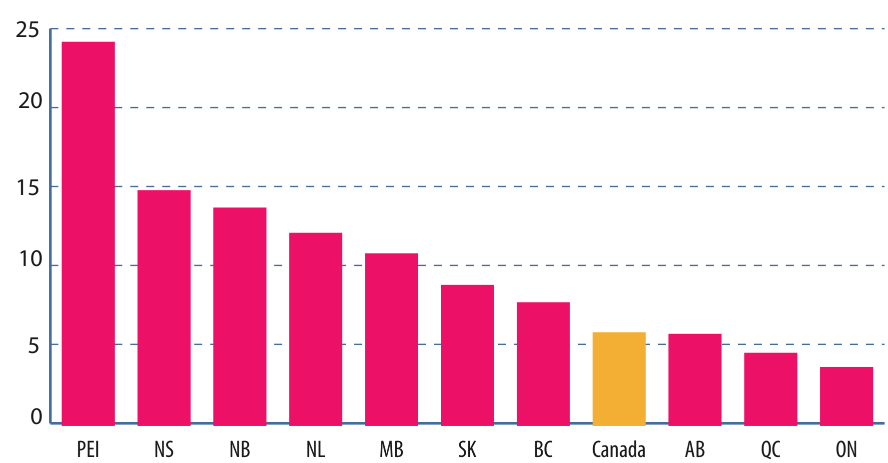
Table 5: Federal government employment, 2011

	Population	Federal government employment, including military	Military personnel	Federal government employment, excluding military	Ottawa-Gatineau employees adjustment	Adjusted federal government employment		
						Total	Per 1,000 residents	Rank
Newfoundland and Labrador	513,000	7,442	1,323	6,119		6,119	11.9	4
Prince Edward Island	146,000	3,746	247	3,499		3,499	24.0	1
Nova Scotia	948,000	24,583	10,740	13,843		13,843	14.6	2
New Brunswick	755,000	16,530	6,298	10,232		10,232	13.5	3
Quebec	7,978,000	87,067	18,534	68,533	-34,610	33,923	4.3	10
Ontario	13,366,000	181,272	31,817	149,455	-104,067	45,388	3.4	11
Manitoba	1,252,000	17,437	4,116	13,321		13,321	10.6	5
Saskatchewan	1,058,000	10,260	1,180	9,080		9,080	8.6	6
Alberta	3,778,000	30,669	9,823	20,846		20,846	5.5	9
British Columbia	4,577,000	42,229	7,886	34,343		34,343	7.5	7
Canada	34,484,000	423,596	92,189	331,407	-138,677	192,730	5.6	8

Notes: Does not include employees outside Canada. The data for Quebec and Ontario has been adjusted deducting the number of employees in the Ottawa-Gatineau area. In 2011, about 32.5% of the total federal workforce (which includes the federal government and the military, Canada and outside Canada) works in this area. Ottawa accounts for 75% of the total employment in this area and Gatineau accounts for 25%.

Sources: Statistics Canada (2011, 2012a, d, e, 2013b); calculations by authors.

Figure 5: Federal employees per 1,000 residents, 2011



Sources: See table 5.

All equalization-receiving provinces except Quebec appear to have federal employment for general government functions that is much higher than would be the case if such employment was primarily viewed as for consumer service, and distributed among provinces in relation to their populations. This raises some questions about the service levels received in these provinces for federal programs.

Differential federal employment and wage bills by province

Federal employment data can be translated into monetary flows by comparing the federal wage bill in each province to the spending levels that would exist given evenly distributed employment for general government programs.

After adjusting for federal employment in the National Capital Region, as well as for employees residing outside of the country, we first observe a fairly large range of federal spending on wages by province (**table 6, figure 6**). Nova Scotia enjoys the largest per capita federal employee expenditure, at $1,532 per 1,000 Nova Scotians. Ontario, on the other hand, receives $281 per 1,000 Ontarians through federal spending on wages for federal employees in the province (excluding employees in the National Capital Region).

Table 7 shows the difference between actual federal spending on federal employees by province and the expected value of that spending if employees were evenly distributed, adjusting for federal employees in the National Capital Region, military personnel, and federal employees working outside of the country. Six provinces receive larger federal spending due to higher levels of federal employment than would have been predicted under an even distribution, after adjustments. The three westernmost provinces receive minor transfers, ranging from $10 per capita in Alberta to $15 per capita in British Columbia. These are greatly overshadowed by those made to the three recipient Atlantic Canadian provinces. Prince Edward Island has the smallest transfer from federal employment of the three recipient Atlantic Canadian provinces, at $329 per capita. Nova Scotia and New Brunswick enjoy marked federal-employment transfers of $1,167 and $1,482 per capita, respectively.

A different way of looking at this transfer is to compare it to the formal value of equalization received by the three Atlantic Canadian provinces. The subsidies received by the provinces in the form of larger-than-expected federal employment for general government functions represent 39.3 percent of equalization in PEI, 44.2 percent in New Brunswick, and a startling 90.1 percent in Nova Scotia. In other words, the value of the transfer from federal employment in Nova Scotia is almost as large as the entire equalization transfer.

Overall, the general pattern is that disproportionate federal employment for general government functions conveys large subsidies to three of the Atlantic Provinces. Much smaller subsidies are also conveyed to some other provinces. These transfers can reasonably be called a form of stealth equalization (Eisen, 2010).

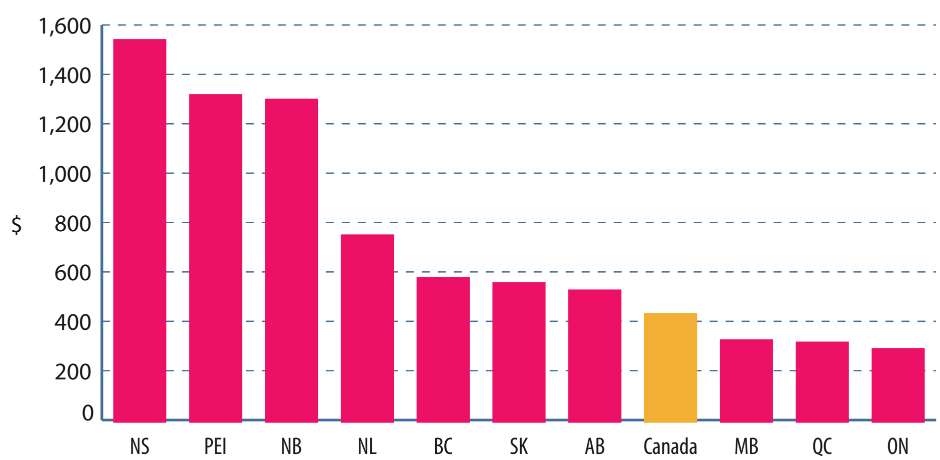
Table 6: Federal wage and salary expenditures, 2011

	Population	Total federal employee compensation ($000s)	Military personnel compensation ($000s)	Federal employee compensation excluding military ($000s)	Ottawa-Gatineau federal employee compensation	Adjusted federal wage and salary expenditure: Total ($000s)	Per 1,000 residents ($)	Rank
Newfoundland and Labrador	513,000	514,657	134,367	380,290		380,290	741	4
Prince Edward Island	146,000	246,200	55,477	190,723		190,723	1,309	2
Nova Scotia	948,000	1,716,518	263,760	1,452,758		1,452,758	1,532	1
New Brunswick	755,000	1,069,988	94,578	975,410		975,410	1,291	3
Quebec	7,978,000	6,021,736	964,742	5,056,994	-2,609,687	2,447,307	307	10
Ontario	13,366,000	13,837,908	2,233,593	11,604,315	-7,846,996	3,757,319	281	11
Manitoba	1,252,000	1,135,682	740,625	395,057		395,057	316	9
Saskatchewan	1,058,000	717,981	137,791	580,190		580,190	548	6
Alberta	3,778,000	2,105,760	147,157	1,958,603		1,958,603	518	7
British Columbia	4,577,000	3,103,154	499,836	2,603,318		2,603,318	569	5
Canada	34,484,000	30,716,408	5,686,777	25,029,631	-10,456,683	14,572,948	423	8

Notes: Does not include employees outside Canada. The data for Quebec and Ontario has been adjusted deducting the number of employees in the Ottawa-Gatineau area. In 2011, about 32.5% of the total federal workforce (which includes the federal government and the military, Canada and outside Canada) works in this area. Ottawa accounts for 75% of the total employment in this area and Gatineau accounts for 25%.

Sources: Statistics Canada (2011, 2012a, d, e, 2013b).

Figure 6: Adjusted federal wage and salary expenditures per 1,000 residents, 2011



Sources: See table 6.

Table 7: Estimated provincial subsidies through federal employment

	A: Adjusted federal wage and salary expenditure from table 5 ($ millions)	B: Federal wage and salary expenditure if employment evenly distributed ($ millions)	C: Total difference, A-B ($ millions)	Per capita difference, A-B ($)	Official 2011/2012 equalization ($ millions)	Federal employment subsidy (C) as share of official equalization
Prince Edward Island	191	62	129	886	329	39.3%
Nova Scotia	1,453	401	1,052	1,109	1,167	90.1%
New Brunswick	975	319	656	869	1,483	44.2%
Saskatchewan	580	447	133	13	—	—
Alberta	1,959	1,597	362	10	—	—
British Columbia	2,603	1,934	669	15	—	—

Sources: See tables 4, 5; Department of Finance (2013); calculations by authors.

3. Airport ground rental arrangements

During the decade from 1990 to 2000, the federal government transferred responsibility for operating major airports to local not-for-profit organizations (Dion, 2002). In return for the airport and related assets being transferred to local authorities, the airports were required to pay ground rentals—based on airport *revenue*—to the federal government on an ongoing basis.[11]

In 2011, Toronto's Pearson Airport alone was responsible for almost half (48 percent) of the total airport rental fees paid to Transport Canada by Canada's major airports (**table 8**). The big four airports—Vancouver, Calgary, Pearson, and Montreal—accounted for nearly 90 percent of rental revenues collected by the federal government in 2011.

However, while the nine airports listed in table 8 shouldered 96.9 percent of total airport rents, they only accounted for 77.6 percent of total passenger traffic and 76.6 percent of total cargo handled by Canadian airports. Although Pearson paid 48 percent of total rental fees to the federal government, it only had 28.5 percent of passenger traffic and 32.5 percent of cargo activity. Montreal PET airport shows a similar but smaller differential.

These figures can reasonably be interpreted as a measure of transfers from these nine airports—and citizens in the provinces in which they are located—to other, smaller airports and the provinces in which they are located. For instance, PEI's Charlottetown Airport has not paid any rental fees and will not be required to make such payments until 2016 (Charlottetown Airport Authority, 2012: 31).

The fee policy has economic implications for affected airports. Indeed, the CEO of the International Air Transport Association noted that these arrangements have major negative implications for Toronto, Ontario, and ultimately Canada:

> "In Canada, you have the Crown rent that is killing the opportunity to have Toronto take full advantage. You are missing an opportunity to expand and to become a real hub for the United States … the Canadian government doesn't understand that cashing in on Crown rent is a short term vision." (Jang, 2011)

Pearson in many ways acts as the gateway to Toronto and Ontario for the world, and the airports in Vancouver, Calgary, and Montreal perform the same function for these cities. Impairing the performance of these airports

11. The Canadian Airports Council (2005) has noted that the amounts collected from airport rental fees greatly exceed the book value of facilities and land transferred initially—more than $2 billion, by 2005, for assets that had an original book value of $1.5 billion. For additional discussion of this issue see Greater Toronto Airport Authority (2012: 30–57).

Table 8: Rents, passengers, and cargo for Canada's major airports, 2011

	Airport rents		Passengers			Cargo		
	$ millions	% of total	Number (enplaned and deplaned)	% of total	Difference	Tonnes (loaded and unloaded)	% of total	Difference
Calgary, AB	29.4	10.8	12,073,264	10.7	-0.1	83,524.3	8.0	-2.8
Halifax/Robert L. Stanfield, NS	5.2	1.9	3,482,421	3.1	1.2	25,471.3	2.4	0.5
Montréal/Pierre Elliott Trudeau, QC	44.2	16.2	13,228,564	11.7	-4.5	76,622.9	7.3	-8.9
Ottawa/Macdonald-Cartier, ON	7.3	2.7	4,359,055	3.9	1.2	10,288.1	1.0	-1.7
Saskatoon/John G. Diefenbaker, SK	0.6	0.2	1,214,704	1.1	0.8	4,797.2	0.5	0.2
St John's, NL	1.2	0.5	1,329,239	1.2	0.7	8,850.1	0.8	0.4
Toronto/Lester B. Pearson, ON	131.0	48.0	32,278,458	28.5	-19.5	339,064.9	32.5	-15.5
Vancouver, BC	39.1	14.3	16,394,986	14.5	0.2	186,385.3	17.8	3.5
Winnipeg/James Armstrong Richardson, MB	6.5	2.4	3,383,882	3.0	0.6	65,254.3	6.2	3.9
Total (all airports, listed above and unlisted)	273.0	96.9	113,083,485	77.6		1,044,177.8	76.6	

Note: Numbers may not add due to rounding.

Sources: Calgary Airport Authority (2012); Halifax International Airport Authority (2012); Aeroports de Montreal (2012); International Airport Authority Ottawa (2012); Saskatoon Airport Authority (2012); St John's International Airport Authority (2011); Greater Toronto Airport Authority (2012); Vancouver Airport Authority (2012); Winnipeg Airport Authority (2012; Transport Canada (2012); Statistics Canada (2012b: 8, 11); calculations by authors.

by forcing them to provide subsidies to other regions, and by charging rents in a way that discourages growth, seems to be both short-sighted and unfair.

The Senate has recognized the problem. In April, 2013, it urged the federal government to "establish and implement a plan to phase out ground rentals completely over time for airports that are part of the national airport system" (Senate of Canada, 2013: 11).[12]

It is beyond the scope of this paper to fully analyze the structure and rationale for airport ground rental payments. However, it is worth noting that the arrangement is unusual for several reasons. First, the rental payments are fairly large, and not just in relation to the assets involved. In the case of Toronto's Pearson's airport, for instance, the value of the airport rental fee is

12. There is a substantial discussion of the ground rents system in appendix B to the Senate report.

greater than all the wages and benefits paid by the airport authority.[13] Second, while the payments are called rentals, the federal government does not incur any costs for expansions, new terminals, or other capital investments. Finally, the rentals are calculated on the basis of each airport's revenues instead of a more conventional arrangement such as traffic.

4. Regional economic development agencies

Concerns about differences between regional development and economic well-being have preoccupied Canada since before Confederation. Canada has a long history of different programs and approaches intended to facilitate greater convergence of economic outcomes.[14] For the purposes of this paper, the most relevant regional development programs are the current regional development agencies, created in 1987–1988 to replace previous agencies and programs.[15]

Three principal regional development agencies were funded by the federal government up until 2009: Western Diversification (WD), the Economic Development Agency for the Quebec Region (CED-Q), and the Atlantic Canada Opportunities Agency (ACOA). In 2009, the federal government created two new agencies: the Federal Economic Development Agency for Southern Ontario (FedDev Ontario) and the Canadian Northern Economic Development Agency (CanNor). These regionally-focused agencies are specifically tasked with trying to improve economic performance in their respective regions, through direct spending and support as well as through indirect measures such as loan guarantees.

Federal regional development spending transfers considerably more resources into Atlantic Canada per capita ($130.1) than into other regions (**table 9**). For example, population-adjusted spending in Quebec through CED-Q is less than one-third the level spent in Atlantic Canada. Interestingly, though, the largest per capita transfers are now made to CanNor—$452 in 2012/2013.

13. In 2012, ground rent expenditures for Pearson were $130.5 million. Expenditures for wages, salaries and benefits for that year were $120 million (Greater Toronto Airport Authority, 2012: 39).

14. See Dupuis (2011) for an excellent overview of federal programs and initiatives aimed at regional development.

15. Federal economic development activities are much broader than the programs of regional development agencies. They are marked by huge projects in some areas—loan guarantees for oil and gas developments in Newfoundland and Labrador, assistance to aerospace industries in Quebec, emergency assistance to the automobile industry in Ontario. These are not included in this analysis because they are non-recurring in nature, and often include provisions for repayment or, in the case of guarantees, fixed terms.

Table 9: Regional Development Agency spending, 2011/2012 and 2012/2013

	Total expenditure ($ millions)		Per capita expenditure ($)		Full-time staff equivalents	
	2011/12	2012/13	2011/12	2012/13	2011/12	2012/13
Western Diversification Program	195.3	176.3	18.3	16.3	397	408
Economic Development Agency for the Quebec Region	305.9	300.8	38.3	37.3	406	359
Atlantic Canada Opportunities Agency	330.4	307.5	139.9	130.1	683	624
Federal Economic Development Agency for Southern Ontario	169.5	218.8	12.7	16.2	75	216
Canadian Northern Development Agency	48.6	51.2	429.5	452.1	77	78

Sources: Western Development Agency (2012, 2013); Economic Development Agency for the Quebec Region (2012, 2013); Atlantic Canada Opportunities Agency (2012, 2013); Federal Economic Development Agency for Southern Ontario (2012, 2013); Canadian Northern Development Agency (2012, 2013).

This pattern of regional development spending by the federal government is not a recent phenomenon. Nearly twenty years ago, for example, Jenness and McCracken (1994b: 2) noted that these agencies were almost completely focused on Quebec and Atlantic Canada. At that time, per capita expenditures were $32 in Quebec and $125 in Atlantic Canada. The corresponding figures for Ontario (north only) and the four western provinces were $18 and $30 respectively.

Overall, based on 25 years of data, it is clear that the pattern of federal economic development expenditures strongly favors Quebec and Atlantic Canada. Federal financial support for economic development agencies is similar to many other programs discussed in this study: disproportionate support for provinces east of the Ottawa River from taxpayers in most provinces west of it.

5. Cultural programs

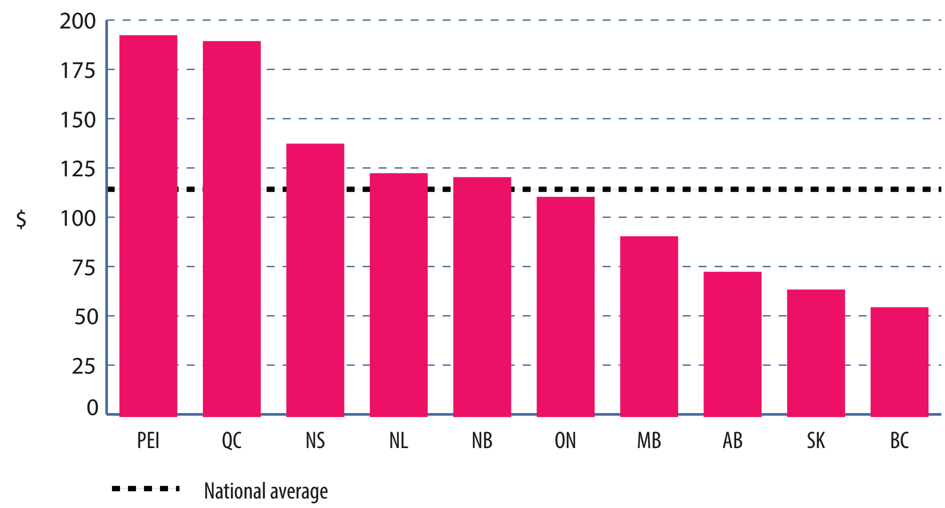
The federal government spends money on a host of culture-related activities. In 2009/2010, the most recent year for which federal spending is available by province, it spent nearly $3.9 billion on culture. This is one area where Canadians might expect a reasonably consistent level of spending, given the nature of the underlying programs. However, per-capita cultural spending by the federal government varies considerably by province (**figure 7**).

Especially telling is the difference in per-capita cultural spending by province relative to the cross-provincial average (**table 10**). The largest positive transfer by this measure—$191 vs. $115—occurs in Prince Edward Island. The total received in PEI is two-fifths larger than it would be if the transfer were in line with the average for all provinces. The Atlantic Provinces and Quebec all receive per-capita cultural spending that exceeds the average.

On the other hand, Ontario and all four western provinces receive per-capita federal spending on culture that is less than the cross-provincial average. These shortfalls are material. For instance, in British Columbia, per-capita federal spending on culture is less than half the national average: $53 vs. $115.

The variations in federal spending on culture therefore follow the pattern observed in several other programs discussed thus far: a significant subsidy for Atlantic Canada and Quebec, with flows coming from Ontario and the western provinces.

Figure 7: Per capita federal government culture expenditures, 2009/2010



Sources: Statistics Canada (2012a, 2012c) and calculations by authors.

Table 10: Federal government expenditure on cultural programs, by province, 2009/2010

	Total cultural program expenditure ($ 000s)	Per capita cultural program expenditure ($)	Deviation from average provincial per capita rate ($)	Implied subsidy ($)
Newfoundland and Labrador	61,699	121	6	3,039,767
Prince Edward Island	26,949	191	76	10,696,396
Nova Scotia	128,220	136	21	19,845,686
New Brunswick	89,132	119	4	2,721,412
Quebec	1,468,861	188	72	567,151,885
Ontario	1,427,875	109	-6	-77,950,876
Manitoba	108,939	89	-26	-31,621,471
Saskatchewan	64,161	62	-53	-54,460,518
Alberta	262,400	71	-44	-160,781,150
British Columbia	235,240	53	-62	-278,641,129
Canada	3,873,476	115		

Sources: Statistics Canada (2012a, 2012c), and calculations by authors.

6. Immigration settlement

Large-scale immigration is an important feature of Canadian society, and one that poses great opportunities and significant challenges in terms of public policy. Most Canadians would agree that fair and substantial efforts to support the absorption of immigrants are necessary if the purported benefits of immigration—improved economic growth, greater innovation, and substantial links with countries of origin, among others—are to be realized.

Given the importance of this issue, a full examination of the fairness of current and past regional subsidies incorporated into federal immigration support arrangements is urgently needed. It is not possible to provide it in this preliminary study. However, some observations can be made based on the work of other researchers.

James McAllister (2010: 9–11) examined the distribution of expenditures for immigrant settlement in 2010, using budgeted figures for the 2010/2011 fiscal year:

- Ontario's share of settlement spending allocations (45.7 percent) was roughly in balance with its percentage of new permanent residents from immigration (44.9 percent).
- Significant funding shortfalls, relative to immigration patterns in other provinces, were evident in BC, Alberta and Saskatchewan.
- BC's funding shortfall was particularly significant. In 2010/2011, that province was allocated 13 percent of settlement funding while it received 18 percent of Canada's new permanent immigrants.
- The extent of overfunding for Quebec, relative to other provinces, was significant. Quebec received 18 percent of new permanent residents coming to Canada in 2010, but was allocated 28 percent of total funding for immigration settlement programming.

Settlement funding was a major issue in the 2005 fiscal-gap negotiations between the federal and provincial governments. Ontario argued that while it took 57 percent of immigrants, it was receiving only 34 percent of federal funding for immigrant support at the time. A decade earlier, Jenness and McCracken (1994c) noted that while immigrant share and immigration support funding were balanced in Western Canada and the Atlantic Provinces, Quebec was grossly overfunded, and Ontario grossly underfunded.

In summary, the underfunding for immigrant settlement that had bedeviled Ontario for decades had been corrected by 2010, but new funding shortfalls have emerged in Western Canada which demand attention. The bias in favor of Quebec persists, but is somewhat less pronounced than previously.

Conclusion

Provincial subsidies incorporated in operating programs are a prominent feature of federal programming. Provincial and regional subsidies other than equalization have an importance that belies the relative lack of attention given to them.

Unfortunately, we do not know just how many federal programs have this strong tendency to create provincial subsidies. However, if provincial subsidies can be built into programs as disparate as culture, airport rentals, and regional development agencies, then it is probable that many other such subsidies are built into other federal programs.

How significant are provincial subsidies incorporated in federal operating programs?

The significance of these arrangements is not just a matter of how many programs exist or the expenditures relating to them, even though these are obviously important. Fairness—or the lack of it—matters too.

Most people assume that similarly situated people are treated in similar ways by governments. Unfortunately, our study indicates that the Government of Canada does not pay enough attention to this fundamental principle of public administration. Similarly situated people seeking EI are treated differently depending on where they live. The same is true of immigrants seeking support after their arrival, or workers seeking access to training programs. The treatment of institutions with similar functions varies widely as well. Airports are just as important to Toronto as they are to Charlottetown, but ground rental arrangements are much more generous for Charlottetown than Toronto.

The most seriously unfair program, of those reviewed in this report, is likely to be EI assistance to fishers. In this case, the federal government provides EI benefits to self-employed people in one sector that it does not provide to similarly situated people in any other sector. A self-employed graphics designer in Medicine Hat does not get EI, while a self-employed fisher in Tignish does.

The Government of Canada needs to consider the implications of routinely treating similarly situated Canadians in very different ways depending on where they live, and to ask whether this is a reasonable way to build a competitive economy or a strong national community in the years to come.

Is "equalization outside equalization" big enough to change perceptions of the entire regional subsidy effort?

Unfortunately, the Government of Canada has never conducted a study of the economic impact of Canada's comprehensive regional subsidy system. It is also probable that the federal legislators who countenance regional subsidies other than equalization have little understanding of how many there are, or of their cost.

However, it appears that the regional subsidy system is so big—much bigger than equalization on its own—that it is not sustainable in anything close to its current form. The Alberta government, for instance, estimates that its net fiscal deficit with the rest of Canada in 2011 was $19 billion (Alberta, 2012)—about 7 percent of output in a province with a GDP of $275 billion that year (Statistics Canada, 2013a). For most of the past fifty years, Ontario's net fiscal deficit with the rest of Canada has been about 4 percent of GDP, although it has been as high as 6 percent and recently has fallen to about 2 percent (Jenness and McCracken, 1993b).

Both provinces face major uncertainties in the global economy. The capacity of both to succeed will be greatly impaired because each is carrying a burden—with no financial return—to support other Canadians.

This system also discourages growth and development in traditional equalization-receiving provinces, a point made by virtually all independent commentators who have studied them (e.g., Boothe and Hermanutz, 1999; McMohan, 2000; Segal, 2010; Ontario Chamber of Commerce, 2011).[16] Regional subsidies encourage excessive infrastructure and excessively large provincial public services; in the case of EI, they also discourage labour mobility. They enable the growth of public sectors in traditional equalization-receiving provinces that are much larger, expressed in terms of employment, than in Ontario, Alberta, and British Columbia (Ecole Nationale de Administration Public, 2013). These factors all discourage growth and negatively affect the people of these provinces.

One conclusion can certainly be drawn from this study: regional subsidies incorporated in programs other than equalization deserve much greater attention than they receive. They are a substantial but little-understood feature of Canadian society.

16. See West (2013) for discussion of an analogous issue in Australia.

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Appendix 1

The issue of scale

Some may consider the extensive subsidies provided to smaller provinces to be justified, in whole or in part, because economies of scale may make it difficult to provide public services in smaller provinces as efficiently as in larger jurisdictions.

It is clear that economies of scale would be evident in some programs, such as the costs of running legislatures. The Prince Edward Island legislature serves 140,000 people, while Ontario's serves over 13 million people. General administration costs of this type are, however, a relatively small portion of provincial public spending. The cost of running the PEI legislature, for example, is $6 million, on a total program budget of $1.5 billion (CBC, 2013; Prince Edward Island, 2013: 7).

Most provincial expenditures are devoted to programming that consists of large retail services—hospitals, schools, universities, policing, and others. The question is whether economies of scale arguments apply to them. The literature on this question is extensive and generally concludes that they do not.

Hospitals demonstrate this pattern. They are the largest line item in some provincial budgets. They are capital intensive and their cost structures are largely fixed. For these reasons, we might expect them to be more and more efficient as they become larger. Indeed, the health policies of most provinces are based on this assumption. However, the evidence does not support the presence of substantial economies of scale in hospitals.

The National Institute for Health and Care Excellence in the United Kingdom, for instance, notes that "economies of scale are evident only for small hospitals (less than 200 beds) … the optimal size for acute hospitals ranges from 200 to 400 beds … above 400–600 beds, average costs increase" (Posnett, 1999).

Similarly, the World Health Organization draws on the experience of its members and comes to the same general conclusion:

> It is tempting to think that larger hospitals are more cost effective than smaller ones because of the operation of economies of scale. However, the evidence does not back up this belief. While increasing hospital size can cut costs for some specific procedures, such economies are exhausted at a relatively small size. (World Health Organization, 2013)

One could generally conclude that similar results would likely be evident for many of the other institutions, in provincial public sectors, that have financial characteristics like hospitals. This means that economies of scale in provincial public sectors are likely to be less important than is commonly presumed.

It is also evident that tools other than subsidies can address economies-of-scale issues. For example, most provinces negotiate contracts with the federal government to use the RCMP as the provincial police force. This spreads the fixed costs of policing over a much larger population base than would otherwise be the case, and overcomes any problems of scale that might confront smaller jurisdictions. One could imagine many other arrangements of this type that could be implemented, particularly in Atlantic Canada.

In summary, economies of scale in provincial public sectors are likely to be less important than is commonly presumed. Even if they are evident in some cases, measures other than subsidies are often available to deal with them. Consequently, Canada's system of regional subsidies probably cannot be justified by economies of scale arguments, although further research is necessary to confirm this.

Appendix 2

Provincial pricing differentials and expenditure needs

Canada's Equalization Program has an important feature that does not receive much public attention. The determination of entitlements for each province is based solely on revenue considerations—tax capacity, tax utilization, and a variety of comparisons that relate to these. The factors that determine actual population need—demographics, population distribution, differences in price levels (or cost inputs for government programs) in provinces, urbanization, and many other factors—are not a part of entitlement calculations for equalization. As is evident from the preceding analysis, factors relating to population need are also absent from many of the other programs by which the federal government delivers subsidies to particular regions or provinces.

The aspirational principle relating to equalization in Canada's constitution is cast in terms of achieving comparable programs, not similar revenues per capita or any other revenue based calculation. There is, therefore, a fundamental contradiction at the heart of the program: the system by which entitlements are determined does not capture many of the real-life factors that determine program comparability, the stated constitutional goal.

This problem has many far-reaching consequences. One of the most serious is that differences in price levels among provinces are not considered in determining equalization entitlements and regional subsidies incorporated in other federal programs. Building on the work of Peter Gusen for the Mowat Centre, Tom Courchene of Queen's University has assessed the changed equalization entitlements that would result if price variations among provinces were included:

> … the results border on the astounding. Ontario, with $8,135 per capita in real-purchasing-power revenues, comes off as the most fiscal-capacity-deprived province, and by a considerable margin. The next closest are Manitoba with $8,674 and Quebec with $8,725. Lest one think that these are small differences, with a population in the neighbourhood of 13 million Ontario's near $600 per capita shortfall (in real terms) relative to Quebec means that it would take nearly eight billion dollars

> (of real purchasing power) to close the Ontario-Quebec gap. Moreover, non-equalization-receiving province British Columbia ends up with a lesser ability to provide per capita real quantities of public goods than does Prince Edward Island. (Courchene, 2013: 9)

It is important to note, then, that although the goal of equalization is to allow for comparable services, the determination of payments excludes many factors influencing the costs of delivering such services.

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David MacKinnon is a frequent commentator on Canadian fiscal issues. He has spoken to audiences across Ontario and his work has appeared in the *Globe and Mail*, *Policy Options*, the *Toronto Star*, the *National Post,* and many local newspapers across Canada. He has also been a guest on *The Agenda* on TVO, the Business News Network, and other national public affairs programs.

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