

THE DONNER PRIZE WINNER

*This year the Donner Canadian Foundation inaugurated the Donner Prize, a \$25,000 award for the best book on public policy published in the previous year. The inaugural winner was Queen's University economist Thomas Courchene, with Queen's Ph.D. student Colin R. Telmer, for *From Heartland to North American Region State: The Social, Fiscal and Federal Evolution of Ontario*, published by the University of Toronto's Centre for Public Management as part of its monograph series on public policy. The award was presented at a dinner in Toronto on May 13, at which, as a condition of winning, Prof. Courchene gave a short talk about his book. Here is the text of his remarks.*

*Cette année, la Fondation canadienne Donner a inauguré le Prix Donner, d'un montant de 25 000 \$, qui récompense le meilleur ouvrage de politique publique publié au cours de la dernière année. Le premier récipiendaire du prix est l'économiste Tom Courchene de Queen's University, conjointement avec un étudiant au doctorat de la même université, Colin R. Telmer, pour l'ouvrage intitulé *From Heartland to North American Region State : The Social, Fiscal and Federal Evolution of Ontario*. L'ouvrage a été publié par le Centre for Public Management de l'Université de Toronto, dans sa collection de monographies sur les politiques publiques. La remise des prix a eu lieu le 13 mai dernier à Toronto. Une des conditions d'attribution du prix stipulait que le professeur Courchene devait prononcer une brève allocution sur son ouvrage. Voici le texte de son allocution.*

Thomas J. Courchene

First and foremost, *From Heartland to North American Region State* is the story of Ontario's transition to an economic powerhouse within North America. But it is also a book about key aspects of Canada's evolution, since the underlying sub-themes relate to Ontario's interaction with her sister provinces, with the federal government and with the emerging NAFTA geo-economic reality.

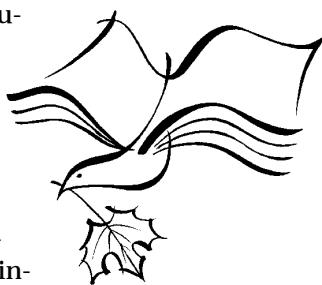
The analytical starting point is John Roberts' Ontario, which we label "heartland." As is evident from the selected defining characteristics of heartland (see Table 1), Ontarians confidently assumed that what was in Ontario's interests was also in Canada's interests. More generally, heartland Ontario was able to wheel and deal and compromise, and to manage its privi-

leged position to ensure that Canada's interests coincided with Ontario's.

The thesis of the book is that heartland is no more.

In tracing the evolution of Ontario, the focus is on successive Ontario governments — from Bill Davis', through David Peterson's and Bob Rae's, to Mike Harris'. Within this administrative framework, we develop three separate "policy histories." The first is a social policy history, in which, during the Peterson era (or perhaps more correctly under the 1985 Liberal-

NDP Accord) Ontario donned the mantle of Canada's social policy leader and went through its own version of *la révolution tranquille*, only later to fall back, under Mike Harris, to its traditional middle-of-the-pack position.



The second is a fiscal history, in which, in often all-too-gruesome detail, we trace: the tax-and-spend policies of the 1985-1990 Peterson Liberals; the “fiscalamity” of the 1990-95 NDP reign (admittedly triggered by the severity of the 1990s recession and the billions of dollars denied Ontario under the infamous cap on the Canada Assistance Plan); and then, finally, the Common Sense Revolution (CSR) and the restoration of a semblance of fiscal sanity.

The third and most fascinating thread is the federal history. Here the storyline is about how Ontario’s comfortable niche in the federation became unstuck. Under Bill Davis, the cleavages were largely inter-provincial as Ontario sided with Ottawa in lowering the boom on the west (with the NEP) and Quebec (in the 1980-82 constitutional round) two episodes which, intriguingly, led to the Quebec-West axis that swept Brian Mulroney to power. In the Peterson era, with Ontario riding the crest of Ronald Reagan’s “military Keynesianism” (that is, tax cuts combined with military expenditures), the cleavages shifted toward a prolonged Ontario-Ottawa tussle. Beyond the obvious, namely the Ontario Liberals’ opposition to the FTA, the GST and price stability, this cleavage extended to an incredibly wide range of policy wars, among them:

- Ontario’s deregulation of the securities industry in the midst of the FTA negotiations, which deprived Ottawa of a key bargaining lever;
- the designation by Ottawa of Montreal and Vancouver, but not Toronto, as international financial centres;
- Ontario’s mid-teens rates of spending growth in an already over-heating provincial economy, just as the Bank of Canada began pursuing price stability, and on and on.

With the imposition of the cap on CAP, Bob Rae and the NDP became so concerned with federal policy that they launched a “fair-shares federalism” — a rallying cry that Mike Harris adopted and that was finally (if only partially) resolved in the 1999 federal budget, which legislated equal-per-capita CHST entitlements.

Meanwhile, underlying these several policy histories, something quite profound and largely irreversible was also occurring — the integration of the North American marketplace. In 1980, Ontario’s inter-provincial and international exports were roughly equal. By 1996, international exports were nearly three times as large as interprovincial exports and increasing nearly an order of magnitude faster. Indeed, close to 50 per cent of Ontario’s GDP is now destined for US markets. Moreover, Ontario is incredibly well-positioned geographically, economically and

Table 1
Heartland Ontario:
Selected defining characteristics

- Ontario was so prosperous and so diversified economically — and so powerful politically — that Canadian policy had little choice but to be cast in a pro-Ontario light.
- Relatedly, the management of the big levers of economic policy always kept a close eye on Ontario, e.g., if the Minister of Finance was not a Toronto MP then at least Toronto would be well represented in the key economic portfolios.
- Since Ontario could generally count on the federal government to further the province’s interests, Heartland Ontario was in favour of a strong central government. For example, Queen’s Park did not assume the role of economic policy maker that L’Assemblée nationale did for Quebec. There was no need for this since Rideau Street was essentially an extension of Bay Street, and Ottawa delivered — the auto pact, the NEP, nuclear power for Ontario Hydro.
- Not surprisingly, therefore, Ontarians tended to direct their attention and loyalties to Ottawa, more so than other provincial residents.
- While Ontario obviously desired sufficient influence to defend its own interests, its preference was to block offending legislation of a sister province rather than by acquiring further provincial powers. For example, it did not take up Ottawa’s invitation to opt out of federal programs, as did Quebec. Had it done so, other provinces would surely have followed and this would have served to reduce Ottawa’s influence.
- With aspects of the National Policy still in play, Ontario’s interests were more in the direction of freeing up internal trade than in pursuing freer trade with the US. This was especially true in the high-energy-price era where Ontario wanted full access to the energy-related mega-projects of the energy provinces in tandem with a “buy Canadian” preference.
- Ontario was not a leader in social policy. Some of this related to the economic diversity of the province and some of it to innate conservatism, but there was also an understanding that social policy leadership by Ontario would trigger regional equality concerns from other provinces, with Ontario ultimately playing a large paymaster role.
- In general, Ontario was able to wheel, deal and compromise and to manage its privileged position to ensure that Canada’s interests coincided with Ontario’s interests.

Table 2
Region-state Ontario:
Selected defining characteristics

- Ontario is a North American region-state and the province will advance its interests within this larger, and effectively, global environment. Specifically, Ontario will pursue this new (largely) economic role by actively promoting a regional-international interface and, in particular, by attempting to create a favourable set of untraded interdependencies (positive locational externalities) designed to privilege Ontario and Ontarians within North America.
- Queen's Park is evolving and will continue to evolve in the direction of assuming powers and influence sufficient to deliver on this new role.
- Ontario remains fully committed to the "Canadian dream." But this will not be the former Heartland relationship. For example, Ontario will give high marks to Ottawa policy that maintains fiscal integrity, low inflation and an overall competitive environment.
- Ontario will become much more involved in issues relating to interprovincial redistribution. It will remain a strong supporter of equalization, but will insist on equal treatment for its citizens from other federal redistributive programs ("fair shares" federalism).
- In protecting its own interests, Ontario may still wish to block offending legislation in a sister province (as under Heartland), but it now will have no qualms about acquiring greater powers. This is "provincial rights if necessary but not necessarily provincial rights."
- International free trade is "in." Nonetheless, Ontario will also attempt to preserve and promote east-west markets. Part of this will be via the pursuit of an effective economic union. Indeed, Ontario will likely attempt to link its commitment to the social union to the commitment by other provinces to the economic union.
- As a result of increased decentralization and the likelihood of increased asymmetry as different provinces choose alternative approaches to forge their human capital subsystems, intergovernmentalism or co-determination will emerge as new governance instruments. Ontario will play a leading role here.
- To be a successful region-state, Ontario will have to become a leader in policies related to the creation of human capital. With human capital at the cutting edge of competitiveness and with skills and education the key to a high-wage economy, an integrated approach to this subsystem must become a defining characteristic of Ontario as a region-state. Ontario is not yet on track here.

institutionally to capitalize on the new opportunities offered in the NAFTA environment. Borrowing a term from the European regional-science literature, we assert that Ontario is now donning the mantle of a powerful North American "region-state." What this means on the economic front is that successive Ontario governments will have little choice but to design policies that will privilege Ontario and Ontarians in this new geo-economic environment. Not to pursue this strategy under the open borders of NAFTA will mean that footloose industry will progressively move south.

What complicates all this from a pan-Canadian perspective is that this north-south integration applies to most other provinces, as well. It is certainly true, as recent research suggests, that borders do matter and that the Canadian economic union is far more integrated than the North American economic union. But the same research shows that border effects are diminishing rapidly. Canada is less and less a single national economy and more and more a series of north-south, cross-border economies. We remain an east-west society, however, in terms both of a social and a human-capital union. Our challenge is how to mount an east-west sharing system over a north-south trading system.

More generally, while Canadians need not alter the goals they set for themselves, they will almost certainly have to alter the instruments by which they pursue them. In particular, the recent social union framework agreement is an excellent example of a new and creative governing instrument, one that reconciles the east-west social union with the north-south trading system by bringing the provinces more fully and more formally into the design of social Canada.

Table 2 presents selected defining characteristics of the emerging region-state Ontario. While these characteristics tend to be associated with the Harris government, our view is that they will transcend the political stripe of Ontario's governing party.

The implications for Canadian governance will be quite profound. Indeed, they already have been. Among other issues, we focus on Ontario's 1997 budget proposal for mounting its own personal income tax (PIT) collection system. Our view was that accommodating Ontario's concerns with respect to the PIT required a shift from the old tax-on-tax approach to the shared PIT to a tax-on-base approach, i.e. letting the provinces apply their own rate and bracket structure to the commonly determined tax base. Shortly after the book went to press, Ottawa did precisely this. And with the recent Alberta proposal for a flat tax of 11 percent against taxable income, the stage is set for

more decentralization and asymmetry in terms of provincial tax rates. This provides yet another rationale for the recent social union framework agreement.

Other implications are likely to be every bit as far-reaching. We Canadians have prospered over our history by building a comprehensive system of east-west economic institutions and trading relationships, safeguarded by tariff walls and transportation subsidies. Unfortunately, in the face of north-south trade, some of this infrastructure is becoming, in economic terms, a "stranded asset." This is a policy challenge of the first order. It is what the bank mergers controversy was largely about. And it also underlies the recent discussion of a North American currency union, along the lines of the euro. All of this follows because Canada is becoming less and less an economic-policy railway — even the ribbons of steel are now veering north-south! — and more and more a social-policy railway. Above all, it represents a clarion call for new and creative instruments to reap the opportunities from North American economic integration without sacrificing our long-standing goals and aspirations on the social, political and cultural fronts. If we should fail in this endeavour, we may well be launched into a process that will make us northern Americans. This

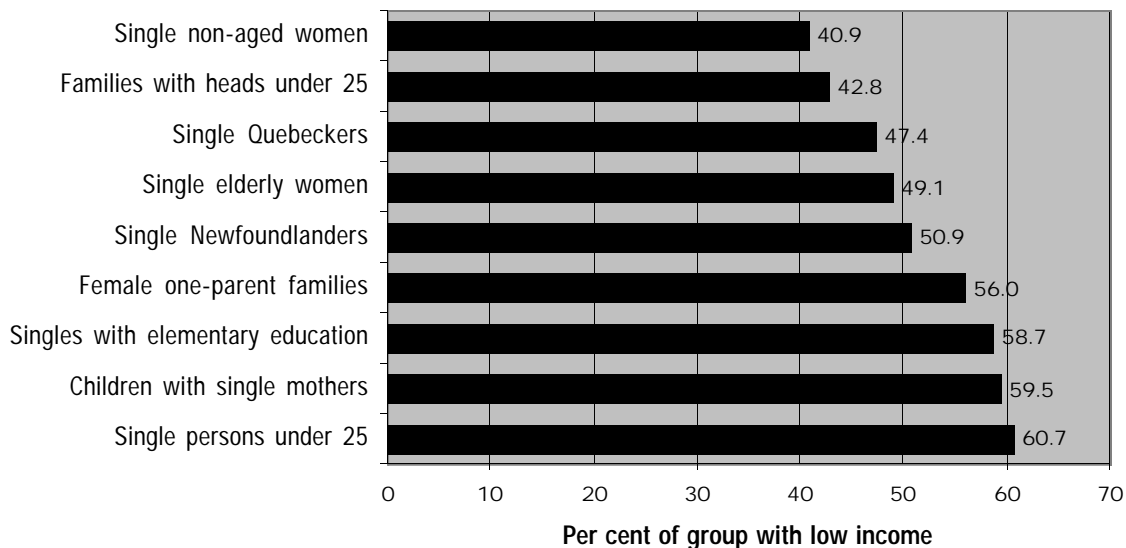
cannot be allowed to happen.

We conclude *From Heartland to North American Region State* with the following paragraph:

Sir Wilfrid Laurier was certainly right in proclaiming that the 20th century belonged to Canada. Our topping of the United Nations listing as the most liveable society on earth is testament to Laurier's vision. The 21st century may well belong to Canada as well, but this will depend more on us than on nature. Apart from the 1980s onward, where we became fixated with constitutional issues, over our history we Canadians exhibited rare genius in terms of designing creative processes and structures that allowed our federation to adjust to internal and external forces alike. It is time to rekindle this innate genius. But in doing so, we must recognize that heartland is no more: Ontario has made the dramatic transition to a North American region state.

Thomas J. Courchene is the Jarislowsky-Deutsch Professor of Economic and Financial Policy at Queen's University, the Director of Queen's John Deutsch Institute for the Study of Economic Policy and a Fellow of the Royal Society of Canada. His co-author, Colin R. Telmer, is now a financial analyst with the debt management division of Finance Canada.

Who has low income? — Qui n'a qu'un faible revenu ?



Source: Caledon Institute of Social Policy, "Poverty Eases Slightly," April 1999, Figure 11.