

What does a fiscal imbalance actually look like?

In this excerpt from a speech at the Canada 2020 Conference at Mont-Tremblant in June, Andrew Coyne wonders what a fiscal imbalance actually looks like, given that 9 provinces in 10 are currently in surplus positions, and Ottawa is already transferring \$42 billion a year to the provinces. Among federations, he points out, Ottawa keeps the smallest share of revenues of any central government in the world.

Dans cet extrait d'un discours prononcé à la Conférence Canada 2020, tenue en juin à Mont-Tremblant, Andrew Coyne s'interroge sur la réalité du déséquilibre fiscal quand 9 provinces sur 10 bénéficient de surplus budgétaires et qu'Ottawa leur transfère déjà 42 milliards de dollars par année. Parmi toutes les fédérations du monde, note-t-il, c'est au Canada que le gouvernement central retient la plus faible part des recettes publiques.

Let me state off the top my firm belief that there is a “fiscal imbalance” in this country, and it's high time the provinces handed over some of those excess revenues they've been hoarding.

I'm joking — sort of. As I'll argue in a minute, there is no sensible construction of “fiscal imbalance” that could be used to describe the situation in Canada today — certainly none that would involve the provinces as the wounded party. But suppose there were a fiscal imbalance such as the provinces describe. How would we know? What would be the telltale signs? What does a fiscal imbalance *look* like?

Perhaps it's that the federal government is running chronic surpluses, while the provinces are wrestling with deficits? Well, no. The provinces are running surpluses, too. Some of them are cutting taxes, some are raising spending, but they're all — well, 9 out of 10 — running surpluses.

Maybe the federal government is hogging the available tax room, leaving the provinces with the crumbs? Well, no. Federal revenues as a share of all government revenues are at or near their all-time *low*.

Perhaps that's the problem: the feds are making up the lost revenues by cutting back on transfers to the provinces? Well, no. Transfers to the provinces as a share of federal spending are at or near their all-time *high*.

So much for historical comparisons. But perhaps that's the wrong reference point. Perhaps Canada has a relatively large, even overbearing federal government, compared to most federations. Maybe all this historical data has just been measuring degrees of overbearingness.

Well, no. Ottawa's share of total revenues is the *smallest* of any central government in the developed world. Not only that, but it places fewer strings on the money it transfers to the provinces than any other federal government. Got that? Provincial governments in Canada have more to spend, and greater freedom to spend it, than any of their counterparts elsewhere. The feds' share of spending is the smallest ever, and the smallest anywhere.

But let's not get hung up on proportions. After all, it's not the relative shares each level of government commands that matters, is it? It's their actual fiscal capacity, their ability to

meet the needs of their citizens. Well, yes. And if you look, you find that provincial revenues, measured in real dollars per capita — that is, adjusting for inflation, and adjusting for population growth — have never been higher. They're *swimming* in revenues.

That's true in terms of their own tax revenues, and it's even more true if you look at the money they receive from Ottawa. That is, federal transfers have *already* been increased, and handsomely too: to \$42 billion last year, from just \$20 billion eight years ago. This, although the federal government remains in a much weaker fiscal situation than the provinces, with a debt-to-GDP ratio nearly twice the provincial average. (How did it run up those debts? Well, transfers to the provinces played a part.)

But never mind all that. Suppose none of this were true. Suppose the federal share of total revenues was not at an all-time low, but an all-time high. Suppose, at the same time, that the portion of federal spending allotted to provincial transfers was not at its highest ever, but at its lowest. Suppose Canada had the largest federal government relative to the provinces in the



Courtesy, Canada 2020

Columnist Andrew Coyne looked and looked, he told the Canada 2020 Conference, and he couldn't find the fiscal imbalance between Ottawa and the provinces.

world, rather than the smallest, and suppose the provinces really were as strapped for cash as they claim — and not so laden down with revenue that they've run out of ways to spend it all.

That *still* wouldn't mean there was a "fiscal imbalance."

The only possible meaning that can be attached to this term is a situation in which the federal government had exclusive right to certain revenue streams not given to the provinces: if the feds had a monopoly on income taxes, say, while the provinces were forced to make do on lottery revenues and sales of scrap metal. But the provinces have access to every significant source of revenue the federal government does: personal income tax, corporate income tax, sales tax, the lot. Plus, the provinces can collect some

others the feds can't — notably resource royalties. I'd say they were fishing from the same pool, except the provinces' is rather better stocked.

But then, which "fiscal imbalance" are we talking about? The one between the federal and provincial governments — or the one between Ontario and the other provinces? To be sure, they *sound* like the same complaint. But when Dalton McGuinty talks about the "\$23-billion gap" between federal spending and revenues in his province, be in no doubt: he means Ottawa should give his province more — and other provinces *less*.

Of course, there are a couple of flaws in his reasoning. One is that much of the money he gets "from Ottawa" will in fact come from Ontario, or more precisely Ontarians.

Processing each dollar of the federal taxes they pay through two levels of government leaves them with rather less than a dollar of services in the end. Wouldn't they be better off with the full dollar, which is to say if it were not taken from them in the first place? Why exactly is the "gap" between what the provinces' *citizens* get out of Ottawa, and what they pay in, supposed to be made up by increased transfers to the provincial *government*? Couldn't the feds just cut taxes?

The other flaw is that the "\$23-billion gap" (actually, it's \$18-billion now) has nothing to do with anything — or almost nothing. You can probably find examples of unfairness in how much Ontario receives for certain federal programs, versus how much other

provinces receive. Possibly it even reaches into the billions. But it's nowhere near \$23 billion, or even \$18 billion. Indeed, not even Ontario claims it is. If Ontario wants to establish itself as Confederation's latest victim, the "\$23-billion gap" is not supporting evidence. It's a non sequitur.

Part of the "gap" is nothing more than a reflection of the fact that the federal budget is in surplus: that is, there is a "gap" between how much citizens pay and how much they receive, for the country as a whole. That Ontario bears a disproportionate share of this gap is explained mostly by three things. One, Ontarians are richer, on average, than people in other provinces, and thus pay more in income taxes and receive less in welfare and other income support programs. Two, Ontario has a lower rate of unemployment than the average, and so receives less in unemployment insurance (though regionally extended benefits skew the program further in favour of high-unemployment regions).

And, three, it receives no Equalization payments, as one of two "have" provinces, in the program's tortured definition. Certainly Ontario is right that one Equalization Program is enough: we don't need to make every federal-provincial transfer redistributive in the same way. But the Equalization Program has much deeper problems than any alleged unfairness to Ontario.

Indeed, it isn't even about equalization any more. While traditionally the program has "equalized" rather too enthusiastically, clawing back payments at punitive rates as a province's fiscal capacity improves, of late it has departed from any principled moorings whatever. The general assurance given to all recipient provinces that a floor would be put under equalization payments, thereafter to increase at a fixed rate, even as disparities in provincial revenues were in fact decreasing, was bad enough. But the side

deals with Newfoundland and Nova Scotia, guaranteeing they would continue to receive payments even as per capita revenues, flush with oil royalties, rose to levels exceeding Ontario's, destroyed what lingering rationale the program had left. It's equalization without the equalization.

We'll see what the Harper government does about that particular problem. But on the "fiscal imbalance" question generally, it's clear they're backing away from their earlier, opportunistic endorsement of the provinces' cause.

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Indeed, the Harperites aren't even talking about "fiscal imbalance," as such: not if it means writing the provinces a series of fat cheques. Rather, their rhetoric suggests they have returned to the traditional conservative concern with "overlap" and "interference," the import of which is that the feds should get out of shared-cost programs altogether.

This is, it should be noted, emphatically not the provinces' position. The provinces do not want the feds to "put up or shut up," either increasing funding to pay for federal conditions or

abolishing the conditions. Rather, the provinces want them to put up *and* shut up, raising transfers even as they are cutting whatever strings remain. But this is incoherent. If there are to be no conditions on federal transfers, then all they are achieving is to let two levels of government spend the same money twice. We get all of the blurred lines of accountability that are the worst defect of shared-cost programs, with none of the overarching national visions that are supposed to be their purpose.

But conditionality was dead already, even before the Harperites took office: another legacy of Paul Martin's penchant for deal-making. After the failure to win any important provincial commitments in the health care agreement — and the exemption of Quebec from even such obligations as the other provinces pretended to assume — it is clear that no federal government is likely to have the courage to enforce its conditions on the provinces. The *Canada Health Act* is a dead letter.

I don't think the Harper government is likely to pull out of these programs altogether, not while it remains a minority at any rate. That would be too radical, and in any case like all governments it rather likes spending the money. But it may claim it is addressing the "fiscal imbalance" simply by cutting taxes — and inviting the provinces to raise theirs, if they dare. Or if it does engage in a more formal transfer of fiscal capacity, it is showing encouraging signs of being prepared to demand something in return: harmonization of provincial sales taxes with the GST, a national securities regulator, a more coherent economic union generally. The provinces are on notice: if you want the quid, come up with the quo.

Andrew Coyne is the national affairs columnist of the National Post. Excerpted from a speech to the Canada 2020 Conference at Mont-Tremblant in June 2006.