

POLICY SERIES



Stealth Equalization

**How Federal Government Employment
Acts as a Regional Economic
Subsidy in Canada**

By Ben Eisen, M.P.P.

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Date of First Issue: November 2010.

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ISSN 1491-78

FCPP Policy Series No. 95 • November 2010

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Foreword

Canada has one of the largest geographically based system of regional subsidies in the world.

Unfortunately, the Government of Canada has never studied the impact of this system on recipient and contributing jurisdictions or Canada as a whole. The few internal studies of it, such as a recent study on needs based equalization, are suppressed.

Federal ignorance of the economic and financial impact of regional subsidies on Canada, including the disastrous impact they have on national productivity, fiscal deficits, and the unnecessary politicization of public services, means that studies conducted by independent commentators and research organizations are disproportionately important. For many years, they have been the only reliable source of information on equalization and other less visible regional subsidies.

Mr. Eisen's paper on stealth equalization fits into this tradition and history. He describes how the federal government uses the disproportionate employment of public servants in most equalization

receiving provinces to convey an extra and invisible layer of subsidies that are a very large fraction of equalization receipts in those provinces.

Mr. Eisen also shows the debilitating effect of these arrangements on the accessibility of federal programs in contributing jurisdictions.

There is another way of looking at this problem. Federal employment in each of the recipient provinces, except for Quebec, is a much larger share of total employment than it is in Ontario, even though the national capital is in Ontario.

The word stealth is very important when applied to this form of regional subsidy. It is dangerous because it is hidden from public view, has grown unobtrusively over the decades, and has never been publicly debated.

In this context, Mr. Eisen's report is a major insight into an important area of public policy and is particularly important because it is the first of its kind on this subject.

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Executive summary

In a 2010 study, Frontier Centre analysts, including the author of this paper, outlined some of the negative unintended consequences of Canada's equalization program. In particular, the study showed that equalization transfers have become so large that they result in the subsidization of relatively high levels of provincial spending on government programs in the have-not provinces. This has contributed to the development of disproportionately large public sectors in recipient provinces, and created disincentives for rational public policy that could increase own-source revenues.

The official equalization program is, however, merely the tip of a much larger iceberg. There are a number of other ways that public policy in Canada extracts disproportionate amounts of tax revenues from residents of the most productive provinces and transfers that money to the large, inefficient public sectors that exist in the recipient provinces. The effect of these additional transfers is to exacerbate

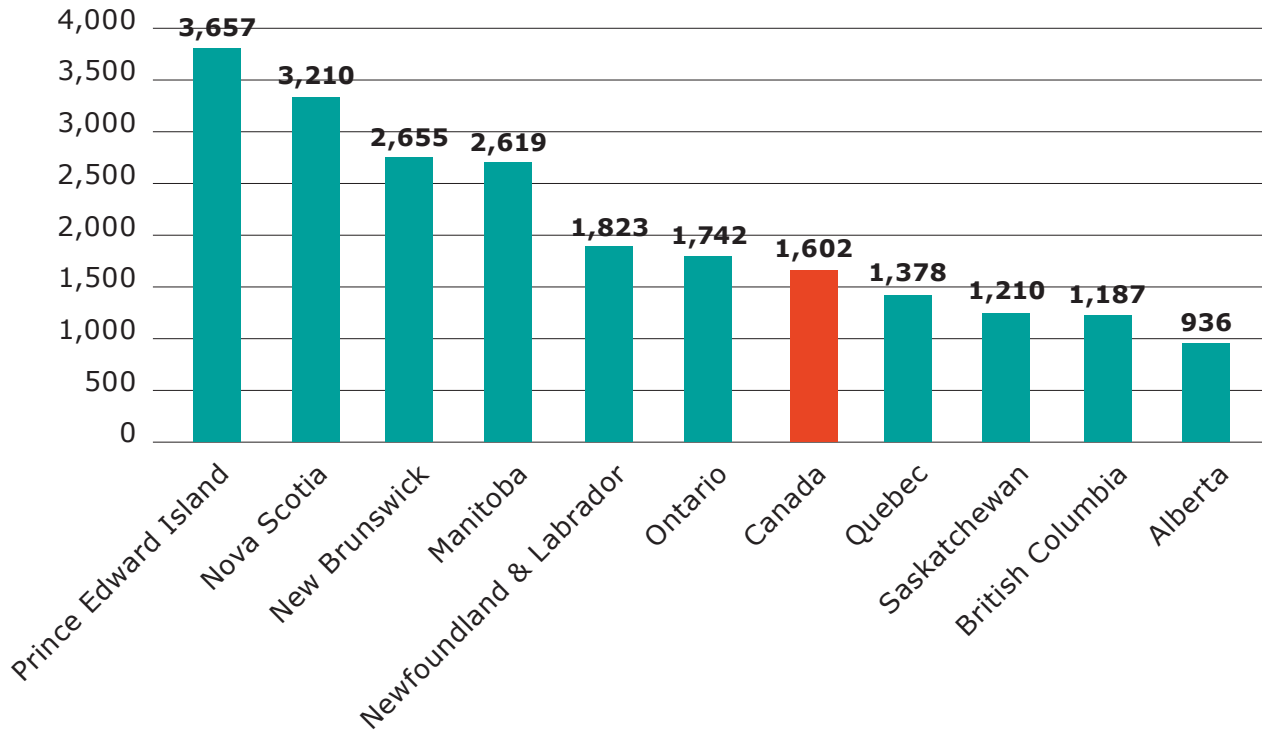
the problems caused by equalization—subsidizing disproportionately large and inefficient government in recipient provinces while burdening taxpayers in paying provinces with higher taxes.

Other components of public policy that create significant transfers of money from taxpayers in more productive provinces to governments in less productive provinces constitute a form of “stealth equalization,” which exists alongside Canada's official equalization program.

This paper examines a major component of this system of stealth equalization: regionally unbalanced federal government employment. Using Statistics Canada data, this paper shows that the federal government employs dramatically more public servants, as a proportion of the population, in the major equalization recipient provinces of Nova Scotia, Prince Edward Island, New Brunswick and Manitoba, than in other parts of the country.

“...the federal government employs dramatically more public servants, as a proportion of the population, in the major equalization recipient provinces...”

Federal Government Employees Per 100,000 Residents



The chart above shows the extent of the provincial imbalance in federal government employment. The graphic illustrates several important facts about federal government employment in Canada.

- Of the five major equalization recipient provinces, all but Quebec have levels of per capita federal government employment far above what would be the case if government employment were distributed according to Canada's population.
- Federal government employment as a proportion of the population in PEI is 2.28 times higher than in the country as a whole. In Nova Scotia, the rate of federal employment is twice as high as the rest of the country. In New Brunswick and Manitoba, the rate of federal government employment is approximately 63 per cent higher than in the nation as a whole.
- The three recipient Maritime provinces and Manitoba have rates of federal government employment that are substantially higher than Ontario's despite the presence of Canada's national capital in that province. For example, Nova Scotia has 84 per cent more federal employees per 100,000 people than does Ontario.
- Exogenous factors such as demographics and the varying sizes of the provinces do not explain this phenomenon. For example, despite being a similar size and having a similar demographic profile, have-not province Manitoba has more than twice as many federal employees as a proportion of the population than does neighbouring Saskatchewan.

Province	Actual Federal Spending on Wages and Salaries	Spending on Federal Wages and Salaries If Employment Were Evenly Distributed	Total Stealth Equalization Transfer (Into the Provincial Economy)
PEI	\$ 298-million	\$ 145-million	\$ 153-million
Nova Scotia	\$ 1.92-billion	\$ 978-million	\$ 942-million
New Brunswick	\$ 1.17-billion	\$ 779-million	\$ 391-million
Manitoba	\$ 1.86-billion	\$ 1.25-billion	\$ 610-million

Province	Actual Federal Equalization Receipts	Stealth Equalization	Stealth Equalization as a Percentage of Official Equalization
PEI	\$ 348-million	\$ 153-million	45%
Nova Scotia	\$ 1.39-billion	\$ 942-million	68%
New Brunswick	\$ 1.69-billion	\$ 391-million	23%
Manitoba	\$ 2.06-billion	\$ 610-million	30%

The money used to pay additional employees in the recipient provinces constitutes an additional transfer of wealth from Canada's most productive provinces into the economies of the have-not provinces. This transfer can be viewed as a sort of stealth equalization payment that extracts additional money beyond official equalization from taxpayers in the paying provinces and transfers it to the recipient provinces.

In Section Two, this study goes on to quantify the stealth equalization phenomenon and describe the impact of unbalanced federal hiring on the provincial economies of the major recipients. The data show that this system of stealth equalization constitutes a significant "top-up" to the official equalization program, and results in the transfer of more than \$2-billion dollars into the provincial economies of the four small have-not provinces.

In addition to supporting large provincial bureaucracies through equalization payments, these data show that Canadian taxpayers in all provinces also finance a large federal bureaucracy in the have-not provinces. The result of high levels of federal and provincial level public sector employment is that the economies of these four provinces are now centered on government rather than private sector activity. The four major recipients of stealth equalization have a much higher rate of government spending than does the whole country. In PEI, Nova Scotia and New Brunswick, more than half of all economic activity in 2007 came from government spending. In Manitoba, 45 per cent of all economic activity was generated by the government in 2007 compared to 37 per cent in all of Canada.

This paper concludes with a discussion of the impact of Canada's system of regional transfers from high- to low-productivity regions for the recipient provinces, the paying provinces and the country as a whole. The transfer of billions of dollars each year to low-productivity provinces has stunted economic development there by maintaining inefficient economies built on the public sector. The system of regional transfers has also had a negative impact in the paying provinces by significantly increasing the tax burden for residents of those provinces.

Furthermore, Canada's system of regional transfers has undermined the country's competitiveness and productivity, a phenomenon which has a direct and adverse impact on the quality of life of Canadians.

The transfer of billions of dollars each year to low-productivity provinces has stunted economic development there by maintaining inefficient economies built on the public sector.

Introduction

Stealth Equalization

Canada's equalization program transfers billions of dollars each year from taxpayers in Canada's so-called have provinces to the governments of Canada's have-not provinces—Prince Edward Island, Nova Scotia, New Brunswick, Manitoba and Quebec.¹ This program works by distributing money drawn from federal tax revenue to the governments of the have-not provinces—those provinces deemed to have insufficient local economic activity to raise enough revenue to deliver adequate public services to their residents. The program will send over \$8-billion to Quebec in 2009-2010 alone, and it sends between one billion and two billion dollars per year to Nova Scotia, New Brunswick and Manitoba. Prince Edward Island will collect \$340-million dollars this fiscal year, almost \$2,500 for every resident.

In a 2010 study, Frontier Centre analysts, including the author of this paper, outlined some of the negative effects of the equalization program. In particular, the study showed that equalization transfers are so large they result in the subsidization of comparatively high levels of provincial spending on government programs in the have-not provinces. This has contributed to the development of large, inefficient public sectors in the recipient provinces and has created disincentives for rational public policy that could increase own-source revenue.

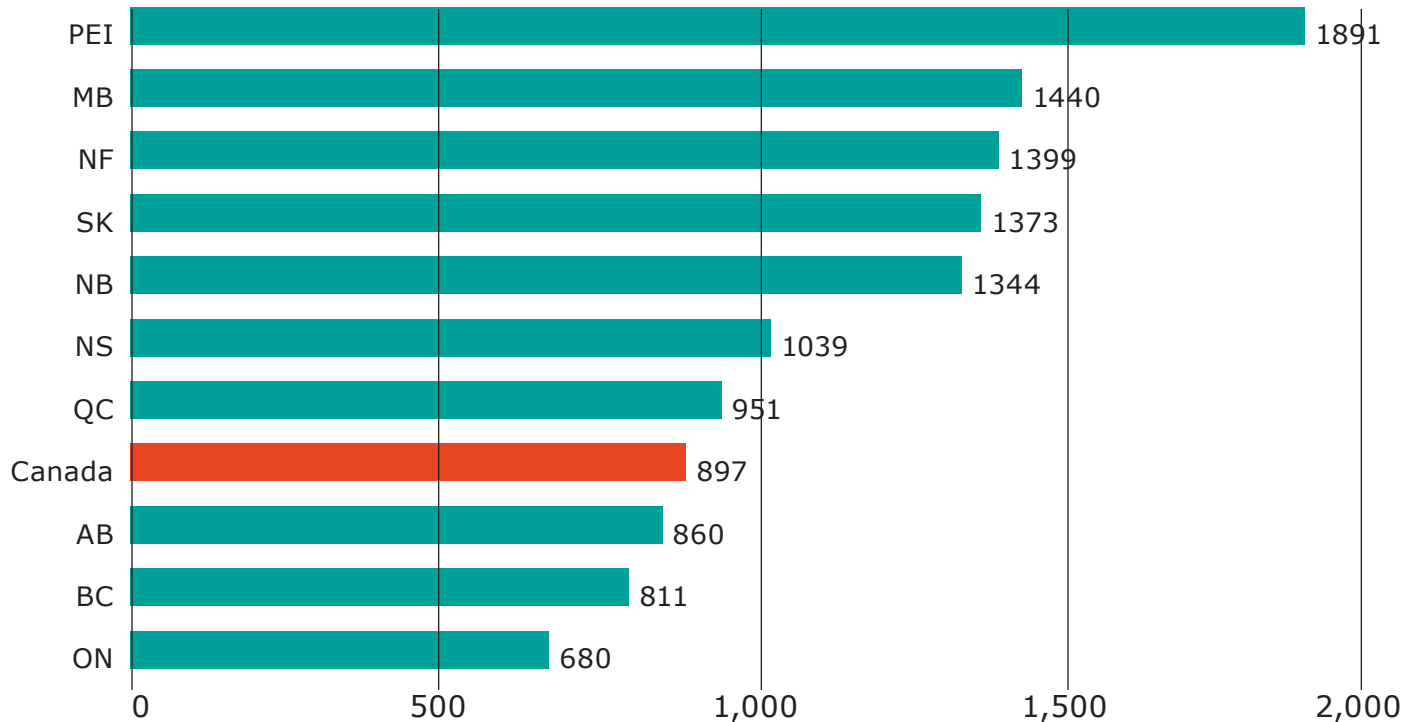
The influx of equalization dollars to the have-not provincial governments enables them to hire substantially larger public

service workforces (as a proportion of population) than do the provinces that are net contributors to equalization. For example, Manitoba employs 1,440 provincial public administration workers per 100,000 people compared to just 860 in Alberta, 811 in British Columbia, and 680 in Ontario.

The economic distortions created by the \$14.2-billion equalization program are significant. However, the equalization program is, in some ways, merely the tip of a much larger iceberg. There are a number of other ways by which Canadian public policy extracts disproportionate amounts of tax revenue from residents of certain provinces and transfers that money to the large public sectors that exist in other provinces. The effect of these additional transfers is to exacerbate the problems caused by equalization—subsidizing disproportionately large and inefficient governments in recipient provinces while burdening all Canadians with higher taxes.

Other components of public policy that create transfers from taxpayers in more productive provinces to governments in less productive provinces constitute a form of stealth equalization that exists alongside Canada's official equalization program. This paper will examine a major component of this system of stealth equalization—regionally unbalanced federal government employment. Using Statistics Canada data, this paper will show that the federal government employs

**Chart 1. Provincial Public Administration Workers
Per 100,000 Residents**



Sources: Calculations by author using Statistics Canada Table 281-0024.

significantly more public servants as a proportion of the population in Nova Scotia, Prince Edward Island, New Brunswick and Manitoba than in any of the other provinces.

The data presented in this paper show federal government employment has been used as a hidden form of regional subsidy—a stealth equalization program that provides disproportionate numbers of federal government jobs to residents of some provinces using tax money extracted disproportionately from taxpayers elsewhere. This contributes to the development of inefficient economies in two ways.

First, it results in the organization of the economy around public sector activities in the recipient provinces. Second, it reduces productivity in the paying provinces by taxing away resources from the private sectors in those provinces.

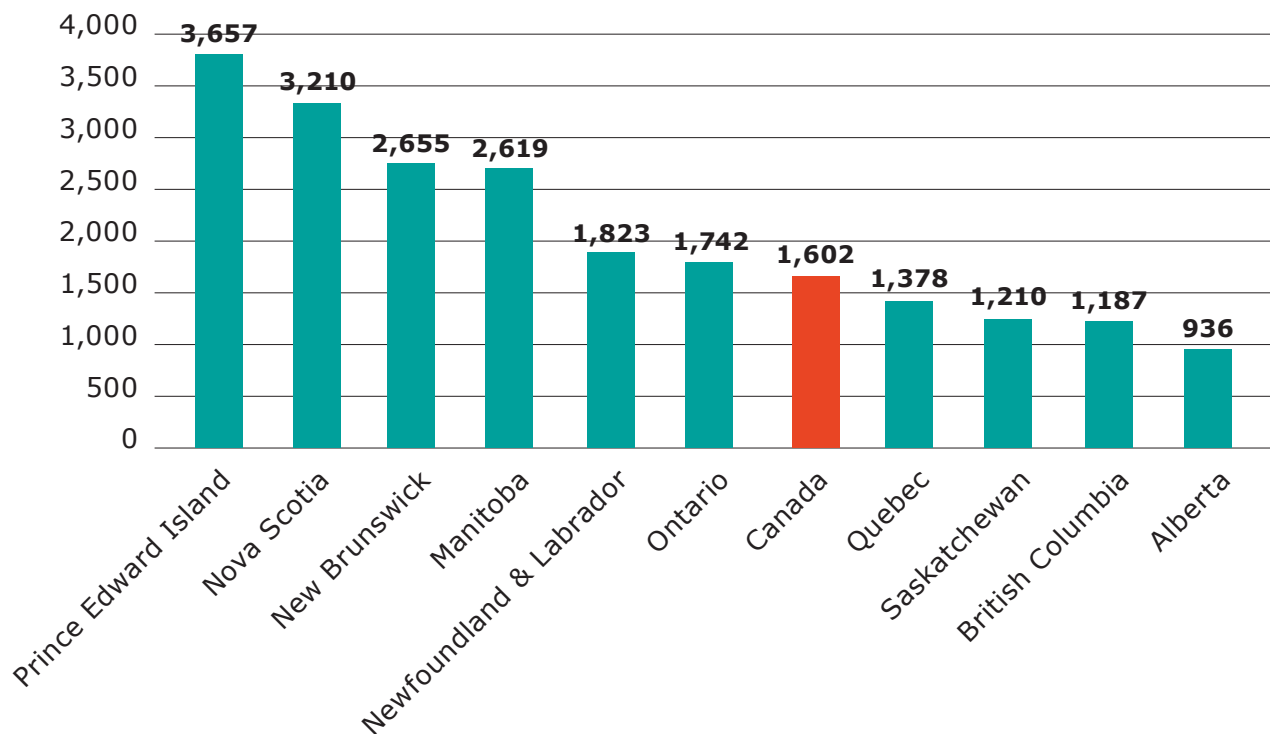
This paper will review the relevant Statistics Canada data to evaluate the scale of the problem, and it will discuss the negative consequences of Canada's stealth equalization program for the recipient provinces, the paying provinces and the country as a whole.

Section One: How Unbalanced is Federal Government Employment?

Canada's equalization program has contributed to the development of economies in the recipient provinces that concentrate around the activities of large, inefficient public sectors. This problem is exacerbated by the phenomenon examined in this paper—regionally unbalanced federal government employment. As Chart 2 shows,

the provincial imbalance in federal government employment is pronounced, with the major equalization recipient provinces except Quebec receiving far more federal government jobs than one would expect if these jobs were distributed roughly in line with the distribution of Canada's population.²

**Chart 2. Federal Government Employees
Per 100,000 Residents (2009)**



Source: Calculations by author based on Statistics Canada Table 183-0002.

Chart 2 shows the extent of the provincial imbalance in federal government employment. The graphic illustrates several important facts about federal government employment in Canada.

- Of the five major equalization recipient provinces, all but Quebec have levels of per capita federal government employment far above what would be the case if government employment were distributed according to Canada's population.
- Federal government employment as a proportion of the population in PEI is 2.28 times higher than in the country as a whole. In Nova Scotia, the rate of federal employment is twice as high as the rest of the country. In New Brunswick and Manitoba, the rate of federal government employment is approximately 63 per cent higher than in the nation as a whole.
- Newfoundland, Ontario and Quebec have levels of federal employment that are approximately equivalent to the national average.
- Saskatchewan, British Columbia and Alberta have very low levels of federal government employment. The rate of federal employment in Alberta is just 58 per cent of the national average.
- The three recipient Maritime provinces and Manitoba have rates of federal government employment that are substantially higher than Ontario's despite the presence of Canada's national capital in that province. For example, Nova Scotia has 84 per cent more federal employees per 100,000 people than does Ontario.
- Exogenous factors such as demographics and the varying sizes of the provinces do not explain this phenomenon. For example, despite being a similar size and having a similar demographic profile, have-not province Manitoba has more than twice as many federal employees as a proportion of the population than does neighbouring Saskatchewan.

The effect of unbalanced hiring is to extract money from Canada's most productive regions and transfer it to less productive regions. This has serious implications for the competitiveness and productivity of Canada as a whole. In order to analyze the seriousness of this problem, the next section will examine how much additional money is transferred to the recipient provinces due to abnormally high federal government employment.

Section Two:

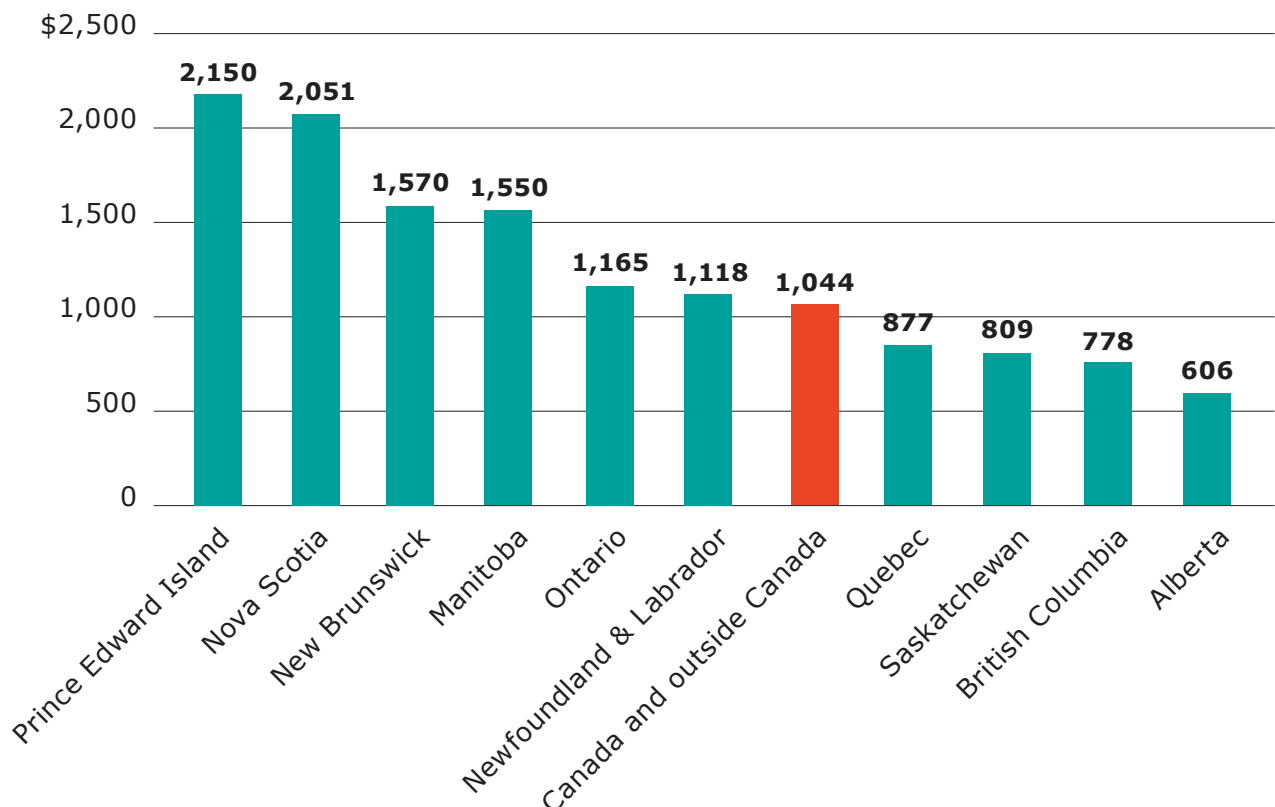
How Big is Canada's System of Stealth Equalization

Common sense suggests that the distribution of federal government jobs should at least roughly match the distribution of Canada's population to ensure equal access to federal government services and contribute to stability for provincial economies during economic downturns. Instead, we have seen that federal government employment levels are far above the national average in some provinces (PEI, Nova Scotia, New Brunswick and

Manitoba) and far below the national average in others (Alberta, B.C. and Saskatchewan).

The money used to pay additional employees in the recipient provinces constitutes an additional transfer of wealth from Canada's most productive provinces into the economies of the have-not provinces. This transfer can be viewed as a sort of stealth equalization payment that extracts

Chart 3. Total Spending on Federal Wages and Salaries in Each Province Per Resident (2009)



Source: Calculations by author based on Statistics Canada Table 183-0002.

additional money beyond official equalization from taxpayers in the paying provinces and transfers it to the recipient provinces.

An analysis of the same Statistics Canada table shows that for the four recipient provinces that experience disproportionately high federal government employment, the size of this additional transfer of wealth into the economy from stealth equalization represents a substantial top-up to the official equalization program.

Statistics Canada data show us the amount paid out to federal government and Crown corporation employees in each province and in the nation as a whole. By dividing this total amount by the population for Canada and each of its provinces, we can see how much money is paid out in federal government wages and salaries per resident of each province. This process produces a population-standardized description of how much money goes back into the economy of each province through the wages and salaries of federal government workers.

“...total spending on federal government wages in the major equalization recipient provinces—except Quebec—is far higher than the national average.”

As one might expect, given the higher levels of federal employment described in the preceding section, total spending on federal government wages in the major equalization recipient provinces—except Quebec—is far higher than the national average. Strikingly, total federal government wages and salaries received per capita are approximately three times higher in Nova Scotia and PEI than in Alberta. Per capita spending on federal wages and salaries in Nova Scotia and PEI are almost twice the rate as in Ontario, which contains the seat of the national government.

We can now estimate the total cost of additional federal employment (the stealth equalization) in the recipient provinces by comparing total spending on federal government wages and salaries in these provinces to the amount that would be spent on wages and salaries if federal spending on government wages per capita were in line with the national average. We do this by multiplying the national average of the total amount spent on government wages and salaries per capita by the population of these provinces. By subtracting this smaller number from the amount of money actually spent on federal government wages, we can determine the additional amount of money spent in these provinces on government wages beyond what would be the case if government employment were distributed across the provinces according to population. This calculation shows us the size of the stealth equalization transfer.

Table 1 (next page) shows this data for the four provinces that experience extremely high levels of federal government employment—PEI, Nova Scotia, New Brunswick and Manitoba—rounded to the nearest million dollars.

Table 1: Stealth Equalization

Province	Actual Federal Spending on Wages and Salaries	Spending on Federal Wages and Salaries If Employment Were Evenly Distributed	Total Stealth Equalization Transfer (Into the Provincial Economy)
PEI	\$ 298-million	\$ 145-million	\$ 153-million
Nova Scotia	\$ 1.92-billion	\$ 978-million	\$ 942-million
New Brunswick	\$ 1.17-billion	\$ 779-million	\$ 391-million
Manitoba	\$ 1.86-billion	\$ 1.25-billion	\$ 610-million

Source: Calculations by author based on Statistics Canada Table 183-0002.

Table 2: Stealth Equalization Compared to Official Equalization

Province	Official 2009-2010 Equalization Receipts	Stealth Equalization	Stealth Equalization as a Percentage of Official Equalization
PEI	\$ 340-million	\$ 153-million	45%
Nova Scotia	\$ 1.39-billion	\$ 942-million	68%
New Brunswick	\$ 1.69-billion	\$ 391-million	23%
Manitoba	\$ 2.06-billion	\$ 610-million	30%

Sources: Government of Canada Department of Finance and calculations by author based on Statistics Canada Table 183-0002.

Table 1 shows that stealth equalization transfers \$2.1-billion additional dollars to these four provinces. For each of these small provinces, this additional transfer of money represents a substantial addition to Canada's official equalization program.

As Table 2 shows, Canada's stealth equalization transfers represent a substantial top-up to the official equalization program for each of these four recipient provinces. For New Brunswick, stealth equalization represents a 23 per cent top-up to official equalization. For Manitoba, stealth equalization is almost a third as large as the official equalization. PEI's stealth equalization transfer is almost half as large as official equalization, and in Nova Scotia, stealth equalization is two-thirds as large as official equalization.

As discussed at length in the Frontier Centre's February 2010 study on equalization referred to in the introduction of this report, the official equalization program strains taxpayers in the paying provinces. These data show that taxpayers in paying provinces bear an additional financial burden through stealth equalization because they are also forced to subsidize a bloated public sector at the federal level in the have-not provinces. Of course, as with official equalization, the taxpayers of more economically productive provinces disproportionately pay the bill for this stealth equalization.

Table 3: Impact of Stealth Equalization in the Western Provinces

Province	Actual Federal Spending on Wages and Salaries	Spending on Federal Wages and Salaries If Employment Were Evenly Distributed	Total Stealth Equalization Transfer (Out of the Provincial Economy)
Saskatchewan	\$ 815-million	\$ 1.05-billion	\$ 234-million
Alberta	\$ 2.15-billion	\$ 3.71-billion	\$ 1.56-billion
British Columbia	\$ 3.34-billion	\$ 4.54-billion	\$ 1.2-billion

Source: Calculations by author based on Statistics Canada Table 183-0002.

The high density of federal offices in these equalization recipient provinces generally results in much lower levels of federal government employment in the paying provinces. All three of Canada's westernmost provinces have levels of federal government employment that are significantly lower than the national average. This means that far more money is extracted from taxpayers in these provinces to pay for federal public servant salaries than is being returned to these provincial economies through wages for federal government workers. By replicating the same process used for Table 2, we can estimate how much money would be returned to the economies of the Western provinces through government salaries if federal employment were equal to the national average.

The data are presented in Table 3, above, again rounded to the nearest million.

In the case of Alberta and British Columbia, stealth equalization results in a net transfer of more than \$1-billion from each provincial economy per year that flows into the public sectors of the stealth-equalization recipient provinces. The net result, as Table 3 shows, is that more than \$2.5-billion is taken from taxpayers in these provinces each year and transferred disproportionately to recipient economies, where the money is put to significantly less productive use precisely because those economies are dominated by large, inefficient public sectors.

Discussion:

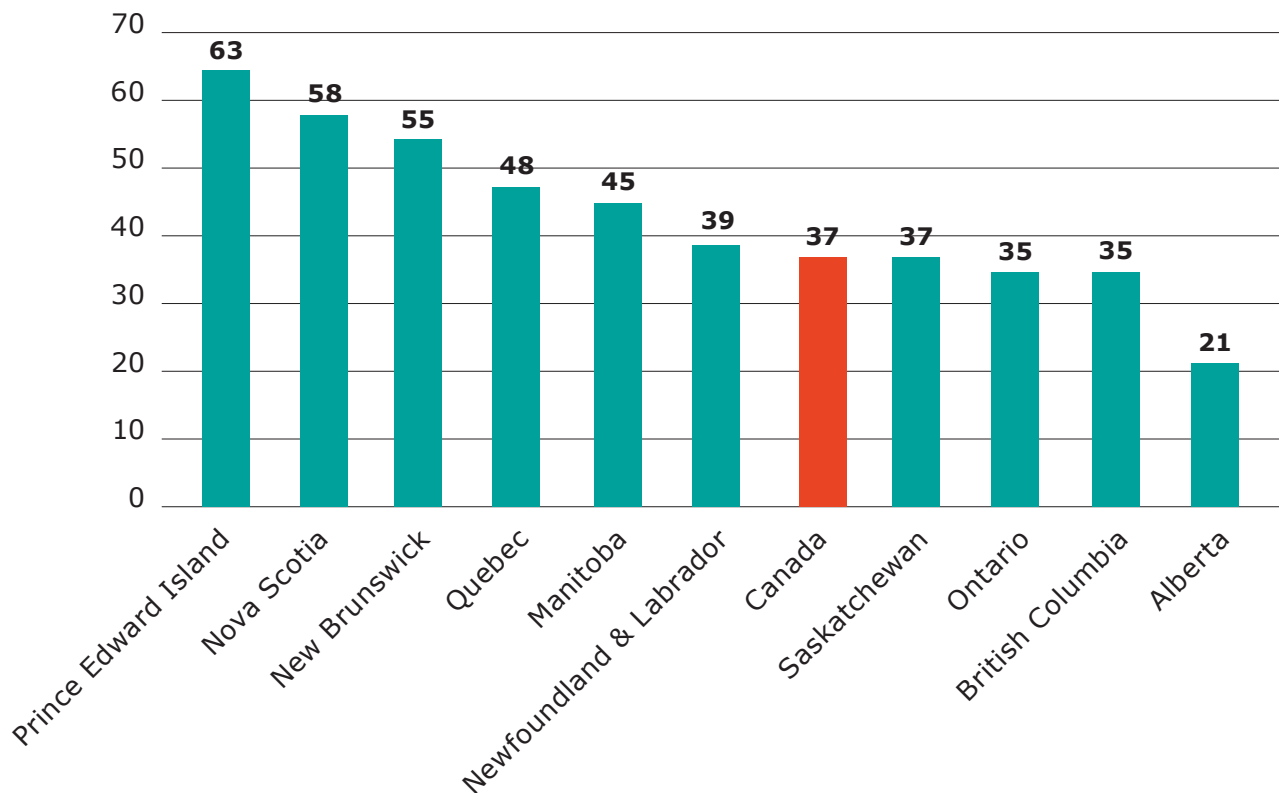
The Negative Consequences of Stealth Equalization

Stealth equalization, like official equalization, transfers billions of dollars from taxpayers in high-productivity provinces to public servants in low-productivity provinces, and this has a significant impact on the Canadian economy. This section will discuss some of the most important negative consequences of Canada's policy of transferring billions of dollars each year from high-productivity regions to low-productivity regions.

Stealth equalization contributes to the entrenchment of large, inefficient public sectors in recipient provinces

The official equalization program sends billions of dollars to provincial governments in economically underperforming regions, thus enabling the development of large, inefficient provincial governments.

Chart 4. Government Spending (All Levels) as Percentage of GDP (2007)



Source: Calculations by author using provincial economic accounts

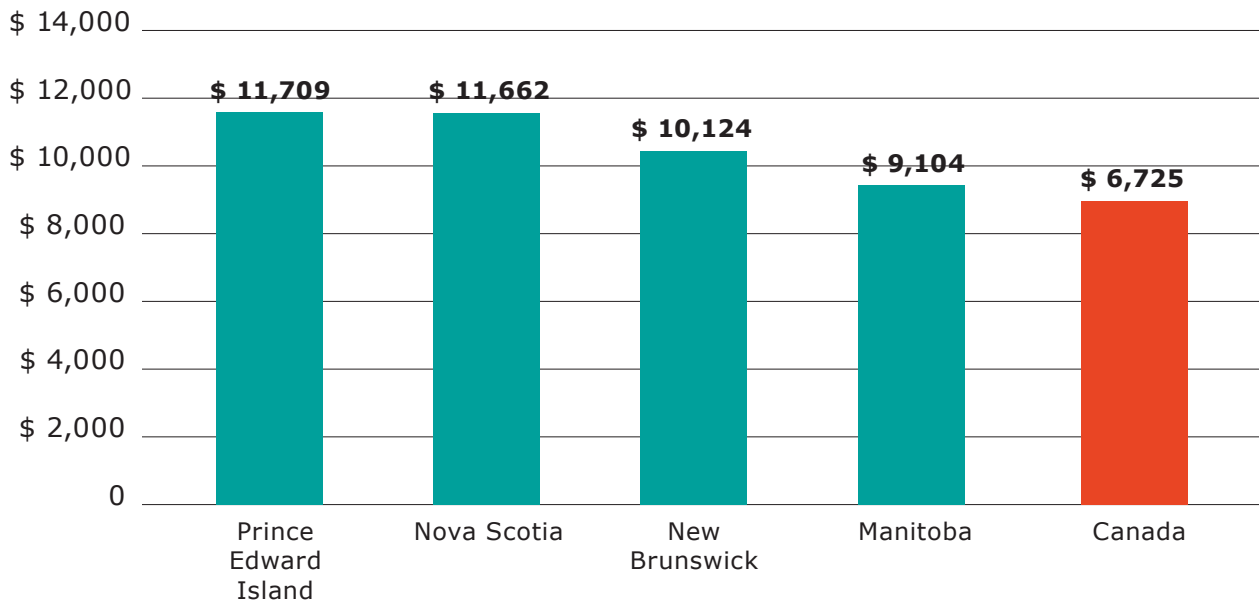
It is therefore unsurprising that, as shown in Chart 1 (page 10), there are far more provincial public administration workers in the recipient provinces than in the paying provinces.

Stealth equalization, by employing large numbers of federal government workers in these same provinces, further increases the percentage of the workforce that is employed directly by the government. These two factors have contributed to the development in the recipient provinces of low-productivity economies built around large, inefficient public sectors.

As Chart 4 shows (page 17), the five major equalization recipient provinces have—by far—the highest levels of government

spending as a percentage of GDP. Unsurprisingly, the four major recipients of stealth equalization have a much higher rate of government spending than does the country taken as a whole. In PEI, Nova Scotia and New Brunswick, more than half of all economic activity in 2007 came from government spending.³ Chart 5 (below) shows that an inflated federal government presence in the provinces that receive stealth equalization payments is an important reason these economies are centred around government spending. This chart compares total federal government spending per capita in the major recipients of stealth equalization to the country as a whole.

Chart 5. Total Per Capita Federal Government Spending (2007)



Source: Calculations by author using provincial economic accounts

The data presented in Charts 4 and 5 portray a stark picture of the current state of economic activity in the provinces that receive both official and stealth equalization. In these provinces, the economies are dominated by the public sector. Between 45 and 63 per cent of all economic activity comes directly from government spending, and much of the rest is largely dependent on relationships with the state.

This situation drains the dynamism and entrepreneurial energy from an economy and creates a state-driven economy incapable of generating self-sustaining private sector growth. This dependency creates an economic culture where entrepreneurialism and economic creativity are stifled. In this situation, the best and brightest young talent overwhelmingly seeks government jobs because there are few other opportunities for rewarding and lucrative work or else they move to have provinces with more-dynamic private sector oriented economies.

In short, the system of transfers—including official and stealth equalization—contributes to a situation in which the economies of the have-nots have come to depend on a large public sector that entrenches a low level of economic productivity. In the absence of a tremendous stroke of good luck—such as the resource boom recently enjoyed in Newfoundland—it is extremely difficult for an economy ensnared in a position of dependence on transfers to ever become productive and self-sufficient. Stealth equalization contributes to this problem by further increasing the importance of government activity in the local economies of these regions beyond what already exists due to their large, inefficient provincial level governments.

Stealth equalization harms the paying provinces by increasing the tax burden

The founder of the Atlantic Institute for Market Studies, Brian Lee Crowley, used the following formulation to describe Canada's system of transfers to less economically dynamic regions: "[I]t entrenches low productivity in recipient provinces and adds to the cost structure of all others, which in turn affects their productivity." While creating a system of dependence and state-driven economics in the recipient provinces, the transfer system harms taxpayers in the paying

This dependency creates an economic culture where entrepreneurialism and economic creativity are stifled. In this situation, the best and brightest young talent overwhelmingly seeks government jobs because there are few other opportunities for rewarding and lucrative work or else they move to have provinces with more-dynamic private sector oriented economies.

provinces by extracting substantial amounts of money out of those provinces to redistribution elsewhere.

The official equalization program alone costs taxpayers across Canada—disproportionately those in paying provinces—over \$14-billion per year. This paper has shown that stealth equalization results in a hidden transfer of approximately \$2-billion additional dollars from taxpayers to finance high levels of federal employment in four small provinces. These are only two components of Canada's system of taxing wealth away from some provinces and distributing it to others. Credible estimates show that in total, between \$40-billion and \$50-billion dollars are transferred from high-productivity jurisdictions to low-productivity jurisdictions in Canada.⁴ This money is taken from high-productivity provinces, where it would otherwise be put to more-efficient use by increasing the productivity of those regions and Canada as a whole.

An additional potential cost of stealth equalization is that the very low levels of federal government employees and offices in the westernmost provinces may affect the quality of government services in those provinces. Residents of Alberta, British Columbia and Saskatchewan have far fewer federal employees per resident than the national average. Chart 2 shows there are only 58 per cent as many federal government employees per 100,000 residents in Alberta compared to Canada as a whole.

This very low number of federal employees may affect the quality of government services; however, an independent analysis of the quality of these services would be required to prove or disprove this possibility. It is also plausible that a low concentration of federal government employees in the westernmost provinces

does not have a significant effect on the quality of services because the benefits of many federal government services flow to citizens across the country regardless of where the government work is actually done. For example, a Canada Pension Plan processing office in Nova Scotia performs services for citizens across the country—not just those in Nova Scotia. For this reason, it cannot be assumed with certainty that the low level of federal government employment in the provinces west of Manitoba affects the quality of services for Western Canadians.

Nevertheless, due to the size of the imbalance and the comparatively low concentration of federal government employees in Saskatchewan, British Columbia and, especially, Alberta, it is worth noting the possibility that stealth equalization influences the quality of federal government services received by taxpayers in the paying provinces. This question is worthy of additional research, but it is beyond the scope of this paper.

Stealth equalization harms the country as a whole by transferring capital out of high-productivity jurisdictions and into low-productivity regions

This effect is closely related to the negative effect on paying provinces described in the preceding paragraphs—however, the effect of stealth equalization and similar transfers on the productivity of Canada as a whole requires special mention as an important negative impact.

When factors of production—such as money—are extracted from the high-productivity regions of a country and

transferred to low-productivity regions, they are put to less efficient and less productive use than would be the case in the high-productivity regions. This is the defining feature of the difference between a more dynamic and a less dynamic economic region. To compound this, markets tend to allocate factors of production more efficiently than do the bureaucratic processes of governments. The impact of transferring money from the private sector of a high-productivity region to the public sector of a low-productivity region is therefore that the money will generally be used less efficiently and contribute less to overall production.

Canadian policy-makers have struggled for many years to increase Canada's level of economic productivity. The productivity gap between Canada and the United States has been a source of deep concern in this country since it was first identified decades ago. This gap has, generally speaking, continued to grow despite concerted efforts by provincial and federal governments to promote productivity increases.

As Canada continues to face increasing competition from around the globe, the impact of Canada's inability to rapidly increase its productivity on the average Canadian's quality of life will continue to grow. Canada's policy of wealth transfer to low-productivity regions is a major impediment to achieving the sort of productivity gains that will allow Canada to compete economically and maintain a very high quality of life for its citizenry.

The precise impact of regional subsidies and transfers on Canada's productivity levels is unknown. Amazingly, the government of Canada has never undertaken a detailed evaluation of the consequences of transferring tens of billions of dollars each year from high-productivity regions

“Amazingly, the government of Canada has never undertaken a detailed evaluation of the consequences of transferring tens of billions of dollars each year from high-productivity regions to low-productivity regions.”

to low-productivity regions. However, due to the size of the transfers and the inefficient, state-centered composition of the recipient provinces, it is safe to assume that the impact on Canada's productivity levels is profound. It is likely that the effect of this wealth transfer to inefficient, state-driven jurisdictions more than offsets all efforts made by the government to boost productivity.⁵ Canada stands in need of a productivity agenda, and yet any such agenda is undermined, if not doomed to failure, so long as the country continues down the path of enabling the growth of large, inefficient public sectors in less productive regions. The stealth equalization described here is a prime example of this approach to policy that must be fundamentally altered to ensure the future productivity and prosperity of the country.

Conclusion

The stealth equalization of unbalanced federal employment described in this paper is part of a much bigger problem—an approach to public policy in Canada that transfers money out of high-productivity regions into low-productivity regions.

Not only is this policy approach harmful to our productivity growth, it is also, quite simply, unsustainable. Historically, the taxpayers in three provinces—British Columbia, Alberta and Ontario, have paid most of the bill for high levels of public sector employment in the have-not provinces. This situation is no longer tenable, as Ontario has suffered during a severe recession and has seen its manufacturing industries hobbled. Ontario's provincial government is burdened with a staggering level of debt. Restoring Ontario's fiscal health will require frugal public management and hard choices at the provincial level. As Ontario struggles to recover from the recent economic shocks it has endured, it is unreasonable and unrealistic to expect its taxpayers to continue to finance unnecessarily high levels of public sector employment elsewhere. Ontarians simply can no longer afford to pay the bills for official equalization, stealth equalization and the other transfers that support excessively large public sectors in less dynamic regions.

With Ontario's 12 million taxpayers increasingly unable to finance big government payrolls in the have-nots, the burden falls even more heavily on taxpayers in British Columbia, Saskatchewan and, especially, Alberta. However, it is unrealistic to expect these provinces to bear even more of these costs than they do currently. Ontario, with its 12 million

residents, has always carried a substantial portion of the burden associated with financing big government in the have-nots. This contribution simply cannot be replaced by extracting even more money from the other smaller contributing provinces.

This paper made note of the difficulty associated with escaping the reliance on big government once the provinces find themselves in that situation. Necessity, however, will force the recipients of stealth equalization to escape or else they will finally be forced to confront the full costs of a state-driven approach to economic development. The capacity of the paying provinces to finance big government elsewhere is approaching the breaking point, and their largesse to the less productive provinces will inevitably decrease in the coming years for both economic and political reasons. To use an old metaphor, the recipient provinces will soon be required to sink or swim.

Most residents of the recipient provinces are unaware of the extent to which their economies are state-driven and reliant on transfers. Beyond the official equalization money, massive amounts of revenue from elsewhere flow into these provinces from a number of different sources. Stealth equalization through federal employment is one important example—but there are others. Higher dependence on federal government transfers to individuals and discrimination in ordinary operating programs in favour of the have-nots are two more examples of ways Canadian public policy transfers wealth into the have-nots.

Economic and political realities dictate that the era of massive transfers must soon end. The open question is how the recipient provinces will cope with this reality.

By describing and quantifying the reality of stealth equalization through federal employment, this paper has sought to illustrate the seriousness of the economic problems these provinces face and demonstrate the need to replace unsustainable transfer programs with pro-growth reforms that will encourage private sector economic development. Economic and political realities dictate that the era of massive transfers must soon end. The open question is how the recipient provinces will cope with this reality. The sooner the scale of the problem is recognized, the more likely it is that this transition can be made with a minimum of economic pain in the jurisdictions where restructuring is necessary.

The purpose of this paper is to contribute to a recognition on the part of policy-makers and citizens in the recipient provinces concerning the scale of their dependency on transfers above and beyond official equalization. This will, it is hoped, encourage substantial dialogue about what sorts of policy reforms are necessary to transform these inefficient, state-centered jurisdictions into dynamic, self-sufficient, market-driven economies.

Endnotes

1. In 2009, for the first time, Ontario received equalization payments due to a severe economic slowdown in the province. However, these equalization payments were trivial compared to those received each year by the perennial have-not provinces. Because Ontario's equalization receipts were very small and Ontario has a consistent record as a contributing have province, Ontario is treated as a have province in this analysis.
2. The data for charts Two and Three include all individuals classified as "federal general government employees" and "federal government business enterprise employees" by Statistics Canada Table 183-0002.
3. This table was built using 2007 data—the most recent comprehensive data available—and it does not take into account the impact of the recent recession. Since recessions tend to reduce private sector economic activity but do not have the same sort of impact on public sector spending, it is almost certain this table understates the government share of GDP in Canada as a whole and in each province.
4. David MacKinnon. Quoted in Lee Greenberg, "Equalization payments a failure: report." *Winnipeg Free Press*. February 25, 2010.
5. David MacKinnon. "Equalization: Deal or No Deal? Does it Matter?" Frontier Centre for Public Policy. Available online at <http://www.fcpp.org/publication.php/1840>.

Further Reading

February 2010

The Real Have-Nots of Confederation: British Columbia, Alberta and Ontario

Ben Eisen and Mark Milke

<http://www.fcpp.org/publication.php/3196>

March 2004

Transformational Equalization: A 3 Part Series

Peter Holle

<http://www.fcpp.org/publication.php/738>