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Mind the Gap

Ontario's Persistent Net Contribution
to the Federation

BY ERICH HARTMANN & JORDANN THIRGOOD

Mowat Centre

ONTARIO'S VOICE ON PUBLIC POLICY



School of Public Policy & Governance
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Ontario continues
to receive
disproportionately
lower shares of
important areas of
federal spending.

EXECUTIVE SUMMARY

In 2014-15, the federal government spent over \$250 billion on various programs including transfers to people, transfers to other governments and direct spending. Canadians expect governments to account for how their tax dollars are used. Is money spent wisely? Does the spending achieve its intended goals? Has federal spending been allocated fairly across the country?

The analysis in this paper will contextualize that last question by attempting to measure the gap between the amount of federal taxes paid by the residents of each province, and what they receive in return, in the form of federal spending. This is not a new field of research – this report is an extension of the Mowat Centre’s fiscal gap papers from 2013 and 2014 which analyzed a snapshot of the 2009-10 fiscal landscape. The suspension of a key dataset required for this analysis meant that further work was not possible beyond 2009, the final year for which data was available.

The release of the Government Finance Statistics data set by Statistics Canada this summer allows for the extension of this analysis to 2014, albeit on a somewhat different accounting basis. Our analysis reveals that, despite economic and fiscal changes, the list of net contributors and beneficiaries is largely unchanged since 2009.

This report is not an attempt to assess the value of the federation. A certain degree of inter-regional redistribution is an expected and often desirable feature of any federation. Rather, this report will undertake a quantitative analysis of the elements of the federal government’s revenue-raising and spending practices to identify which of those elements lead to net contributions or benefits to the federation, with a particular focus on Ontario.

Specifically, this report finds that Ontario continues to receive disproportionately lower shares of important areas of federal spending. Furthermore, despite having a fiscal capacity lower than the national average, Ontario continues to contribute more to the federal government in revenue than it receives in spending, just as it did in 2009.

1 THE FISCAL GAP

In 2013 the Mowat Centre examined Ontario's fiscal balance within the federation – that is, what the province contributes to the federal government in total tax revenue compared to what we get back in federal spending. Our findings from *Filling the Gap* revealed an \$11.1 billion imbalance between these figures, equivalent to 1.9 per cent of the provincial GDP.¹ This meant that despite Ontario being an Equalization recipient, Ontarians were seeing their federal tax dollars redistributed away from the province on a net basis.

Ontario, historically a relatively wealthy province, has always been a net contributor to the federation. However, in the final years of the previous decade, a number of factors served to reduce Ontario's relative economic weight within the federation. On the one hand, a boom in commodity prices – up until the summer of 2014 – greatly increased the revenue-generating capacity of resource-rich provinces such as Alberta, Saskatchewan and Newfoundland and Labrador. On the other hand, the challenges associated with the ongoing restructuring of Ontario's economy were compounded by a severe recession in 2008. Taken together, these factors resulted in Ontario becoming eligible for Equalization payments in 2009.

This led to the counter-intuitive result of Ontario simultaneously being a recipient of Equalization payments and a net contributor to the federation. While the share of federal revenue collected in Ontario remained close to its share of Canada's population, the substantial gap in

what was received in direct spending, transfers to individuals and businesses, and transfers to provincial and local governments persisted despite its Equalization-receiving status.

We dug a little deeper in 2014 with a follow-up report that applied a refined methodology to all Canadian provinces.² The updated calculation showed Ontarians' net contribution to the federation to be \$9.1 billion. Ontario proved to be a unique outlier as the only province to receive Equalization and make a net contribution to the federation. Saskatchewan and Newfoundland and Labrador were also outliers, but in stark contrast, these provinces continued to be net recipients of federal spending despite being more prosperous than the national average. While some provinces received payments that matched expected patterns, the findings generally confirmed that the overall structure of fiscal federalism is slow to adjust to shifts in revenue-raising capacity.

1 Zon, N. (2013) "Filling the gap: Measuring Ontario's balance with the federation" *Mowat Centre*. https://mowatcentre.ca/wp-content/uploads/publications/62_filling_the_gap.pdf.

2 Granofsky, T. and Zon, N. (2014) "Cheques and balances: The finances of the Canadian federation." *Mowat Centre*. https://mowatcentre.ca/wp-content/uploads/publications/87_cheques_and_balances.pdf.

A province making a net fiscal contribution to the federation is not inherently wrong. Quite the opposite, redistribution is a natural and desirable aspect of federalism and is to be expected. However, that a handful of provinces are persistent net contributors to the federation should at a minimum spark a conversation on how federal spending in Canada is allocated, and whether Canadians are getting their fair share across the board. When funds are not allocated on a principled basis, this can deprive Canadians of comparable access to public services – violating the core principle of fairness.³

Both of our previous studies were forced to use outdated data dating back to the 2009-10 fiscal year because Statistics Canada had temporarily suspended a data set required for the analysis. The suspension was required as Statistics Canada converted the data set to be compatible with internationally accepted accrual accounting frameworks for government finance statistics. For those wanting to learn more about the differences between the Financial Management System and the Government Finance Statistics, we would suggest further reading.⁴

As a result of this suspension, no relevant new data had been released until this summer, leaving policymakers to draw conclusions about the federal fiscal landscape based on a snapshot that may no longer be reflective of economic reality.

3 Zon, N. (2014) "Slicing the pie: Principles for allocating transfer payments in the Canadian federation" *Mowat Centre*. https://mowat-centre.ca/wp-content/uploads/publications/90_slicing_the_pie.pdf.

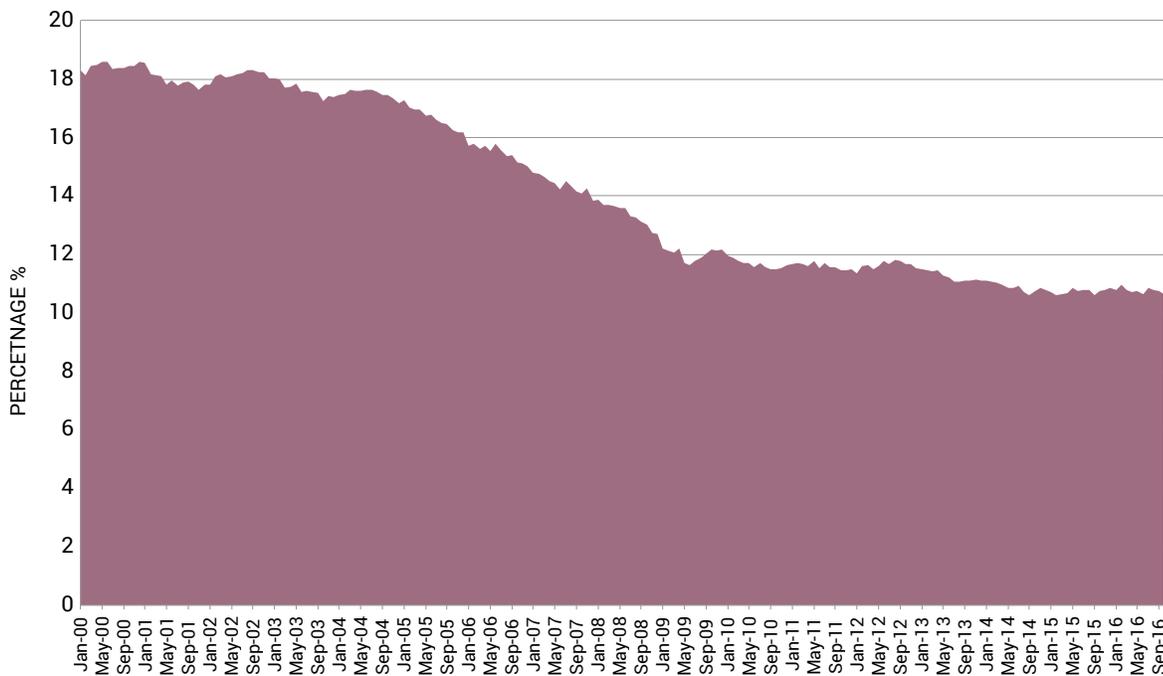
4 For the differences between the old and new accounting approaches used by Statistics Canada see Statistics Canada. 2015. "Moving from the Financial Management System to Government Finance Statistics." <http://www.statcan.gc.ca/pub/13-605-x/2010001/article/11155-eng.htm> and International Monetary Fund. 2001. "Government Financial Statistics Manual." http://www23.statcan.gc.ca/imdb-bmdi/document/5174_D4_T9_V1-eng.pdf.

Of course, a lot has changed since 2009. At the time, we were looking at a snapshot of a nation that had experienced an economic recession, and had only just begun the long process of recovery. While Canada’s recovery has been comparatively swift, scars remain and the economic shifts have had differential impacts across provinces. Resource booms benefited some provinces more than others. Subsequent resource busts have in turn damaged the economies of these same regions. And Ontario’s economy continues to transform in ways that have important implications on the ability to generate revenue, including the ongoing decline of the province’s manufacturing sector (see Figure 1).

Important programmatic details of various fiscal transfers have changed since 2009 as well. Overall, transfers have increased. The 2014-15 fiscal year was the first in which the Canada Health Transfer (CHT) was distributed on an equal per capita basis, resulting in disproportionately substantial increases for Alberta and the Northwest Territories.⁵ The Canada Social Transfer (CST) was already allocated on an equal per capita basis. However, because of different population growth rates across provinces, growth in CST entitlements has also varied across provinces.⁶

Canada’s Equalization program – often the source of contention – has also been changed periodically, often to the detriment of Ontario. Reforms in 2009 (Ontario’s first year receiving payments) introduced a cap to limit the growth

FIGURE 1
Manufacturing as a Percentage of Total Employment in Ontario 2000 to 2016



Source: Statistics Canada, Table 282-0088 Labour force survey estimates (LFS), employment by North American Industry Classification System (NAICS).

5 Nadeau, Jean-Francois. (2014) "2014-2015 Federal Transfers to Provinces and Territories". *Office of the Parliamentary Budget Officer*. http://www.pbo-dpb.gc.ca/web/default/files/files/files/Transfer-Payments_EN.pdf.
6 Ibid.

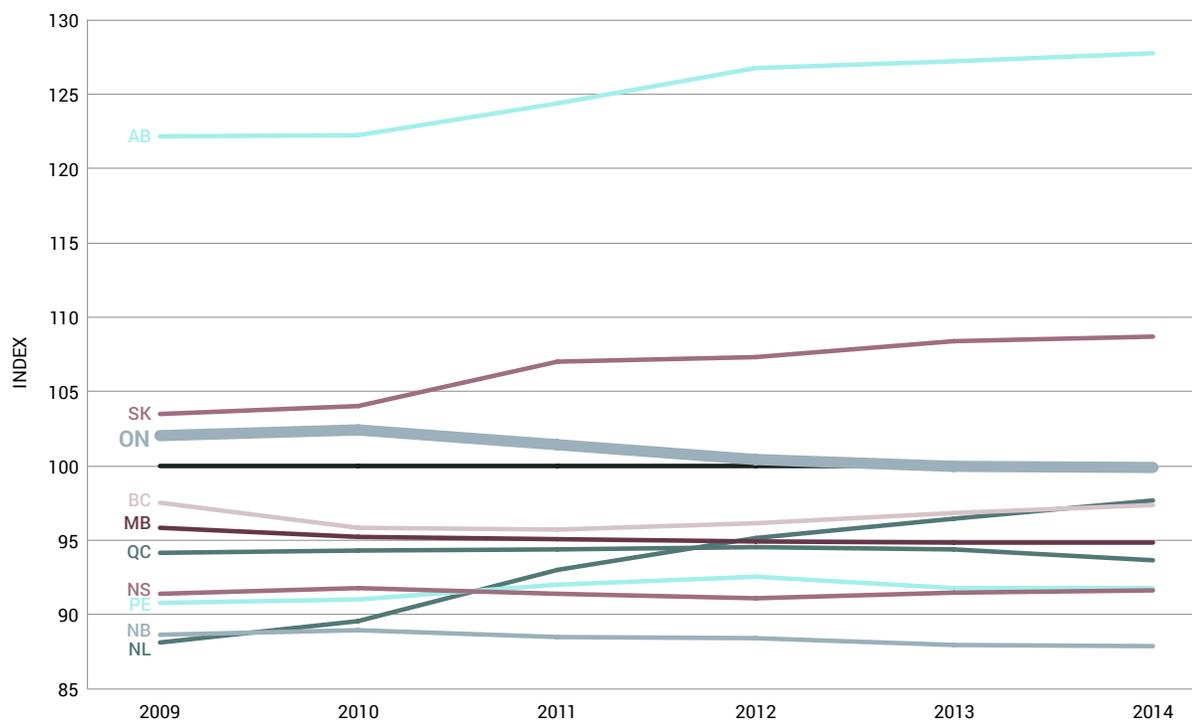
in total payments across the country from exceeding nominal GDP growth, in large part to reduce the federal government's financial exposure to the program. Between the envelope restriction and the fiscal capacity cap, total Equalization payments to the provinces were reduced by \$2.4 billion in 2014-15. Ontario received \$668.9 million less than it would have received otherwise under an uncapped program in that year.⁷

Without new data, it has been difficult to determine how these changes have impacted the overall landscape of federal revenue collection and spending. In the summer of 2016, however,

Statistics Canada released the long-awaited data necessary to replicate and update our fiscal gap analysis.⁸

We applied our previous methodology to the new revenue and expenditure figures from the 2009-10 to 2014-15 fiscal years, to get an idea of how the landscape has changed since our last analysis⁹. Given some drastic economic shifts between 2009 and 2014, including the resource boom and Ontario's median family income falling below the national average (see Figure 2), one would have hoped that the results would better reflect the current state of the federation. Unfortunately, it looks like the more things change – the more they stay the same.

FIGURE 2
Annual Income Estimates for Census Families and Individuals, Median Total Income, All Families, (Index = 100)



Source: Statistics Canada Table 111-0009 Family characteristics, summary, annual

8 CANSIM Table 384-0047 Revenue, expenditure and budgetary balance - General governments, provincial and territorial economic accounts, annual (dollars x 1,000,000).

9 Lags in the collection and release of Canadian Government Finance Statistics currently preclude the extension of this analysis beyond 2014.

7 Ibid.

2 WHAT HAPPENED IN ONTARIO?

Drilling down into the numbers, we found that in 2014-15, Ontarians accounted for 38.9 per cent of the contributions to the federal treasury, and received 35.9 per cent of federal spending in return. This resulted in Ontarians making a net contribution of \$7.7 billion to the federation in that year, equivalent to 1.1 per cent of provincial GDP. Again, while the share of federal revenue collection was closely reflective of Ontario's share of the population (38.5 per cent), the gap emerges in the share of federal spending. For the full calculations behind our methodology, please see the appendix.

At first blush, it would appear Ontarians' net contribution to the federation has decreased since our last attempt to estimate it. Two years ago, the Mowat Centre estimated the gap to be \$9.1 billion in 2009-10. However, as noted in the previous section, our original 2009-10 estimate calculated Ontario's percentage-share of federal revenues and expenditures based on data that Statistics Canada had generated through a different accounting approach than its 2014-15 data.

In response to this change in accounting frameworks, we also updated our calculation of the gap for 2009-10 to Statistics Canada's new accounting framework so that we could compare apples to apples over time. Statistics Canada's revisions changed the shares of both Ontarians' contribution to federal revenues and federal spending in Ontario as calculated for 2009-10. The estimated share of federal revenue raised in Ontario dropped from 39.0 per cent using the previous data to 38.3 per cent using the updated

FIGURE 3
Ontario's Share of Federal Revenue and Spending, 2014-15

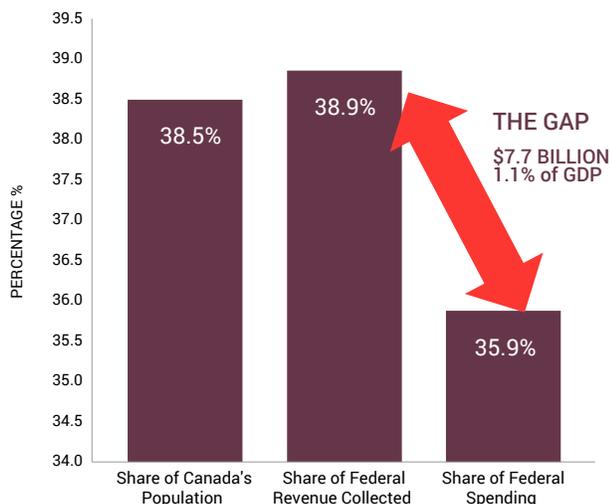
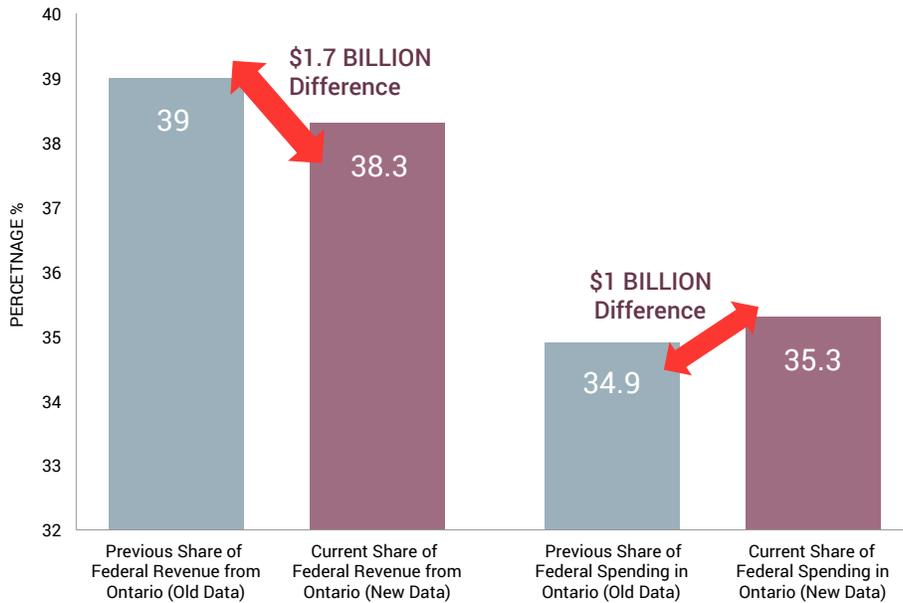


FIGURE 4

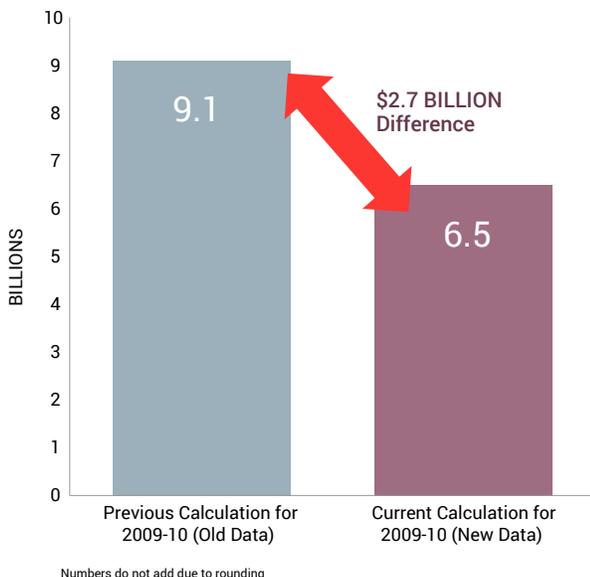
Breaking Down the Re-Calculation of the Gap for Ontario, 2009-10 (\$ Billion)



figures. On its own, this translated into a \$1.7 billion decrease in Ontario’s gap for 2009-10. At the same time, the new data increased the estimate for the federal share of spending in Ontario from 34.9 per cent to 35.3 per cent, which translated into a further \$1 billion decrease in the gap, for that year.

Using Statistics Canada’s updated figures for 2009-10, then, the gap in that year was \$6.5 billion; \$2.7 billion lower than the older data had previously suggested.

FIGURE 5
Re-Calculating the Gap for Ontario Using Previous and Revised Data, 2009-10



After making the necessary adjustments to the numbers over this time period, it becomes clear that Ontarians’ net contribution has actually increased from \$6.5 billion in 2009-10 to \$7.7 billion in 2014-15.

Both Ontarians’ contribution to federal revenues and the level of federal spending they receive in return have an impact on their net contribution to the federation. Taken together Figures 6 and 7 show that, as the share of either revenue or expenditure shifts, the size of the gap shifts with it. In 2010-11 for example, Ontario’s share of federal revenue was relatively low, and the share of federal spending hit its recent high-water mark. As a result, the corresponding gap was the smallest over the time period analyzed at only \$4.1 billion (see Figure 6).

To more fully understand which specific federal policies impact Ontarians’ net contribution to the federation, a more detailed analysis is required.

FIGURE 6

The Evolution of Ontarians' Net Contribution to the Federation, 2009-10 to 2014-15

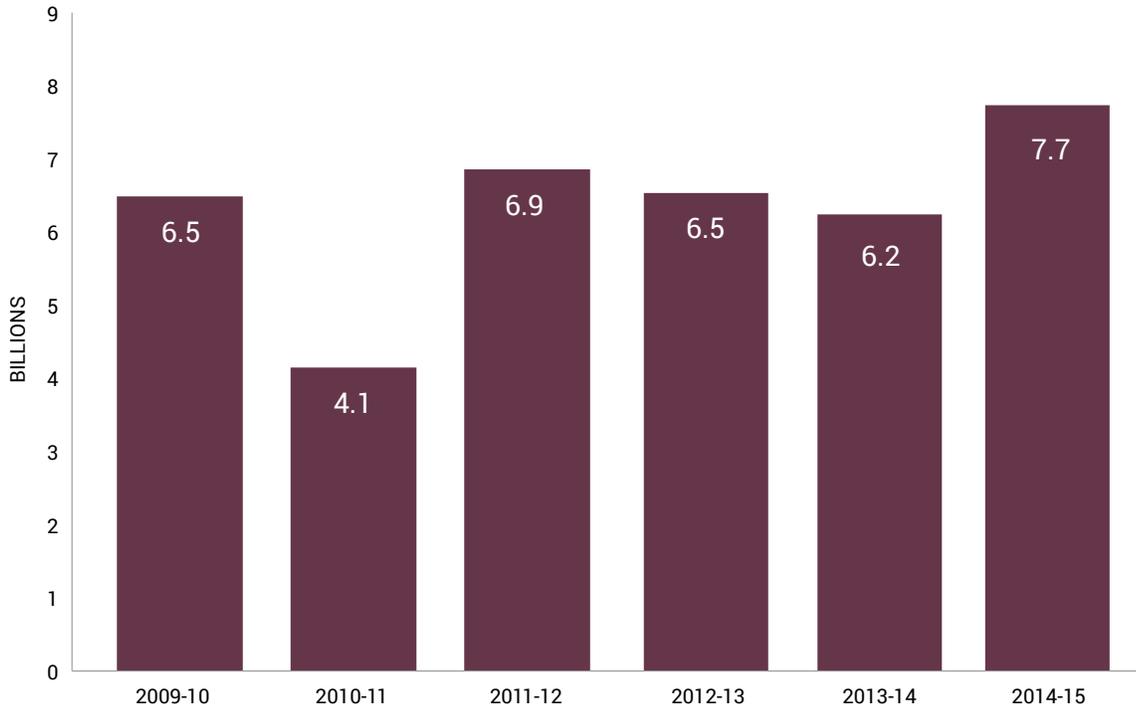
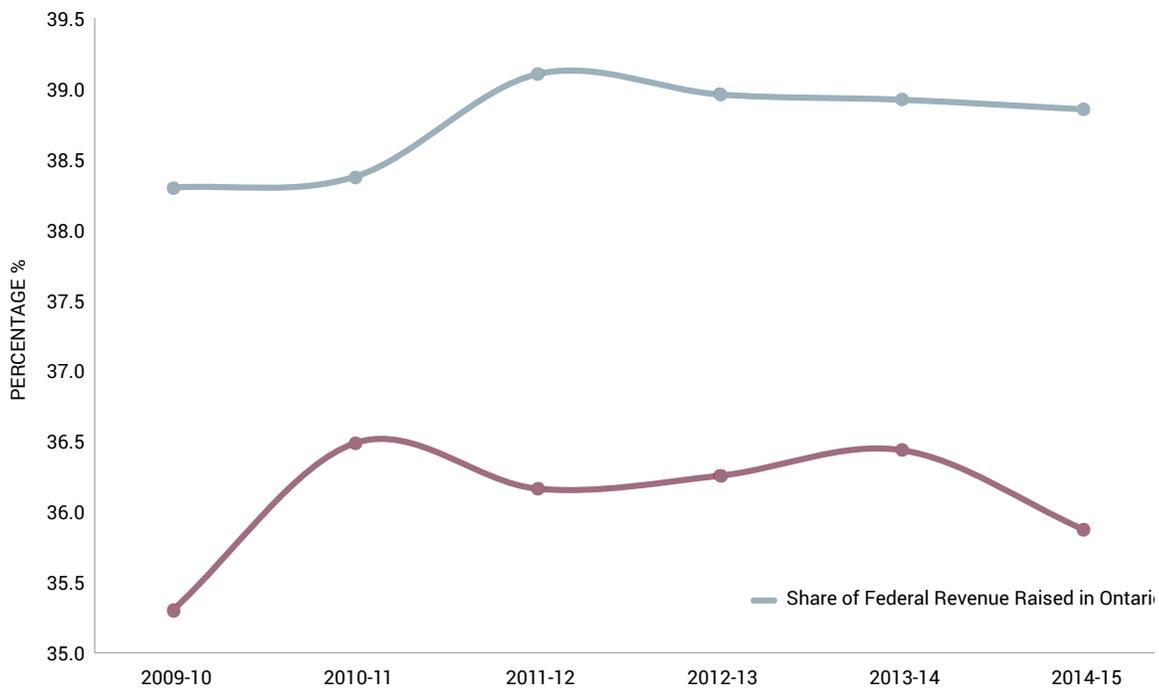


FIGURE 7

The Evolution of Ontario's Share of Federal Revenue and Spending, 2009-10 to 2014-15



Over the years,
there has been a
select group of
provinces who
have always
remained net
recipients.

3 FACTORS CONTRIBUTING TO ONTARIANS' NET CONTRIBUTION

Ontarians' net contribution to the federation can be attributed to both a higher-than-average contribution to federal revenues and lower-than-average overall federal spending in the province. The split between these two factors, however, is far from equal.

Ontarians' Contribution to Federal Revenue

Roughly 10 per cent of Ontario's \$7.7 billion gap can be explained by the fact that Ontarians contribute more than their per capita share of federal revenues. While Ontarians represented 38.5 per cent of Canada's population, their contribution to federal personal incomes taxes – by far the largest source of federal revenue – was 41.4 per cent in 2014-15. Ontarians also contributed more than their population share to Employment Insurance premiums, at 39.0 per cent. Ontarians' contributions to corporate income taxes and the Goods and Services Tax, however, were slightly below the province's population share in 2014, at 36.2 per cent and 37.9 per cent respectively.

Federal Spending in Ontario

The other 90 per cent of the gap comes from the fact that federal spending in Ontario is well below the province's share of the population. Federal spending on goods and services in Ontario is higher than the national average, largely due to the fact that the national capital region is largely in Ontario. However, federal spending in Ontario is below the national average for both transfers to individuals and transfers to governments.

TRANSFERS TO INDIVIDUALS

When it comes to federal transfers to individuals, Ontarians receive less than their population share with respect to both Old Age Security and Employment Insurance (EI) benefits. Average total income for seniors in Ontario is above the national average. As such, Ontario's seniors were, in the aggregate, entitled to less Old Age Security payments. In the case of EI, Ontarians received only 33 per cent of total benefits paid out in 2014-15. Much has been written about how the structure of EI makes it harder for unemployed Ontarians to qualify for benefits than elsewhere in the country.¹⁰ This situation is made worse by the fact that significant amounts of funding for skills development and job training is tied to receipt of EI benefits, effectively barring many who need active labour market supports the most from those programs.¹¹ A renewed principles-based discussion on reforms to EI and EI-funded training programs is long overdue.

10 Hjartarson, J and L. McGuinty. (2012). "A Federal Agenda for Ontario." *Ontario Chamber of Commerce*. <http://www.occ.ca/Publications/FINAL-A-Federal-Agenda-for-Ontario.pdf> and Zon (2013) are two good examples.

11 Morden, M. (2016). "Back to Work." *Mowat Centre*. https://mowat-centre.ca/wp-content/uploads/publications/123_back_to_work.pdf.

TRANSFERS TO PROVINCES AND TERRITORIES

The most significant factor contributing to Ontario's current gap is the allocation of federal transfers to provinces and territories. For the purpose of this analysis, these transfers can be broken into four sub-categories:

- 1] The Canada Health Transfer (CHT) and the Canada Social Transfer (CST);
- 2] Other transfers to provinces and territories;
- 3] Territorial Formula Financing (TFF); and
- 4] Equalization.

Measuring the impact of the CHT and CST is straightforward: as of 2014-15, both the CHT and CST were allocated on a per capita basis, so neither had an impact on the current gap.

The impact of the second category on Ontario's fiscal gap is significant. "Other transfers" to provinces and territories is a grab-bag of dozens of smaller transfers, which are mostly for targeted programs. Between 2009 and 2014, Ontario received the lowest per capita amount in this category in every year but one. The only exception was 2010, the year in which the federal government made time-limited payments to facilitate Ontario's transition to the Harmonized Sales Tax.

Ontario is consistently well below the national average in terms of the "other transfers" it receives on a per capita basis. Table 8 exemplifies this divergence between Ontario's per capita

transfers in this category relative to the average of all Canadian provinces and territories, as well as the average excluding outliers Newfoundland and Labrador, Nova Scotia and the territories. Newfoundland and Nova Scotia have special arrangements with the federal government with respect to their offshore petroleum resources and the territories receive disproportionately large transfers to reflect their unique needs.

In either case, the gap is still significant. To close the 2014-15 gap between Ontario (\$240 per capita) and the national average excluding these outliers (\$326 per capita), an additional \$1.2 billion in "other transfers" to Ontario would have been required in 2014. Further discussion as to whether these transfers are being fairly allocated across Canada in a principled manner is most certainly warranted.

Finally, Canada's two primary equalizing transfers, TFF and Equalization, represent the biggest net contributions from Ontario. TFF is the main transfer that the federal government uses to support territorial governments in financing public services in the North. The program takes into account the high cost of delivering public services in the North, especially with respect to offering services to small, isolated communities. These challenges are unique and significant. They justifiably require a dedicated federal transfer such as TFF to address them, along with a disproportionate contribution from the rest of Canada. Equalization will be discussed at length in the following section.

FIGURE 8
Other Transfers to Provinces and Territories (\$ per capita)

	2009	2010	2011	2012	2013	2014
Ontario	265	623	277	302	228	240
Average of All Provinces and Territories	394	619	393	411	351	362
Average Excluding Newfoundland, Nova Scotia and the Territories	314	551	336	368	322	326

Ontarians
represent **38.5%**
of Canada's population

Share of Federal
SPENDING
in Ontario

35.9%

Share of Federal
REVENUE
Raised in Ontario

38.9%

Ontarians
received **33%**
of total EI benefits but
contributed **39%**
of EI premiums

To close the gap
on Other Transfers,



an additional
\$1.2 BILLION
would have been required

4 INTERPROVINCIAL DYNAMICS AND THE EQUALIZATION PROGRAM

Ontarians have long supported the principle of equalization. However, whether or not the Equalization program is working as it should is an open question. There is currently a disconnect between the measurement of fiscal capacity in the Equalization program and the overall net contribution that Ontarians make to the federation. But to put that point into context, one needs to examine the interprovincial dynamics to assess where Ontario stands in relation to other provinces' fiscal capacities and balances.

For the most part, there has been very little change in terms of other provinces and their balance with the federation. Over the years, there has been a select group of provinces who have always remained net recipients: Newfoundland and Labrador, the Maritime Provinces, Manitoba, and Quebec. Consistent recipient status of the majority of Maritime Provinces is neither surprising nor unprincipled, as the purpose of redistribution is to ensure that all Canadians have equal access to goods and services no matter where they reside. This means lifting up provinces that are less prosperous than the Canadian average, and transferring funds away from more

prosperous regions on a net basis. The smaller economies of the east coast, such as PEI, have significantly below-average fiscal capacities and thus benefit greatly from these transfers. The same goes for Manitoba and Quebec, which signals that a portion of the system is largely working as it should.

A slight exception in this case is Newfoundland and Labrador. Our 2014 report highlighted that, for 2009-10, the province had an impressive fiscal capacity and soaring resource revenues but continued to be a net recipient of federal spending. This remained true over the period analyzed, as the province continued to be a

FIGURE 9
Net Contribution/ (Benefit) by Province, 2009-10 to 2014-15 (\$ billions)

Fiscal Year	AB	ON	BC	SK	PE	NL	MB	NB	NS	QC
2009-10	20.5	6.4	3.6	0.1	(1.1)	(2.1)	(4.2)	(3.9)	(5.5)	(11.0)
2010-11	20.9	4.1	2.8	0.3	(1.1)	(1.7)	(3.9)	(3.8)	(5.2)	(9.6)
2011-12	19.7	6.9	3.6	0.3	(1.1)	(1.4)	(4.1)	(4.1)	(5.8)	(10.9)
2012-13	20.6	6.5	4.8	0.4	(1.1)	(1.5)	(4.1)	(4.3)	(6.4)	(11.7)
2013-14	22.7	6.2	4.0	0.7	(1.2)	(1.3)	(4.0)	(4.3)	(6.6)	(12.7)
2014-15	23.9	7.7	4.4	0.5	(1.2)	(1.4)	(4.0)	(4.5)	(6.6)	(14.9)

net recipient of federal spending despite a significantly higher fiscal capacity than the Canadian average in the 2014-15 fiscal year. However, the size of Newfoundland's fiscal gap has been consistently shrinking over the past five years. In 2009-10, the province was receiving \$2.1 billion more than they contributed, which dropped to only \$1.4 billion in 2014-15. Given the precipitous drop in natural resource prices since 2014-15, it is not clear that the trend of a shrinking net contribution will continue for the province.

Fiscal capacity is a concept used in the Equalization program to estimate how much revenue a province could generate if it levied national average rates on its own tax and resource bases.

Alberta on the other hand has always remained a net contributor – and a very large one at that. This is because Alberta continues to be among the most prosperous and wealthy provinces: at the time of our last study, Alberta's ability to provide public services at the national average tax rate was approximately twice that of Manitoba or Quebec.¹² For this reason, their contribution to federal revenues has been redistributed elsewhere on a net basis.

More recently however, Alberta has faced significant hardships that are not fully captured in the new Statistics Canada dataset, which ends in the 2014-15 fiscal year. As a province that is heavily reliant on resource revenues, plummeting oil prices have had devastating impacts on the economy and job prospects for Albertans.

Between June 2014 and February 2016, the price of oil fell from USD \$86.56 to \$16.30 per barrel (according to Western Canada Select, which is widely used by Alberta's oil producers)¹³. As a result, provincial government resource revenues fell by \$7.6 billion – from what represented 18 per cent of provincial revenue to only 3 per cent. Wildfires in May-July 2016 wreaked further havoc across the local economy of Fort McMurray, the heart of the oil sands development, with a recent estimate pegging the wildfires' province-wide effect at a 0.1 per cent (\$456 million) reduction to Alberta's 2016 GDP and \$1.4 billion in lost oil revenues.¹⁴

Finally, there are the provinces which have closely straddled the line between net recipient and net contributor over the years – namely Saskatchewan and British Columbia. Our 2009 publication identified Saskatchewan as a net recipient of federal funds, although only by a very small margin relative to other beneficiaries. However, as discussed above, the methodology used by Statistics Canada to calculate and report some of the necessary data has changed since our first analysis, altering some findings from our earlier reports. The updated figures instead reveal a net positive number for Saskatchewan, although still within a very small margin at \$136 million. Regardless, Saskatchewan continues to climb further into net contributor status: the size of its gap has been on a steady incline from \$136 million in 2009 to \$517 million in 2014.

British Columbia also straddles this line, although not quite as closely. In 2009, BC was contributing \$3.6 billion more than it received in federal

13 <http://economicdashboard.alberta.ca/OilPrice>, retrieved September 13, 2016.

14 However, the same Conference Board of Canada estimate also expects a 0.4 per cent (\$1.1 billion) 2017 boost to Alberta's GDP and 9,000 jobs generated in 2017 from rebuilding efforts. See http://www.conferenceboard.ca/e-library/abstract.aspx?did=8432&utm_source=linkedin&utm_medium=social&utm_campaign=share.

12 Zon & Granofsky, 2014.

funding – a gap smaller than Ontario at the time but larger on a per capita basis. Since then, the gap between federal revenue collection and public spending has been growing quite quickly and consistently: as of 2014, the province’s fiscal gap sat at \$4.4 billion. Figure 10 shows that while British Columbia’s gap remains smaller than Ontario’s, it continues to be substantially higher on a per capita basis. The \$953 per capita net contribution greatly exceeds both Ontario’s (\$566) and Saskatchewan’s (\$466). British Columbia is a relatively prosperous region, with a slightly above-average fiscal capacity.¹⁵

Ontario continues to contribute more to the federal government in revenue than it receives in spending, despite having a fiscal capacity lower than the national average.

FIGURE 10
Net Contribution/ (Benefit) to the Federation by Province in 2014-15 (\$ per capita and \$ billions)

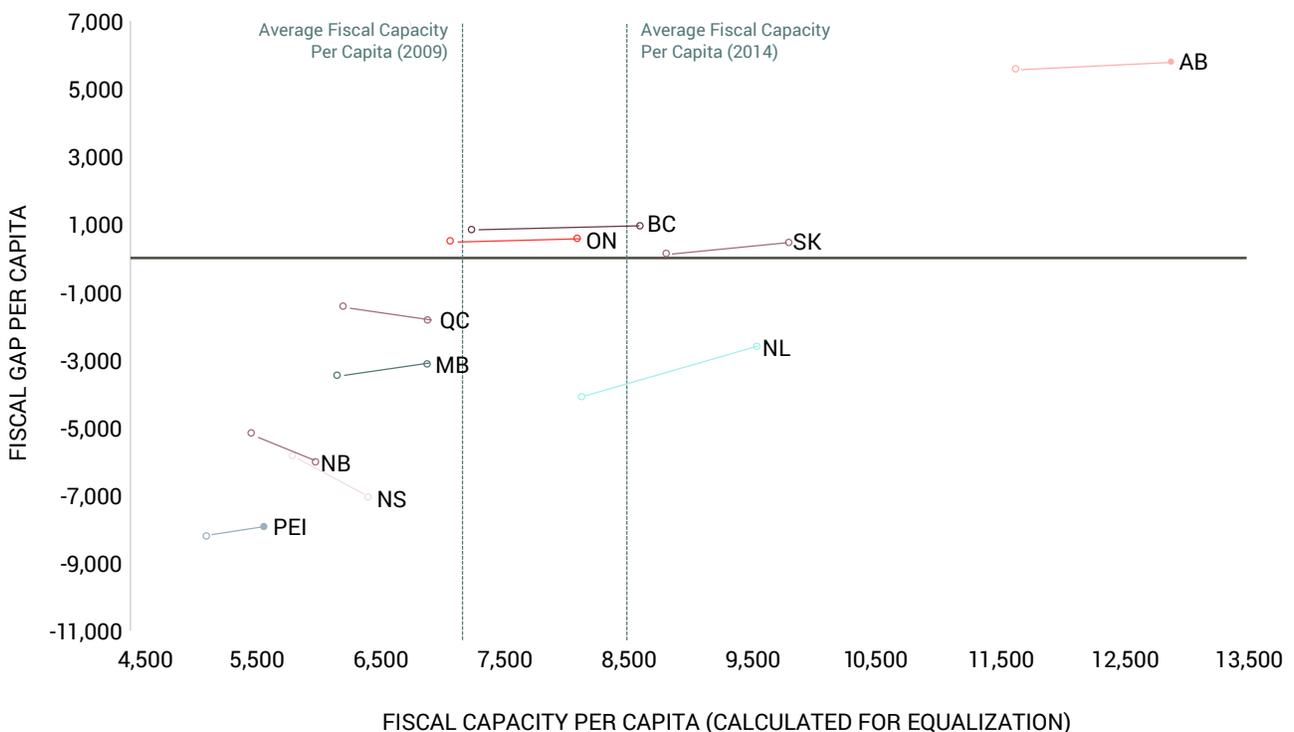
Province	Net Contribution/ (Benefit) \$ Per Capita	Net Contribution/ (Benefit) Billions
AB	5,815	23.9
BC	953	4.4
ON	566	7.7
SK	466	0.5
QC	(1,811)	(14.9)
NL	(2,619)	(1.4)
MB	(3,127)	(4.0)
NB	(6,020)	(4.5)
NS	(7,043)	(6.6)
PE	(7,897)	(1.2)

¹⁵ The territories (Yukon, Nunavut, and Northwest Territories) were excluded from this analysis. These governments are subject to a different fiscal transfer structure than the provinces, receiving funds under the Territorial Formula Financing program instead of Equalization. The principle remains mostly the same, although with an additional caveat that recognizes the higher costs involved in providing public services to isolated communities, and the unique circumstances of each territory. The territories are consistently net recipients of federal spending on a dollar basis, and to an even larger extent on a per capita basis. On average, the three territories receive \$1.3 billion more than they contribute – around \$34,179 per capita.

Figure 11 outlines the relationship between a province's fiscal capacity and their balance with the federation, as well as how these provinces have shifted over time. Changes since 2009-10 have been largely insignificant: while most provinces do appear to see slight increases in their fiscal capacity, the average fiscal capacity shifts concomitantly. Thus the position of each province in relation to the national average fiscal capacity and to each other remains almost entirely unchanged. Alberta, Saskatchewan and British Columbia continue to have above average fiscal capacity and contribute to the federation on a net basis, while Quebec, Manitoba, New Brunswick, Nova Scotia, and PEI have fiscal capacities substantially below the national average and continue to receive more from the federal government than they contribute. When the federal government redistributes funds on a net basis to the provinces with a below-

There is currently a disconnect between the measurement of fiscal capacity in the Equalization program and the overall net contribution that Ontarians make to the federation.

FIGURE 11
Fiscal gap and fiscal capacity by province (at 50% natural resources) in 2009-10 and 2014-15



average capacity to raise revenue, this is generally consistent with expected and principled patterns of redistribution.

Two obvious outliers remain, which seem to fall out of line with the principled case for redistribution. Despite having one of the highest fiscal capacities in the country in 2014-15, Newfoundland and Labrador continued to be a net recipient of federal funds in that year. Ontario on the other hand, despite having a fiscal capacity lower than the national average, continues to contribute more to the federal government in revenue than it receives in spending. Just as in 2009, Ontario is still the only province with a below-average fiscal capacity that remains a net contributor to the federation, despite receiving Equalization payments (see Figure 12).

FIGURE 12
Equalization and Net Contribution/ (Benefit) by Province, 2014-15 (\$ per capita and \$ billions)

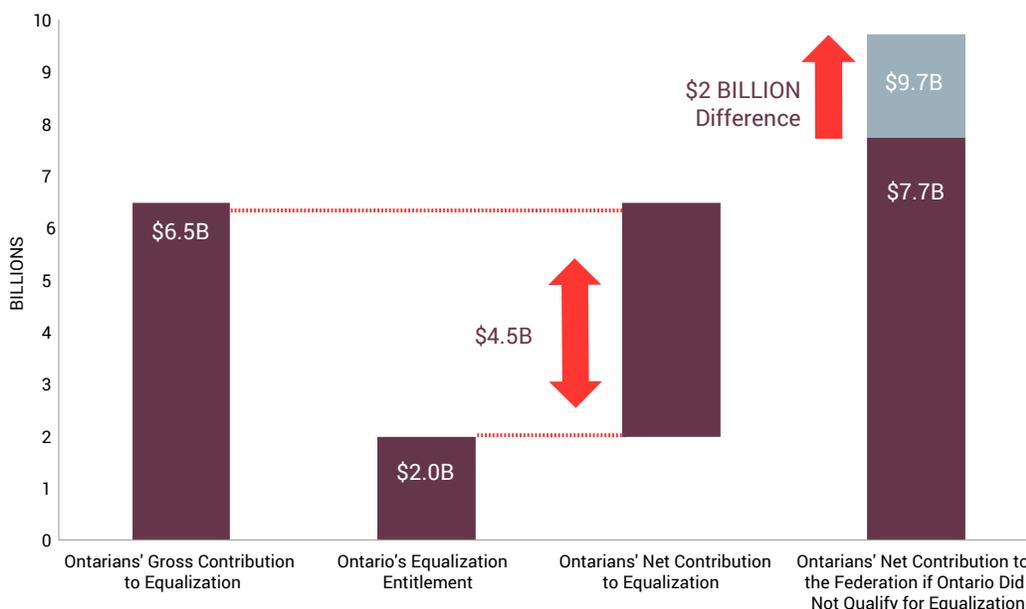
Province	Equalization Per Capita (\$)	Equalization (\$ billions)	Net Contribution/ (Benefit) (\$ billions)
PE	2,501	0.4	(1.2)
NB	2,205	1.7	(4.5)
NS	1,784	1.7	(6.6)
MB	1,415	1.7	(4.0)
QC	1,158	9.3	(14.9)
ON	150	2.0	7.7
NL	-	-	(1.4)
SK	-	-	0.5
BC	-	-	4.4
AB	-	-	23.9

5 LOOKING FORWARD

Looking beyond 2014-15, predicting exactly how Ontarians' net contribution to the federation will have unfolded is an inexact science. Lower commodity prices have not only affected resource-rich provinces, but have had nation-wide implications as well. This will likely mean that Ontario's relative weight in the economy – and Ontarians' relative contribution to federal revenues associated with it – will increase as the revenue contributions of resource-rich provinces falter.

Furthermore, with falling commodity prices and growth in Ontario's economy forecast to outpace other provinces,¹⁶ it is conceivable that Ontario could cease to qualify for Equalization in the not-too-distant future. Had this occurred in 2014-15, Ontario's net contribution to the Equalization program¹⁷ would have increased by \$2 billion, in turn increasing Ontarians' net contribution to the federation by the same amount. In the event that Ontario does not qualify for Equalization in the future, it is reasonable to assume that, all things being equal, its net contribution to the federation will increase.

FIGURE 13
Thought-Experiment: Increase to Ontarian's Net Contribution if Ontario Were to Receive No Equalization in 2014-15



¹⁶ <http://www.rbc.com/economics/economic-reports/pdf/provincial-forecasts/provfscst-sep2016.pdf>.

¹⁷ That is, the notional contributions Ontarians made to the Equalization program through their contribution to federal revenues, less Ontario's Equalization entitlement.

CONCLUSION

The analysis in this report is not an attempt to assess the value of the federation. Some degree of inter-regional reallocation of resources is both desirable and to be expected in a federal system that includes progressive taxation and redistributive policies. It would be neither reasonable nor desirable to expect each province's contribution to the federation to net to exactly zero. However, the persistence of provinces as either net contributors or beneficiaries over time suggests that an evaluation may be required to determine whether Canada's system of inter-regional redistribution is working as intended. In addition, the mismatch between Ontario's below-average fiscal capacity and net contributor status suggests that the ongoing conversation on a principle-based allocation of federal spending decisions remains warranted.

APPENDIX: THE MODEL

Conceptually speaking, the fiscal gap represents the difference between federal revenue collected within a province and what the province gets back in federal spending. By simply calculating this number however, you don't get the whole story. For one, methodological criticisms of previous studies indicated that a federal government surplus or deficit could artificially inflate or deflate the size of a reported gap, regardless of its magnitude.¹⁸ For example, a large federal surplus could create an impression that all provinces are contributing more than they are getting back, while a large deficit could create an opposite impression.¹⁹

In an attempt to mitigate this effect, our model adjusts both the revenue and spending sides of the equation on the assumption that the federal government is trying to balance its books. The *Balanced Budget Approach* then takes an average of two scenarios: the net contribution when revenues are set to match expenditure (plus public debt interest); and the net contribution when expenditure is set to match revenues (subtracting public debt interest). The average is what we refer to as the *net contribution to the federation*.

The reported figures are also adjusted to account for the Quebec Abatement, distribute federal excise tax revenue on an equal per capita basis, and remove any federal expenditure or revenue raised outside of Canada, such as foreign aid and the Foreign Service. The share of federal spending on public debt interest in each province is set at its share of the nation's population.

Below is the table that captures the full calculation behind our methodology for the 2014-15 fiscal year, for each Canadian province. The provincial shares of federal revenue, expenditure and public debt interest were calculated using the recent available data from Statistics Canada's Provincial and Territorial Economic Accounts for each fiscal year from 2009-10 to 2014-15. These shares were then applied to the annual, Canada-wide, Public Accounts of Canada.²⁰

18 Holden, M. (2005). "A closer look at Ontario's \$23-billion gap" Library of Parliament Canada. <http://www.lop.parl.gc.ca/content/lop/researchpublications/prb0515-e.htm>

19 Zon, 2013.

20 Provincial shares of federal revenue, expenditure, and public debt interest were calculated from CANSIM Table 384-0047 Revenue, expenditure and budgetary balance - General governments, provincial and territorial economic accounts, annual (dollars x 1,000,000). Statistics Canada, available online at <http://www.statcan.gc.ca/daily-quotidien/160516/dq160516d-eng.pdf>; these shares were applied to the figures reported in Public Accounts of Canada for each year.

BALANCED BUDGET: REVENUE SIDE											
	NATIONAL	BC	AB	SK	MB	ON	QC	NB	NS	PEI	NL
FEDERAL EXPENDITURE	252.5	27.1	20.7	7.9	11.3	90.6	62.0	8.5	12.0	1.8	5.6
SHARE (%)		10.7	8.2	3.1	4.5	35.9	24.5	3.4	4.7	0.7	2.2
FEDERAL PUBLIC DEBT INTEREST	26.6	3.5	3.1	0.8	1.0	10.2	6.1	0.6	0.7	0.1	0.4
SHARE (%)		13.1	11.6	3.2	3.6	38.5	23.1	2.1	2.7	0.4	1.5
FEDERAL REVENUE (ADJUSTED TO MATCH TOTAL EXPENDITURE)	279.1	34.9	47.3	9.3	8.3	108.4	53.5	4.6	6.1	0.8	4.6
SHARE (%)		12.5	16.9	3.3	3.0	38.9	19.2	1.6	2.2	0.3	1.7
NET CONTRIBUTION		4.3	23.5	0.5	-3.9	7.6	-14.7	-4.5	-6.5	-1.1	-1.4

BALANCED BUDGET: EXPENDITURE SIDE											
	NATIONAL	BC	AB	SK	MB	ON	QC	NB	NS	PEI	NL
FEDERAL EXPENDITURE (ADJUSTED TO MATCH TOTAL REVENUE)	260.0	27.9	21.3	8.1	11.7	93.3	63.8	8.8	12.3	1.9	5.7
SHARE (%)		10.7	8.2	3.1	4.5	35.9	24.5	3.4	4.7	0.7	2.2
FEDERAL PUBLIC DEBT INTEREST	26.6	3.5	3.1	0.8	1.0	10.2	6.1	0.6	0.7	0.1	0.4
SHARE (%)		13.1	11.6	3.2	3.6	38.5	23.1	2.1	2.7	0.4	1.5
FEDERAL REVENUE	286.6	35.9	48.5	9.5	8.6	111.3	54.9	4.7	6.3	0.8	4.7
SHARE (%)		12.5	16.9	3.3	3.0	38.9	19.2	1.6	2.2	0.3	1.7
NET CONTRIBUTION		4.5	24.2	0.5	-4.1	7.8	-15.1	-4.6	-6.7	-1.2	-1.4

FISCAL GAP (AVG OF EACH SCENARIO)										
BC	AB	SK	MB	ON	QC	NB	NS	PEI	NL	
4.4	23.9	0.5	-4.0	7.7	-14.9	-4.5	-6.6	-1.2	-1.4	

