

# BC Commentary

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## BEYOND "HAVES" AND "HAVE-NOTS"

### A Closer Look at BC and Equalization

By Marc Lee

ACCORDING TO FEDERAL calculations, BC joined the ranks of "have-not" provinces in 1999/2000. This pronouncement has been charged with emotion, as if a badge of shame has been pinned to our collective lapels. But the rhetoric of BC's situation is overstated—it comes part and parcel with a political agenda aimed at blaming BC's woes on the previous government.

The reality is that BC has been close to the Equalization line for two decades, usually just above it, and now, just below. The drop itself primarily reflects a change in the methodology for calculating Equalization payments. Nonetheless, the change in equalization status reflects an underlying trend: BC's economic performance has been sub-par since the early 1980s. This points to deeper structural issues that transcend the tenure of any one government, and the need for an economic strategy that goes well beyond blind faith in tax cuts, privatization and the Olympics.

For now, we need to abandon the simplistic rhetoric of "haves" and "have-nots," and put our Equalization dollars to good use.

#### A Primer on Equalization

The federal Equalization program is one that Canada's Right loves to hate. It is equated to welfare for needy provinces, and portrayed by many, including

Alberta Premier Ralph Klein, as a direct transfer of funds from the "haves" to the "have-nots." It is neither, but the fact that Equalization is poorly understood makes it vulnerable to such rhetorical attacks.

At heart, Equalization is based on the principle of sharing the wealth. This is embedded in Section 36(2) of Canada's Constitution:

Parliament and the government of Canada are committed to the principle of making equalization payments to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonable comparable levels of taxation.

The Equalization program is the principal means by which the federal government levels the playing field to ensure equality of opportunity.

Equalization is the little brother of the other major federal transfer program, the Canada Health and Social Transfer (CHST). The CHST represents the federal contribution to provincially-run health care, post-secondary education and social assistance. It totals \$19.1 billion for 2002/03. No province dares to call this a handout; in fact, every year, provincial premiers ask for a bigger federal contribution to help finance programs.

Equalization transfers from the federal government amounted to \$10.3 billion in 2002/03. Payments are calculated according to a complex formula that estimates the capability of a province to raise revenues, called *fiscal capacity*, based on 30 different revenue sources, such as income taxes, sales taxes, property taxes, lottery sales, and resource royalties. Fiscal capacity measures are not based on how much revenue provinces actually take in (i.e. whether they choose to tax a certain revenue source or not), but their *potential* for generating revenues.

These numbers then get converted into a per capita *fiscal standard*, equivalent to the weighted average fiscal capacity of the five "middle-income" provinces—Quebec, Ontario, Manitoba, Saskatchewan and BC. Alberta is deliberately left out of the calculation due to the impact of volatile swings in oil and gas prices.

For 2002/03, the estimated fiscal standard is \$5,863 per person; that is, Equalization ensures that all provinces can provide at least this amount per person in public services. Provinces with fiscal capacity less than this threshold receive an Equalization transfer from the federal government to top them up, while those above the threshold do not receive any payments.

As Figure 1 shows, Alberta and  
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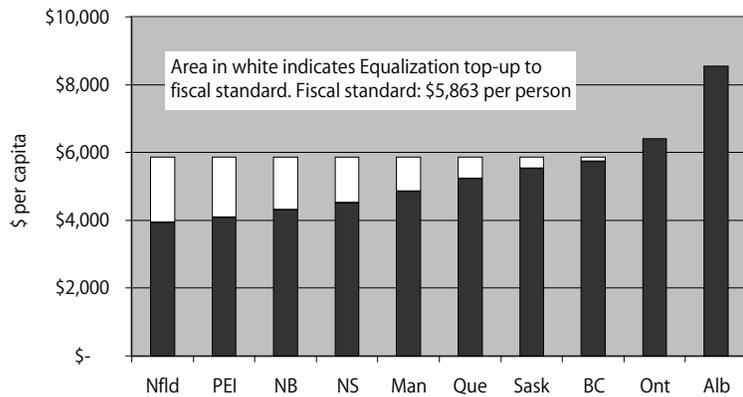
Ontario are estimated to be the only provinces not to receive Equalization in 2002/03. It is important to note that Equalization is *not* a direct transfer of funds from the “haves” to the “have-nots.” Alberta and Ontario, as “haves,” do not pay into a kitty that then gets disbursed among the other provinces. All Canadians, through their federal taxes, pay for Equalization, with the federal government transferring money to provinces based on a formula that is revised from time to time.

For some provinces, Equalization payments are large enough to constitute a significant portion of total provincial revenues. Equalization transfers to Newfoundland in 2002/03 amount to 26.5% of provincial revenues, or \$1,915 per Newfoundlander. Other Atlantic provinces also receive around one-quarter of their provincial revenues from Equalization transfers. About 45% of the total Equalization pot goes to Quebec because of the province’s large size, although this amounts to only 9.4% of its provincial revenues. In

### Equalization and BC

BC slipped below the fiscal standard in 1999/2000, receiving \$125 million, largely due to a change in the methodology for calculating the property tax base component of Equalization. Current estimates are that BC moved back above the threshold, and will receive no Equalization payment in 2000/01, due to the impact of high energy prices. BC is expected to receive \$41 million in 2001/02, and \$488 million in 2002/03 (more recent numbers are subject to ongoing revision, and are finalized 30 months after the end of the fiscal year). In

**Figure 1: Per Capita Fiscal Capacity and Equalization, 2002/03**



Note: Figures are based on the most recent estimates, updated October 2002. Final numbers are not determined until 30 months after the end of the fiscal year. Source: BC Ministry of Finance based on Federal Department of Finance estimates.

spite of the large projected jump for 2002/03, Equalization is quite small for BC relative to other provinces and on a per person basis. In 2002/03, the Equalization transfer will amount to 2.2% of provincial revenues, or \$118 per person.

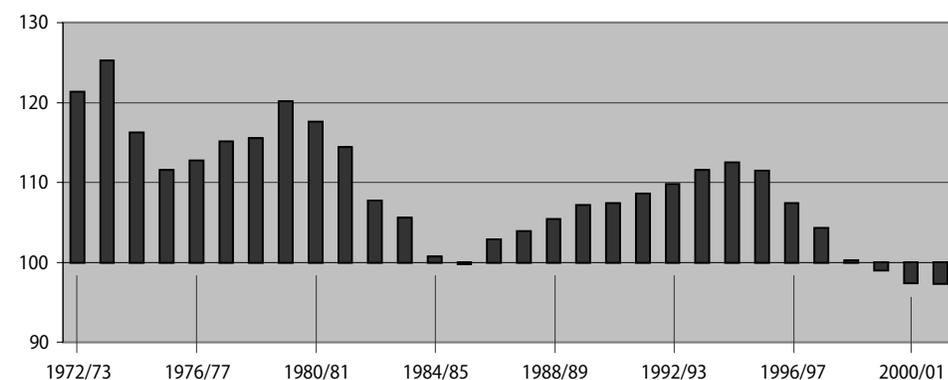
This is not the first time that BC has received Equalization. Since the inception of the Equalization program in 1957/58, BC received Equalization up to 1961/62, as did Alberta up to 1964/65. Ontario is the only province to have never received an Equalization payment from Ottawa.

Whether fiscal capacity is sufficient or not depends on relative economic performance. Strong economic growth compared to other provinces increases a province’s relative fiscal capacity, while a stagnant economy reduces it. Year-to-year fluctuations in world market conditions, such as the prices of natural resource commodities, also affect whether a given province ends up above or below the fiscal standard. Alberta has substantially more fiscal capacity than any other province as a

result of its oil and gas production, while global market forces have not been so kind to BC’s timber-based economy. In the early- to mid-1980s, Saskatchewan did not receive Equalization due to high oil prices.

BC’s drop below the fiscal standard also speaks to some longer-term structural issues. Fundamentally, BC is still a small economy heavily dependent on the export of resource commodities. This made BC what it is today, but over-reliance on

**Figure 2: Index of BC Fiscal Capacity relative to other provinces (all provinces=100)**



Note: The combined fiscal capacity of all provinces (not just the five-province standard) is set at 100. BC numbers higher than 100 indicate greater fiscal capacity than the average of other provinces, numbers lower indicate less fiscal capacity. Source: “The Equalization Program”, Federal Department of Finance, Federal-Provincial Relations Division, October 2001.

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## Ontario learned the hard way

By Hugh Mackenzie

The latest Ontario provincial budget probably does not sound like exciting reading to most people, but British Columbians might want to pay close attention. The political message from the budget is clear: Mike Harris' so-called "Common Sense Revolution" is nearing the end of the road—just as BC's "New Era" is getting going.

Ontario's budget suspended previously promised tax cuts, increased health care spending substantially, and provided new funding for water treatment. This change of direction offers some hope for the future to Ontario citizens concerned about the deterioration of public services and quality of life since 1995. It also offers an opportunity for others in Canada, whose governments have picked up "Harrisism" as an export product, to learn from our painful experience.

Mike Harris' "revolution" has been an abject failure both fiscally and socially, even on the Ontario Conservatives' own terms.

The Common Sense Revolution was supposed to be about fiscal responsibility and reducing the deficit. Yet despite the longest continuous economic expansion in the province's history, Ontario's public debt has increased by \$20 billion under the Tories. Half of that increase was incurred to pay for tax cuts granted before the books had been balanced.

The Common Sense Revolution was supposed to be about tax relief for average families. In fact, most of the benefits of the tax cuts went to the wealthiest 20% of the population, and to profitable corporations. For most people, the tax cuts have been gobbled up by user fees and increased costs to provide services privately instead of publicly.

In the process, Ontario's revenue base has been slashed by 20%. A recent estimate by the Federal Department of Finance puts the impact of provincially-initiated corporate and personal income tax cuts at \$12.3 billion for 2002/03.

This huge hole in government revenue is reflected directly in a large and growing public services deficit. In the K-12 education system, the effects of over \$2 billion in cuts since 1995 are being felt in school closures, program cuts, and waiting lists for special education programs. Parents are being asked to fundraise for books and gym equipment. Physical education programs are being restricted. And many school boards, having hit the wall financially, will operate with deficits in 2002-03 in defiance of the *Education Act*.

After closing hospitals and laying off nurses, the government has recently gone on a hospital-building spree and created an emergency program to deal with a shortage of nurses. Waiting lists for basic services are growing, and Emergency rooms are routinely closed to new patients arriving by ambulance.

Many working families live from crisis to crisis, as they scramble to fill the void created by child care funding cuts. College and university tuition have soared, putting post-secondary education out of reach for many families. And perhaps most shamefully, in a wealthy province, homelessness and hunger are growing and growing.

A deficit of tens of billions of dollars in public infrastructure investment has emerged. Our sewer and water systems have been found by public inquiry to be sub-standard. Roads are deteriorating. The highest profile case in the mess of Ontario's public-private partnerships—the construction and sale of

Highway 407—took the people of Ontario to the cleaners, selling an asset for \$1.6 billion that is now valued on the books of the purchasing company at more than \$5 billion.

This is just the tip of the iceberg. Both economically and politically, the Harris Revolution is over. Every day, Ontarians are reminded that the cuts of the Harris years are not sustainable. The Conservatives themselves are now rushing back to the political center in the hopes of salvaging the next election. Unfortunately, it is difficult to take much satisfaction in the early stages of this retreat. It will take years to renew Ontario's public services, and the damage caused to the province's social fabric may never be repaired.

The same is in store for BC, only worse. Gordon Campbell's policy script is a warmed-over and speeded-up version of the failed Ontario experiment. Tax and spending cuts have been implemented faster and on a larger scale, in spite of the fact that BC doesn't have the prospect of record growth in exports to the United States to bail the government out of its self-inflicted fiscal mess.

There is an important message here for people in provinces headed down the road paved by Mike Harris: the bridge is out, and at the end of the road you will find inequality, social division, higher levels of public debt, impoverished public services, costly policy reversals, and a daunting task of renewal. Read the last chapter of the book now, and change the ending.

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## Did you know?

### Olympics Reality Check

*“[The Olympics] will have a \$10 billion economic impact, create 220,000 new jobs, and bring \$2.5 billion in revenues to the government. But say we’re wrong, say it’s only half that, why would we turn our backs on this opportunity?”*

- Premier Gordon Campbell, October 26, 2002

- ➔ Number of *person-years* of employment created by the Olympics from 2001-2020, in the *best-case scenario*, according to the report “Economic Impact of the Winter Olympic and Paralympic Games” prepared by the BC Ministry of Competition, Science and Enterprise: 83,000
- ➔ Number of total jobs this represents: 4,150
- ➔ Number of *person-years* of employment created in *worst-case scenario*: 37,000
- ➔ Number of jobs this represents: 1,850
- ➔ Net economic impact of the Olympics, according to the government’s study, in best-case scenario: \$3.5 billion over 20 years
- ➔ Net economic impact in worst-case scenario: \$1.6

billion over 20 years

- ➔ Total value of BC’s GDP over this period, assuming no economic growth whatsoever: \$2,500 billion.
- ➔ Increase in BC’s GDP represented by the Games: range from 0.06% to 0.14%.
- ➔ Increase in BC government revenues, best-case scenario: \$426 million over 20 years
- ➔ Increase in BC government revenues, worst-case scenario: \$164 million over 20 years
- ➔ Total amount of BC government revenues over 20 years, at current levels, assuming no revenue growth: \$440 billion
- ➔ Increase in provincial government revenues due to the Olympics: range from 0.04% to 0.1%

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resources means that BC is too easily affected by declining terms of trade and swings in foreign markets.

While the province only recently dropped below the Equalization threshold, we have long been just slightly above it. Figure 2 shows an index of BC’s fiscal capacity relative to other provinces over the past 20 years. The combined fiscal capacity of all provinces is set at 100; BC numbers higher than 100 indicate greater fiscal capacity than the average of all other provinces, numbers lower than 100 show less fiscal capacity.

BC had much greater fiscal capacity relative to other provinces in the 1970s, but has declined since the early 1980s. BC just missed qualifying for Equalization in the mid-1980s. Over the past 20 years, BC’s relative fiscal capacity peaked in 1995/96, when the economy was stronger and international commodity prices were up. Rhetoric

that BC has gone from the status of a “have” province to the stigma of a “have-not” makes it sound as if the province dropped off a cliff, when in reality the province has been tip-toeing around the line for two decades.

BC’s over-reliance on resource exports points to the need for a more comprehensive industrial strategy that goes beyond tax cuts and the Olympics. The current game plan is not working. Private sector estimates point to a provincial economy that continues to trail the rest of the country in growth, without the hoped-for boost in capital spending, over the foreseeable future. Yet, the provincial government has displayed little interest in being a leader for a bold economic strategy, preferring instead to stay on the sidelines and root for the market.

In the meantime, given BC’s fiscal situation, we should take the money, do

good things with it, and not get hung up on false labels like “have-not.” It is ironic that while the BC government has been playing up the “stigma” of Equalization payments, it has eagerly sought relief money from Ottawa for companies and workers hard hit by the softwood lumber dispute.

Fiscal capacity is not the same as standard of living. BC’s pride may have been wounded by recent name-calling, but British Columbians should remember that we have the highest average personal wealth in the country, and more millionaires per capita than any other province. At the end of the day, BC is still a rich province, and we have lots of policy tools at our disposal to actively improve our standard of living.

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