



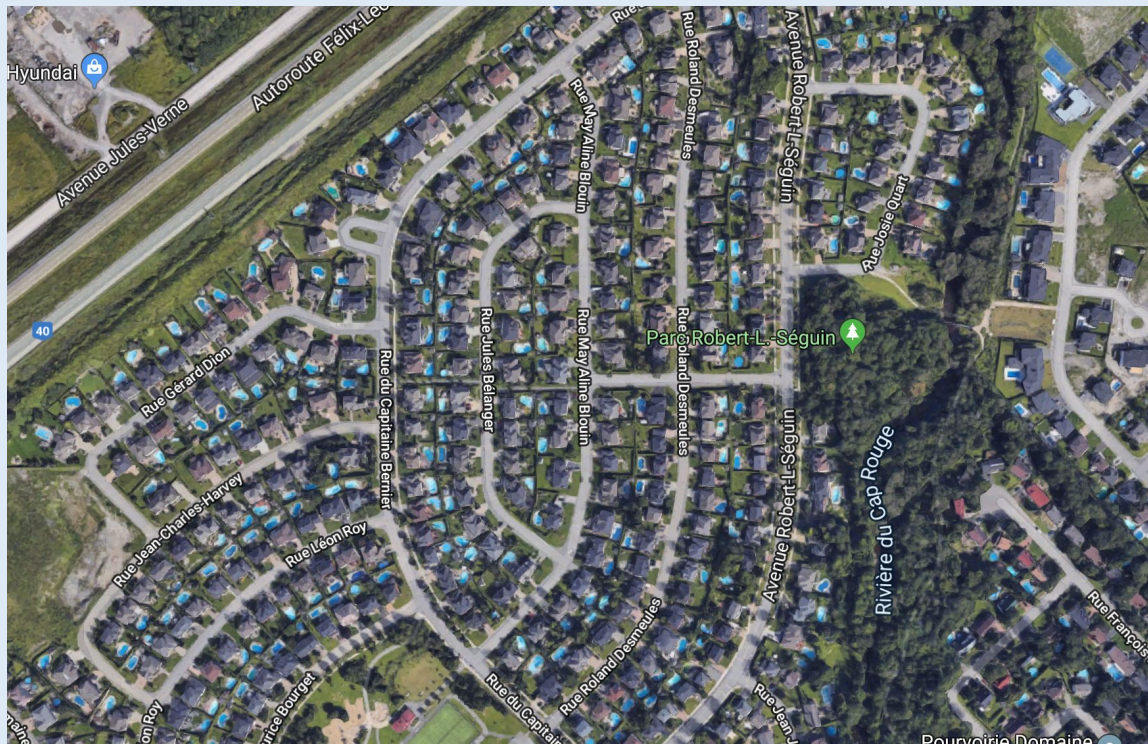
# Equalization

*How it Works...*

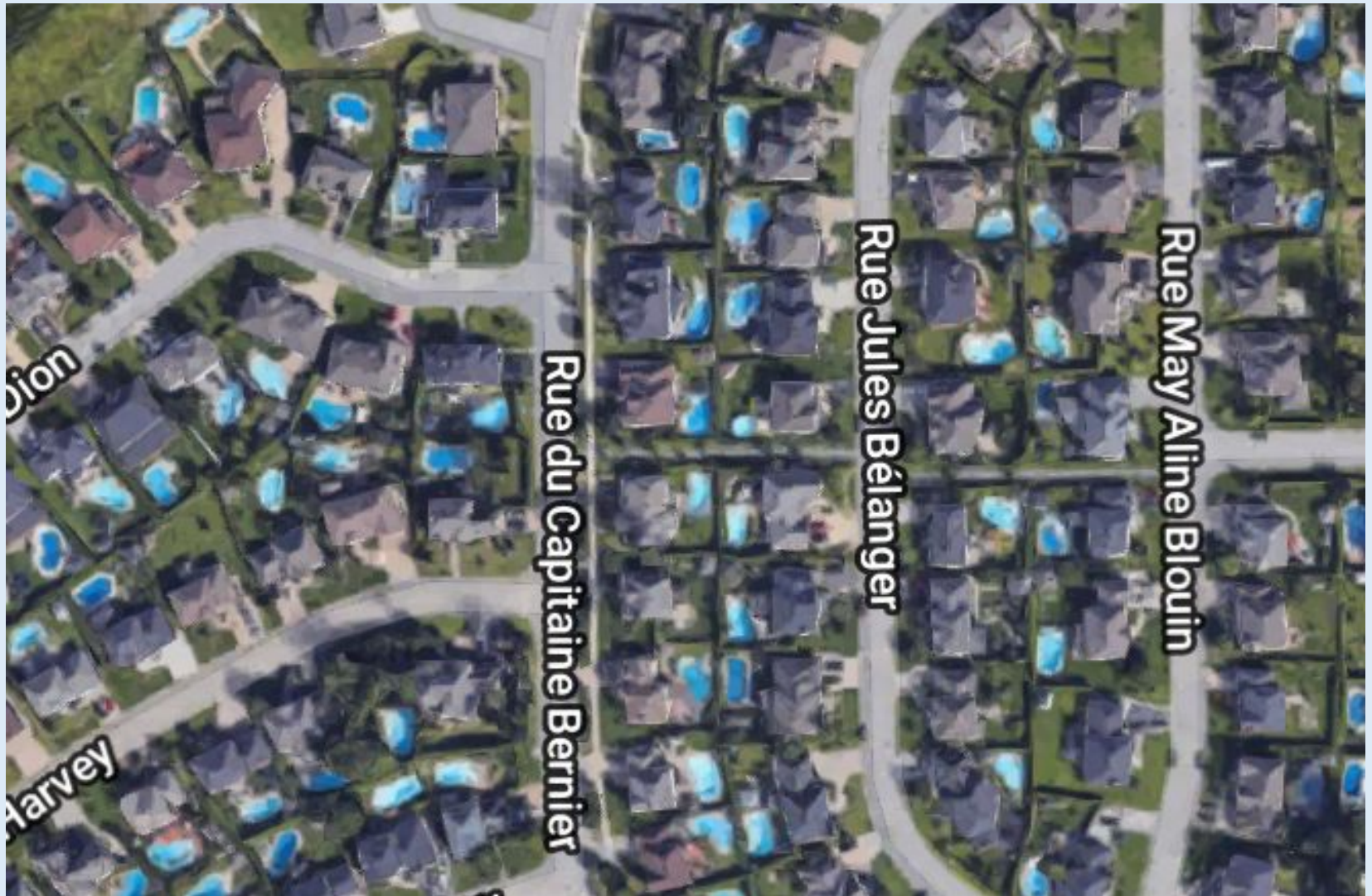
*And why it doesn't*

# *A Visual Depiction...*

A southwest suburb of Quebec City – but it could almost any community in the province...



Zooming in...





The formula may be complex, but the essential impact...  
- not so much.

Simply put: Funds are transferred from high-income provinces to lower-income ones.

*(The terms “rich” and “poor” are not appropriate as many of the low-income provinces are very rich in natural resources.)*

The idea of this being that it would **help maintain a similar level of services that are provincial jurisdiction across Canada** (i.e. education and healthcare).



It is a system that is written into the Canadian Constitution  
- courtesy of Pierre Trudeau and the nine premiers that  
signed off on it.

Its formula is set by the federal government – the Prime Minister.

- No approval from the provinces is required to make changes.
- The formula is based on the five “middle income” province’s **income** into provincial general revenues
- (BC, Ontario, Quebec, Manitoba and Saskatchewan).

It is based on a per-capita calculation:

- More population means **more total monies** transferred in or out.
- Thus, **Quebec gets the greatest total amount**, while **Prince Edward Island gets the most per capita**.

# But let's Flashback to 2006...

Why?

- Because it was when the province that was the largest per capita recipient - shouldn't have been.
- It really exposed the flaws in the formula and the perverse incentives it creates

In

2006

The biggest beneficiary on a per capita basis and as a percentage of the province's total budget is Newfoundland and Labrador.

Prior to the one-off ad hoc deal cut between Paul Martin and Premier Danny Williams it ranged as high as **49% of the entire provincial budget or approximately \$2400 per capita.**





## Elsewhere in 2006...

- **13% of Alberta's total revenues** in 2005 were taken as transfer payments.
- How much is the gross transfer out of Alberta? – **\$12 to \$15 Billion per year** in 2006,
- Plus approximately **\$1 to \$1.5 billion** in **Employment Insurance premiums** collected from **Alberta employers and their employees** were **paid out to recipients** living in other provinces.

# So we also have to take into consideration:

## Employment Insurance (EI)

- It needs to be understood that **EI** is another inter-provincial transfer system that **plays an important role in Equalization's impact** on the beneficiary provinces.
- Additionally, EI is significantly easier to qualify for in high unemployment regions.
- *(AKA "10-42" - for 10 week's work gets you 42 weeks of EI)*

# Equalization

*the ground-level view*

# So, let's look at how Equalization and its equally-evil sister EI...

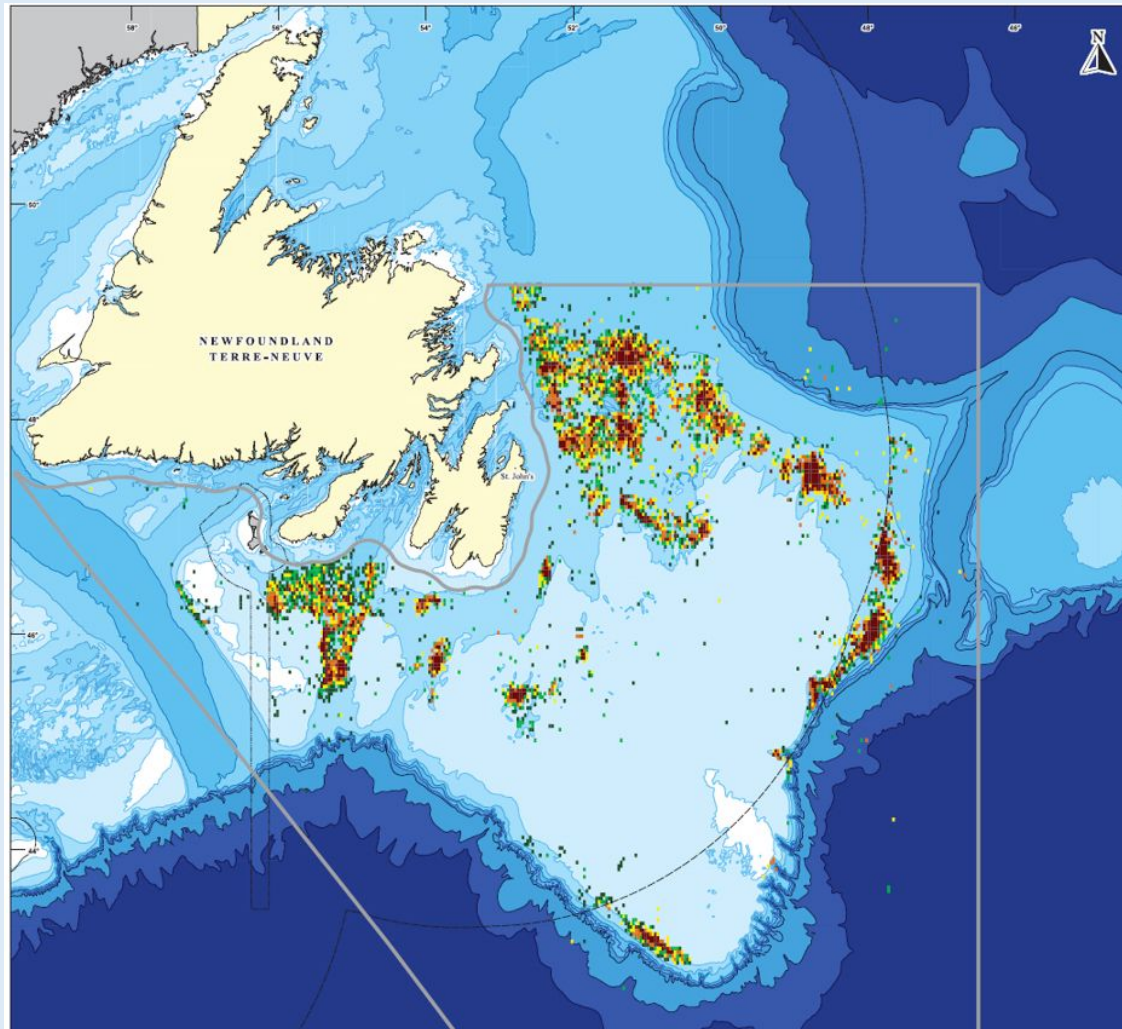
destroy the incentives to reform and improve the economic plight of the recipient provinces and their citizens.

*We will do this by looking at an extreme example of what can happen.*

*However, while this is the extreme, it is by no means an uncommon happening.*



# The Crab Fishery





alamy stock photo



# So

...

A crab-processing plant in Newfoundland has its quota of crab cut back to the point that there is only enough crab to keep the plant operating **for 3 weeks of the whole year.**

*(Apparently, Newfoundland currently has 2 times more crab-processing capacity than there is crab caught in the entire world.)*

# The province is faced with two problems as a result:

1. All of the workers will be 7 weeks shy of what they need to qualify for EI benefits.

As a result, those workers will fall back on welfare payments and **welfare is a provincial program** that is funded by provincial general revenues.

2. If the workers and their families leave the province, they reduce the population of the province and...

thus the per capita equalization transfer that is attached to them **will be lost**.



# So, what does the provincial government do?

It starts up a “make-work” project that runs for precisely 7 weeks...

and that does not take work away from legitimate government or business work

For example:

- tourist walking trails - trails to nowhere or,
- clearing brush along roadsides using axes and handsaws sometimes to reduce equipment costs and maximize the labour required for the job.

# What does the Provincial government pay for this?

7 weeks work approximately 50% funded by the federal government via Equalization

= 3.5 weeks minimum-wage funding from the provincial tax base.

# For that expenditure the individual plant worker gets:

42 weeks of (taxable) EI payments - 100% funded by the federal government program.

(Remember: The vast majority of the EI premiums collected were **from workers outside** of Newfoundland and Labrador.)

## And from this the province gets:

- The provincial tax revenues from EI payments.
- The provincial share of the HST (15%) on any of those EI monies spent in the province.
- And, assuming the crab-plant worker has a spouse and two children,
  - \$9,600 ( $2,400 \times 4$ ) in Equalization transfers.



Thus, there is a huge incentive to **under-employ** people.

- This is also evident in the provincial public service where there is a priority placed on employing the maximum number of people versus investing in labour-saving equipment.

And this is compounded by the equalization formula's treatment of provincial income from non-renewable resources...

# Prior to the side deal with the Paul Martin Liberals:

- The royalties reported into general revenue essentially reduced - dollar for dollar - the province's equalization funding.
- Thus the incentive for the province wasn't to maximize royalty and tax revenues from the non-renewable resources, **it was to maximize the number of jobs.**

The two most publicized examples are known locally as:

**Hibernia and Voisey's Bay...**

# Hibernia

...

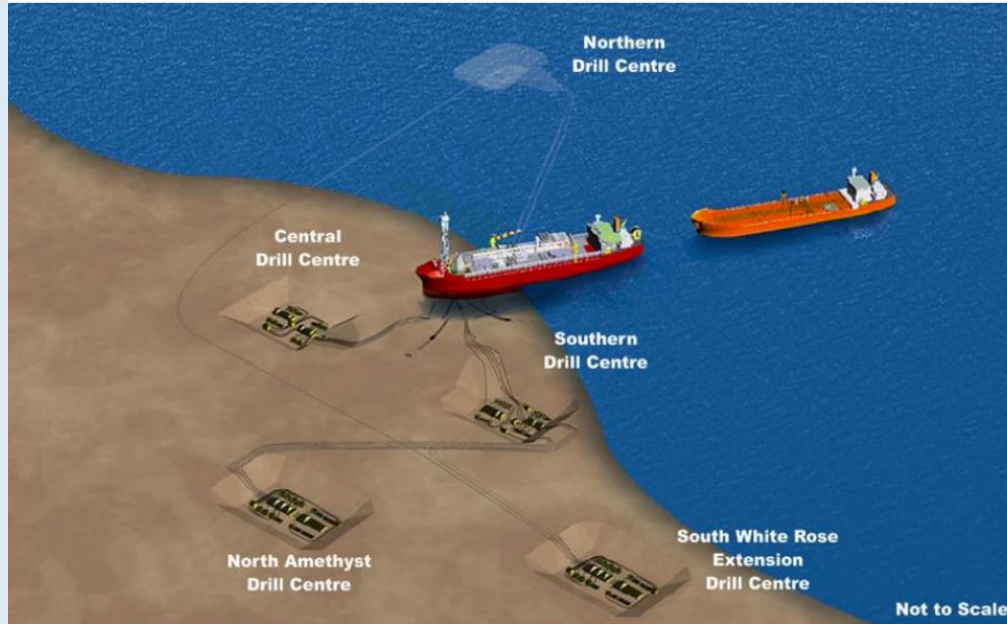


**Mobil**



LIBERTAS  
ALBERTA

The Hibernia oilfield was brought into production using a multi-billion dollar offshore platform system that **cost roughly twice** what a sub-sea completion system would have.



It also created 15,000 man-years of construction work in the province **whereas the sub-sea method would have created far less jobs.**

The trade off in order to get the oil companies to risk so much more capital upfront? Newfoundland gets about a 1 to 2 % royalty on 225,000 barrels/day of production or about 73 cents per barrel on \$4.9 billion in oil produced annually.

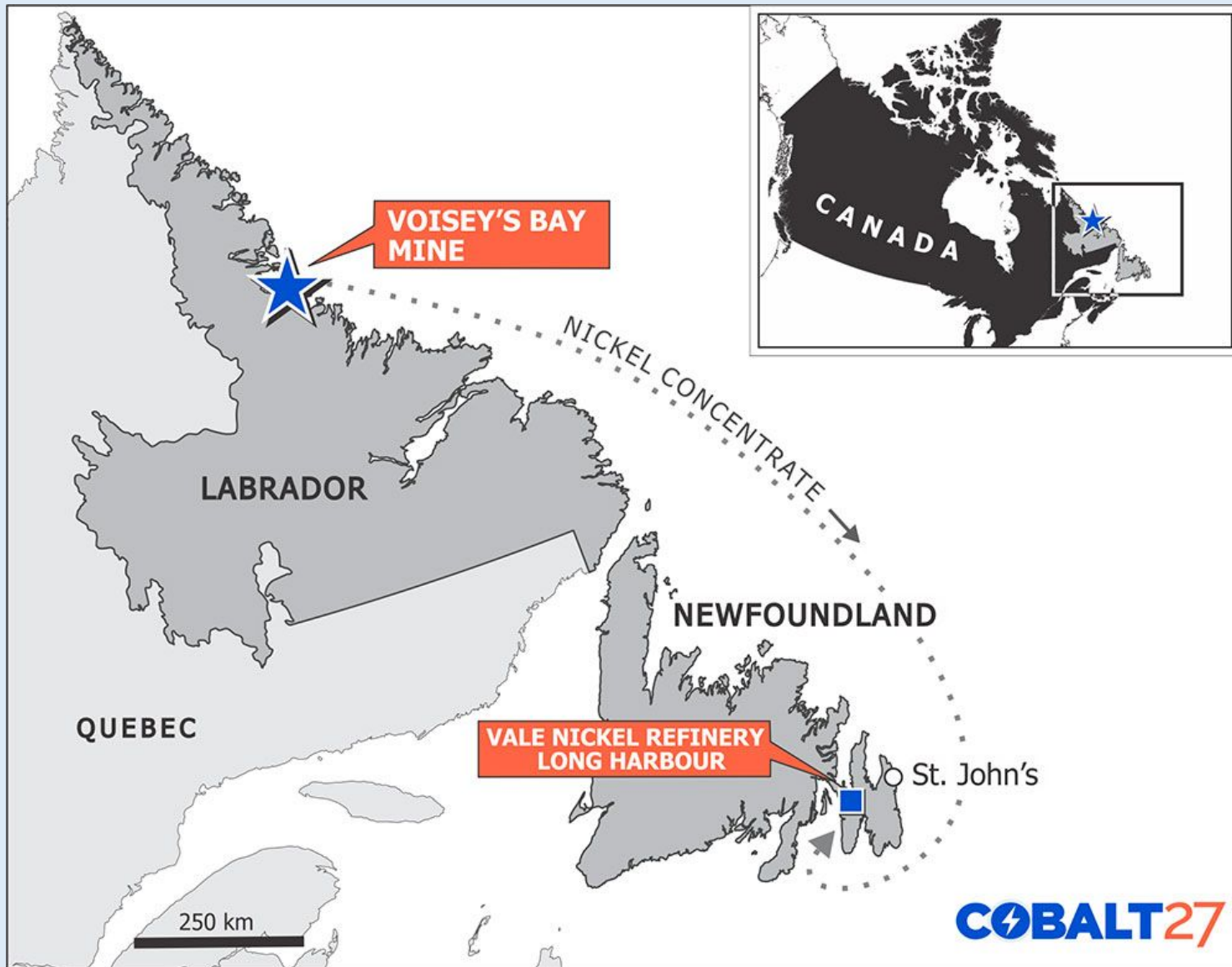
To make matters worse, prior to the Martin deal, almost all of this royalty income was **lost in equalization claw backs**.

But of course, thousands more Newfoundlanders stayed in the province and generated equalization income for the province.

# Voisey's Bay – the Mine...









# And the Refinery at Long Harbour...



Voisey's Bay is a nickel/cobalt discovery that is the largest mineral find in Canada in forty years.

It was found in 1993 and did begin producing until 2011 – 18 years...

The province has spent those years trying to maximize jobs created via smelting the ore in the province (creating more jobs) rather than focusing on maximizing royalty revenues.

Not surprisingly, the province has been dubbed a “Northern Banana Republic” and further exploration in the province has fallen back considerably.

# And what about Renewable Resources?

Well, they **are included** in the formula,

but in the case of Quebec, for example, those assets are owned by a provincial crown corporation - Quebec Hydro

and while the net revenues from electricity sales are added to the province's revenues for the calculation of the equalization transfer,

they have been **selling the power** since the mid-1970s to Quebec customers for rates that are **far below** the neighbouring state's and province's **market rates**.

## Further...

In 2006 the Edmonton Journal estimated the discount to be over \$400 per capita per year

for a total of over 3 Billion in unreported benefit to the province annually

and thus Quebec received a corresponding over-transfer of equalization funds.

Also gross inefficiencies in staffing and bloated payrolls are encouraged as they too reduce reported revenues and increase the number of people staying in Quebec and thus the amount of equalization funding.

**In Conclusion...**

**Equalization is broken.**

**What has to change to fix it?**