

WITH Bryan Schwartz, Law Professor at University of Manitoba



**Bryan Schwartz** is the Asper Professor of International Business and Trade Law at the University of Manitoba. He holds a LL.B. from Queen's and a Master's and Doctorate in law from Yale Law School. He is the author of seven books and over sixty academic articles in a wide variety of areas, including constitutional and international law, law and economics and law and literature. He is the inaugural editor of two journals: the Asper Review of International Business and Trade Law and Underneath the Golden Boy, an annual review of legislative developments in Manitoba. Over the years, he has received numerous awards and honours for teaching, research and community service. Bryan is also a practicing lawyer. He has been counsel to the Pitblado law firm since 1994, and appeared many times before the Supreme Court of Canada. He frequently advises governments, organizations and individuals on legal issues involving policy development or legislative reform. He has often appeared as a media commentator, and has published op-ed pieces in newspapers such as the Winnipeg Free Press, Ottawa Citizen and Globe and Mail. He was interviewed after his April 9<sup>th</sup>, 2008 speech to the Frontier Centre.

**Frontier Centre:** The title of your Frontier speech refers to federal transfers as the “opiates of the messes.” This is a pithy play on Marx.

**Bryan Schwartz:** Marx referred to religion as the opiate of the masses, a form of false consciousness that made people overlook the material causes of their misery. The messes I'm referring to in Manitoba are a number of conditions of mediocrity or worse. My university, surveys, has been rank last among the major universities in the country; a healthcare system that is not functioning well; crumbling infrastructure. These conditions are largely the result of bad public policy, and would provoke strong calls for reform if they were not papered over in various ways – e.g., but the provincial government using public money (largely obtained from Ottawa) to support a tuition freeze, or the government's creating jobs in public works projects (using federal money) to help overcome lack of opportunity in the private and non-profit sectors. .

**FC:** So the point of your talk was that federal transfers give the province scope for bad policy. Can you connect the dots on that?

**BS:** For one thing, transfer payments reward underperformance. The worse you do in terms of generating a strong private sector, the more transfer payments you get. So our governments are in fact compensated for policies that are destructive of having a vibrant commercial sector and policies that at the same time also tend to stifle the non-profit sector. Second, there is a “crowding out” effect. When government has “free money” at hand, it is able to outbid the private commercial and non-profit sectors in areas such as recruiting talented employees, and thereby drives up the their cost of operations and impairs their own ability to thrive. Third, we become a “suppliant society” Businesses, non-profits and local governments do not have sufficient ability to raise their own resources from the private sector, so are constantly looking to government for help. As a result, the imagination and initiative of people is skewed towards the government agenda, and free and robust public debate suffers as people become wary of criticizing their patron. What we need as a balanced society, in which government and the private and non-profit sectors each play a proper and effective role.

**FC:** You mentioned several examples of poor policy making. Can you elaborate? Let's start with Manitoba Hydro. Does the presence of massive federal subsidies allow cheaper than market pricing?

**BS:** If we didn't have federal transfers we would certainly, as a province, be looking for other sources of revenue. Our equivalent of oil is our hydro-generated capacity. Instead of making a lot of money off of it, we sell it at a subsidized rate locally and that means that a lot more of it is consumed and we have less of it to export. If we had a more market-oriented policy we could generate a lot of export dollars from it, but we don't.

**FC:** What about the west side/east side debate where the government is running a planned transmission line the long way south?

**BS:** The choice of having the proposed transmission on the west side rather than the east side is one that no government could indulge if it wasn't getting a lot of federal transfers. If you had to live off your own means of income you wouldn't even be thinking of wasting, according to various estimates, half a billion to 1.5 billion dollars putting a transmission line on the wrong side of a lake for political reasons.

**FC:** What are the political reasons?

**BS:** The government of Manitoba originally planned to have the line on the east side. They got some flack, as I understand it, largely from American environmentalist groups. Rather than try and rationally make the case that the east side makes more sense environmentally they took the easy way out. They said ok if we're going to get some fuss, we're going to get e-mails and faxes from Robert F. Kennedy Jr.'s environmental group lets put it on the west side. It's the kind of thing you can do if you're not worried about wasting half a billion to 1.5 billion dollars over the long run because you think Ottawa is going to make up for your ineptitude.

**FC:** You touched on healthcare. Despite all these transfers it's hard to say that we've seen big improvements in services like shorter wait lists.

**BS:** Even within the single-payer system there's lots of room for innovation in our system. The Kirby report, which

was released around the same time as the Romanow report, proposed a lot more innovation within the single-payer system. Instead the government has rather aggressively stifled innovation. For example, we had a successful privately-owned sports clinic, The Pan-Am Clinic, which the government used public money to buy out. The government actually passed a law to ban a private overnight hospital even though it was prepared to work within the Medicare system. So you don't have to abandon the single-payer system to have a lot of innovation but we don't have it.

**FC: Why would they do that? Why would they restrict private alternatives, for example, in healthcare delivery?**

**BS:** Politics, ideology, and a concern or perception that somehow private sector delivery of certain types of health services is intrinsically offensive. Or perhaps concerns about some of the unions reacting to more private sector participation even though a vibrant private sector would create jobs, including union jobs. But again if you didn't have federal transfers to help you with healthcare in a very massive way you would have to think a lot more intensely and a lot smarter about how you improve the system with existing resources.

**FC: Manitoba has, by several measures, many more public employees per capita than other provinces, particularly Ontario, which is a main source of these transfers. Why does the transfer system seem to favour public spending over private economic activity?**

**BS:** The dollars go directly to government in our current form of equalization. As some people have said there's a "flypaper effect", it sticks to government. So government becomes the mother bountiful. You want to do anything, whether you need a subsidy to overcome the regulatory tax environment or your non-profit entity needs government support because you're not getting enough private sector donations, whatever it is you need to go to government. So government develops a controlling interest in almost everything that moves.

**FC: Why is that bad?**

**BS:** For one thing, it doesn't foster a free and democratic society let alone an innovative one. If everyone is beholden to government, if you have a supplicant society people are hesitant about engaging in free thinking and forthright criticism of government because that's their funder. The other thing is that if you're dependent on government you are less likely to think imaginatively and innovatively and cleverly about how to solve your own problems.

**FC: Manitoba's university tuition freeze, in a way, is bad policy made possible by these transfers. You also mentioned the rather poor ranking of the University of Manitoba. Can you comment on that?**

**BS:** The University of Manitoba is our biggest university, the one with the professional schools. It is consistently rated poorly by a variety of measures and surveys that are done. In the latest survey the University of Manitoba tried to overcome this by not providing data. If you want accessibility you have to think of accessibility to quality.

Everyone should have access to quality not just the ability to get their foot inside an institution. We found that, at the Faculty of Law, by raising tuitions we were not only able to improve quality we were actually able to improve accessibility to that quality because we used a lot of that money for bursaries. It's an example of how you can find optimal solutions if you allow a hundred schools of thoughts to contend you allow a hundred flowers to bloom. People will come up with their own innovative solutions which may be better in all respects than the greyness imposed by government policy from a distance.

**FC: But doesn't keeping tuition low benefit low-income and lesser-advantaged students?**

**BS:** It disadvantages them in another respect because, like everyone else, they don't have access to the high quality that they ought to be getting. The problem of accessibility for low-income people is totally legitimate one but there are other ways of addressing it. For example, you can use increased tuitions in part to provide bursaries to those who are in genuine financial need and that experiment has been successfully conducted, for example in my own faculty.

**FC: You commented on the concept of "gaming" the equalization system in your speech. What did you mean by that?**

**BS:** Some critics have pointed out that you can actually play with the formula as a provincial government in order to enhance your revenues. For example, suppose average levels of taxation are taken into account for the formula of equalization. You're a large province, like Quebec, and your own tax rates are taken into account when determining what average tax rates are so you have an incentive to actually raise your tax rates because that is then factored into the national formula and you get more money out of it. You get more money in two ways, you get more tax money in the short run and you get more equalization payments so it's actually an incentive to policies such as high taxes that damage society as a whole both in terms of commercial activity in the non-profit sector. That's not to say that all taxes are bad ideas because some taxes are necessary and some taxes that are well-invested will promote economic growth. The current system actually encourages the kinds of taxes that are destructive.

**FC: So would this explain why Manitoba has the highest income taxes in Western Canada?**

**BS:** I don't think so. The gaming the system concept seems to be more plausible in the case of large provinces which are big enough to affect the national formula so I don't think that that particular consideration is why we have high taxes. I think the reason we have high taxes is because the government has no incentives to think in an intelligent fashion about the relationship between taxes and the health of the private and non-profit sectors. If you get a dollar from Ottawa, it's a dollar. If you get a dollar by taxing private sector, it's still a dollar. Society is way better off if that dollar is coming from taxes of a vibrant commercial sector but to a government it seems pretty much the same so why not have high taxes?

**FC: Federal transfers are increasing much faster than the rate of economic growth. In 1999, federal transfers**

**made up 32% of the Manitoba budget. They have now risen to almost 37% of the budget. What's going on?**

**BS:** The federal government has had initiatives over the years to raise the level of transfers in a number of respects. One is improved transfers to healthcare. People will remember that there were a lot of complaints around the time of the Romanow commission about under funding so the federal government increased transfer levels in that respect. The current federal government has talked about remedying the fiscal imbalance which again has been favourable to the province. The other thing is that Manitoba's private sector's underperformance continues. If you add a more generous formula to a continued underperformance and you get transfer payments that are actually increasing ahead of inflation or just about any other index that you'd want to compare it to. It's ironic that Manitoba in its latest budgets is proudly proclaiming that we have more GDP growth than a lot of other provinces. A lot of that GDP growth comes from government spending. Anyone can look up that the formula for GDP includes government spending. If you're getting money and you spend it, your GDP is going to look pretty good but it's awfully hypocritical to take money from other provinces, use it to promote your own GDP and then somehow crow that you're outperforming them.

**FC: Saskatchewan has its rising oil revenues clawed-back under the equalization formula. Manitoba sells its power below market and this subsidy is not caught by the equalization formula. What's your view on this?**

**BS:** One of the reasons Manitoba has been able to ride on equalization system is that in some ways it always has been historically compared to Quebec. Quebec has a lot of hydro power. I would guess, I haven't seen this documented anywhere, but I guess one of the reasons that the formula doesn't take into account hydro power is sensitivity to Quebec's interests here. Any federal government is going to be especially sensitive to Quebec's concerns because we always have the unity issue, so that might be the reason why Manitoba gets very favourable treatment of its hydro-generated potential. I'm told that Mr. Selinger in an interview recently said, that Hydro pays its own way. This to me is almost an unimaginable defense of the way Hydro is managed. We have potentially the single biggest revenue generator for the province of Manitoba, aside from taxes, and his defense is that it is paying its own way? Isn't it supposed to be making a lot of money that could be used for the benefit of the province?

**FC: It seems the equalization transfer system is not helping the have provinces or the recipient have-not provinces. Why is there so little recognition of that fact?**

**BS:** The damage it causes to have-not provinces is completely counterintuitive because people ask themselves, "how can getting money for nothing actually be a bad thing? It's not obvious how it could. And in the short run it is beneficial. You take one single budget year, you take \$3 billion in transfers out of the budget and you've got a catastrophic problem. You have to stand back and look at the long run of the consequences. The way it fosters

government dependency, the way the government competes with the private sector using federal money and crowds out private sector activity, the way it tends to lead to a supplicant society that doesn't engage in the kind of vigorous democratic debate that you want, all of these I think are demonstrably true. The other thing is that we're reluctant to revisit equalization because I think equalization at its root is a national unity program. It is sometimes explained on economic ground but from the inception of the federation, equalization has always been a means of a way of trying to cement the loyalties of various regions of Canada, including the province of Quebec where there are a lot of strong, natural tendencies to divide the country.

**FC: So you're suggesting Manitoba is free-riding on federal pussy-footing around the Quebec issue. How do we separate Manitoba from the larger Quebec issue?**

**BS:** The one thought I have is that if we want to send transfers to Quebec as a national unity issue lets identify what's distinctive about Quebec, including the French language majority as well as the English language minority. We could have a program that specially targeted to support francophone language and the culture of Quebec, to recognize that maybe there's a higher cost of doing business in the province of Quebec because it is predominately French language. In other words, the national unity subsidy would be expressly framed as a national unity subsidy that's geared to specific conditions in Quebec and it could be to some other provinces like New Brunswick with its large francophone population rather than be wrapped up in a general equalization program.

Perhaps an approach to the people of Quebec could be something like this. We believe that Canada has so much to offer the province of Quebec in terms of being an economic union, a human rights union, having a strong international presence that we don't think that your loyalty is dependent on federal transfers. We want to work with you to encourage you to become much more self-sufficient." Now arguably, separatists will like that because they will say that this puts us in a better position to eventually become more independent. But perhaps federalists in Quebec will like the idea because it is respectful of Quebec's potential in all dimensions, including its ability to become more economically self-sufficient, and would address some of Quebec's own problems with an overly statist society.

**FC: What about the idea of simply transferring tax points in place of equalization?**

**BS:** I don't know if simply transferring tax points works because it doesn't have an equalization point built into it. In other words, the so-called have-not provinces would complain that our tax points are worse less than Ontario or Alberta's tax points. It could be part of a solution though. Part of a solution of trying to establish a clearer line of accountability that a provincial program is paid for by the province and federal programs are paid for by the feds. If there are transfers, they are very clear and transparent. There's only one transfer program that's addressed to deal with economic imbalances. You don't build equalization into the other social transfers just one very simple, transparent,

up front equalization program and a program that would actually be aimed at encouraging provinces to get off transfers in the long run.

**FC: If you were to provide advice to a Manitoba politician interested in getting off the equalization train what would you advise to place Manitoba on a self-reliant track?**

**BS:** I would start off by challenging Manitoba to reflect on what their current conditions are. Are things really so ok? Why does Manitoba's main university rank so low in surveys? What was your last experience with the healthcare system? What's your experience with the roads in Manitoba? Are you satisfied with the quality of infrastructure? What are the chances that your kids are going to stay here rather than go to other provinces? And then ask yourself, why are we experiencing these conditions? Then I would try to make the case that yeah in the short run we are benefiting but if we were more self-sufficient our society would be better on the whole. We would have a better government. We would have a stronger private sector. We would even have a stronger non-profit sector. Non-profit organizations, often based on the contributions and volunteer work of people from various faith or cultural communities, used to have a larger, more autonomous, role in providing quality hospital health care to all in need. Their role is been squeezed out by the provincial government, flush with federal funds. So I think you have to make it real in terms of asking people what's really going on in your lives and I don't think you talk down to people. There's a credible intellectual case. I've been persuaded of it that transfers actually damage us in the long run. I think the average person is pretty smart and that a reasoned public debate would actually get some purchase in public opinion.

**FC: Would you have any specific ideas to move this ball? If you were Hugh McFadyen, let's say, and you want to have the province pay its own way forward within 20 years what would you do?**

**BS:** I think Mr. McFadyen actually went about it the right way. First of all, you've got to recognize that that's the objective. Task number one, is that status quo should not be continued indefinitely and then you try and break that down into pieces. What will we have to do in terms of management of Hydro? What will we have to do in terms of damaging taxes? Do we really want to continue a payroll tax in this province as a tax on jobs? Try and explain more creative ways of program delivery in the healthcare sector that don't challenge the single-payer system. Other ways of funding infrastructure development, public/private partnerships. Break it down in a way that you can actually succeed and explain to people how it can be introduced incrementally in a way that isn't going to leave them feeling personally jeopardized. If you say to people ok the

objective is let's cut us off federal equalization tomorrow and take \$2 billion out of the economy, in the short run I believe it would be catastrophic. You'd have layoffs. You wouldn't just have Filmon Fridays you'd have Filmon Mondays, Tuesdays and Wednesdays. So we didn't get into this instantly. It's going to take a measured series of steps to get out of it. So it's identifying the kind of steps we can make and explaining to people no we're not instantly going to commit transfer payment Hari Kari. We're going to proceed in a measured fashion.

**FC: It looks like Ontario might demand substantial change to the transfer system in view of the fact that it has lower quality services and lower provincial revenues per capita than recipient have-nots like Manitoba. Do you think that is a bad thing?**

**BS:** I think it's a good thing that Ontario will be demanding changes because everybody is losing out by the status quo. The long term future of Manitoba has been jeopardized by its dependence on federal transfers. The economic help of Ontario is being jeopardized by the amount of money that is being shipped out of that province to support have-not provinces. Just as the whole federation is better one when Manitoba thrives, the same holds for Ontario. It's a major source of federal tax revenues and a major source of economic activity and non-profit activity and cultural activity. We in Manitoba benefit when we have a strong Ontario. When Ontario suffers, we in Manitoba suffer. These tax dollars to pay for equalization are damaging Ontario. They take money out of the economy that could be used for investing in innovation or hiring and training more private sector employees. It may be encouraging people to move operations elsewhere from the relatively high tax climate in Ontario that's not good for the country either. So the fact that Ontario is perhaps in its poise to open up a national debate will ultimately be to the benefit of us all.

By the way, one point that I'd like to make, again, in response to Mr. Selinger's CBC radio interview about transfers

([http://www.fcpc.org/main/media\\_file\\_detail.php?StreamID=880](http://www.fcpc.org/main/media_file_detail.php?StreamID=880)). He made the remarkable claim that equalization is ok because it's just a question of taxing rich people elsewhere to provide us with equalization. Well the reality is that tax rates in Ontario have to be higher across the board to support equalization. Most taxes are paid by middle and lower income people. Equalization therefore means, in effect, that poor people in Ontario are sending some of their tax dollars to Manitoba where it benefits the rich as well as the poor.



## MacKinnon vs Selinger on Manitoba federal transfer dependency (CBC radio)

David MacKinnon, Frontier Senior Fellow, and Greg Selinger, Finance Minister, discuss transfer payments with CBC Winnipeg's Information Radio program host, Marcy Markusa. (April 12, 2008)

2008-04-12

Radio

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