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Manatchewan and Mantario? A Cost-Benefit Analysis of a Union of Northwestern Ontario
and Manitoba and a Provincial Union of Manitoba and Saskatchewan

by

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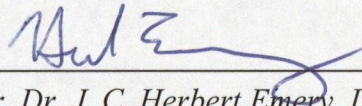
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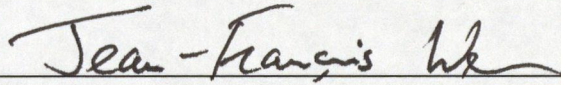
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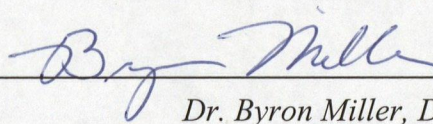
The undersigned certify that they have read, and recommend to the Faculty of Graduate Studies for acceptance, a thesis entitled "Manatchewan and Mantario? A Cost-Benefit Analysis of a Union of Northwestern Ontario and Manitoba and a Provincial Union of Manitoba and Saskatchewan" submitted by Ryan Charles Rand English in partial fulfillment of the requirements for the degree of Master of Arts.



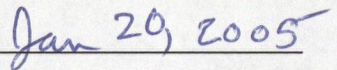
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ABSTRACT

This thesis investigates the cost and benefits of a provincial union of Manitoba and Saskatchewan and a political union of Northwestern Ontario and Manitoba. For the Manitoba and Saskatchewan merger, I find that Saskatchewan would benefit from greater economic stability, larger equalization payments, increased program spending, and a partner to share resource development expenses. Manitoba would benefit from an increase in per capita GDP, higher resource revenues, and the distribution of provincial debt charges over a larger population. In the second union, I find that there would be political benefits for the residents of Northwestern Ontario from merging with Manitoba, as they would have a larger voice in the Manitoba legislature than they have in Queen's Park. Northwestern Ontarians would also see increased spending on health and education. Manitoba would benefit from new resource revenues, a port on Lake Superior and offsetting of debt charges to the people of Northwestern Ontario.

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CHAPTER ONE: INTRODUCTION

“To the government settlement was vital to the building of a nation. Its primary consideration therefore was to devise a system under which the country could be rapidly and accurately subdivided into land holdings and which would forestall the confusion that would follow large-scale immigration into unsurveyed territory. There were several ways in which the ‘unorganized territory’ could be ‘organized’. Separate provinces could be created out of the ‘unorganized territory’ or parts of the ‘unorganized territory’ could be included in an adjacent province, merely by extending the boundaries of the province. Alternatively the ‘unorganized territory’ could be divided into tracts and each tract could then be given limited jurisdiction over its own affairs under administration controlled completely from Ottawa.” Nicholson 1954

In 1870, the Government of Canada acquired the title to thousands of square miles of former Hudson Bay Company territory that today represents the three Prairie Provinces, the three northern territories, and the north of Ontario and Quebec. Through numerous federal government initiatives the provincial and territorial borders were drawn. How those borders came to be and what effect the division of these lands into politically independent zones has had on the different jurisdictions is an important question to ask.¹

Since the establishment of the provincial and territorial borders out of the former Hudson Bay Company territory, three regions of particular note, which include Manitoba, Saskatchewan, and the Northwestern Ontario, have shared a common quality. All three regions have failed to achieve the same level of wealth and success as their richer neighbors, namely, Alberta for the two western provinces and Southern Ontario for the North of Ontario. Many factors come into effect when explaining diversity in regional performance that range from political instability, to the lack of natural resources, and other

¹ Throughout this paper, I use the words “region”, “province”, and “jurisdiction” interchangeably.

public policy intangibles. However, another explanation may have to do with the decisions to establish the provincial border as how we see them today.

The purpose of my thesis is to determine if changing history and redrawing the provincial borders of Saskatchewan, Manitoba, and Ontario would be beneficial to the people who live in all three regions.² To investigate the border rearrangement scenario I will use theories related to optimal policy areas. The idea behind the theory of optimal policy areas is of creating a country that is of optimal size concerning population, market size, resources, and cultural differences to maximize efficiency gains in taxation and the administration of public goods. There have been relatively few formal economic models created to capture the formation of a country. Some who have contributed models include Friedman (1977) who argued, “counties are shaped by rulers in order to maximize their joint potential tax revenues” and Casella and Feinstein (1990) who studied the relationship between economic and political integration. However, over the last few years, there has been a growing literature in the field of optimal policy areas, amplified by the demise of communism and the redrawing of many political borders throughout Europe and in many Eastern European countries. Two important contributors to the growing literature are Alesina and Spolaore (1997 & 2003) and Bolton and Roland (1997) who developed models that capture the trade offs between the costs of heterogeneity in large populations and the benefits of large political jurisdiction.

² New provinces may be created out of existing provinces as set out in the British North American Act (1871) that states: “*The Parliament of Canada may from time to time, with consent of the Legislature of any Province of the said Dominion, increase, diminish, or otherwise alter the limits of such Province...*” Boundaries between two provinces in Canada may be changed if agreement in the Legislature and the Parliament of Canada over such changes occurs (Nicholson 1954, 106).

“When contemplating a move toward independence, voters in each region must then weigh the efficiency benefits of the union against the benefits of having a government ‘closer to the people’ (that is, a redistribution policy closer to the preferences of a majority in the region)” Bolton and Roland 1997

Many of the models developed for optimal policy areas have been at a national level, but my paper will focus on how the theory of optimal policy areas is redirected to regional matters. In Canada, for instance there has been growing support for greater regional autonomy at the provincial and local level and greater provincial political cooperation. In western Canada for example, Robert Roach (2003) lays out an argument for greater policy coordination amongst western provincial governments. He argues that benefits from such cooperation comes from increases in economic competitiveness, strength in numbers in response to external threats, freer regional trade, greater economies of scale and gains from the internalization of fiscal externalities.³ In a follow up paper by Roach and Fox (2003), they illustrate many examples of provincial cooperation that are currently active in the west today, which occurs in such sectors as agriculture, culture and tourism, education, energy, environment, finance and trade.

Emery and Kneebone (2003) address the issue of regional optimal policy areas through an examination of a potential political merger of Saskatchewan and Alberta. They incorporated the efficiency gains mentioned by Alesina and Spolaore (1997), which includes benefits derived from economies of scale in the administration of public goods, the internalization of provincial fiscal externalities, and freer access to a larger market for goods, services, labour, and capital against the loss of heterogeneous preferences in policy

³ All which are arguments that are supported by the theory of optimal policy areas.

initiatives. Gains in efficiency were then expressed in terms of provincial spending and revenue. They concluded that such a merger would not be in the best interest of the voters in either province.

Di Matteo (1997) brings up the subject of a new Northern Ontario political entity by promoting the idea that optimal policy areas can be created by giving regions greater control over provincial policies. He proposes the idea of transferring provincial decision-making power to regional governments in the north. His arguments stem from the view that the north of Ontario is geographically and economically distinct from the south as a result gaining greater regional control over public policies will better address the preferences of those living in the north.⁴

The importance of this topic is to determine from a public policy point of view the significance of readjusting borders to capture the economic benefits from optimal policy areas. To apply the theory of optimal policy areas I created two case studies. The first case study will be a readjustment of the Manitoba and Saskatchewan border to create a single Prairie Provinces of “Manatchewan.” I will use the theories by Alesina and Spolaore (1997) and Bolton and Roland (1997) to judge if such a merger makes sense and is in the best interest of those residing in the area. The theory includes greater economic benefits from reduction in per capita cost of public goods, greater economies of scale and greater regional stability to uninsurable shocks from belonging to a larger country versus the cost of giving up heterogeneous preferences. If Manitoba and Saskatchewan have homogenous preferences with respect to public goods and services then a merger between the two

⁴ Di Matteo, “A Case for a Northern Regional Government” The Chronicle-Journal Thunder Bay Saturday March 29, 1997, page A7.

regions may be beneficial to both populations due to gains from observable economic variables.

The second case study will be a readjustment of the Manitoba and Northern Ontario borders to create a new province called “Mantario.” For this study, I will include the work by Alesina and Spolaore (2003) who incorporate the concept of “distance from the centre” of public goods and services. The closer one is to a public good or from where decisions regarding public goods are made the greater the utility voters will derive from those goods. In the case of Northern Ontario the main city, Thunder Bay, is considerable closer to Winnipeg than to their capital of Toronto. One would assume by sheer proximity that the population would derive greater utility by merging with Manitoba.

The purpose of the border readjustments will be to reassess the impact of such amalgamations on the welfare of voters in those regions. Welfare will be determined by studying the “trade off between the benefits of large countries and the costs of heterogeneity in large populations” (Alesina and Spolaore 1997, 1028). Table 1.1 lists the potential benefits and costs of inter-provincial mergers and shows which of these impacts are quantified. The non-quantified impacts are described and evaluated qualitatively. For benefits and costs associated with larger jurisdictions, I will not quantify most variables, except for the case of economic stability, but rather describe the concepts of how benefits-costs will be derived from them. The majority of my calculations in the merger scenarios are intended to represent the degree of similarity of preferences of populations under consideration as opposed to representing economies of scale in the provision of public goods. From those findings, I can ultimately question the original decisions to create the

provincial borders as they are today and investigate the economic theory behind optimal borders.

Table 1.1: Optimal Policy Area Theory, Benefits-Costs Associated with larger Jurisdictions

Potential gains from a union (from being larger)	Described	Quantified
Economies of scale in the administration of public goods	✓	
Internalization of fiscal externalities	✓	
Elimination of Inter-provincial trade barriers	✓	
Greater economic stability	✓	✓
Potential costs of a union	Described	Quantified
Greater dissimilarity between policies in place and most preferred policies	✓	✓

This paper is organized as follows: Chapter 2 presents the case study on the cost-benefits of a provincial union of Manitoba and Saskatchewan. Chapter 3 will consist of a cost-benefit analysis of a union of Manitoba and Northern Ontario. The final chapter will be a conclusion.

CHAPTER TWO: THE CASE FOR MANATCHEWAN

“...it was of the highest importance to the province of Manitoba and the Northwest Territories that the former should be increased by an extension of boundaries so as to embrace and include a portion of the districts of Assiniboia and Saskatchewan and northwards to Hudson Bay.” (Nicholson 1954, 80)⁵

In 1901 and again in 1902, the Manitoba government passed legislation to extend its boundary into the surrounding districts of Keewatin, Assiniboia, and Saskatchewan. The main reason given for the extension of its borders was to incorporate areas that had “agricultural, commercial, and educational interests in a great measure common to its own.” (Nicholson 1954, 80) Keewatin represented the northern part of its border and access to the Hudson Bay. The territories of Saskatchewan and Assiniboia represented a new western border that in the view of the Manitoba government was a natural progression of the province since they share common climatic and agricultural conditions. Gaining control of those territories would have given Manitoba much of the land that today falls within Saskatchewan’s borders. Ultimately, the federal government, by decision of Wilfred Laurier in 1905, rejected Manitoba’s bid in favour of creating two provinces (Saskatchewan and Alberta) of roughly equal size with a border running north and south. Since their establishment, a polarization of economic success has occurred throughout the prairie region. In 2001, Alberta had a per capita GDP level of \$49,465. Saskatchewan and Manitoba had per capita GDP levels of \$32,745 and \$30,203 respectively. Population levels for Alberta in 2001 were 3.03 million, which was 0.88 million larger than the combined total for Manitoba and Saskatchewan.

⁵ Sessional Papers of Canada: No. 64a, 1906-07

One question to be answered is whether residents in Saskatchewan and Manitoba would have been better off today if Manitoba had won its claim over the region in 1905. This chapter will examine the cost and benefits of a merger between Manitoba and Saskatchewan into a single unified province, hence changing history and awarding Manitoba's request to acquire Saskatchewan in 1905. The majority of my calculations in the merger scenario are intended to represent the degree of similarity of preferences of populations under consideration as opposed to representing economies of scale in the provision of public goods.

Alesina and Spolaore (1997) developed a theoretical framework, which describes an optimal policy area that includes economic benefits from large countries or regions. In particular they, "focus on a trade-off between the benefits of large countries and the costs of heterogeneity in large populations." The economic benefits include internalizing fiscal externalities, economies of scale in administration of public goods and services, reduced trade barriers and greater regional stability. In other words, merging two provinces creates a larger population, which leads to reductions in per capita costs of providing public goods and services, because more taxpayers are available to pay for them, larger economies and larger markets, which increase productivity, and therefore arguably create richer regions. Larger regions also provide greater regional stability. Should one part of the province experience a recession that is more severe than the average then it would receive transfers from those parts of the province that are experiencing growth. (Alesina and Spolaore 1997, 1029) The cost side associated with a larger population includes the increase in heterogeneity of preferences, which means that uniformly applied public policies and public goods will be further from the most preferred policies for more of the population.

Belonging to a larger provincial body implies that voters in each region have to agree to a set of public policies, be they redistribution schemes, public goods and service, or trade (Alesina and Spolaore 2003, 4).

The idea of merging two adjacent provinces is symptomatic of many economic factors described by Alesina and Spolaore (1997). Combining the resource rich province of Saskatchewan with the successful manufacturing sectors of Manitoba creates an excellent case study to apply Alesina and Spolaore's framework for assessing the welfare impacts of redefining borders. In this paper, I will refer to the new Saskatchewan/Manitoba province as "Manatchewan." The combined province would represent a population of 2,149,828 people in 2001.

The idea of a provincial merger in the west is not without precedent. Recently, Emery and Kneebone (2003) investigated the possible benefits of a political merger of Alberta and Saskatchewan into a single unified province. Their findings were less than enthusiastic. They conclude that, "significant differences in public policies make it less than obvious that a merger of Alberta and Saskatchewan would be attractive" (Emery and Kneebone 2003, 18). They believe that the sacrifice in local preferences by Saskatchewan voters in favour of preferences of the larger population of Alberta was not worth the additional \$100 per capita in public revenue per year they would receive.⁶ In contrast to those findings, I find that a merger between Manitoba and Saskatchewan would be beneficial to both provinces. For Saskatchewan, the merger would create greater economic stability, increase spending on program expenditures, the ability to share in the expense of

⁶ Emery and Kneebone's (2003) study addresses the larger issue of whether the citizens of Alberta and Saskatchewan would gain from closer economic and policies coordination in terms of economic welfare. They identified economic gains in terms of provincial spending and revenue.

resource development and a greater share of equalization transfer. Manitoba on the other hand would benefit from greater per capita GDP levels, access to Saskatchewan's natural resource potential, and the offsetting of debt charges to the larger population while at the same time maintaining provincial preferences for public goods and services. Interesting enough, the gains Manitoba will see in natural resource revenues and the offloading of its provincial debt payments will be approximately the same amount that they will give up in equalization transfer when merged with Saskatchewan.⁷

The chapter will consist of four sections followed by a conclusion. The first section will be a historic look at how the borders came to be for Manitoba and Saskatchewan. The second section explores the benefits from a combined Saskatchewan/Manitoba province incorporating theoretical framework by Alesina and Spolaore (1997). The third section will focus on the cost side of a merger with specific reference to heterogeneous preferences for publicly provided goods and services. The section will also bring in the concepts put forth by Bolton and Ronald (1997) on identifying voter preference by means of income distribution. I will also use other preference indicators that were mentioned by Emery and Kneebone (2003) that include age distribution, taxation levels, and program spending. The final section will attempt to ascertain a fiscal reality for the new combined province of "Manatchewan." I will create a scenario in which the two provinces come together under the tax and spending policy of Manitoba to determine by means of changes in per capita revenue and expenditures if such a situation would be beneficial or negative for each province. The majority of my calculations for the merger scenario section will not represent the degree economies of scale in the provision of public goods, but rather show

⁷ The revenue and expenditure numbers are based on Financial Management Systems (FMS) provincial

how the combination of two homogenous populations would influence the fiscal reality of the new jurisdictions.

2.2 The Creation of the Provincial Borders

The first major alteration to the Northwest Territories after the Dominion gained control from the Hudson Bay Company in 1870 was the creation of the Province of Manitoba. The province was to be located within Lord Selkirk's Red River settlement established 1811. The 1811 settlement was 116,000 square miles in size and was an important destination for many travelers, trade goods, and numerous settlers throughout its existence. (Friesen 1987, 113) Manitoba officially became a province when the Manitoba Act was signed in 1870, as a result of negotiations between then Prime Minister MacDonald and a delegation of French Métis rebels under the leadership of Louis Riel. The rebels were one of many settlement groups that were eager to protect and establish their own place before the complete encroachment of English protestant settlement. The Métis were also looking to gain provincial authority and the power to protect their rights and heritage against Dominion rule.

On May 12, 1870, the Act received Royal Assent and came into effect when proclaimed on 15th of July 1870. Manitoba's boundaries were then defined as the parallels of north latitude 49° and 50°30' and the meridians of west longitude 96° to 99°, and hence covered about 14,340 square miles. The new province was similar in location and size to the former Red River colony that existed in Selkirk's settlement area, but fell short of Selkirk's settlement area by approximately 101,660 square miles (Nicholson 1954,25). The

budget break down and on Courchene (2003) equalization calculations.

federal government also retained control of resources and all unallocated land, which they intended to sell to support the building of a railway to the Pacific and encourage immigration (Hayes 2002, 214). In 1877, the provincial eastern and western boundaries were moved westward by approximately five miles to correspond with the Dominion Lands System of surveys, but the change did not affect the size of the original area.

The provincial status of Manitoba became the catalyst that helped jump-start growth in the region, which was spread out along the banks of the Red and Assiniboine Rivers. The province's population grew from 25,228 in 1871 to over 60,000 in 1881, then to 152,506 by 1891. The growth in populations led to demands for the provincial government to expand its territory. This created conflicts with neighboring provinces and districts that also sought greater territory or provincial status. One such example of a dispute happened between Manitoba and Ontario.

The northern and western boundaries of Ontario were in dispute since the time that the Dominion of Canada was created in 1867 (Nicholson 1954, 71). In order to provide some sort of government in the non-provincial areas east and north of Manitoba and north of Ontario, the government of Canada set apart a separate district named the District of Keewatin. The District was inaugurated on October 7, 1876 by the Keewatin Act, which was intended to be a temporary arrangement to manage the area until a proper arrangement to govern the land was resolved.

Under the Act, the Lieutenant Governor of Manitoba was designated as the Lieutenant Governor of the District of Keewatin. With an influx of population in the area in 1880 and with many settlers unhappy about the unorganized political structure of the region, a desire emerged amongst many residents of Keewatin to be incorporated into the

province of Manitoba. Manitoba wanted the boundaries to correspond with the line marked as the west boundary of Ontario near the 89th meridian of west longitude so it could log the timber from the eastern portion of the Province and obtain a port on Lake Superior (Nicholson 1954, 63). With the help of an eager Manitoba Government, those calls became the catalyst for the federal government led by Sir John A. MacDonald to pass an Act on March 21, 1881, to provide for the extension of the boundaries of the Province of Manitoba. The Act was incorporated on July 1, 1881 and subsequently extended the boundaries of Manitoba to incorporate most of the land east of Manitoba all the way to Lake Superior, including Port Arthur and Fort William (Thunder Bay).

The Government of Ontario was not pleased with this decision and felt that her boundary should reach as far as the Lake of the Woods, near Rat Portage (Kenora). Ontario laid claim to the land, stating that it had originally been part of Upper Canada, which Britain had legally acquired from France in 1759 after the Battle of the Plains of Abraham. They also argued other legal precedence for the claim such as the Treaty of Ryswick in 1700. Manitoba countered such claims by arguing that the development and administration of this intervening territory could best be secured by Manitoba as the seat of government of Ontario was far removed from the area and geographically (Nicholson 1954, 87).⁸

After an extensive dispute between both provinces, the matter was finally submitted to the Judicial Committee of the Privy Council for a definite decision. The decision of the Council came on July 16 1884 when the eastern boundary was set at the west side of Lake of the Woods, where the southern part of the Manitoba-Ontario boundary

⁸ The argument that Nicholson reports on the geographic distance from the seat of political power is the same used by Alesina and Spolaore (2003) as a variable in optimal policy areas.

is today (Hayes 2002, 254). Manitoba remained a small "postage stamp" province until the federal government granted it its current boundaries in 1912.

Another regional dispute occurred to the west of Manitoba. During the period of 1897-1905, the territories outside that of Manitoba, which included the District of Athabaska, the territories of Saskatchewan, Assiniboia, and Alberta also experienced rapid development. With the establishment of the Canadian Pacific Railway in the early 1880s and an active Immigration policies that followed Confederation the west experienced rapid population growth. The task of providing for the immigrants was the responsibility of the Territorial Government, but due to their territorial status, they were limited in their ability to support the new arrivals. Those limitations included the inability to borrow money on the public credit, while the Dominion government, upon which they were dependent upon for revenue, controlled their land, timber and mineral resources. Financial problems created by these policies and population growth prompted the call for provincial status (Nicholson 1954, 79).

It was the intention of the federal government to give provincial autonomy to the territories situated between the American boundary, the 60th parallel of north latitude, and between BC, Manitoba, and the District of Keewatin. The area comprised of 550,345 square miles and according to federal government opinion, was to be divided into multiple provinces due to its excessive size yet still have enough population and agricultural potential to be able to support their own governments. Several proposals were heard. Among them was one put forth by Manitoba in 1901 and 1902 to extend its borders westwards to include a portion of the districts of Assiniboia and Saskatchewan. Others included the call for two provinces divided along a line of latitude separating the section

into a north and south province.⁹ Other proposals included calls for one large province and even for the formation of three and four provinces. In 1905, Wilfred Laurier decided in favour of a two-province proposal, hence the provinces of Saskatchewan and Alberta were created. The border was established running north and south along the 4th meridian dividing the area into two regions of approximately equal size. The division would give to each of the new provinces an area of approximately 275,000 square miles and a population of about 250,000.

Manitoba remained small and the northern boundaries of Quebec and Ontario were unchanged. The creation of the two Prairie Provinces and the fact that BC, Alberta, and Saskatchewan all extended to the 60th parallel intensified the demands of Manitoba, Ontario, and Quebec for a northward extension of their own borders. To complicate matters for Manitoba, Saskatchewan in 1905 made a claim for the extension of her borders eastward to include access to the shores of the Hudson Bay. The Saskatchewan government argued that it had a provincial right to have direct water communication with the Atlantic Ocean by way of the Hudson Strait (Nicholson 1954, 86). If that proposal were granted that would have seen Saskatchewan take possession of the northern part of what today belongs to Manitoba. Ultimately, Saskatchewan bid failed as those lands north of Manitoba because, “the weight of argument to have territory lying north of Manitoba and west of Saskatchewan allotted to either province was in favour of Manitoba” (Nicholson 1954, 88). The full implementation of Manitoba’s borders occurred in 1912.

⁹ Many Calgarians who aspired to have their city as a provincial capital liked the idea. The basis for the north south provinces was one of geographic make up. The south due to its flat prairie terrain would be a basis for

2.3 Benefits from a Merger

To make a case for the combined province of Saskatchewan and Manitoba, hence rewriting history and awarding Manitoba all lands east to Alberta, I will first describe the economic benefits that such a merger will incur. The merger scenario between the two Prairie Provinces fits nicely into the framework for optimal policy areas described by Alesina and Spolaore (1997), which includes favourable economic benefits associated with larger countries that come in the form of greater economies of scale in the administration of public policy, elimination of trade barriers, larger markets, and greater economic stability. Another concept that builds on the framework provided by Alesina and Spolaore includes internalizing fiscal externalities. For this concept, I will turn to Mintz's (2001) study of public expenditures and tax policies in Canada.

2.3.1 Economies of Scale: Fixed Costs of Administration and Other Infrastructure

The first benefit that Alesina and Spolaore (1997) observe from a larger country is that the per capita cost of providing a public good decreases with the number of people who finance it, reflecting economies of scale in the administration of public goods. Alesina and Spolaore (2003) define public goods in a broad sense to include functions such as the provision of monetary and financial systems, tax collection, fiscal institutions, a legal and judicial system, infrastructures, communication systems, law and order, public libraries, public parks and educational institutions. In most instances the provision of public goods include fixed costs, that is, some fraction of the total cost of providing certain public goods is independent of the number of taxpayers who pay for it and use it, hence the average fixed

grain farming and ranching. The north due to its rolling hills and well-watered terrain would be more suitable

costs of providing public goods declines as the number of taxpayers increases (Alesina & Spolaore 1997, 18). By increasing economies of scale, we can reduce both marginal and per capita costs and increase the efficiency of government provided public goods and services for both provinces.

Fox and Roach (2003) have produced a list of over 150 examples of integration and coordination of public policies amongst the western provinces with the intention of exploiting economies of scale. For example, Saskatchewan has exploited scale economies in niche areas as education and health. In advanced education, Saskatchewan has established agreements whereby students from Saskatchewan get access to programs in Alberta and Manitoba in return for Saskatchewan covering the costs of expanding the programs to accommodate them. These arrangements involve such programs as Occupational Therapy, Respiratory Therapy, and Nuclear Medicine. The idea of combining educational programs across provinces instead of creating similar ones in each province shows how cost savings can incur. Overall, the CWF study illustrates how combining policy programs can have mutually beneficial results and does not necessarily require redefinitions of provincial sovereignty.

2.3.2 Internalizing Fiscal Externalities

Mintz (2001) study on the beneficial result of greater policy and tax coordination also brings in the concept of internalizing fiscal externalities. In the study, Mintz argues that increasingly people and business are willing to compare different economic environments in order to determine the best location to set up a business. What this means

for mixed farming (Nicholson 1954, 80).

for a country or province is that, “the jurisdictions that provide the best package of spending and taxes will be able to attract jobs and people.” (Mintz 2001, 3) Provinces and countries have to keep in mind when making public policies that, “inefficient spending and poor tax policies will impose high economic costs, undermining the economy’s ability to grow.” (Mintz 2001, 3)

A fiscal externality is either a fiscal benefit or cost arising from a policy action that occurs in any province other than the province that created the policy (Eaton, Eaton & Allen 1999, 579). If those externalities are not taken into account by the provincial spending and tax policies then the province will not optimize total spending on public goods and services. By capturing fiscal externalities created by inefficient spending and taxation policies, an economy places itself in a better position to attract business and maintain a high level of competition in a new global economy. One solution to the problem of fiscal externalities is to create greater policy coordination between regions or provinces, which would occur in a provincial merger case.

Saskatchewan and Manitoba for example have different taxation policies. Saskatchewan has a personal income tax regime with lower rates in both the mid and high tax categories along with a higher income exemption. Manitoba on the other hand has lower capital and corporate tax rates. The importance of such factors comes into effect when the object of these taxes is able to reallocate out of the jurisdiction to avoid paying the higher rates (Emery, Kneebone 2003, 12). Once the jurisdiction of residence is changed, all income becomes subject to a different tax schedule. Mintz (2001) shows an example concerning a Canada/US perspective. Canada tends to have higher average tax rates than the United States on annual income of \$40,000 or more. Thus, the tax system

may encourage individuals who earn income above this level to migrate to the United States. Hence, relatively high-income individuals flee high-tax jurisdiction in favour of low tax jurisdiction, depriving the high tax jurisdiction of revenue. If this occurs, a fiscal externality is created from one of the province's tax policies.

The taxation policies of Saskatchewan with regard to corporations and capital could explain why Manitoba and Alberta have more head offices of large Canadian corporations. Of the 800 largest (ranked by revenue) corporations in Canada in 2003, 227 head offices are located in the west. Out of those 227, 27 are located in Manitoba and 16 are located in Saskatchewan. Manitoba has nine corporations that made over \$1 billion in revenue in 2003 while Saskatchewan had six. Agricultural firms dominate Manitoba's largest corporations, the largest being Cargill with a revenue of \$3.654 billion in 2003 followed by the Canadian Wheat Board with \$3.339 billion, and Agricare United with \$2.726 billion.¹⁰ Saskatchewan's largest companies are Federated Co-operative Ltd, located in Saskatoon with revenue of \$3.551 billion, Potash Corporation of Saskatchewan at \$3.455 billion and IPSCO Incorporated with \$1,814 billion in 2003.¹¹ Concerning the top 100 Subsidiaries in the National Post FP500 ranking, four have headquarters located in Manitoba, which include Great-West Life Co. Inc., Investors Group Inc., Centra Gas Manitoba Inc., and SAAN Stores Ltd. There are no top 100 subsidiaries in Saskatchewan.¹²

One way to show Manitoba's competitive advantage over Saskatchewan is by the marginal effective tax rate or METR on capital. The METR on capital takes into account

¹⁰ In all, the majority of the 27 corporations in Manitoba are made up of agricultural firms (7), general manufacturing (4), general merchandisers (2), property and causality insurance (2), and Services (2).

¹¹ The large firms in Saskatchewan consist of Chemical and Fertilizers firms (3), Mining (2), Utility (2) and Property and Casual Insurance (2).

¹² Source: "FP500: The Rankings", *Nation Post Business*, June 2004.

all relevant taxes and tax base definitions that affect the rate of tax paid by a corporation. In essence, the METR is the tax paid as a proportion of the income generated by the last or marginal dollar of capital invested. Calculating METRs on capital allows us to compare in a meaningful way the extent to which the business tax regimes differs in the incentives provided for investment across jurisdictions, industries, and types of investments (Rosen, Boothe, Bahlby & Smith p. 707).

Table 2.1: Taxes on Business in Manitoba and Saskatchewan

Taxations	1987	1996	1997	1998	1999	2000	2001	2002	2003	2004
Corporate Income Tax, Small Business Rate										
Manitoba	10	9	9	9	8	7	6	5	5	5
Saskatchewan	10	8	8	8	8	8	7	6	6	5.5
Corporate Income Tax, General Rate										
Manitoba	17	17	17	17	17	17	17	16.5	16	15.5
Saskatchewan	17	17	17	17	17	17	17	17	17	17
Capital Tax, Financial Institutions										
Manitoba	3	3	3	3	3	3	3	3	3	3
Saskatchewan	3	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25
Capital Tax, General										
Manitoba	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Saskatchewan	0.5	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6

Manitoba and Saskatchewan Budgets various years

Table 2.2 illustrates McKenzie's (2004) calculations on interprovincial comparison of aggregate METRs on physical capital.¹³ The aggregate METR on capital reflects the industrial make-up of the provinces, with differences being driven by different statutory corporate income tax rates and capital tax rates. Looking at the numbers in Table 2.2 shows that Manitoba holds a slight advantage of 0.2 percent over Saskatchewan in terms of METR. The main advantage for Manitoba is seen in what they charge business to operate in the province. In Table 2.1, we see the different business tax rates charged in each

province dating back to 1987. In 2004, Manitoba charged a corporate tax rate, which is a tax paid on a firm's profit, of 5 percent for small businesses and 15.5 percent to large businesses. Saskatchewan in 2004 charged 5.5 percent to small business and 17 percent for large corporations. With regard to capital taxes, which is a tax paid on corporate revenues, Manitoba had a rate of 3 percent for financial institutions and 0.3 percent for general capital rates. Saskatchewan charged financial institutions 3.25 percent in 2004 and the general rate was set at 0.6 percent.¹⁴ Hence, by McKenzie's (2004) calculations Manitoba has a slightly more business competitive environment than Saskatchewan.¹⁵

¹³ I would like to thank Dr. McKenzie for providing me with the METR numbers.

¹⁴ The one recent area where the two provinces have differed with respect to tax cuts is for large business. In Manitoba, the provincial government has recently made efforts to lower the corporate rate from the decade long 17% to 15.5% in 2004. With respect to large corporate tax rates, it is not surprising to see that Saskatchewan has maintained the same level of 17% for the past 17 years, as large corporations are not in abundant and Crown Corporations are not going to move out of the province. One interpretation of why Saskatchewan has not followed suit in cutting corporate and capital taxes as is the case in Manitoba and Alberta is that Saskatchewan has little to gain from cutting corporate tax rates on large corporations because it has none to lose. While Saskatchewan has not kept up with Manitoba's recent cuts to corporate taxes, it has been competitive with regard to cuts to small business taxes. Emery and Kneebone (2003) suggest that Saskatchewan may be foregoing the opportunity of attracting large corporations or keeping the small firms that grow big because the government hopes to remain as attractive to small business as Manitoba and Alberta. As Dwain Lingenfelter, the economic development minister for the NDP in the early 1990s declared in response to the post Devine era, "Small business is the key to the province's economic recovery." (Financial Post, 24 April 1993) Should any small business grow to something larger, Saskatchewan seems willing to let it go to a lower tax province hence forgoing potential future revenues.

¹⁵ McKenzie uses a capital tax rate of 0.5 percent and 0.6 percent for Manitoba and Saskatchewan respectively to calculate the figures in Table 2.

Table 2.2: Marginal Effective Tax Rates on Capital – Large Corporations, Aggregate, By Province 2004

	Alberta	Saskatchewan	Manitoba	Ontario	Canada
Forestry	26.40%	36.90%	35.00%	31.60%	28.50%
Manufacturing	24.40%	31.60%	33.40%	29.00%	27.90%
Construction	30.00%	39.60%	38.10%	35.00%	32.60%
Transportation & Storage	27.00%	36.80%	35.10%	32.10%	29.90%
Communications	23.70%	33.70%	31.90%	28.80%	27.20%
Power, Gas & Water	22.20%	32.20%	30.30%	27.30%	23.30%
Wholesale Trade	33.10%	41.70%	41.20%	37.80%	36.20%
Retail Trade	35.80%	45.00%	43.30%	40.50%	38.60%
Services	29.40%	38.70%	37.10%	34.20%	32.20%
Aggregate	27.30%	35.90%	35.70%	32.10%	30.50%

Source: McKenzie 2004, Business Taxation in Alberta, a paper prepared for the Government of Alberta

Through business tax policies, the Saskatchewan governments have created a fiscal externality of lost revenue associated with not having head offices located in the province. Therefore, the government is either content or unaware of any fiscal externalities created by such actions or does not believe it will attract head offices. Alternatively, since a large number of the corporations are owned and operated by members of co-operatives and the Saskatchewan government there is little chance of them moving despite higher taxes. The relatively high tax region thus generates a fiscal externality (an outflow of high-income individuals and an outflow of capital) to the relatively lower tax rate jurisdiction.

A fiscal externality can also occur with respect to provincial expenditure policies. Mintz (2001) states that, “some public expenditures ultimately could lead to higher incomes and employment.” However, government program expenditures can, “deter businesses and people from locating here,” if those programs prove to be inefficient (Mintz 2001, 54). Canada allocates vast amounts of funds to programs, which need to be financed by taxes. If local public expenditures benefit outsiders and those external benefits are not taken into

account by local authorities then the optimal levels of spending for those residing in the jurisdiction will not take place. The government will always spend less than is needed to maximize local benefits. Public expenditure externalities may be significant in Canada due to the high degree of provincial spending responsibilities and free mobility of people across provincial boundaries (Emery & Kneebone 2003, 13).

A prime example of a fiscal externality is spending on advanced education. In provinces like Manitoba and Saskatchewan, the government sets aside a large amount of funding for post secondary education and training. In a perfect world, the funding should be a major contributor to productivity gains for the province once the graduates have entered the respective workforces. However, many post-secondary graduates leave both provinces for more prosperous job markets like Alberta. This migration is a net benefit to the province who receives the students. Not only do they import a higher educated workforce, but they also forgo the costs of educating those workers. The original province endures all the costs without any compensation for its payments. Consequently, if these fiscal externalities are not integrated into the level of funds appropriated to publicly provided goods and services then those services will under invest hence not provide efficient level of funding. One solution to the problem is to create a single provincial entity out of the different jurisdictions, hence harmonizing tax rates on mobile factors. This in essence will internalize some of the fiscal externality that is created by different tax and spending regimes for Manitoba and Saskatchewan.

However, there are arguments that minimize the efficiency gains with respect to the elimination of fiscal externalities through policy or political mergers. Day and Winer (2001) for example present evidence that suggests mobile factors (interprovincial

migration) are not sensitive to policy related differentials.¹⁶ The major determinants of interprovincial migration come from non-policy related aspects, which included differentials in earnings, employment prospects, and moving costs. Public policy was considered a minor factor for inter-provincial migration in both absolute and relative terms to the non-policy related variables. Additionally they found that policy induced migration did not occur because of provincial social assistance, healthcare, education, and personal income tax policies, but had more to do with Employment Insurance programs. Day and Winer's (2001) findings suggest the harmonization of provincial policy would have little effect on net inter-provincial migration. These results are consistent with the Berdahl (2003) CWF survey that emphasized the importance of job opportunities, not taxation levels, as the key reason for migration.

One last factor that reduces the potential size of efficiency gains from internalizing fiscal externalities is the federal equalization program. Federal government transfers that come in the form of equalization payments compensate lost tax revenue by provinces, hence; compensate provinces for fiscal externalities that are attributed to tax base mobility. Thus, the monetary transfers of the equalization program will compensate provinces like Manitoba and Saskatchewan who may lose high income tax earners or export university graduates to provinces with more attractive job and tax regimes (Emery & Kneebone 2003, 15).

¹⁶ The data used for the survey was constructed from personal income tax files for the years 1974 to 1996.

2.3.3 Elimination of Inter-provincial Trade Barriers

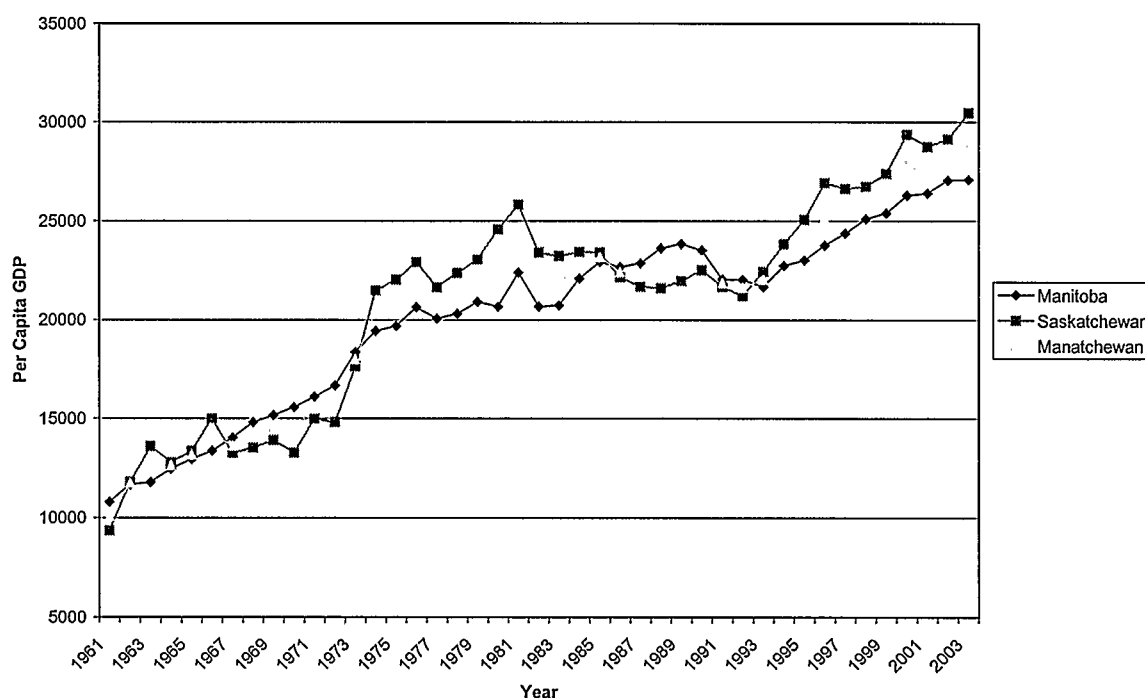
A third argument for expected economic gains from political union is the elimination of inter-provincial trade barriers between the two provinces. The idea of freer trade amongst neighboring states is not a new one. It was the logic behind the benefits of Confederation and written into the British North America Act of 1867 where the regulation of trade and commerce was formally deemed the responsibility the federal government. Since the Act, other agreements have been created with respect to inter-provincial trade between the ten provinces and the federal government, which in theory, according to Beaulieu, Higginson and Gaisford (2002), removed most barriers to the free movement of goods and services. There is also evidence that shows distortions resulting from inter-provincial trade barriers are insignificant, hence if all agreements are enforced a provincial union would then not cause significant additional effects on goods trading.

2.3.4 Economic Structure of the Two Provinces: Benefits of Diversification

The fourth benefit of a merger would be the stability created by combining two provincial economies. Alesina and Spolaore (1997) argue that exposures to uninsurable shocks are more costly for smaller countries than larger ones. A region in a large country hit by a negative regionally specific shock will be compensated by a redistribution of funds from the rest of the country. Saskatchewan and Manitoba have different characteristics when it comes to the major sectors. In particular the goods sectors subcategories of manufacturing and natural resources. Manitoba's manufacturing sector represents 12.7% of GDP, while in Saskatchewan it is only 7% of GDP. On the other hand, Saskatchewan's oil and gas sector represents 23.3% of its GDP as opposed to just 2.6% for Manitoba. In the

service-producing sector of the economy, both provinces have similar ratios with respect to contribution to GDP. Arguably, for Saskatchewan, diversification by incorporating Manitoba's manufacturing sector would go a long way in protecting the economy from drops in world oil, gas and potash prices, which have historically hurt the resource vulnerable economy as was the case in the 1980s and early 1990s.

Figure 2.1: Real Per Capita GDP, 1996 Constant Dollars



Source: CANSIM II Table 3840013 & 3840035 (GDP), 510005 (Population) and Table 3260001 (CPI All Items)

An example of the greater economic stability that Saskatchewan would experience if merged with Manitoba is presented in Figure 2.1 and Table 2.3. Figure 2.1 illustrates Manitoba, Saskatchewan, and the combined province of Manatchewan's per capita GDP for the years 1961 through 2003 in 1996 constant dollars. The average per capita real GDP values for Manitoba and Saskatchewan dating back to 1961 are \$20,174 and \$21,019 respectively. When combined the new Manatchewan province's per capita average rate of

GDP would be \$20,572 for the years 1961 to 2003. The result, represented in Table 2.3, indicates that under the merged scenario, Saskatchewan would have experienced lower average per capita GDP values dating back to 1961, but would have also experience lower levels of volatility as represented by lower standard deviation figures. Manitoba on the other hand would benefit from higher per capita income levels.

Table 2.3: Standard Deviation and Average Real Per Capita GDP, 1996 Constant Dollars			
	Manitoba	Saskatchewan	Manatchewan
<i>Standard Deviation in Real GDP</i>			
<i>1961-2003</i>	4,577.94	5,517.27	4,968.01
<i>1981-2003</i>	1,872.77	2,890.14	2,238.53
<i>1993-2003</i>	1,841.38	2,449.46	2,101.46
<i>Average Real Per Capita GDP</i>			
<i>1961-2003</i>	\$ 20,174.30	\$ 21,019.62	\$ 20,572.97
<i>1981-2003</i>	\$ 23,574.62	\$ 24,726.27	\$ 24,118.58
<i>1993-2003</i>	\$ 24,803.29	\$ 26,966.07	\$ 25,818.80

Source: CANSIM 11 Tables 3840013, 3840035, 510005 and 3260001

Variance: $n\sum x^2 - (\sum x)^2 / n(n-1) = v$.

Standard Deviation: $\sqrt{v}$

2.4 Opportunity Costs of the Merger

Opportunity cost associated with a merger or the creation of a larger jurisdiction, as stated by Alesina and Spolaore (1997) and Bolton and Roland (1997), has to do with the concept of heterogeneous preferences for public policies and goods. Larger populations are more likely to be less homogeneous in preferences for publicly provided goods and services, “in small, relatively homogenous countries, public choices are closer to the preferences of the average individual than in larger, more heterogeneous countries” (Alesina and Spolaore 1997, 1029). The greater the degree of homogeneity in preferences across the populations the better the chance economic benefits from a larger population will outweigh local populations being less able to implement their most preferred policies.

Therefore, a successful merger between Saskatchewan and Manitoba will depend on the degree of homogeneity with respect to preferences for public goods and services. In the case of rearranging the Manitoba and Saskatchewan border, a majority of the citizens affected by the border change would have to weigh the costs associated with giving up local preferences for greater economic benefits associated with larger populations.

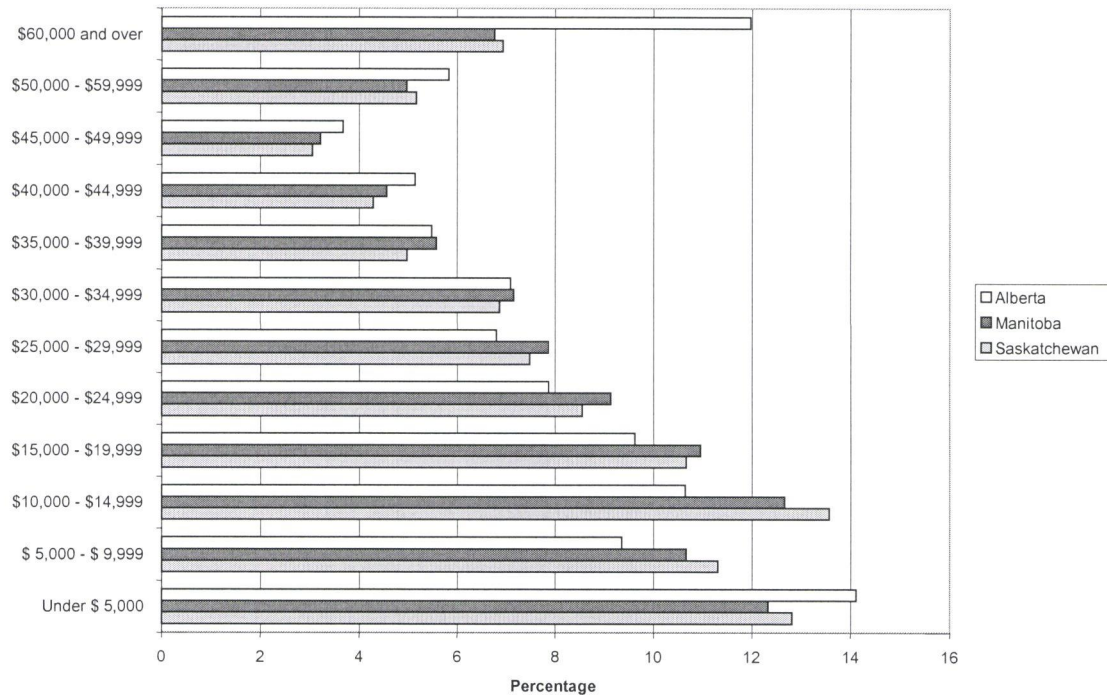
To proxy jurisdictional preferences, I will use demographic and economic factors that characterize each area. Differences in these factors will result in different preferences for publicly provided goods, services, and policy orientations. The comparisons will use such provincial characteristics as income and age distributions, per capita expenditures and revenues, and personal tax rates. The idea is to evaluate the homogeneity of the two groups of voters. The greater the similarities between these characteristics the greater the potential net gains from public policy related to increasing economies of scale, internalizing fiscal externalities, economic stability and reduction in inter-provincial trade barriers from a redefined border area.

2.4.1 Income Distributions

One determinant of provincial preferences for tax rates and publicly provided goods and services mentioned prominently by Bolton and Roland (1997), are income distributions. Income distributions can inform policy makers about the needs and wants of a particular population. One would expect a proportionally wealthier population to be in favour of a low tax, and/or a less redistributive regime, while a lower income population may be in favour of tax policies that promote greater income redistribution such as welfare benefits. With large differences between provincial income distributions, public policies in

each region may conflict with respect to the design of tax systems and the generosity of income redistribution schemes (Bolton and Roland 1997, 1058).

Figure 2.2: Individual Income Distribution, 2001



**All income as reported before tax.*

Source: 2001 Statistics Canada Census

Figure 2.2 represents the before tax income distributions for Manitoba, Saskatchewan and Alberta.¹⁷ In 2001, Manitoba's median income was \$20,469 while Saskatchewan's was \$19,636. The median income for Alberta was \$23,025. With respect to average incomes, the Albertan average was \$31,350, which was greater than both Manitoba's at \$26,416 and Saskatchewan's at \$25,811. From the above graph, it is evident that income distribution between Manitoba and Saskatchewan are practically identical.¹⁸ From the similarities between Manitoba and Saskatchewan's income distributions, I will

¹⁷ I use Alberta to better illustrate the similarities between income distribution in Manitoba and Saskatchewan.

¹⁸ Using Census data going back to 1981 shows that Manitoba and Saskatchewan have consistently had similar income distributions.

assume that preferences for redistribution schemes in Manitoba and Saskatchewan will be homogenous.¹⁹

Table 2.4: Personal Income Taxes, Manitoba and Saskatchewan

	1996	1997	1998	1999	2000	2001	2002	2003	2004
Tax on Tax Regime (% of federal tax rate)									
Saskatchewan	50%	50%	50%	48%	48%				
Manitoba	52%	52%	51%	48.50%	47%				
Tax on Base Regime									
<i>Low rate</i>									
Saskatchewan						11.50%	11.25%	11%	11%
Manitoba						10.90%	10.90%	10.90%	10.90%
<i>Medium rate</i>									
Saskatchewan						13.50%	13.25%	13%	13%
Manitoba						16.20%	15.40%	14.90%	14%
<i>High rate</i>									
Saskatchewan						16%	15.50%	15%	15%
Manitoba						17.40%	17.40%	17.40%	17.40%
<i>Income exemption</i>									
Saskatchewan						\$8,000	\$8,000	\$8,000	\$8,264
Manitoba						\$7,634	\$7,634	\$7,634	\$7,634

Manitoba Budget various years

Another area that is indicative of voter preferences for redistribution policy is in the amount that each province charges for income tax. Since 2001, provincial governments have replaced the tax-on-tax approach to provincial income tax for a flexible tax-on-base system. The change, which was the result of extensive federal-provincial negotiations, enabled provinces to define their own tax brackets, basic exemption levels, and income tax rates. This resulted in the provinces having greater freedom to design a personal income tax system that represents the individual preferences of their populace. Table 2.4 presents

¹⁹ Further evidence that supports the notion that preferences in Manitoba and Saskatchewan for redistribution schemes are similar is found in the amount that they allocate to welfare payments. In 2002, couples with two children received \$13,076 in Saskatchewan and \$13,129 in Manitoba, a difference of only \$53 per household. With respect to single parents with one child Manitoba welfare contribution was \$9,636, which is almost identical to Saskatchewan's \$9,687 contribution (National Council of Welfare Reports: Welfare Incomes 2002, Spring 2003, Minister of Public Works and Government Services Canada 2003).

the key characteristics of the personal income tax regimes in the two provinces, both before and after the switch to the tax on base system in 2001.

In 2003, Manitoba charged an 11 percent tax rate to low income earners, which was almost identical to that of Saskatchewan. In the middle-income bracket, the difference between the two provinces was only one percent with Manitoba charging 14 percent and Saskatchewan charging 13 percent. The major differences between the two provinces come in the higher income tax rates, with Saskatchewan at 15 percent and Manitoba with 17.4 percent and in the income exemption charges with Saskatchewan's rate being \$366 higher.²⁰ From the above observations, Saskatchewan has lower personal income taxes than Manitoba, but given the income distribution, which shows the majority of the population in the middle and lower income brackets, both provinces show many more similarities than differences. The tax systems of both provinces support the notion of homogenous preference for redistribution schemes.

2.4.2 Differences in Age

The age distribution of a province can be revealing of voter preferences for health care or education spending. Older populations will most likely demand more generous health care spending as opposed to a younger population that has other priorities like

²⁰ Saskatchewan has made a greater attempt over the last four years to lower the personal tax rate in all three levels. Since 2001, the tax rate for the low-income earners in Saskatchewan has dropped half a percentage to 11% for the 2004 tax year. Over the same period, middle-income earners also received 0.5% tax cut while the upper income earners rate drop from 16% to 15%. In 2004, Saskatchewan also increased the general income exemption rate from \$8,000 in 2003 to \$8,264. One would suspect that its close proximity to Alberta was the main reason for many of its tax policies as Alberta has implemented a flat tax for all categories at 10 percent while its general income exemption rate is much higher than Saskatchewan at \$13,525 in 2003 alone. Manitoba over the same period has cut taxes for the middle bracket dropping its rate 2.2%, from 16.2% in 2001 to 14% in 2004, giving one percent advantage over its neighbor. The low tax bracket rate has remained

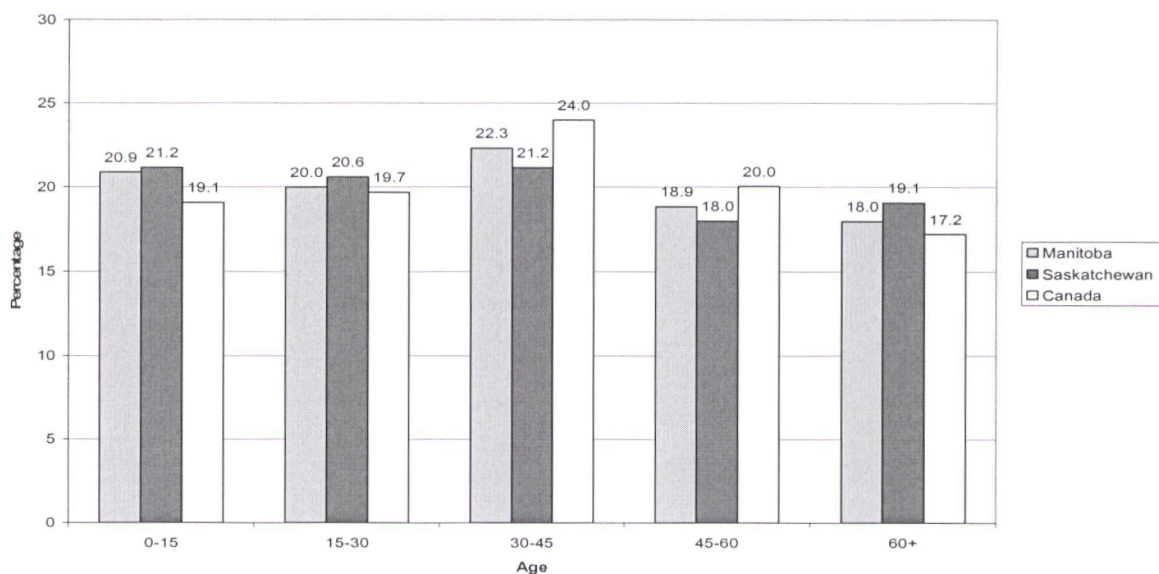
university education and other youth policy incentives to keep them from migrating to other provinces. Represented in Figure 2.3 are the age distributions of Saskatchewan, Manitoba, and Canada.²¹ In the 60 and older age bracket, the difference between the two provinces is only a percentage point with Manitoba at 18 percent and Saskatchewan at 19 percent. Canada as a whole has 17 percent of its population in the 60 years and older group. In Saskatchewan, people under the age of 15 represent 20.9 percent of the total population, while in Manitoba, young people represent 21.2 percent of the total population. The Canadian value is 19.1 percent. What the distribution shows is that Manitoba and Saskatchewan have greater representation in both young people and the senior age groups than is found in the rest of Canada. I will then assume that do to similar age distribution patterns that both provinces support homogenous public policies associated with education, keeping young people in the province and health care spending.²² Again the greater the homogeneity between the populations the better chance that any merger between the two jurisdictions would be beneficial when taking into account economic benefits from internalizing fiscal externalities, economies of scale and economic stability.

constant at 10.9%, which is slightly smaller than Saskatchewan rate and the upper bracket at 17.4% giving Saskatchewan a 2.4% advantage.

²¹ Canada is used as a comparison outside that of Manitoba and Saskatchewan.

²² In a survey done by the Canada West Foundation, "Looking West 2003: survey" Loleen Berdahl asked residents of Western Canada their five top policy priorities. Manitoba and Saskatchewan had the most in common with health care and keeping young people from leaving the province being the two top priorities.

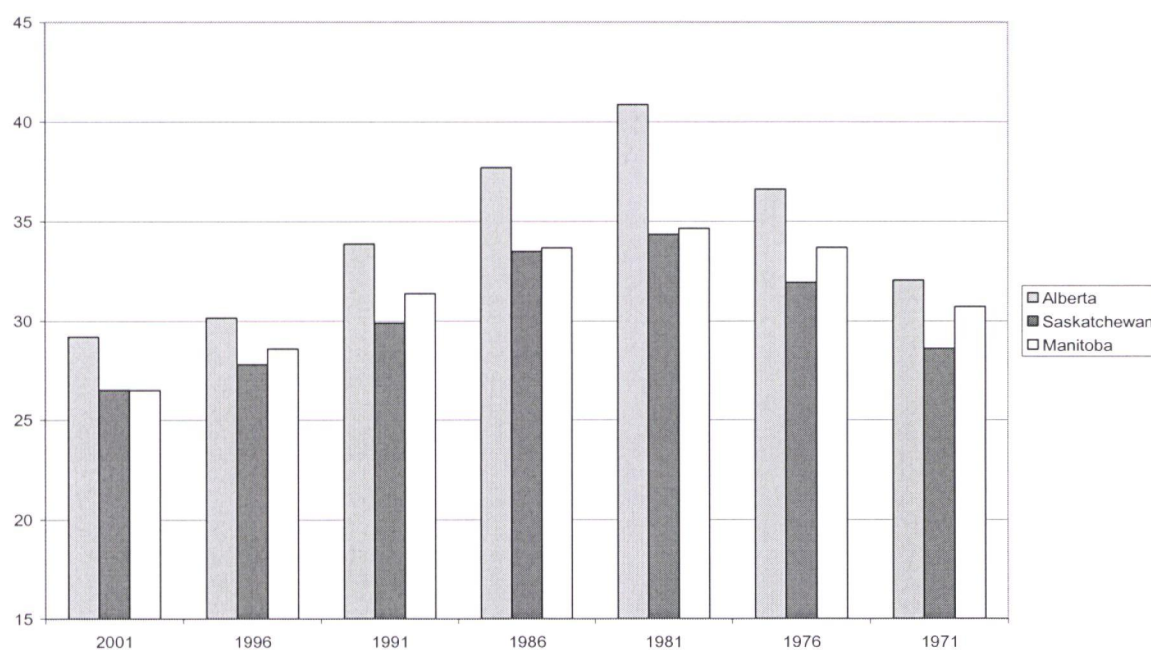
Figure 2.3: Age Distribution Manitoba and Saskatchewan



Source: Census 2001

Another example of the similarities in population characteristics between Manitoba and Saskatchewan is seen in Figure 2.3.1, which compares the prime age populations (ages 15-34) of Manitoba, Saskatchewan, and Alberta from 1971 to 2001. The first observation that the graph depicts is that all three provinces have experienced a decline in this age group starting from 1981, which can be attributed to an aging baby-boomer population. Despite this decline, Alberta has always maintained an advantage over the two Prairie Provinces, which is attributed to a net-out migration of young working age people from both Manitoba and Saskatchewan and a net in-migration of those workers to Alberta. Manitoba and Saskatchewan then have a common problem of losing their prime age populations to other jurisdictions. It is not surprising that Berdahl's (2003) survey found that people in Saskatchewan and Manitoba placed solving the out-migration of young people as the number one policy concern.

Figure 2.3.1: Prime Age (15-34) Population Distribution for the Prairie Provinces

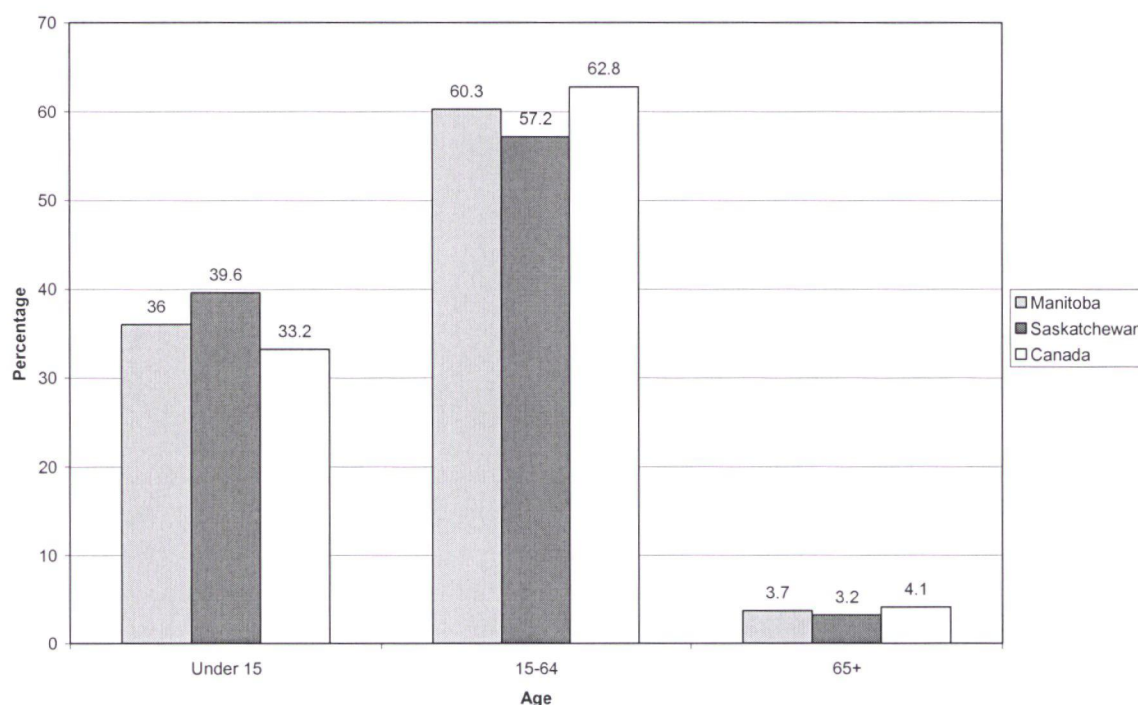


Source: Census 1971-2001

2.4.3 Aboriginal Population

A large and influential minority group in both Manitoba and Saskatchewan is the Aboriginal people who represent 13.6 percent and 13.5 percent of the total population respectively. In Canada, the total aboriginal population only represents 3.25 percent of the total population. In Figure 2.4, we see the age distributions of the Aboriginal populations for Manitoba, Saskatchewan, and Canada. In Saskatchewan, Aboriginals of the age 15 years and under, represent 39.6 percent of the total Aboriginal population. In Manitoba, a similar distribution is found with young Aboriginals representing 36 percent of the total Aboriginal population. It does not seem too contentious to conclude that Saskatchewan would likely find that Manitobans have more understanding and interest in their public goods needs related to their large, young aboriginal population.

Figure 2.4: Age Distribution of Aboriginal Population

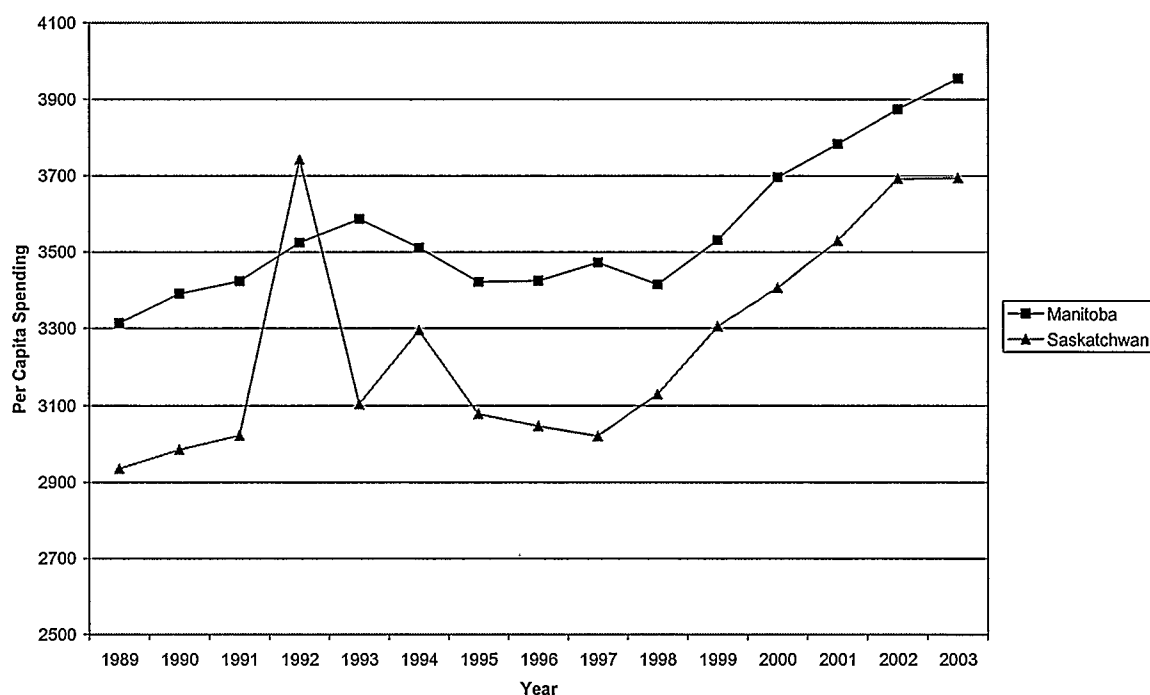


Source: 2001 Canadian Census Aboriginal Profile

2.4.4 Program Expenditures

Provincial program expenditures are another expression of voter preference. Program expenditures are typically the largest form of spending that a government will undertake in a fiscal year and include for the purpose of this paper health care, social services, and education (both primary, secondary and post secondary). The amount a government spends on programs can indicate the relative importance of such programs to the populations involved, particularly in times of financial crisis when governments are forced to make difficult decisions (Kneebone and McKenzie 1999, 89).

Figure 2.5: Constant 1992 Dollars Per Capita Program Expenditure



Source: CANSIM II table 3850002 and 1992 CPI all items table 3260001.

Real per capita program expenditures for Manitoba and Saskatchewan from 1989 to 2003 are presented in Figure 2.5. Over that period, Manitoba has maintained an average per capita advantage of \$304 over Saskatchewan, but as recently as 1997, Saskatchewan has made efforts to increase program funding to program spending. From 1997 to 2003, Saskatchewan's annually program spending grew at a real rate of 2.8 percent. Manitoba's program spending grew by 2 percent over the same period. However, the increase in program spending for Saskatchewan coincides roughly to the average annual real growth rate of per capita revenue, which was approximately 2 percent from 1997 to 2003 period. In Manitoba, average growth in real per capita revenue was only 0.5 percent. This suggests that differences in spending may reflect growing revenue levels rather than Saskatchewan's

preferences for increased spending on programs. In Manitoba, it seems that the government made a conscience decision to increase program spending.²³

Table 2.5 contains all per capita program expenditures for Manitoba and Saskatchewan for the fiscal year 2002. The difference in program spending between the two provinces was approximately \$216 per capita, with the advantage going to Manitoba. In 2002, Manitoba spent \$2191 per capita on health, which was approximately \$100 per capita more than Saskatchewan. On social services spending, Manitoba spent \$1145 per capita, which was \$61 per capita greater than Saskatchewan and in education; Manitoba spent \$1274 per capita, which again was \$57 per capita greater than that of Saskatchewan. How Manitoba is able to spend more on programs over a province that has an identical income distribution can be answered by looking at the revenue and expenditure categories of both provinces.

Table 2.5: Manitoba and Saskatchewan 2002 Per Capita Program Expenditure by Source		
	Manitoba	Saskatchewan
Total Per Capita Program Expenditures	4610.59	4394.16
<i>Health</i>	2191.14	2092.36
<i>Social Services</i>	1145.05	1084.26
<i>Education</i>	1274.4	1217.54
Elementary & Secondary	826.45	619.29
Postsecondary	360.27	486.01

Source: CANSIM II Table 385004

²³ Saskatchewan's percentage of program spending to total spending actually dropped from 56.1 percent in 1997 to 54.3 percent in 2003. Manitoba's rate went up despite the lower growth rates from 60.87 percent to 64.89 percent of total spending from 1997 to 2003. The other percentage of total spending for both provinces went to servicing the debt, housing, resource conservation, and industrial development, transportation and general government services.

2.4.5 Provincial Revenue by Source

Table 2.6 lists all categories of per capita provincial revenues from the Financial Management System (2004) for the year 2002 for both provinces.²⁴ In 2002, Manitoba was able to generate \$402.96 per capita more total revenue than Saskatchewan. This is surprising since own source revenue for Saskatchewan was actually \$72.54 per capita larger than Manitoba.²⁵ Where Manitoba was able to generate its advantage came in the category of general-purpose federal government transfers, which includes amongst other things equalization payments and the Canada Health and Social Transfer.

In 2002, Saskatchewan received \$1121 per person (or \$1.115 billion) from the general transfer. Manitoba, on the other hand, received \$1815 per capita or a total of \$2.102 billion. In that same year, the equalization payment to Manitoba was \$1113.8 per capita (or \$1.283 billion) as opposed to just \$145.3 per capita (or \$0.145 billion) for Saskatchewan. Taking federal equalization payments away from both governments, we see that Saskatchewan's average per capita total revenue going back to 1992 would in fact be \$731 per capita greater than Manitoba's.

²⁴ The FMS statistics consist of financial and employment data on government and government-owned enterprises at the federal, provincial, territorial, and local levels. This data allows for inter provincial budgetary comparisons since all calculations are identical for each province. With respect to equalization payments, all recalculations will be an approximation as data referring to the thirty-three categories was unavailable. The data for Northern Ontario will also be an approximation using Ontario provincial per capita values from the (FMS) as provincial spending at the local level was also not available.

²⁵ Own source revenue includes only revenue generated within the province and excludes all federal transfers.

Table 2.6: Manitoba and Saskatchewan 2002 Per Capita Revenue by Source		
	Manitoba	Saskatchewan
Total Revenue	7531.82	7128.86
Own Source Revenue	5522.12	5594.66
<i>Income Tax</i>	1782.25	1464.05
Personal Income Tax	1490.56	1198.5
Corporation Income Tax	283.88	146.31
Mining and Logging Taxes	7.81	118.25
<i>Consumption Tax</i>	1575.64	1640.42
General Sales Tax	901.98	779.63
Alcoholic Beverages and Tobacco Taxes	119.8	120.25
Amusement Taxes	2.6	1
Gasoline and Motive Fuel Taxes	193.59	354.74
Liquor Profits	140.64	124.26
Remitted Gaming Profits	215.29	259.54
<i>Property and Related Taxes</i>	308.18	364.76
General Property Taxes	180.57	1
Capital Taxes	114.59	363.76
Other Property Related Taxes	12.15	0
<i>Other Taxes</i>	375.03	407.85
Payroll Taxes	211.82	0
Motor Vehicle Licenses	62.5	118.25
Natural Resource Taxes and Licenses	7.81	132.28
Miscellaneous Taxes	93.76	157.33
<i>Health and Drug Insurance Premiums</i>	0	0
<i>Contributions to Social Insurance Plans</i>	125.01	158.33
<i>Sales of Goods and Services</i>	173.62	355.74
<i>Investment Income</i>	1172.83	1183.47
<i>Other Revenue from Own Sources</i>	9.55	20.04
General Purpose Transfers from Other Government Subsectors	1815.24	1121.34
Specific Purpose Transfers from Other Government Subsectors	194.46	411.86

Source: CANSIM II Table 3850004

Why does Manitoba receive greater amounts of equalization payments? To begin with, it is first important to understand what equalization means. Equalization is a federal government program created to reduce fiscal disparities across provinces. The goal of the

equalization payments is to allow governments in the less prosperous provinces to have the ability to provide their residents with public services that are reasonably comparable to those in other provinces. Equalization payments have no specific condition, which means provincial governments can allocate the funds in any way they feel appropriate. The calculation for the payments follows the formula stated below (Equation 2.1), which is the formula set out in federal legislation:

$$\frac{E_{ij}}{P_i} = t_{cj} \left(\frac{B_{rj}}{P_r} - \frac{B_{ij}}{P_i} \right) \quad 2.1$$

Where,

E_{ij}	=	Equalization to province (i) from revenue source (j)
P_i	=	Population of province (i)
E_{ij}/P_i	=	Per capita equalization to province (i) from revenue source (j)
t_{cj}	=	The national average (all-province) tax rate, defined as total revenues from revenue source (j) or TR_j divided by the total base for source (j) or B_{cj} , where subscript (c) refers to Canada or more correctly, the all province total
B_{rj}/P_r	=	The per capita base for source (j) in the Five Province Standard provinces, where subscript (r) relates to the Five Province Standard
B_{ij}/P_i	=	Province (i)'s per capita base for revenue source (j).

For each province, Equation 2.1 is applied to 33 tax categories (revenue sources). Those categories are listed in Table 2.7 on the left hand side. If the value of Equation 2.1 is positive, then this province is considered a “have not” area and the corresponding per capita value is the equalization allotment. If the sum is negative, then equalization is set to zero. Poor provinces are brought up to the five-province standard (FPS), but the rich provinces are not equalized down. The five-province standard refers to the standard tax base, which

is not a Canadian average tax base, but an average over five provinces; British Columbia, Saskatchewan, Manitoba, Ontario, and Quebec. The current five-province standard brings all provinces up to 97 per cent of the level of the national average.

To understand why Manitoba has an advantage over Saskatchewan with respect to equalization payments we have to look at the 33 revenue categories in which equalization is calculated. For convenience, I will look at the 2000-01 year as a reference source for all categories. The five-province standard for each revenue source, $t_{cj} (B_{ij}/P_r)$, appears in the FPS column of Table 2.7. For the provinces, the corresponding calculation for each revenue category is the product of a national average tax rate (t_{cj}) (not the province's own tax rate) and the commonly measured tax base for the particular province (B_{ij}) (Courchene 2004, 23). Once the fiscal capacity of the province's 33 categories is calculated, those numbers are subtracted from the corresponding FPS column to see if the province's revenues are above or below the standard. If the fiscal capacity is below the standard then the difference will be the per capita equalization entitlements for that particular revenue category, which appears in Table 2.8. If the provincial revenue value is larger than the FPS then the province will not qualify for an equalization payment. After calculating figures for all categories, the equalization values are summed (both negative and positive) for each province. If the summed values are positive then this is the per capita equalization transfer that the province will receive (row 34 Table 2.8).

Out of the 33 revenue categories, Saskatchewan had a per capita revenue advantage over Manitoba in 20 and received per capita equalization entitlements in 16 categories. The largest contributing categories to Saskatchewan equalization entitlements came in the personal and business income tax revenue categories. In those categories, Saskatchewan

fell short of the five-province standard by \$577.91 per capita and \$250.28 per capita respectively. In 14 revenue categories, which include new oil revenues, heavy oil revenues, natural gas revenues and mineral resources revenues, Saskatchewan fiscal capacity is above the five-province standard, which has a negative effect on equalization calculations. By summing the per capita equalization payments, we see that Saskatchewan received \$58.51 per person in 2000-01 or \$66.9 million in total equalization payments. Manitoba was below the five-province standard in 23 of the 33 categories. Where Manitoba generated greater fiscal capacity than the five-province standard was in waterpower rentals with \$47.31 per capita advantage, mineral resources with \$26.2 per capita advantage, and other games of chance revenue with \$5.36 per capita advantage. The largest shortfalls in Manitoba revenue occurred in personal income taxes with a \$331.45 per capita difference, provincial property tax revenues with a difference of \$202.27 per capita and in business income revenues with \$191 per capita difference. Manitoba received \$1,094.16 per capita in equalization payments in 2000-01.

Saskatchewan's ability to generate revenue in the primary industry categories such as new oil, mineral resources, and natural gas is a major reason why they receive limited amounts of Equalization payments. Manitoba's inability to generate revenue in most fiscal categories, especially the oil and gas categories is why they receive large amounts of transfers.

Table 2.7: Fiscal Capacity-Per Capita Yield of Tax Bases at National Average Tax Rates By Province and Revenue Source, 2000-01(dollars)			
Revenue source	Manitoba	Saskatchewan	FPS
1. Personal income tax revenues	1334.83	1088.37	1666.28
2. Business income revenues	317.26	258.48	508.76
3. Capital tax revenues	90.03	90.33	130.68
4. General and miscellaneous sales taxes	802.25	899.67	918.69
5. Tobacco taxes	60.67	68.8	74.59
6. Gasoline taxes	158.37	177.24	154.81
7. Diesel fuel taxes	61.62	138.56	57.17
8. Non-commercial vehicle licenses	51.14	61.86	54.49
9. Commercial vehicle licenses	35.85	37.34	32.01
10. Revenues from the sale of alcoholic beverages	133.64	124.63	136.96
11. Hospital and medical insurance premiums	67.11	64.25	71.21
12. Race track revenues	0.59	0.29	1.33
13. Forestry revenues	14.21	29.35	62.9
14. New oil revenues	9.31	307.85	16.69
15. Old oil revenues	2.15	25.24	1.72
16. Heavy oil revenues	-	118.76	5.04
17. Mined oil revenues	-	-	-
18. Third tier oil revenues	0.73	113.9	4.68
19. Heavy third tier oil revenues	-	67.43	2.7
20. Natural gas revenues	-	270.25	61.5
21. Sales of Crown leases	1.57	137.03	14.14
22. Other oil and gas revenues	0.47	26.95	2.04
23. Mineral resources	45.77	204.59	19.5
24. Water power rentals	91.71	10.07	44.4
25. Insurance premium revenues	41.51	43.72	45.55
26. Payroll taxes	175.78	149.12	224.53
27. Provincial local property tax revenues	953.03	989.98	1155.3
28. Lottery ticket revenues	51.44	50.14	68.24
29. Other game of chance revenues	155.22	150.94	149.86
30. Misc. prov. Local taxes and revenues	318.51	311.25	386.28
31. Shared revenues: offshore activities (NFLD)	-	-	-
32. Shared revenues: offshore activities (NS)	-	-	-
33. Shared revenues: preferred share div.	7.26	1.3	4.12
34. Total	\$4,982.01	\$6,017.67	\$6,076.18

Source: Department of Finance Canada, *Provincial Fiscal Equalization: Final Calculations, 2000-01 (Federal-Provincial Relations Department, Finance Canada, 2003), Summary Table 6A*

Table 2.8 Per Capita Equalization Entitlement, 2000-01(dollars)		
Revenue source	Manitoba	Saskatchewan
1. Personal income tax revenues	331.45	577.91
2. Business income revenues	191.5	250.28
3. Capital tax revenues	40.65	40.35
4. General and miscellaneous sales taxes	116.44	19.02
5. Tobacco taxes	13.92	5.79
6. Gasoline taxes	-3.56	-22.43
7. Diesel fuel taxes	-4.45	-81.39
8. Non-commercial vehicle licenses	3.35	-7.37
9. Commercial vehicle licenses	-3.84	-5.33
10. Revenues from the sale of alcoholic beverages	3.32	12.33
11. Hospital and medical insurance premiums	4.1	6.96
12. Race track revenues	0.74	1.04
13. Forestry revenues	48.69	33.55
14. New oil revenues	7.38	-291.16
15. Old oil revenues	-0.43	-23.52
16. Heavy oil revenues	5.04	-113.72
17. Mined oil revenues	0	0
18. Third tier oil revenues	3.95	-109.22
19. Heavy third tier oil revenues	2.7	-64.73
20. Natural gas revenues	61.5	-208.75
21. Sales of Crown leases	12.57	-122.89
22. Other oil and gas revenues	1.57	-24.91
23. Mineral resources	-26.27	-185.09
24. Water power rentals	-47.31	34.33
25. Insurance premium revenues	4.04	1.83
26. Payroll taxes	48.75	75.41
27. Provincial local property tax revenues	202.27	165.32
28. Lottery ticket revenues	16.8	18.1
29. Other game of chance revenues	-5.36	-1.08
30. Misc. prov. Local taxes and revenues	67.77	75.03
31. Shared revenues: offshore activities (NFLD)	0	0
32. Shared revenues: offshore activities (NS)	0	0
33. Shared revenues: preferred share div.	-3.14	2.82
34. Total	1094.16	58.51

Source: Department of Finance Canada, Provincial Fiscal Equalization: Final Calculations, 2000-01 (Federal-Provincial Relations Department, Finance Canada, 2003), Summary Table 7A

2.4.5 Provincial Expenditures by Source

Another explanation of why Manitoba is able to spend more on programs than Saskatchewan has to do with provincial spending habits. Table 2.9 illustrates the differences in per capita expenditures between Manitoba and Saskatchewan according to the Federal Management System (2004). In 2002, Saskatchewan outspent Manitoba by \$164.15 per capita, which put it in a deficit position of \$533 per capita.²⁶ Manitoba on the other hand had a surplus position of \$34 per capita. Manitoba's greatest expenditures outside of program spending were debt charges with \$1451.5 per capita. For Saskatchewan, debt charges represented \$914.91 per capita in 2002, which was a difference of \$536.59 from the Manitoba rate.

Saskatchewan's greatest expenditures outside program spending were in resource conservation and industrial development. The category is comprised of funds allocated to the promotion of tourism and the development of the oil and gas industries. In 2002, Saskatchewan spent \$1020.13 per capita on resource conservation and industrial development, which was \$730.13 per capita greater than Manitoba. In the last 15 years, the

²⁶ Saskatchewan has had troubles with its deficit spending over the last two decades. It is well documented that Saskatchewan has had to improve its financial accountability from a decade long abuse at the hands of the Conservative government under leadership of Grant Devine (MacKinnon 2003, 56). The Devine government came into power during the 1980s, inheriting a province that was enjoying large primary surpluses due to increases in oil and gas prices and a net asset position accomplished over the course of the 1970s. When the recession of the 1980s occurred, Saskatchewan found itself in the same position as the federal government and other provinces. Tax revenues fell, expenditures increased and primary deficits grew as did the debt/GDP ratios grew (Kneebone & McKenzie 1999, 27, 56). Saskatchewan also had the additional problem of dealing with collapsing of oil and gas prices in 1986 and low potash, uranium, and grain prices throughout the decade. Saskatchewan's net asset position rapidly moved to a net debt position by 1985/86. The financial situation prompted a series of credit downgrades that pushed up borrowing costs for the province. The Devine government's solution to the crisis was to increase government expenditures. By 1987, government spending in Saskatchewan was at 35 percent of its GDP, which was 13 percent higher than the rest of Canada. Saskatchewan's per capita deficit in 1987 was \$691 and its per capita debt was \$10,172, while the other nine provinces average per capita deficit was only \$201 with a per capita debt of \$5,658. Mackinnon (2003, 55) argues that the Devine Conservative government was a, "more reckless and extreme model of what was happening elsewhere in the 1980s."

government of Saskatchewan on average spent \$797 per capita per year on this category. Manitoba on the other hand spent an average \$315 per capita per year. With the importance of oil and gas to the Saskatchewan economy, one would assume that spending here would hold more importance than in Manitoba. Although Alberta, another oil and gas province, spent on average just \$543 per capita over the same period. If Saskatchewan were to spend the same per capita amount that Alberta had over the last 15 year, it would save an additional \$254 per capita per year in taxpayer money. With those funds allocated to program spending the gap between Saskatchewan and Manitoba with respect to program expenditures would be reduced to \$50 per capita compared to the current 15-year average of \$304 per capita.

Table 2.9: Manitoba and Saskatchewan 2002 Per Capita Expenditure by Source		
	Manitoba	Saskatchewan
Total Expenditures	7498.83	7662.98
<i>General Government Services</i>	150.18	139.29
<i>Labour, Employment and Immigration</i>	26.04	15.03
<i>Housing</i>	60.77	146.31
<i>Foreign Affairs and International Assistance</i>	0	0
<i>Regional Planning and Development</i>	67.71	38.08
<i>Research Establishments</i>	0.87	8.02
<i>General Purpose transfers to Other Government Subsectors</i>	184.04	69.14
<i>Debt Charges**</i>	1451.5	914.91
<i>Protection of Persons and Property</i>	315.13	366.76
<i>Transportation and Communication</i>	211.82	355.74
<i>Health</i>	2191.14	2092.36
<i>Social Services</i>	1145.05	1084.26
<i>Education</i>	1274.4	1217.54
<i>Resource Conservation and Industrial Development</i>	290.82	1020.13
<i>Environment</i>	39.93	88.18
<i>Recreation and Culture</i>	90.28	106.22

Source: CANSIM II Table 385004

2.5 The Fiscal and Political Impact of Union: The Case for Manatchewan

Would voters in Saskatchewan and Manitoba benefit from a merger of the two provinces? Both provinces have homogenous qualities with respect to preferences. From this perspective, the theory of optimal policy area assumes that a merged province should see net economic benefits from internalizing fiscal externalities, economies of scale in the administration of public goods, reduction in trade barriers and economic stability. Yet the one unknown factor that we have yet to explore for a provincial merger is the fiscal impact. To address this issue I will assume that the preferences for Manitoba and Saskatchewan both support adopting a Manitoba tax and spending mix.²⁷ When merged I find that Manitoba would benefit from offsetting its debt service charges and gain natural resource revenues, while Saskatchewan will benefit from increase program spending, offsetting its industrial development costs and receive greater equalization payments. The revenue and spending results of the newly merged Manatchewan province, found in Table 2.10 and 2.11, will then indicate the fiscal viability of the new provincial entity.²⁸

The first new calculations for Manatchewan that I calculated revolve around 14 of the 27 revenue sources of the Financial Management System. For 14 revenue tax categories, which include personal income tax, corporate income tax, consumption tax,

²⁷ In an earlier draft, I had done the analysis with Saskatchewan's tax and spending policies imposed instead of those of Manitoba. From what I calculated, I excluded this scenario based on two points. The first was that if Manitoba wanted to have Saskatchewan's spending and tax mix, they could have adopted it without merging. The fact that they did not, suggests that those policies would not help make the merger look palatable for Manitobans. In contrast, Saskatchewan could not afford Manitoba's policies without merging since they lack the equalization revenues and due to potential externalities created by increasing corporate and income tax rates from being in close proximity to Alberta. The second reason was that under the tax and spending policies of Saskatchewan, following the same calculations made in the "Manatchewan" scenario, I found that revenue in 2002 would be \$7129 per capita and expenditures would equal \$7558 per capita, which means a deficit position of \$430 per capita. The big difference occurred due to lower revenue generation from income tax, corporate tax rates, and that lack of a payroll tax. Therefore, the merger scenario that applies Manitoba's tax and spending mix was the more viable of the two options.

property tax (which includes capital tax and general property taxes), payroll tax, motor vehicle licenses, and miscellaneous taxes I will use Manitoba's per capita tax rates include. Those results are found in Table 2.10. From the theory of optimal policy areas, I assume that residence of Saskatchewan would support the tax policies of Manitoba as I have concluded from such preference indicators as income and age distributions that two populations are homogeneous concerning policies with respect to income redistribution schemes and age related policies. When using per capita values for Manitoba with respect to Saskatchewan's tax system we do see some differences. As one would expect from the similar income distributions between the two provinces, greater revenue is generated under Manitoba's personal income tax system, due to higher rates in all but the lowest categories. The personal income tax categories will bring in an extra \$292 per capita for Saskatchewan in 2002. Under Manitoba's corporate tax rate, Saskatchewan will gain an additional \$137 per capita. Consumption tax income will subsequently decline for Saskatchewan with a loss of \$66 per capita. Under the category of property and related taxes, Saskatchewan would lose \$250 per capita in capital taxes, but would benefit from an additional \$179 per capita in general property taxes for a net loss of \$57 per capita. Saskatchewan would also be the beneficiary of Manitoba's payroll tax, a value of \$211 per capita, since it does not collect this in its own budget. Since neither province collects a health care premium there will be no change in this category.

In the other eight revenue categories found in Table 2.10, which include mining and logging taxes, natural resource taxes and licenses, contribution to social insurance plans, sales of goods and services, investment income, other revenue from own source and the

²⁸ Budget data comes from CANSIM II Table 350002.

general and specific transfers the calculations were done differently.²⁹ Instead of using the per capita revenue rates from Manitoba, I summed the total revenue generated by both provinces then derived a new per capita amount for the combined populations. I then used the new per capita amounts and calculated Saskatchewan's losses and gains. The reason for the new calculation was due to unique provincial revenue characteristics found in each of these categories, which allows for revenue generation that the other province would otherwise not have been able to generate.

With respect to mining, logging, and natural resource taxes and licenses Saskatchewan would lose \$126 per capita in 2002. Social insurance, goods, services, and other revenue categories would also prove to be a net loss of \$121 per capita for Saskatchewan. With respect to investment income Saskatchewan would sustain a loss of \$5.69 per capita. When it comes to federal transfers Saskatchewan would gain \$371 per capita in general purpose transfers while giving up \$116 per capita in specific transfers. Equalization payments, which are a subcategory of general-purpose transfers, would contribute \$519 per capita to Saskatchewan in 2002 at the same time taking away \$450 per capita from Manitoba.

Summing all revenue categories and subcategories of the FMS under a Manitoba system for Saskatchewan would result in a \$398 per capita increase for Saskatchewan in 2002 over its current per capita total revenue numbers. The main source of funds will come from a reallocation of equalization transfers from Manitoba's coffers to Saskatchewan's, which adds up to \$519 per capita additional revenue in 2002, higher personal income taxes

²⁹ The General Purpose Transfer category includes such transfers as general-purpose capital transfers from federal government, statutory subsidies, shares of federal taxes on preferred share dividends and on income of

in the order of \$292 per capita, and greater contribution from corporate tax rates. Manitoba would lose only \$4 per capita in total revenue in 2002. Manitoba would gain in natural resource revenues by \$58 per capita and logging and mining taxes would bring in an additional \$51 per capita in 2002. Finally, Manitoba would gain about \$4 per capita in investment income.

Table 2.10: Manitoba, Saskatchewan and Manatchewan 2002 Per Capita Revenue by Source			
	Manitoba	Saskatchewan	Manatchewan
Total Revenue	7531.82	7128.86	7527.74
Own Source Revenue	5522.12	5594.66	5739.23
<i>Income Tax</i>	1782.25	1464.05	1833.51
Personal Income Tax	1490.56	1198.50	1490.56
Corporation Income Tax	283.88	146.31	283.88
Mining and Logging Taxes**	7.81	118.25	59.07
<i>Consumption Tax</i>	1575.64	1640.42	1573.90
General Sales Tax	901.98	779.63	901.98
Alcoholic Beverages and Tobacco Taxes	119.80	120.25	119.80
Amusement Taxes	2.60	1.00	2.60
Gasoline and Motive Fuel Taxes	193.59	354.74	193.59
Liquor Profits	140.64	124.26	140.64
Remitted Gaming Profits	215.29	259.54	215.29
<i>Property and Related Taxes</i>	308.18	364.76	308.18
General Property Taxes	180.57	1.00	180.57
Capital Taxes	114.59	363.76	114.59
Other Property Related Taxes	12.15	0.00	12.15
<i>Other Taxes</i>	375.03	407.85	433.67
Payroll Taxes	211.82	0.00	211.82
Motor Vehicle Licenses	62.50	118.25	62.50
Natural Resource Taxes and Licenses**	7.81	132.28	65.59
Miscellaneous Taxes	93.76	157.33	93.76
<i>Health and Drug Insurance Premiums</i>	0.00	0.00	0.00
<i>Contributions to Social Insurance Plans**</i>	125.01	158.33	140.48
<i>Sales of Goods and Services**</i>	173.62	355.74	258.16
<i>Investment Income**</i>	1172.83	1183.47	1177.77
<i>Other Revenue from Own Sources**</i>	9.55	20.04	14.42
General Purpose Transfers from Other Government Subsectors**	1815.24	1121.34	1493.14
Specific Purpose Transfers from Other Government Subsectors**	194.46	411.86	295.37

** Categories Where Rates Apply to Total Amounts Averaged Over a New Population

All Other Categories are Rates Applied to a Manitoba Per Capita Base

Source: CANSIM II Table 350002

certain public utilities, tax revenue guarantees, equalization, Canada health and social transfer, reciprocal taxation, stabilization and other general purpose transfers from federal government. (FMS pg. 70)

The next calculations will have to do with Manatchewan's expenditure sources, Table 2.11. Using Manitoba's per capita expenditure rates for Saskatchewan in the 2002 budget, we see some important changes. One such change comes in program spending with health expenditures up by \$98 per capita, social service spending increased by \$60 per capita, and education expenditures increased by approximately \$56 per capita above the Saskatchewan values. Saskatchewan would also cut \$51.5 per capita on protection of person and property. The increase in program expenditures for Saskatchewan, based on the preference indicators, is one of the benefits the voters of this jurisdiction would experience in the merger.

A quantifiable example of benefits that come from a larger population, which is a major point in the optimal policy theory, is seen in the new resource-conservation, industrial development, and debt charges spending, whose calculations are done by combining spending across both provinces then calculating the per capita amount given the larger population size. From those calculations, we see that Saskatchewan would cut spending on resources by \$390 per capita and increase debt spending by \$287.51 per capita respectively. Manitoba on the other hand would see its debt charges drop by \$249 per capita because of offsetting payments to a larger population. In resource conservation and industrial development spending Manitoba would then sustain a \$339 per capita portion of Saskatchewan's spending.

Table 2.11: Manitoba, Saskatchewan and Manatchewan 2002 Per Capita Expenditure by Source			
	Manitoba	Saskatchewan	Manatchewan
Total Expenditures	7498.83	7662.98	7586.13
<i>General Government Services</i>	150.18	139.29	150.18
<i>Labour, Employment and Immigration</i>	26.04	15.03	26.04
<i>Housing</i>	60.77	146.31	60.77
<i>Foreign Affairs and International Assistance</i>	0.00	0.00	0.00
<i>Regional Planning and Development</i>	67.71	38.08	67.71
<i>Research Establishments</i>	0.87	8.02	0.87
<i>General Purpose transfers to Other Government Subsectors</i>	184.04	69.14	184.04
<i>Debt Charges**</i>	1451.50	914.91	1202.42
<i>Protection of Persons and Property</i>	315.13	366.76	315.13
<i>Transportation and Communication</i>	211.82	355.74	211.82
<i>Health</i>	2191.14	2092.36	2191.14
<i>Social Services</i>	1145.05	1084.26	1145.05
<i>Education</i>	1274.40	1217.54	1271.40
<i>Resource Conservation and Industrial Development**</i>	290.82	1020.13	629.35
<i>Environment</i>	39.93	88.18	39.93
<i>Recreation and Culture</i>	90.28	106.22	90.28

** Categories Where Rates Apply to Total Amounts Averaged Over a New Population

All Other Categories are Rates Applied to a Manitoba Per Capita Base

In total, as illustrated in Table 2.11, Saskatchewan's annual spending would decrease by approximate \$77 per capita while Manitoba's spending would increase by \$87 per capita in 2002. The new provincial per capita revenue values for Manatchewan would be \$7527 per capita with spending levels of \$7586 pre capita in 2002, which would lead to a deficit position of approximately \$49 per capita for the new province. This would be an improvement for Saskatchewan whose original deficit position was \$534 per capita in 2002 while Manitoba would be worst off from its original \$49 per capita surplus in 2002. Under a Manitoba system, Saskatchewan would benefit from increased government program spending, greater fiscal restraint in other government spending and greater equalization

transfers. Manitoba would benefit by increased revenue from natural resources and by having more people to support debt payments.

2.6 Conclusion

In 1870, the province of Manitoba was created. By 1902, Manitoba was attempting to annex the portion of the NWT that would eventually become Saskatchewan in 1905. From their initial starts, the separation of these two territories by a political boundary has had the effect of creating two unique economic structures. Manitoba's economy has developed with the help of vibrant manufacturing and financial services sectors and has exploited such resources as hydroelectric energy, while Saskatchewan's economy has exploited its natural resources such as agriculture, potash, uranium, oil, and gas to fuel its economy. In this chapter, I have investigated the possible benefits and costs that would come from changing history and awarding Manitoba with control over Saskatchewan. The benefits ranged from internalizing fiscal externalities, creating greater economies of scale in the administration of public goods, eliminating potential barriers to trade and greater regional stability. The costs were associated with the loss of heterogeneous preferences for public goods and services.

Opposite to the findings of Emery and Kneebone (2003), who concluded a Saskatchewan and Alberta merger to be unattractive, for Manitoba and Saskatchewan the merger makes sense despite the deficit position that I calculated for the new combined province. Both provinces would benefit from internalization of fiscal externalities, greater economies of scale in the administration of public goods and the elimination of trade barriers. In addition, Manitoba would benefit from the larger jurisdiction from higher per

capita GDP, offloading of debt service charges, and get a piece of the natural resource potential of Saskatchewan, while maintaining spending preferences. All at the cost of some short term loss of equalization payments. For Saskatchewan when it comes to implementing Manitoba's public policies on the "big ticket" items such as spending on programs like education, health and social services Saskatchewan would find the change affordable in 2002 and desirable. Saskatchewan would also benefit from greater economic stability, hence would be less vulnerable to changes in resource prices, which is mentioned by Alesina and Spolaore (1997) as benefits from larger jurisdictions. This was not the case in a Saskatchewan and Alberta merger.

What I have also shown is that the cost associated with the loss of heterogeneous preference would not be large since both provinces have homogeneous preferences for public goods and services. This is an important factor because under the merger situation Saskatchewan would not represent the majority of voters or hold a majority in the legislature. In Saskatchewan there are 58 MLA sitting in their legislature, which is an average of one MLA for every 17,205 people. In Manitoba, the number of MLA positions is 57, which on average is one MLA for every 20,209 people in the province. If we merge the two provinces under the Manitoba system Saskatchewan would have 49 MLAs in the new 105-member assembly. Saskatchewan would then control 47 percent of the voting share, which is still a much better scenario than the one described in the Alberta and Saskatchewan merger.

Ultimately, any such talk of a provincial union comes down to the voters in each jurisdiction. They will have to judge for themselves the benefits that such a union could

have given the potential loss of public policies that more accurately represent their values and politics.

CHAPTER THREE: THE CASE FOR MANTARIO

“Ontario’s North is geographically and economically distinct from the south and the case can be made that policies applied uniformly across the province may not take regional preferences into account. Institutional arrangements which centralize decision making power at Queen’s Park hinder the North’s economic and social progress. This has certainly been the case in health and education funding decisions which apply uniform funding models across a province with substantial differences in costs due to geography and climate.” Di Matteo 1999

Brock (1978, 3) asserts, “The feeling of isolation, neglect and colonialism has been suffered in this region (Northern Ontario) since the huge area was acquired by the Ontario government”. The Queen’s Privy Council officially designated the north of Ontario, formerly the property of the Hudson Bay Company, to the province of Ontario in 1884 (with its borders fully implemented in 1912) (Nicholson 1954, 64). Prior to that decision, both Manitoba and Ontario claimed jurisdiction over the territory between Port Arthur and Lake of the Woods. Manitoba and the federal government held the view in the early 1880s that it was Manitoba who was better suited to administer and encourage the development of the disputed territory over that of Ontario since Ontario’s seat of government was so distant from the area (Nicholson 1954, 87). Ontario laid claim to the territory on the grounds that it had originally been part of Upper Canada which Britain had acquired from France in 1759 after the Battle of the Plains of Abraham.

It is of on-going interest as to whether residents in Northwestern Ontario would have been better off today if Manitoba had gained possession of the disputed territory instead of Ontario. From a historic context, the usual focuses for answering this question are the economic development and economic diversification of Northern Ontario (Brock 1978, Di Matteo 1999). There is general agreement that Southern Ontario benefited from

the timber and mineral resources of its northern districts. Some commentators have interpreted that Southern Ontario's economic success has occurred at the expense of industrialization in the north of the province.³⁰ On the other hand, Zaslow (1967, 114) argues that it is doubtful that Northern Ontario would have been as developed as it is "without continuing oversight and expenditures by successive provincial governments, backed by the financial strength and the tax resources of the wealthiest section of Canada." In all likelihood, however, as a small open economy exporting natural resources and dependent on external sources of capital, it is likely the case that the boundary decision that allocated the region to Ontario would have made little difference for the long run development of the Northern Ontario economy.³¹

The more relevant grievance of Northern Ontario communities is that policies concerning taxation and spending set in Toronto may not address Northern Ontario interests. As Di Matteo (1997) notes, "Northern Ontario is geographically and economically distinct from the South and as a result the case can be made that policies applied uniformly across the province may not take regional preferences into account." Of particular concern for Northern Ontarians today is that the costs of providing public goods in their region are higher than in the south of the province and this reality is not addressed

³⁰ Brock (1978) highlights the export of unprocessed resources as evidence that forward processing opportunities have been foregone. Di Matteo (1999) argues that the net fiscal flow from Northern Ontario to Southern Ontario between 1871 and 1911 reduced the growth of population and GDP in the North. To the extent that this limited the size of the "home market" in Ontario's North reduced the profitability of manufacturing in the region, the north of Ontario was smaller and less diversified than it could have been.

³¹ Chambers and Gordon (1966) show that resource booms largely result in a larger economy (extensive growth), population size, and value of the fixed factor (land). Emery and Kneebone (2003) argue that in the case of Alberta and Saskatchewan, policies and ideologies of governments have had little impact on the economic development of those provinces. In addition, provincial status of Canada's western provinces has not resulted in their industrialization, as they remain dependent on their natural resource bases. The long run fates of the western economies reflect the value and extent of depletion of the resource endowments. Brock (1978) proposed that taxes on exports of unprocessed natural resources would encourage forward processing

under current provincial spending allocations. In addition, the demographics of the Northern Ontario population create different needs in terms of health care services and education. The small population of the northern Districts relative to the southern counties of the province means that legislative decisions are dominated by southern Ontario preferences. The difficulty with this reality for Northern Ontario is that over the last 25 years, spending levels in the northern districts have been subsidized by taxpayers in the south of the province and since the mid-1990s, the choice of Ontario governments has been to adopt lower tax levels and lower spending levels. Residents of Northern Ontario may prefer higher spending levels but the likelihood of encouraging the rest of Ontario to support such a direction, particularly when the south subsidizes the north, is low. This situation has inflamed long-standing feelings of “Northern Alienation” that have at various times over the past century led to periodic calls for greater regional autonomy in governance, potentially secession to create a new province, and for a merger with Manitoba. In all cases, the goal is to secure greater powers to establish policies that are more reflective of Northern Ontario interests.

Alesina and Spolaore (2003) develop a theoretical framework with which to describe an optimal policy area that incorporates the idea of distance from the centre that provides public goods and services. Voters who share the same public policies and goods can take advantage of several benefits of population size that confer economies of scale in the provision of public goods, access to larger product markets and the internalization of fiscal externalities that would otherwise exist between two separate but economically integrated political jurisdictions. A disadvantage to larger single policy areas is that the

industries in the North of the Province. Di Matteo and others have called for twinning of the TransCanada

more heterogeneous are preferences of the population within the political jurisdiction, the lower likelihood that an individual with preferences far from the “centre” will see policies close to their most preferred policy. Alesina and Spolaore (2003) introduce geographic distances (i.e. how distant an individual is from where a public good is provided) by assuming that an individual’s utility derived from consuming publicly provided goods will diminish with the distance from the political centre where policy decisions are made.

“Northern Alienation” and northern secessionist movements are likely symptomatic of the economic factors described by Alesina and Spolaore. Winnipeg, Regina, and Edmonton are all closer to the Northern Ontario town of Kenora than Kenora is to her own capital city of Toronto. MacKirdy (1959, 197) noted “Certainly the recent (in 1959) organization in the Lakehead area of a Union-with-Manitoba League is a reminder that this region is more closely identified economically and socially with the prairie west than with southern Ontario.” Combining MacKirdy’s view and the historical claims of Manitoba over Northwestern Ontario, I believe that an examination of the implications of redefining the Ontario—Manitoba border for the three affected political jurisdictions, the “Rest of Ontario”, Northwestern Ontario and Manitoba, is an ideal situation to apply the Alesina and Spolaore framework for assessing the welfare impacts of policy unions. Following Di Matteo’s (1997) proposal for the area that would be optimally governed by a Northwestern Ontario Regional Government, I examine whether residents of the Thunder Bay, Rainy River and Kenora Census Districts would be better off as residents of Manitoba than they are as residents of Ontario. This delineation of Northwestern Ontario has a 2001 population of 234,771, which is just over 2 percent of the total Ontario provincial

population and a land area of 526,355.39 square kilometers, which represents 58 percent of Ontario's total area.³²

In promoting his Northwestern Ontario secessionist agenda, Di Matteo (1997) suggests that joining Manitoba would amount to nothing more than replacing alienation from Toronto with Alienation from Winnipeg as “we go from being Northwestern Ontarians to Eastern Manitobans.” In contrast, I find that there would be clear political benefits as Northwestern Ontarians would have a larger voice in the Manitoba legislature than they have in Queen's Park. I estimate the size of federal equalization payments that would support Northwestern Ontarians as part of Manitoba at around \$819 per person, which interestingly is close to what I estimated to be the size of subsidy to Northwestern Ontario from Southern Ontario based on Mullins' (2004) calculations of net tax burdens for Ontario Counties. The bottom line for Northwestern Ontarians is that as part of Manitoba, spending levels would be higher than they are as part of Ontario, particularly on health and education. At the same time, income taxes would be higher as part of Manitoba suggesting that voters in the Thunder Bay, Rainy River and Kenora Census Districts would have to decide if they want to pay more for higher spending as part of Manitoba, or live with Ontario's lower spending levels that come with lower tax burdens. From this context, Northern Alienation is a choice as opposed to an inherent condition of life on the Canadian Shield.

³² The Thunder Bay District has a population of 150,860 and has a land area of 103,714.37 square km. The Kenora District has 61,802 people and a land area of 407,167.33 square km, and the Rainy River District has 22,109 people and a land area of 15,473.69 square km. The three-census districts definition of Northern Ontario closely parallels that of Elections Ontario classification of Northern Ontario.

3.2 The Boundary Decision

MacKirdy (1959) notes that when the question of the western and northern boundaries for the province of Ontario come up the only parties to dispute ownership over the territory were Ontario and Dominion governments. Manitoba's involvement in the boundary decision began in 1881 when the Dominion parliament enlarged the boundaries of that province to the north and to the east to meet the western boundary of Ontario, the boundary under dispute. Ontario asserted that her legitimate western boundary was to the west of Kenora. The Dominion government's proposal for the boundary would have resulted in the province of Manitoba extending to Lake Superior to include the Lakehead ports.

The 1876 Keewatin Act introduced by the MacDonald Government created a district that encompassed most of northern Manitoba and Northern Ontario. The Act made Manitoba responsible for the 300,000 square miles of the district and gave the Lieutenant Governor of Manitoba the additional responsibility of being Lieutenant Governor of Keewatin. The Ontario government refused to recognize any authority other than its own over the region rendering the Act ineffective. The Ontario government believed that the legitimate western boundary of Ontario lay somewhere west of the Lake of the Woods, about 50 kilometers west of Kenora (formerly known as Rat Portage), which represented a sizable portion of the Keewatin District.

MacDonald's successor as Prime Minister, Alexander MacKenzie, was openly sympathetic to Ontario's claim over the disputed territory. He appointed a Board of Arbitrators to determine Ontario's western boundary but the Board did not have a single representative from either Manitoba or the District of Keewatin. On August 3, 1878, the

Board ruled that Ontario's boundary lay west of Rat Portage (now Kenora). When the MacDonald government returned to power in the following election, it overturned the Board's decision and passed an Act on March 21, 1881 that set the eastern border of Manitoba around Port Arthur (Nicholson 1954, 63). The Government of Ontario once again ignored the decision and prolonged the border dispute. By 1880, the government of Manitoba was busy creating several boundary Acts to enlarge her own borders to include the lands north of Lake Superior and to the east of its 1870 border. Soon both provinces began appointing officials to take up duties in the disputed territory. Prisoners arrested by order of one province's magistrate were liberated by an order of the other province's magistrate. Constables who made arrests to enforce their province's laws found themselves arrested for doing so by constables from the other province.³³ The conflict that resulted from the lack of settlement over the disputed District culminated in the "Rat Portage War" of 1883.

Ultimately, such incidents became the catalyst for both provinces to seek a final settlement on the conflict. The matter was brought before the Queen's Privy Council (the Privy Council being the highest law in Canada at that time) in July 1884. On August 11 1884, the Privy Council chose to uphold the 1878 Boundary Decision of the Board of Arbitrators establishing Ontario's western boundary to the west of Kenora. Ontario's well

³³ For example, in 1881 Constable Patrick O'Keefe from Manitoba seized four barrels of illicit liquor in the town of Rat Portage (Kenora). The Federal Public Works Act prohibited the sale of intoxicants at or near any Public Work. Instead of destroying the liquor, O'Keefe took it back to his room for safekeeping. His room happened to be within the jurisdiction of a Public Work and as a result was arrested by Dominion Police Officers (Ontario Police), who were routinely on the lookout for illegal liquor. For breaching the federal prohibition against having liquor in the area, O'Keefe was brought before a Dominion Magistrate (Ontario Magistrate) and fined for unlawful possession of intoxicating liquors. After paying the fine, O'Keefe waited for the Magistrate to leave the Bench and subsequently arrested him for having the same liquor in his possession without a Manitoba provincial permit. The Dominion Magistrate was then taken before a Manitoba Magistrate where he was fined \$100 (MacKirdy 1959, 195).

researched and prepared argument and clear popular support from the south of the province apparently convinced the Privy Council to side with its interpretation of former legislation and treaties, one of which was the Treaty of Versailles (1783), with respect to its boundary claims (Zaslow 1967, 112-13). Manitoba on the other hand had a poorly prepared case that was also hurt by a lack of support for this initiative by both government officials and the provincial population. MacKirdy (1959, 195) argues that:

neither the public nor the government in Manitoba developed an interest in the disputed area akin to that displayed by their Ontarian counterparts... Manitobans of that day were preoccupied with wheat land, and this territory was unsuitable for agriculture. Whatever future profits might accrue to Manitoba from the possession of the region in question, its immediate result in the eyes of the impoverished provincial government, was an increase in administrative charges with no corresponding increases in revenue – especially since, under the natural resources policy adopted by the Dominion government upon the creation of Manitoba, the federal authorities retained control of the mineral and timber rights.

The federal government was evidently not very pleased with the Privy Council's decision as they did not recognize Ontario's "new" boundary for another 5 years when they "officially" enlarged the province by an Act of Parliament in 1889. It passed the House of Commons in 1908 and was implemented by 1912. MacKirdy (1959, 197-198) suggests that while Manitobans in 1884 were not overly concerned with the boundary dispute, the decision that gave the disputed territory to Ontario did bother them in later years. For example, in 1905, while introducing a series of resolutions calling for the northern extension of the province's boundaries Manitoba's Attorney General C. H. Campbell made reference to the award of 1884 and how it had deprived Manitoba of its "own port facilities" at the Lakehead.

3.3 A Brief History of “Northern Alienation”

Nelles (1974) describes how the government of Ontario envisioned the north of the province as a ‘New Ontario’ that was to be an agricultural frontier for settlers who would provide a market for the manufacturing output of the south of Ontario. MacKirdy (1959, 194-195) notes that in the 1880s, the expectation was that the population of “New Ontario” would reach 1 million. Thus, the massive size of the north of the province was to provide land for the permanent renewal of the pioneer cycle, bringing in its wake increased and sustained commercial prosperity for the south of the Province. It was to furnish new ground for the extension of familiar activity and raw materials to fuel the growth of a whole new generation of modern industries (Nelles 1974, 52-53).

Ontario’s vision of an ‘Agricultural New Ontario’ eventually failed due to poor soil in the north, but the North did prove to be a good revenue generator for the south through its natural resources (Di Matteo 1999). Over the period 1871 to 1914 natural resource revenue arising from Northern Ontario natural resource production and exports at times represented over 25 percent of total provincial revenue.³⁴ The North of Ontario has also been described as an important reason for Ontario’s dominance within Confederation:

“By entering upon this vast new territorial heritage Ontario secured an unshakeable position within the Canadian federation. The whole Great Lakes system in Canada was enclosed within the province and Manitoba’s ambition of gaining an outlet of its own on Lake Superior was frustrated. With Ontario lapping the edge of the prairies, and in control of that region’s most convenient water outlet, its commercial and social hegemony over the Canadian West was assured. Thanks to the integration of the economies of western and central Canada, Ontario’s manufacturing and financial sectors were able to attain heights unequalled within the Dominion.” (Zaslow 1967, 114)

³⁴ Di Matteo, *A Northern Province? Part II* Monday February 5 1997 The Chronicle Journal

In contrast, despite all of its resources, Northern Ontario has seen a major decline over the years in its traditional natural resource and transportation employment base. Since the mid twentieth century, the north's economy and population have grown at a much slower pace than the south and has experienced much higher levels of unemployment. The north of the province has failed to diversify and Di Matteo (1999) suggests that this could be the long run result of the fiscal drain from north to south earlier in the century. Nicholson (1954) and Brock (1978) suggest that Northern Ontarians believe that their economy would be much wealthier and diversified had Northern Ontarians had a greater voice in the management of mineral and timber resources.

Over the last 30 years, provincial government spending has been of growing importance for Northern Ontario economy and with its small population size relative to the south of the province, Northern Ontario residents have had their standard of living directly affected by the decisions of southern Ontario. Feelings of "Northern Alienation" are also alleged to be the result of the economic, social and geographic differences between the North and South of the province. Zaslow (1967, 116) suggests that "Periodically, northern and northwestern communities complain that their needs are misunderstood or ignored by southern-dominated Ontario legislatures." MacKirdy (1959, 197) suggests, "the recent organization in the Lakehead area of a Union-with-Manitoba League is a reminder that this region is more closely identified economically and socially with the prairie west than with southern Ontario." Di Matteo argues that:

Ontario's North is geographically and economically distinct from the south and the case can be made that policies applied uniformly across the province may not take regional preferences into account. Institutional arrangements which centralize decision making power at Queen's Park hinder the North's economic and social progress. This has certainly been the case in health and education funding decisions which apply uniform

funding models across a province with substantial differences in costs due to geography and climate... Centralized decision making makes it more difficult for regional differences to be accommodated whether those differences are in health care, education or transportation.

The vast distances of many Northern Ontario communities from southern Ontario, and a lack of political power within Ontario have contributed to longstanding feelings of alienation in the North resulting in several movements over the years that have called for greater regional autonomy. The creation of a northern province was proposed as early as 1875 to prevent Ontario from having a disproportionate influence in Confederation.³⁵ Between 1900 and 1910 secessionist talk resumed along with the creation of the provinces of Alberta and Saskatchewan in 1905. Several proposals were made for the creation of various configurations of a northern province named Algoma, or Huronia, or New Ontario. In 1911, the Kenora District called for a Union with Manitoba. Hubert Limbrick of Fort William and his “New Province League” campaigned for the creation of a northern province named Aurora in the 1940s and 1950s with Fort William/Port Arthur as the New Province’s capital.³⁶ Running in the 1959 Ontario Provincial election as an Independent candidate in Fort William, Limbrick received 382 of 21,990 votes and his agitation for a new province died shortly after. Ed Diebel of North Bay campaigned for the creation of the Province of Northern Ontario with Geraldton as the proposed capital in the 1970s. Most

³⁵ MacKirdy (1959, 197) argues that “it is probable that a larger Manitoba and a smaller Ontario would have made for a more balanced federation in the years which followed.”

³⁶ Limbrick believed that: “The natural eastern boundary of the province of North Ontario extends north from Sault Ste. Marie, following approximately the route of the Algoma Central Railway to Hearst, and hence to Port Albany. In the event that residents of Algoma and Cochrane preferred to keep their attachment with South Ontario, the boundary line could follow the eastern Boundary of the District of Thunder Bay, taking a general north and south line from Lake Superior through White River to Port Albany. In either case, such a partition would set aside a compact area unbroken by physical barriers and people by those with common problems and ambitions. In either case, such a partition would be comparable with Manitoba, Saskatchewan and Alberta. The initial population of 200,000 should be just the same as the population in Alberta and

recently, in the late 1990s Livio Di Matteo of Thunder Bay has called for greater regional autonomy for what he calls “Northwestern Ontario” and has gone so far as to suggest that there “is not an overwhelming case against the creation of a new northern province”.

An important source of Northern Alienation is how geographically and socially distant Northern Ontarians feel from the decision makers in the south. Recognizing the apparent closer geographic and social proximity of Manitobans for Northwestern Ontarians, a natural question arises as to whether Northwestern Ontarians would be “better off” as Eastern Manitobans.

3.4 Optimal Policy Areas and the role of Geographic Distance from the Centre

As mentioned in their 1997 paper Alesina and Spolaore (2003) define public goods in a broad sense to include functions such as the provision of monetary and financial systems, tax collection, fiscal institutions, a legal and judicial system, infrastructures, communication systems, law and order, public libraries, public parks, and educational institutions. They also argue that the provision of these goods include fixed costs, costs that are independent of the number of taxpayers who pay for and use the public good. The existence of fixed costs in the provision of public goods means that there are advantages for taxpayers in a larger political jurisdiction providing public goods since the average fixed costs of providing public goods declines with the number of taxpayers increases.

Heterogeneity of preferences due to differences in ideology, demographics and/or incomes of taxpayers within a political jurisdiction represent an opportunity cost for larger political jurisdictions since the distance between a given individual’s most preferred policy

and the policy actually selected may be larger than it would have been in a smaller jurisdiction characterized by a greater homogeneity of preferences. Individuals within a population may have different views on the amount governments should spend and the policies that support that spending.

Alesina and Spolaore (2003) assume that public goods have geographic dimensions to their provision. For example, being close to some public goods like schools reduces travel costs. In the case of post-secondary education, it is believed that having a local institution raises the likelihood that the educated workforce will remain in the local economy potentially attracting capital to the local economy. Other public goods such as bureaucracies and universities are concentrated in a small number of locations (like the capital city) and often living closer to these locations results in taxpayers deriving a greater benefit from the public good than taxpayers who reside a greater distance from the location.

Alesina and Spolaore (2003) argue that the geographic sources (how distant the taxpayer resides from where the public good is provided) and ideological sources (how close the quantities of, and public policies in support of, public goods are to the individual's most preferred policy) of heterogeneity in preferences over policies are correlated. They argue that the transaction costs of governance and public goods provisions results in political jurisdictions being geographically compact rather than disjoint even though many government functions do not require that taxpayers living in close proximity otherwise.³⁷

Northern Ontario: Fort William, The New Provincial League, 1950

³⁷ For a concrete example of their point, in the nineteenth century Ontario laid claim to the land directly to its north (forming a compact jurisdiction) but showed little interest in having the territory that later became Alberta allocated to Ontario's jurisdiction (a disjoint jurisdiction). Alesina and Spolaore's contention for this result seems to work well in current times, but historically it is harder to reconcile with earlier eras of British and Spanish empires that were essentially disjoint political jurisdictions.

Alesina and Spolaore (2003) observe that voters with comparable preferences tend to live in close proximity to one and other. Through a sorting process, such as chain migrations or immigration networks, individuals with similar attitudes, income, ideologies, and race tend to live in close proximity to one and other. Over time, the sorting of population and the path dependence that it generates, results in greater uniformity of beliefs and preferences within a local population.³⁸ Finally, the correlation of geographic and ideological distance from the provision of public goods may be the product of public policies and policy decisions. For example, hiring rules that favor local populations or educational curriculum that focuses on local culture help reinforce local preferences and attitudes over assimilation of “national” values. When the provision of public goods is centralized in a small number of locations, taxpayers who have a higher demand for those public goods will choose to reside close to those public goods. Thus, it would be expected to see the preference for spending on that public good to be highest amongst those taxpayers living close to where it is provided and lowest where taxpayers live most distant from the public good. For example, taxpayers in Kenora may not share the enthusiasm of Toronto taxpayers for greater spending on Toronto post-secondary institutions.

Alesina and Spolaore (2003) examine the trade-off between the size of the political jurisdiction and the degree of heterogeneity of preferences within the jurisdiction as determined by geographic distance between where a taxpayer resides and where the public good is provided. They define a state as a political jurisdiction that monopolizes the

³⁸ See Akerlof (1991) “Procrastination and Obedience” for an interesting discussion of these processes. For example, a group that started out as a “rehab” society for drug users and alcoholics evolved into a para-military organization that loyally followed their leader’s “maniacal whims”. Jon Krakauer’s (2003) history of the Latter Day Saints *Under the Banner of Heaven* and the survival of the fundamentalist polygamists within the religion provides another stark illustration of these processes. The LDS fled persecution in the US

provision of certain essential public goods and policies and takes prerogative over a host of other functions for reasons of economies of scale or transaction costs. Some functions are delegated to a subnational level of government whose borders are enclosed within the national one. In my scenario, I envision Ontario as equivalent to Alesina and Spolaore's national government while the northwest of Ontario is my subnational jurisdiction of interest. Thus, Toronto will play the role of the central government since it is the provincial capital of Ontario.

For their modeling, Alesina and Spolaore assume that ideology (preferences) and geographic proximity to the public good are perfectly (positively) correlated. Assuming perfect correlation allows the model to be viewed in a single space where the distance between two points on a segment represents both an ideological and a geographic dimension. The authors simplify the analysis by transforming the nation into a unidimensional space or a linear segment with individuals organizing themselves into political jurisdictions. Those political jurisdictions are defined by borders that identify individuals who pay taxes for a specific public good that only taxpayers can use. Thus, policies followed by one jurisdiction will not affect any to her jurisdiction; hence, there are no externalities across jurisdictions.

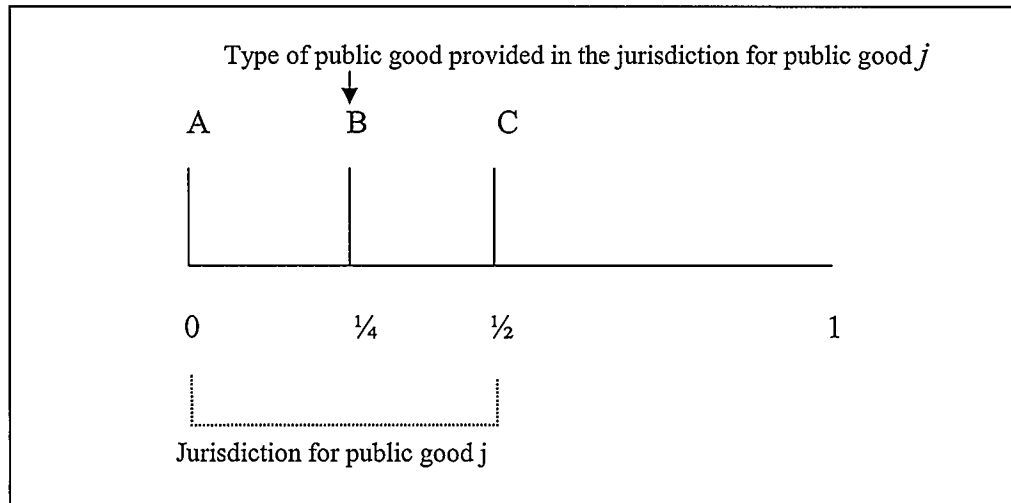
Alesina and Spolaore's (2003) unidimensional spatial model consists of a world that is represented by a line segment of length one with area and individuals uniformly distributed on that segment. There are (G) public goods, indexed by $j=1, \dots, G$, which are available in a continuum of types with each type identified by a point on the segment. If

Midwest to Utah where they evolved as an insular society, hostile to the encroachment of the territorial expansion of the US.

good (j) is located at $\frac{1}{4}$ or equivalently is of type $\frac{1}{4}$ it means that the good is at the midpoint of the first half of the segment.

Figure 3.1 depicts Alesina and Spolaore's example of a jurisdiction that provides the j th public good. Three points on the segment define a jurisdiction for the j th public good: A, B and C with $A < B < C$ and with $A=0$, $B = \frac{1}{4}$, and $C = \frac{1}{2}$. The middle point B indicates where the public good is located; the other two are the borders of that jurisdiction. In this scenario, we can picture Toronto being the middle point B and Thunder Bay being one of the borders or point C.

Figure 3.1 Example of a Jurisdiction



In the model, an individual belongs to only one jurisdiction that provides the j th public good. The individual obtains utility from his consumption of that good, which is equal to his income (y) minus taxes (t_i), and experiences disutility from his distance from where the public good is provided. δ_{ji} denotes the distance between the location of individual i and the location of the j th public good in his j -level jurisdiction. These costs are zero if the individual is located exactly where good (j) is. An individual's utility is;

$$u_i = y - t_i + g - \sum_{j=1}^G \gamma_j \delta_{ji} \quad (4.1)$$

$\gamma_j > 0$ represents the marginal cost of a unit of distance from public good (j). The total utility arising from the consumption of all public goods is given by:

$$g - \sum_{j=1}^G \gamma_j \delta_{ji}$$

Each j th public good's total cost (c_j) within a jurisdiction is given by

$$c_j = F_j + \alpha_j S \quad (4.2)$$

where S is the size of the jurisdiction; F_j is a fixed cost that does not depend on S and $\alpha_j > 0$ is the marginal cost of jurisdiction size. Total taxes in my j -level jurisdiction with borders at A and C equals (c_j) or the total cost,

$$\int_A^C t_i di = c_j \quad (4.3)$$

with the implication that jurisdictions have balanced budgets. Alesina and Spolaore assume that a social planner maximizes a Utilitarian Social Welfare Function, so summing up all individual utilities:

$$SWF = \int_0^1 u_i di = y - \sum_{j=1}^G \left(F_j N_j + \sum_{x=1}^{N_j} \gamma_j S_{jx} + \gamma_j \int_0^1 \delta_{ji} di \right) \quad (4.4)$$

N_j is the number of j -level jurisdictions and S_{jx} is the size of a j -level jurisdiction x where:

$$x = 1, 2, \dots, N_j. \quad (4.6)$$

The size of each jurisdiction is inversely related to the ratio (γ_j/F_j). The optimal jurisdictional size decreases with the marginal cost of distance and increases due to economies of scale in the production of the public good. Thus, the social planner chooses many small jurisdictions for the good with a high ratio of heterogeneous costs relative to economies of scale and a few large jurisdictions for the public goods with the opposite

characteristics. The optimal size of a jurisdiction is then the result of a trade off between economies of scale in the production of goods, services and policies provided by it, distance from the public good and the heterogeneity of the populations. The optimal point in this trade off is generally different for each good, service or policy.

Northern Alienation discussed earlier is a prediction of Alesina and Spolaore's (2003) model. They demonstrate that for a given political jurisdiction, the distribution of benefits among its citizens becomes uneven as those who are closer in preferences and to the centre of the jurisdiction have higher welfare. In the absence of compensating transfers from the centre to the periphery of the jurisdiction, taxpayers located further away from the government have incentive to break up the jurisdiction and redraw borders to reflect regional preferences. In the case of Northwestern Ontario, Thunder Bay is 1375 km away from Toronto the provincial capital of Ontario, while it is only 685 km away from the Manitoba's capital, Winnipeg. It has also been argued that Northwestern Ontarians have more in common socially and economically with Manitobans than they have with southern Ontarians. Therefore based on the assumptions and the model developed above, geographic and social distances, all else being equal, would suggest the existence of gains for Northwestern Ontarians from a Manitoba-Northwestern Ontario union. Working against these forces of secession, however, are the existence of compensatory transfer payments from the south of Ontario to Ontario's North. Whether or not Northwestern Ontarians would vote in favour of secession from Ontario for a Union with Manitoba depends upon whether the utility gains from being closer to the new centre, Winnipeg, and living with Manitoba's policies and public goods instead of Ontario's are large enough to compensate for the loss of transfer payments from southern Ontario.

3.5 The Case for “Mantario”

*Would Northwestern Ontarians Benefit from the Merger with Manitoba?*³⁹

Northwestern Ontario will benefit from being geographically closer to the centre of public policy and goods for Manitoba, Winnipeg, by assumption of Alesina and Spolaore’s model. The transaction cost associated with distance from the centre will be decreased and the Northwest’s political influence will increase. Currently the Northwest of Ontario is represented by three MPPs from the election districts of Kenora-Rainy River, Thunder Bay-Atikokan, and Thunder Bay-Superior North. The Ontario legislator seats 103, which means that the Northwest MPPs represent less than 3 percent of total MPP seats. Using Manitoba’s population per MLA values, the addition of the Northwestern Ontario to Manitoba would increase the number of seats in the Manitoba Legislature by 11 to 68. Northwestern Ontario would have 16 percent of the seats so even if the preferences of the population were not close to Manitoba’s, they would still have considerably more influence in that legislature than in Ontario’s.

One of the biggest potential gains for Northwestern Ontarians would result if Manitoba taxpayers had preferences over public goods and public policies that are closer to those of Northern Ontarians than were those of southern Ontarians. To get an idea of the jurisdictional preferences we can look at different aspects of the demographic and economic factors that characterize Ontario, Manitoba and Northwestern Ontario with respect to the similarity of income distributions, demographic characteristics of the

³⁹ The majority of my calculations are intended to represent the degree of similarity of preferences of populations under consideration as opposed to representing economies of scale in the provision of public goods. For the Northwestern Ontario, Manitoba scenario, is a “preference-based” story as distance from the centre (theoretically) is interpreted as a preference measure.

populations and the expression of preferences as suggested by per capita expenditures and personal tax rates.

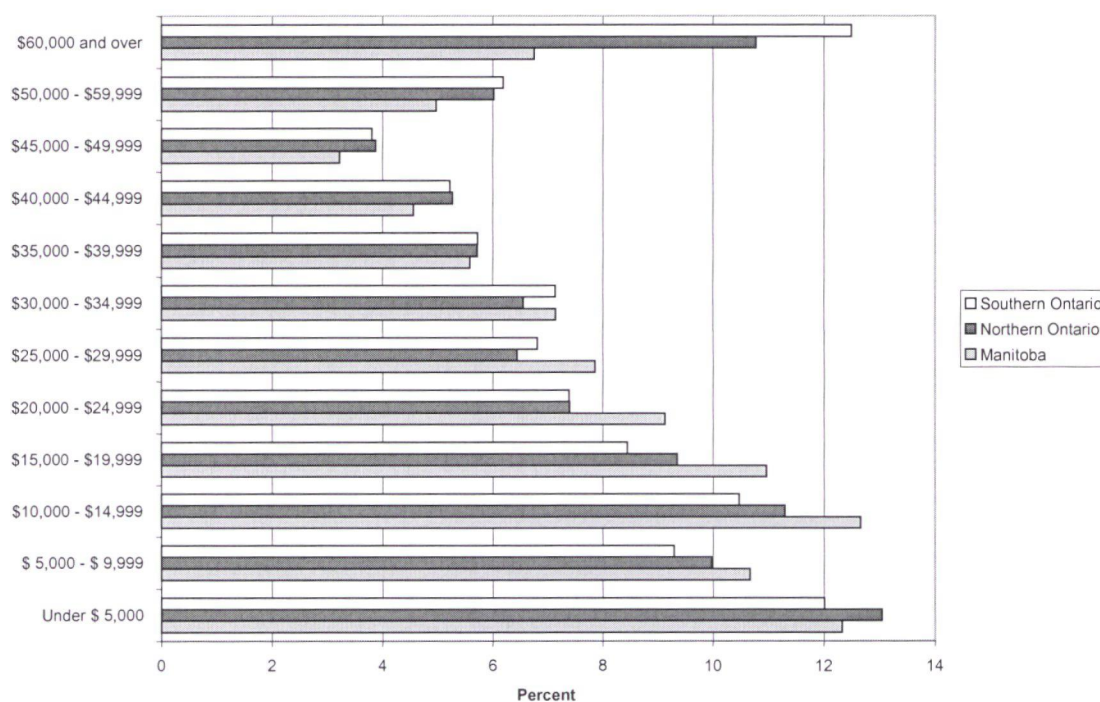
3.5.1 Incomes and Income Distribution

The 2001 Census data indicate that for individuals 15 years and older, 75 percent of income of Northwestern Ontarians comes from employment, 14 percent comes from government transfer payments and 11 percent from other sources. In Manitoba, employment income represents 75 percent of total income while government transfers make up around 13.4 percent. In Ontario, total income from employment is around 79 percent while government transfers represent only 10 percent. This statistic indicates that government transfers for both Manitoba and Northwestern Ontario are more important determinants of total income than when compared to Ontario's values.

Figure 3.2 presents the income distributions before tax for Manitoba, Ontario, and Northwestern Ontario using 2001 Census data. The median income in Northwestern Ontario is \$22,724, \$20,469 in Manitoba and \$24,816 in Ontario. Average incomes in 2001 are \$29,160 in Northwestern Ontario, \$26,416 in Manitoba and \$32,865 in Ontario. Northwestern Ontario has 10.8 percent of its population in the high-income category (the \$60,000 and over category) compared to 6.8 percent for Manitoba.

From Chapter 2, Bolton and Roland (1997) argued that income distributions generate preferences that are expressed through jurisdictional tax structures. In Table 3.1 list the statutory rates for Manitoba and Ontario for 1996 to 2004.

Figure 3.2: Income Distribution Individuals 15 years +



*All income as reported before tax.

Table 3.1: Personal Income Taxes

	1996	1997	1998	1999	2000	2001	2002	2003	2004
Tax on Tax Regime (% of federal tax rate)									
Manitoba	52%	52%	51%	48.50%	47%				
Ontario	58%	49%	45%	40.50%	37.70%				
Tax on Base Regime									
Low rate									
Manitoba						10.90%	10.90%	10.90%	10.90%
Ontario						6.16%	6.05%	6.05%	6.05%
Medium rate									
Manitoba						16.20%	15.40%	14.90%	14%
Ontario						9.22%	9.15%	9.15%	9.15%
High rate									
Manitoba						17.40%	17.40%	17.40%	17.40%
Ontario						11.16%	11.16%	11.16%	11.16%
Income exemption									
Manitoba						\$7,634	\$7,634	\$7,634	\$7,634
Ontario						\$7,412	\$7,634	\$7,756	\$7,927

Manitoba Budget various years

Ontario has lower personal income taxes rates than Manitoba in every category. This is not surprising given the differences in income distribution. In the low tax category, Manitoba has maintained a rate of 10.9 percent while Ontario has been cutting that rate from 6.16 percent in 2001 to 6.05 percent in 2004. The medium rate for Manitoba has dropped from 16.2 percent in 2001 to 14 percent in 2004, while Ontario has cut its rate in 2001 from 9.22 percent to 9.15 percent in 2004. The high income tax categories has seen no change since 2001 for both provinces, but Ontario has a much lower rate of 11.16 percent compared to Manitoba's 17.4 percent. Ontario has also increased its income exemption from \$7,412 to \$7,927, which is higher than Manitoba's rate. The differences in rates, particularly in the high-income brackets, illustrate that with regard to incomes the voters in Ontario prefer lower taxes than do Manitoba's voters.

In terms of incomes and income distributions, Northwestern Ontarians are in between Ontario and Manitoba.⁴⁰ Personal income tax burdens are lower in Ontario than in Manitoba so a union of Manitoba and Northwestern Ontario would result in higher personal taxes paid by Northwestern Ontarians.

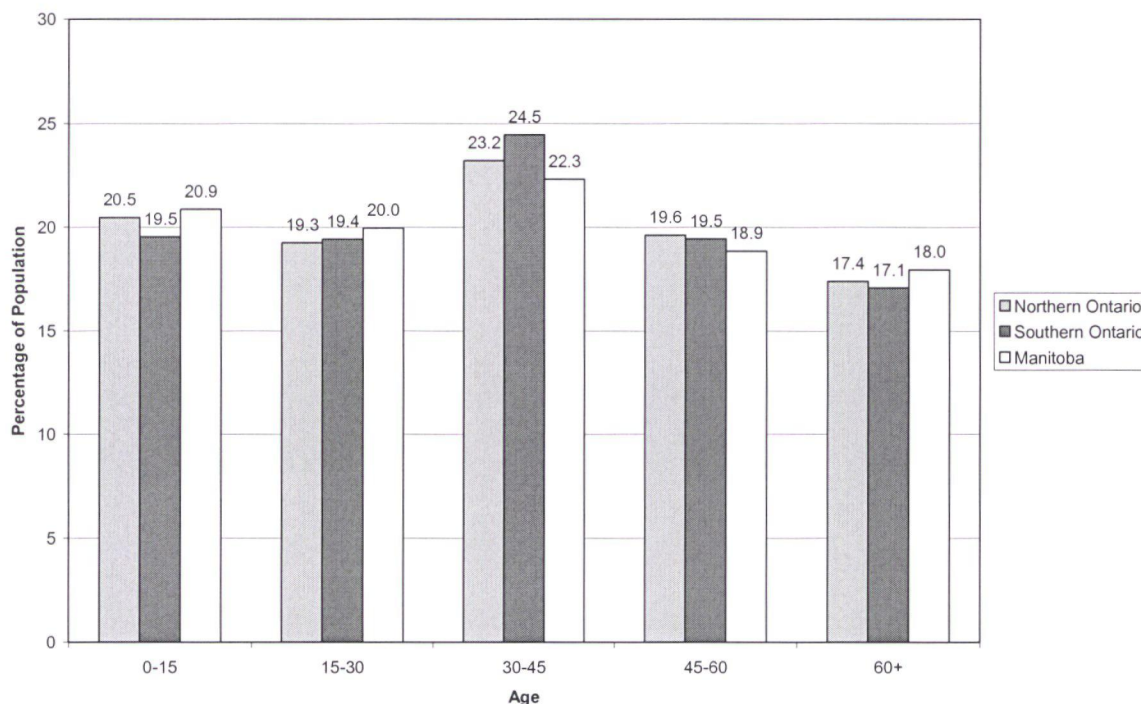
3.5.2 Age Distribution

Jurisdictional preferences for spending on public goods associated with health and education will be reflective of the age distribution of the population. Figure 3.3 shows that the age distributions of populations in Manitoba, Ontario, and Northwestern Ontario were not dramatically different in 2001. If one were to highlight the relevant differences,

⁴⁰ Historically, looking at census data on income distributions for Manitoba, Northwestern Ontario, and Ontario dating back to 1981, the income distributions for the three jurisdictions have followed a similar pattern as those in 2001.

however, Northwestern Ontario and Manitoba have slightly higher dependency ratios (population aged 0 to 15, and over 60 relative to population 16 to 59) which would suggest that those jurisdictions may prefer to see higher spending levels on education and health care than Ontarians.

Figure 3.3: Population Distribution

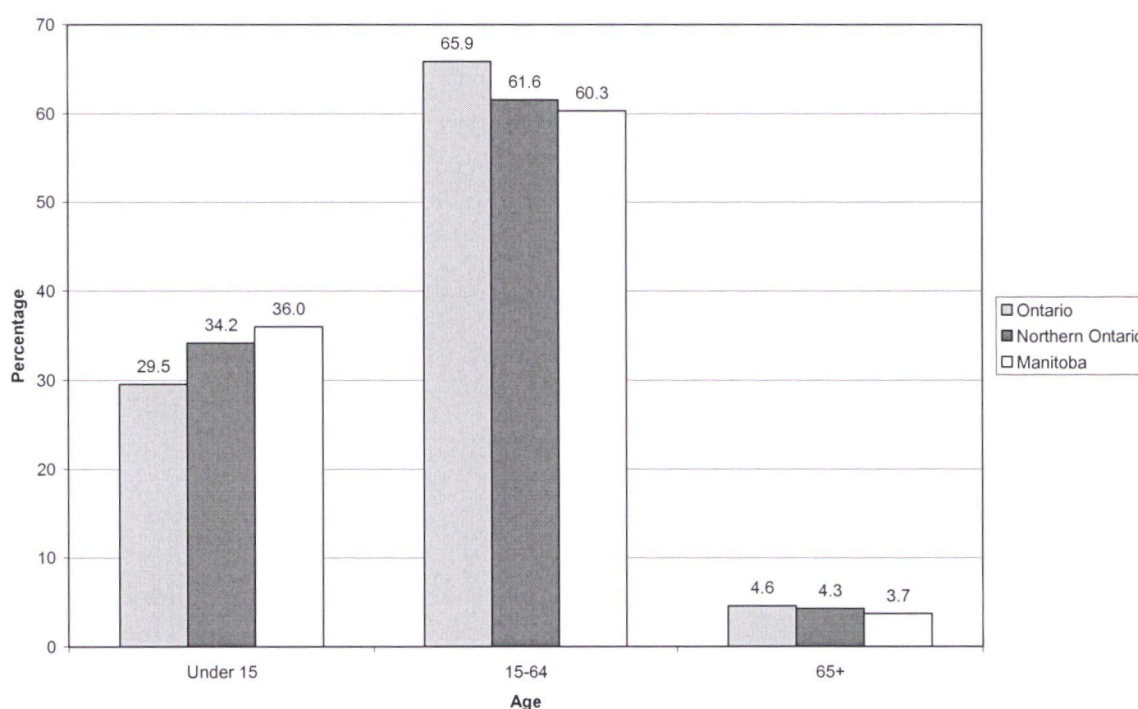


Source: 2001 Census

A demographic characteristic that Manitoba and Northwestern Ontario populations share is the importance of the aboriginal population. Northwestern Ontario's Aboriginal population represents 18 percent of the total population, while in Manitoba; the Aboriginal population represents 14 percent of total population. In contrast, for Ontario as a whole, the aboriginal population represents only 3 percent of total population. The age distribution of the aboriginal population is distinct from the population age distributions shown in Figure 3.4. Figure 3.4 shows that the public spending needs of the aboriginal populations

in Manitoba and Northwestern Ontario are those of a young population as just over a third of those populations are under age 16. It does not seem too contentious to conclude that Northwestern Ontarians would likely find that Manitobans have more understanding and interest in their public goods needs related to their large, young aboriginal population than they receive from Queen's Park.

Figure 3.4: Age Distribution Aboriginal Population



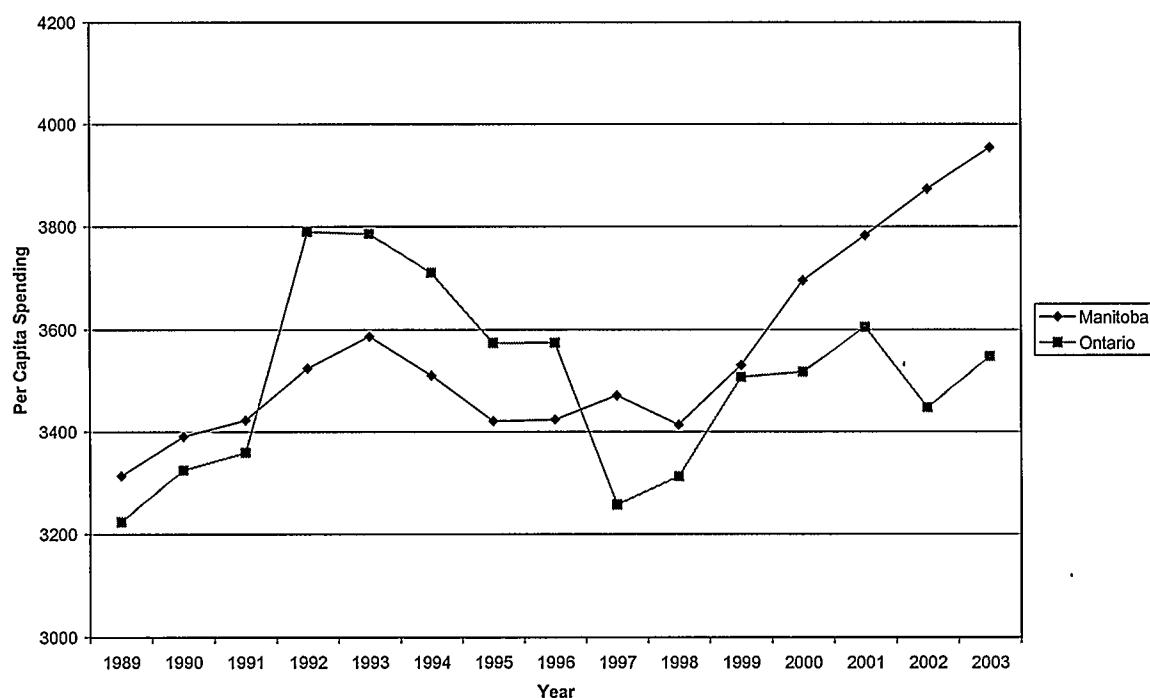
Source: 2001 Census Aboriginal Population Profile

3.5.3 Program Expenditures

The amount a government spends on programs reflects the relative importance of public programs to voters in the jurisdiction. We assume that per capita spending levels for Ontario are reflective of per capita spending in Northwestern Ontario. Figure 3.5 shows per capita program spending (in constant 1992 \$) by the Manitoba and Ontario provincial governments from 1989 to 2003. From 1989 to 1991, Manitoba spent \$72 per capita more

than Ontario. Between 1992 to 1996, Ontario increased spending and spent \$184 more per capita than Manitoba. Since the expenditure cuts associated with the “Mike Harris revolution”, per capita spending in Manitoba has exceeded Ontario’s.⁴¹ Thus, Northwestern Ontarians will need to assess whether they prefer the low tax, low spending policies of Ontario or the higher tax but higher spending policies of Manitoba.

Figure 3.5: Constant 1992 Dollars Per Capita Program Expenditure



Source: CANSIM II table 3850002 and 1992 CPI all items Table 3260001.

Table 3.2 shows per capita spending by program category for Ontario and Manitoba for the fiscal year of 2001. Manitoba spent \$1409 per capita more than Ontario in 2001 but \$671 of that amount was for Manitoba’s higher debt charges so in terms of program spending for current public goods and services, Manitoba spent \$700 more per capita. Perhaps most relevant for Northwestern Ontario, Manitoba spent \$175 more per capita on

⁴¹ Perhaps not surprisingly, this is also the timing of the beginning of the Di Matteo articles in the Thunder

education, \$160 more per capita on Resource Conservation and Industrial Development, \$60 more per capita on Recreation and Culture, and transferred \$150 more to other government subsectors. The Manitoba spending mix would appear to reflect the demands of “Alienated Northerners” suggesting that Manitoba’s preferences are closer to their own than the rest of Ontario.

Table 3.2: Manitoba and Ontario 2001 Per Capita Expenditure by Source		
	Manitoba	Ontario
Total Expenditures	7338.98	5930.30
<i>General Government Services</i>	161.95	80.17
<i>Labour, Employment and Immigration</i>	23.51	7.73
<i>Housing</i>	67.91	129.94
<i>Foreign Affairs and International Assistance</i>	0.00	0.00
<i>Regional Planning and Development</i>	67.91	23.70
<i>Research Establishments</i>	0.87	3.23
<i>General Purpose transfers to Other Government Subsectors</i>	168.91	18.77
<i>Debt Charges</i>	1515.86	845.15
<i>Protection of Persons and Property</i>	296.03	258.70
<i>Transportation and Communication</i>	210.71	180.56
<i>Health</i>	2075.71	2057.87
<i>Social Services</i>	1072.68	1067.16
<i>Education</i>	1255.52	1071.23
<i>Resource Conservation and Industrial Development</i>	286.45	124.42
<i>Environment</i>	46.15	28.62
<i>Recreation and Culture</i>	89.68	33.04

Source: CANSIM II Table 3850002

How does Manitoba pay for its higher expenditure levels? While Manitoba has higher tax rates, Table 3.2 shows that Manitoba generates lower per capita revenues from personal income taxes than Ontario. Perhaps more to the point, Manitoba generated around \$250 more per capita in own source revenues than Ontario but could substantially outspend

Ontario because of federal equalization payments and investment income.⁴² Manitoba receives \$1293.87 more than Ontario from general-purpose transfers from the federal government. Of the general-purpose transfer, \$1094.16 per capita is from equalization payments for Manitoba. Ontario does not receive federal equalization.

Table 3.3: Manitoba and Ontario 2001 Per Capita Revenue by Source		
	Manitoba	Ontario
Total Revenue	7594.09	5932.42
Own Source Revenue	5629.83	5367.46
<i>Income Tax</i>	2016.50	2268.76
Personal Income Tax	1582.03	1642.22
Corporation Income Tax	394.42	618.64
Mining and Logging Taxes	39.18	7.98
<i>Consumption Tax</i>	1526.31	1772.34
General Sales Tax	877.65	1146.82
Alcoholic Beverages and Tobacco Taxes	106.22	81.02
Amusement Taxes	2.61	43.74
Gasoline and Motive Fuel Taxes	195.03	235.09
Liquor Profits	136.70	71.51
Remitted Gaming Profits	207.22	194.24
<i>Property and Related Taxes</i>	296.90	183.71
General Property Taxes	178.49	1.19
Capital Taxes	107.96	116.86
Other Property Related Taxes	10.45	65.74
<i>Other Taxes</i>	370.91	452.34
Payroll Taxes	208.09	293.86
Motor Vehicle Licenses	61.82	81.70
Natural Resource Taxes and Licenses	8.71	0.25
Miscellaneous Taxes	93.16	76.52
<i>Health and Drug Insurance Premiums</i>	0.00	0.00
<i>Contributions to Social Insurance Plans</i>	121.02	209.61
<i>Sales of Goods and Services</i>	157.59	273.90
<i>Investment Income</i>	1132.76	192.79
<i>Other Revenue from Own Sources</i>	8.71	14.01
General Purpose Transfers from Other Government Subsectors	1730.92	437.05
Specific Purpose Transfers from Other Government Subsectors	233.34	127.91

Source: CANSIM 11 table 3850002.

⁴² Investment income is a revenue category that is divided up into four sub-categories, which include natural resource royalties, remitted trading profits, interest income, and other investment incomes. Natural resource royalties include leases of land and royalties paid on extraction.

The amount Manitoba receives in equalization payments is an important factor for the merger scenario with the Northwest of Ontario. Those in Northwest will have to weigh giving up provincial government transfers from the south of Ontario with the chance of becoming part of a “have not” province and receive funding from the federal government. This brings in the concept of the importance that redistribution schemes play in attracting the Northwestern Ontario population to Manitoba. Alesina and Spolaore (2003, 67) conclude that government transfers are a way to compensate voters for being distant from the public good. The irony in this scenario, is that while Northwestern Ontarians would be giving up transfers from southern Ontario that presumably compensate them for distance from the centre, by uniting with Manitoba they will potentially gain greater transfers to the region as well as reducing the distance from the legislative centre. Thus, along with the higher tax burdens and spending levels, Northwestern Ontario voters will have to decide whether the loss of transfer payments from the south of Ontario will be sufficiently compensated by the equalization payments that they would receive as Manitobans.

3.5.4 Northwestern Ontario's Equalization Payments

Manitoba is a “have not” province and receives equalization funding. If merged with Northwestern Ontario, Northwestern Ontarians would receive equalization but the question is how much would it be, and how do those amounts compare to what the north receives from the south of Ontario under the status quo?

As mentioned in Chapter 2, when calculating revenue capacity of an individual province the Department of Finance uses a national average tax rate (not the province's own tax rate) and the commonly measured tax base for the province in each revenue

category of which there are thirty-three (Courchene 2004, 23). A tax base is the sum of taxable activities in each category.⁴³

Equalization calculations for the proposed union of Northwestern Ontario and Manitoba are in Table 3.4 under the column titled “Mantario”. The calculations for Mantario are an approximation based on multiplying the per capita Ontario revenues by the population of Northwestern Ontario and then adding that total to Manitoba’s for each of thirty-three revenue categories. We convert them to a per capita basis by dividing by the combined population of Manitoba and Northwestern Ontario. Table 3.5 shows the equalization entitlements after subtracting revenue categories of Mantario from the Five Province Standard (FPS) column of Table 3.4. To the extent that Northwestern Ontario cannot generate the same public revenues as the south of the province, I interpret the Mantario equalization amount as a lower bound estimate since we have likely overstated the Mantario fiscal capacity.

I estimate Mantario equalization entitlements at \$819 per capita in 2001. With the increase in population and new revenue sources Manitobans will forgo equalization payments of \$275 per capita. When I calculate the per capita debt payments for Mantario, I find that Northern Ontarians would have to pay an additional \$556 per capita on debt charges, which accounts for most of the Mantarian equalization payment. Thus, I believe that the desirability of Mantario for Northwestern Ontarians still depends on whether they prefer Ontario’s low tax, low spending policies or Manitoba’s higher tax, higher spending

⁴³ Because the equalization calculations use a national average tax rate Ontario’s revenues are overstated compared to their own provincial budget and the Financial Management System calculations from the federal government in 2000/01. The reason for the overstated values is that Ontario’s tax rates are on average, lower than the average Canadian tax rate. Manitoba’s tax rates tend to be higher than those average rates; hence, Manitoba’s revenues in Table 4.3 will appear lower than in either its provincial budget or the general rate of the FMS found in Table 4.2

policies. Complicating this matter is the fact that Northwestern Ontarians do not raise enough revenue in the region to finance the level of expenditure that does occur. As such, the gain in equalization from a union with Manitoba needs to be compared to what Northwesterners already receives from the south.

Table 3.4 Fiscal Capacity-Per Capita Yield of Tax Bases at National Average Tax Rates, by Province and Revenue Source, 2000-01(dollars)				
Revenue source	Ontario	Manitoba	Manitrio	FPS
1. Personal income tax revenues	1985.51	1334.83	1445.26	1666.28
2. Business income revenues	606.67	317.26	366.38	508.76
3. Capital tax revenues	159.45	90.03	101.81	130.68
4. General and miscellaneous sales taxes	967.5	802.25	830.3	918.69
5. Tobacco taxes	78.03	60.67	63.62	74.59
6. Gasoline taxes	160.94	158.37	158.81	154.81
7. Diesel fuel taxes	56.9	61.62	60.82	57.17
8. Non-commercial vehicle licenses	54.81	51.14	51.76	54.49
9. Commercial vehicle licenses	34.18	35.85	35.57	32.01
10. Revenues from the sale of alcoholic beverages	140.07	133.64	134.73	136.96
11. Hospital and medical insurance premiums	72.98	67.11	68.11	71.21
12. Race track revenues	2.12	0.59	0.85	1.33
13. Forestry revenues	15.92	14.21	14.5	62.9
14. New oil revenues	0.35	9.31	7.79	16.69
15. Old oil revenues	0.04	2.15	1.79	1.72
16. Heavy oil revenues	0	0	0	5.04
17. Mined oil revenues	0	0	0	0
18. Third tier oil revenues	0	0.73	0.61	4.68
19. Heavy third tier oil revenues	0	0	0	2.7
20. Natural gas revenues	1.68	0	0.29	61.5
21. Sales of Crown leases	0.32	1.57	1.36	14.14
22. Other oil and gas revenues	0.06	0.47	0.4	2.04
23. Mineral resources	19.2	45.77	41.26	19.5
24. Water power rentals	10.84	91.71	77.99	44.4
25. Insurance premium revenues	47.73	41.51	42.57	45.55
26. Payroll taxes	263.61	175.78	190.69	224.53
27. Provincial local property tax revenues	1257.58	953.03	1004.72	1155.3
28. Lottery ticket revenues	68.07	51.44	54.26	68.24
29. Other game of chance revenues	157.98	155.22	155.69	149.86
30. Misc. provincial. Local taxes and revenues	433.33	318.51	338	386.28
31. Shared revenues: offshore activities (NFLD)	0	0	0	0
32. Shared revenues: offshore activities (NS)	0	0	0	0
33. Shared revenues: preferred share div.	4.81	7.26	6.84	4.12
34. Total	6600.66	4982.01	5256.72	6076.18

Each provincial revenue source is calculated using the following formula $t_c(B_i/P_i)$ which is referred to as the provinces fiscal capacity for revenue base for each category - it is the product of the national-average- tax rate (not the province's own tax rate) and the commonly measured tax base for the province.

Table 3.5 Per Capita Equalization Entitlement, 2000-01(dollars)			
Revenue source	Ontario	Manitoba	Manitario
1. Personal income tax revenues	-319.23	331.45	221.02
2. Business income revenues	-97.91	191.50	142.38
3. Capital tax revenues	-28.77	40.65	28.87
4. General and miscellaneous sales taxes	-48.81	116.44	88.39
5. Tobacco taxes	-3.44	13.92	10.97
6. Gasoline taxes	-6.13	-3.56	-4.00
7. Diesel fuel taxes	0.27	-4.45	-3.65
8. Non-commercial vehicle licenses	-0.32	3.35	2.73
9. Commercial vehicle licenses	-2.17	-3.84	-3.56
10. Revenues from the sale of alcoholic beverages	-3.11	3.32	2.23
11. Hospital and medical insurance premiums	-1.77	4.10	3.10
12. Race track revenues	-0.79	0.74	0.48
13. Forestry revenues	46.98	48.69	48.40
14. New oil revenues	16.34	7.38	8.90
15. Old oil revenues	1.68	-0.43	-0.07
16. Heavy oil revenues	5.04	5.04	5.04
17. Mined oil revenues	0.00	0.00	0.00
18. Third tier oil revenues	4.68	3.95	4.07
19. Heavy third tier oil revenues	2.70	2.70	2.70
20. Natural gas revenues	59.82	61.50	61.21
21. Sales of Crown leases	13.82	12.57	12.78
22. Other oil and gas revenues	1.98	1.57	1.64
23. Mineral resources	0.30	-26.27	-21.76
24. Water power rentals	33.56	-47.31	-33.59
25. Insurance premium revenues	-2.18	4.04	2.98
26. Payroll taxes	-39.08	48.75	33.84
27. Provincial local property tax revenues	-102.28	202.27	150.58
28. Lottery ticket revenues	0.17	16.80	13.98
29. Other game of chance revenues	-8.12	-5.36	-5.83
30. Misc. provincial Local taxes and revenues	-47.05	67.77	48.28
31. Shared revenues: offshore activities (NFLD)	0.00	0.00	0.00
32. Shared revenues: offshore activities (NS)	0.00	0.00	0.00
33. Shared revenues: preferred share div.	-0.69	-3.14	-2.72
34. Total	-524.49	1094.16	819.46

3.6 Transfers from the Rest of Ontario to Northwestern Ontario

Mullins (2004) estimates the local tax and public spending flows in Ontario counties and districts to investigate the comparative fiscal burden of urban, suburban, and rural areas. The analysis consists of taking overall government revenue and spending line items for Ontario and allocates them to the 49 counties and districts in the province using Statistics Canada's provincial accounts for Ontario. The county totals are created by summing up the locally allocated tax and spending amounts. Excluding federal taxes and spending that are part of the calculations in Mullins (2004); Mullins calculates the numbers in Table 3.6 for the three northwestern districts of Thunder Bay, Kenora and Rainy River.⁴⁴

Table 3.6: Average Per Capita Revenue and Spending by the Ontario Government, 1999-2001

	Thunder Bay	Rainy River	Kenora	Total
Revenue	5216.76	4703.97	4546.78	4992.10
Spending	6270.71	5789.50	5501.44	6022.89
*Net Lending	1047.33	1085.53	954.66	1026.53

**Net Lending is the amount that the provincial government gives to those counties to compensate for short falls in revenue.*

Table 3.6 shows that the average per capita revenues generated by the Ontario government from 1999 to 2001 from the Northwestern Ontario Districts of interest for this study were \$4992. Per capita expenditures averaged \$6023 per capita over the two-year period. Thus, total provincial transfers into Northwestern Ontario were on average \$1026.53 per capita. Mullins (2004) shows that the north is unable to produce enough revenue to cover total expenditures. The Northwest is reliant on the Rest of Ontario to pay for the full cost of program spending in the region.

Table 3.7 compares the per capita revenue and expenditure rates for Manitoba, Northwestern Ontario, and Ontario for 2001. Northwestern Ontario generates less revenue

per capita than either Manitoba or Ontario, but has more spending per capita than the Ontario average. Manitoba spends more per capita than Northwestern Ontario and the Rest of Ontario. Merging with Manitoba would mean increased spending for the Northwestern districts, but at the cost of increased taxes and debt payments. Since Northwestern Ontario's fiscal capacity seems lower than Manitoba's despite its higher incomes and natural resource revenues, the Manitoba equalization payment calculated above using the average fiscal capacity for Ontario is too low and actual equalization may be closer to what Manitoba actually received in 2001. What Northwestern Ontario lacks are Manitoba's corporate income tax base and investment income.

Table 3.7: Per Capita Spending and Revenue 2000-2001			
	Manitoba	Ontario	Northwestern Ontario
Revenue	7594.09	5932.42	4992.10
Spending	7338.98	5930.30	6022.89

To get a better understanding of government spending in the north I use numbers from the Ontario Department of Finance's community redistribution fund and various school board budgets for the year 2001. Table 3.8 shows the main categories of government transfers. The Table shows that for Northwestern Ontario to maintain the level of funding for health care, social services and education it has to rely on government transfers of \$1143 per capita in 2001. In education, \$893.62 per capita alone comes from government transfers. With regard to health and social service spending \$250 per capita comes from direct transfers from the provincial government. If the Northwest were part of Manitoba, it would give up those grants in place of receiving higher per capita spending

⁴⁴ We thank Mark Mullins for providing these calculations, which were not published in Mullins (2004).

and tax rates. These within Ontario subsidies are directly comparable to the federal equalization payments estimated above.

Table 3.8: Ontario Provincial Government Per Capita Transfers to Northwestern Ontario (2000-2001)	
Elementary and Secondary Education	\$744.93
Post Secondary Education	\$148.69
Community Reinvestment Fund	\$250.00
Total Transfer	\$1,143.61

Source: Finance Department CRF calculations and various school board budgets

In terms of transfers, one of the main conclusions from the previous section, which used per capita levels in Ontario to represent an average voter in the north, was that equalization payments would be a major benefit to those living in the north. However, Mullins (2004) calculates the South's transfer to the Northwest being \$1027 per capita in 2001, and our calculations, which show a transfer of \$1143.61 in 2001 to support Northwestern public spending by the provincial government. If the Northwest chooses to secede from Ontario and join Manitoba they would gain \$819 to \$1094 per capita in equalization payments, which it turns out, may be roughly equal to what they receive from southern Ontario already. From this perspective, gaining federal equalization payments should be seen as irrelevant to the evaluation of the desirability of a union with Manitoba.

3.6 Conclusions

Whether a merger of Northern Ontario and Manitoba makes sense depends upon the cost and benefits associated with a union of the two regions and for the jurisdiction that would be left behind. If Manitoba unites with northwestern Ontario then it would be taking on a jurisdiction that is unable to support its current lower levels of spending. This

suggests that Manitoba's concerns from the 1880s that Northwestern Ontario would be an administrative and fiscal burden are still valid today. At the same time, Manitoba will potentially gain the economic benefits associated with a larger province such as greater economies of scale in the provision of public provided goods and services, a larger provincial "home" market that arises from the elimination of inter-provincial trade barriers and the internalization of fiscal externalities between Manitoba and Northwestern Ontario. Northwestern Ontario in seceding from Ontario would not gain these benefits, as it would be uniting with a smaller jurisdiction. Manitoba will see gains from the merger by offsetting some of its debt payments to the people of Northwestern Ontarians, gaining greater natural resource revenues and by having a port on Lake Superior.⁴⁵

With the merger, Ontario would be much smaller in land area, marginally smaller in population and slightly diminished in public revenues due to the loss of natural resource revenues from Northwestern Ontario. In addition, Mullins (2004) demonstrates that spending in the north of the province is subsidized by southern Ontario, primarily Toronto, so being relieved of responsibility for Northwestern Ontario results in more public resources being available for the "Rest of Ontario". Therefore, unless "size matters" to southern Ontarians, it would appear that uniting Northwestern Ontario and Manitoba would provide a clear fiscal benefit for the "Rest of Ontario".

⁴⁵ Having access to Lake Superior and access to the Atlantic Ocean by means other than Churchill Port is important because of several factors. The Port of Thunder Bay and the Seaway System operate 24 hours a day, seven days a week, from the end of March through to late-December. The Churchill Port is available for shipping and receiving ocean vessels only from July until November. Canadian National and Canadian Pacific Railways, as well as major Canadian trucking companies serve Thunder Bay's port facilities while Churchill maintains its own northern rail lines, which is costly and less efficient. The Port of Thunder Bay has nine-grain terminals with a total storage capacity of 1.4 million tonnes. Loading rates at the terminals range from 1,000 to 3,400 tonnes/hour. Churchill on the other hand has only a 140,000-tonne elevator Shipping Capacity and operates at maximum 1,623 tonnes per hour.

The North of Ontario would see benefit from some aspects of a merger even though its demographics and income distributions lie somewhere in-between that of Ontario and Manitoba, hence it is a convex combination of the two. Those benefits include being geographically closer to the provincial capital of Winnipeg as opposed to Toronto, hence deriving greater utility from publicly provided goods and services. They would also benefit from increased influence in the Legislature. The north would also benefit from increased spending on many government programs. In the end, the answer to the question as to whether it is better to be a Northwestern Ontarian or an Eastern Manitoban comes down to whether voters in the Kenora, Thunder Bay and Rainy River Census districts prefer to pay higher taxes for higher spending levels, or to live with low taxes and low but subsidized spending levels.

CHAPTER FOUR: CONCLUSION

The purpose of this thesis was to determine if a political union between Manitoba and Northwestern Ontario and a provincial merger of Manitoba and Saskatchewan would be beneficial for the populations in these regions. To understand how the welfare of the voters will change I incorporated Alesina and Spolaore's (1997 & 2003) theory on optimal policy areas that included the potential economic benefits of a larger political jurisdiction versus the loss of heterogeneous preferences for publicly provided goods and services.⁴⁶ I then created a cost and benefit analysis for the two scenarios: the first a political union between Manitoba and Saskatchewan and the second a union of Northwestern Ontario and Manitoba.

For the Saskatchewan and Manitoba union I created a scenario in which Manitoba had won its claim over the region from a bid it made in 1901. The purpose was to determine if the voters in both regions would be better off today under a single political entity. What I found was that this merger would be beneficial for both voters despite losing some heterogeneous preferences for public policies and goods. The benefits ranged from increased economies of scale in the administration of public policies and goods, internalizing fiscal externalities between the two provinces, greater economic stability for Saskatchewan economy and lower inter-provincial trade barriers. Some specific benefits to Saskatchewan under a Manitoba tax and spend system included increased equalization payments, lower variances in per capita GDP values, spreading the cost of financing natural

⁴⁶ The majority of my calculations are intended to represent the degree of similarity of preferences of populations under consideration as opposed to representing economies of scale in the provision of public goods.

resource and industrial development, increased spending on government programs and joining a jurisdiction that has homogenous preferences with respect to publicly provided goods and services. For Manitoba, I showed that benefits from a union would include increased natural resource revenues, greater per capita GDP values and the ability to offset its debt charges to the residents of Saskatchewan, while at the same time maintaining its preferences for publicly provided goods and services.

For the Manitoba and Northwestern Ontario political union I found that Northwestern Ontario residents would benefit from increased political influence, as their representation in the Manitoba legislature would be sufficiently higher than what it has in Queen's Park. I also determined that the North would benefit from increased program expenditures on health and education that is more representative of their own preferences and from being closer to the centre of public policies in Winnipeg, which is a major component of Alesina and Spolaore's (2003) optimal policy area theory. With respect to specific transfers, the Northwest of Ontario receives approximately \$1000 per capita from the south of Ontario, which from my calculations would be equivalent to the transfers they would receive under a Manitoba system. The decision then to secede from Ontario for the northern residence would come down to whether they would be willing to give up the low tax and spend policy mix of Southern Ontario for a higher tax and spend policy mix of Manitoba.

Ultimately, the decision to enter any new provincial arrangement will come down to the individual voters whom will have to decide if change is in their best interest. Without their support, any merger scenario no matter how beneficial in theory will remain just that, a theory.

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