REVENUE SHARING

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It seems to me therefore that we need to face up to the question that is known in my trade as Fiscal Federalism, that is, how is money going to be distributed by the federal government out of its so- called surplus, either to people or the States, or localities? When we look at this issue, which is definitely a Georgist issue, we'll find interestingly enough that a lot of economists have gotten there first. Many of these are Canadian economists, and without exception they talk about rent. They talk about rich provinces and poor provinces, and the rich provinces are those that have resource rents. And when they say rent they are not talking about Frank Sinatra's voice, or Bridget Bardot's figure. They're talking about the income of natural resources. Now it's not just a question of distribution here... but a whole question of whether a growth oriented policy will sell at the local level.

The reason it's so hard to sell growth policies at the local level today in the United States is very much due to the fact that the United States federal government taxes people and it gives subventions to landlords. So the landlords can get the subventions without having the people. So who needs people? That's it in a nutshell. We need to reverse that, I think, if we're going to be able to make Georgism work at the local level.

Cannan's Law

The last time I discussed this subject was in Las Vegas before a tax group. I started out by saying 'I hope there are no Canadians here!' It would be vain to say that to this group, so I'll say I hope there are no sober Canadians here, at least none who possess a high degree of expertise on this subject, because I may have to skip over some of the high spots. I lay some claim to being Canadian myself, I should say. I have two children who have dual citizenship because they originated in Canada, or possibly three children depending on where you stand on the right-to-life controversy. But at any rate I would like to emphasize that the Canadian system of revenue distribution, fiscal sharing, or equalization as we call it in Canada, is much more based on correct principle than the one you find in the United States. By 'correct principles' I mean the ones I just enunciated. At any rate, let's begin by looking at the similarities between the federal systems in the United States and Canada. In both countries we find something called 'vertical balancing' which means that the senior governments send money to the junior governments. We find also something called 'horizontal balancing' which means that the payments are made more to the poorer governments, those that are poorer on a per capita basis, than to richer ones. We have the principle that the Crown may not tax the Crown. We've an economic principle, which I'll call Cannan's Law. The cannan here is not a weapon, but an economist of very little note, Edwin Cannan, who however did make one very important point. He made it in the period when the single tax in England was on everyone's lips. And if you read the Economic Journal, the stuffy, establishmentarian journal of the economics profession, it's full of criticisms of the Single Tax. No respectable English economist could fail to write at least one article criticizing the Single Tax. And Edwin Cannan criticized it in the following way. He said, in effect, local taxation of land makes private land an open range. His idea was something like Garret Hardin's idea of the 'tragedy of the commons'. Or I should put it the other way around because Hardin came later and he obviously borrowed from those who wrote earlier.

But the general idea is, you may think you have tenure control of land but if the municipal government can tax that land and use that money to finance public welfare services, public education and other things that are open to all comers, then you will end up with an uneconomical distribution of population. You'll have more people clustered around the honey pot in places like Vancouver where there's a lot of economic rent per capita than you will in areas with less economic rent per capita.

So we found in the mining country of Northern Minnesota back in the days when iron ore was worth something. They had the best schools in the mid-west there at the iron mines and all those Finnish miners' kids got first rate educations. You run into them everywhere now: they've become an awful nuisance— very well educated though.

All this tends to distort the economical allocation of population and also to reduce the incentive of local government to provide public services that are open to all comers. That I refer to as Cannan's Law. And you find that, of course, in all countries. It's an economic law.

Hammer's Law

At the same time, in both countries you find something I will call Hammer's Law. This is not a carpenter's tool but again the name of a man, an economist in Missouri, who observed in 1935 that if you compared population to land values in the different counties of his State (in the very poor counties of the Ozarks the land was hard scrabble land of very little value, with the very rich lands in the north-western part of the State, which resembles Iowa) you found that the population density was much greater on the very poor land of the Ozarks than it was on the very rich land of the northwest. He took this to be a sign of market failure. Three years later the Establishment got to him and he said, well maybe I can rationalize this after all. But actually it's the American counterpart of the familiar pattern in the less developed countries where the flat land, the good flat land, is used for grazing cattle at a very low level of productivity, and the mass of the people in their minafundia are found on the hard scrabble land on the steep hill sides. I call it Hammer's Law of Market Failure where, because of the operation of the land market, whose evils we are so familiar (continued on page 8)

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with, you do not get the population distributed over the land in an economically rational manner, because of the tendency of the better land to be agglomerated into large holdings which are not optimumly developed. Comparing States, this results in the fact that a poor State like West Virginia has large numbers of people living on very poor land, and a wealthy State like Iowa (speaking now just of farming) has a small number of people on very good land. And this results in inter-jurisdictional equalization problems. In Canada this takes the form of the Maritime provinces in the east being densely populated like the Ozarks, and the wealthier, in a resource sense, western provinces being relatively underpopulated.

Now another similarity to the two countries is that the subventions that do go from the federal government to the provinces in Canada (and you find a similar thing in the United States) do not come from the richer provinces. They come instead from the general fund, the general taxpayer. There is in other words more vertical balancing than there is horizontal balancing (horizontal balancing you remember means equalization among the different jurisdictions). It's a little like what somebody said about foreign aid. 'Foreign aid is a device by which poor people in rich countries are taxed to subsidize rich people in poor countries.'

We'll see that equalization in most countries works something like that; that is, in addition to this inter-provincial equalization, there's a tax shift involved where local sources of taxation like the property tax are being displaced by the federal income tax. I suppose Ferdinand Marcos would be a splendid example of the kind of person I was talking about in the poor country and in West Virginia you have all these coal companies whose owners live in Palm Beach, whose shareholders live in Palm Beach and such places, who benefit from an inter-state equalization that benefits West Virginia. Well these are similarities. Now differences.

Amount of Equalization

I learned that if you want to get along in this country you have to emphasize the differences. If there's anything a Canadian fears, it's not the hostility of the United States, it's the embrace. When Canadians say 'Vive la difference' they are not being male chauvinists, just regular chauvinists. So, let's look at the differences.

The federal aid in Canada goes to provinces, whereas in the United States it goes to specific cities. The U.S. Congressman likes to have his fingerprint, as they say, on every dollar that goes from Washington. The Canadian provinces are much larger and stronger, and fewer than the American States. There is much more horizontal balancing among provinces in Canada than there is among States in the United States. The Maritimes for instance get about 50% of their provincial revenues from equalization entitlements. Fifty percent. Nothing in the United States matches that. In fact, if you look at the U.S. Constitution, it's quite specifically planned to prevent that sort of thing. Equalization is not what the Founding Fathers had in mind.

On the contrary, there is a provision which you may be familiar with which says that direct taxes will be apportioned among the States according to their respective populations. So in the States the idea has been: Tax the States according to their population and then give the money back according to political power. In the United States Senate it means that the smallest State has just as much clout as the biggest State or would have if their senators weren't so merchantable. (I mean, in California when we need something we just look to Nevada or one of those places for a Senator who is having difficulty raising funds for his next election. But that's another story.)

Another difference is that the Crown provincial owns a very large share of the public domain, especially in the western provinces. I wouldn't want to overstate that difference. Alaska after all owns Prudhoe Bay and California owns three miles offshore— that includes the Wilmington Basin off Long Beach. You get a lot of State revenue from those things. But it doesn't really compare with 94% of British Columbia being owned by the Crown provincial. That makes a difference. We'll see that part of the game in Canada is the effort on the part of the federal government to prevent the provinces from fully extracting that economic rent from their Crown lands for public purposes.

Surpluses

Another difference is that Canadians are much more restrained and self-controlled than Americans, and therefore they've managed to build up enormous surpluses. There's something called the Alberta Heritage Fund, where instead of just blowing that money as it came in, they squirreled it away and saved it up and it's now considered I believe the largest single block of available capital in North America: \$6-10 billion (I lost sight of the figures somewhere as they were going up). But can you imagine Howard Jarvis in Alberta with his beady eyes on the Alberta Heritage Fund? Why, when we built up a surplus of just a few million dollars in Sacramento Howard Jarvis climbed all over everybody, 'We've got to cut taxes.' And that's when we got 'Proposition 13'. Saskatchewan has a Heritage Fund too, quite modest compared with Alberta's, but worth mentioning.

Then of course Canada has a high degree of separatism to overcome, for a variety of reasons which I'll let Canadians speak to. You're familiar of course with some of those problems.

Another difference is that populism is much stronger in Canada, western Canada especially, than it is in the United States— both left wing and right wing populism. We are now under the aegis of a government of right-wing populists called the Social Credit Party. Although the name sounds rather left-wingish, the party obviously isn't. And Bob Williams represents a left-wing populist party.
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Even the Conservatives are called 'Progressive' Conservatives in Alberta, and they collect a large amount of economic rent, more in fact than anyone else.

Shared Rent

But the most delightful distinction about Canadians is the strong and explicit recognition among almost everyone, even if he's an economist, who discusses this subject, that different resource endowments are the basis of inter-provincial differences. Equalization in Canadian politics means sharing the economic rent. Everybody talks that way. Canadian economists even when they come to the States talk that way. Just as though rent were a permissible word in polite discourse. It's very refreshing. However there's a very selective attitude towards rent— towards what rents are shareable, I should say. Rents from oil and gas are fair game. Forest revenues are fair game. Mineral revenues of other kinds are fair game. Water power is fair game. But now how about the rents that are generated by the valuable lands of Montreal, or Toronto, or some of those other big and powerful cities in the east? They are not fair game. As a matter of fact, if you pore through the fine print of the equalization law, which I did on the airplane, you find the most interesting exception to what's included in the formula. I'll explain the formula to you in a moment if you are still awake.

The formula says that the greater the capacity to raise taxes that a province enjoys, the less will be its equalization payment. And various potential tax bases are included in this formula. And one of those is the property tax. But then you look at the fine print and only the improvements are included. The land is specifically excluded. Very peculiar. In the formula as it's commonly printed you don't see that exclusion; it's only in the footnote. But in the footnote it says 'Instead of the value of land we will substitute the gross provincial product.' Of course, all right thinking people know that land value is in direct proportion to the growth of the provincial product. Or do they? I always thought that was the product of other inputs. What it means is that if a province has a great deal of valuable land which is not being used to a highest and best use, that valuable land will not be included in its potential tax base, and it can continue to get subventions from the federal government. Whereas on the other hand if its potential tax base includes oil and gas, then the revenues that it receives from that, or the ability it has to receive revenues from that, is counted against it in the sharing formula. So this is a very peculiar sort of rent sharing. Some rents are shared and others are not. You might even call it a conspiracy against Alberta. I'm sure that's the way they look at it.

Now another difference is the high degree of foreign ownership. Actually there's no higher degree of absentee ownership in Canada than there is in the United States but it is much more visible because it's international absentee ownership, whereas our absentee owners live in some other corner of the United States, at least some of them do, or in Canada — we have quite a few of them. Of course Hong Kong, Belgium, you name it. This high degree of absentee ownership, as Bob Williams more than hinted this morning, is one of the reasons for the success of the populist parties. They recognize property ownership is an alien phenomenon in some considerable measure and therefore a legitimate target for attack. Some economists say that the ideal taxpayer is a non-resident alien. In the case of these foreign owned resources you're getting pretty close.

Sharing Formula

Now another thing about Canada is that it is a net exporter of these resources which are being shared and, because of this, price control is a major mechanism for sharing the rents. In short, the price of Alberta oil is being held down below free market levels and thus that economic rent, in part, is being shared with the consumers in the eastern part of the country. This works out well, coupled with a phenomenon that might be called negative dumping. (Dumping is when you sell things overseas for less than you sell them at home.) Canada is more rational, they sell them for more, especially in the United States. They even have export duty on oil. Of course if United States puts an import duty on, that's not fair.

Another characteristic is eastern population dominance. Alberta and British Columbia have the resources of Texas and California, without the votes, which makes them more vulnerable of course.

Now let's look at the sharing formula. The sharing formula in Canada is essentially based on population and potential tax base. And it can be made to look very complicated but I think I've boiled it down to its essence. You take a province's percentage of the population of Canada, and then you take the percentage of the tax base that it has, subtract that and that gives you another percentage. And then you multiply that times the total tax revenue that's collected throughout Canada from that tax source, and then you pay them that amount out of the provincial treasury. Let's give an example here. Let's say Alberta has, what, 7% of the population (don't make a liar out of me now for a percentage point) — this is only for illustration. Say it has 7% of the population and it has 85% of the oil and gas base. Well, you subtract 85% from 7%, you get 78%, minus 78%. Very important, minus 78%. And then you multiply that times the total amount of money that's collected by all the provinces from oil and gas, and well, what that means in effect is that Alberta doesn't get any money from the federal government. Now if it had worked out the other way, Say Prince Edward Island, and again these are hypothetical figures, (although I've got the real figures in here, but you don't want me to take the time to look them up), say it's got 8% of the population and 4% of the tax base, Then you subtract the 4 from the 8 and you get 4% and you multiply that times all the money that's collected from this tax base, and hypothetically say we're talking about oil and gas. Then 4% of that tax base is paid from Ottawa to Prince Edward Island to help them run their government. That is basically the equalization formula. But you do it tax by tax, then you add them all up. (continued on p. 10)

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Now the way this works is: Prince Edward Island gets paid some money because their equalization number came up positive. But if it comes out negative, as in the case of Alberta, that doesn't mean that they have to pay any money to Ottawa. It's strictly a one-way street. So who does pay this? Well, it's the general taxpayer. And that's what I meant of course when I said that this is a system where poor people in rich provinces subsidize rich people in poor provinces. But let me get back to that in a moment. Now it helps us understand this if we look at the impact of the oil price revolution on this formula because it was originally set up before the oil price revolution. And then when that occurred it naturally changed the quantities.

Actually the difference in per capita income is not very great, personal income that is, as reported for tax purposes. The difference between Alberta and almost any other province in terms of oil revenues per capita is extremely great. So that's where most of the interprovincial differences come from, and therefore that's what triggers off most of the payments.

When the oil price revolution came it meant of course the oil rich provinces got a lot more money out of oil. The royalties went up. Leasehold sales brought more money, there was more profit from Crown corporations, which is a form of royalty as Bob Williams explained this morning. They also levy taxes on the industries in the normal way. All this increased the payments that were due to the have-not provinces, without increasing the contributions from the have provinces. Because, remember, this thing just works in one way. So the median taxpayer in Ontario got soaked because he, and median taxpayers everywhere who paid the federal tax bills, were called upon to increase their payments to the federal government so that the federal government could pay more money to the poor provinces.

Royalties

The next episode in this drama might be called 'the Empire strikes back', with John Turner as Darth Vader. This was back in '74 or so. He said, since these pesky western provinces are collecting so much economic rent from their Crown lands by raising their royalties and going up with the market, what we are now going to do is to fool them. We are going to say that these royalties are not deductibles for federal income tax purposes. And since all the provincial income taxes are piggyback on the federal tax, or most of them, that also went for provincial income tax purposes. Thus in effect the provinces were penalized for this effort to collect economic rent at the provincial level. This had two objectives. The good reason and the obvious reason was to protect the federal revenues. But the subtler one, I think, was one of protecting the major rent barons by assuring that the provinces would not get carried away with raising their royalties. In effect, the provincial governments were being penalized by the federal government for raising royalties. And although in the short run this obviously damaged the lessees and they screamed bloody murder, in the not so long run it forced the provinces to back off on their royalties and it certainly forced them to sell their leaseholds for lower prices in the future. Those that hadn't yet been sold because the anticipation that the royalties would not be deductible. So as it was viewed in the western provinces, and I think correctly, this was an attempt on the part of the government in Ottawa to protect the absentee owners of western resources from provincial populism.

It must not be forgotten that John Turner got his training with the Bechtel Corporation, just like George Schultz, or perhaps with him.

It was at this time I think that the profit made by the British Columbia Petroleum Corporation that exported gas and extracted economic rent on the pipeline — that was recognized as a royalty and was not deductible. Price control of oil was made very stringent and the export tax on oil was imposed at a high level. Well, in that wonderful Canadian way, there was a compromise. There's always a compromise. The compromise here that affected Alberta especially was that the weight of oil in the equalisation formula was reduced in that the only revenues that were counted in the formula were revenues that were taken for current use, and when they put money into the Alberta Heritage Fund that wasn't counted. And that I suppose helps account for the build up of the Heritage Fund.

The conclusion of all this is that the Canadian system is really better in terms of its Georgist implications because the payments to the provinces, with all the faults that I've described, are essentially based on population. Population is in the formula. And if you compare this with the way things are done in the States, population plays a very minor role in the formula for equalization payments in the United States.

What To Do

Now, how should it be done? Well, there's a well known Georgist economist who figured this out a long time ago and wrote an article about it. His name is Colin Clark. There are two Colin Clarks extant. There's one in Vancouver, who is a Marxist mathematician turned resource economist, who's written some very interesting things, and I wouldn't criticize him for the world, especially if he's here. But he's not the one I'm referring to. The other one was a premature Arthur Laffer who wrote about 20 years ago that once a government took 25% of GNP, that was an upper limit on taxation. And he made a great name for himself writing that, and it's probably not true, but that's how he became famous. But aside from becoming famous, he's a very good Georgist economist. He came up with a plan for collecting economic rent at the federal level, and he said what we really should do, and this I think is the ultimate equalization payment, is we should classify local jurisdictions according to land value per capita, and those that have the least land value per capita, we'll leave all of that land value for them to use for local purposes. But then we will graduate the federal land tax according to the amount of land value per capita in the jurisdiction, (continued on page 11)

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and thus we will have a federal tax that automatically achieves inter-regional equity, without all this razzmatazz that I've been describing about inter-regional equalization payments.

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