

## Notes

- 1** All figures are presented in 1997 dollars. Note that the real GDP figures are provided by Statistics Canada using a more detailed and comprehensive deflator series than the commonly used Consumer Price Index (CPI).
- 2** Real GDP values from the United States are provided in 2000 dollars while Statistics Canada's real GDP series is provided in 1997 dollars. The simplest manner in which to present the combined rankings for Canada and the United States, given the scope of this paper, was to present 2000 nominal per-capita GDP values. It should be noted that this poses a problem in terms of over-estimating per-capita GDP in jurisdictions like Alberta and Alaska, which benefited from a spike in oil and gas prices.
- 3** Note that had actual exchange been used, the differences between the US states and Canadian provinces would have been even larger than they are using the PPP exchange rate.
- 4** The Task Force on Competitiveness, Productivity, & Economic Progress (2002) reached a similar conclusion about Ontario's income performance (measured as per-capita GDP) in comparison to that of a select group of US states.
- 5** Similarly, Bartel (1999) found that public-sector enterprises are inefficient because of soft loans.
- 6** For a discussion of productivity, see Law 2000.
- 7** Bartel (1999) argues that public-sector enterprises that have been shielded from import competition are inferior performers.
- 8** Mueller found that the premium was highest for federal employees followed by local and provincial government employees. He argued that determining the level of government where the premiums are the highest has important implications for public policy. In this case, cutting spending at the federal level would be more useful than cutting spending at the provincial and local level because it is at the federal level that the wage premiums are the highest (Mueller 2000).
- 9** The more narrowly defined public sector (definition more commonly used in Canada) increased 30.4% between 1981 and 1991, increasing from 618,891 to 806,847.
- 10** Another method by which to measure the relative size of the public sector is comparing it with population. According to this measure, Ontario still maintains the smallest public sector, with 6.4% of the population employed. For brevity, this study uses public sector as a percent of total employment exclusively as it is a more accurate measure of public sector activity in the labour market.
- 11** Kuhn (1998) came to similar conclusions, arguing that unions raised wages by 15% in Canada and the United States. This reduced corporate profits and, ultimately, impeded re-investment.
- 12** Studies have found rather wide variation across industries with respect to unionization and productivity: see Clark 1984; Hirsch 1991a; and Hirsch 1997. For industry-specific studies, see Allen 1986a and 1986b; Clark 1980a and 1980b; and Mitchell and Stone 1992.
- 13** Connolly et al. (1986) found that unionization decreased the returns to, and levels of, investment in research and development. This, they argue, has negative implications for economic efficiency and economic growth in the long run.
- 14** Fallick et al. (1999) found that union certification reduced a firm's ratio of investment to capital by 0.04%, a significant amount, the following year.
- 15** There is an important dichotomy, outside the focus of this paper, between unionization in the private sector and in the public sector. That is, unionization rates in the private-market economy range from a low of 8.8% in Prince Edward Island (2001) to a high of 27.7% in Quebec. The unionization rates for the public sector are drastically higher, ranging from a low of 70.1% in Ontario to 81.4% in Quebec. Note also that both Ontario and Alberta rank low on both

private-sector and public-sector unionization rates while Quebec ranks high on both.

- 16** See De Long and Summers 1990.
- 17** For a discussion of the link between productivity and wages (income), see The Task Force on Competitiveness, Productivity, & Economic Progress (2002).
- 18** There are essentially two ways in which to look at business investment, formally referred to as business capital formation. The first is to look simply at the gross or total amount of investment undertaken by business. This is by far the most easily accessible data. It does, however, miss an important aspect of business investment, depreciation. Gross business investment fails to account for the depletion of previous business investment in the form of depreciated assets such as plants, machinery, and equipment. A more accurate measure and the one employed by this study is to examine net capital formation by business. In other words, this study looks at the amount of investment made by business after accounting for the depreciation of existing business assets.
- 19** The measure employed for the Ontario-US comparison is a more narrow definition of business investment that includes only machinery and equipment.
- 20** The *Investment Managers Survey* is a quarterly survey investigating the opinions and views of investment and pension fund managers. Respondents surveyed in 2002 managed in excess of \$330 billion in assets.
- 21** Scully further concluded that the excess aggregate tax burden (beyond the optimal) had resulted in roughly \$30 trillion in lost output in the United States between 1949 and 1989 (Scully 1995).
- 22** It is interesting that L. Jay Helms investigated the effect of government expenditures on growth in the US states. Helms found that states that increased taxes or fees to finance transfers experienced reduced growth in state income (Helms 1985).
- 23** In OECD countries, less than one fifth of all government expenditure is allocated to programs such as education, infrastructure, and R&D, which are deemed to have positive growth effects, while the rate in many developing countries is greater than 50%. Thus, over 80% of government expenditure in the rich countries of the OECD is spent on programs that do not have any positive effects on economic growth (Folster and Henrekson 2001).
- 24** They also note that there are critical functions provided by government and that the composition of government activities are equally as important as the aggregate size of government.
- 25** The observed effects of increases in government spending were even more pronounced when the increases occurred in the government wage bill: an increase of one percentage point in government spending on salaries and wages resulted in a decrease in the ratio of investment to GDP of 0.48 percentage points and 2.56 percentage points cumulatively over five years.
- 26** Government financial reports are based upon different accounting and reporting procedures. For example, one government may report on a cash basis while another may use the accrual approach. Statistics Canada's Financial Management System (FMS) corrects data for this and many other jurisdictional differences and, thus, provides comparable, uniform data.
- 27** Note that statistics relating to government spending, taxation, and fiscal balance are based on government fiscal years, April 1 to March 31. The periods are referred to as split years and written, e.g., "2000/01." This means that the nine months of the fiscal period from April 1 to December 31 fell in 2000 while the three months from January 1 to March 31 fell in 2001.
- 28** It is interesting to note that the Fraser Institute's 1997 study of Ontario's public policy, *The Harris Government: A Mid-Term Review*, recommended freezing nominal government spending at the 1997/98 level (\$54.3 billion) in order to provide for a more rapid decline in the size of government as a percentage of the economy and permit tax relief on a greater scale (Law et al. 1997).
- 29** A consistent time series for consolidated government spending is limited to the period after 1989/90.
- 30** Alberta recorded the largest average decline of any province in year-over-year changes in real consolidated spending over this time period.
- 31** This is the case for Canada and the United States. Spending per capita on its citizens by the United

States is almost as great as that of Canada but it consumes a much smaller portion of its economy.

- 32** There is a strong theoretical argument to be made that the optimal size of government in Canada and, indeed, in most western countries has declined over the last century as markets and technologies have developed.
- 33** To maintain consistency, federal government spending less transfers to the provinces, calculated based on FMS data, was allocated according to federal government expenditures less transfers by province as determined by the Provincial Economic Accounts (PEA).
- 34** The following section is based on summary data extracted from Ontario budgets (1985–2002). There may, therefore, be minor discrepancies between budget-based data and retrospective studies due to timing differences.
- 35** The interaction among tax rates, economic growth, and tax revenues is often referred to as the Laffer Curve, which illustrates the theory that, for any given level of tax revenues, there are two tax rates that will generate such revenues. One accomplishes this through high tax rates and relatively lower rates of economic activity while the second uses lower tax rates and relatively higher rates of economic activity. The Laffer Curve focuses on both the arithmetic affect (tax rate) and the economic affect (economic activity) of tax policy. For discussion of the Laffer Curve, see Buchanan and Lee 1982; Feldstein 1986, 1993; Fullerton 1980; Minford and Ashton 1991; Stuart 1981.
- 36** Comparable consolidated data from Statistics Canada's Financial Management System are only available from 1989/90. Thus comparisons in revenues are not attainable for the full period from 1985 to 1995.
- 37** Government financial reports are based upon different accounting and reporting procedures. For example, one government may report on a cash basis while another may use the accrual approach. Statistics Canada's Financial Management System (FMS) corrects data for this and many other jurisdictional differences and, thus, provides comparable, uniform data.
- 38** It should be noted that tax revenues as a percent of GDP is not the best indicator of the size of government due to the presence of surpluses (over-taxation) or deficits (over-spending). A more appropriate measure of the size of government is government expenditures as a percent of GDP.
- 39** Relates to provincial revenues only.
- 40** Alberta is excluded from this analysis since it maintains a single-rate tax on personal income.
- 41** The Fraser Institute's study, *The Harris Government: A Mid-Term Review*, contained three tax policy recommendations of which one was the elimination of the surtaxes on personal income so as to reduce marginal tax rates (Law et al. 1997).
- 42** For information on the efficiencies and costs of different taxes, see Diamond and Mirless 1971a, 1971b; Jorgenson and Yun 1991; Kesselman 1986a, 1986b, 1997, 1999; and OECD 1997.
- 43** An increase of one percentage point in the sales tax rate could generate additional revenues ranging between \$1.3 billion and \$3.2 billion, depending on the particular method of forecasting employed. Unfortunately, requests to the Department of Finance for estimates of revenue from sales taxes were rejected. Understanding the potential revenue changes necessitated by an increase or a decrease in the provincial sales tax is critical, since fundamental reform of the sales tax base is needed in Ontario and will obviously affect revenues.
- 44** The Ontario Government recently undertook a major review of the property-tax system. Marcel Beaubien, MPP for Lambton-Kent-Middlesex and the Special Advisor to the Minister of Finance, led the Property Assessment and Classification Review, which is available at [www.gov.on.ca/FIN/english/publications/2002/acr2002-2.htm](http://www.gov.on.ca/FIN/english/publications/2002/acr2002-2.htm). The Review examines all of the existing property classifications and the assessment process.
- 45** Formally referred to as the Royal Commission on Taxation (1966).
- 46** In 2001, the Province of Ontario reduced corporate income-tax rates from 14.82% to 13.62% for general corporations, from 12.82% to 11.75% for manufacturers and processors, and from 7.32% to 6.37% for small businesses. In other words, the provincial government reduced all three corporate income-tax

rates by roughly one percentage point. The total estimated loss of revenue associated with the reduction in tax rates was \$790 million. Unfortunately, the Ministry of Finance would not provide more up-to-date, specific estimates of changes in revenue for this study.

- 47** British Columbia eliminated the general corporate capital tax on September 1, 2002 and Quebec has announced a series of rate reductions.
- 48** The Ontario government raised \$1.3 billion in capital taxes (both general and financial services) in 2001/02, the most recent year for which data is available.
- 49** The Task Force on Competitiveness, Productivity, and Economic Progress (2002) also concluded that effective business tax rates were too high and affect innovation and investment negatively.
- 50** For information on the efficiencies and costs of different taxes, see Diamond and Mirless 1971a, 1971b; Jorgenson and Yun 1991; Kesselman 1986a, 1986b, 1997, 1999; and OECD 1997.
- 51** Government financial reports are based upon different accounting and reporting procedures. For example, one government may report on a cash basis while another may use the accrual approach. Statistics Canada's Financial Management System (FMS) corrects data for this and many other jurisdictional differences and, thus, provides comparable, uniform data.
- 52** Comparisons with the US states are not included since they, by law, are precluded from accumulating net debt.
- 53** In other words, Albertans, on average, possess \$3,394 in government financial assets in excess of gross debts owed by the government.
- 54** It is important to note that the historical estimates of the optimal size of government are generally considered to be generous estimates due to improvements in technology, reductions in transaction costs, and improved public policies, including free trade and low inflation.
- 55** Part of Ontario's march to smaller government should be placing greater pressure on Ottawa to follow suit. Given Ottawa's taxing and spending authority, any move towards fundamentally smaller government should be coordinated with a similar initiative in Ottawa. That is not to say that there are no benefits to pursuing smaller government in isolation from Ottawa but rather that the effect will be amplified by the uniform pursuit of smaller, smarter government.
- 56** For a comprehensive discussion of TELs, see Clemens et al., forthcoming; New 2001; Stansel 1994.
- 57** See Law 1998.
- 58** See Wilson 2002; Kendrick 2001; Mihlar (ed.) 1997; Bennett 1994; and Moore 1985.
- 59** See Esmail and Walker 2002; Lofgren 2002a, 2002b; Migue 2002; Gratzner 2000, 2002; Ramsay 1998, 2001; McArthur et al. 1996.
- 60** See Hepburn 1999, 2001; Children's Educational Opportunity Foundation of America 1999; Cheung et al. 1998; Morrison 1998; Greene et al. 1997a, 1997b; Greene et al. 1997; Miron 1996; Peterson et al. 1997; and OECD 1994.
- 61** See Schafer and Clemens 2002.
- 62** See Schafer and Clemens 2002, 2003; and Schafer et al. 2001.
- 63** For a discussion of other needed reforms of policy in areas such as labour markets, health-care, education, regulatory policies, privatization, and municipal affairs, see Law et al. 1997.

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## About the authors & Acknowledgments

### **Jason Clemens**

Jason Clemens is the Director of Fiscal Studies at The Fraser Institute. He has an Honours Bachelor of Commerce and a Master of Business Administration from the University of Windsor as well as a Post Baccalaureate Degree in Economics from Simon Fraser University. His publications and co-publications for The Fraser Institute include *Canada's All Government Debt* (1996), *Bank Mergers* (1998), *The 20% Foreign Property Rule* (1999), *Returning British Columbia to Prosperity* (2001), *Flat Tax: Issues and Principles* (2001), *The Corporate Capital Tax: Canada's Most Damaging Tax* (2002), and *Saskatchewan Prosperity: Taking the Next Step* (2002).

His articles have appeared in such newspapers as *The Wall Street Journal*, *The National Post*, *The Globe & Mail*, *The Vancouver Sun*, *The Calgary Herald*, and *The Montreal Gazette*. He has been a guest on numerous radio and television programs across the country and has appeared before committees of both the House of Commons and the Senate as an expert witness.

### **Amela Karabegović**

Amela Karabegović is a Research Economist at the Fraser Institute. She holds a B.M. (Great Distinction) in General Management from the University of Lethbridge in Alberta, and an M.A. in Economics from the Simon Fraser University in British Columbia. She is a co-author of *Economic Freedom of North America*.

### **Niels Veldhuis**

Niels Veldhuis is Senior Research Economist at The Fraser Institute. He has a Bachelor of Business Administration and an M.A. in Economics from Simon Fraser University. Mr. Veldhuis is the primary researcher for Tax Freedom Day, *Tax Facts*, and the Institute's provincial fiscal and state-provincial fiscal comparisons, the *Budget Performance Index* and the *Fiscal Performance Index*. He writes *Questions & Answers* in the *Fraser Forum*, the Fraser Institute's monthly magazine. His work has appeared in such newspapers as *La Presse* and *The Vancouver Sun*.

### **Acknowledgments**

The authors wish to express their sincerest thanks to Joel Emes, Senior Analyst with the BC Progress Board and the former Senior Research Economist in Fiscal Studies at The Fraser Institute for providing peer review of this study. Mr. Emes was a co-author of previous Prosperity Reports, including *Returning BC to Prosperity* and *Saskatchewan Prosperity: Taking the Next Step*. The authors would also like to thank Fred McMahon, the Director of the Centre for Globalization and Trade at the Fraser Institute and the author of *Road to Growth: How Lagging Economies Become Prosperous* for also providing peer review. The authors would similarly like to thank David Perry of the Canadian Tax Foundation for providing an overview of property tax reform in Ontario (Appendix A) and a review of the property tax section in the main paper. Finally, we would like to express our gratitude to Claudia Rebanks Hepburn, Cynthia Ramsay, Nadeem Esmail, and Chris Schafer for their work on education reform, healthcare reform, and welfare reform, respectively, which we used as references in the paper. The authors, of course, take full and complete responsibility for any remaining errors or omissions. We would finally like to thank all those involved in the production and release of this study. As we have worked independently, the views expressed in this study do not necessarily represent the views of the trustees or members of The Fraser Institute.