Recommendations

Ontario's economic performance is consistently better than that of the other Canadian provinces except Alberta. There can be little doubt that Ontario has one of Canada's leading economies. The question facing Ontarians is whether being the best of the second best is good enough. The answer for those who value prosperity, wealth, and opportunity has to be "No". Ontario's performance, like that of all Canadian provinces, ranges from poor to miserable when compared with the American states. The set of policy recommendations outlined below is meant to provide the economic policies and framework necessary for Ontario and, indeed, any Canadian jurisdiction wishing to increase its prosperity.

Setting clear goals

The immediate goal for Ontario should be to achieve economic performance in income, labour, and investment that are competitive with that achieved by average US states. The short-term goal for the Province of Ontario should be to rank in the middle of American states on the various measures of economic performance examined previously. The long-term objective for Ontario should be to achieve results comparable to those of the top one-fifth of US states. It is against these bench marks that Ontario should evaluate its economic performance during the next decade.

Reduce spending

Combined spending by federal, provincial, and municipal governments in Ontario stood at 34.3% of GDP in 2001, placing Ontario second among the provinces, behind Alberta (28.1%), for the size of government. The historical estimates for the size of government that maximize economic growth are roughly 30.0% of GDP.[54] All jurisdictions in Canda, save for Alberta, need to reduce their spending in order to move towards government of this optimal size.

Ontario's rank for performance on the size of government falls once US states are included from a relatively strong position in the Canadian context (second) to a ranking of 36th in the Canadian-US rankings.

The need for reductions in consolidated spending in Ontario implies the outright elimination of redundant and ineffective programs and the reform of surviving programs. Reforming delivery of programs in areas such as health-care, education, and welfare can achieve better results at lower prices. The over-arching goal must be for government spending to account for less of the economy than it does now and to be more competitive with levels in the United States.[55]

Taxation

The reduction in the size of government through spending cuts and reform must be accompanied by tax relief for both individuals and businesses. The following provides a prioritized list of tax relief for Ontario:

- complete elimination of the corporate capital tax
- harmonization of the provincial sales tax with the GST or an independent reform of Ontario's sales tax in order to exempt business inputs from sales taxes
- complete elimination of the high-income surtaxes
- reduction of the personal income-tax rates on middle and high incomes and an increase in the thresholds at which they apply
- further reductions in the corporate income-tax rates
- review of the rates of property tax applied to different classifications with particular emphasis placed on eliminating allocative distortions.

Tax and expenditure limitations (TELs)

One way in which future government spending could be controlled in Ontario and, indeed, in any jurisdiction, is through the adoption of "Tax and Expenditure Limitation" laws (TELs).[56] Such laws limit increases in government spending and taxes to the rate of inflation plus population growth, unless increases are specifically authorized by the general populace through a referendum. Evidence from the United States indicates that TELs control spending effectively.

Fiscal balance and debt management

Ontario should focus on debt payment by legislatively requiring that any unexpected surplus, regardless of its origin, be applied to the province's debt. Any accordant savings in interest costs should be earmarked for future tax relief.

Other reforms of policy

There are other reforms that will enhance Ontario's economic performance by eliminating or rationalizing programs and reducing costs. Many of these have been discussed in previous studies published by The Fraser Institute.

Increased flexibility in the labour market would clearly improve its performance, bringing higher rates of employment growth and lower rates of unemployment. Policies that would increase the flexibility of the labour market include reducing regulation of the labour market, reducing the minimum wage,[57] and introducing Right-to-Work legislation.[58]

A little more than two-thirds (66.8%) of total spending in Ontario is consumed by health-care (28.9%), social services (15.1%), and education (22.8%). Any material effort to reduce or reform spending must include these portfolios. There are a great many reforms available to Ontario and, indeed, to any government focusing on achieving better results at the same or lower costs. For example, introducing more choice for individuals and competition for suppliers in healthcare[59] and education[60] would improve provision of programs and lower prices. Another example of potential savings coupled with improved program delivery is welfare. Ontario has implemented successful and effective welfare reform but should do more to re-establish the principles of hard work, self-reliance, and responsibility. Welfare reforms in Alberta and British Columbia[61] as well as in the United States[62] provide ample evidence as to how Ontario could further reform its welfare system. There is, therefore, an opportunity in Ontario to reform program delivery such that better results are achieved at the same or lower costs to taxpayers.[63]

Conclusion

Rationalized, focused, government spending coupled with meaningful tax relief will place Ontario on a trajectory towards prosperity. The measures outlined above represent the major steps required to develop the foundation for such prosperity but should not be viewed as a place to stop. Economic prosperity and development is an ongoing process and one that requires consistent attention. Reducing spending and implementing prioritized spending reforms and tax relief will benefit Ontarians now and in the future.

Appendix A: Major Tax Changes in Ontario (1985–2002)

1985
- Personal income tax (PIT) rate increased from 48% to 50%
- Introduction of a 3% surtax on Ontario income tax in excess of $5,000
- Corporate income tax (CIT) rate is increased from 15.0% to 15.5%
- Increased land transfer taxes
- Taxes/mark-ups on gasoline, diesel fuel, tobacco, and alcoholic products all increased

1986
- Ontario Tax Reduction (reduces PIT for lower-income families) increased
- Tobacco taxes increased

1987
- Increases to the Property Tax credit, Property Tax Grants for Seniors, and the Ontario Tax Reduction
- Three-year corporate income tax exemption implemented for new mines
- Assistance for the Ontario Health Insurance Plan enhanced

1988
- Ontario mitigated the net tax reduction implemented by the federal government; allowed a $238 million PIT reduction aimed solely at low-income families compared with a reduction of $510 million if nothing had been done
- Increased the Ontario Basic PIT rate to 51% in 1988 and to 52% in 1989
- Surtax was increased to 10% for provincial income tax payable in excess of $10,000
- Ontario Tax Reduction program was enhanced
- Tiered system of capital taxes for non-financial companies implemented
- Capital tax levied on financial institutions increased from 0.6% to 0.8%
- Gasoline and tobacco tax rates increased
- Mark up on alcohol products increased
- provincial sales tax (RST) increased from 7% to 8% with some exemptions

1989
- Increased the Ontario PIT rate to 53% (previously scheduled to increase to 52%)
- Ontario Tax Reduction enriched
- Gasoline, diesel, and aviation fuel tax rates increased
- Series of environmental tax policies introduced
- Land Transfer Tax was extended to include more types of properties
- Commercial property taxes were increased
- OHIP was eliminated and replaced with the Employer Health Levy—a new payroll tax with a minimum rate of 0.98% on gross wages and salaries under $200,000 and a top rate of 1.95% on wages and salaries above $400,000

1990
- Tobacco taxes were increased

1991
- Surtax was increased to 12% for 1991 on provincial income tax payable in excess of $10,000; scheduled to increase to 14% in 1992
- Ontario Tax Reduction was enriched
- Gasoline, diesel fuel, and tobacco taxes were increased
- Mark-up on alcohol products was increased
- Surtax of 3.7% was applied to small business income in excess of $200,000
- Capital tax assessed on financial institutions was raised from 0.8% to 1.0%

1992
- Ontario PIT increased to 54.5% and scheduled a further increase to 55.0% for 1993
- Tiered system of surtaxes was introduced: 7.0% on Ontario PIT between $5,500 and $10,000 and 14.0% thereafter; increased to 14.0% on Ontario PIT between $5,500 and $8,000 and 20.0% thereafter beginning in 1993

- Ontario Tax Reduction program enriched
- Levy assessed on beer was increased and environmental levies on alcoholic products was also increased
- Capital tax for financial institutions was increased to 1.12%
- Temporary surtax on financial institutions' income tax payable of 10% was implemented
- CIT rate for manufacturing, processing, mining, farming, logging, and fishing was reduced from 14.5% to 13.5%
- CIT rate for small business was reduced from 10.0% to 9.5%
- Surtax on small business income in excess of $200,000 was increased to 4.0%

1993
- PIT rate increased to 58% of basic federal rate
- Both PIT surtaxes increased: tier one increased from 14% to 20% on Ontario PIT payable between $5,500 and $8,000 and tier two increased from 20% to 30% on Ontario PIT payable in excess of $8,000
- Ontario Tax Reduction program enriched
- Creation of a Corporate Minimum Tax with a minimum rate of 4%
- Series of business deductions reduced or eliminated

1994
- Changes to the Ontario Health Tax regarding new hires and additional payroll expenses

1995
- None

1996
- Announced a 3-year, 30% PIT reduction plan
- PIT rate dropped to 56% from 58% immediately
- scheduled PIT rate further reduced to 49% in 1997
- further scheduled reduction in 1998 to 40.5%
- Surtax was renamed the Fair Share Health Care Levy (FSHCL) and was restructured
- 1996, it was assessed at 20% of Ontario PIT in excess of $5,310 plus 13% on Ontario PIT in excess of $7,635
- 1997 scheduled changes: thresholds were reduced and the rates altered: 20% of Ontario PIT in excess of $4,650 plus 24% on Ontario PIT in excess of $6,360
- FSHCL once fully implemented (1998) would be assessed as 20% of Ontario PIT in excess of $3,845 plus 36% on Ontario PIT in excess of $4,800
- Ontario Tax Reduction enriched
- Implemented an exemption on the Employer Health Tax: started at $200,000 of payroll in 1997 and increased to a $400,000 exemption in 1999

1997
- Further reduced the PIT rate from 49% (cut to 49% from 56% in 1996 budget) to 48%
- Changes implemented to the FSHCL (surtax): for 1997, calculated as 20% of Ontario PIT in excess of $4,555 plus 26% of Ontario PIT in excess of $6,180; scheduled changes for 1998 as follows: calculated as 20% of Ontario PIT in excess of $4,270 plus 30% of Ontario PIT in excess of $5,635
- Enhanced the Ontario Tax Reduction

1998
- Ontario PIT rate reduced to 40.5%
- FSHCL (surtax) changes confirmed
- Enrichment of the Child Benefit program
- Reduced the CIT rate for small business to 9.5% from 15.5% and announced an 8-year plan to reduce rates to 4.75% and increase the threshold to $500,000
- Announced an 8-year plan to reduce commercial and industrial education tax rates (property taxes) in municipalities where the rates were above the average

1999
- Announced an additional 20% reduction in Ontario PIT
- Ontario PIT rate reduced to 38.5% from 40.5%
- Altered the applicable thresholds for the FSHCL (surtax): for 1999, 20% of Ontario PIT in excess of $3,655 plus 36% of Ontario PIT in excess of $4,562
- Implemented a 10% cut in residential educational taxes (portion of property taxes) in this fiscal year with an additional 10% cut promised in subsequent years

2000

- Announced a PIT rebate based on the 1999 tax year
- Transition to a tax-on-income from the previous tax-on-tax approach
- Implemented three income brackets: less than $30,004, between $30,004 and $60,009, and over $60,009 with rates as follows: 6.37%, 9.62%, and 11.16% respectively
- Announced 2001 rate reductions required to achieve 20% PIT reduction objective
- Surtax remained and rescheduled as: 20% of Ontario PIT in excess of $3,466 plus 36% of Ontario PIT in excess of $4,373
- Enacted full and complete protection against inflation through indexation
- Announced a 6-year plan to reduce both the general CIT rate and the manufacturing and processing CIT rate to 8.0% from its current levels of 15.5% and 13.5%
- General CIT rate cut to 14.5% and the manufacturing and processing CIT rate reduced to 12.5%
- Small business CIT rate for 2000 reduced from 8.0% to 7.0%
- Announced an acceleration and enhancement of the cut in the small business CIT rate; specifically, the rate will be reduced to 4.0% (original target of 4.75%) by 2005
- Announced the increase in the threshold and phase-out of the small business surtax; specifically, the lower rate would apply to income up to $400,000 and the phase-out range would be from $400,000 to $1 million (previously the bottom threshold was $200,000 with a phase out between $200,000 and $500,000)
- Reduced the capital gains inclusion rate to 62%
- Announced a 5-year plan to reduce the inclusion rate for capital gains to 50%
- Enriched the Ontario Child Care Supplement for Working Families
- Multi-year plan of tax rate reduction for mining announced

2001

- Additional PIT rate reductions announced for 2001 and 2002 for the bottom two tax rates: bottom rate reduced from 6.2% to 6.05% in 2001 and then further reduced to 5.65% in 2002; middle rate reduced from 9.24% to 9.15% in 2001 and further reduced to 8.85% in 2002
- Announced two-tiered surtax would be replaced by one tier as of January 2003, specifically assessed at 56% of Ontario PIT in excess of $4,491
- Introduced a tax credit program for education (first in Canada) applicable on the first $7,000 in tuition costs per child; tax credit rate implemented at 10% in 2002 and scheduled for full implementation by 2006 at 50% of tuition costs
- Increases to the disability credit, caregiver credit, inform dependent credit, and education credits announced
- CIT rates, both general and manufacturing and processing further reduced to 12.5% and 11.0%, respectively
- Capital tax exemption for small business increased to $2 million with a scheduled further increase to $5 million in 2002
- Accelerated the capital gains tax reduction; fully implemented the changes in 2001 (inclusion rate reduced to 50%)

2002

- PIT rate reductions scheduled for 2002 delayed until 2004
- Increase in the value of the Education Tax Credit scheduled for 2002 delayed until 2004, implying a full implementation delay until 2009
- Delayed the elimination of the lower PIT surtax and its restructuring until 2004
- Delay in the planned reductions in education property tax rates
- Increased the Ontario Tax Reduction
- Reduced the mining tax to 12%
- CIT rate reductions (both general and manufacturing and processing) delayed; full implementation delayed until 2006 with no incremental reductions until 2004
- Increased tobacco taxes

Sources: Ontario Ministry of Finance, 1985-2002; Treff and Perry (2001 and 2002).

Appendix B: The Reform of Property Tax in Ontario

by David Perry, Canadian Tax Foundation

Traditionally, Ontario municipalities and school boards have relied heavily on property taxes. The total burden has remained relatively constant as a percentage of gross domestic provincial product, implying both strong growth in the tax base—new development and construction—and increased rates to make up for increases in price levels and improved or additional services. Hidden under the aggregate numbers, however, are changes introduced in the last five years that will, over time, change the distribution of the burden and introduce more restraint on municipal temptations to raise rates.

Prior to the recent reform, the provincial government used two methods to reduce the burden on residential property, both owner-occupied and rental property. Earlier legislation provided that residential and farm mill rates were to be set at 85% of the rate applicable to commercial and industrial property. The refundable property-tax credit, delivered through the personal income-tax system, provides relief from high burdens on low- to middle-income owning or renting families. This assistance does not appear in the property tax collection data, so the burden appears higher in Ontario than the real impact. The credit continues under the reformed system.

Ontario had been one of the few provinces with a seriously out-dated system for assessing property taxes. The procedures provided that old properties were assessed for tax purposes at replacement values from as far back as 1940, whereas otherwise identical, new properties were assessed at much higher values. Residential, commercial, and industrial assessments were all biased in favour of old properties, and the disparities were so great that a simple shift to assessed values approximating current or market values would have caused significant shifts in the tax burden and intolerable increases for some taxpayers. As shown during several abortive attempts to convert to market-value assessment, the cries of those who would suffer increased tax burdens were far louder and more politically effective than the sighs of relief from those expecting reductions in the annual bill. Many areas of the province had made the change, with varying degrees of success, but the Metropolitan Toronto area, where the disparities were the greatest, had not. A change was forced when a series of successful appeals from valuations for tax purposes drastically lowered the burden on key properties and threatened to shift intolerable burdens to other properties, particularly small businesses and residential properties.

The province finally imposed market-value assessment standards on all municipalities but avoided using that term to lessen the emotional impact. There was an extensive phase-in for residential properties to reduce the increased taxes that would have resulted for older properties but the phase-in also blunted the benefit to be gained by new properties. The new legislation allowed local governments to create a series of separate property classes, each with different rates, in order to lessen the impact of the new assessment system.

Non-residential properties are now protected in several ways. The province eliminated the local business tax system, which was the commercial-industrial rate applied to varying percentages of assessed values, depending on the type of business. The move effectively froze the general tax rate applicable to all non-residential properties. The legislation and regulations imposing the limits to rate changes for non-residential properties spell out a complex set of changes allowed according to the fairness ratios—the ratio of business to general tax rates. The restrictions imposed have the effect of limiting rate increases to a very narrow range, in essence below the increase to be expected from normal inflation and population growth. Unfortunately, the methods of calculating rates on properties subject to the limits set a new high (or low) in complexity. A major advantage of the property tax system is that it is transparent and predictable. For a large number of non-residential taxpayers, the new system has neither attribute.

The second revolutionary change, for Ontario at least, was to remove the taxing powers of school boards. The province took over the financing of all elementary and secondary public education, shifting to the local government budget responsibility for a number of services previously financed by the province. Across the province, the move was revenue neutral and had the effect of removing education as a driver of higher property tax rates.

The switch to effective provincial control over school-board spending has been anathema to Ontarians. The successful adoption of the same system in other provinces seemed to be ignored. The pressure is mounting on provincial authorities in Ontario to recognize local conditions and local preferences in the funding formulas.

The effect of the reforms was to freeze for an indefinite period the distribution of the burden of local property taxes as it had been before the changes. While equity will eventually improve, the antipathy of the taxpayers will continue as each step of the transition produces higher tax bills for particular taxpayers. Most importantly for local government financial management, however, the net effect of the changes meant that any increase in local government spending not covered by increased assessment—new development—would have to come entirely from the residential property-tax burden. This neatly linked a higher tax burden exclusively to those who vote.