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Avoiding a Crisis: Fixing Ontario's Deficit

SPECIAL ISSUE

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Introduction

Facing a deficit of nearly $16 billion this year and $136 billion more over the next six years, the reality is beginning to set in that the Ontario government is in a precarious fiscal situation. For quite some time, researchers at the Fraser Institute have been critical of Ontario Premier Dalton McGuinty's record of managing his province's finances.

Last month, the *Commission on Reforming Ontario's Public Services*, headed by noted economist Don Drummond, released its recommendations (362 in total). While many of the Commission's recommendations are worthy of implementing, the Commission was restricted by the government's mandate making its proposed reforms too timid in many cases. In this special issue of *Fraser Forum*, the contributors faced no such constraints.

As we note in the opening article, *A credible 2-year plan to balance the budget,* the timeline proposed by the government and Commission for balancing the budget is far too long. A subsequent article, *Canada's history of dealing with deficits in the 1990s is a lesson for Ontario today*, shows that Canadian governments of all political stripes eliminated budget deficits in the 1990s and did so swiftly.

In the remaining articles, Fraser Institute experts outline bold reforms that both reduce government spending and change the way public services are delivered. For example, in *Wage board: The solution to reining in public sector compensation*, Amela Karabegović and Milagros Palacios suggest a mechanism to bring public sector pay in line with comparable private sector jobs—potentially saving Ontario taxpayers $3.8 billion annually.

Improve health care and tackle the deficit by Nadeem Esmail proposes that Ontario adopt two key health policies which are common in other nations with universal access health care and would save another $7.8 billion per year.

In *Time for Ontarians to Consider Fundamental Education Reform*, Lance Izumi proposes reforms that would restructure Ontario's K-12 education system based on models of success in other parts of Canada. The annual savings could total $1.3 billion.

Mark Milke calls for an immediate end to business subsidies totalling $2.7 billion each year in *Ontario's easiest budget cut of all: Corporate welfare*.

And in *Ending Ontario's costly and misguided electricity subsidies,* Dr. Joel Wood recommends the Ontario government immediately scrap the Ontario Clean Energy Benefit and do away with its feed-in tariff (FIT) program for annual savings of $1.1 billion.

Ontarians need and deserve a plan to return fiscal sanity to the province. This special issue of *Fraser Forum* provides bold reforms to fix Ontario's deficit crisis and provide taxpayers with better value for money.

~ Niels Veldhuis and Charles Lammam,
contributing editors

Fraser Forum

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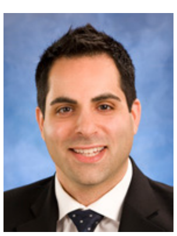

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A credible 2-year plan to balance the budget

Charles Lammam and Niels Veldhuis

Last year, the Ontario government put forth its deficit reduction plan which unfortunately proposed that deficits continue until 2017/18 (Ontario, Ministry of Finance, 2011a). More worryingly, the Ontario government hoped to grow itself out of deficit by relying on overly optimistic projections for revenue growth (averaging 4.3% annually) and unrealistic restraint in the growth of program spending (1.4% annually).

Shortly after the government delivered its plan, we concluded that:

> Ontario's budget lacks a credible plan… this government's fiscal record has been nothing short of a disaster and [the] budget did little to bolster its credibility… the government is relying on the hope that it will be able to constrain spending growth in the future and eventually match revenues… [the government] deferred the hard decisions—conveniently until after the provincial election later this year (Veldhuis et al., 2011).

With the 2012 budget expected soon, the Ontario government desperately needs a credible plan to eliminate the deficit—one that sets Ontario back on the right fiscal path. Our proposal is for the government to balance the budget in two years through spending reductions and several program reforms.

McGuinty's bleak fiscal record and free-spending problem

The unfortunate reality for Ontarians is that their government's fiscal record has been extremely poor compared to others in Canada. In fact, a recent Fraser Institute study, *Measuring the Fiscal Performance of Canada's Premiers*, found that Premier McGuinty performed ninth (second worst) among 10 provincial premiers at managing government spending, tax policy, and deficits and debt (Lammam et al., 2011).

Premier McGuinty's inability to control government spending is best illustrated by comparing average spending increases to economic growth in the province. From 2003/04 to 2011/12, the McGuinty government increased program spending by almost double the rate of economic growth. Specifically, program spending increased annually by 6.3% compared to annual economic growth of 3.3%.[1]

Since government spending ultimately drives taxation, it's no surprise that the McGuinty government has relied on a combination of tax increases and deficits (which are deferred taxes) to finance its spendthrift ways.

From 2003/04 to 2011/12, Premier McGuinty has accumulated nearly $60 billion in deficits with plenty more to come.[2] While McGuinty and his colleagues are apt to blame a lagging economy for their deficit woes, the reality is that Ontario's current deficit problems are primarily the result of the Liberal government's wild spending spree before the recession.

This year, Ontario has the dubious distinction of running the largest budget deficit among the federal and provincial governments totalling 2.5% of all the income generated in the province. Making matters worse, it will take Ontario longer than any other jurisdiction to eliminate its deficit; only the federal government is planning for a remotely similar deficit reduction timeline.

Ongoing deficits into the foreseeable future will result in a dramatic expansion in government debt. And investors have already put Ontario on notice. Late last year, Moody's Investors Service, a prominent credit rating agency, warned that Ontario's credit rating could be downgraded if the province fails to get its fiscal house in order in the upcoming budget (Howlett and Perkins, 2011). With a lower credit rating, investors would be less inclined to lend to the Ontario government unless they are compensated with significantly higher interest payments to cover the increased risk of default.

Further deterioration in investor confidence, coupled with a persistently sluggish global economy, could rapidly degrade Ontario's already fragile fiscal position.

Commission confirms the need for a credible plan

The one positive outcome from the 2011 Ontario budget was the creation of the Commission on Reforming Ontario's Public Services headed by noted economist Don Drummond.

Last month, the Commission released its weighty 544 page report which essentially reiterated our assessment of the province's deficit reduction plan:

> "The projection of program spending was simply the residual that would bring the budget to balance in 2017/18. It was not a spending forecast that depicted how spending would grow if current

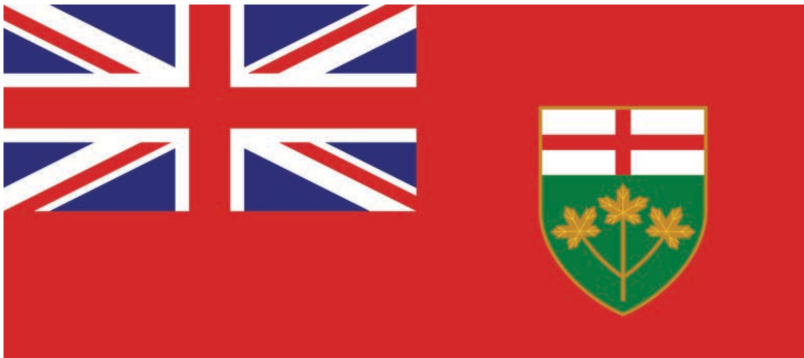

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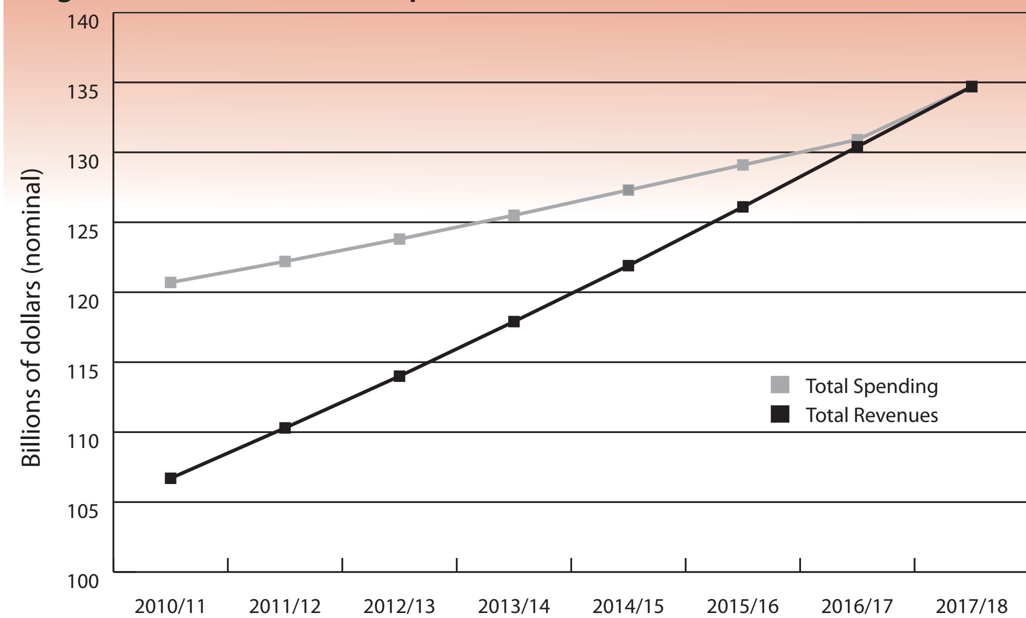
Figure 1: The Commission's plan to eliminate Ontario's deficit in 2017/18



Source: Drummond et al. (2012); calculations by the authors

> programs were maintained… During the recent election, all political parties pledged to balance the budget by 2017/18, but none presented a credible plan to accomplish this outcome" (Drummond et al., 2012).

The Commission noted that the government's assumptions on revenue growth are overly optimistic and that spending likely won't be restrained to the Ontario government's commitment. In fact, the Commission projected that, under the government's current plan, Ontario will not eliminate its deficit in 2017/18 at all. Rather, it will nearly double in size from about $16 billion this year to around $30 billion in six years.[3]

The Commission recommended 362 reforms that would enable the government to restrain the growth of program spending to 0.8% per year until 2017/18. With slower program spending growth and more conservative revenue assumptions, the Commission believes its alternative plan would allow the Ontario government to realistically balance the budget by its target date of 2017/18.

Importantly, however, the Commission's plan still proposed that total (nominal) government spending increase steadily to the target deficit elimination date. In other words, it did not recommend a cut in overall spending (see figure 1).

More aggressive action needed to eliminate the deficit

While we commend the Commission for providing a more credible alternative and sparking a more informed debate about Ontario's dire fiscal situation, a key problem with the Commission's proposal is the timeline for balancing the budget. Simply put, another six years of deficits totalling over $26 billion is unacceptably long.[4]

Over the past 20 years, Canadian governments—both federal and provincial and of all political stripes—have successfully eliminated their deficits and have done so swiftly (within a two to four year timeline).[5]

Another six years of deficits, as is the case under the Commission's proposal, will see Ontario's debt increase to $300 billion from $238 billion today[6]—this after the debt has already increased by over 70% since 2003/04. The added debt will be a significant drag on the economy (Kumar and Woo, 2010; Reinhart and Rogoff, 2010) and will only further saddle young Ontarians with the heavy burden of repayment. Doing so is grossly unfair to them.

A six-year plan to balance the budget also increases the risk of future economic shocks adversely affecting the government's finances and the deficit reduction plan.

Finally, such a plan significantly delays the feasibility of enacting tax reductions that are needed to improve Ontario's economic environment and investment climate. Consider that Ontario's personal income tax rates on skilled and educated workers are among the highest in Canada (Lammam et al., 2011).

A credible plan to balance the books in two years

The Ontario government should take a page from the playbook of their federal counterparts and balance the budget in two years—the same time horizon achieved by the federal Liberals in the 1990s. To do so will require a re-

Table 1: A credible plan to eliminate Ontario's deficit in 2013/14 (in $ billions)

	2011/12	2012/13	2013/14
Status quo program spending	115.1	119.1	123.3
Proposed spending in 2012/13 and 2013/14		109.7	104.3
Proposed decrease from previous year:			
in $ billions		-5.4	-5.4
% change		-4.7%	-4.9%
Status quo Ontario deficit projection	-15.5	-17.2	-19.0
Revised deficit plan		-7.8	0.0

Note: Ontario's fiscal data for 2011/12 and the projections of the status quo are calculated from Drummond et al.'s (2012) status quo scenario.

Source: Drummond et al. (2012); calculations by the authors

duction in program spending of $10.8 billion over the next two years (see table 1). Phased-in over two years, the annual reductions would amount to $5.4 billion, or less than 5% per year.

The proposed plan would reduce the tremendous debt burden being passed to the next generation of Ontario families. Specifically, if the government balances the books in 2013/14 and restrains total spending thereafter to the rate of revenue growth, Ontario's projected debt would decrease by $128 billion over the next six years and result in substantially lower annual interest costs.[7]

While our plan calls for a $10.8 billion spending reduction over the next two years, making these cuts should be manageable. The government already has over 350 recommendations from its Commission, most of which should be implemented.

Unfortunately, however, the proposed policies tinker at the edges; they do not go nearly far enough. In the articles that follow, Fraser Institute experts outline bold and specific reforms that would enable the Ontario government to exceed the proposed reductions in our plan. The reforms cover many areas of government spending including health care, education, public sector compensation, business subsidies, and pension guarantee funds. With their economic and fiscal future in mind, Ontarians would be wise to seriously consider all of them.

Notes

1 For this calculation, program spending for 2011/12 is from Ontario's 2011 economic outlook and fiscal review (Ontario, Ministry of Finance, 2011b).

2 For this calculation, the deficit for 2011/12 is from Ontario's 2011 economic outlook and fiscal review (Ontario, Ministry of Finance, 2011b).

3 The Commission also projected that, under the current plan, the provincial debt will rise to $411 billion or 50% of GDP—significantly more than the forecast contained in the government's 2011 budget of $323 billion, 40% of GDP (Drummond et al., 2012).

4 The cumulative deficit total from 2012/13 to 2017/18 is from Drummond et al.'s (2012) preferred scenario.

5 See Veldhuis et al. elsewhere in this issue for a succinct review of these historical Canadian achievements.

6 The debt figure for 2011/12 is from Ontario's 2011 economic outlook and fiscal review (Ontario, Ministry of Finance, 2011b).

7 The calculated debt savings are relative to Drummond et al.'s (2012) status quo scenario. If Ontario continues on its current path, it will accumulate $136 billion in deficits from 2012/13 to 2017/18. Under our proposed plan, the province will run a total deficit of $8 billion over the same period. Thus, the total savings on the debt is equal to $128 billion, which excludes potential savings from reduced interest costs.

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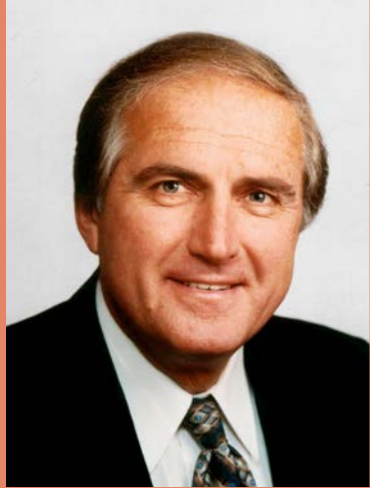
Jean Chretien,
Liberal



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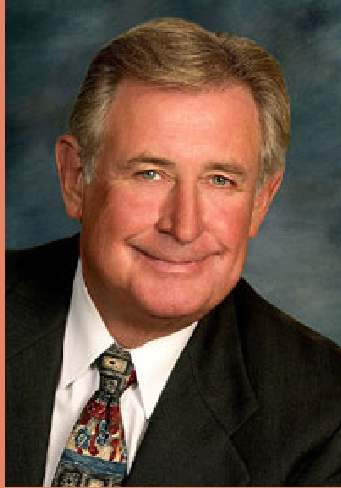
NDP



Ralph Klein,
Progressive Conservative

Mike Harris,
Progressive Conservative

Joe Howell , OECD, Legislative Assembly of Alberta, Fraser Institute

Canada's history of dealing with deficits in the 1990s is a lesson for Ontario today

Niels Veldhuis, Milagros Palacios, and Charles Lammam

The 1990s was a period of tremendous policy reforms and successes in Canada. Governments across the country of all political ideologies acted decisively to enact spending reductions to bring government expenditures in line with revenues and thus achieve balanced budgets. Such actions, while difficult in the short term, lead to better results in the medium and long term, including balanced budgets, declining debt, lower interest costs, and a more prosperous economy.[1] Canada's resulting remarkable fiscal transformation (federally and provincially) contributed significantly to our outstanding economic performance from 1997 to 2007.

The lessons about how governments solved their serious fiscal problems in the 1990s can, and should, be applied in Ontario today. While the Commission on Reforming Ontario's Public Services recommended that the government stick to its current timeline and balance the budget in six years, history shows that a significantly reduced timeline is not only possible, but preferable.

Federal Liberals reduce spending to balance the budget

Beginning in 1995, the Liberal government led by former Prime Minister Jean Chretien and Finance Minister Paul Martin enacted a substantial deficit

Table 1: Federal Liberals reduce spending to balance the budget

	1994-95	1995-96	1996-97	1997-98
Program spending, in $ billions	123.2	120.9	111.3	114.8
Increase/decrease from previous year				
in $ billions		-2.4	-9.5	3.5
% change		-1.9%	-7.9%	3.1%
Deficit/surplus, in $ billions	-36.6	-30.0	-8.7	3.0

Source: Canada, Department of Finance (2011); calculations by the authors

Table 2: Saskatchewan's NDP cuts spending to balance its budget

	1991-92	1992-93	1993-94	1994-95
Program spending, in $ millions	4,390	4,228	4,079	4,215
Increase/decrease from previous year				
in $ millions		-162	-149	136
% change		-3.7%	-3.5%	3.3%
Deficit/surplus, in $ millions	-843	-592	-272	128

Source: Canada, Department of Finance (2011); calculations by the authors

reduction plan after the government's finances had deteriorated to a point where the *Wall Street Journal* suggested the Canadian government was nearing bankruptcy.[2]

To deal with Canada's debt crisis, the Liberals' 1995 budget set in motion fundamental reforms that significantly reduced government spending and that structurally changed the federal government's involvement in the Canadian economy. The enactment of meaningful reductions in nominal spending coupled with fairly stable revenues allowed the federal government to quickly balance its budget. In fact, the Liberals outperformed their spending reduction goal and actually cut spending by $11.9 billion or 9.7% from $123.2 billion in 1994/95 to $111.3 billion in 1996/97 (see table 1). As a result, it took just two years for the federal government to balance the budget.

Saskatchewan's NDP government cuts spending to balance its budget![3]

In 1991, Roy Romanow and the NDP were elected in Saskatchewan with a commitment to eliminate the budget deficit. The Romanow government's strategy for reducing the deficit centred on reviewing all government spending. In delivering the 1992 budget, the Romanow government highlighted the dire fiscal situation and the cuts to come: "We can no longer pay for all programs and services government provides. Programs that we simply cannot afford will be eliminated"(Saskatchewan Finance, 1992).

While the Saskatchewan government laid out a plan to balance the budget by 1996/97, they actually achieved their goal two years earlier. In just three years (from 1992/93 to 1994/95) the NDP government went from an $843 million budget deficit to a $128 million budget surplus. In part, Romanow's NDP government had broken away from its historical roots of championing increases in the size of government to reducing program spending by over $300 million, or 7.1%, in its first two years in office (see table 2).

What ultimately differentiates the reforms in Saskatchewan with the more aggressive reforms in Alberta and Ontario (discussed below) is that Saskatchewan relied in part on tax increases to achieve a balanced budget. Nonetheless, while the fiscal reforms in Saskatchewan were less significant than those implemented in Alberta and Ontario, the fact that these fiscal reforms were enacted by an NDP government, which historically had promoted expansive government spending, was critical in establishing the non-ideological importance of balanced budgets. Indeed, the changes enacted by Saskatchewan's NDP government provided the ultimate stamp of credibility for federal Finance Minister Paul Martin a few years later.

Alberta's Progressive Conservatives restore fiscal responsibility

In the early 1990s, Alberta was caught in a fiscal spiral of persistent and substantial annual deficits, ever increasing government debt, and a growing interest burden. As a result of rising unhappiness with the government's fiscal situation, Alberta Premier Don Getty stepped down as leader of the Progressive Conservatives in December 1992. Ralph Klein won the ensuing party leadership race. In the race, Klein campaigned on the need to restore fiscal responsibility in Alberta through decreasing the size of government, balancing the provincial budget, and paying down the provincial debt.

The first two budgets of Ralph Klein's tenure fundamentally changed the status quo in Alberta. The fiscal austerity programs delivered in the 1993 and 1994 budgets were bold, innovative, and aggressive. The government was determined to end the downward fiscal spiral that threatened the province's future.

In Premier Klein's first four years in office, government spending decreased from $16.2 billion in 1992/93 to $12.7 billion 1996/97, a reduction of over 20%. While revenues as a percentage of GDP also decreased, spending fell even faster, resulting in a budget surplus of just under $1 billion or 1.1% of GDP in 1994/95—in just the second year of Klein's reforms. This was a stark change from a deficit of $3.3 billion or nearly 4.4% of GDP in 1992/93 (see table 3).

After the government balanced its budget in 1994/95, it ran consecutive budget surpluses for the next 14 years. These surpluses helped pay down the provincial debt. In fact, by 2004/05 Alberta had eliminated its provincial debt (Department of Finance, 2011).

A common sense fiscal plan from the Ontario Progressive Conservatives

In the mid-1990s, Ontario's provincial government was in a fiscal crisis. Over the course of five years from 1989/90 (the last year the budget was balanced) to 1994/95, the government accumulated $49 billion in debt (Statistics Canada, 2010). The provincial net debt which stood at 13.5% of GDP in 1989/90 had more than doubled by 1994/95. As a result of the rapidly escalating debt, interest costs had steadily increased from 9.3% of government revenues in 1989/90 to 17.0% by 1994/95 (Department of Finance, 2011). Ontario was caught in a spending-induced fiscal spiral of persistent and substantial deficits, increasing government debt, and growing interest costs. Like Saskatchewan and Alberta, Ontario's status quo was simply not sustainable.

Following the June 1995 provincial election, the Progressive Conservatives led by Mike Harris wasted little time in enacting major reforms. In only a month's time, the Harris government released a fiscal overview and outlined its plan to address the budget deficit. The July 1995 Fiscal Overview was followed by a landmark budget in 1996 that presented Premier Harris's three-year fiscal austerity program to deal with the province's fiscal crisis.

In the first year of the Harris government's austerity plan, program spending was reduced by over $2 billion or 4.1%. Over the following two years program spending growth averaged 1.1% and spending in 1998/99 remained lower than the level of three years earlier in 1995/96.

By 1999/00, one year earlier than anticipated, the Harris government achieved the goal it set out in its original Balanced Budget Plan. For the first time in over a decade, Ontario's provincial government ran a small surplus. In just four years, Ontario went from running a substantial $8.8 billion deficit to a surplus of $668 million (see table 4). Despite tackling the deficit, the Harris government also enacted a significant tax cut to improve the incentives for Ontarians to work, save, invest, and engage in entrepreneurial activities.

Table 3: Alberta's Progressive Conservatives restore fiscal responsibility

	1992-93	1993-94	1994-95	1995-96	1996-97
Program spending, in $ millions	16,176	15,123	13,480	12,681	12,701
Increase/decrease from previous year					
in $ millions		-1,053	-1,643	-799	20
% change		-6.5%	-10.9%	-5.9%	0.2%
Deficit/surplus, in $ millions	-3,324	-1,371	938	1,151	2,489

Source: Canada, Department of Finance (2011); calculations by the authors

Table 4: Ontario's common sense fiscal plan

	1995-96	1996-97	1997-98	1998-99	1999-00
Program spending, in $ millions	50,062	48,012	48,019	49,036	53,347
Increase/decrease from previous year					
in $ millions		-2,050	7	1,017	4,311
% change		-4.1%	0.0%	2.1%	8.8%
Deficit/surplus, in $ millions	-8,800	-6,905	-3,966	-2,002	668

Source: Canada, Department of Finance (2011); calculations by the authors

Conclusion

As discussed elsewhere in this issue, the current Ontario government needs to change its fiscal course and put forth a credible deficit reduction plan. While the Commission on Reforming Ontario's Public Services recommended that the government stick to its current timeline for balancing the budget, history shows that a significantly reduced timeline is possible. In the 1990s, governments across the country spanning all political parties and ideologies enacted spending reductions and achieved balanced budgets within two to four years.

Notes

1 For a more thorough discussion of the reforms see Veldhuis, Clemens, and Palacios, 2012 or Chapter 4, Fiscal Reform: Unsung Provincial Heroes, in Crowley, Clemens, and Veldhuis, 2010.

2 It is important to note that numerous factors motivated, some argue forced, the government into action. In fact the Liberals 1994 budget is generally considered a status quo budget that did not undertake the difficult steps needed to reign in the deficit. Critically important to the push for reform was the unified, ideologically coherent opposition from Preston Manning's Reform Party. In addition, a broad array of think tanks, advocacy groups, and business organizations had been educating the public on the risks and costs of the deficit and debt, such that the general public increasingly supported change. Reforms implemented in Saskatchewan and Alberta created some political consensus regarding the need and efficacy of change. Externally, the collapse of the Mexican peso in 1994 provided real-world evidence of the costs of ignoring deficits and debt. International organizations such the International Monetary Fund and the Organization for Economic Cooperation and Development (OECD) were calling for faster reductions in the country's deficit.

3 This article covers the fiscal reforms of the past 20 years in Canada. The first restraint program was implemented in 1983 by then BC Premier Bill Bennett.

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Time for Ontarians to consider fundamental education reform

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Lance Izumi

In February, eminent economist and former senior bureaucrat in the federal department of finance, Don Drummond, delivered a sobering assessment of the state of finances and public services in Ontario.[1] Drummond's stark conclusion of Ontario finances is that rather than heading towards a balanced budget in 2017-18, the province will face a deficit of roughly $30 billion that year. The implications of the report are straightforward: Ontario has no choice but to fundamentally reform public services or face grave fiscal threats and potentially outright crisis in the not-so-distant future.

Unfortunately, the responses thus far from the Ontario government seem to indicate that they wish to continue existing policies with some tinkering at the periphery. For example, in elementary and secondary education, Premier McGuinty has rejected the recommendation by the commission on reversing full-day kindergarten and instead suggested a two-year partial wage-freeze for teachers, which while providing some savings will not yield the total required.[2]

It's time for Ontario to consider much deeper, broader reforms of K-12 education. Just as Ontarian workers are looking west for employment, so too the province can look west for alternatives on how to provide high-quality but less expensive K-12 education.

Ontario's system of K-12 education

Before discussing an alternative education model, it is useful to summarize the status quo in Ontario. Like many jurisdictions, Ontario still anachronistically restricts access to public schools based on the location of residence. However, uniquely within Canada, Ontario possesses four separate public systems of K-12 education—an English public system, an English Catholic system, and their French counterparts.[3] Depending on one's location, families can have up to four different types of publicly-funded schools from which to choose for their children's education (Ontario Ministry of Education).

In 2009-10, the most recent year for which comprehensive, comparable data is available, the Ontario government spent $20.6 billion on K-12 education covering some 2.1 million students. Roughly calculated, that translates into approximately $9,990 per student.[4]

There is also an active independent school system in Ontario. According to the Ontario Federation of Independent Schools, some 126,000 Ontario students (roughly 6 percent) attend the 976 independent schools in the province along with another estimated 20,000 students who are home-schooled.[5] No funding or support is provided to these schools or students.

An alternative model: British Columbia[6]

British Columbia maintains one public system of education that covers roughly 89 percent of the students in the province (2009-10). The remaining 11 percent of students attend 347 independent schools[7] that receive varying levels of support from the BC government (British Columbia Ministry of Education, 2010). Specifically, British Columbia maintains four classes (or groups) of independent schools that receive different levels of support for operations. (There is generally no capital funding provided to independent schools).

Group 1 – These schools employ BC certified teachers, have education programs consistent with ministry guidelines, and employ the provincial curriculum. They receive 50 percent of their local board's per student operating grant. This group is the largest category of independent schools in the province, representing 77.6 percent of the students attending independent schools.

Group 2 – These schools meet the same requirements as Group 1 but only receive 35 percent funding because their per student operating costs exceed the ministry grants provided to local school boards. This is the second largest category of independent schools in the province covering 20.2 percent of the students attending independent schools.

Group 3 – These schools receive no funding from the province and are therefore exempt from requiring BC certified teachers and ministerial guidelines for curriculum and education programming. In 2009-10, the most recent year of data, there were 19 Group 3 schools with 544 students (0.8 percent).

Group 4 – These are also non-funded schools that largely serve non-provincial students. There were 10 Group 4 schools in 2009-10 with 943 students (1.3 percent of independent school students) (British Columbia Ministry of Education, 2010).

Applying BC's model to Ontario

Introducing the British Columbia system to Ontario would be nothing short of a fundamental remake of the province's education system. It would require transitioning the two public Catholic systems (English and French) to a more independent, non-government model similar to British Columbia. In addition, changes would likely be required for many current independent schools in Ontario should they choose to apply for funding. Finally, it would require large-scale re-orientation/down-sizing of the education bureaucracy in the province.

Critically, there is little or no evidence that such a transition would necessarily harm the educational outcomes of Ontario students. Indeed, results from international tests consistently indicate that Ontario performs proximately with both British Columbia and Alberta. Specifically, the Progress in Trends in International Mathematics and Science Study (TIMSS) and Progress in International Reading Literacy Studies (PIRLS) tests, which cover mathematics, science, and English, all show the three provinces performing at similar levels.[8]

One of the key considerations, given Ontario's increasingly dire fiscal state, is cost. British Columbia spent $4.6 billion on K-12 education in 2009-10, representing roughly $8,150 in per student costs. According to the British Columbia Ministry of Education, it saved some $300 million (roughly 6.7 percent) in operating costs in 2009-10 plus potential additional capital costs because of independent school enrolment.

Back-of-the-envelope savings

A rough calculation for Ontario suggests the potential for real savings for the province without jeopardizing education accessibility, outcomes, or performance. It is important to emphasize, though, that the transition to a new model as well as the resulting regulations introduced to govern the reformed system would determine the magnitude of savings.

Assume, however, an orderly transition from the status quo to the reformed system with minimum conflict regarding the disposition of capital assets (i.e., schools and related facilities). Further, assume that like British Columbia, 8.8 percent of all students in the province attend Group 1 schools (50 percent operating grant) while 2.3 percent attend Group 2 schools (35 percent operating grant). The savings calculation will be restricted to operating grants and based on the 2009-10 provincial public per student operating cost. Finally, no savings from administrative and bureaucratic down-sizing are included. The result is annual savings of $1.3 billion or almost 6.5 percent of the provincial K-12 education budget (2009-10). These savings emerge from having nearly 11 percent of students attend independent schools (as in British Columbia) where the province only provides for up to 50 percent of the operating cost per student.

The approximate nature of this estimate needs to be re-emphasized. There are a host of factors that could easily decrease as well as increase the savings. For example, the analysis assumed parallel usage rates as in British

Columba. However, according to the 2001 Census (2011 results were not available at the time of writing), Ontario's Catholic population of 3.9 million represented 34.7 percent of the province's total population. In British Columbia the portion of the population self-describing themselves as Catholic was basically half that rate: 17.5 percent. In addition, the rate of non-religious people in British Columbia is slightly more than double the rate of Ontario: 35.9 percent vs. 16.3 percent. (Statistics Canada, 2001). Religious considerations are important since a majority of independent schools and their students are religious, with particular emphasis on Catholics. The implication of these basic population statistics is that it is fairly easy to envision a Catholic system of independent schools in Ontario covering a much larger portion of the population than in British Columbia, which could mean greater savings.

In addition, the estimate of $1.3 billion assumes no savings from reducing administration of 72 separate boards of education or down-sizing the Ministry of Education itself. Obviously including such realistic assumptions would increase savings.

Countervailing examples also exist. For instance, many independent schools that do not receive support currently would most likely become eligible for support, which would reduce the overall savings. Incorporating an assumption wherein all current independent school students received support at the 50 percent level results in a halving of the annual savings available, which are still, however, substantial at $658.8 million.

There are also risks imbedded in the transition from the current system to a reformed one based on the British Columbia model with particular risks linked to how capital assets are moved from the public sphere to private organizations. These are just a couple of many examples that could reduce the savings available from such reforms.

The fiscal crisis on Ontario's doorstep demands action, either now or in response to a crisis later. Education reform must be part of the solution given its relative size to total spending. Reforming Ontario's education system rather than simply trying to make cuts or tinkering at the margins offers a real opportunity to simultaneously save money while continuing to provide Ontarians with excellent primary and secondary education. It's time for Ontarians to consider real education reforms based on proven successes in other parts of Canada.

Notes

1 For information on the report by the Commission on the Reform of Ontario's Public Services or what has been referred to more commonly as the Drummond report, please see **http://www.fin.gov.on.ca/en/reformcommission/**.

2 See for example **http://www.thestar.com/news/canada/politics/article/1139851--dalton-mcguinty-pleads-for-teacher-wage-freeze-on-youtube**.

3 In all there are 31 English public boards, 29 English Catholic boards, 4 French public boards, and 8 French Catholic boards in the province.

4 There is quite a bit of variability in per student estimates of K-12 education spending in Ontario. Much of the variance is due to whether or not, and to what extent supplemental funding and special grants are included along with basic funding. For the purposes of this article, the total amount of spending indicated in the provincial public accounts for K-12 education was used along with the Ministry of Education numbers for students enrolled in the public system.

5 See http://www.ofis.ca/index.htm for information and statistics.

6 Due to space limitations, the article was only able to present information for British Columbia, however, Alberta also offers an important alternative. For information on the individual provincial approaches to K-12 education see William Robson and Claudia R. Hepburn (2002). *Learning from Success: What Americans Can Learn from School Choice in Canada*. Milton and Rose D. Friedman Foundation. Available at **http://www.edchoice.org/Research/Reports/Learning-from-Success--What-Americans-Can-Learn-from-School-Choice-in-Canada.aspx**.

7 For information on British Columbia's independent school system please see **http://www.fisabc.ca/**.

8 For example, the international tests for mathematics, science, and English all indicate proximate results for the three provinces. For specific information please see **http://timssandpirls.bc.edu/TIMSS2007/PDF/TIMSS2007_InternationalMathematicsReport.pdf; http://timssandpirls.bc.edu/TIMSS2007/PDF/TIMSS2007_InternationalScienceReport.pdf; and http://timssandpirls.bc.edu/PDF/PIRLS2006_international_report.pdf**.

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Ontario's easiest budget cut of all: *Corporate welfare*

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Mark Milke

When politicians wish to look as if they are "doing something" for voters concerned about their economic prospects, "jobs" is a word that often arises. In Ontario, the Ministry of Economic Development and Trade reports that one key performance measurement is "jobs created/retained" (Ontario, 2011b: 13); the reference in that case was to business subsidies—also known as corporate welfare— which often advance through the jobs justification. The province even has a "Strategic Jobs and Investment Fund" which in the 2011 budget year provided support of more than $52.4 million in grants and $31 million in loans for selected businesses (Ontario, 2011a: 133).

However, before taxpayers buy into the notion that politicians can magically create jobs through redistributing tax dollars from one person or business to another, it's worth asking if such attempts to create jobs actually work. First though, a review of the current state of corporate welfare in Ontario.

Ontario corporate welfare between 1991/92 and 2008/09: $27.7 billion

Since the early 1990s, Ontario governments of every partisan stripe have used tax dollars to subsidize private for-profit businesses. Between 1991/92 and 2008/09 (the first and the last years for which comparable data is available) Ontario's governments spent $27.7 billion on direct subsidies to corporations, and averaged $2.7 billion over the past five years for which statistics are available (Statistics Canada, 2011a).

Automotive corporate welfare

Most recent corporate welfare to the automotive sector is not included in $27.7 billion figure as such payments occurred in fiscal 2009/10, beyond the Statistics Canada data currently available. Thus, that $27.7 billion figure does not account for the $13.7 billion loaned to General Motors and Chrysler in late 2009 by the Ontario and federal governments, or subsequent repayments and write-offs in 2009 and 2010.

Of note on that topic, in May 2011, federal Finance Minister Jim Flaherty claimed that as regards Chrysler Canada Inc., "The outstanding loans have now been repaid in full, more than six years ahead of schedule" (Canada 2011a). Minister Flaherty's words were only technically correct if taxpayers ignored

government loans to the "old" (pre-bankruptcy) Chrysler and concentrate only on the post-bankruptcy Chrysler. The Minister thus gave the media and public the impression that Chrysler had repaid all its loans to the federal government and Ontario. That was not in fact the case.

For example, the "old" (pre-bankrupt) Chrysler did not repay $1.2 billion in loans (Canada 2011d) and $6.6 billion in General Motors loans were also written off in the federal public accounts in 2009/10 (Canada 2011b and 2011c). Given that Ontario shared in both the loans and the losses, one-third of that $7.8 billion loss is borne by Ontario's taxpayers.

At present, the eventual net loss looks likely to be less than those two combined figures of $7.8 billion because the federal and Ontario governments continue to hold common and preferred shares in GM through Canada Development Investment Corporation (EDC 2010, 4). After subtracting the partial repayment made by both companies, the governments' sale of some shares obtained via the bailout, and the present value of GM stock still held by the two governments, taxpayers are still out $810 million on the Chrysler bailout and $4.74-billion on the GM loan. That's an estimated $5.5-billion loss, which will fluctuate only slightly, depending on the final GM share price when governments relinquish their remaining shares (EDC 2010 and Canada 2011d; calculations by author as of mid-February).

The result is that net losses to federal and Ontario taxpayers of the 2009 automotive bailouts are not yet finalized and will not be until the final tranche of shares in GM is sold.

The jobs justifications for corporate welfare flawed

A review of national and international literature on job creation claims does not support the employment claims made by governments. Timothy Bartik (1994) found that extra job growth in one locale due to targeting comes, in part, at the expense of reduced job growth in another region. Terry Buss (2001) notes that for subsidies to be justified and for accompanying job creation estimates to be credible, such studies would have identified new employment, not merely employment shifted from one job site to another.

Nigel Driffield (2004) tested the fundamental assumption of *regional* policy makers over a 20-year period, the job creation angle, and found that Western governments spent significant sums of public money on *subsidies* in order to attract internationally mobile capital in both the United States and Europe. However, he points out that the "cost per job" of the investment incentives cannot be justified "on the basis of the number of jobs directly associated with the investment alone."

Table 1: Ontario subsidies to business 1992-2009 (in $ millions)

	Operating	Capital	Total
1991/92	987	153	1,140
1992/93	970	148	1,118
1993/94	658	-311	347
1994/94	628	172	800
1995/96	602	107	709
1996/97	549	197	746
1997/98	351	74	425
1998/99	300	60	360
1999/00	396	18	414
2000/01	683	34	717
2001/02	1,152	188	1,340
2002/03	3,610	317	3,927
2003/04	1,952	255	2,207
2004/05	2,482	340	2,822
2005/06	1,698	1,166	2,864
2006/07	1,943	286	2,229
2007/08	2,658	207	2,865
2008/09	2,216	453	2,669
	21,526	**3,384**	**27,699**

Source: Statistics Canada 2011a, CANISM 384-0010

A summary of peer-reviewed judgments on business subsidies

Peer-reviewed research on business subsidies does not support political or recipient claims that corporate welfare is responsible for widespread economic growth.[1] The World Trade Organization (WTO) notes that even when considering the most celebrated examples of assistance to business—industrial policy in East Asia—at best, the results indicate that industrial policy made "a minor contribution to growth in Asia" (2006). At worst, as the literature overwhelmingly concludes, there may not be a demonstrable positive impact upon the economy, employment, and tax revenues because of the substitution effect; that is, where hiring at one company, or tax revenues in one locale, merely displace jobs and tax revenues elsewhere, but with no new employment or revenues created overall).

However, peer-reviewed literature does suggest that the best means to encourage a strong business sector for governments to ensure their jurisdictions have the most attractive investment climate possible. (see Lammam et al, 2010).

Recommendations

In the context of cutting Ontario's massive deficit, the straightforward and logical recommendation is to immediately end its $2.7 billion annual corporate welfare bill. A more neutral policy—lower tax rates for all businesses—has been shown empirically to foster business investment and economic growth (see Lammam et al., 2010). With the money saved on corporate welfare the Ontario government could continue reducing its general corporate income tax rate and help erase the rather substantial provincial deficit.

Note

1 For a full review of the literature on business subsidies, see Milke, 2007: 27-36.

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Wage board:

Fotolia

The solution to reining in public sector compensation

Amela Karabegović and Milagros Palacios

Ontario Premier Dalton McGuinty hinted last month that public sector wages may not be spared as his government looks for ways to scale back spending and eliminate the deficit (Campion-Smith, February 9, 2012). This is welcome news. Public sector compensation makes up roughly half of the province's budget so any credible plan to balance the books must tackle the thorny issue of public sector compensation (Commission on the Reform of Ontario's Public Services, 2012: 7).

To help bring public sector wages in line with the private sector and to provide the government with a tool to reduce spending in a clear and transparent fashion, Premier McGuinty would do well to consider establishing a wage board in Ontario.

Public sector wage premium

In Ontario, like other jurisdictions in Canada, public sector workers enjoy a significant wage premium. That is, public sector workers typically receive higher wages than their private sector counterparts for comparable work.

Without accounting for personal characteristics such as age, education, and experience, the average wage difference between the public and private sector workers is over 40 percent in Ontario (table 1, fourth column).[1] This wage difference ranges from about four percent for occupations in art, culture, recreation, and sports to 124 percent for those in protective services.[2]

After accounting for key wage-determining characteristics, those in the public sector[3] in Ontario earn about 14 percent (table 1, last column) more, on average, than their private sector counterparts.[4]

Ontario's public sector wage premium varies by occupation. Those in protective services receive a premium of nearly 50 percent whereas nine occupations out of 22 analyzed, including those in management occupations (not including senior managers), clerical occupations, and childcare and home support workers enjoy a premium of about 20 percent.

Table 1: Ontario, average hourly wages for 25 occupations, Labour Force Survey, April 2011 (1)

	Average wages		Raw wage premium, %	Statistically calculated wage premium, % (2) (3) (4)
	Public	Private		
All Occupations	**30.5**	**21.0**	**45.4**	**13.9**
Senior management	50.3	47.6	5.8	4.4
Other management	44.7	33.9	31.7	**19.2**
Professionals in business and finance	35.8	33.0	8.8	**8.4**
Financial, secretarial, and administrative	25.7	21.4	19.9	**9.6**
Clerical	22.7	17.4	30.8	**20.7**
Natural and applied sciences and related	35.6	31.7	12.5	**9.2**
Professionals in health, nurse supervisors, and registered nurses	36.0	32.5	10.6	5.0
Technical, assisting, and related occupations in health	27.5	21.0	31.1	**19.5**
In social science, government service, and religion	32.2	22.4	43.8	**19.5**
Teachers and professors	34.5	26.6	29.6	8.3
In art, culture, recreation, and sport	23.6	22.8	3.6	2.0
Wholesale, technical, insurance, real estate sales specialists, and retail, wholesale, and grain buyers	23.2	25.0	-7.1	n/a
Retail salespersons, sales clerks, cashiers, including retail trade supervisors	17.5	12.8	37.0	**22.3**
Chefs and cooks, and occupations in food and beverage service	17.8	12.7	40.1	**17.5**
In protective services	31.5	14.1	124.0	**48.7**
Childcare and home support workers	19.9	14.1	40.8	**23.0**
Sales and service, including travel and accomodation, attendants in recreation and sport	19.2	12.9	48.8	**18.1**
Contractors and supervisors in trades and transportation	34.9	28.4	22.8	**12.8**
Construction trades	29.0	22.5	28.6	n/a
Other trades	32.0	24.3	31.7	**18.3**
Transport and equipment operators	25.0	19.8	26.1	**17.3**
Trades helpers, construction, and transportation labourers	20.0	18.1	10.9	-3.9
Unique to primary industry	21.7	18.1	20.0	9.2
Machine operators and assemblers in manufacturing	33.3	20.8	60.1	**38.2**
Labour in processing, manufacturing and utilities	n/a	16.0	n/a	n/a

Notes:
(1) Self-employment is not included.
(2) Bolded estimates are signficant at either a 90%, 95% or 99% level.
(3) n/a indicates that there were very few or no public sector workers in an occupation to compute a premuim.
(4) The control variables used in these regressions include controls for sex, age, marital status, education, experience, type of employment (seasonal, contractual), establishment size, and part-time work.

Sources: Statistics Canada (2011); calculations by the authors.

When governments have a monopoly on service provision, it enables the public sector unions to extract a significant wage premium by threatening to strike. If they strike, the public has no alternative to the monopolized services, services nobody else can legally provide.

Even chefs and cooks and other food and beverage service (including supervisors) occupations receive a 18 percent wage premium.[5]

Given the average wage premium of 14 percent, a rough calculation indicates that the Ontario government could save up to $3.8 billion by calibrating pay in the public sector to that in the private sector. Put differently, the government of Ontario could eliminate nearly one-quarter of the current deficit, of $16 billion in 2011/12, by reining in public sector wages (Ontario, Ministry of Finance, 2011).[6]

Importantly, these premiums and cost savings are for wages only. Benefits, such as pension and health, vacation time, and job security, are also typically more generous in the public sector than in the private sector. The overall compensation premium and the cost savings are therefore higher than the wage data suggests.

While the Commission on the Reform of Ontario's Public Services dedicated a chapter on public sector labour relations and compensation, it unfortunately did not address the substantial premium enjoyed by the public sector. Rather the Commission called for reforms such as increased transparency of total public sector compensation (wages, pensions, and other benefits) and better tracking of changes in compensation, among other things. (2012: 363-381). Even though these recommendations would enable the government to make better informed decisions when negotiating with public sector unions, they leave the same inefficient compensation structure in place.

Extracting higher than normal compensation from the government

The main drawback of the current structure is that public sector workers are employed by the government whose services (health care, education, public transit) do not face competitive pressures and are not driven by profitability objectives.

When governments have a monopoly on service provision, it enables the public sector unions to extract a significant wage premium by threatening to strike. If they strike, the public has no alternative to the monopolized services, services nobody else can legally provide.

In the private sector, in contrast, where there is competition, a strike simply means that the public has to choose from many other alternative products or services. That is, a strike in the private sector does not result in significant inconvenience to the public.

Moreover, in the private sector both the employer and union have an incentive to settle their differences quickly. Unions know that excessive wage demands will make the firm uncompetitive and result in a reduction in employment. Employers, on the other hand, face trade-offs between wage demands and a loss of market share, profitability, etc. that result from a prolonged dispute. Ultimately, parties come up with a compromise acceptable to both. In the public sector, excessive wage demands do not typically translate into lay-offs or higher unemployment since the public sector has no profit constraint.

Simply put, the lack of competition and profit motive allows public sector workers to extract higher than normal compensation from the government.

The solution: An Ontario wage board

Given the inherent structure of the public sector, more sweeping reforms are needed to rein in the Ontario government's wage bill.

For starters, the government should create a wage board, an independent governmental body responsible for collecting, analyzing, and setting public sector wages and benefits based on private sector equivalents.[7] There are many benefits of this approach.

A wage board would de-politicize the negotiation process on matters related to public sector compensation and better match public sector wages with the economic conditions of the times. This is a more rational approach than the status quo which can include ad hoc cycles of generous increases in good economic times and freezes or even cuts in bad times.

Premier McGuinty has a great opportunity to tackle public sector compensation in his upcoming budget. Establishing a wage board would fix the imbalance in the public sector and work toward the

ultimate goal of getting Ontario's fiscal house in order.

Notes

1 Unless otherwise noted, the calculations presented in this article are by the authors and based on Statistics Canada Microdata file, April 2011 Labour Force Survey.

2 There is only one occupation—Wholesale, Technical, Insurance, Real Estate Sales Specialists, and Retail, Wholesale and Grain Buyers— for which the wage difference between the public and private sector workers is negative, indicating that the public sector workers are paid less than those in the private sector.

3 Public sector employment includes employees in public administration at the federal, provincial and municipal levels, as well as Crown corporations, liquor control boards, and other government institutions. Unfortunately, the Labour Force Survey does not break down the data by the level of government. For this reason, the average wage premium of 14 percent is based on public sector workers working for all three levels of government, federal, provincial, and local in Ontario.

4 These findings are in line with the research on public sector wage premium in Canada. See, for example, Gunderson (1979), Gunderson, Hyatt, and Riddell (2000), Tiagi (2010), and Lahey (2011).

5 For some occupations, even though there is a large raw wage difference, the wage premium is not significant, i.e., it is not statistically different from zero. Teachers and professors are a good example. The raw wage difference between the public and private sector teachers is about 30 percent but once other factors are taken into account, the wage difference disappears. In the teachers and professors example, it is the longer tenure of public sector teachers that, once accounted for, makes the wage premium insignificant.

6 The costs savings were computed by multiplying the total wage bill of Ontario public servants and those working in the education and health sectors in 2011, $27.6. billion, by the wage premium of 13.9 percent (Statistics Canada, 2012; calculations by authors).

7 For a detailed discussion of wage boards, see Christensen (1980).

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Improve health care and tackle the deficit

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Nadeem Esmail

Thanks to poor management, the government of Ontario is faced with a difficult fiscal situation. Given that tax increases would severely hinder the province's economic recovery, the Ontario government must begin contemplating reductions in government spending. With health spending being the government's largest expense at 42% of program spending, health care is an obvious target (Ontario, Ministry of Finance, 2011b).

While past experience has shown that governments looking to reduce health care expenditures should expect backlash from the public, this need not be the case. Canadians simply do not want to see increased rationing of health care services that might result from reduced expenditures. The key to avoiding that outcome is to reform the way in which health care is financed and delivered.

Lessons from other nations

Canada maintains the developed world's fifth most expensive universal access health care system as a share of GDP after the Netherlands, France, Germany, and Denmark. Our health care expenditures are 22 percent higher than in the average developed nation that has a universal access health care system (OECD, 2011; calculations by author).

Within Canada, provincial health expenditures in Ontario are only slightly below the national average on a per capita basis (CIHI, 2011). In spite of these high expenditures, Ontarians endure relatively poor access to medical professionals and technologies, are cared for with far too many old and outdated pieces of medical equipment, and must wait for health care in some of the longest queues for treatment in the developed world (Esmail and Walker, 2008; Esmail, 2008).

Ontario should be taking lessons from other nations that are able to purchase higher quality health care for similar or less money. Getting more for less in health care, however, will require adopting two key health policies that are common in other nations with universal access health care: consumer cost sharing and competition in the delivery of publicly funded care.

Cost sharing

Cost sharing—that is, requiring patients to share in the cost of their care—is essential to providing a less expensive and more accessible universal health care system. The reasoning is straightforward: people spend their own money more wisely than they spend

someone else's. According to research and international evidence, when patients are responsible for some of the cost of their care, they use fewer resources, making more available for other patients and saving money overall, and end up no worse off in terms of health outcomes (Esmail and Walker, 2008).

Just how much money might such a policy save? A 2004 study of cost sharing in Alberta found that a 25% coinsurance payment (with reasonable annual limits for patients, old-age and low-income exemptions, and exemptions for hospital care for children and the elderly) would reduce total Medicare spending (including the additional out-of-pocket payments made by Albertans under the scheme) by some 12%. The resulting reduction in public spending on health care would be approximately 20% (Ramsay and Esmail, 2004).

The same approach in Ontario could be expected to reduce the $47.1 billion the province plans to spend on health and long term care in 2011/2012 by approximately $9.4 billion (Ramsay and Esmail, 2004; Ontario, Ministry of Finance, 2011b; calculations by author).

Despite the fact that cost sharing for core services like hospital care and physician services is used in a large majority of developed nations with universal access health insurance programs (Esmail and Walker, 2008), it remains a violation of the Canada Health Act. This leaves open the possibility that Ontario's cash transfers for health and social services could be reduced by the federal government as a result of non-compliance with the Health Act. Under section 20 of the Canada Health Act, the federal government shall deduct from cash transfers the amount that was charged through user fees. Under the scenario above, this would mean a penalty of approximately $3.8 billion.[1]

Competition in delivery

Another way to reduce spending and improve the state of health care in Ontario would be to change the way hospitals are funded and allow more competition in the delivery of publicly funded services. To that end, Ontario should scrap its current "global budget" funding model for hospitals, through which hospitals receive a set amount of money each year and thus see every patient as a drain on their budget. Instead, the province should move to activity-based funding, through which hospitals would be paid per patient. This would save Ontarians significant resources, while at the same time providing them with a greater quantity and quality of services from hospitals that would be operating more efficiently (Esmail, 2007).

Sweden's experience with moving to activity-based funding provides some insight. Gerdtham, Rehnberg, and Tambour (1999) studied the move to activity-based funding by the Swedish county councils (provinces) in 1993 and 1994 and estimated that the cost savings resulting from this reform were approximately 13%. For Ontario, a 13% cost savings on hospital care[2] would be equal to about $2.2 billion in 2011/12 (Gerdtham et al., 1999; Ontario, Ministry of Finance, 2011b; calculations by authors).

Conclusion

Through consumer cost sharing and competition in the delivery of publicly funded care, Ontario could have reduced public health spending by roughly $11.6 billion in 2011/2012. That reduction in spending would have

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Our health care expenditures are 22 percent higher than in the average developed nation that has a universal access health care system

cut the $16 billion forecast deficit by a remarkable 72% (Ontario, Ministry of Finance, 2011a; calculations by authors). Of course, as user fees/cost sharing would be a violation of the Canada Health Act, these savings would be reduced through required penalties levied under section 20 of the Act to $7.8 billion or 49% of the forecast deficit—still a substantial savings and reduction in the deficit.

This would be of immense benefit in getting Ontario fiscally back on track. At the same time, the allocation of medical resources in the system would have improved, actually leading to better access to health care services for Ontarians.

Ontario's history of poor fiscal management is likely to result in a reduction in spending in the future. But that reduction in spending need not reduce the quality of public services. Indeed, the level of misallocated and wasted resources in health care is high enough to allow the province to substantially reduce spending through sensible health care reform while actually improving access to health care.

Notes

1 This would be the amount of health expenditures shifted from tax-funded sources to users of the health care system as a result of user fees. The federal government could also determine that cost sharing is a violation of the principles of the Canada Health Act and thus withdraw all health and social cash transfers to Ontario. The penalty in that scenario would be $15.2 billion (Department of Finance Canada, 2012). However, given the common application of cost sharing in health care systems that in many cases outperform Canada's (Esmail and Walker, 2008), the substantial improvement in Ontario's fiscal balance that would result, and the fact that no province has yet been penalized for a violation of the principles of the Act (Boychuk, 2008), this seems a less likely outcome.

2 The estimated cost of hospital care for 2011/12 is calculated from budget spending estimates using the forecast percentage distribution of provincial health expenditures to hospitals for 2011/12 in CIHI, 2011.

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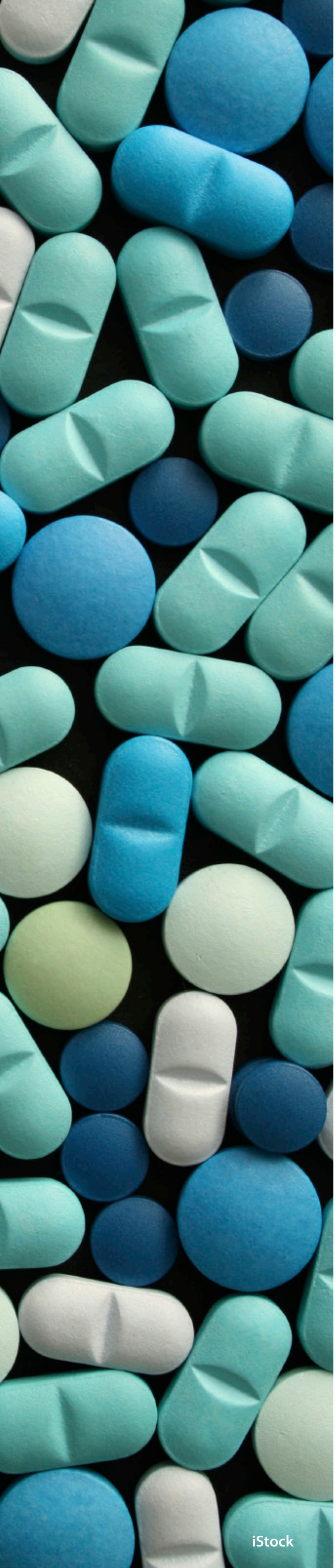

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Reformring Ontario's Public Drug Plan

Mark Rovere

The government of Ontario currently operates Canada's largest taxpayer-funded prescription drug program, accounting for 45 percent of the province's total drug expenditure and covering 2.8 million residents at a cost of over $4 billion per year (Ontario, Ministry of Health and Long-Term Care, 2011a). One way to significantly reduce public drug spending in Ontario is to take a serious look at how the province manages its publicly-funded drug plans.[1]

Three reasonable reforms could provide significant savings for the province, which would allow Ontario to reduce its existing deficit more quickly than currently expected. First, the province could achieve significant savings by allowing competition to determine prices for generic drugs. Second, the province should replace flat co-payments with percentage based co-payments for public drug plan recipients. Doing this would create price-sensitivity and therefore further generate price competition among retail pharmacies. And third, the public drug plan's aged-based eligibility criteria should be replaced with means-tested eligibility for catastrophic coverage.

Price-fixing a failure

It has been well documented that Ontarians, and Canadians more generally, pay significantly more for generic drugs than their international counterparts (Skinner and Rovere, 2008; Skinner and Rovere, 2010a).[2] Government policies that have removed incentives for retail pharmacies to compete on price are the primary reason for inflated generic drug prices.[3]

Unless physicians stipulate that a brand name drug is medically necessary, Ontario's public drug plan will only reimburse pharmacists for the lowest cost interchangeable generic drug (a generic drug with the same active ingredients as the prescribed brand name drug) (Ministry of Health and Long-Term Care, 2011b). This "forced substitution" policy is intended to maximize savings by using cheaper generic medicines.

In order to ensure that the province would reap the financial benefits from forced generic substitution, in 1993 Ontario introduced the "75/90" legislation, the first provincial legislation regulating the prices of generic drugs entering the market (Anis et al., 2011). This legislation stipulated that new generic drugs listed on the public formulary (list of publicly covered drugs) could not be priced at more than 75% of the original brand name product price, and subsequent generics were required to be no more than 90% of the first generic. Since pharmacists know well in advance what the government is willing to pay for their product, there was no incentive for retail pharmacies to compete on price.

The unintended consequence of the "75/90" legislation was evident when Ontario amended the law in 1998 to "70/90," and again to "50/90" in 2006 in order to reduce the prices it was paying for generic drugs (Anis et al., 2011). In 2010, the government imposed an even lower fixed price for generic alternatives—25 percent of the brand name equivalent (Ontario, Ministry of Health and Long-Term Care, 2010).

While it is encouraging that the province has recognized that taxpayers are overpaying for cheaper generic alternatives, setting maximum price levels was part of the problem in the first place. Ontario could save significantly more if it allowed drug prices to be determined by competitive market forces, thus lifting the arbitrary maximum price levels that the province has imposed[4], in combination with introducing greater price sensitivity for public drug plan recipients.

Introducing price sensitivity to public drug plan recipients

In addition to removing the "fixed price" approach for generic drug pricing, the Ontario

government should also consider reorganizing the way in which recipient co-payments are structured.

Under the current model, public drug plan recipients are responsible for paying a very small flat co-payment when they buy their drugs, regardless of the drug or the quantities prescribed, and are not responsible for paying dispensing fees.[5] Because the total prescription cost does not affect the co-payment amount, and because the co-payment is low, there is no incentive for consumers to shop around for the lowest drug prices or dispensing fee—for them, the price is the same at every pharmacy. In other words, consumer price sensitivity is essentially non-existent.

Ontario's public drug plans could use a more effective approach to insurance by charging its recipients a percentage based co-payment when they buy their drugs, up until a predetermined means-tested threshold has been met. By doing this, consumers would care more about price and would be motivated to shop around—creating additional incentives for pharmacies to offer competitive prices and dispensing fees. Charging patients a percentage based co-payment for prescription drugs (and medical services more generally) is an economically sensible policy that is common in many European countries (European Observatory on Health Systems and Policies, 2010).

If prices were determined by competitive market forces instead of fixed prices set by the province, and if consumers were responsible for paying a co-payment based on a percentage share of the full prescription price (up to a predetermined deductible), they would naturally be encouraged to shop around for the lowest prices—forcing pharmacies to compete—which would save the provincial government a significant amount of money.

Replace age-based drug subsidies

Another problem with Ontario's public drug plans is that they cover those who do not require financial assistance. While all of the province's drug plans provide subsidies for individuals and families with low incomes, as of 2008 1.8 million Ontario residents over 65 were eligible for the Ontario Drug Benefit (ODB) program, regardless of their income.

Ontarians aged 65 years and older account for 69 percent of ODB recipients (Ministry of Finance, Ontario, 2010; Ministry of Health and Long-Term Care, 2011a). However, not all seniors require financial assistance to pay for their prescription drugs. While it is true that on average, seniors spend between three and four times more on medication than those under the age of 65 (CIHI, 2010), it does not mean that they require a public subsidy to pay for their drugs. In 2008, the median after-tax income of families 65 years and older in Ontario was $51,600 (Statistics Canada, 2010). Moreover, according to the Ontario government, 7 percent of the ODBs beneficiaries account for 32 percent of the program's total costs. In other words, ODB recipients with catastrophic drug expenditures are few in number and account for a little less than one third of the ODB's total costs. Thus, instead of providing comprehensive drug coverage for people based on age alone, the province could save significant money by allocating public funds only to those with catastrophic drug expenses relative to their income regardless of age.[6]

An estimate of the potential savings from this type of reform can be made based on the experience of British Columbia. In 2003, BC replaced its aged-based public drug program with Fair PharmaCare, an income-based plan. Under the program, financial assistance is provided to any BC resident who has catastrophic prescription drug costs relative to his or her net income (Ministry of Health, British Columbia, 2011). A 2006 study showed that the substitution of the province's age-based program with Fair PharmaCare likely resulted in a 16.9 percent decrease in public spending without reducing access to prescription drugs for seniors (Morgan et al., 2006).

If a similar policy were implemented in Ontario (and assuming comparable savings could be generated), the province could save a minimum of approximately $710 million (16.9 percent of Ontario's $4.2 billion public drug program) (Ministry of Health and Long-Term Care, 2011c; Rovere and Barua, 2011).

Conclusion

At a cost of over $4 billion dollars a year, and with significant room for reform, the Ontario government could reduce its deficit at a much faster pace by restructuring the province's publicly funded drug program.

Notes

1 The program consists of four publicly funded drug plans: the Ontario Drug Benefit [ODB] program for all seniors over age 65, the Trillium Drug Program for Ontarians with catastrophic drug cost relative to income, and two special access programs (the Special Drugs Program and the New Drug Funding Program for Cancer Care) (Ministry of Health and Long-Term Care, 2011a).

2 For example, a recent analysis found that in 2008, average generic drug prices in Canada were 90 percent higher on average than American prices for the exact same drugs (Skinner and Rovere, 2010a). Further, average retail prices for generic drugs in Canada were 73 percent of the price of their brand name equivalent in 2008, compared with just 17 percent on the price of their brand name version in the US (Skinner and Rovere, 2010a).

3 Because Ontario's public drug plans are such a significant purchaser of generic drugs (45 percent of total drug

expenditures), the province's public policies have distorted the entire market. Consequently, price competition among drugs purchased by private insurers is essentially non-existent.

4 Importantly, markedly lower generic drug prices found in the US result from competition in the marketplace rather than direct government intervention. Under the current structure, where generic drug prices are "fixed" at a percentage of the brand name version, there is no incentive for pharmacies to compete on price because they know well in advance what the public insurer is willing to pay. By contrast, in the US where prices are determined by competitive market forces, pharmacies are forced to compete by lowering their prices. For instance, as a result of Wal-Mart's $4 prescription drug plan introduced in 2006, most other US pharmacy chains now offer similar in-house drug programs (Skinner and Rovere, 2010a). This intense competition has enabled Americans to take advantage of low cost generic drugs at prices that are well below that in Ontario even with the government's price fixing. In fact, a 2008 study that compared generic drug prices among 12 countries found that the cheapest generic drugs were in the US, where there is no government involvement in generic drug pricing (Furukawa, 2008).

5 Retail pharmacies in Ontario charge a dispensing fee for filling prescriptions. However, the Ontario government covers the dispensing fee for all of the province's public drug plan recipients (Ministry of Health and Long-Term Care, 2011d).

6 For example, the Kirby Report (2002) suggests that drug costs more than 3% of an individual's income should be considered catastrophic. Similarly, the Trillium Drug Program considers drug costs exceeding 4% of income as catastrophic.

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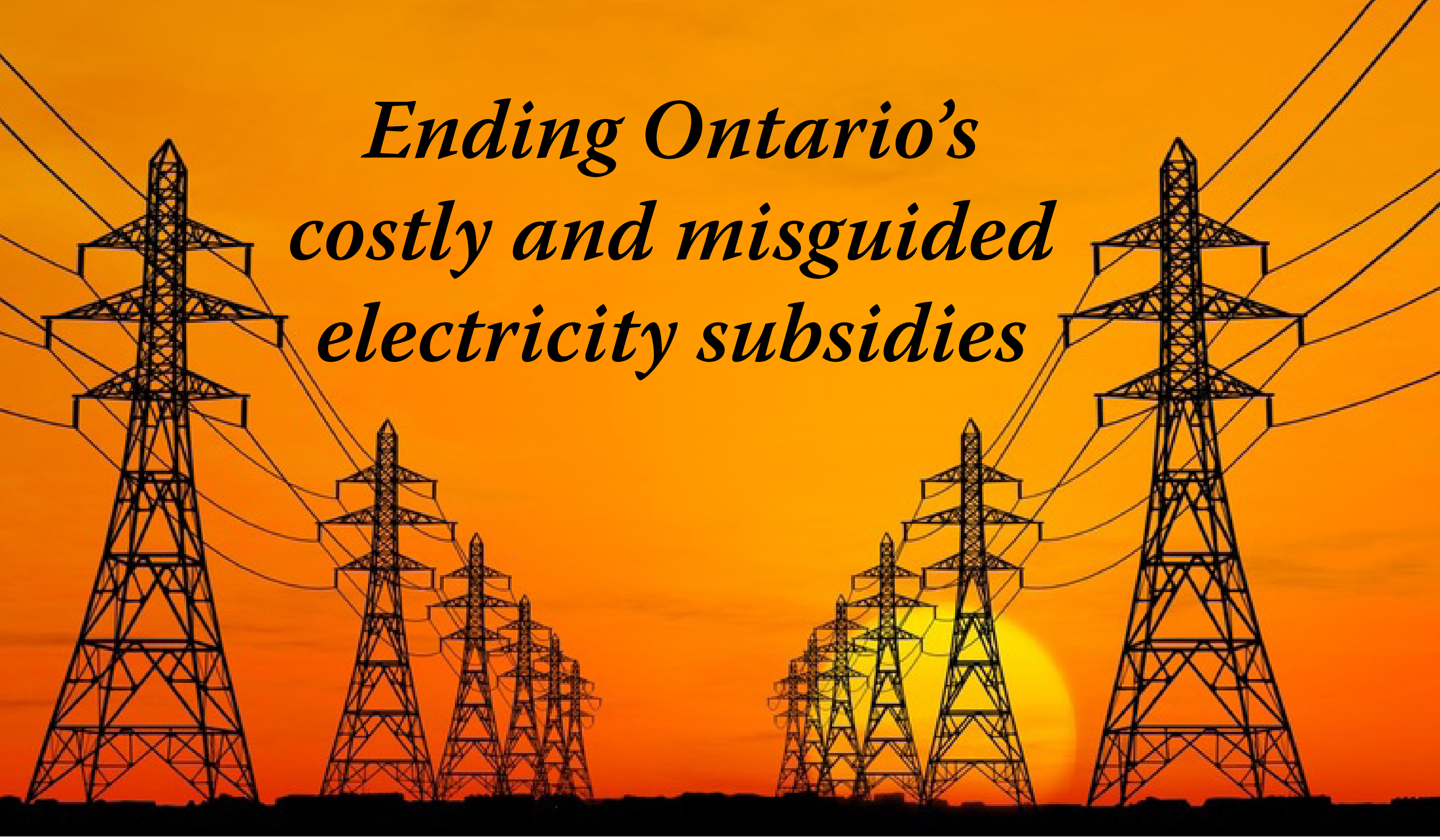

Ending Ontario's costly and misguided electricity subsidies

Fotolia

Joel Wood

The Ontario government currently subsidizes both the consumption and production of electricity. These subsidy programs are very costly and operate at cross purposes; ending them provides an opportunity to make a real dent in the provincial budget deficit.

Due to public outcry about rising electricity bills, the Ontario government introduced the Ontario Clean Energy Benefit (OCEB) to reduce the electricity bills of households, small businesses, and farms. The OCEB, effective January 1, 2011 is a subsidy that provides an immediate 10 percent reduction on electricity bills (OME, 2011). The OCEB is paid directly out of provincial revenues and is scheduled to be doled out until 2016.

According to the recently released report by the Commission on the Reform of Ontario's Public Services, the OCEB is estimated to cost $1.1 billion in fiscal year 2011/12 (CROPS, 2012). Electricity prices in Ontario are forecasted to continue to increase (OME, 2010); therefore the cost of the subsidy will increase proportionally in the future.

The subsidy is equivalent to a 10 percent decrease in electricity prices for eligible groups. The OCEB encourages these electricity consumers to use more electricity than they otherwise would have without the OCEB. The additional electricity consumed is electricity that could be either sold to other jurisdictions or not generated at all. Indeed, the OCEB discourages energy conservation (CROPS, 2012).

Also, considering that household energy use increases with household income (Statistics Canada, 2007), it is likely that that the OCEB benefits higher income households more in absolute terms than lower income households. This means the program provides more relief to households that are less in need of that relief.

A major flaw in the rationale for the OCEB is that the subsidy only delays the eventual increase in electricity prices five years into the future (CROPS, 2012). When the OCEB ends, electricity consumers in Ontario will face a 10 percent increase in their electricity bills, plus any additional increase due to rising electricity prices more generally. The cost of delaying this price increase is over a billion dollars a year in added provincial debt, which will require higher interest payments for servicing the debt. The added debt will also need to be repaid in the future placing the burden on the next generation of Ontario families.

Ontarians are rightly concerned about rapidly rising electricity prices, but the government's energy policies targeted at renewable electricity producers are exacerbating the problem. Forecasts in *Ontario's Long Term Energy Plan* predict that Ontario elec-

tricity prices will increase by about 46 percent between 2010 and 2015, with 56 percent of that increase attributed to investment in renewable energy (OME, 2010). However, the forecasts in the long term energy plan significantly underestimate the price increases due to the planned renewable energy investments (Gallant and Fox, 2011).

A large portion of the investment in renewable energy in Ontario comes through the feed-in tariff program that provides renewable energy projects with 20 year contracts with guaranteed purchase rates provided by the Ontario government, depending on technology, that are far above the current rate at which electricity is sold to Ontario consumers. Put simply, the feed-in tariff program is a very expensive way of achieving environmental improvements (see Dachis and Carr, 2011; Wood, 2011). And the program was recently criticized by the Auditor General of Ontario (Office of the Auditor General of Ontario, 2011).

The feed-in tariff program is a costly approach to reducing greenhouse gas emissions. Dachis and Carr (2011) calculate that emissions reductions under the program cost on average $177 per tonne of emissions reduced. Wood (2011) examines the cost with respect to each specific technology and finds that the cost per tonne of greenhouse gases reduced ranges from $86 for Hydroelectric and $819 for solar. Using natural gas generation and purchasing greenhouse gas emission offsets is much cheaper at around $27 per tonne of emissions reduced(Wood, 2011).

The Auditor General recently criticized the feed-in tariff program for high rates, limited oversight, and misleading publicity. First, the Auditor points out that Ontario offered much higher feed-in tariff rates than other jurisdictions in North America that have implemented similar programs (Office of the Auditor General of Ontario, 2011). Second, the Auditor points out that the Ontario government has never conducted a proper cost benefit analysis on the program (Office of the Auditor General of Ontario, 2011). Third, the Auditor claims that the number of jobs created by the program is misleading because the government does not count the jobs destroyed through higher electricity prices due to the program and that most of the jobs created are short term construction jobs (Office of the Auditor General of Ontario, 2011).

Scrapping the feed-in tariff program will result in smaller increases in electricity prices than proceeding with another round of feed-in tariff contracts.[1]

The government of Ontario should immediately scrap the Ontario Clean Energy Benefit, thus reducing the 2012/13 deficit by over $1.1 billion. Long term solutions are needed to address Ontario's escalating electricity prices, such as walking away from the feed-in tariff program.

The Auditor General recently criticized the feed-in tariff program for high rates, limited oversight, and misleading publicity.

Note

1 The guaranteed rates offered through the feed-in tariff program are significantly higher than the cost estimates of natural gas generation provided by EIA (2011).

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Getting Ontario's taxpayers off the hook for private pension liabilities

Nachum Gabler and Neil Mohindra

Fotolia

Of the 362 recommendations contained in the Commission on the Reform of Ontario's Public Services (2012), one that failed to draw significant attention was the notion of scraping Ontario's Pension Benefits Guarantee Fund (PBGF).

The PBGF is a fiscal albatross. The fund was initially established to protect beneficiaries of privately-sponsored Defined Benefit (DB) pension plans if the plan sponsor became insolvent and unable to meet its pension obligations. DB pension plans entail an employer allocating sufficient money for entitled employees, based on certain demographic characteristics and employment history, such that the benefits are known and assured from the outset. The benefits are "defined" in the sense that the formula for computing the level of benefits is known at commencement and the employer is the party exposed to any investment risk. The PBGF currently guarantees up to $1,000 per month for covered employees. The guarantees are supposed to be funded by premiums collected from plan sponsors but, as we shall see, the premiums often fall short.

Memberships in DB pension plans in the private sector has dropped over the past two decades, falling to 15% in 2010 from 30% in 1990, in favour of increasing enrollment in defined contribution (DC) pension plans. DC plans entail an employer allocating a specified sum of money on behalf of the employee. The employee then bares the investment risk. For DC pensions, the amount contributed is fixed, but unlike DB pensions, the benefits are not. There are several causes for declining membership in DB plans, primarily related to changes in regulations and economic circumstances. On the regulatory side, the causes include changes in pension management and investment rules as well as changes in accounting rules and procedures. On

Table 1: Ontario Pension Benefit Guarantee Fund cumulative deficits/surpluses (year end March 31) (in $ millions)

2003	2004	2005	2006	2007	2008	2009	2010	2011
-137.5	-107.2	-237.4	-274.2	-112.8	-102.2	-47.4	103.3	-6.2*

*Note: The PBGF has typically been in deficit. At its peak in 2006 the PBGF's cumulative deficit reached $274.2 million. By 2009, the PBGF's cumulative deficit had fallen somewhat, but was still running at $47.4 million. Then, in 2010 the PBGF ran its first and only cumulative surplus, amounting to $103.3 million. The change in financial position during 2010, from a $47.4 million deficit to a $103.3 million surplus was the result of a $500 million transfer by the Ontario government to the PBGF, in order to insure Nortel's pension obligations to its Ontario employees after filing for bankruptcy in 2009. However, the $500 million transfer from the Ontario government was a one-shot financial injection that has been dispersed among Nortel employees who were entitled to the PBGF's coverage. As of 2011 the PBGF had returned to a deficit position, with a cumulative deficit amounting to $6.2 million.

Source: Financial Services Commission of Ontario, 2011, 2010, 2009, 2008, 2007, 2006, 2005, 2004

the economic side, the causes include changes in workers' characteristics, changes in employers' characteristics, and macroeconomic changes like falling long-term interest rates and depressed equity prices that reduce the value of a pension fund's invested assets (Turner and Hughes, 2008; Expert Commission on Pensions, Ontario, 2008).

The PBGF constitutes a subsidy to the shrinking number of employees still entitled to DB plan coverage, at the expense of the tax paying public and an increasing number of employees who are not privy to these entitlements. And these subsidies have been substantial; the fund's financial position has been and continues to be weak with the Ontario government stepping in and using tax dollars to cover the fund's deficits on more than one occasion. For example, in 2002 when Algoma Steel was unable to meet its pension obligations the Ontario government transferred $330 million to the fund; another $500 million was transferred in 2010 when Nortel's pension plan proved insolvent.

A 2010 report authored by actuaries at Eckler Ltd. (2010) on behalf of the Ontario Ministry of Finance concluded that "the PBGF is not sustainable in its current form" and stated that, "expected future assessments are insufficient to cover expected future claims plus expenses." As of March 2011, Ontario's pension regulator, the Financial Services Commission of Ontario, reported the fund's cumulative deficit was running at $6.2 million despite the most recent bailout (Financial Services Commission of Ontario, 2011). However, the deficits have often been higher and tend to increase in times of economic hardship when claims are on the rise and income from the investment of assets is declining (Financial Services Commission of Ontario, 2010). The PBGF's cumulative deficit/surplus position is presented in table 1. According to the Drummond Report "The Fund is no longer sustainable in its current form as it presents a large fiscal risk for the province in the event of another economic downturn" (Commission on the Reform of Ontario's Public Services, 2012). The fund is unsustainable because collected premiums intended to support current and future claims have been insufficient to meet those obligations.

Although Ontario is the only Canadian province with a fund guaranteeing private sector defined benefit pension plans, the problems it is experiencing are similar to those of comparable funds in other jurisdictions, including the United States and United Kingdom. According to a Brookings Institute report, the US Pension Benefit Guarantee Corporation's finances have never balanced the payout risks and the level of premiums being charged (Elliot, 2009). The Pension Benefit Guarantee Corporation ran a deficit of US$26 billion in 2011; the deficit is at the largest it has been since the corporation's inception in 1974 (Pension Benefit Guarantee Corporation, 2011). The UK's Pension Protection Fund has acknowledged that it currently does not have sufficient financial resources to pay existing levels of compensation, is not yet self-sufficient, and will not be fully funded until at least 2030 (Pension Protection Fund, 2010).

Government sponsored pension guarantee funds are not financially sustainable because the funds often fail to collect adequate premiums that accurately account for, and fully offset, the risks being insured against (Government Accounting Office, 2005; Blahous, 2011). Furthermore, guaranteeing private defined benefit plans via a commitment from taxpayers creates a "moral hazard"—the notion that plan sponsors (employers) will take on more risk because the full costs of their actions are borne by someone else. The Ontario Expert Commission on Pensions (2008) noted the potential for the PBGF to induce "overly risky behavior." Employers are tempted to make overly generous benefit commitments in the belief that difficulties in meeting future liabilities will be mitigated by the fund, or more accurately taxpayers (Elliot, 2009). That is, the risks of promising unaffordable benefits are mitigated because the PBGF will insure the imprudent commitment.

Dismantling the taxpayer-guaranteed fund will not necessarily result in significant hardship to DB plan members in Ontario. It is difficult to envision a scenario where plan members would experience a complete loss. Although a plan may be underfunded when the sponsor goes bankrupt, the plan will nevertheless have assets from the sponsor's previ-

ous contributions. Hence, the likely scenario would be reduced benefit levels for plan members rather than a complete loss. The upwards of a 35% reduction in benefits that some Nortel pensioners experienced is a good example (Wilkinson and Sproule, 2009; Lewis, 2011); the cut was unpleasant but not catastrophic. Also, reductions only apply to the private pension commitments between an employer and their employee. Other sources of retirement income like monthly Canadian Pension Plan and Old Age Security payments and investments in RRSPs would be unaffected.

The experience in Ontario and other jurisdictions has demonstrated that government sponsored pension benefits protection plans are not sustainable without broader taxpayer support. Drummond is right in that the guarantee fund should be scrapped, and the Ontario government should announce a plan to this effect in the next budget.

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FRASER INSTITUTE

POLICY BRIEFINGS

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Understanding
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Lessons for Greece? Currency Partner for Canada?

Heidar Gudjonsson

Economist and chairman of Iceland's Centre for Social and Economic Research (RSE), an independent free-market think-tank.

Ársæll Valfells

Assistant professor of finance at the University of Iceland and non-executive board member of Islandsjodir, the country's largest fund management company.

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