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Ontario's Corporate Welfare Bill: $27.7 billion

by Mark Milke, Ph.D.

Main Conclusions

- **Between 1991/92 and 2008/09, Ontario's governments spent $27.7 billion on direct subsidies to corporations.**
- **In 2008/09 alone, the bill for corporate welfare amounted to almost $2.7 billion. For anyone who paid income tax in 2008, the cost of corporate welfare was $424 per Ontarian (or $848 per dual-income couple).**
- **By lowering taxes rates for all and offering subsidies to none, Ontario's government could concentrate its spending and tax policy where it would do the most good.**
- **Ontario's corporate welfare has an opportunity cost. The province's corporate welfare expenditures could have been redirected (in the current fiscal year) to one of the following:**
    - **Nearly eliminate Ontario's Health Premium, estimated at $3.1 billion for 2011/12;**
    - **Nearly eliminate the top personal income tax (PIT) surtax of 36% and reduce the lower surtax from 20% to 10% (a loss in personal income tax revenue of $3.3 billion in 2011/12);**
    - **Further reduce the corporate income tax (CIT) rate to 8% in 2011/12, a $2.9 billion revenue loss.**
    - **Reduce Ontario's annual deficit by $2.7 billion a year.**

What is corporate welfare?

A government subsidy to business occurs when a government transfers tax dollars to business for reasons other than the receipt of goods or services. In academic jargon, such a subsidy is often referred to as "targeting," because government support is "targeted" at a particular business or industry. In common parlance, such business subsidies are known as "corporate welfare." These terms are largely interchangeable.

This definition of corporate welfare does not include tax reductions, deductions, credits, or exemptions. Money earned by individuals or businesses belongs first to those who earned or created it. Thus, in most cases, it is incorrect to label a tax reduction, deduction, credit, or exemption as a subsidy, though in the case of *preferential* tax treatment given to one business or sector, such special treatment mimics subsidies. However, a subsidy clearly occurs when resources are transferred (e.g., when tax dollars are transferred from the public treasury to a business).

About the author

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Governments can—and do—pick winners and losers in the business world through other means: trade protection, the granting of domestic monopolies (for example, agricultural "supply management" boards), and preferential "Canada first" bidding for government contracts are all examples of how governments favour some companies over others. While these other forms of favouritism are important and most often reduce competition, this analysis will focus on direct government payments to individual businesses for the reason that the available Statistics Canada data are structured in just that manner. Such an approach is also useful given that the data are comparable between provinces and over successive years (for both federal and provincial governments).

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 are available), Ontario's governments spent $27.7 billion on direct subsidies to corporations (Statistics Canada, 2011a). Thus, the penchant for corporate welfare has been consistent regardless of party affiliation and ideological leaning. In the time analyzed, corporate welfare has taken place under the New Democratic Party government of Bob Rae (1990-1995), the Progressive Conservative government of Michael Harris and Ernie Eves (1995-2003), and the present Liberal government under Premier Dalton McGuinty (first elected in 2003).

New corporate welfare in the automotive sector not yet captured

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

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). However, Minister Flaherty's words were technically correct only if taxpayers ignored government loans to the "old" (pre-bankruptcy) Chrysler and concentrated only on the post-bankruptcy Chrysler. The Minister 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 (Personal e-mail communication with Stephanie Rubic, Department of Finance, Ottawa (November 2, 2011)[1]). Similarly, $6.6 billion in General Motors loans were also

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

	Operating subsidies	Capital subsidies	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; CANSIM, 384-0010.

written off in the federal public accounts in 2009/10 (Personal e-mail correspondence with Department of Finance Canada (May 30, 2011); and Canada, 2011b). Given that Ontario shared in both the loans and the losses, Ontario's taxpayers are bearing one-third of that $7.8 billion loss.

At present, the eventual net loss looks likely to be less than $7.8 billion because the federal and Ontario governments continue to hold common and preferred shares in GM through Canada Development Investment Corporation worth approximately $3.5 billion as of November 2011. The result is that net losses to federal and Ontario taxpayers from the 2009 automotive bailouts are not yet finalized, and will not be until the final tranche of GM shares is sold. However, it appears that the net loss at present is $4.3 billion ($7.8 billion already written off set against the value of the $3.5 billion in existing GM shares held).

Thus, when the tally is divided between Ontario and the federal governments, the province of Ontario has lost just under $1.4 billion to the automotive bailout (and the federal government over $2.9 billion) (EDC, 2010; Personal e-mail communication with Stephanie Rubic, Department of Finance, Ottawa (November 2, 2011); and calculations by author).

Other examples of recent Ontario corporate welfare

In addition to the corporate welfare doled out to the automotive sector, Ontario's government has also disbursed taxpayer dollars to other sectors in widely varying amounts. Here are some examples of multi-year programs. The list is meant to be illustrative, not comprehensive.

- In Ontario's 2011 budget, the government noted that since 2008 its Next Generation of Jobs Fund has "committed about $714 million in support to 33 projects"; that between 2005 and 2010, its Advanced Manufacturing Investment Strategy made "loan commitments of more than $160 million"; and that the Strategic Jobs and Investment Fund has provided support of more than $52.4 million in grants and $31 million in loans (Ontario, 2011a: 133).[2]

- Ontario's Ministry of Economic Development and Trade notes $1 million in payments per year for three years to "support the growth and development of Ontario craft brewers" and through another fund, $2 million per year for four years to also "support the growth and development of Ontario craft brewers," or $9 million in total for craft breweries between the two support programs (no years were provided on when disbursements occur/occurred) (Ontario, 2011b: 10).

- Ontario's Ministry of Economic Development and Trade also highlights $3 million per year for five years for marketing and tourism for Ontario's wine industry and $6 million per year for five years to encourage the sale of 100 percent Ontario-grown grapes (no years are provided by the Ontario government as to when disbursements occur/occurred) (Ontario, 2011b: 10-11), or $45 million to Ontario's wine industry over five years in total.

- In the provincial government's 2010 budget, the government noted how, since 2005, $708 million has been given to the manufacturing sector (Ontario, 2010a: 27).

- In Ontario's 2011 budget, the government noted how, since 2003/04, it gave $1.9 billion to the agricultural sector (Ontario, 2011a: 29).[3]

A newer form of corporate welfare: green energy subsidies

In some cases, corporate welfare can occur for goods or services received. This occurs when governments purposely overpay for the same. For example, the newest addition to the corporate welfare file in Ontario is taxpayer support for "green" energy.[4] In the case of green energy, a product is indeed delivered, but often only because the producer(s) receive an explicit subsidy for it. This is in contrast to other forms of energy which can often be produced and bought at market rates without subsidies. The subsidy element becomes obvious where a transfer of tax dollars occurs from a government to a producer over and above what the producer would receive in the marketplace for their end product.

Ontario encourages green energy in two ways, both economically artificial: the first, through partnership programs, and the second, through "feed-in" tariffs that subsidize the relatively high cost of production for various forms of renewable energy. However, in keeping with its goal of illustrating *straightforward* cash payments to business, this report will not delve into the feed-in tariffs, though that topic is worth further research. On cash payments to green energy initiatives, the government of Ontario provides four programs. They are:

- Aboriginal Energy Partnerships Program (the government specifies no cost amount for this);

- Aboriginal Loan Guarantee Program where up to $250 million in loans and loan guarantees (in total disbursements) are available;

- Community Energy Partnerships Program (CEPP): The Ontario government makes no total program cost figure or estimate available; it only states that 90 percent of eligible development costs will be covered up to a maximum of $200,000;

- Municipal Renewable Energy Program: The Ontario government makes no total program cost figure or estimate available; it only states that the province will provide support for the "extra costs associated with new renewable energy projects."

(All of the above programs are from Ontario Ministry of Energy and Infrastructure, 2011).

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. At best, a generous interpretation of the literature suggests that subsidies *may,* in very specific locations, produce *some* effect on *some* local economic behaviour.

The World Trade Organization (2006) 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." At worst, as the literature overwhelmingly concludes, there may not be a demonstrable positive impact upon the economy, employment, and tax revenues due to 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).

Thus, the literature suggests that the best means by which to encourage economic growth is not through assistance from the government, but through neutrality in the competitive marketplace. (For a full review of the literature on business subsidies, see Milke, 2007: 27-36).

The question of job creation

That noted, one key reason governments give for subsidies to business is job creation. Ontario's government follows this rationale with the notion that jobs will be created or "saved" through corporate welfare. For example, Ontario's Ministry of Economic Development and Trade reports that one key performance measurement is "jobs created/ retained" (Ontario, 2011b: 13). The Ontario Finance Ministry makes specific claims that the GM and Chrysler bailouts preserved "at least 85,000 jobs" (Ontario, 2010b: 27), though later estimates in a joint news release from the federal and Ontario governments claimed "approximately 52,000 Canadian jobs were protected by government action to support the automotive industry" (Canada, 2011a). Thus, as with most job estimates from supporters of subsidies to business, estimates vary dramatically even from the same sources.

In the case of the manufacturing sector, the Ontario government claimed that tax relief *and* the $708 million subsidy to the manufacturing sector were collectively responsible for "securing about 10,300 jobs and leveraging over $3.9 billion in investments" (Ontario, 2010b: 27). In its 2011 budget, the provincial government's defence of three business support programs (Next Generation of Jobs Fund, Advanced Manufacturing Investment Strategy, and Strategic Jobs and Investment Fund) was that such subsidies leveraged private sector investment and 15,688 jobs were thus created (Personal communication with Scott Blodgett, Ontario Ministry of Finance, April 1, 2011).

A review of the literature on job creation claims—literature based on a national and worldwide look at such claims—does not support the employment claims made by governments. Timothy Bartik (1994) found that extra job growth in one locale that resulted from 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 job creation assumption of *regional* policymakers over a 20-year period, 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" (p. 579).

Part of the reason job creation arguments are made are due to numbers produced by non peer-reviewed studies. As Terry Buss (1999) notes, popular or non-peer reviewed studies are often used by businesses, industry associations, sectors, or governments to promote subsidies to a particular corporation or industry. Problematically, they lack scientific rigour. Industry studies that purport to show the value of corporate welfare routinely are "based on poor data, unsound social science methods, faulty economic reasoning, and is largely a political activity" (p. 321). As a result, Buss notes that propriety and secrecy are rife in such studies. This is incompatible with a scientific approach, given that independent replication is necessary to ensure accountability. Moreover, Buss finds that claims of increased investment and employment in industry studies are the result of correlation-causation errors.

Buss also notes that because industry studies are cloaked in the legitimacy of scientific and economic rationale, they provide politicians and bureaucracies with the justification to award political favours without appearing to be political. Such industry-sponsored studies give politicians the false sense of being in command of economies over which, in reality, officials have little control. Often, projects are justified on the basis that some entity other than the local government will pay all or a large portion of the costs. As Buss notes, "To most, targeting can be promoted as a benefit without cost. Potential losers are always in other cities or states, and few people concern themselves with the national interest" (Buss, 2001).

Spurious industry claims on job creation: An example from Ontario

A good example of the type of spurious industry to which Buss refers occurred in late 2008 in the midst of the financial crisis. It happened just as Ontario's automotive industry made clear to the Ontario and federal governments it desire for bail-out money (Van Praet and Viera, 2008). In December 2008, the Milton, Ontario-based Centre for the Study of Spatial Economics released a report on the possible effects of a partial or total shutdown of the automotive industry in Canada. The report, prepared for the Ontario Manufacturing Council, claimed initial job losses across Canada of between "157,000 and 323,000, which would rise to 296,000 and 582,000 job losses over time should the automotive sector partly or fully shut down" (Centre for Spatial Economics, 2008).

The numbers were widely reported at the time, including on the CBC, the *Toronto Star* and *Globe and Mail* among others (FPInfomart, 2011).[5] Little attention was given to the fact that 126,786 people worked in the motor vehicle and parts manufacturing sector in Canada in December 2008 (Dennis Desrosiers, personal correspondence: Employment Levels, 2000-2010; information and tables received March 2, 2011). That meant the Centre's/Ontario Manufacturing Council's estimate of job losses assumed every single automotive company in Canada would shutter. Its worst-case scenario also assumed the spinoff job losses from vehicle and parts job losses would amount to about three-and- a-half spin-off jobs for every one direct job lost.

In its nightmare scenario, the Centre for Spatial Economics never accounted for the possibility that *other* Canadian-based automakers, such as Toyota or Honda or Ford, would *increase* production and thus offset the employment losses at Chrysler or GM, or that bankruptcy proceedings without government bailouts would result in slimmed-down and smaller companies which would still employ some Canadian workers at GM and Chrysler.[6]

The process of shifting from "Detroit" to non-Detroit manufacturers was already occurring. In 2000, GM and Chrysler's share of Canadian production in the light vehicle segment (cars, light trucks, SUVs, vans, and luxury automobiles) was 56.3 percent. By 2008, before the bailouts, GM and Chrysler's share of Canadian production was down to 45.5 percent. That left 55.5 percent for others, including Ford, Honda, and Toyota, manufacturers never in any danger of bankruptcy (Dennis Desrosiers, personal correspondence: Production in Canada by Company, 2000-2009; information and tables received January 21, 2010).

By 2009, GM and Chrysler's combined share of Canadian-based production was just 37.5 percent, which meant a 62.5 percent production share for all other automotive manufacturers (Desrosiers, personal correspondence, January 21, 2010). Thus, the transformation from a "Detroit Three"-based auto manufacturing sector had long been underway by the crisis year of 2008 and the bailout year of 2009. The nightmare scenarios from the Centre for Spatial Economics were unrealistic for that reason; the other automotive companies were financially healthy.

Also, the study was methodologically flawed as it never measured the opportunity cost of taking tax dollars from taxpayers at large and other businesses and diverting them to one sector—the automotive industry. Money is fungible. Whether taken through taxes from taxpayers and spent on government priorities as opposed to individual priorities, or when spent in a subsidy to one sector or business, an opportunity cost exists.

This is especially relevant when a market is itself shrinking, as was the case between 2008 and 2009 when light vehicle sales in Canada alone dropped from over 1.6 million vehicles in 2008 to just over 1.4 million vehicles in 2009 (Dennis Desrosiers, personal correspondence: Canadian Sales by Nameplates, 2006-2010; information and tables received January 27, 2011). The result was that whether in recession or recovery, market share was already moving away from GM and Chrysler to other companies, as would employment shares insofar as companies had domestic production in Canada, which Honda, Toyota, and Ford each did.

Why do business subsidies continue? A public choice answer

If the empirical evidence for corporate welfare's economic utility is lacking, the question arises: why does it continue to persist? Here, public choice theory is helpful in explaining less-than-optimal public policy.[7] The theory explains that government subsidies to business continue because:

- it is in the interest of some special interests who desire a specific lucrative benefit;
- it allows political actors to appear to be "doing something" (e.g., they are "saving jobs"), which is in their interest as "vote-maximizers";

If the empirical evidence for corporate welfare's economic utility is lacking, the question arises: why does it continue to persist?

- it is not likely to be opposed by most civil servants as that would contradict their own self-interest (e.g., for job security and/or a larger budget);
- its cost per person is not enough to arouse the general public to active opposition; and,
- its cancellation would politically endanger some, and offend others, in a small group of politicians and bureaucrats, including the caucus and other civil servants.

The opportunity cost of Ontario's corporate welfare

There is an opportunity cost to Ontario's corporate welfare. Expressed in individual terms, in 2008 (the calendar year that mostly overlaps with the 2008/09 fiscal year) almost 6.3 million Ontarians paid $24.5 billion in provincial income tax. Expressed per tax filer who paid income tax, the cost of corporate welfare was $424 per Ontarian, or $848 per dual-income couple (Canada Revenue Agency, 2010; Statistics Canada, 2011b; and calculations by author).

Had Ontario's corporate welfare expenditures—$2.7 billion as of 2008/09—been redirected to personal or corporate income tax reductions in equal dollar amounts in the current fiscal year, the money could have been used to, among other things,

- nearly eliminate Ontario's Health Premium at an estimated cost of $3.1 billion for 2011/12; or
- nearly eliminate the top personal income tax (PIT) surtax of 36 percent and reduce the lower surtax from 20 to 10 percent. (This would represent a loss in personal income tax revenue of $3.3 billion in 2011/12); or
- further reduce the corporate income tax (CIT) rate to 8 percent in 2011/12, a $2.9 billion revenue loss. If this option were chosen, Ontario would have the lowest CIT rate in the country. That policy would be significantly beneficial given the links between low corporate tax rates and employment creation already noted previously,[8] or
- reduce Ontario's annual deficit by $2.7 billion a year.

In other words, the province's current corporate welfare policy—justified on the grounds of job creation—has it exactly backwards. It is low corporate rates—not high corporate welfare payments—that will contribute to employment growth in Ontario.

Summary and recommendations

Ontario has been at the forefront of reducing business tax rates. Since 2001, the general corporate rate under both Progressive Conservative and Liberal governments has fallen, from 13.6 percent in 2001 to 11.5 percent as of 2011, and is budgeted to fall further to 11 percent in 2012 and to 10 percent in 2013 (Treff and Perry, various issues, 2001-2009; Ontario, 2010a: 157). Ontario businesses already have and will continue to benefit from falling provincial business tax rates. This reality makes continued corporate welfare unnecessary even from a political and public relations point of view: governments that cut business taxes can hardly be said to be anti-business should they discontinue business subsidies, the empirical basis for which is weak. The result is that a *policy of lower tax rates for all businesses, which treats all alike, can and should be accompanied by a similarly neutral policy on public expenditures to specific businesses or sectors.* Thus, three recommendations are in order:

1) Wind down and end business assistance programs. In the face of overwhelming empirical evidence, the case has not been made for corporate welfare. A more neutral policy—lower taxes rates for all and subsidies for none—is not only defensible empirically, but practically and politically. Neutrality between various businesses and sectors would allow Ontario to concentrate spending and tax policy on where it will do the most good and have the most beneficial and broad-based effects, both in prioritized government spending and in tax policy.

2) Continue to support federal and provincial efforts to end subsidies within Canada and internationally, including through the use of bilateral and multilateral agreements. Also support efforts to strengthen existing country-to- country treaties and to initiate new ones. It is in Canada's interest to reduce rules against our imports and to be able to compete with non-subsidized companies from other jurisdictions.

3) Trade the money spent on business subsidies for business tax reductions or on reducing Ontario's annual deficit.

End notes

1 Readers should note that the agreement on cost-sharing between the federal and Ontario governments is not publicly available nor given to the author when requested. Details here are from this personal communication with the Department of Finance.

2 Note that because of the time frames noted in some of the programs here, the dollar figures should not be read as in addition to the $27.7 billion between 1991/92 and 2008/09; there would be some overlap in some cases. Ontario government disbursements to business beyond the available Statistics Canada fiscal year (to 2008/09) will be recorded and updated in future years.

3 Because of the 2003/04 to 2009/10 time-frame, the $1.9 billion figure should not be read as wholly in addition to the $27.7 billion spent between 1991/92 and 2008/09. There would be some overlap.

4 I use green and renewable energy in this paper as those are the terms used by the Ontario government in its description. The distinction and definition are arguably artificial. After all, hydroelectricity, beyond the initial disturbance to an eco-system, is also renewable and green. Still, when the Ontario government refers to "green energy," it is not normally accounting for hydro-type electricity, but other, more expensive forms.

5 The search for "Centre for Spatial Economics" calculated 25 results from FPInfomart member media, including mentions in the National Post, Globe and Mail, Toronto Star, Canadian Press, Broadcast News, CBC-TV and several smaller newspapers and media outlets across the country. Note that not all Canadian media is tracked by FP Infomart—the Sun chain is excluded, for example.

6 Another thing to note about the study from the Centre for Spatial Economics: it appears to have been financed by the Ontario government itself, presumably because such nightmare numbers might be seen as independent if they came from a source other than the provincial government. The 2008/09 Public Accounts of Ontario note a payment of $67,021; the 2009/10 Public Accounts note a payment of $80,975 to the Centre for Spatial Economics (Ontario, 2009: 158; and Ontario, 2010a: 149).

7 See Milke, 2007, pp. 40-42 for a full discussion of public choice theory as it concerns corporate welfare and individual references for past automotive subsidies.

8 Also, the economic effect of taxes on investment and then employment creation are quite clear. A 2008 study by Simeon Djankov et al. examined the effects of corporate taxes on investment and entrepreneurship in 85 countries. It found that increasing the effective corporate tax rate by 10 percentage point reduces investment and entrepreneurial activity by an average of 2 percentage points of GDP during the first year of implementation. Another 2008 study, this time looking at the effect of reduced corporate tax rates from Mark Parsons for Canada's Department of Finance, explored the effect of the federal government's reduction in corporate income tax to 21 percent in 2004 from 28 percent in 2001. The finding was that corporate tax reductions led to higher investment in Canada, specifically, "a 10 percent reduction in the user cost arising from changes in the tax parameters [was] associated with an approximately 7 percent increase in the capital stock" (2008: 15). Higher investment is important because job creation results from such investment.

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