Time for Tax Reform in Ontario

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FRASER INSTITUTE

2018
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Executive summary

Over the past fifteen years, Ontario’s provincial economy has struggled relative to the rest of the country. The reasons for Ontario’s economic weakness are complex and varied. However, public policy choices have been a contributing factor.

One area that stands out as a particularly strong candidate for reform is tax policy. Specifically, Ontario’s personal income tax (PIT) system undermines Ontario’s economic competitiveness and therefore hinders economic growth. With seven brackets and high marginal rates, Ontario’s PIT discourages a wide range of productive activities and makes it more difficult for Ontario to retain and attract higher-earning individuals. These problems are compounded by the fact that Ontario’s PIT is not competitive with peer jurisdictions in North America. Ontario has the second highest top marginal PIT rate in North America (combined federal/provincial or federal/state) at 53.53 percent.

This study presents an outline for tax reform in Ontario which would transform the province’s uncompetitive PIT system, while also reducing the province’s Corporate Income Tax (CIT) to make Ontario a more attractive destination for investment and entrepreneurship.

The paper examines the status quo in Ontario, and Ontario’s competitiveness in a North American context when it comes to both personal and corporate income taxes. Specifically, we show that Ontario’s PIT system is uncompetitive in the North American context, while the once strong corporate income tax advantage Ontario until recently enjoyed compared to the United States has for the most part disappeared.

The paper also describes an outline for policy reform, which includes replacing Ontario’s seven-bracket PIT system with a single-rate PIT in which all taxable income is taxed at a rate of 8 percent. The reform outline presented here also would lower the CIT from 11.5 percent to 8 percent.

Taken together, the PIT and CIT reforms outlined in this paper would create an important advantage for Ontario’s economy by making the province one of the most attractive tax jurisdictions in North America with respect to the taxation of both personal and corporate income. As a result, these changes would help create an economic environment in which businesses,
entrepreneurs, and other skilled workers are better incentivized to work, invest, and create opportunities.

With new competitiveness pressures emerging from the United States, the advantages of policy reforms that make Ontario more attractive for investment and human capital are particularly pronounced at this moment in history.
Introduction

Over the past fifteen years, Ontario’s provincial economy has struggled relative to the rest of the country. In terms of real per-capita GDP growth, household income, business investment, job creation, public debt accumulation, and most other economic metrics, despite an uptick in recent years, Ontario’s recent medium-term performance has been weak (Eisen and Palacios, 2018).

The reasons for Ontario’s economic weakness since the start of the new millennium are complex and varied. However, public policy choices have been a contributing factor. Specifically, electricity policy, fiscal policy with respect to debt accumulation, and labour laws are a few areas where policy changes may have had an impact on Ontario’s growth prospects and undermined Ontario’s attractiveness as a destination for both investment and people (Cross, 2017).

Another policy factor contributing to the province’s weak economic performance has been the tax system and, in particular, its uncompetitive and economically harmful personal income tax (PIT) system. The province’s seven-bracket PIT and high marginal tax rates facing entrepreneurs, investors, and business owners hurt Ontario’s attractiveness as a destination for investment and mobile human capital while creating economically harmful disincentives for productive activity.

This paper describes one option for reforming Ontario’s tax system which would significantly improve Ontario’s tax competitiveness, helping create an economic environment that encourages businesses, entrepreneurs, and skilled and educated workers to come to Ontario to work, invest, and create opportunities for others.

Our reform proposal focuses primarily on reforming Ontario’s personal income tax system, by replacing the current uncompetitive seven-bracket system with a single-rate income tax of 8 percent.¹ We also discuss

¹ The model presented in this paper uses projections from the 2017/18 budget and subsequent fiscal updates and does not include updates found in the recently tabled 2018/19 budget. Of particular significance, the estimates presented here show changes relative to the pre-budget tax structure, and do not include the very minor changes to the organization of Ontario’s tax system proposed in that budget. The replacement of existing surtaxes
the benefits of reducing the province’s general Corporate Income Tax from 11.5 to 8 percent, with the objective of making Ontario a more competitive and attractive destination for entrepreneurs, skilled labour, and investment.

The plan of the paper is as follows. First, we will show how Ontario’s current tax system undermines the province’s competitiveness and attractiveness as a destination for people and investment. Next, we will describe our specific reform proposal, and the transformative impact that a reform such as ours would have on the province’s tax competitiveness. We then discuss the distributive effects of our proposal as well as options for offsetting the resulting revenue loss, before briefly concluding.
Strengthening Ontario’s competitiveness through tax reform

Reforming the PIT

One of the most promising policy strategies for improving Ontario’s competitiveness and creating an economic climate that fosters entrepreneurship, dynamism, and growth is tax reform. Specifically, evidence shows that establishing competitive PIT and CIT regimes are an important dimension of how governments can establish economic conditions that foster investment, entrepreneurship, and ultimately stronger economic growth.2

Research suggests that for corporate and personal income tax rates, it is not just the absolute level of key rates that matters, but also their relative level compared to competing jurisdictions.3 This is the essence of the concept of tax competitiveness: that a jurisdiction can create a significant advantage (or disadvantage) for its economy if its rates in key tax areas are significantly different from competing jurisdictions.

This is a particularly important consideration in Ontario when it comes to the PIT. In short, Ontario’s PIT is uncompetitive in the North American context.4 Figure 1 demonstrates the extent of Ontario’s current lack of competitiveness with respect to the upper end of its personal income tax rates. Top marginal rates are an important metric because people make decisions at the margin and so when it comes to entrepreneurs, professionals, investors, and business owners who tend to face marginal rates at the higher end, it is these rates that generally influence economic decisions.5

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3. For a detailed analysis, see OECD (2007).
4. Throughout the paper we use the term “North America” as a short form to identify only Canada and the United States; Mexico is not included in this analysis.
5. All of the tax rates are adjusted for surtaxes and the Quebec abatement where appropriate. The federal abatement means that Quebecers pay less in federal taxes than other provinces. The abatement exists as part of an arrangement that allows provincial governments...
Figure 1 shows that Ontario currently has the second highest combined (federal and provincial/state) top marginal statutory tax rate\(^6\) (at 53.53 percent) of any province or state in Canada or the United States. Additionally, Ontario’s top combined tax rate applies to income above CA$220,000, which is less than half the threshold applicable in the US, which is US$500,000 (Tax Foundation, 2018a). In other words, entrepreneurs, business owners, and highly skilled high-earning professionals start paying the top combined federal-provincial personal income tax rate in Ontario much sooner on earnings than their US counterparts. Generally speaking, the states have comparatively low thresholds compared to the federal government, which means that for the most part the top combined rate in each state applies at US$500,000, which is the top federal rate. Nearby states with whom Ontario competes, including Michigan, Pennsylvania, and Indiana, all have top combined rates that are at least ten percentage points below Ontario’s combined federal/provincial rate.

In short, it is clear that Ontario is not competitive in the North American context when it comes to the PIT. With the second highest top rate in North America, and a substantial disadvantage of upwards of ten percentage points relative to many neighbouring jurisdictions, Ontario’s PIT system makes it more difficult for Ontario to attract and retain entrepreneurs, business owners, and skilled professionals.

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\(^6\) Technically speaking, the marginal rather than statutory tax rate has the greatest impact for economic incentives. For income earned in the top bracket, we would assume statutory rates are basically the same as the marginal rates.
Reducing the CIT

Ontario’s current competitive positioning in North America with respect to corporate taxes is much stronger than in the case of personal income taxes. But this should not be a source of complacency as Ontario now faces new competitive challenges from south of the border.

Until recently, Ontario and most Canadian provinces enjoyed a competitive advantage in business taxes relative to American jurisdictions. The single most useful measure of business tax competitiveness is the Marginal Effective Tax Rate (METR) faced by firms. This metric reveals the extent of the tax advantage Ontario until recently enjoyed. In 2017, Ontario’s METR was 19 percent compared to an average US rate of 34.6 percent (Bazel, Mintz, and Thompson, 2018).

However, tax reform in the United States at the federal level has transformed this reality. Major tax policy changes and, specifically, reductions to the statutory corporate income tax rate and accelerated depreciation have completely erased Ontario’s competitive corporate tax advantage relative to the American average.\(^7\) The recent tax reforms have brought the average METR in the United States down to 18.8 percent—almost exactly in line with Ontario’s (Bazel, Mintz, and Thompson, 2018).

Data is not readily available showing how US tax reform has changed METRs at the state level. However, it’s clear that this transformation in the United States’ overall competitive standing will have a substantial impact on state-level competitiveness throughout the union. We can see one key way that Ontario has lost its tax advantage relative to specific American states by considering changes in the statutory CIT facing American firms in various states, which is an important contributing factor to the METR.\(^8\)

Specifically, in the absence of US reform, Ontario would have had the lowest combined provincial/state and federal general statutory corporate tax rate of any state or province and would have enjoyed an especially large advantage over several important US states with whom it competes.\(^9\) For instance, absent tax reform Michigan’s combined federal/provincial statutory general CIT would have been 41 percent this year, and New York’s would have been 41.5. Instead, those numbers are 27 percent and 27.5 percent respectively.

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7. On top of this federal change, some states, including nearby Michigan, have also recently introduced pro-growth business tax reform, increasing the competitive pressure on Ontario.

8. Several states have no statutory CIT, but do have economically harmful Gross Receipts Taxes, which are generally more harmful for competitiveness.

9. Though due to complexities in the tax code, most large corporations paid a lower effective rate than the statutory rate of 35 percent due to exemptions and other complexities.
However, by reducing the federal statutory CIT rate from 35 to 21 percent, the recent US tax reform has basically wiped out this advantage. Ontario no longer has a corporate tax advantage when it comes to the statutory CIT rate. As figure 2 shows, Ontario no longer has the lowest statutory CIT rate in North America, as it would have in the absence of US tax reform. Instead, it has the 14th lowest rate. Indeed, there has been a substantial compression, with the highest combined CIT rate (Iowa) falling from 47 percent to 33 percent. While Ontario’s 26.5 percent is still relatively low, there are now states that have combined CIT rates up to 5.5 percentage points lower. And to return to our above example, neighbouring Michigan and New York, which used to have far higher statutory rates, are now nearly identical to Ontario, which significantly reduces Ontario’s advantage on statutory CIT rates relative to its neighbours.

This evaporation of Ontario’s statutory CIT advantage over the jurisdictions with whom it competes will necessarily also dramatically undermine the province’s overall business competitiveness as measured through METRs, even though we have not quantified the precise degree to which this is true.

These competitive pressures and the loss of Ontario’s corporate tax advantage relative to the United States make the present moment a particularly promising one for the consideration of corporate tax reductions in Ontario.

In summary, Ontario is currently uncompetitive with respect to the PIT and has recently lost a big competitive advantage over the United States with respect to business taxes. What follows is a description of one option for comprehensive tax reform that would address both of these issues.

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**Figure 2**
Combined province/state and federal general statutory corporate income tax rate

Notes: These rates may change with the release of forthcoming budgets. Nevada, Ohio, Texas, and Washington do not have a corporate income tax but do have a gross receipts tax with rates not strictly comparable to corporate income tax rates. Delaware and Virginia have gross receipts taxes in addition to corporate income taxes.

Sources: The Fraser Institute Tax Database; Tax Foundation, 2018b.
An outline for reform: An eight percent corporate income tax rate and a single-rate personal income tax

In this section, we describe one option for pro-growth tax reform. The framework we present here is straightforward: it would involve setting the province’s CIT at 8 percent (down from 11.5 percent) while replacing the province’s seven-bracket PIT system with a single rate set at 8 percent. We also show how this change would enhance Ontario’s tax competitiveness through a comparison to other North American jurisdictions.¹⁰

Personal Income Tax reform

As discussed, Ontario’s seven-bracket tax system with high marginal rates is one of the most harmful features of the tax system. A high and progressive personal income tax system has negative consequences for investment, a jurisdiction’s ability to retain and attract skilled labour, professionals, and entrepreneurs, and overall economic growth.¹¹ One of the key reasons high marginal PIT rates are harmful is that they create powerful disincentives that discourage professionals, entrepreneurs, investors, and business owners from

¹⁰. A further advantage of setting a single rate PIT at the same rate as the CIT rather than at a different rate is that it could, depending on future federal action, be a first step towards a truly integrated tax system in Ontario in which income from all sources is taxed at the same rate. A significant body of economic research shows the advantages of an integrated tax system, and it is beyond the scope of this paper to describe those advantages. For these benefits to be realized, it would be necessary for the federal government to cooperate, by integrating its PIT and CIT rates at a single level. Our proposed reform in Ontario would create an opportunity for a future reform-minded federal government to introduce integrated PIT/CIT rates of their own, thereby essentially creating an integrated tax system within Ontario, which represents 40 percent of the national economy. The economic benefits of such an outcome could be substantial. See Lammam et al. (2015) for further discussion.

¹¹. For a thorough discussion see Ferede and Dahlby (2018).
expanding their activities in Ontario as well as discouraging new ones from locating themselves in Ontario.

We propose reforming Ontario’s PIT system by eliminating its multi-rate structure and taxing all taxable income at a single rate of 8 percent.

**Figure 3** shows that the reform proposed here would transform Ontario’s competitive standing within North America. Specifically, with a new top combined rate of 41 percent, Ontario would move from having the second highest top personal income tax rate in North America to having the 12th lowest rate. This would significantly enhance the competitiveness of the province, overall and relative to key competing jurisdictions. For example, this reform would bring Ontario’s top marginal statutory income tax rate slightly below neighbouring Michigan, which currently enjoys a roughly 12 percentage point advantage over Ontario.

This change would also cause Ontario to go from being a laggard within Canada to the undisputed leader.

**Reduce the Corporate Income Tax rate to eight percent**

If the PIT reforms discussed above were combined with reductions in the province’s CIT, the overall reform package would leave Ontario with one of the most pro-growth tax systems in North America, helping the province attract both investment and human capital while also creating positive economic incentives for businesses and people already here.
Including CIT reduction as part of an overall tax reform package would enhance Ontario’s attractiveness as an investment destination and therefore add to the economic-growth-enhancing effects of the reform package outlined here.

Again, while we have not compared state and provincial METRs in light of American federal tax cuts, an examination of the impact on the CIT shows how lowering Ontario’s CIT by three and a half percentage points would help enhance Ontario’s competitiveness. Figure 4 illustrates this reality.

A reduction of the general corporate income tax from 11.5 to 8.0 percent would move Ontario from 14th lowest combined statutory CIT to 7th lowest, and would bring the province to within 2 percentage points of the handful of states which have no state-level corporate income tax.\footnote{Although they have no corporate income tax, four of these six states (Nevada, Ohio, Texas, and Washington) levy a gross receipts tax which are widely considered to be inequitable and economically destructive. See <https://taxfoundation.org/missouri-want-gross-receipts-tax/> for a summary and Tax Foundation (2018b) for rates.}

Under this scenario, Ontario would enjoy a statutory CIT advantage over all jurisdictions in North America except for the six US states with no state level CIT at all. Further, four of the US states that do not have a state level CIT do have economically harmful Gross Receipts Taxes, which are profit insensitive and therefore can cause more economic damage by potentially acting as a tax on the capital of the firm. Ontario would likely enjoy an overall corporate tax advantage relative to these jurisdictions as well.

In short, the reform proposed here would leave Ontario with one of the lowest statutory combined CIT rates in North America and would therefore represent a meaningful response to the new competitiveness pressures emanating from south of the border.

**Summary**

Unlike with respect to the PIT, Ontario is already relatively competitive within North America with respect to its business taxes. However, a meaningful response to new competitive pressures from the US as a complement to major reforms and reductions to the PIT would represent a significant reform package that would substantially enhance Ontario’s economic competitiveness. Taken together, these two reforms would create an economic advantage for the province by making the province one of the most attractive jurisdictions in North America from a tax competitiveness perspective for both people and investment.
Figure 4
Ontario statutory CIT compared to 60 jurisdictions, 2018 (proposed)

Notes: These rates may change with the release of forthcoming budgets. Nevada, Ohio, Texas, and Washington do not have a corporate income tax but do have a gross receipts tax with rates not strictly comparable to corporate income tax rates. Delaware and Virginia have gross receipts taxes in addition to corporate income taxes.

Sources: The Fraser Institute Tax Database; Tax Foundation, 2018b.
Other considerations

In this section, we turn to discuss a number of considerations related to tax reform including some distributive effects of our outlined reforms.

Let us begin with the CIT. While the popular perception may be that corporate income tax relief only benefits wealthy owners of big companies, the distributive effects are in fact considerably more complicated and salutary. First, it is important to recognize that a great many middle-income Canadians own shares in publicly traded corporations through RRSPs, TFSAs, and other investments. All workers in Canada outside of Quebec hold shares indirectly through the CPPIB, which invests money for the CPP. Higher after-tax corporate profits resulting from CIT reform would directly benefit these shareholders through increased share prices and/or profits.

Further, substantial research on the incidence of corporate taxes shows that the CIT in fact is largely borne by the people who work for companies, and not simply by those who own them. In fact, recent research by Ebrahimi and Vaillancourt (2016) finds that “a 1% increase in the statutory corporate income-tax rate reduces the (inflation-adjusted) hourly wage rate by between 0.15% and 0.24%.” Similarly, McKenzie and Ferede (2017) found that reducing Ontario’s CIT by $1 would increase wages by $1.97 in the long run.

This is something that was well understood by former Ontario Finance Minister Dwight Duncan. Upon releasing the 2009 budget, which reduced the CIT from 14 to 12 percent (and committed to a further reduction to 10 percent over time), Minister Duncan noted that “[w]e will all benefit from the more than half a million additional jobs that will be created in Ontario as a result of the HST and tax cuts for people and businesses” (Ontario, 2009b).

In the case of the PIT, it is certainly true that the direct benefits of the reforms we have proposed would be enjoyed in large measure by Ontarians facing the highest marginal rates. This, however, is largely a function of the fact that the PIT is paid primarily by those Ontarians.

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13. According to Statistics Canada, 62.5 percent of Canadian households contributed to at least one of an RRSP, RPP, or TFSA in 2015 (Statistics Canada, 2016). Moreover, many Canadians have pension plans that invest in Canadian securities, as does the Canadian Pension Plan.
For example, just 1.39 percent of households in Ontario earn over $250,000. However, this small group of households currently pays 14.5 percent of all provincial income tax. Similarly, 12.2 percent of Ontario families earn over $100,000, but this group pays 40.9 percent of all provincial PIT.\(^{14}\) As such, it is almost inevitable that any effort to reform this especially economically harmful component of Ontario's tax mix will result in direct benefits for higher income households, particularly if enhancing competitiveness for investment and human capital is a key objective.

A further distributive concern relates to the fact that our reform, as described so far, would increase the marginal statutory tax rate faced on the first $42,960 of taxable income from 5.05 percent to 8.0 percent. In the absence of other revisions, this would actually result in a net tax increase for many families.

There are several options available to address this issue at a manageable cost. For example, to ensure lower-income families do not face increased taxes the government could enhance Ontario's Working Income Tax Benefit, which would have the added benefit of enhancing work incentives for these families.

A second option would be to modify our proposed PIT reform by maintaining two PIT rates, rather than one, and leaving the lowest tax bracket at 5.05 percent. Alternatively, a low-middle income tax credit, basically retaining the 5.05 percent rate effectively for incomes up to the existing threshold, could be used with essentially the same effect.

It is beyond the scope of this paper to lay out the advantages and disadvantages of these options; it suffices here to say that addressing distributive concerns by compensating low and middle income households that would otherwise experience a tax increase under our proposal is not prohibitively expensive. Indeed, the cost of simply issuing a rebate to all households that experience income tax increases to offset these losses would be $2.8 billion, increasing the overall cost of the reform package by 35.0 percent (as discussed in more detail below). In short, any government wishing to ensure tax reform did not result in any households facing an increase to their tax burden would have options available.

In sum, Ontario’s current top PIT rates were introduced as an emergency measure, justified as necessary to fight the province’s large deficit.\(^{15}\) By stating the increases would only be temporary, the government of the day implicitly recognized the damaging effects of such high marginal rates over the long term. Since then, the creation of a new top federal bracket has exacerbated the problem. Ontario’s status as having near the highest top statutory PIT rates in North America was not meant to be permanent. The reforms we

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\(^{14}\) Calculations by authors, using Statistics Canada SPSD/M.

\(^{15}\) In fact, the new top rate was termed the “Deficit Fighting High-Income Tax Bracket” (Ontario, 2012).
have outlined would ensure that it will not be, and would eliminate one of the most economically harmful components of Ontario’s tax system.
Is such tax reform fiscally feasible?

We now turn to discuss the implications of our proposed reforms on provincial finances. Ontario currently carries a debt burden of approximately 38 percent of GDP, up from 26 percent prior to the 2008/09 recession (Ontario, 2017a, 2017b). In this context, the implications of decreased revenue for the province’s fiscal balance must be taken seriously. Fortunately, a reform-minded government would have many options for offsetting revenue losses.

In order to estimate the cost of this tax reform outline we use a “static” model,\(^\text{16}\) which assumes no behavioural changes will take place as a result of the tax changes. In other words, we assume that lower and reformed taxes won’t increase economic activity at all—a very conservative assumption.\(^\text{17}\) Our estimates show that the PIT reforms described above (a single rate at 8 percent) would reduce revenue from that tax source by $4.8 billion in 2018/19. This represents a 12.8 percent reduction in PIT revenues. The reform proposed here would also reduce CIT revenue by roughly $3.4 billion in 2018/19.\(^\text{18}\) This represents a 23.1 percent decline in CIT revenues.

\(^{16}\) Using version 26.0 of Statistics Canada’s Social Policy Simulation Database and Model we changed all rates to 8.0 percent, and raised the non-refundable tax credit rate to 8.0 percent.

\(^{17}\) One way to quantify the potential for tax reductions to increase economic activity is to look at the elasticity of taxable income, which measures the responsiveness of the tax base to changes in tax rates—in other words, whether a change in tax rates would be likely to increase or decrease the amount of economic activity, and by how much. The responsiveness of the tax base to an increase in tax rates is particularly high for corporate taxes, since capital is mobile across borders, and for personal income taxes on high income earners. For instance, Milligan (2014) notes that studies tend to estimate the elasticity of taxable income for high income earners to range from around 0.25 to 0.6. In other words, for a one percentage increase in taxation for that group, their economic activity would be expected to decrease by between 0.25 and 0.6 percent. He also notes that the very highest earners are even more responsive to tax changes, estimating that taxable income from those in the 99.9th percentile would be expected to decline by 30 percent in response to a 10 percentage point increase in their marginal rate.

\(^{18}\) This is a crude estimate based on the percentage point reduction in the share of corporate income tax supplied by corporations taxed at the general rate.
In total, our model suggests our proposed tax reform would result in a revenue loss of $8.2 billion in 2018/19.

In the forthcoming consideration of options to offset the revenue effects of our proposal, we assume that implementation would include some measure to offset increased personal income tax bills that our outlined reforms taken alone would produce for lower and middle-income households. We set this revenue cost at $2.8 billion; as discussed above, this is the amount that would be required to simply provide offsetting rebates to negatively affected families. With this cost factored in, the total “price tag” of the reform outlined here under our static model is approximately $11 billion. This would reduce government revenue as a share of GDP by 1.3 percentage points.

However, it is important to recall that this revenue estimate makes the conservative assumption that the tax reductions induce no behavioural response, such as increased investment due to lower corporate income tax rates. While the size of these behavioural effects, and associated impacts on economic growth and revenues, are an open question, the direction is not—both the PIT and CIT bases would undoubtedly expand in response to the rate reductions. As such, the lower PIT and CIT rates would be applied to a larger base, resulting in revenue beyond what is projected by our static model.19

In short, while it is beyond the scope of this paper to present a detailed estimate of the extent to which behavioural changes and resulting tax-base expansions would offset the rate reduction, we note that our estimated revenue loss of $11 billion and 1.3 percentage points of GDP represents a top end and is in fact likely to be an unrealistically high estimate of the proposal’s cost.

A reform-minded government would have several available options for offsetting this revenue loss. The first of these options would be a brief period of spending restraint. For example, in 2017/18, Ontario increased program spending by 6 percent. In its just published 2018 budget, the government calls for a further 6 percent spending increase this year. If the government were in fact to forego the spending increase planned for this year, and instead hold nominal spending at 2017/18 levels, provincial spending as a share of GDP would fall by 0.7 percentage points to 17.2 percent. The savings from this one-year change in spending plans would be sufficient to offset more than half of the revenue losses from our proposed reform.

It should be noted that under this scenario spending in 2018/19 would be up 6 percent in nominal terms from 2016/17 levels, representing a small real per-capita increase over the past two years.

In the likely event that our estimates of the revenue effects of this tax reform proposal are overstated due to unaccounted-for dynamic effects, this single year of restraint may, on its own, be nearly sufficient to “pay for” the reforms outlined here. If not, a second year of frozen nominal spending

growth would be sufficient to achieve the rest of the required savings. Under this scenario, there would still be an aggregate nominal spending increase of 6 percent over the three-year period from 2016/17 to 2019/20, meaning essentially flat real per-capita spending levels.

It should be noted that the analysis shown here has sought to show in broad terms what type of spending restraint would be necessary to offset the tax reductions we have proposed with no change to the provincial budget balance, which is currently expected to stand at a deficit of $7 billion over the next three years. Eliminating the deficit as well over a similar period would of course require additional restraint or spending reductions. For example, assuming a two-year nominal spending freeze proved necessary to offset the cost of the tax reforms proposed here, reaching a balanced budget in 2019/20 would require a nominal program spending reduction of 4.4 percent over the next two years.

Another or perhaps complementary option would be for the province to broaden the tax base upon which the PIT is applied by reducing or eliminating some “tax expenditures.” Tax expenditures, which the Office of the Auditor General (2015) defined as “[t]ax measures that governments use to promote specific policy objectives,” reduce government revenue substantially, without necessarily having the same pro-growth effects of tax rate reductions. Past research suggests that significant revenue gains are possible through this approach, with the marginal cost of raising such funds being substantially lower than money raised as a result of higher rates. Reducing the number of tax expenditures would have a further benefit of improving economic efficiency by eliminating distortionary elements of the tax code.20

This discussion has sought to demonstrate that the tax reforms suggested here are feasible from a fiscal perspective. Simply declining to proceed with nominal spending increases planned for this year would be sufficient to “pay for” more than half the cost of the proposed reform and potentially close to all of it due to dynamic effects. Achieving these tax reductions while also moving quickly to a balanced budget would require further fiscal consolidation and, in fact, would involve nominal spending reductions over the next two years.

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20. See Lammam et al. (2015) for a discussion of the advantages of eliminating or reducing some tax expenditures to create room for statutory tax rate reductions.
Conclusion

The last fifteen years have proved challenging for Ontario’s economy. Given sluggish growth projections, pro-growth policy reform aimed at making the provincial economy more competitive and more attractive for investment is overdue.

The tax reforms described in this paper represent an example of pro-growth policy reform. By reforming and reducing Ontario’s uncompetitive and economically damaging PIT rates and lowering the CIT, this sort of tax reform would create a lasting economic advantage for Ontario. Specifically, it would create one of North America’s most attractive tax systems from the perspective of attracting investment and human capital in North America. It would be a big step towards the creation of an economic environment in which businesses, entrepreneurs, and skilled and educated workers want to come to work, invest, and create opportunities for other Ontarians.

Reducing Ontario’s tax burden and reforming the growth-restricting PIT would not be a silver bullet. There are many areas of public policy, as well as factors outside the government’s control, that help determine economic growth. But moderate and competitive personal and corporate income taxes are important factors in attracting business investment, and so reform to provide a tax-competitive environment is a promising strategy for helping to encourage investment, dynamism, and growth. This paper provides a realistic estimate for how Ontario could significantly increase its competitiveness and in fact create one of the most attractive tax environments in North America. The paper has also shown that doing so while also addressing distributive concerns is entirely feasible from a fiscal perspective.
References


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Acknowledgments

The authors thank the anonymous reviewers of early drafts of this paper. The authors would also like to thank Niels Veldhuis and Jason Clemens for their important contributions to this report and helpful advice throughout the research and editorial process. Any errors and omissions are the sole responsibility of the authors. As the researchers worked independently, the views and conclusions expressed in this paper do not necessarily reflect those of the Board of Directors of the Fraser Institute, the staff, or supporters.
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ISBN
978-0-88975-492-8

Date of issue
April 2018

Citation
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