Only Higher Taxes Will Cure Ontario's Fiscal Ills

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Ontario's Premier Kathleen Wynne has a majority mandate and four years to make some serious, difficult decisions. One of her biggest challenges will be to balance her government's books, but doing this sensibly requires understanding the nature of Ontario's fiscal problem.

Ontario's budget deficit is by far the largest of all the provinces, forecast to be about $12.5 billion this fiscal year. As a share of provincial gross domestic product (GDP), it is 1.7 percent. This is considerably smaller than Ottawa's deficit back in the late 1980s and early 1990s, but it will still require serious effort by Ms. Wynne's government.

The essence of eliminating a budget deficit is simple – either cut spending or raise taxes – but as usual the devil is in the details. By examining revenues and expenditures separately, and comparing them with other provinces, we get a better idea of Ontario's real fiscal problem.

Consider expenditures first. Ontario's program expenses, which exclude the interest payments made on the public debt, are 16.7 percent of provincial GDP. By Canadian provincial standards, this is actually quite low. In fact, only two provinces spend less, Alberta at 11.4 percent and Saskatchewan at 16.2 percent. All others spend more than Ontario. In Quebec, program expenses are 17.4 percent of GDP; in British Columbia it is 17.9 percent. The highest-spending province is Prince Edward Island, at 26.2 percent of GDP.

Examining these expenditures on a per capita basis, we see that Quebec is actually the lowest spender, at $8002 per person annually, and Ontario is the second lowest, at $8676. Alberta is actually much higher, at $9679, but the highest spending province is Newfoundland and Labrador, at $13209 per person annually. These numbers reveal the scale economies in many types of public spending: highly populated provinces are able to provide a given level of public services at a lower average cost per person than sparsely populated ones.

Now consider the revenue side of the provincial budgets. Ontario's public revenues are 16.6 percent of provincial GDP. This is the second lowest of all the provinces, with Alberta the lowest at 12.0 percent. Quebec is at 18.9 percent and British Columbia is at 19.1 percent. The highest is Prince Edward Island, at 27.7 percent.

What conclusions can we draw from these data? First, it is probably not very sensible to compare Ontario's public finances with those of Alberta, where enormous resource royalties permit that province to have very low income taxes and no provincial sales tax. It makes more sense to compare Ontario to the other provinces, especially the larger ones like Quebec and British Columbia.

Second, by these standards at least, Ontario does not appear to be a profligate spender. This doesn't mean that Premiere Wynne should ignore the spending side of the ledger and deny the existence of expensive and ineffective government programs. These

programs certainly exist, and she should find them and scale them down, if not eliminate them entirely. What is suggested by Ontario's relatively low spending is that the scope for large-scale spending cuts is probably far less than claimed by the shrillest fiscal conservatives.

The third conclusion follows straight from the second. If Ontario has a large budget deficit that needs to be reduced but doesn't have an obvious spending problem, then we must conclude that Ontario has a revenue problem. In other words, the lion's share of Ontario's budget deficit needs to be eliminated by increasing tax revenues.

Ontario's tax revenues can be increased in two general ways. The first is through a faster-growing economy. Higher growth would obviously be nice, but this isn't something Premier Wynne can simply enact through policy. The second, the policy approach that she will need to take, is to raise selected tax rates. There are many choices here, all pretty unpopular. Rates could be raised on corporate income taxes, personal income taxes, the Harmonized Sales Tax (HST), or various excise taxes or user fees.

Kathleen Wynne has some tough decisions to make in the months ahead as she prepares for the 2015 budget, one that will set the path for Ontario's fiscal health for many years to come. In my next column I'll outline some of the pros and cons of raising different taxes, and suggest a way that she might be able to have her fiscal cake, and eat it too.

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