Ontario is left with few options to fix its revenue problem

Christopher Ragan
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I argued in my last column that Premier Kathleen Wynne faces a challenge in balancing Ontario's books, promising to reduce the province's budget deficit from this year's predicted $12.5-billion to zero within a few years. I also argued that, compared to other provinces, Ontario has more of a revenue problem than a spending one; the lion's share of the deficit will need to be eliminated by increasing tax revenues.

When it comes to seeking new revenues, some politicians like to claim that economic growth will somehow increase and greater tax revenues will naturally follow. More growth would certainly be nice, but it isn't something a government can just will into being. The Ontario government needs to find more revenues in the actual economy, not some fantasy one.

Ms. Wynne will therefore be thinking about raising tax rates. And she will immediately encounter a tension between which taxes are least economically damaging and which are least politically unpopular. But there is nothing surprising here – most discussions about taxes have to address this tension.

One option is to increase Ontario's corporate income-tax rate. Many ordinary people like this option, claiming that businesses don't pay their "fair share" and so they feel it's only right for their tax rates to rise. The problem is the abundance of economic logic and empirical evidence, from Canada and elsewhere, showing that corporate taxes are one of the most growth-retarding taxes politicians have at their disposal. Taxes on profits reduce firms' incentives to generate them, and this leads to less investment in productivity-enhancing equipment and less time and money spent on research and development. Over time, the lower investment and innovation result in lower wages and slower economic growth.

Another option is to increase personal income-tax rates. Not surprisingly, most ordinary people dislike this option, unless it is clear that taxes will only rise for people richer than themselves. But there are few enough truly rich people that if the Ontario government chooses this option, many ordinary people will end up feeling the pinch. In addition, marginal tax rates that get increased too far reduce incentives for many people to work harder, thus impacting negatively on growth.

The third option is to increase the provincial component of the Harmonized Sales Tax (harmonized with the federal GST). Economists have long argued that of the three major taxes mentioned here, consumption-based taxes do far less economic damage, partly because they provide fewer disincentives to saving and growth. The big problem with increasing sales taxes is political: The GST is probably the most hated tax in Canadian history, and Ontario's HST version can't be far behind.

So Premier Wynne and her Finance Minister Charles Sousa have an important choice to make, especially for the 2015 budget now being planned. They have a budget deficit of 1.7 per cent of provincial GDP and most of this gap needs to be filled with new revenues. None of the three major taxes is a "good" choice; raising rates on any of them will cause either political or economic problems, or both. Isn't there some way out of this fiscal conundrum?

As it turns out, there is. Ontario could choose to follow British Columbia's lead and introduce a tax on the emission of greenhouse gases – a carbon tax. Such a tax would be applied to the consumption of all major types of fossil fuels, based on the fuel's carbon content. Consumers and businesses alike would feel the impact; they would face greater incentives to economize on fuel use, and firms especially would be led to develop innovative ways of doing business that rely less on fossil fuels. Rebates for low-income households could easily be built into the policy. An Ontario carbon tax would represent a pragmatic blending of fiscal and environmental policies.

The intermittent debate in Canada about policies to address climate change has too often focused on the damaging effect of taxes. But some level of taxation is a necessary part of life, and a crucial task for governments is to choose from among the alternative taxes the ones least economically damaging and most conducive to economic growth.

A new Ontario carbon tax could fill that province's fiscal hole, avoid the economic damage caused by higher income taxes, dodge the unpopularity of increasing the HST, and improve Canada's performance on a critical environmental challenge. Premier Wynne should consider it seriously.

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