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Fiscal Soundness and Economic Growth: An Economic Program for Ontario

The province of Ontario is on an unsustainable fiscal course. The first order of priority for this Economic Program is to bring the long-term cost of government programs in line with the revenue-raising capacity of the province.

Benjamin Dachis

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The Study In Brief

Ontario is on an unsustainable fiscal course. The government must act to bring the long-term cost of government in line with the revenue-raising capacity of the province. This Economic Program shows a number of policy directions in areas as diverse as healthcare, labour and education policy, tax reform, housing and municipal policy, as well as electricity and greenhouse gas policy, that can balance increases in spending with the generation of new revenues and cost-savings measures.

This Economic Program adopts the fiscal presentations of the independent officers of the Ontario legislature – the Auditor General and Financial Accountability Office – as the authoritative sources for the short-, medium- and long-term fiscal outlook. The medium- and long-term fiscal outlook for Ontario is dire. This Economic Program recommends that the government restate the province's books to reflect the Auditor General's accounting treatment of pension assets and electricity-sector debt. Further, the government should adopt a sound long-term fiscal policy – which requires surpluses, not just balanced budgets – that meets the government's debt-to-GDP target ratio of 27 percent.

In healthcare, which already consumes roughly half of the province's own-source revenues, policymakers will face continued cost pressure. This Economic Program views progress in addressing this issue – in addition to limiting public and private gaps in coverage for prescription drugs and mental health – as a critical challenge.

This Economic Program also focuses on reforms to labour and employment legislation to increase the flexibility of existing minimum wage policies and employment and labour laws. It also focuses on improving the skills of Ontarians seeking mid-career improvements, and improving the performance of Ontario's K-12 and post-secondary education systems.

With recent United States tax reform considerably raising the attractiveness of the United States for new business investment, this Economic Program takes steps to improve the competitiveness of the province as a destination for firms to make investments and for workers to live.

With regard to housing and municipal policy, this Economic Program seeks to lower the cost of housing across the province by taking steps to reduce barriers to construction and eliminating economically costly rent controls and transfer taxes. It would also fundamentally change the relationship between municipalities and the province by granting cities the ability to put their budgets on a sound financial footing and allow them more flexibility in financing infrastructure.

Finally, no policy area has been more controversial than Ontario's greenhouse gas and electricity policies. This Economic Program would preserve the best parts of the current government's plan, while cutting ineffective policies and reducing costs to households. This Economic Program would seek long-term cost savings in the electricity sector, as opposed to short-term fixes that only add to the long-term cost of energy.

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With an election looming in 2018, Ontario faces difficult choices regarding the fiscal outlook and long-term sustainability of a number of government programs.

This Economic Program for Ontario lays out a series of priorities to frame the debate in the coming months. The province is on an unsustainable fiscal course, as we will show more clearly to Ontarians by adopting the recommendations of Ontario's Auditor General with respect to the accounting treatment of certain assets and debt.

The first order of priority for this Economic Program is to bring the long-term cost of government programs in line with the revenue-raising capacity of the province. It would broadly balance increases in spending and cuts to poorly designed taxes with new ways to generate revenues and reduce spending on ineffective programs.[1] To be sure, this will involve slowing down growth in major areas of spending. This Program, however, specifically focuses on measures by which the government can provide Ontarians with greater bang for their buck, and stimulate economic growth at little cost to the Treasury. These measures will be valuable tools in balancing the books through more efficient spending and revenue raising. Ontarians' standards of living will be enhanced as the government balances the books through these prudent measures.

In that vein, this Economic Program proposes 15 steps toward fiscal soundness and economic growth:

- Restate the province's books to reflect the Auditor General's recommended accounting treatment of pension assets and electricity-sector debt;
- Adopt a sound long-term fiscal policy – which requires surpluses, not just balanced budgets – to meet the government's debt-to-GDP target ratio of 27 percent;
- Contain healthcare costs by extending capitated payments to family doctors and revising contractual arrangements with healthcare providers;
- Replace the age-based drug supports of OHIP+ and the ODB with an income-tested drug benefit;
- Slow the increase in the minimum wage and focus on improving education to create economic opportunities for Ontarians;
- Adopt an Indigenous identifier in standardized tests and oversample Indigenous students to permit reliable rural-urban and district-level analysis;
- Modernize funding formulas for post-secondary education by taking outcomes into consideration;
- Open retailing for alcohol and marijuana and revise the tax scheme for both products;
- Adopt personal income tax reforms that reflect the cost of raising children, while reforming personal income taxes to reduce high marginal rates, which occur even at low incomes;

Many thanks to Colin Busby, Alexandre Laurin and Rosalie Wyonch for their contributions to a number of sections of this Economic Program. I also thank Åke Blomqvist, Stephen LeClair, Jeff Parker and anonymous reviewers for their helpful comments on an earlier draft. I retain responsibility for any errors and the views expressed.

1 This Economic Program presents the broad policy choices and leaves implementation details elsewhere. Unlike the provincial budget, this Economic Program relies on the fiscal projections of others, particularly the Financial Accountability Office of Ontario.

- Replace targeted business tax breaks with lower provincial business property taxes to create a level playing field across the province and across different types of businesses;
- Rethink the fiscal relationship between municipal government and the province by retooling grants and transit governance while modernizing municipal financial reporting to match that of the province;
- Reduce the costs that governments impose on building new housing;
- Replace financial support for social housing construction with a matching grant from the federal Canada Housing Benefit;
- Retain the plan to price greenhouse gas emissions, but re-focus the government plans to spend money raised by such a price away from cost-inefficient programs; and
- Seek out further long-term cost savings in the electricity sector as opposed to short-term fixes that only add to the long-term cost of energy.

The Fiscal Outlook

This Economic Program adopts the fiscal presentations of the independent officers of the Ontario legislature – the Auditor General and Financial Accountability Office – as the authoritative sources for the short-, medium- and long-term fiscal outlook. While the government may claim to have balanced the budget for 2017/18, the medium- and long-term fiscal outlook for Ontario is dire.

Cleaning up Ontario's Books – The Short-Term Deficit Debate

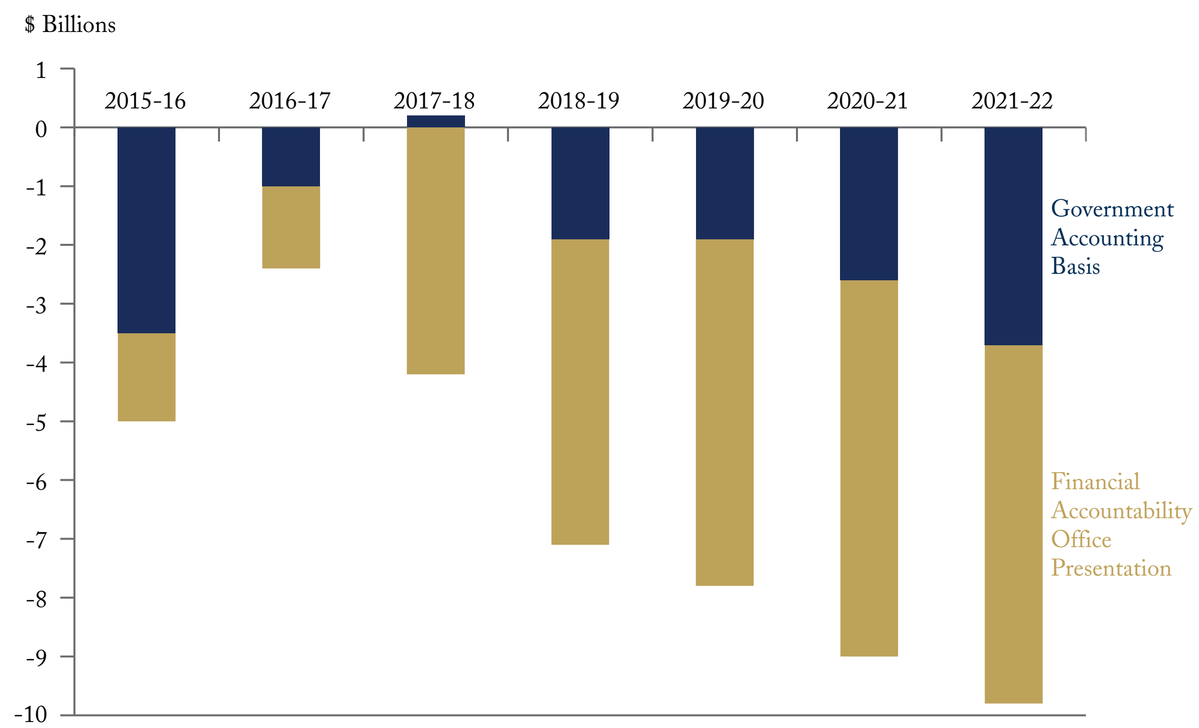
The government has made the argument that it has reached a balanced budget. However, the Auditor General has two specific objections related to this claim because of the government's accounting treatment of pensions and whether the recent Fair Hydro Plan amounts to new spending.

The pension dispute centres on the government's treatment of the Ontario Teachers' Pension Plan (OTPP) and the Ontario Public Service Employees' Union Pension Plan (OPSEUPP). The province reports the net asset value of the plans on the province's balance sheet, which reduces the debt, as well as the deficit. The Auditor General (2016) objects to this on the grounds that it fails to conform to Canadian Public Sector Accounting Standards because the province does not have the unilateral legal right to access the pension assets – which are invested at arm's length. Further, as Robson and Laurin (2016) argue, the government discounts OTPP and OPSEUPP liabilities by more than the plans do themselves. This understates the liabilities provincial taxpayers face.[2]

The second dispute hinges on the Fair Hydro Plan. As the Auditor General (2017a) points out, the government "is making up its own accounting rules" by creating an accounting asset for a government-controlled entity (the Independent Electricity System Operator) to offset the debt the province placed on another government-controlled entity (Ontario Power Generation). The asset the government created only exists because of legislation that gives a government entity the authority to collect higher prices in the future. The Auditor General argues that creating off-book assets such as that created by the Fair Hydro Plan is not consistent with commonly accepted accounting standards in Canada. Therefore, the asset and liabilities should be included in the Government's fiscal presentation.

2 However, the view of the Auditor General is not universally shared. The Ontario government appointed a Pension Asset Expert Advisory Panel to advise on the difference of opinion between the government and Auditor General. The Panel's Report (2017) argued that an asset does exist for the government, saying that the government does have indirect access to the plans' assets through jointly negotiated employer/employee contribution reductions to these plans.

Figure 1: Ontario Budget Balance



Source: Financial Accountability Office of Ontario 2017 Fall Economic and Fiscal Outlook. Does not include reserve fund. 2017-18 and beyond are projections by the Financial Accountability Office.

This Economic Program proceeds on the basis that the government should show no asset related to future electricity sales at higher prices. Electricity markets may change because of technology. For example, distributed solar power and batteries may make it impossible for a central government agency to collect future revenues to pay this debt. This debt should be reflected in the province's financial statements now. Incorporating the debt amount in today's books would increase the deficit by $2.5 billion per year through to 2027.

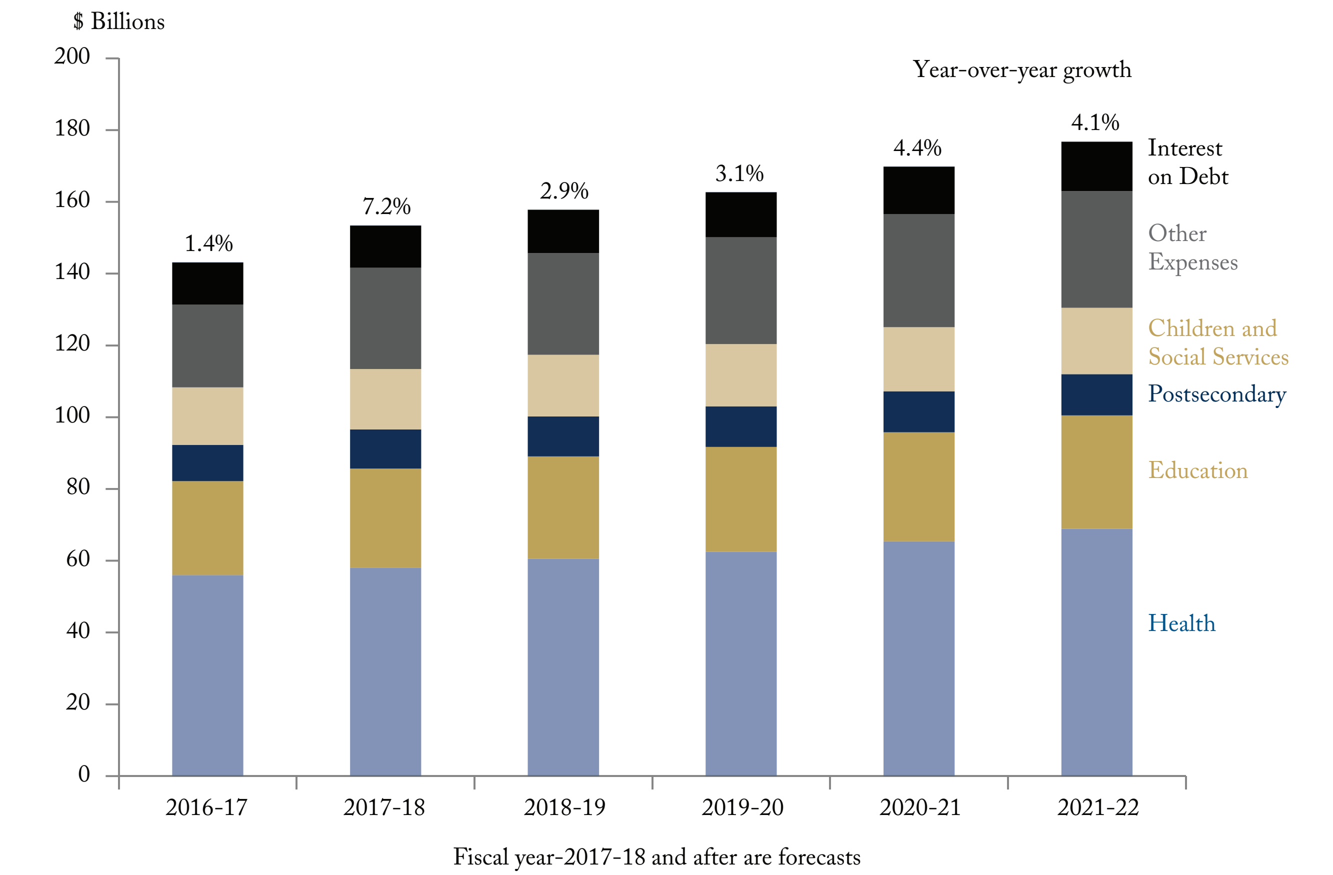
Improper financial presentation means that legislators and voters don't fully understand a government's fiscal plans and cannot hold it to account for fulfilling those plans (Busby and Robson 2017). Indeed, Ontario is only one of a handful of major Canadian governments to have received a qualified audit from its Auditor General. This qualification lowered Ontario's financial accountability score from among the highest in Canada to the middle of the pack in 2017 (Busby and Robson 2017).

The Financial Accountability Office (FAO) of Ontario has adopted the Auditor General of Ontario's presentation as the appropriate interpretation and application of accounting standards for the province. Similarly, this Economic Program restates the province's books to reflect the Auditor General's concerns. It restates the province's finances to show a deficit in the upcoming 2018/2019 fiscal year of about $7 billion (Figure 1).

Medium-term Fiscal Sustainability

Under the FAO's presentation, the government is expected to record a deficit of $4.0 billion in 2017/18, mainly due to the effect of the Fair Hydro Plan and the pension adjustment. The question

Figure 2: Ontario Provincial Spending and Year-over-Year Spending Growth Rates



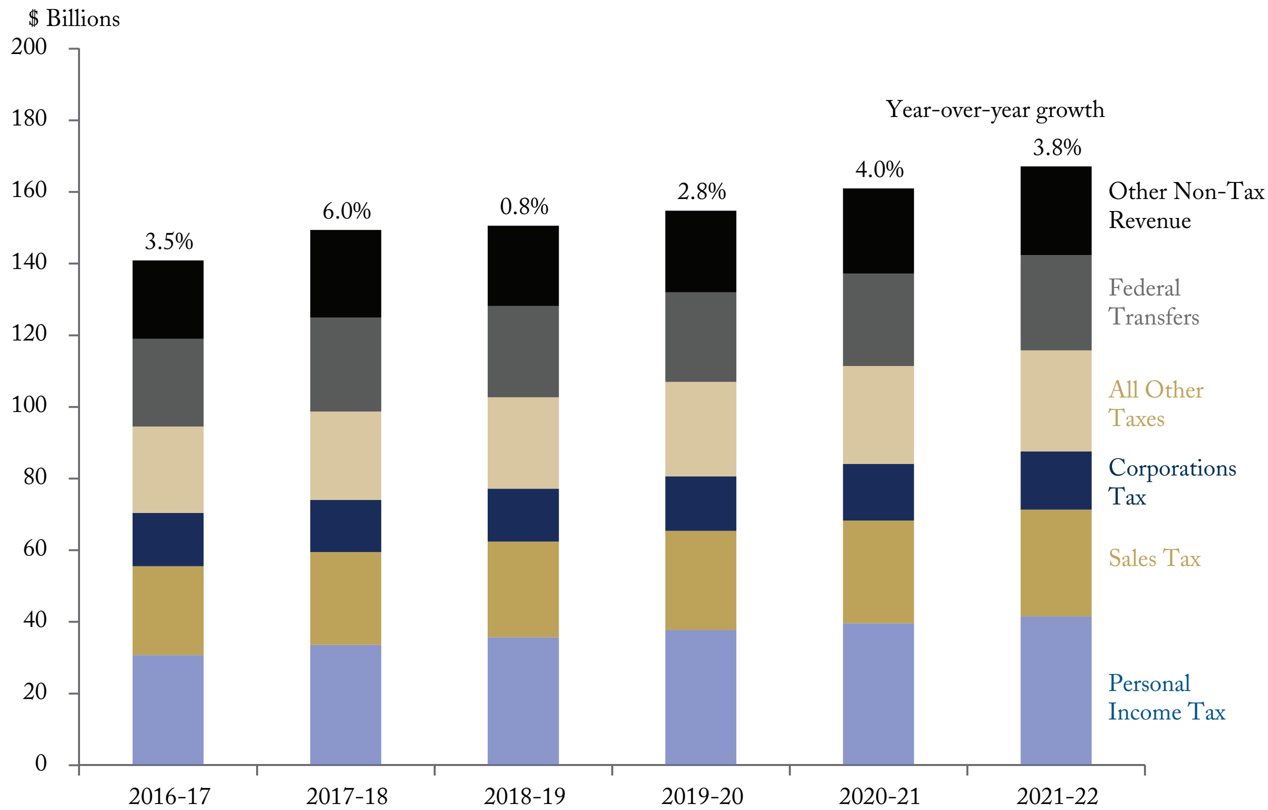
Source: Financial Accountability Office of Ontario 2017 Fall Economic and Fiscal Outlook.

of whether there is a deficit for the 2017/18 fiscal year is far less important, from the point of view of the sustainability of public finances, than future trends. Under current trends, the deficit would rise to nearly $10 billion by 2021/22 (Figure 1), because of decelerating revenue growth combined with accelerating expense growth. Growth in total expenditures is expected to reach 4.1 percent by 2021/22, significantly higher than the 1.4 percent growth recorded in 2016/17 (Figure 2).[3]

On the revenue side, corporate income tax revenues, which have been the fastest-growing source of revenue from 2015/16 to 2017/18, are likely to come under pressure from the US tax reforms that may result in companies booking less of their profit in Canada. Further, the Financial Accountability Office (2017a) argues that the government's revenue forecasts rely on above-

3 The FAO is forecasting 2017/18 total expense growth of 7.2 percent, mainly due to higher spending from the introduction of the Fair Hydro Plan.

Figure 3: Ontario Provincial Revenue and Year-over-Year Revenue Growth Rates



Source: Financial Accountability Office of Ontario 2017 Fall Economic and Fiscal Outlook.

trend income growth, resulting in overly optimistic personal and corporate income tax forecasts.

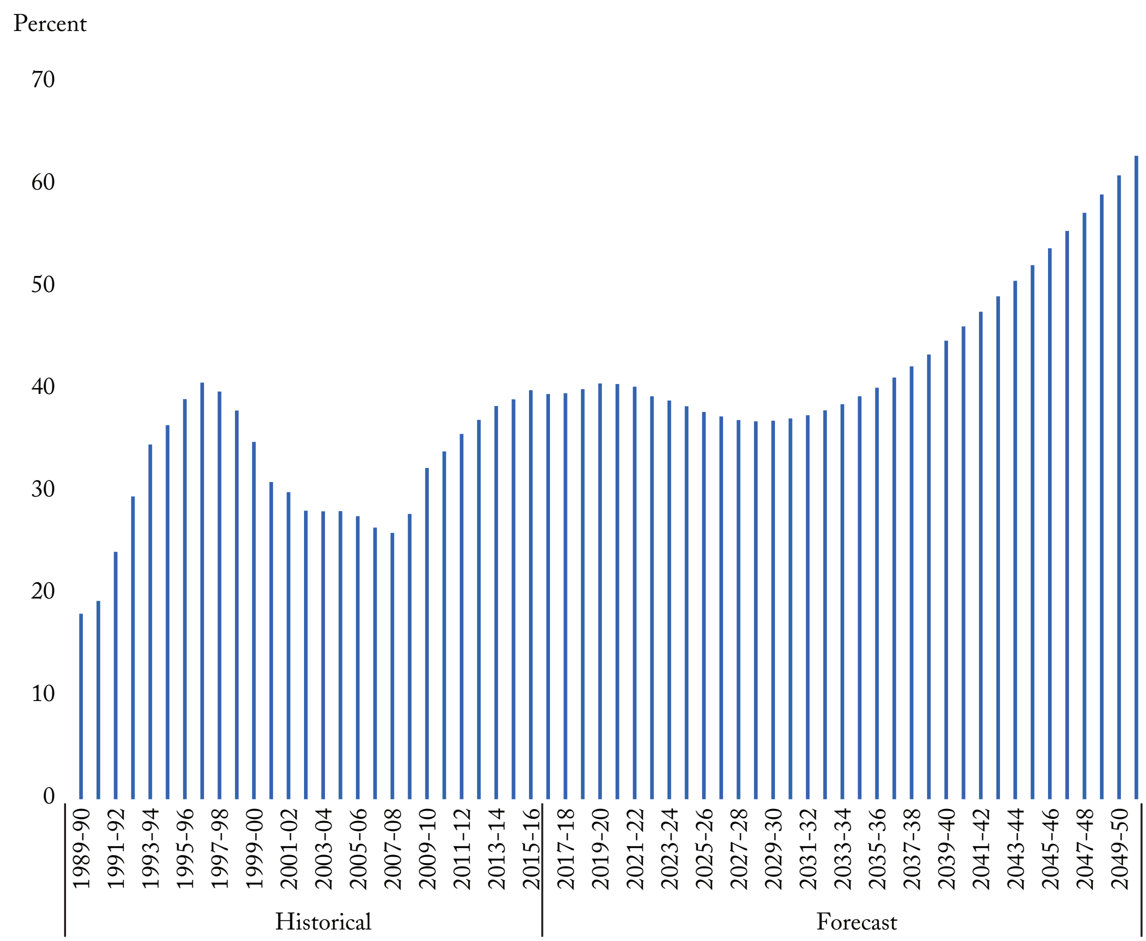
Absent raising taxes substantially or receiving more federal grants, the province must look to restrain spending to reduce its deficit. When the final numbers come in, the FAO projects 2017/18 spending will have grown 7 percent from the previous year.[4] This kind of spending growth is unsustainable. The FAO projects long-term revenue growth to average 3.7 percent annually. This Economic Program aims to reduce future expense growth to reach a balanced budget as soon as possible.

Long-term Fiscal Sustainability

Balanced budgets will not be enough for Ontario's finances to become fiscally sustainable. The government has targeted a net debt-to-GDP ratio of 27 percent, a sensible target that is similar to that of the federal government's target ratio

4 Excluding the cost of the Fair Hydro Plan, the growth rate in spending that year was 5.7 percent.

Figure 4: Net-Debt-to-GDP, Under Current Fiscal Trajectory

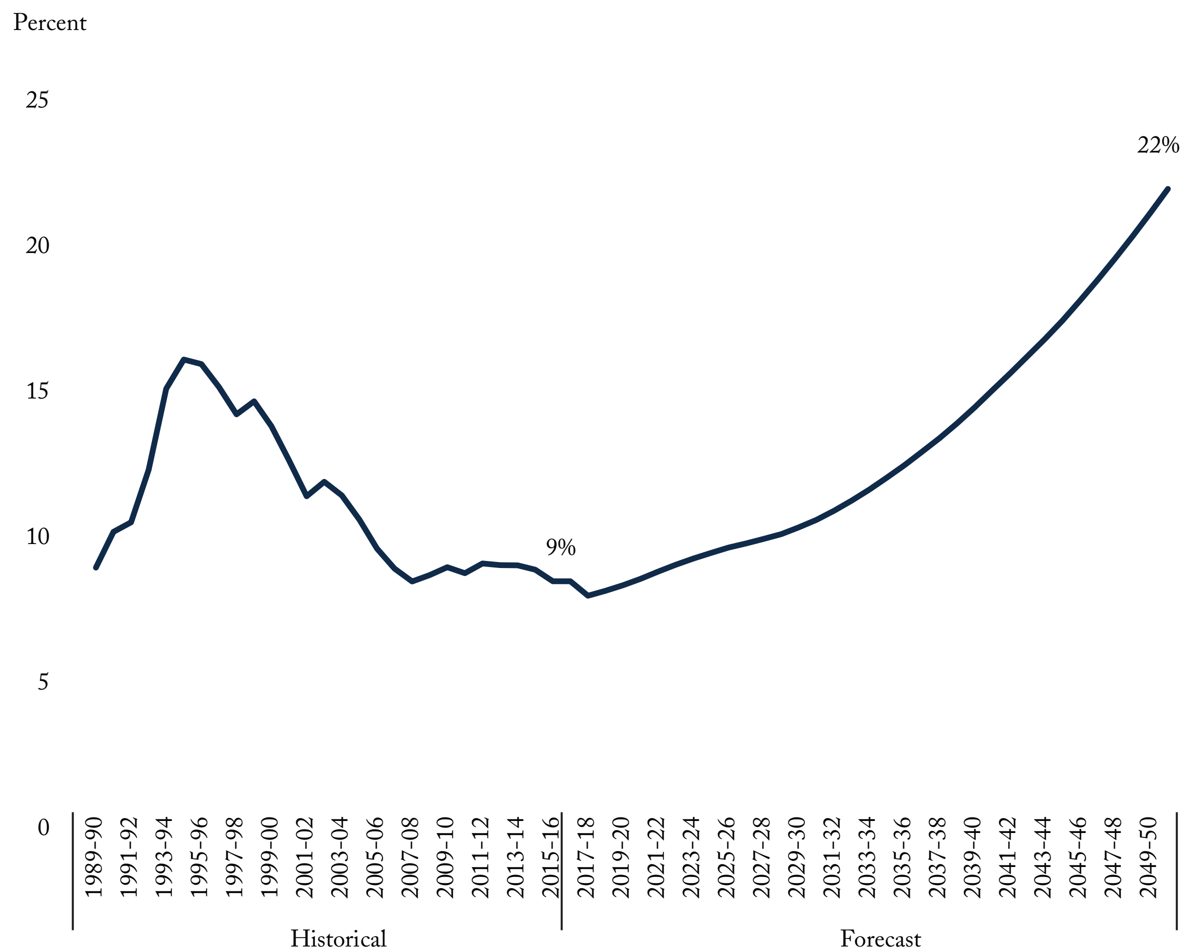


Source: Financial Accountability Office of Ontario

of 25 percent of GDP. This Economic Program would continue pursuing such a target and take the necessary action to achieve it within 15 years. As the Financial Accountability Office (2017b) projects, achieving 27 percent requires the province to run budget surpluses until 2029/30. If the province continues on the current trend, and does not run, first, balanced budgets and then surpluses, the net debt-to-GDP ratio will reach 63 percent by 2050/51, according to the FAO (Figure 4).

If the government doesn't tackle the long-term fiscal challenges, the cost of debt will take up an enormous share of total government revenues. Interest costs currently sit at between 8 and 9 percent of revenues. At current trends, interest costs will increase to a staggering 22 percent of revenues in 2050/51 (Figure 5), which leaves practically no fiscal room in the event of a sustained increase in interest rates beyond projected levels. If debt costs take up a large share of total revenues,

Figure 5: Interest Expense as a Share of Revenue



Source: Financial Accountability Office of Ontario.

that will leave less for other needs. Without a doubt, the looming future healthcare liabilities for the provincial government are the largest fiscal threat and driver of new debt. One estimate, which assumes that people will retire later in life than today, pegs the total healthcare liability at over $1.4 trillion in Ontario (Robson, Busby and Jacobs 2017).

Health Policy

Given that Ontario spends roughly half of its own-source revenues (which exclude transfers from the federal government) on health, getting good value for money in healthcare will be critical for the financial and societal well-being of Ontarians. Despite the province having successfully contained the annual growth of healthcare spending from 2010 to 2015 to 2.4 percent, on average, population aging dictates that the rate of health spending will start to tick upwards again. At the same time, policymakers will face pressure to prevent emergency-room overcrowding, long waits for long-term care beds, and overburdened caregivers. Progress on addressing these issues – in addition to limiting public and private gaps in coverage for prescription drugs and mental health – is a critical challenge.

Efforts to enable self-directed homecare services – such as recent moves to increase the number of hours nurses, personal support workers, and therapists will provide care in homes – should help alleviate the emergency room pressures for elderly patients, and these programs should continue to expand on their current trajectory. Relative to providers, patients with mild to modest physical disabilities are more likely to know the capabilities of family and informal caregivers to offer care, and which services they would prefer to have delivered by health professionals. Although there are some legitimate concerns about patients' ability to choose among different kinds of healthcare professionals to meet their needs, there should still be enough flexibility around the use of self-directed home care budgets to ensure appropriate innovation from those delivering services. This means sufficient flexibility in how patients select and schedule professional help.

How We Pay for Healthcare Influences How Much We Pay for Healthcare

The way the province pays for the delivery of health services matters. Currently, hospital-based physicians are paid out of a different envelope than other hospital costs. Paying hospitals, hospital-based doctors and necessary outpatient services for a needed intervention often results in silos of poorly coordinated care. This Economic Program would instead look at more bundled payments by procedure for hospital-based services and promote team-based care models (Sutherland and Hellsten 2017).

Although government needs to spend more money to improve access to mental health services, more money alone will not ensure that all illnesses are treated in appropriate timeframes. We need to review how we pay providers – primary care doctors and pharmacists, dentists and dental hygienists, and psychiatrists and social workers – to improve the efficiency of spending in these areas.

As suggested by Blomqvist and Busby (2016b), this Economic Program moves ahead with reforms that pay family doctors with a per patient (capitation) model, instead of the predominant fee-for-service model. Capitation systems produce better value for money than fee-for-service because doctors look to keep their patients healthier and add more patients to their roster (Blomqvist and Busby 2012). Capitated payments to family doctors for enrolled patients may evolve to cover budgeted amounts for such complementary medical costs as drugs, lab and diagnostic imaging (Blomqvist and Busby 2011).

Creating a Truly Universal Prescription Drug Plan

Prescribed drugs as a percentage of total health expenditures in Ontario are forecast to reach 15.3 percent in 2017, up dramatically as a share of total health costs.[5] Canada is one of few countries with government-organized health that does not have universal drug coverage. Ontario does have age-based criteria for universal drug coverage: The Ontario 2017 budget announced a universal drug program dubbed OHIP+ for those under age 25, and Ontario has a drug plan for seniors, known as the Ontario Drug Benefit (ODB), covering prescription drug costs for approved medications for small annual deductibles and co-payments (Busby and Pedde 2014). Ontario spent $5.9 billion on public drug support programs in 2016/17, with the largest share of that going to age-tested programs (Auditor General 2017c). The ODB alone cost $5.4 billion after including co-payments and deductibles.

5 This is a forecast total from National Health Expenditure Trends, 1975 to 2017.

Age-based eligibility criteria have a number of problems. First, age cut-offs are arbitrary. Why would someone 65 years of age be more deserving of public support than someone who is 64, or someone who is 24 more worthy than 25? Second, these thresholds create incentives for participants to use health services intensively near cut-offs of their coverage, driving up costs (Omran 2017). In addition, such age-based programs, particularly for seniors, will cause major demographic-driven cost pressures that will make the program fiscally unsustainable. The ODB is forecast to cost around 2 percent of provincial GDP by 2030 and about 3.5 percent of GDP by 2050 (Robson and Busby 2011). Age-based criteria don't address the core drug cost problem: most of those without sufficient coverage are people in low-wage occupations without drug benefits and the self-employed (Busby and Blomqvist 2017).

Blomqvist and Busby (2015) suggest transitioning to an improved approach to income-tested drug coverage. Such a reform would amount to expanding and improving upon the existing programs, such as the Trillium Plan. The current income-tested plans are focused on providing drug coverage for people on social assistance and to ensure that drug costs do not make up more than 4 percent of a person's income in case of a catastrophic need.

These income-tested programs could be improved in a number of ways. First, a drug program that is tied to participants being on a specific government support program results in a large amount of government benefits shrinking at once as a person takes on more work and comes off social assistance. The clawback of support discourages people from taking on work and getting off social assistance programs (Busby and Pedde 2014). A plan that is geared to income for all, not just those on social assistance, can reduce these welfare walls.

Second, this Economic Program would transform the ODB and OHIP+ in a revenue-neutral manner into a pharmacare model similar to that of the current B.C. Fair Pharmacare plan (Busby and Pedde 2014), which would reduce the cost of prescription drugs while ensuring universal coverage for those unable to pay for drugs, and cap drug costs as a share of income.

Labour and Education Policy

Recent changes to Ontario's labour policy and minimum wage target workers with precarious work, defined variously, but often meaning jobs different from full-time, permanent ones. Half of all prime working age males (aged 25-54) in part-time positions would prefer full-time employment (Busby and Muthukumaran 2016). As of April 2017, the gap between average hourly wages for part-time and full-time jobs was $10 in Ontario (Mahboubi 2017). However, based on the evidence in other jurisdictions, this gap is not entirely explained by differences in employees' characteristics.

This Economic Program would focus on reforms to labour and employment legislation to increase the flexibility of existing minimum wage policies and employment and labour laws. This Economic Program would focus on improving the skills of Ontarians seeking mid-career improvements, and improving the performance of Ontario's K-12 and post-secondary education systems.

Labour and Employment Policy

Precarious work – employment that is often more insecure and uncertain than traditional full-time employment – presents many challenges, including wage gaps between temporary or part-time workers vis-à-vis full-time workers.

While there are no ideal policy levers for addressing these issues, it should be recognized that, in general, minimum wage increases are a reasonable option available to policymakers if the increases are gradual and evaluated over time. Ontario's recent, large and sudden increase in the minimum wage means that the right response for government should now be to pause and evaluate. One particular concern is the impact on businesses in smaller municipalities that risk being most negatively affected.

This Economic Program would amend the current minimum wage in two ways, as recommended by Marchand (2017). First, it allows for regional variation in minimum wages. Upper-tier and single-tier municipalities across the province will have the option of returning to a lower minimum wage for a five-year period. New York has a similar policy, in which the minimum wage is higher in New York City than in other parts of the state. Second, this Economic Program would build a provision into the minimum wage legislation to reduce it in the case of a recession, as California has recently done.

The province has also looked to boosting employment standards through Bill 148 to tackle worker vulnerability. This legislative effort has focused on regulations that govern the employee-employer relationship. For example, the government has required companies to have equivalent pay for part-time worker and full-time employees. European countries put in place similar policies, resulting in lower job creation while gaps between full-time and part-time pay remained (Mahboubi 2017, Busby and Muthukumaran 2016). Many have since moved to a model known as "Flexicurity" that balances employment flexibility and security. This Economic Program initiates a review of how best to transition rigid labour and employment rules to a Flexicurity model.

Finally, improving access to education and programs to upgrade skills is a good way to break the cycle of temporary and precarious work. However, most mid-career training and job programs can only be accessed through federal Employment Insurance. This Economic Program would expand access to such programs by using existing funding from the joint federal/provincial Job Training Grant to create pilot programs testing new ways to extend skills training for temporary workers.

K-12 and Post-Secondary Education Policy

As trade, technology and worker preferences continue to change the dynamic for skills desired by employers, a competitive labour force will need an abundance of core numeracy and literacy skills. For Ontario, the news on these scores is mixed. On literacy, the results are strong (EQAO 2015). In terms of numeracy, however, the results are alarming – only half of all grade 6 students in the province meet the provincial standard for numeracy. As well, Ontario's scores on the OECD Programme for International Student Assessment (PISA) have plummeted over time, from 530 in 2003 to 509 in 2015, one of the largest drops among Canadian provinces, putting Ontario statistically below the average in Canada (Richards 2017). This needs fixing.

The province's re-examination of the math curriculum and pedagogy, where the effectiveness of different pedagogies is explored as potential causes, is therefore a worthwhile step (Stokke 2015).

Furthermore, collecting, analysing, and reporting educational outcomes are essential to closing the achievement gap between more and less advantaged students. Including a question that identifies Indigenous students in PISA tests is a way to track the educational achievement of Indigenous students and help educators and policymakers design more effective strategies to improve outcomes. The province should also oversample to ensure a sufficiently large sample of Indigenous students to produce reliable estimates at the district level and allow urban/rural analysis (Richards and Mahboubi 2018).

Many OECD countries consider Performance-Based Funding (PBF) systems for their post-secondary education, but Canadian provinces, including Ontario, lag behind in adopting this innovative way of financing. Usher (forthcoming) shows the benefits associated with PBF include reducing the burden of funding negotiations, higher accountability of the post-secondary institutions, and greater competition between institutions, leading to a greater focus on results. A similar approach to competition in grants for research has been effective at improving the performance within universities, and should apply to universities themselves. The government needs to review its funding formula and learn from the experience of other developed countries.

Tax Policy

The recent US tax reform considerably raises the attractiveness of the United States for new business investment, especially for projects intended to serve North American and world markets. These tax changes mean Ontario should focus on improving the competitiveness of the province as a destination for firms to make investments and for workers to live.

Business Taxation

A properly designed business tax regime would provide a common provincial tax rate for all businesses operating across the province, regardless of their location or sector. However, Ontario's tax regime selectively rewards a number of sectors, such as manufacturing, through the income tax system while punishing companies through overly high provincial property tax rates. Ontario can, on a revenue-neutral basis, simplify its tax regime, create a more level playing field across sectors and the province, and reduce the effective tax rate on new business investment.

Eliminating Wasteful Business Tax Expenditures

The largest tax expenditure in the corporate income tax system, by far, is the Small Business Deduction, which costs Ontario over $2 billion in forgone revenue. A better alternative to the Small Business Deduction is a lower general corporate income tax rate. That is because the net impact of the Small Business Deduction is an expansion of the small business sector at the expense of large businesses. Since small firms are less productive than large firms, the Small Business Deduction lowers overall economic performance (Dachis and Lester 2015). This Economic Program would not proceed with any further cuts geared to small business.

In addition, the province provides manufacturing and processing businesses a preferential lower tax rate than those in the rest of the economy: 10 percent instead of the usual 11.5 percent. This lower rate cost taxpayers $290 million in the 2017 calendar year.

This Economic Program would eliminate the lower rate for manufacturing and processing, and use that revenue to cut high provincial property tax rates that choke investment, as discussed below. It would also initiate a comprehensive review of tax expenditures to determine which tax expenditures are appropriate and which should disappear.

Cutting Provincial Business Property Taxes – A Revenue Neutral Cut in Investment Taxes

Ontario took over the local education property tax from local school boards in 1998. When the province took over, school boards had widely varying tax rates across the province and by property type. The province immediately made its residential tax rate the same for all residents across the province. It's a different story for businesses. Each year since 2007, the province has set a maximum tax rate, called the ceiling rate, and a lower target rate designed to be revenue-neutral for the province. The province committed in its 2007 budget to lower higher rates down to the target rate over time, but the province has stalled on tax cuts since 2013.

The provincial property tax still varies wildly across cities and for different buildings within cities (See Figure 6a and 6b, which shows provincial rates for commercial and industrial properties). Provincial commercial property tax rates in some Ontario municipalities are more than three times those in others. The provincial tax is highest on industrial property across much of Southern Ontario. As Found (2017) shows, the average provincial business property tax rate is more than six times its residential counterpart.

In the 2017/18 fiscal year, the province will collect $6 billion in property taxes, which it reports as general revenue. Since different education tax rates by region have nothing to do with local school spending, each school board now gets a provincial top-up grant in order to level the playing field. Each school board's total revenue is based on its enrolment and the needs of students, not the value of buildings in the area. That means the provincial property tax now has no bearing on school boards' spending. Yet, the province still uses the misleading name "education property tax" to describe it on tax bills.

These high property taxes have a large economic cost. Property taxes act like a tax on capital, specifically building capital. A tax on capital reduces the incentive to invest, resulting in lower investment, which leads to lower productivity and therefore income and standards of living for Canadians. A 10 percent increase in commercial property tax rates decreases the long-run value of the business property assessment base by 8.2 percent.[6] At the average level of business property taxation in Ontario, a $1.00 business property tax hike costs the Ontario economy $5.56 (Found 2017). Higher taxes shrink the tax base, which makes it harder for governments to raise revenues. The total business tax rates in some cities across Ontario – such as London, Windsor and Brantford – are so high that cities and the province might see revenues increase if they cut their taxes to attract more business investment.

This Economic Program proposes to complete the harmonization of business property tax rates. To make such a tax reform revenue-neutral, it proposes to eliminate the lower manufacturing and processing corporate income tax rate, and review tax expenditures with a view of eliminating those that do not pass the cost-benefit test. With those savings it would reduce provincial business property taxes. Such a change would have a number of benefits. First, it would create a more level playing field across different types of businesses that currently face different tax rates. Secondly, it would improve fairness in the provincial property tax regime across the province. Third, a revenue-neutral property tax reduction would lower the marginal effective tax rate on new investment in most of the province. Property taxes have a larger effect on the tax burden on investment than corporate income taxes because they are insensitive to profit and are akin to a direct tax on capital (Found and Tomlinson 2017). Such a reduction in provincial property taxes would be largest for the same sectors that would see a removal of their special, lower income tax rate, across most of Southern Ontario.

Personal Taxation

Income taxes affect individual and business incentives to earn income, save, invest, and take risks. Excessively high taxes at the margin can also drive tax avoidance behaviour. This Economic Program proposes to reduce personal income taxes by reallocating money saved through the rationalization of wasteful subsidies to adopters of emissions- and energy-reducing technology (as discussed later in this Economic Program on greenhouse gas policy).

At the personal level, the impact of income tax variations on work participation decisions is particularly acute for the secondary earner in families with children and for lower-skilled workers. In general, lower-income, less-educated people have a greater tendency to adjust their paid

6 This occurs for two reasons. First is a capitalization effect: properties have a lower value because owners know they will need to pay higher taxes in the future. Second, is lower investment because of the discouraging effect of the tax.

Figure 6a: Provincial Commercial Property Tax Rates in Southern Ontario

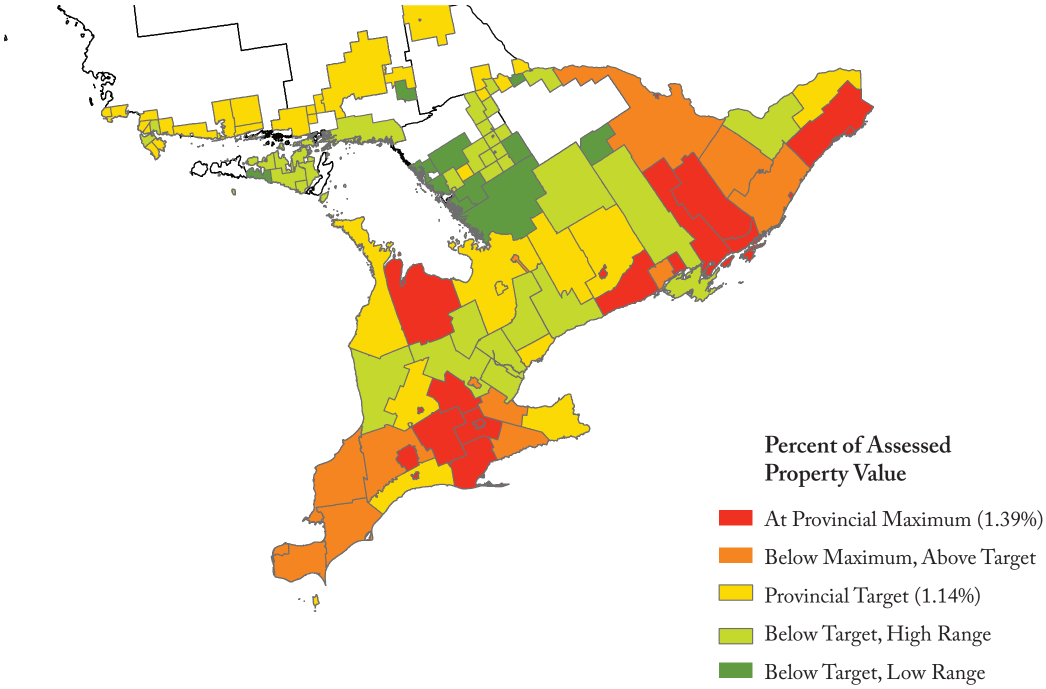
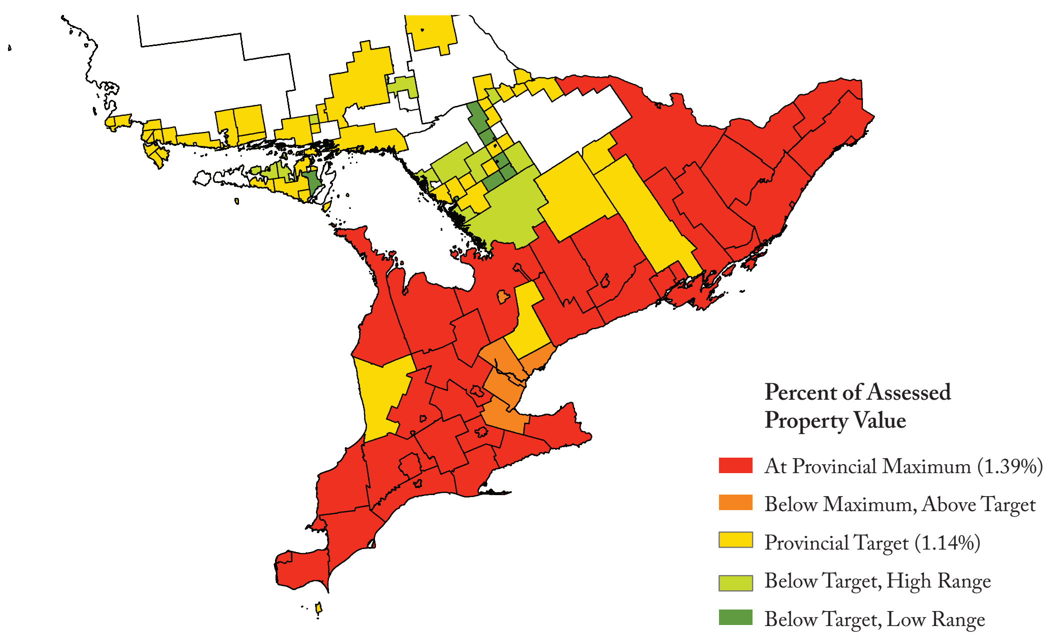


Figure 6b: Provincial Industrial Property Tax Rates in Southern Ontario



Source: Jacobs, Dachis and Found (2017). Results include Northern Ontario. Hollow areas not subject to provincial property tax.

work behaviour through workforce participation decisions, while more-educated workers and high-income earners tend to adjust through the number of hours they work (Duclos et al. 2015).

High-income earners' taxable income has been shown to be particularly responsive to high marginal tax rates – through both tax planning avoidance behaviour and earnings decisions (Laurin 2015). And the sensitivity to rate changes is higher at the provincial level in response to provincial rate changes than at the federal level in response to federal changes. This is because high-income earners can take advantage of provincial tax rate differences by shifting their income tax attributes and work locations to the most tax-advantageous province (Milligan and Smart 2014).

Ontario has one of the highest top combined federal and provincial marginal tax rates at over 53 percent on high-income earners. It should reduce that rate to a level at or below 50 percent. The responsiveness to the change would have a beneficial impact on the tax base that would ensure a very low fiscal cost for the policy. Furthermore, the income tax system should be clear and transparent. Ontario has a surtax notionally in place for healthcare expenses. However, the money raised by this tax is treated as general revenue. The province should replace this surtax and set income tax rates and brackets that transparently show the marginal tax rate people are paying.

Other tax changes should aim to lower the burden of taxes on secondary earners in families with children. This Economic Program would reform the tax recognition of child care expenses through the replacement of the child care expense deduction, and transfers to local governments to operate child care services, with the introduction of a new refundable tax credit for child care expenses. It would encourage stay-at-home parents to join the workforce, producing extra tax revenues, considerably limiting the net fiscal cost of its implementation (Laurin and Milligan 2017).

Also, typical labour arrangements are changing with technological change. Workers are becoming less attached to a single employer and move around more freely between projects and contracts. Their incomes are also more prone to fluctuating from year to year – a period of low earnings followed by a year of higher earnings, or vice versa. But a worker with fluctuating income may end up paying more tax (and losing more income-tested government benefits) than another worker with a flat income profile but earning the same amount over a period of years. Wen and Gordon (2017) find that Canada's "fluctuation tax penalty" is most severe for individuals who earn lower incomes or are self-employed. This Economic Program would lessen the impact of fluctuating incomes on tax liability by allowing workers to average their income over many years, so that any single large earning year would not lead to a disproportionate loss of fiscal benefits and higher tax payments.

Commodity Taxation

Alcohol

In 2016/17, the Liquor Control Board of Ontario (LCBO) paid the provincial government a dividend of $2.1 billion. It also remitted $897 million to the federal and provincial governments in Harmonized Sales Tax, excise taxes and customs duties (LCBO 2017). In addition to the LCBO, there is a system of beer and stores owned by wineries, which operate as a quasi-monopoly thanks to government regulation. Masson and Sen (2014) find that freeing up alcoholic beverage retailing would result in increased government revenue, lower prices, and more convenience. They find that, other factors being equal, Western Canadian provinces with more beverage alcohol retail competition had 7 percent more per capita provincial alcohol profits than provinces with government-run monopolies. The province has begun to introduce beer sales at grocery stores. However, it has done so slowly. This Economic Program would go further by auctioning licenses for other retail outlets. It would auction licences for off-winery stores to other wineries and also to new wine retailers. The result would be increased provincial revenues and more choice for Ontario consumers.

This Economic Program would also revise taxation of alcoholic beverages. Currently, tax rates are set as fixed per litre volume charges and other charges that are not closely related to alcohol strength. Wine and spirits are taxed as fixed amounts per litre plus a percentage of the retail price set through LCBO markups. This Economic Program would graduate the tax on alcohol to relate to alcohol content. This reform would target the health problems caused by alcohol, which is directly in line with the alcohol content of any drink. Although such a reform may reduce revenues, as the higher tax rate would be targeted at a smaller target population, the reduction in revenue is likely to be offset by auction revenues.

Marijuana

The federal government has legalized marijuana for recreational consumption with legal sales currently scheduled to begin this year, depending on passage of the necessary federal legislation. Ontario has announced that it will restrict retailing of recreational marijuana to LCBO-run stores. Only 40 of these locations will be in place by July 1, the target date for legalization, with a total of 150 locations expected by 2020.

The province missed the opportunity to create a competitive market for retail marijuana. More competition between businesses would constrain operating costs and keep prices low. Lower prices in the legal market would make it more likely to be competitive with the existing black market.

Having few retail locations means that access to recreational marijuana will be inconvenient for a significant number of Ontarians. Recreational consumers are highly unlikely to switch their dollars to the regulated market if there isn't easy access. This means that there will be significant opportunity for the black market to continue operating in all the areas without enough legal stores to meet market demand or that are convenient to access. (By contrast, there are more than 650 LCBO outlets in the province.) Further, to levy penalties against illicit businesses will require significant justice and police resources. This Economic Program would make retailing of marijuana competitive and allow for the licensing of privately run retail stores. This could take the form of entirely private retailing, as in Alberta. Alternately, licensed establishments could operate alongside government retail stores and deliver better market coverage faster than the crown corporation on its own.

Ontario has joined the federal government's proposed coordinated excise tax framework for recreational marijuana. Keeping taxes low will help ensure that the legal market will be price competitive with the illicit market. The revenue from this excise tax will initially be modest, estimated to bring in for Ontario \$50 to \$95 million in 2018 and \$175 to \$200 million annually by 2021 (Sen and Wyonch 2017).

Gasoline and Fuel

The government should be cognizant of the prospect of declining revenues from fuel and gasoline taxes, which will intensify as vehicles become more fuel efficient and increasingly electric. This Economic Program would begin replacing fuel taxes with tolls for road users. The best solution for traffic congestion is a road toll. Road pricing could also bring the price that drivers pay for infrastructure they use closer to its actual cost. Gas taxes (which are about 75 to 80 percent of road-related revenues), vehicle licences and other revenues from drivers have covered less than two-thirds of roadway expenses across Canada since 2008. Furthermore, a well-designed road toll can increase the overall capacity of a road by increasing speeds and therefore the total hourly volume of vehicles using a roadway lane (Dachis 2013).

Housing, Municipal, and Infrastructure Policy

This Economic Program would seek to lower the cost of housing across the province by taking steps to reduce barriers to construction and eliminating economically costly rent controls and transfer taxes. It would also fundamentally change the relationship between municipalities and the province by granting cities the ability to put their budgets on a sound financial footing and allow them more flexibility in financing infrastructure.

A Smart Housing Plan

The cost of housing in Ontario has increased dramatically in recent years. According to data from Brookfield's Real Property Solutions, home prices in the Greater Toronto Area increased by more than 250 percent between January 2005 and the end of the 2017. In response, the province has taken steps such as introducing taxes on foreign buyers and rent controls. The government's policies have focused mostly on curtailing the demand of housing. In contrast, the actions so far for boosting housing supply have been largely limited to minor rebates on some types of development charges and taxes for multi-residential units and forums for discussing future action. This Economic Program would take action to reduce the costs of buying and building across the spectrum of housing.

On April 20, 2017, the province introduced a 15 percent Non-Resident Speculation Tax in the Greater Toronto Area. This transfer tax is substantially higher than the existing provincial land transfer tax that has a maximum rate of 2.5 percent. Although it is too early to judge the specific impact of the Non-Resident Speculation Tax, land transfer taxes such as these have a high economic cost by reducing the mobility of households (see Dachis 2012 and Dachis, Duranton, Turner 2008). In addition, land transfer taxes are highly volatile and present a large fiscal risk to the province – not to mention the City of Toronto, which has its own Land Transfer Tax – if the housing market has a serious downturn (Ngo, Angastiniotis, and West 2017). This Economic Program would immediately eliminate the additional 15 percent tax and look to begin reductions in the general land transfer tax in future fiscal years.

On the same day, the province expanded rent control to all rental units in the province, rather than only those built before 1991, as was the prior case. Solid empirical evidence has shown that rent control does not lower the cost of housing in the long-run (Kronick 2017). The likely result of rent control is that housing developers will not build rental housing knowing they face a cap on potential returns, while facing no commensurate cap on their investment risk. The result will be fewer units available, leading to housing shortages. This Economic Program would phase out rent control on all rental units. It would start by reducing the extent to which rent control binds the market by increasing the allowable increase, doing so annually until eventual repeal. Rather than rely on rent control, this Economic Program would embrace the recent federal decision to create a Canada Housing Benefit that provides low-income renters with the funds to seek a wide range of market-priced rental units (Canada 2017). This Economic Program proposes a revenue neutral re-orienting of financial support for housing construction, which is often part of transfers to local governments, as discussed below, to match the federal contribution through the Canada Housing Benefit.

More Housing Reduces Cost

There is strong evidence that restrictions and extra costs on building new housing – such as zoning regulations, delays on permit approvals, development charges, and limits on greenfield housing development – are dramatically increasing the price of housing (Dachis and Thivierge forthcoming).

What can the province do to reduce supply barriers? A clause in the provincial *Planning Act* – the legislation governing municipal zoning policy –allows cities to require additional payments from developers in exchange for a site-specific variance from zoning bylaws (Moore forthcoming). These additional payments, known as section 37 payments for the relevant part of the *Act*, increase uncertainty for developers and therefore increase the cost of housing. This Economic Program would place greater restrictions on the use of section 37 of the *Planning Act*, which would result in municipalities having a greater incentive to set more appropriate zoning regulations.

Developers pay development charges to compensate municipalities for the cost of building municipal infrastructure that services homes and commercial properties in a newly developed area. The largest single component of these charges is for water and wastewater construction (Dachis forthcoming). This Economic Program would require that cities replace development charges for water and wastewater infrastructure with volumetric usage fees that reflect capital costs. Such a move would mark a change to a utility-based model and encourage conservation of water. To aid in this transition, this Economic Program would recast the Ontario Energy Board to instead become the Ontario Utilities Board, expanding its rate-regulation power to water utilities across the province.

Finally, housing developers in GTA cities are facing a shortage of land available for new housing development (Clayton 2015). The primary cause is not the existence of the Greenbelt, a policy that forbids development on certain agricultural and parkland. Dachis and Thivierge (forthcoming) find that the main land-supply driven cause of higher house prices is not the Greenbelt, but the Growth Plan for the Greater Golden Horseshoe, a policy that requires cities in the GTA to approve a certain share of their homes within existing urban development boundaries and at a certain density. This Economic Program would relax the density and intensity targets that may not be appropriate across all cities subject to the Growth Plan while preserving the Greenbelt.

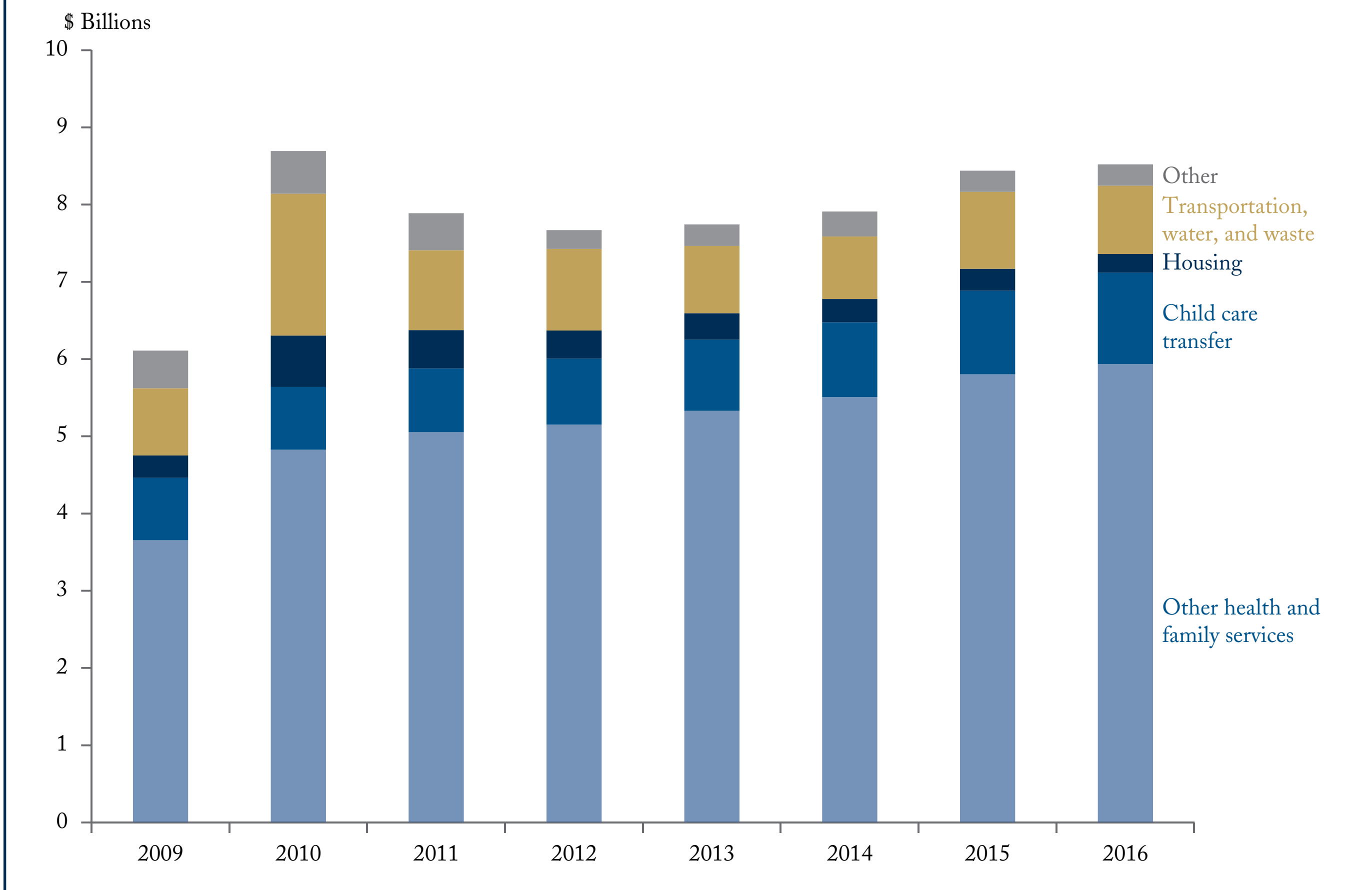
Rethinking Relative Municipal and Provincial Fiscal Health

One of the province's largest expenditures is on grants to municipalities. Transfers to municipalities have increased since 2009, including a large spike in 2010 to support infrastructure stimulus projects. Transfers to municipal governments from the province are now over $8 billion (Figure 7). Indeed, this trend is set to accelerate. In January of 2017, the province committed to doubling the amount of the fuel tax it transfers to municipal governments for transportation investment (Jones 2017). Ontario transferred $335 million in provincial gas tax revenue to municipal governments in 2017, and made a commitment to double the funding to bring the total transfer to $642 million by 2021/22.

The largest share of transfers is for family and health services – such as public health or social programs – and for childcare benefits delivered by municipal governments. The latter, in particular, are dispersed to municipalities under a complex set of qualification criteria. The child care transfer has increased by nearly 50 percent since 2008 reaching $1.2 billion in 2016, suggesting that a review of the program is in order.

Does it make sense for the province to send such grants to municipal governments? Ontario's municipalities are, on average, in better fiscal shape than the provincial government. They are major investors in capital assets, but unlike the province, whose chronic deficits have resulted in financial liabilities that vastly exceed its financial and non-financial assets, Ontario municipalities have positive net worth. They have borrowed to finance some capital assets, but the value of their assets exceeds their debt by a substantial margin. In the nine years from 2008 to 2016, Ontario municipal governments increased their net worth by more than 50 percent, registering an increase of over $50 billion

Figure 7: Ontario Provincial Transfers to Municipalities, 2009-2016



Source: Authors' calculations from Ontario Financial Information Return.

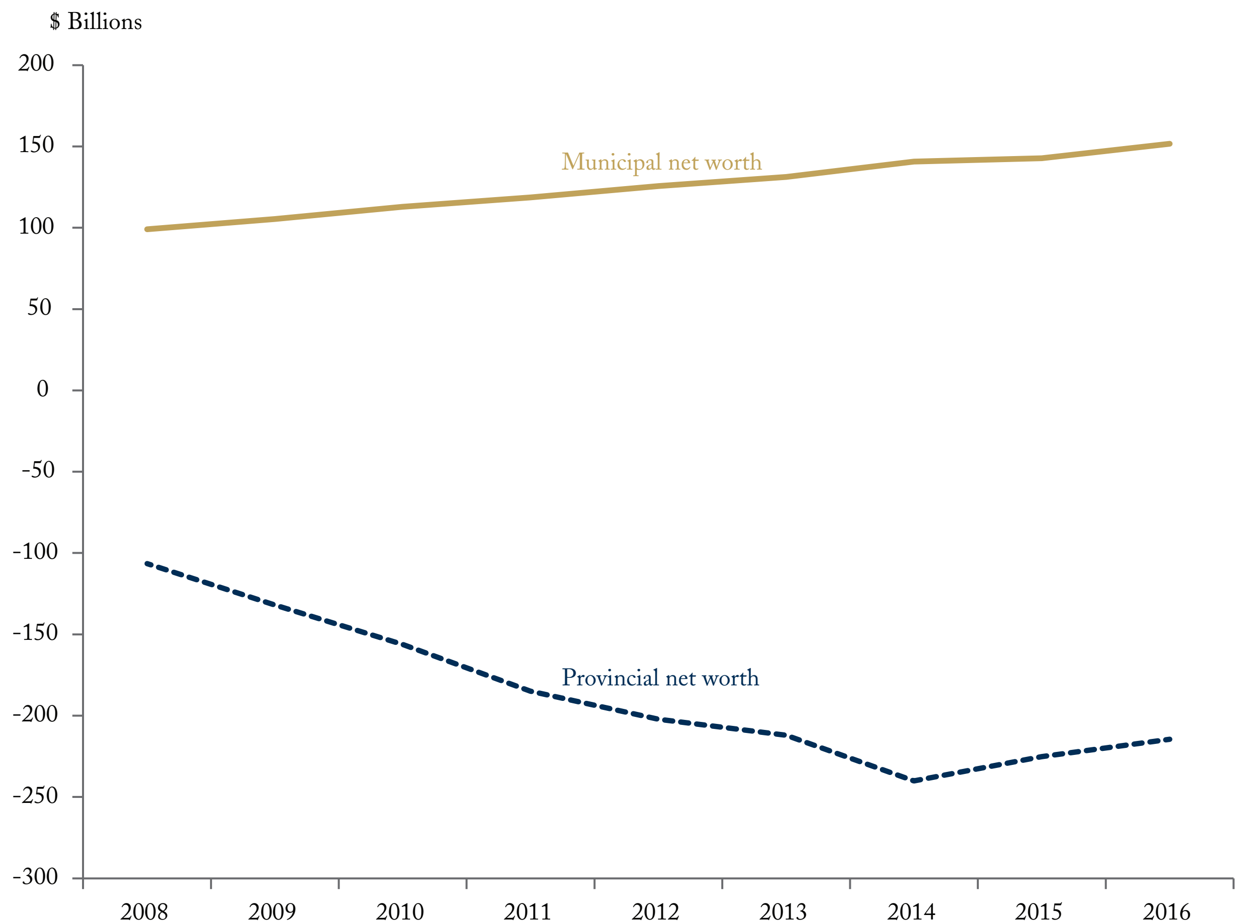
(Figure 8). In contrast, provincial net indebtedness has approximately doubled over that time, even after a slight improvement in net asset values over the last two years.[7] The main driver of the positive net municipal wealth lies in the value of physical assets. Although many of these assets would be impossible to for them to monetize – such as local streets or parks – many others are. As discussed in more detail below, assets such as electricity distribution or water and wastewater infrastructure are prime candidates for private investment, which would enable governments to reallocate the proceeds from such sales into desirable assets elsewhere.

The Important Difference between Municipal and Provincial Accounting

The way that cities present their budgets, especially relative to the way the province reports its finances,

7 The story doesn't change appreciably when looking at financial net worth, thus excluding the value of physical assets. Cities have a close to neutral net financial worth. The province in 2016 had negative net financial worth of $279 billion.

Figure 8: Ontario Provincial and Municipal Net Worth, 2008-2016



Source: Authors' calculations from Cansim Tables 385-0034 and 385-0037.

makes municipal finances appear more precarious than they actually are. Ontario municipalities typically use cash accounting in their budget.[8] However, the province – as well as municipal end-of-year financial statements – uses the accrual accounting standard.[9]

Municipalities budget in this way in large part because of the province's requirement that cities run a balanced operating budget. However, a standalone operating budget is incompatible with accounting on an accrual basis. The result is that today's taxpayers – whether through property taxes, grants to cities, or development charges on houses

8 A common practice is to show expected cash outlays in a "capital" budget alongside an "operating" budget for items to be consumed and expensed during the year.

9 Accrual-based financial documents appropriately do not record the entire cost of capital items as expenses in the year of the cash outlay, but apply annual amortization over their useful lives.

– are paying disproportionately more than they are receiving in municipal services.

This Economic Program would require municipal governments to produce their beginning-of-year budgets on an accrual basis, as recommended by Dachis, Robson, and Omran (2017). A revised budget process would allow cities the flexibility they need to finance long-term infrastructure without relying on provincial grants or upfront revenues. This would allow cities more flexibility to self-finance infrastructure over the life of an asset with user fees directly tied to an asset.

Reframing the Municipal-Provincial Financial Relationship

This Economic Program would cancel the proposed doubling of provincial fuel tax revenues the province transfers to municipal governments. In fact, it would go further. This Economic Program would begin a long-term commitment to reducing property taxes levied by the province. Every dollar of provincial property tax reduction creates tax room that municipalities can decide to take up. Cities should focus on increasing residential tax rates, and at any rate would be constrained by existing provincial rules on how much they can increase business tax rates relative to residential rates. Cities would have the freedom to choose how best to finance local services or whether to increase or reduces taxes
and services.

The province's commitment to double gasoline tax transfers to municipalities emerged as a response to the City of Toronto's request for the province to enact enabling regulation for introducing tolls on municipally owned highways. The province forbade Toronto from the move, offering all cities the gasoline tax transfer instead. This Economic Program would allow cities the ability to introduce road pricing without requiring a provincial regulation, as long as the intention and design of the toll is to reduce congestion, not as a purely revenue-raising option.

This Economic Program would expand the ability of cities to put in place a tax-increment financing plan for major infrastructure. This would allow cities to capture some of the increase in property values of existing properties, not only newly built ones, that results from a new transportation or other municipal investment that increases the value of nearby properties (Found 2016). Such 'value capture' is akin to a user fee in that those who benefit from a government investment are the ones who pay for it.

Transit Governance

Originally created in 2007, Metrolinx started with the intent of creating a regional transit plan for the Greater Toronto and Hamilton area with a board made up of local government officials. Two years later, Metrolinx expanded to become the GO Transit operator. The province then removed the local government officials from the Metrolinx board, which is now made up of members appointed by the province.

How can the region overcome local opposition to transit plans while finding a way to act in the regional interest? Rather than amalgamation, which has shown to not result in significant savings (Bish, 2001, Found 2012), another approach is to restore a partial role for municipal governments on the board of Metrolinx.

Toronto should follow the Vancouver model, in which provincial legislation tasks a Mayor's Council made up of representatives from each of the region's 21 municipalities to appoint a board of Translink, the regional transit coordinating body. Translink has many subsidiary companies that operate transit services under contract (Translink 2017). The regional transit body should be the regional coordinator, rather than a regional authority and another new layer of government

(Spicer and Found 2016). The reformed Metrolinx can contract with subsidiary transit operators, private contractors, or municipal governments that can supplement Metrolinx-supported routes.

Greenhouse Gas and Energy Policy

No topic has generated more controversy in Ontario than energy policy. This Economic Program would preserve the best parts of the current government's plan, while cutting ineffective policies and reducing costs to households.

Greenhouse Gas Policy

This Economic Program would continue to increase the price on greenhouse gas emissions. It does not take a position on whether to use a cap-and-trade program as opposed to a carbon tax. There are merits to both. A carbon tax would be simpler to administer than a cap-and-trade program and would also generate more revenue for the province of Ontario. On the other hand, a cap-and-trade program that allows Ontario to link with the emissions permit markets in California and Quebec could potentially result in a lower cost on emissions to meet the same reduction target. Trading emissions permits across borders and between markets allows emissions reductions to occur wherever it is cheapest to do so, reducing the overall cost (Thivierge 2017).

If prices on emissions rise to $50 per tonne, in line with federal government policy, the upfront cost to the average Ontario household would be around $700 per year (Figure 9). However, the final cost to consumers will depend on how governments recycle that revenue back to households. This Economic Program proposes a change of direction in how the government plans to use the revenues.

Eliminate Energy Efficiency Programs and Consumer Subsidies

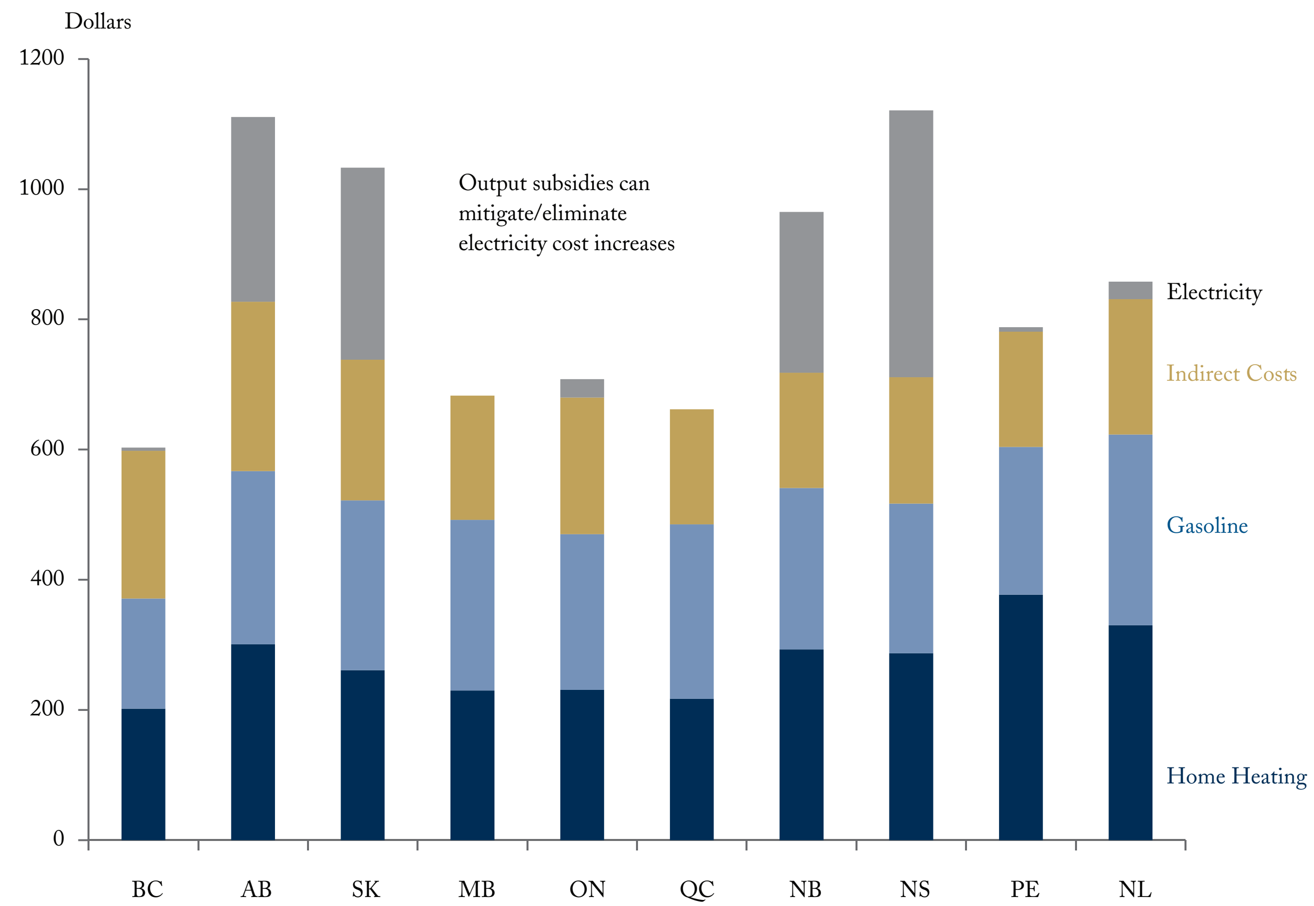
The current government plan is to spend between $6 and $8.3 billion over five years on projects intended to further reduce emissions beyond those planned for the existing cap-and-trade policy (Ontario 2016). The government plans to finance the subsidies with revenues from an auction for permits that greenhouse-gas-emitting companies must buy. Many of the proposed spending programs are exceptionally costly. For example, subsidies to retrofit apartments will cost as much as $900 million over five years. They will cost taxpayers as much as $425 per tonne of GHG emissions reduced. Although there may be other benefits to such a program, the costs of the program that can be justified on an emissions reduction basis are much higher than any reasonable estimate of the social cost of greenhouse gases foregone. Another example of a wasteful subsidy is the Electric Vehicle Incentive Program, which provides incentives of up to $14,000 per electric vehicle.[10]

This Economic Program would eliminate nearly all of these existing subsidies and mandates and instead use the revenue to reduce taxation on households and businesses. The exact design of the tax cuts is outside of the scope of this Economic Program, but such a tax cut should reduce the average cost to businesses of emissions and households should receive tax cuts broadly in proportion to the cost of emissions pricing as a share of their income.

To aid the competitiveness of industrial energy users, this Economic Program would prefer to adopt Alberta's emissions cost rebate policy, which is similar to the federal system. Companies still have a strong incentive to reduce their emissions while having a minimal net impact on the competitiveness of industrial emitters (Dachis

10 See http://www.mto.gov.on.ca/english/vehicles/electric/electric-vehicle-incentive-program.shtml.

Figure 9: Annual Cost of a $50/Tonne of Greenhouse Gas Emissions Price on a Typical Household



Source: Dachis and Tombe (2017) from Jennifer Winter.

2018).[11] This Economic Program would adopt a similar system if the cap-and-trade program is no longer the most effective means of putting a price on emissions. Theoretically, a tax and a cap-and-trade policy are economically identical. The true test of which is a better system depends on the reality of implementation, which is beyond the scope of this Economic Program.

Promote Long-term Energy Research

As research from Popp (2016) shows, a carbon price will drive 95 percent of the lowest-cost emissions reductions to meet reduction targets. However, there is a market failure for longer-term energy research. The benefits of such research are broad, but the returns to firms doing such

11 Producers in Alberta face little competitive disadvantage under this model (Dachis 2018). Although emitters pay the full cost of their own emissions, they receive a credit per unit of output, with the amount of the credit based on a provincial average emissions benchmark. Indeed, companies with below-average emissions are better off in this system.

research are relatively smaller, uncertain, and if they materialize at all will be far in the future. On their own, research subsidies would help achieve about 10 percent of economically efficient emissions reductions (Popp 2016). As such, this Economic Program would devote a share of revenues from an emissions price to long-term research.

Electricity Policy

Few topics have generated as much debate in Ontario as electricity policy, with a number of previous policies resulting in a dramatic increase in electricity prices (Trebilcock 2017). The government has taken a series of measures that will immediately reduce electricity prices for residential customers. However, within five years, prices are forecast to bounce back (Figure 10). Further, many industrial consumers are receiving no incremental reduction in their bills from the Fair Hydro Plan. This Economic Program would take actions now that will begin to reduce system cost and reduce prices for businesses and consumers in the future.

Market Design and Regulation

The Independent Electricity System Operator (IESO), which manages the electricity market for Ontario, is undertaking a major market reform. The IESO projects that the market reform will reduce the cost of purchasing electricity by billions of dollars, eventually resulting in savings for consumers. The single-largest cost savings for consumers is set to come from the IESO adopting what is called a capacity market.[12] Such a market is a major improvement to the government's previous approach of signing 20-year contracts with generators. The government's plan is a sensible one that has been shown to be effective in a number of other jurisdictions, and this Economic Program would continue to proceed with it (see Goulding 2013 and Wyman 2014).

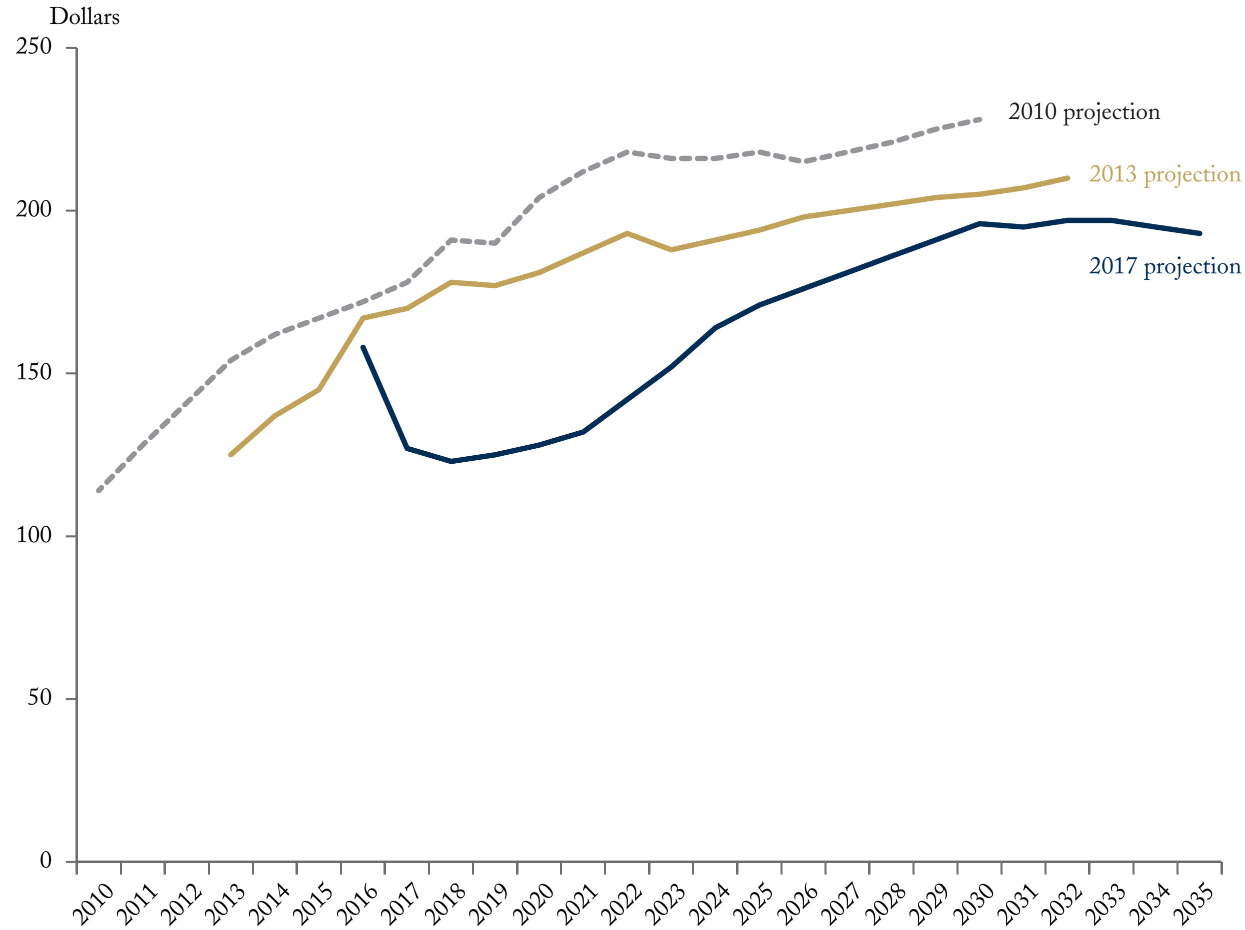
This Economic Program proposes the government take market reform one step further by reforming the purchasing role of the IESO. The current proposal for the capacity market is to make the IESO the only buyer of generation contracts. The downside of that plan is that it does not create competition among potential electricity buyers. This Economic Program would delegate the purchasing power in the capacity market to local buying groups across the province. These local buying groups, known as load-serving entities, would be made up of regional local distribution companies and have the ability to purchase electricity that suits local needs. These local buyers would compete with each other to get the best possible price. They would have greater incentive to seek out the lowest-cost generators than the current single-buyer at the IESO. Large businesses, currently limited to buying electricity from the IESO and paying a share of the Global Adjustment, which pays for capacity investments, could form their own load-serving entities and contract directly with generators. Further, these local buying groups would encourage consolidation of local distribution companies, to which we will return to below.

This Economic Program would end the cycle of government price interventions, specific directives, and decisions on procurement (Vegh 2016). It would require the Ontario Energy Board to review all major decisions in the energy market with a mandate to approve actions only if they increase economic efficiency (see Church 2017 for a discussion of economic efficiency in regulatory hearings).

Economic efficiency means having an electricity market that has decisions determined by prices, and

12 A capacity market provides electricity generators with a revenue stream for being available to produce electricity, in addition to their revenues from selling electricity.

Figure 10: Electricity Price Outlook – Monthly Bill for Residential Consumers



Source: Ontario (2017b). Note: 2010 and 2013 bill estimates are for a customer with 800 kWh of consumption; 2017 is for a customer with 750 kWh of consumption.

not arbitrary government rules. One of the most intrusive arbitrary government electricity market rules is the Industrial Conservation Initiative. In this program, eligible industrial consumers save money if they slash electricity use during the five highest Ontario-wide demand hours of the year. It's an arbitrary and expensive way to cut electricity costs for some (Sen 2015). Small businesses and residents pay higher bills because of the policy.

In theory, the Industrial Conservation Initiative is meant to reduce peak demand, reducing the need for investment in generation. The Industrial Conservation Initiative policy uses the measure of Ontario demand to encourage businesses to save electricity, not the overall market. Arbitrary thresholds and market definitions in Ontario's electricity pricing program are not as effective as using prices to determine when customers should try to cut back on electricity (Dachis 2016a). Instead, this Economic Program would eliminate this program and let large consumers pay only for what they buy in a capacity market and the hourly electricity market. That will restore the role of market prices as the main tool for customers to reduce their demand during hours of the greatest strain on the electricity market, not necessarily the hours subject to the Industrial Conservation Initiative.

A portion of the electricity bills received by Ontario households support subsidies for residential consumers to purchase smart thermostats and other energy-efficiency devices. These programs cost ratepayers $600 million in 2016 (Auditor General 2017b). As with direct government spending on such programs, these programs often do not pass a cost-benefit test for the use of government funds (Dachis 2016b). Many households would make such investments if energy prices were sufficiently high and they were sufficiently informed. This Economic Program would remove any directives requiring such energy efficiency measures, and grant the Ontario Energy Board the authority to approve or reject energy efficiency programs, such as the Industrial Conservation Initiative, based solely on whether they improve economic efficiency.

Encouraging Private Investment in the Ontario Energy Sector

As of 2017, municipal governments in the province owned local electricity distribution companies that had a value of $11 to $15 billion, which is the potential net sale value they could earn given current government policies and market valuations of electricity assets (Robins 2017a). Cities could sell these companies to finance infrastructure investment. Sales would have no negative effect on ratepayers, since the Ontario Energy Board keeps a close regulatory eye on all price changes regardless of who owns the companies. Private investors would bear the consequences of poor choices, but reap some of the rewards of good mergers (Fyfe, Garner, and Vegh 2013). The incentives for these private-sector companies to keep costs down are often better aligned with ratepayers than are those for publicly owned electricity companies.

However, cities have not been able to take advantage of the value of these assets because of provincial taxes on such sales.[13] The province would collect $1.8 to $2.5 billion in such taxes (Robins 2017a). These overly high taxes pose a significant barrier to any sale. This year will be the last year of a three-year partial tax holiday on provincial transfer taxes in Ontario on the sales of small municipally owned local electricity distribution companies. The intent of this tax change was to encourage mergers using private investors, rather than only encouraging mergers with other government-owned companies. However, there have been few sales so far, partly because the tax holiday was limited to sales of very small companies. Private investors showed little appetite for such assets. This Economic Program would exempt municipalities entirely from all taxes on sales, as long as the proceeds of a sale are reinvested in qualifying infrastructure projects.[14]

Private investment in provincially owned electricity assets has been a controversial topic, but a wise policy move. As Robins (2017b) argues, it is not necessary for the province to continue to own its minority share in Hydro One, the transmission and distribution utility, or Ontario Power Generation (OPG), a major power generator, if its policy objective is to keep electricity prices down. As with municipal companies, a strong Ontario Energy Board can protect consumers no matter the owner. Robins (2017b) estimates that a sale of the remaining government stake in Hydro One

13 See Fyfe, Garner, and Vegh (2013) for more details on the complex system of transfer and departure taxes in the Ontario local electricity distribution sector.

14 Australia did so for its previous asset recycling program (Dachis 2017).

would net the province somewhere in the order of $7 billion and a sale of OPG could also generate substantial revenue.

The upfront revenue is not necessarily the best reason for the province to sell electricity assets. The main reason to sell is reduced risks. The electricity system of the future may look very different. The result could be a decline in value of, and therefore dividends flowing to the treasury from, Hydro One and OPG. The best way for the province to mitigate that risk is to continue selling stakes in Hydro One and begin to include private investors in OPG. Private buyers are often willing to take this risk and are willing to pay large premiums for what are, compared to assets elsewhere in the private economy, relatively low-risk assets.

Conclusion

The province should take action to correct a fiscal course that is unsustainable. The government must act to bring the long-term cost of government in line with the revenue-raising capacity of the province. This Economic Program shows that there are a number of policy directions the government can take in areas as diverse as electricity, greenhouse gas, municipal, health, social and tax policy that can balance moderate increases in spending with sensible revenue generation and cost-savings measures, to enhance the general economic well-being of Ontarians.

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