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Monday 26 January 2004

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Lundi 26 janvier 2004

Standing committee on finance and economic affairs

Comité permanent des finances et des affaires économiques

Pre-budget consultations

Consultations prébudgétaires

Chair: Pat Hoy
Clerk: Katch Koch

Président : Pat Hoy
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LEGISLATIVE ASSEMBLY OF ONTARIO

ASSEMBLÉE LÉGISLATIVE DE L'ONTARIO

STANDING COMMITTEE ON FINANCE AND ECONOMIC AFFAIRS

COMITÉ PERMANENT DES FINANCES ET DES AFFAIRES ÉCONOMIQUES

Monday 26 January 2004

Lundi 26 janvier 2004

The committee met at 0900 in room 228.

SUBCOMMITTEE REPORT

The Chair (Mr Pat Hoy): The standing committee on finance and economic affairs will please come to order. I would first of all remind persons in the room to please turn their cellphones off. Thank you very much.

The first order of business is the report of the subcommittee.

Mr Mike Colle (Eglinton-Lawrence): Mr Chairman, I move to read into the record for approval the report of the standing committee on finance and economic affairs' subcommittee on committee business:

Your subcommittee on committee business met on Wednesday, December 17, 2003, and recommends the following with respect to pre-budget consultations:

1. That the Minister of Finance be invited to appear before the committee on the first day of the hearings in Toronto from 9 to 10 am to make a presentation and answer questions from the three parties.

2. That the staff from the Ministry of Finance be invited to appear before the committee on the first day of hearings in Toronto from 10 am to 12 noon to make a presentation and answer questions from the three parties.

3. That the committee will meet from 9 am to 12 noon and from 1 pm to 4 pm.

4. That an advertisement will be placed for one day in a major paper of each of the cities to which the committee intends to travel at least one week prior to the meeting. Advertisements will be placed in both English and French papers if possible. An advertisement will be placed on the Ontario parliamentary channel and on the Internet.

5. That each party will provide the clerk with the name of one expert witness.

6. That each party is entitled to select the same number of witnesses in a given location.

7. That if all deputants can be scheduled in a given location, the clerk can proceed to schedule all interested parties/groups, and therefore no party selection is required for that location.

8. That expert witnesses will be offered 60 minutes to make a presentation. Groups will be offered 20 minutes and individuals 10 minutes.

9. That the expert witnesses be scheduled on the first day of the hearings in Toronto from 1 to 4 pm.

10. That the research officer will provide a summary of the presentations and a draft report to the committee members.

11. That the clerk of the committee, in consultation with the Chair, be authorized prior to the adoption of the report of the subcommittee to commence making any preliminary arrangements to facilitate the committee's proceedings.

In addition to the subcommittee meeting, the whips also met pursuant to the order of the House dated December 18, 2003, and have agreed to the following:

12. That the committee meet on January 26 in Toronto, on January 27 in Niagara Falls, on January 28 in London, on January 29 in Windsor, on February 2 in Toronto, on February 3 in Ottawa, on February 4 in Timmins, on February 5 in Thunder Bay, on February 9 in Peterborough, on February 10 and 11 in Toronto, on February 12 in Kitchener-Waterloo, and on March 10 for the report writing.

Having received the whips' sign-off on the agreed dates for the hearings, the Chair has approved the following:

13. That interested people who wish to be considered to make an oral presentation should contact the committee clerk by 5 pm on Friday, January 16, 2004.

14. That the clerk will distribute to each of the three parties a list of all the potential witnesses who have requested to appear before the committee by noon on Monday, January 19, 2004.

15. That, if necessary, the three parties shall provide a prioritized list of their selections to the clerk by 5 pm on Wednesday, January 21, 2004.

16. That the deadline for written submissions be Friday, February 13, 2004, at 5 pm.

17. That the research officer will provide a summary of the presentations on Monday, March 1, 2004.

18. That the research officer will provide a draft report to the committee members on Monday, March 8, 2004.

19. That the deadline for dissenting opinions, if any, be Thursday, March 11, 2004, at 4 pm.

I move adoption of the subcommittee report.

The Chair: All those in favour? Carried.

PRE-BUDGET CONSULTATIONS

MINISTRY OF FINANCE

The Chair: I want to welcome the Minister of Finance, the Honourable Greg Sorbara, to this morning's meeting. You have approximately an hour for yourself and perhaps for questions. Welcome, Minister.

Hon Greg Sorbara (Minister of Finance): Thank you. Good morning to members of the committee and invitees. Congratulations to the Clerk's office for the retrofit of this room. Thanks, everyone, for getting down here at such an early hour.

I understand, Mr Chair, that the committee is moving to Niagara Falls this evening. Looking out the window, I suggest you set aside about five hours for the bus trip and I wish you well on your ventures.

I'm delighted to be with you this morning as you begin what I consider to be extremely important pre-budget consultations. Je suis très heureux d'être avec vous ce matin au commencement de ces consultations au sujet du budget de l'Ontario.

Your work is a vital part of a much bigger consultation which will be taking place over the next few weeks. There are slides that will appear up here. If we are coordinated between Victor and myself, they will bear some sort of relevance to the remarks I'm going to be making this morning. I'm quite certain that the work you do will make the work that I do much easier. I want to thank you in advance for the work that you're going to do.

The 2004 budget will be critical to this province's future. It will not only be the first budget of a new government, but the first budget of a new kind of government. It's going to signal a new era of transparency, accountability and, above all, absolute commitment to the public services Ontarians need and want most.

What I hope to do for you this morning is to set the stage for the discussions you are going to have as you consult with Ontarians across the province. I'm going to talk about the priorities of the government, I'm going to report to you on the situation as it now stands and I'm going to tell you about the steps we have taken and that we plan to take as we proceed toward the 2004 budget and beyond.

Let's be clear about one thing: What is beyond the budget is just as important as what is in the budget. Too often, governments focus on just one year, treating budgets as things to be got through or survived instead of things upon which we should be building. We're not going to do that. This budget is going to be the cornerstone of a new, long-term approach to government, one that is going to benefit Ontarians long after all of us here in this room have left the picture.

To begin, what are the priorities we have as a government? Quite simply, they are the priorities of the people who elected us. Last fall, Ontarians chose change. They asked for—in fact, they demanded—a different approach because they could see that the old one wasn't working. They weren't getting the services they needed. We have to change that.

Ontarians want excellence in their public schools. Having a number of kids failing to meet provincial standards in reading, writing and math greatly concerns parents and should be of concern to all of us. Our future depends on those kids doing well.

0910

Ontarians want the kind of health care that was once a source of pride in this province. Doctor shortages, nurse shortages, waiting times for cancer treatment—these things are not a source of pride; they are a source of grave concern and we have to address them.

Ontarians want clean communities, and that means doing something about the smog that is killing 2,000 people in this province every year.

Ontarians want something done about gridlock. That means improving and expanding public transit. In fact, if I might just interject a quote from an American political scientist named Robert Putman, in his book Bowling Alone: "Each additional 10 minutes of commuting time cuts all forms of civic engagement, such as attending public meetings and volunteering, by 10%." Think about that a little bit as you're stuck on the QEW this afternoon on your way to Niagara Falls: Each 10 minutes of commuting time cuts all forms of civic engagement by 10%. We have to do something about gridlock, and that means improving and expanding public transit.

Ontarians want us to achieve our economic potential not through competitive tax rates alone but also by building the most highly skilled workforce in North America. That's how we will compete for the highest wages and the best jobs.

Ontarians want all of those things, and they demand one other thing: They want us to live within our means. The people of this province understand that a deficit isn't simply some abstract economic bogeyman. If you have more money going out than coming in, your debts rise, your interest payments increase, and all of a sudden you have less money to pay for the services that you've been trying to protect and improve in the first place. Ontarians know that we can only live well by living within our means. They have told us to make that happen, and we will.

Before I move to where we are going, let me tell you a little bit about where we are. And I must say, where we are is quite a bit better than where we were four months ago. Ontario has emerged from an economic downturn into a period of solid economic growth. Later today we will be releasing the Ontario Economic Accounts for the third quarter, that is, July to September 2003. As everyone in this room knows, Ontario faced an extraordinary series of problems that started last spring with the SARS outbreak, continued with border problems relating to the war in Iraq and the impact of mad cow disease, and climaxed with the blackout in August of last year. These were the main factors behind the downturn in the July to September quarter. Ontario's real gross domestic product fell by 0.6% during that period. We expect that the year as a whole could fall below the current consensus estimate of 1.6% economic growth. As you will appreciate, the economic weakness of that quarter, as well as the quarter previous to that one, contributed to the enormous fiscal challenge that we are addressing, which is the deficit of $5.6 billion which we inherited from the previous administration.

The good news, though, is that the new information about the third quarter has not worsened our current deficit projections for 2003-04. The reason for that, as I said, is that the economy is beginning to bounce back. We are emerging strongly from the third quarter, and the most recent data suggest that economic growth resumed in the fourth quarter of 2003. In part, the upturn reflects the fact that we have moved past the severe problems earlier in the year.

The evidence shows that the economy has started to grow and will continue to grow. Ontario added 35,000 net new jobs in December, and the unemployment rate fell to a nine-month low of 6.7%. The housing market also remained very healthy through the final months of 2003. Resales were at a record level, and new housing starts were at a 14-year high.

However, our currency has risen sharply against the US dollar. This unprecedented increase creates a very tough challenge for Ontario businesses that compete in open world markets. It was probably a major factor behind a decline in Ontario's real international exports of 1.1% in October and 1.9% in November.

There are positive aspects to the dollar's rise: It will help to keep interest rates low; it reduces the price of imported capital goods that will help businesses to become more productive; and for conservatives—for consumers, it makes imported goods more affordable. It also makes them more affordable for Conservatives, but consumers are the main issue here.

I am confident that Ontario business will meet the challenge of the rising dollar, and so are most economists, by the way. Although there have been some recent lower forecasts, economists still expect growth to strengthen in 2004 and 2005. Staff from the ministry will present more information on the economic situation and outlook later this morning.

What I want to make clear here today is that while the economy looks to be getting stronger, our fiscal situation is not. We cannot grow our way out of this deficit. We can't even come close to growing our way out of this deficit. The deficit is the result of eight years of a chronic mismatch between revenues and expenditures. It is structural in nature. Spending has grown very rapidly over the past few years, and tax revenues have stalled. We've moved to restore our revenue base somewhat with Bill 2, but that won't bring us back to a balanced budget either.

To the members of this committee I say we are not going to get rid of this thing by closing our eyes and wishing really, really hard that it will disappear. We are going to get rid of it by taking decisive and dramatic action, keeping in mind always the priorities that we share with the people of Ontario. There won't be any slash-and-burn quick fixes. We've seen a lot of that approach, and the results speak for themselves. Ontarians have been left with weakened public services and an unacceptable deficit. With the greatest respect to the previous administration, slash-and-burn quick fixes represent a failure of fiscal management and a failure of the imagination. What this government is going to do instead is improve services and create real, positive change in Ontario. That is no more or less than we were elected to do.

We know where we are, and we know where we want to be. There remains only the question of how to get there. The fiscal situation may require us to alter our timetable for improvements, but it has not altered by one iota our commitment to making those improvements, and in fact we've already begun. As I mentioned, Bill 2 cancelled the tax cuts that were damaging public services. They're going to save us $3 billion as of the next fiscal year.

We also moved to ensure that the organizations we fund are as vigilant as we are going to be in pursuit of better and more affordable services. Our amendments to the Audit Act would give the Provincial Auditor, who would be renamed the Auditor General under the act, the right to carry out value-for-money audits on all organizations that receive significant provincial government funding. These include hospitals, school boards, long-term-care facilities, colleges and universities, not to mention Ontario Hydro and OPG.

0920

We've also enlisted the help of our dedicated public service. We have asked government employees, the front-line workers in the many areas we plan to improve, for their ideas. So far, as you may have heard, more than 2,000 suggestions have come forward for ways in which we could do better with the money we have.

That, of course, is the name of the game. It isn't about how much more we spend; it's about spending better. It's whether you're getting the results for what you spend. The way to improve and protect our public services in a sustainable manner is to take a long, hard look at the results we're getting for the money we are spending and then to weigh those results against the priorities we've established, and that's what we're going to do. We are undertaking a complete reassessment of how we do things as well as what things we do.

This is going to mean a significant redesigning of government. We're going to examine government programs against the priorities that we ran on and that Ontarians voted for. That includes the array of programs that are provided through the tax system.

We're going to focus on what Ontarians have told us they want most from government and build our budget strategy around that. It may result in doing some things differently. It may result in our deciding to stop doing some things altogether, things we no longer need and can no longer afford, in order that we can continue to do those things that are of greatest importance to our citizens. Surely that is a better kind of choice than simple across-the-board cuts, with an eye only to the bottom line.

And it isn't a choice, as you know, that we're going to make alone. In the coming weeks, we are going to consult with the people of this province like no government has ever done before. We're going to give them the straight goods, and we're going to ask them for the same thing in return.

The bottom line on which we all agree is the need to balance the books. In our recent fall statement, we included medium-term projections and described the changes in spending that would be needed to reach a balanced budget by any of the next three years. As I stated then, these do not represent options so much as starting points for our consultation.

In that context, we are asking Ontarians from every walk of life—not just business people or interest groups—to talk to us, not only about what they want to see in the budget but also about what they want to see after the budget. We are going to ask them to examine their priorities, to balance the things they need against the things they have simply always taken for granted.

I can tell you the discussions will not be painless. I can't tell you that the decisions we weigh will be easy, because they won't be. I can tell you the process will have integrity. It will be honest, it will be entirely focused on the change people want and need, and at the end of the day it will go a very long way toward bringing about that change. This isn't about asking Ontarians to do our work for us; it's about asking them to help us work better for them.

As I said at the outset, our government's first budget will be a critical event in this province's history. It will be a departure from doing things in the old way and a celebration of the fact that we don't need to do things in the old way any more. It will be born in consultation and co-operation. It will be informed always by the priorities we share with the people we are honoured to serve.

The work of this committee is, I believe, an integral part of the efforts required to reach out to Ontarians and understand their priorities and aspirations for the future. It complements well my own pre-budget consultations, which I will soon commence, and the other consultations being undertaken by the government.

I want to thank you for this chance to outline my thoughts as you begin your work. I hope it will be of some help to you as you carry on with this extremely important job.

The Premier has made it clear that our priorities have to be protecting and improving public services Ontarians need and deserve. He has given me the job of finding the resources to make that happen. So if I might, I'd like to ask you please to always keep in mind why we are here. It isn't just to crunch numbers, although that's a big part of the job, and it isn't just to worry about the bottom line, although that is a big part of the job. We are here to improve the quality of our schools and our hospitals, to make our communities clean and safe, and to have the best workforce and the best economy on the continent. We want the people to tell us how we will know four, five or six years from now whether we've been successful. Doing those things while getting our fiscal house in order isn't just a big part of the job, it is the job.

You have a unique perspective on the hopes and expectations of the people of Ontario, and your contribution to this process will be invaluable. I look forward to your report and to working with you as we move toward and beyond the 2004 budget.

The Chair: Thank you, Minister. We have time for questions, about 11 minutes per caucus. We'll start with the official opposition.

Mr John O'Toole (Durham): Thank you, Minister, for a presentation as we look to the people of Ontario to tell you what to do—the consultation, I mean. Clearly, during the election you—I looked to the future; I always think you should have a look at the past.

You made a couple of comments which I think, with respect, were rather complimentary. You did say that the economy was strong, that there was a net increase in jobs. If you're to take credit for that in the first 100 days of a reign, then you'd have to give some credit to the infrastructure that was put in place. You did say also that spending had increased considerably. For the most part, we could argue most of the day whether or not that number is $5.6 billion or some other number. I do recognize that we did increase spending, mostly on services for people, as you mentioned, to the MUSH sector; $10 billion in health care, and I think you've acknowledged that and I do appreciate it very much.

You're still forecasting, as I look briefly at the numbers here, about a $4.5-billion shortfall going forward for 2004-05. As a preliminary question, would that be a correct assumption, that you're looking at a $4.4-billion to $4.5-billion deficit for the coming budget?

Hon Mr Sorbara: No, it wouldn't be correct. If you recall, John, in the fall economic statement we presented three scenarios for balancing the budget. We presented those scenarios, as I said in my remarks, not as options but as a starting point for examination. The $4.5-billion figure that you referred to is the amount of shortfall or deficit in the absence of any measures to adjust spending or adjust revenues.

Mr O'Toole: That's very good, because I know one of the 231 promises, of course, was to balance the budget, so I'll be on your side on that. As we all know, the government's role is to make difficult decisions, not the easy ones. To start on a positive note today, I'm not here to wrangle, except to point out those things, the difficult decisions going forward. You said the consultations with the public will not always be easy, and I found that to be the case in the minor roles that I tended to play. I guess I had a couple of other questions, to be a bit more focused here.

0930

If I looked forward to the impact of the dollar, given that the Ontario economy is basically an export-based economy, what will the implications for a decline in the value of the dollar do to your revenue side? In your estimation, for every point or penny, if you will, of decline in the dollar, which is the pressure now—the federal monetary policy has shifted to lower interest, and consequently should have some implications with respect to your cost of borrowing as well as the economy—are there any numbers in the ministry that can relate to what the impact would be on revenue? They do have that same number in the GDP. I think that for every point in the GDP, it's about $500 million of revenue, roughly, one way or the other. Is there a similar kind of number for the dollar implications?

Hon Mr Sorbara: I'm going to make some preliminary comments and ask Bob Christie, the deputy minister, to expand on that and give you some specifics.

The volatility of the Canadian dollar has some very negative impacts on our export market, John, there's no doubt about that. We've heard from exporters. I've heard from economists who have suggested to me that the single most important thing I could do as Minister of Finance is try to prevail on David Dodge to lower interest rates because of the impact the higher dollar has on Ontario exports. On the other hand, there are some positive aspects to the dollar as well, and those relate primarily to our Ontario businesses' ability to purchase both manufacturing equipment and technologies in the world market with a stronger dollar. A higher dollar also represents a higher overall evaluation for the entire Canadian economy. So I don't think there's an easy answer to what those fluctuations will do. Dodge just lowered interest rates, and that lowers our cost of borrowing and reduces our interest expense on a going-forward basis. On the other hand, if it has the impact of reducing the strength of the economy, it's going to attack us on the revenue side.

Bob, do you want to comment further on Mr O'Toole's question?

Dr Bob Christie: Mr O'Toole, there were some figures in the document accompanying the fall statement that may be helpful to you in this regard. Page 11 of the accompanying document, the economic and fiscal review, shows some of the sensitivities of the economy to external events, including the dollar, and indicates, for example, that in the first year an appreciation of the Canadian dollar by five cents US would have an effect of minus 0.2% to minus 0.9% on Ontario's real GDP growth. In terms of the effects of GDP growth on the economy, as you note—and this is shown on page 13 of the same document—the sustained higher growth of one percentage point in Ontario's real GDP means about $625 million.

Mr O'Toole: A very good number—I appreciate that. The $500 million—I was kind of going low on that implication. But, I guess, representing my riding in Durham, of course, with General Motors and a heavy auto sector, interest rates are extremely important domestically as well as to the export climate. Based on what you're saying on anticipated revenues, the interest rate implications for the housing market are extremely important. As well, certainly we see that zero interest in the auto sector is what's driving the market there.

One other point, just to change a little bit here in the limited time I have—I appreciate your leaving as much time as you did. You mentioned Bill 2, which sat before this very committee. It really was a tax increase; there's no question about it. I read an article in the entertainment section about the implications for Corus, a company. This has caused their revenue to be struck to the tune of about $17.5 million in increased taxes as a result of the small business tax, or corporate tax, as it's called. Do you have any comment, going forward, on whether there is going to be a considered effort to continue to raise business tax? I'm going to put that in the climate that Professor Mintz will likely make a comment, and hopefully Mr Martin as well—I mean the one from the business school—with respect to our competitiveness outside of the tax regime or the interest regime, which basically is a federal responsibility, on the monetary side. But in terms of our competitiveness, Mr Phillips said many times, many days in the Legislature—no disrespect; Mr Phillips is an extremely good finance critic—that we are uncompetitive. The experts don't say that's the case. Whether it's in the form of corporate tax or monetary policy, how important is competitiveness and tax policy? That's the question. Is it part of your strategy to keep the manufacturing sector and the export sector, which we've already established is Ontario's strength—what measures can I anticipate going forward on the corporate tax side and business competitiveness?

Hon Mr Sorbara: John, I think it's a very important question. I'm not sure you are representing Gerry Phillips's views accurately. I think for years he said in the Legislature that the corporate tax cuts that were a part of the previous administration brought corporate tax rates well below what they needed to be for Ontario's businesses to remain competitive. I think that competitiveness and productivity will drive what we do in all aspects of both budgetary planning and organization of our tax system as we go forward.

The measures we took in the Fiscal Responsibility Act, 2003, rolled back certain tax cuts that were part of your administration. With those measures fully in place, Ontario's corporate tax rates remain very competitive with our major competitors, in particular US jurisdictions and other Canadian jurisdictions. That's why we had no hesitation in bringing forward those measures. One has to balance the need for revenues against the ability to generate increased revenues through the tax system. We made it perfectly clear, notwithstanding all the political rhetoric while the bill was being debated, that we would take those steps during the campaign. We are satisfied that we have not made Canadian and Ontario businesses less competitive as a result.

The Chair: We'll now move to the NDP.

Mr Michael Prue (Beaches-East York): I have a few questions here because I'm hearing a juxtaposition. I'm hearing that you want to do so many more good things and then shave out some other stuff and then not raise taxes. Quite frankly, I think it's an impossible dream. If I could just start with that: You're dreaming the impossible dream.

I want to be very pointed and ask you the question: Is one of the options on the table having a deficit this year and no increases in taxes?

Hon Mr Sorbara: Our objective is to present a balanced budget. That's what we're working on, and I've said on a number of occasions that we need to do that without further increases in personal income taxes. I have mentioned, Michael, on a variety of occasions that we will look at non-tax-based revenues to support the revenue side of the balance sheet and our objective is to balance the budget. Have we made a commitment that come hell or high water that budget will be balanced? The answer is no.

Mr Prue: On to non-tax revenues, I read in the paper the musings of the Premier, in terms of non-tax revenues, imposing a means test on seniors and their drug benefits and imposing new user fees for the services the province provides. Is that where we're headed?

Hon Mr Sorbara: I think there has been a great deal of speculation about what steps could be taken to reduce expenditures and raise additional revenues. I don't engage in that speculation, simply because I don't think it's particularly helpful. I think it arises because we are about to begin these sets of hearings and there may be people who come before this committee to make certain recommendations. We're here to listen to that, but we're also about to begin a unique budgetary conversation with the people of Ontario, and we want to leave open to those who participate in those conversations—my goodness, you just appeared out of nowhere.

Interjection.

Hon Mr Sorbara: We want to encourage people to bring forward whatever suggestions they think it is reasonable for their government to consider.

0940

Mr Prue: On that same vein, there has been a second set of musings that involve selling off perhaps Hydro, TVOntario, the LCBO and a great many other things. Is that still a commitment of your government?

Hon Mr Sorbara: Once again, it is not a commitment of our government. These are not suggestions that we are putting on the table; they are suggestions that others have argued we ought to consider. But again, Michael, I don't want to engage in speculation as to whether or not we would get into the business of selling assets. In fact, I do not use that expression when I look at ways in which to increase revenues for the province.

Mr Prue: You've talked about reordering government and getting some 2,000 suggestions from our civil service. My reading between the lines here seems to indicate that there will be some type of downsizing about to occur. Is that a correct reading?

Hon Mr Sorbara: No, I wouldn't characterize that as a correct reading. It may be that as a result of this examination there is a consensus that there are some lines of business that the government need not be in any more. Then we'll get out of those lines of business. But our overall objective is to concentrate on the priorities that we were elected on, and that is improving the quality of our schools, improving the quality of our health care system. What is different than the pre-election period is that the revenues available for us to achieve those objectives are significantly less than we had contemplated. That's why this exercise is so important.

Mr Prue: I think the people of Ontario deserve to know, and you must have some inkling at this stage, what sorts of programs you think the government of Ontario should not be in. Is it in the area of conservation or parks? Is it in the area of roads or maintenance? It doesn't appear to be in education or health. Is it in transit? I mean, you must have some inkling of where you want to steer.

Hon Mr Sorbara: It certainly wouldn't be in transit. Again, I don't want to compromise or prejudice the discussions we're about to have by suggesting particular areas of business that we should no longer be in. But what's interesting, and I go back to the preamble of your question, is that the consultation that we've had with the Ontario public service has not been seen as a precursor to downsizing. It has been very welcome by the 63,000 people who come to work for this government every day. The suggestions have been remarkably interesting and informative and may help us—and will help us—in the tough decisions that we're going to have to make.

Mr Prue: Can we foresee a restructuring in terms of management, layers of management, that kind of thing? Is that what you're looking at?

Hon Mr Sorbara: That is a possibility, and that's not to say that the previous administration did not undertake a restructuring of government. The public service is significantly smaller after eight years of Conservative administration than it was in 1995. It is only to say that in an organization that is as large and comprehensive in its mandate as the government of Ontario, there is a need for an environment of continuous improvement, a culture of continuous improvement and reshaping of the organization.

Mr Prue: My next question has to do with cities. We've just had a number of mayors from across the country here in Toronto meeting with Mayor Miller and a great deal of talk about needing money from senior levels of government—the federal level and, as well, the provincial level. In the provincial level they're still looking at the gas tax; they're still looking at reductions in PST; they're looking at grants. In fact, the city of Toronto alone is staring down a $344-million debt. How, in any way, are your budget or your proposals or what you're looking at going to alleviate the problem of cities?

Hon Mr Sorbara: I think it's a very important question. I think the dialogue that is going on now between mayors of major cities and the new administration in Ottawa and the new administration here will be very productive. Again, I don't want to put any specifics on the table now. We are very sensitive to the needs not just of the city of Toronto—let's be clear here: We cannot make this debate about the city of Toronto. In fact, from my perspective, I look at the greater Toronto area as one economic area comprised of many urban jurisdictions. So when I look at transit, for example—and I think transit has to be an important element going forward, an important element in assisting cities with their mandate—we have to look at the transit needs of the greater Toronto area and the city of Ottawa and the Kitchener-Waterloo region.

I would say that if we can work on specific elements like transit and affordable housing, and assist in a new understanding and agreement with the federal government in assisting in those sorts of things, then I think we'll start to see some major progress on issues that have been languishing for quite some time.

Mr Prue: Do I still have some time? All right.

Let's stay with the transit and the housing stuff.

You have talked about not wanting to increase personal income tax, which we understand. Is your government considering at all—I mean, if you don't have the two cents of the gas tax that you initially promised because we need it ourselves, are you considering an additional two cents dedicated to the cities?

Hon Mr Sorbara: I should say that the commitment of two cents a litre toward transit remains a commitment of this government. The question for us is—

Interjection.

Hon Mr Sorbara: The question for us, I tell my friend from Nepean-Carleton—

Mr Prue: My question is, are you considering, if we need the two cents and we can't give it to them because we need it—are you looking at another two cents?

Hon Mr Sorbara: No, we are not at this time—

Interjection.

Hon Mr Sorbara: We are not, at this time, considering an increase in the gas tax of two cents to cover that commitment.

Mr Prue: OK, and in terms of—

Interjection.

Mr Prue: I thought it was my turn.

I'm looking in terms, then, of housing. Money was promised for housing, some 20,000 new starts, if I remember your platform correctly. Is that commitment still there, and from where are you going to get the money? That's a pretty expensive promise.

Hon Mr Sorbara: And that's the challenge. As I said in my opening remarks, this isn't going to be easy. There are some very pressing priorities. The exercise that we're engaged in now is to determine how to order those priorities, which ones to defer somewhat to, say, the 2005-06 budget, and how we will aggregate all the revenues necessary to get on with the work we are committed to doing. It's not easy.

Mr Prue: No, and again I go back—I think it's an impossible dream, unless you're willing to raise additional revenues, to actually do some of these things. I know you're trying to be purposely vague, because we're at this stage—

Hon Mr Sorbara: Only to inspire the broadest debate during your hearings.

Mr Prue: I am trying to figure in my own head, because you will be holding your own hearings, the direction that this government, the members sitting opposite me here, might be taking. Is it in user fees; is it in taxes; is it in cutting of programs; is it all of the above? Is that what we're looking at here? Is that what we're going to go around the province doing for the next three weeks?

Hon Mr Sorbara: Well, let me simply put the challenge back to you, Michael, or invite you to participate in realizing the dream. I'm here this morning because I am very interested in how this committee and its members will report to the government and the Legislature on how to do that.

We have definitely left the era of "The only important thing to do is cut taxes" politics in Ontario. That was the mantra of the previous administration. Everything else was subservient to the belief that cutting taxes would be the best way to grow a stronger province. We don't believe that; we are committed to improving the quality of public services. We inherited a rather delicate fiscal challenge. So I'm inviting this committee to help define the road, help give definition to that exercise.

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The Chair: Now we'll move to the government.

Mr Colle: Mr Minister, this committee is about to embark on a month-long tour of the province—we're going from Timmins to Thunder Bay to Kitchener—and traditionally these pre-budget consultation hearings hear from witnesses representing certain sectors that naturally would try to explain to this committee how important their sector is and that usually they require more government resources than fewer or a change in the way that sector operates. If you were us on this committee going across the province, in our chairs here, what kinds of questions would you ask the witnesses that would help you in your deliberations in terms of the tough choices?

Hon Mr Sorbara: I think one of the comments I would invite would be to ask deputants to go beyond their individual or sectoral interest and to comment on, offer advice on, ways in which we could meet our collective challenge. Let's take health care as an example. You will be hearing, I take it, from a variety of deputants in the health care sector. Currently, health care consumes 46% of Ontario's operating budget. That's a significant amount. I think we need to begin to look at how we can deliver services in that area more efficiently, and so I would encourage you as members of the committee to put the challenge back to the people who come before this committee, to suggest to them, "Don't just come and ask for more or a bigger chunk; come with solutions that will inspire a stronger Ontario in all sectors."

Mr Bruce Crozier (Essex): Good morning, Minister. Some would say that the only salvation is to continue to reduce taxes. As you have used the term, they say that will "grow" the economy, which simply means that if we require more revenue, the taxes come from somewhere else in the economy, let's say provincial sales taxes. And provincial sales taxes of course are paid by everybody because in some cases there are certain necessities, certain daily needs that you have so you have to pay those taxes. On the other hand, you'll get advice that the only way to work our way out of this is to simply increase taxes. Can you give me some perspective of where you as minister have to weigh these two pieces of advice, one to simply keep reducing taxes to goodness knows where, because they haven't given us any idea how low they should go, except they should be lower than everybody else, and on the other hand we can't simply raise taxes.

Hon Mr Sorbara: I think I'm going to leave the mantra of "Let's just keep reducing taxes further and further" to the three folks that want to be the leader of that new Conservative Party.

Mr Crozier: Whatever the name of it is today.

Interjection.

Hon Mr Sorbara: Two of them? No, just one of them. I was thinking of Klees, but he's running for your party.

The problem with that is that at some point—it's like the guy who tries to stay in business by continually lowering his prices until he's losing more and more money. His friend says to him, "How did you stay in business?" "I decided to close on Saturday, and then I'll close on Friday. I'll take a long weekend." Ultimately, it doesn't work. If, for example, you look at what's happening in the United States of America, there you have, I think, some very serious economic problems because President Bush has put in place significant tax cuts and significant new expenditures, with a deficit that is now approaching half a trillion dollars—I mean, it's unprecedented.

They keep saying, "It's all entirely manageable." Frankly, in the Ontario context, that kind of approach is not manageable and simply had to come to an end. The bubble burst. What happened during the election was that the people of Ontario realized, finally, that the bubble had burst and the path of more and more tax cuts was not going to result in increased revenues to the treasury to enhance services. That road really came to a dead end, and it came to a dead end most clearly in the report that Erik Peters did, commenting on the fiscal circumstances of 2003-04.

On the other hand, Bruce—and I want to make this point very, very clearly—we have to be concerned as we look at our tax system to make sure that Ontario businesses are competitive and that Ontario families have enough money in their pockets to provide for themselves. I do not believe there is any capacity to raise personal income taxes or corporate taxes in the current fiscal environment. That's why we have said we are not going to do that. That's why we've said this is very challenging, because at one and the same time we have to live within our means. Living within our means means the taxes we are currently collecting, whether they be personal or retail sales tax. That's why our challenges are so great. That's why we will have to make some adjustments in government. But to suggest that somehow we can assist ourselves by reducing taxes at this stage just doesn't bear any connection to reality in Ontario.

Mr John Wilkinson (Perth-Middlesex): In the last few weeks in my riding of Perth-Middlesex, I've been talking to our transfer partners—the hospitals and school boards—and I've been asking them the question which I think the Premier raised: We're spending our money, and our priorities have been set for the last eight years by the previous government. If we are going to redo this, because there is a new government because people have voted for change, how would you change that?

It's interesting, because rather than people just coming to us and saying, "This is what we want. Spend more money; we don't care how you come up with it," we've asked, "What are the low priorities? What are the things that you think are stupid? What are the things we're spending money on that are ineffective?" I've been surprised by the number of suggestions I got locally.

My question, Minister, being a rookie, is how do we get these cost-saving ideas—things that the government does that perhaps have just been driven by politics in the past, which on the face of it just don't make any economic sense—these suggestions that are coming forward from our transfer partners to you? I know we're doing that with the public service, but how do we get that to you?

Hon Mr Sorbara: I think there are a number of ways. First of all, just bringing them forward to this committee or sending them directly to me. I will be involved in an across-the-province consultation process as well, so they could come to the government via that route. But I think the most effective way is to urge those individuals in Perth-Middlesex to participate in this unique conversation we're about to start with the people, because that is designed to encourage those very kinds of comments. In those consultations one could participate via the Web, via electronic town hall meetings, just through submissions to you in your own capacity as an MPP, and feeding those suggestions into that process.

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Now, does that mean that each one of them is going to find a place in the budget? No. But if there are some 3,000 or 4,000 suggestions that come in, some of them I think inevitably will find their way into the budget and into changing the way in which we do business in a small or perhaps big way in Ontario.

Mr Wilkinson: Thank you.

Mr John R. Baird (Nepean-Carleton): On a point of order, Mr Chair: I was talking to my good friend John O'Toole. He said, "Don't ask. He won't want to do it." I said, "This guy, this new Minister of Finance, is really sharp. He'll want to do it." Would you agree to stay for another 10 or 20 minutes and answer more questions?

Hon Mr Sorbara: Perhaps 10. It's up to the committee. I'm available. I mean, the next hour is dedicated to ministry staff and technical questions.

Mr Baird: Would you agree to take 10 minutes?

Hon Mr Sorbara: Sure. Let's take 10 minutes. OK? That's up to the committee.

The Chair: Minister, we appreciate your enthusiasm, but I would need unanimous consent to allow the minister to speak or answer for another 10 minutes. Do we have unanimous consent?

Mr Colle: On a point of order, Mr Chair: We have unanimously agreed to a subcommittee report, and I guess what we have to do is move to amend the subcommittee report that they agreed to.

Mr Baird: He's agreed to 10 more minutes of questions.

The Chair: I remind the member that with unanimous consent of all on the committee, we could embark on this road.

I'll ask again: Is there unanimous consent to allow the minister to remain here for questioning for another 10 minutes? Agreed.

Mr Baird: Thank you, Minister. I appreciate that.

Hon Mr Sorbara: It's really just so that Baird can get on the record.

The Chair: Then we'll start the rotation with Mr Baird, with approximately three minutes each.

Mr Baird: Thank you, Minister. It's greatly appreciated. You're an open guy today, and I appreciate it.

Hon Mr Sorbara: Only because it was you that asked, John.

Mr Baird: Well, I appreciate it.

It would be helpful for us: What commitments can we say are sacrosanct? What promises did Dalton McGuinty and Greg Sorbara make that we just can't touch?

Hon Mr Sorbara: We could get into a careful analysis of the election campaign, but I don't think we want to do that in the three minutes that are available to us. I simply repeat the remarks that I made at the opening of these hearings, that our priorities remain the priorities that we talked about during the campaign and that we were mandated to achieve by the people who elected us. That has to do with improving our schools so that our kids are doing better; fixing our health care system so that it delivers the kind of health care that the people of Ontario want; strengthening our communities, in particular in areas like transportation and the quality of our air.

But we do not have time, nor would I want to go through a checklist to say this has—

Mr Baird: But are there any promises where you could just say to this committee, "Dalton McGuinty will never agree to a tax increase. He promised not to raise taxes in those TV ads. You're wasting your time. Dalton McGuinty has promised that"? Anything like that?

Hon Mr Sorbara: I think you've heard me say that we are not going to be raising personal income taxes as a way of solving the deficit problems that we inherited from the previous administration.

Mr Baird: I must have missed that word "income" in the commercials.

Finally, I just have one quick question: the TTC. If I was talking to David Miller and Toronto city councillors later today and they were to say, "You were talking to Sorbara this morning," would you advise them not to raise the TTC fares and to wait for your provincial budget for help? Because they're going to have to raise fares by twice as much as they would have, possibly a 50-cent fare hike, if they started July 1. What advice would you have for David Miller and Toronto city council? Are they doing the right thing by not raising taxes, by waiting for Greg Sorbara to come to the rescue?

Hon Mr Sorbara: I think I would advise David Miller to continue the wonderful work that he's doing trying to resolve some very difficult financial issues facing the city. I would not give him specific advice on the TTC. I would tell him, as I will tell you, that public transit and gridlock, not in the city of Toronto but in the GTA, is a very serious concern to me and to our government.

Mr Baird: No specific advice for him?

Hon Mr Sorbara: We will be looking at ways to reverse the eight years of deterioration of public transportation because of the decisions that were made by the previous administration. We have to turn that around and we will turn that around.

Mr Baird: Are you talking about Mr Lastman? Are you going after Mr Lastman?

Hon Mr Sorbara: The question of fare increases we will leave to David Miller and the chair of the TTC.

Mr Baird: Minister, I want to thank you for coming before us today.

The Chair: We will move to the NDP.

Mr Prue: Back to the statement you made that our fiscal situation is not stronger and, secondly, that we cannot grow ourselves out of the deficit. I'm intrigued with that statement because the economic outlook and fiscal review from last fall says something quite different from that on page 21. On page 21 it talks about the total revenues available to the province: $68.6 billion for last year; $69.5 billion, which is not much growth at all; but then it shows in 2004, 2005, 2006 and 2007 growth rates which would significantly outpace inflation—significantly. Is there no way that we can grow ourselves out? I'm just curious, given your own numbers.

Hon Mr Sorbara: Significantly outpacing inflation, Michael, isn't enough to match the growth in expenditures. It's the rate of growth in expenditures, which significantly outpaces inflation, that gives us the eternal gap between revenue and expenditures. That's why we say we can't simply grow our way out of it. A stronger economy alone won't do that.

Mr Prue: But if all of the programs were untouched, if the wages of our civil servants, which are a huge portion of it, more or less matched inflation and if your growth rate went beyond, I'm failing to see why you would have to spend more money.

Hon Mr Sorbara: Again, the rate of growth of expenditures, notably health care—and I think I heard one of my colleagues say, "health care"—is well above the rate of inflation. Nobody comes to power and puts the system into neutral and just lets it just sort of proceed down the mountain, but if we were to do that, the growth rate of revenues would not ever match the growth rate in expenditures, so that differential there would be significant.

Mr Prue: And that's because you would be expanding the programs? You would allow them to expand?

Hon Mr Sorbara: I'm talking about program expansions at their current rate. So, for example, health care expenditures have been growing historically, over a significant period, at around 7% to 8%. Assuming the continuation of the growth rate at that level, assuming the continuation of the growth rate in colleges and universities, our education system—that's what I mean. Part of our job as legislators and as government is to reshape programs so that by the end of the exercise we've got a healthy balance sheet, that we are living within our means, that we have effected program reductions where appropriate and we have met our priorities, which is ultimately what we were elected to do.

The Chair: We'll move to the government caucus.

Ms Judy Marsales (Hamilton West): Mr Minister, earlier you referenced Mr Dodge's reduction in the interest rate. While that does reduce interest charges to the deficit, it is at a rate now where reducing it further is limited in the amount of stimulation to the economy. May I ask if it's possible to demand a better share from Ottawa to help balance the books? In Hamilton, as you well know, we are a city in transition and have really been ignored by the city of Toronto relative to transit. We are going to need some injection of funds, and also to be invited to the table dealing with gridlock. May I ask for a response to that?

Hon Mr Sorbara: I'll start with your last comment. I think that corridor from downtown Toronto to downtown Hamilton is one of the most burdened maybe in the continent. We have to look to that. I remember before your election your saying to me, "I want to come to the Legislature to put Hamilton back on the map." I will be supportive in that work.

Now let's get to interest rates and to Ottawa. It was interesting that the last reduction in rates had virtually no impact on the dollar. In fact, the dollar went down when the announcement was made and jumped back up and beyond what it was, I think on the day of the announcement. So it is an imperfect tool because there are so many factors that impact on the value of the Canadian dollar, and there is virtually nothing that a government in Ontario can do to affect that at all. And Dodge sees that his powers are limited.

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You suggested that maybe there is a lot more that Ottawa should be doing to deal with our fiscal circumstances, and I would agree with you on that. One of the things, frankly, that has emerged in the new federalism under a variety of new governments is the creation by provincial Premiers, under the leadership of Jean Charest, of something called the Council of the Federation—provinces getting together to deal collectively with their relationship with Ottawa.

One of the elements of the Council of the Federation is—and I'm sorry to be so technical—the secretariat on fiscal imbalance. It's led by Yves Séguin, my finance counterpart in Quebec. The thesis of the secretariat is that there is a fiscal imbalance in Canada: Provinces have a greater burden for service delivery than they should have, given their ability to tax. I think the secretariat on fiscal imbalance is going to be one of the mechanisms used to work out the next generation of relationship between Ottawa and the provinces. Ottawa does have tax levers that are not available to us. They are running a surplus; increasingly, provinces, including Ontario, are running significant deficits. That will be part of the great Canadian debate: Are we sharing revenues appropriately?

I know that on Friday the Prime Minister and the Premiers will be getting together to address that topic and I hope there is good news coming out of that meeting.

The Chair: I thank you again, Minister, for being here with us this morning—

Hon Mr Sorbara: Could I stay another 10 or 20 minutes, please?

The Chair: —and spending that extra time with the committee.

I would call upon the Ministry of Finance to come forward. I would ask that members of the Ministry of Finance please introduce yourselves for the benefit of the members on the committee and as well for Hansard.

Mr O'Toole: Mr Chair, just before we get going, can we get a copy of Mr Sorbara's comments? He seemed to be reading from a text. If we can get a copy of that, I'd appreciate it.

The Chair: We can ask.

Mr O'Toole: Not just the Hansard, which will be a couple of weeks.

The Chair: You would like a copy of the minister's opening address.

Mr O'Toole: Remarks, yes.

The Chair: We will see if we can have that for all members of the committee.

You may begin. As I stated, would you please introduce yourselves for the benefit of our Hansard record. Go ahead, gentlemen.

Dr Christie: My name is Bob Christie. I'm the deputy minister at the Ministry of Finance. I'll do a short introduction of my colleagues here at the table and then have them, as the responsible assistant deputy ministers, give you a more in-depth briefing on the various areas for which they are responsible and which form the core of the fall Ontario Economic Outlook and Fiscal Review.

As you know, the government has announced a public engagement process leading to the 2004 budget. Information contained within the quarterly finances and the economic accounts being released today, as well as in the economic outlook and fiscal review in December, hopefully will provide a useful context for the committee and for that public process.

To my left is Phil Howell. Phil is the chief economist and assistant deputy minister of the office of economic policy. Phil will provide more information on Ontario's economic situation and economic outlook.

To my right is Gabriel Sékaly. He is the assistant deputy minister of the fiscal and financial policy division. Gabe will be providing details of the province's fiscal situation, as well as accounting and financial presentation changes implemented in the 2002-03 public accounts.

Gadi Mayman, sitting to Gabe's right, is the acting CEO and vice-chair of the Ontario Financing Authority. Gadi will provide a review of our debt and financing activities.

I'll ask Phil to begin.

Mr Phil Howell: I'm pleased to have the opportunity to address the standing committee today. I would like to provide some perspective on the current performance and outlook for the Ontario economy. I'll discuss the most recent economic data, and then I will address some risks to the outlook, with a particular focus on the Canadian dollar and the competitiveness challenge posed by the exchange rate. Finally, I will discuss factors shaping the economic outlook and update you on the consensus forecast for the economy. I hope this economic backdrop will assist you in your forthcoming hearings at Queen's Park and around the province.

This slide summarizes the outlook for the Ontario economy. Private sector forecasters, on average, expect Ontario real economic growth to accelerate from 1.6% in 2003 to a range of between 3% and 3.4% over the next three years. This expected growth in real GDP translates into nominal GDP growth of about 5% per year. That is the current dollar value of goods and services produced in Ontario. The reason for that is that inflation is expected to remain low. Job creation is expected to continue and accelerate over time, helping the unemployment rate decline.

Before looking more closely at the outlook, let me now turn to recent economic developments. The Ministry of Finance is releasing the third quarter Ontario economic accounts today for the July to September period. They show that Ontario's real gross domestic product fell at an annualized rate of 2.5% in the third quarter of 2003, following a 0.7% decline in the previous quarter. The two-quarter decline in real GDP marks the first time since the third quarter of 1992 that growth has declined in two consecutive quarters. However, the downturn was almost entirely the result of the extraordinary events of this past spring and summer, namely, the SARS crisis, mad cow disease and the August blackout.

Strong gains in household and business spending, including a surge in machinery and equipment investment, offset some of the third quarter weakness. Spending in these areas helped raise final domestic demand 1.2% higher in the third quarter.

While the fourth quarter economic accounts will not be available for some time yet, recent data suggest the Ontario economy rebounded in the fourth quarter and is well positioned for solid growth through 2004. Private sector forecasters are unanimous in calling for a rebound in Ontario and Canadian growth in the fourth quarter, with the consensus expecting Canada to grow by 3.9% at an annual rate and Ontario to grow by 3% at an annual rate.

In particular, the Ontario labour and housing markets closed out 2003 with very strong results in December. Employment grew by 35,400 jobs in December, bringing the number of jobs created during the September to December period to 72,600.

Businesses cut non-farm inventories by more than $2.1 billion in the third quarter, reversing the $4.5-billion buildup in the second quarter. With stocks now significantly lower, the likelihood is strong that both inventory rebuilding and increased production will occur in the upcoming quarters as businesses replenish stocks to meet strengthening demand as the domestic and international sectors continue to expand.

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The data for the first three quarters of 2003 compared to the same three quarters in 2002 show that domestic demand—that is, spending by consumers on goods and services and housing and by business on machinery, equipment and factories—stayed quite strong. However, as this slide shows, net trade—that is, exports minus imports—subtracted from growth over this period.

As mentioned earlier, the impact of the rising Canadian dollar and the pervasive effects of last August's Ontario-US power outage were contributing factors slowing Ontario's export growth. Furthermore, US demand weakness in several of Ontario's key export markets exacerbated the problem. US auto sales slipped nearly 1% to 16.6 million units in 2003, the lowest level since 1998, and real business spending on non-computer machinery and equipment fell over 5% in the first three quarters of 2003 compared to a year earlier. At the same time, the strength of domestic demand has boosted import growth, resulting in a drop in Ontario's net trade balance.

Private sector forecasters now believe that real growth for 2003 as a whole will be 1.6%. Growth has come down sharply from expectations at last March's budget, in large part reflecting the uncertainty created by the war in Iraq, the negative impact of severe acute respiratory syndrome on the Ontario economy, the August blackout and the higher value of the Canadian dollar.

The consensus estimate of growth for 2003 has also slipped by a tenth of a percentage point from the 1.7% estimate published last month in the fall economic statement. The private sector estimates for 2003 have not yet fully incorporated the latest information about how the economy did last year, including the third quarter data to be released later today.

It is quite possible, indeed likely, that the consensus will fall further. However, we have not changed our revenue projection for 2003-04 from the fall statement at this point. Income tax returns from both individuals and corporations become known to us only with a considerable lag, and final information is not yet available. However, risks to the revenue forecast do remain, even though we are in the final months of the fiscal year.

Employment fell by 24,000 jobs from April to August in 2003 as the economy weakened, reflecting the negative impact of the series of shocks which hit the economy. As mentioned earlier, the Ontario economy closed out 2003 on a strong note by creating 35,400 net new jobs, two thirds of which were full-time positions, bringing the number of jobs created during the September to December period to 72,600. For the year as a whole, Ontario employment increased by over 160,000 jobs, up from 105,300 net new jobs in 2002. The annual average unemployment rate declined slightly to 7% in 2003 from 7.1% the previous year. As of December, the unemployment rate was 6.7%.

Ontario is quite dependent on trade, specifically exports to the US. It is no secret that competition in the international economy has been growing increasingly challenging over the past decade. The recent increase in the Canadian dollar adds to those challenges. It will not make life easier for Canadian exporters, but it does have positive aspects as well. It will encourage them to try to achieve higher levels of productivity.

The Ontario government has an important role to play in this challenge as well, because the quality of infrastructure and services provided by government is one of the key factors in what makes our economy competitive.

The US dollar has fallen against all major currencies, with the exception of the Chinese yuan. Since the beginning of 2003, the Canadian dollar is up more than 20% relative to the US dollar. This is the largest increase in the Canadian dollar relative to the US dollar that we have ever had in a one-year period. You have to go back to 1988 to find the previous largest 12-month increase, and then it was only about 10%.

The Canadian dollar was clearly undervalued in the past several years, and a rise in the dollar from that perspective was desirable. The rapid pace of adjustment, however, makes it particularly difficult for exporters. The Bank of Canada is aware of this problem and it cut its key lending rate last week. It's possible that further rate cuts will be needed in coming months.

A stronger dollar has some clear benefits, including raising the standard of living of Ontario consumers by making imported goods cheaper. It also makes investment in new, higher-productivity machinery and equipment more affordable for Ontario companies, since the bulk of this equipment has to be imported. However, it is likely to lead to a restructuring in terms of greater efficiency and reduced job growth in manufacturing.

The next few slides will help illustrate the competitive challenge facing Ontario's businesses. Nowhere is this more important than in manufacturing, since about 60% of our manufacturing production is exported to the US.

Manufacturing employment has been on a declining trend in most advanced countries, including the US. Ontario bucked that trend mainly because of the low dollar in the second half of the 1990s. Manufacturing employment started to weaken in 2001 with the decline in high-tech manufacturing. This weakness continued in 2003, with a variety of sectors affected. Auto industry employment has not declined in absolute terms but has had no net growth since 2000.

In order to remain competitive, Ontario manufacturers will have to increase efficiency and cut costs. Lower prices for imported equipment will help encourage productivity, enhancing investment. In some cases this will involve job reduction, so we should not expect a resumption in manufacturing job growth in the coming year. The manufacturing sector accounts for about 18% of total Ontario employment.

In addition, manufacturing industries purchase many business services from the rest of the economy, so the overall importance of manufacturing to the economy is considerably larger when this multiplier effect is taken into account. Incomes in manufacturing are higher than average, and manufacturing exports account for about a quarter of Ontario's GDP.

In this chart we compare average hourly wage costs in manufacturing in Ontario with the US average. From 1995 to 2002, wage costs rose faster in the US than in Ontario, at the same time as the Canadian dollar declined. As a result, by 2002, average hourly wage costs in manufacturing in Ontario, including benefits, were about 20% below the US average. This was a very unusual situation and indicated that our dollar was significantly undervalued.

In 2004, if we assume the consensus forecast of about US$0.78 per Canadian dollar, Ontario's manufacturing wage costs per hour will be about equal to the US. By this measure, Ontario is still in a much better relative position than in the early 1990s, when Ontario's wage costs were 30% higher than in the United States.

Ontario's manufacturing employment growth has been particularly impressive, compared to the declining total of manufacturing jobs in the US, which have fallen about 15% since 1995. Ontario's strong performance would probably not have been possible without the market access that we gained due to NAFTA. Ontario's manufacturing employment is equal to about 6.5% of manufacturing employment. Taking into account Ontario's relative population, on a per capita basis Ontario has 50% more manufacturing jobs than the US.

In the current dollar environment, the price of new machinery and equipment has fallen, since it's largely imported. Since machinery has become cheaper relative to wage costs, many companies will look to installing new productivity-boosting equipment in order to cut costs and become more efficient. It will take time to acquire and install new productivity-boosting equipment, so employment impacts will lag. The historical pattern suggests that exchange rate changes affect employment with a lag of about two years. Therefore we should expect continuing pressure on manufacturing in 2004.

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The previous chart compared only wage costs and did not attempt to take into account differences in productivity growth between Ontario and the US. For comparisons of competitiveness, economists often look at the change in labour costs per unit of output, which reflects changes in productivity. Here our advantage has begun to erode when we factor in the stronger productivity growth in recent years. However, the productivity differential was primarily attributable to the extraordinary productivity growth in the computer and electronic products industries, which are significantly larger in the US than here, in a relative sense.

For the majority of manufacturing industries, including transportation equipment, Ontario's productivity growth matched or exceeded the US average during the 1990s. Therefore, overall US performance considerably exaggerates the relative competitive ability in all manufacturing industries. In fact, there are numerous reasons to believe that our industries are still very competitive. We have a very advantageous location within the open North American market. NAFTA is more than 10 years old now, and there has been considerable integration of production lines for greater efficiency. Ontario products and production have become a vital and integral part of the output of many major continental operations. Our health care system still delivers very high quality health care at less cost than in the US. We have one of the best-educated workforces in North America, and we have a stable social climate that is conducive to efficient business operations.

The dollar's fluctuations have had the most dramatic impact on Ontario's competitiveness in the past year, but there are many other factors that affect our competitiveness in the long run. Tax rates are one factor affecting the location of investment, and it is important for them to remain competitive. Ontario's corporate tax rates for 2004 are about three percentage points lower than the US average. However, international studies have found that numerous other factors are also important, including the quality of infrastructure and the quality of training and health care available to the labour force.

The Ontario government's focus on fiscal responsibility is also very important. Investors will shy away from a jurisdiction with persistent deficits because of concerns that it will lead to a combination of higher taxes and reduced government services in the future.

I will now turn to the outlook over the next three years. This slide shows the evolution of the private sector forecasters' real GDP growth outlook for Ontario since last March and since the economic outlook and fiscal review a month ago. Real growth is now expected to be slightly weaker over the forecast period. Ontario is wide open to the world economy. Its growth depends to a large extent on external developments, notably the economic health of its leading trading partner, the United States, as well as the rise and fall of interest rates and movements in the Canada-US exchange rate. As the experience of the past year vividly shows, the economy can also be severely impacted by unanticipated shocks. The potential impact of these unexpected events underscores the need for prudence in planning.

The US is our most important trading partner. Their growth is expected to accelerate to 4.6% in 2004 and then stay at healthy rates of 3.7% and 3.5% in the following two years. The improvement in US growth reflects ongoing low interest rates; the stimulative effect of increased government spending, largely on defence; significantly stronger business investment; rising consumer and business confidence; higher profit margins; and steady income gains. This pattern is one of the reasons that forecasters see Ontario growth strengthening in 2004 compared to this year.

As mentioned earlier, the Bank of Canada reduced its key overnight interest rate by a quarter point on January 20 to help offset the Canadian dollar's negative impact on economic growth.

Lower interest rates are another reason for some optimism about the outlook. With inflation contained, monetary authorities have the latitude to maintain low interest rates. Long-term bond rates are expected to remain largely unchanged in 2004. Yields are projected to increase gradually during the 2005-06 period as the performance of the economy strengthens.

As noted earlier, the steep rise in the Canadian dollar is a significant challenge. However, this slide shows that despite the high dollar, exports are expected to rebound this year. The reason for this optimism is found in the expected strong growth of the US economy. Despite a 20% appreciation in the Canadian dollar over the past year, Canadian business confidence has risen, up 15.1% in the fourth quarter, following a similar increase of 15.7% in the third quarter.

Household spending is also expected to be a source of strength over the next few years. Although household debt levels have continued to rise, the cost of carrying that debt is low by historical standards. The ratio of Canadian household debt cost to personal disposable income was 7.5% in the third quarter of 2003, below the average 8.1% over the 1980 to 2003 period. The reasons are low interest rates and higher personal income. Furthermore, rising house values and an improvement in the stock market have bolstered household wealth. Healthy household finances are expected to sustain solid consumer spending over the forecast period. Low interest rates combined with steadily rising personal disposable incomes are also contributing to an improvement in consumers' ability to service their debt. This is a key factor that will continue to support consumer spending.

Ontario consumers remain confident in the face of setbacks such as SARS and the electricity blackout. While consumer confidence slipped 2.5% in December, it remains 2.6% higher than its level at the end of 2002 and is 7.2% higher than the average over the 1980 to 2003 period. Low mortgage rates and rising incomes have helped keep housing affordable for Ontario's growing population. Starts reached 85,200 in 2003, up from 83,600 in 2002 and the highest level since 1989. Though new starts are expected to retreat somewhat from last year's exceptionally robust performance, relatively low mortgage rates and healthy levels of immigration will continue to encourage historically high levels of housing demand and construction.

Corporate balance sheets are also quite strong. This slide reveals how business debt-to-equity ratios have declined. Healthy balance sheets, favourable financing conditions and competitive corporate income tax rates will support a pickup in investment spending over the next three years as businesses respond to increasing demand.

Business investment in plant and equipment has been weak since the high-tech bubble burst in 2000, and only began to recover in 2003. This recovery in business investment which has started to take shape is expected to continue, reflecting improving underlying demand conditions, rising profits, stock market gains and healthy balance sheets. The higher dollar has lowered the cost of investing in machinery and equipment—about 60% of capital equipment used by Ontario businesses is imported. This will help to spur increased investment in productivity-enhancing machinery and equipment.

As noted earlier, real GDP is expected to strengthen. This will support continuing job creation and a decline in the unemployment rate. The unemployment rate in December was 6.7%, and it is likely that the consensus forecast for the unemployment rate will come down as forecasters update their labour market projections.

Ontario's inflation rate is expected to moderate to 1.5% in 2004. Lower inflation reflects lower oil and gas prices measured in Canadian dollars, continued competitive pressure to improve cost efficiencies in production, plus the government's actions to lower auto insurance premium rates.

The behaviour of the US economy, crude oil prices, interest rates and the exchange rate can have a significant impact on Ontario's economic performance. The table shows the typical range for the first- and second-year impact of changes in these outside forces on the real growth of our economy. These estimates are based on historical relationships and illustrate the upper and lower bounds for the average response. In any actual situation, of course, the combination of other circumstances can also have a substantial bearing on the outcome. The magnitude of these impacts shows the importance of cautious planning, since the growth of Ontario's economy and revenues depends critically on factors outside our control. Other unpredictable events, such as the outbreak of SARS and the power blackout in August, also underscore the need for prudent fiscal planning.

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The next slide shows the sensitivity of the fiscal balance to the direct impact of higher interest rates on interest on debt and the impact of stronger economic growth on revenues and expenditures. These responses would hold, on average, but could vary significantly depending on the composition of change in income and expenditures.

Private sector forecasters are clearly confident that Ontario's economy is poised to continue its rebound from the 2003 slowdown. While individual forecasts naturally vary around the average, all expect solid growth over the next three years. Consumers and businesses are equipped with healthy balance sheets to take advantage of the opportunities provided by the domestic and international economies. The dollar will pose challenges, but strong US growth will mitigate some of the impact. As well, the Bank of Canada appears likely to keep interest rates in check over the near term. Thank you.

Mr Gabriel Sékaly: Good morning. My name is Gabriel Sékaly. I'm the assistant deputy minister of the fiscal and financial policy division. I would like to spend a few moments to provide you with an update of the province's fiscal situation as reported in the third quarter Ontario finances, released today, as well as briefly outline recent accounting changes and some initiatives aimed at making the government more efficient, effective and accountable.

To begin, I'd like to briefly summarize Ontario's fiscal performance for last year. As this slide shows, the 2002 public accounts reported a surplus of $117 million in 2002-03 on revenues of $68.6 billion. This surplus was smaller than the $375 million reported in 2001-02 and the $1.9-billion level reported in 2000-01, as provincial spending growth has exceeded revenue growth in recent years.

As many of you know, and as the minister talked about this morning, Ontario is currently facing a structural deficit, one that is permanent in nature unless action is taken. This imbalance between expense and revenue in Ontario can best be illustrated using this slide: In 2000-01, Ontario recorded a $1.9-billion surplus; taxation revenues, at $49.5 billion, were almost equal to Ontario's program spending of $51.1 billion. Since 2000-01, however, tax revenues have increased marginally, by half a billion dollars, as the impact of a slowing economy and provincial revenue was further impacted by provincial tax reductions. Over the same period, spending on provincial programs increased by over $10 billion. While these past spending increases were often for priorities—higher spending on health care, for example—the province's revenue base could not support these higher levels of spending and tax cuts at the same time. As well, more spending does not necessarily translate into better services.

The rapid growth in spending in recent years, combined with the impact of tax cuts on base revenue growth, has produced a fiscal situation that is not sustainable. This year, the province is spending considerably more than it collects in revenue. To put it simply, the province is not living within its means.

The third quarter Ontario finances, released today, show that as of December 31, 2003, Ontario is projecting a deficit of $5.6 billion for 2003-04, unchanged from the 2003 Ontario Economic Outlook and Fiscal Review, which was released in mid-December. This outlook is also consistent with the Erik Peters report, updated to reflect the impact of recent revenue and expense measures announced by the government.

Total revenue is currently projected at $69.5 billion for 2003-04, unchanged from the level reported in mid-December and up $923 million from the 2002-03 level.

This increase from last year is primarily due to higher payments from the federal government—$1.4 billion—and a modest increase in tax revenues, partially offset by lower income from government enterprises and other non-tax revenue.

Total expense in 2003-04 is projected at $75.2 billion, unchanged from the level reported in mid-December, but is an increase of $6.7 billion from the 2002-03 level of $68.5 billion. This increase in expense is primarily due to higher levels of spending for health care, education, the post-secondary sector and infrastructure.

While total expense at $75.2 billion at the third quarter is unchanged from the mid-December fall statement, there have been a number of in-year increases, but they were all offset from either the operating or the capital contingency fund. Major changes this quarter in operating spending include $45 million for a negotiated settlement between the province and the Ontario Provincial Police Association, $10 million for child care and early learning programs, $2 million for a major case management computer system in the Ministry of Community Safety and Correctional Services and $1 million for First Nations policing for renewal of funding agreements. All of these in-year increases were fully offset from the operating contingency fund. In addition, a further $19 million in new capital spending was approved, fully offset from the capital contingency fund for capital projects at colleges and universities to create new spaces for students.

As I've indicated, the third quarter $5.6-billion deficit outlook is consistent with the Erik Peters report, updated to reflect a recent announcement. This slide highlights major changes from Erik Peters's report and, as you can see, the most significant change is due to the change in accounting for the Ontario Electricity Financial Corp to bring the 2003-04 presentation in line with the 2002-03 public accounts. This change in OEFC presentation is fiscally neutral and did not affect the bottom line. The current revenue outlook as of third quarter is $2.4 billion higher than the level in the Peters report, with $2.1 billion of the increase due to the inclusion of OEFC revenue in the province's revenue total as per the 2002-03 public accounts. The balance of the difference is accounted for: a half-a-billion-dollar increase due to the estimated impact of revenue measures in the Fiscal Responsibility Act; an $830-million increase from a change in the treatment of SARS-related support from the federal government, which was partially offset by a half-a-billion deterioration in the tax revenue outlook based on the most recent economic information.

Expense was increased $3.1 billion from that reported in the Peters report, with $2.8 billion of the increase due to including OEFC spending in provincial expense, as per the 2002-03 public accounts. The balance of the difference is due to a $330-million increase from a change in the treatment of federal SARS-related support, and a $625-million increase for the establishment of a contingency fund, which is consistent with the Peters report recommendations, offset partially by about a $400-million expense savings from cancelling the seniors' property tax rebate. A $700-million increase in electricity sector stranded debt that was included in the Erik Peters report does not appear as a separate line in the current presentation, as OEFC revenue and expense have been included on a line-by-line basis in the provincial totals.

The next slide illustrates the longer-term implications of the structural deficit that Ontario currently faces. The medium-term fiscal projection provided on this slide for Ontario is based on a no-policy-change outlook that assumes no further changes to the current tax structure beyond those already announced or to existing programs and services. Revenue growth into the medium term is based on the projection of the economy that uses the average of private sector forecasts for Ontario. The revenue outlook does not include any further tax changes beyond those already announced by the government. The expense outlook into the medium term assumes program spending growth of about 5%, in line with experience in recent years. Capital spending is maintained at $2.5 billion annually. Interest on debt costs increase to reflect the estimated impact of ongoing deficits. This projection shows that without policy action, the deficit will be in the range of $4.5 billion for the next few years. The government has indicated that this no-policy-change outlook is unacceptable and has indicated it will initiate a public engagement process with the general public and stakeholders on how best to deal with the fiscal challenges ahead.

The no-policy-change projection also shows that given the current revenue outlook over the medium term, revenue growth from a growing economy alone will not be sufficient to balance if spending growth continues at current rates.

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This slide illustrates the impact of different assumed levels of spending growth on the province's deficit, beginning with a $5.6-billion deficit outlook for 2003-04.

To balance the budget in 2004-05, total spending would actually have to decline by 2.6% from the projected 2003-04 level, excluding the impact of the $720 million in SARS-related expenses in 2003-04.

Provincial spending has declined year over year only once in the past 10 years. Balancing the budget by 2005-06 or 2006-07 is possible as long as spending growth is more moderate than in recent years.

To balance by 2005-06, spending growth would have to be held to a maximum of 1.3% on average for the next two years. Balancing by 2006-07 requires spending growth to be held to an average of 2.3% a year for three years.

A no-policy-change scenario assumes total spending growth of about 4.6% on average, which reflects historical growth patterns consistent with the past five years and interest on debt costs associated with the ongoing deficits.

While these fiscal scenarios serve to illustrate the many difficult choices facing the government as it plans for a balanced budget, it should be noted that these scenarios use planning assumptions only. These underlying assumptions could be materially altered by government decisions and advice, including advice received through the forthcoming public engagement process. It is expected that, as a result of the public engagement process, the eventual outcome could differ substantially from the scenarios presented.

I'd like to now turn to accounting changes implemented in the 2002-03 public accounts. The 2002-03 fiscal year was a landmark year for implementing improvements in Ontario's public accounts. Consistent with new accounting standards recommended by the public sector accounting board of the Canadian Institute of Chartered Accountants, the province implemented the most significant improvements in its financial reporting since 1993-94.

First, the province introduced a new financial statement discussion and analysis section into the 2002-03 annual report and consolidated financial statements. This new section of the annual report provides an easy-to-read discussion and analysis of the province's financial results and is similar to the management discussion analysis section found in private sector annual reports. It is a straightforward description of the actual revenues received and expenses incurred by the province in 2002-03, compared to those budgeted. It graphically depicts the growth in revenues and expenses over the last 10 years. It highlights the significant growth in health care, education and social program spending in the last three years, compared to the marginal change in taxation revenues.

A new financial discussion analysis is a major step forward in communicating the financial results of the province in the public accounts and increasing transparency and understanding.

In terms of the consolidated financial statements themselves, the province implemented a number of other significant improvements in 2002-03 as public sector accounting standards move closer to the accounting practised by corporations and other non-government organizations in Canada.

In accordance with the new PSAB standards, tangible capital assets have been recorded in the province's consolidated financial statements for the first time. The province is phasing in the implementation of this new accounting policy.

In 2002-03, land, buildings, roads and transportation infrastructure assets owned by the province were recorded in its financial statements. It is estimated that this represents over 90% of the total value of tangible assets owned by the province. In addition, all tangible capital assets owned by government organizations consolidated in the financial statements were recognized.

Under this new accounting policy, the costs of tangible capital assets are being capitalized and amortized as expenses of operations over their estimated useful service life. In prior years, the costs of tangible capital assets were recognized as expenses when the assets were acquired or constructed.

To implement this new policy, a major effort was required by staff at the Ministry of Finance, the Ministry of Transportation and the Ontario Realty Corp to determine the $13.3-billion net book value of the province's tangible capital assets as at April 1, 2002. The introduction of this new policy provides not only a much better accounting basis for determining the actual annual costs of operations but also a stronger base for government decision-making in the management of these assets.

With the introduction of tangible capital asset accounting, a new financial statement presentation was adopted for the 2002-03 fiscal year, consistent with the new format recommended by the Public Sector Accounting Board. With the adoption of this revised format for its financial statements, the province is more clearly presenting its critical bottom-line financial results, its annual fiscal balance, its accumulated deficits, its change in net debt and the change in its cash position during the year.

Furthermore, commencing in the 2002-03 public accounts, the Ontario Electricity Financial Corp has been included in the province's consolidated financial statements on a line-by-line basis, consistent with the Public Sector Accounting Board's recommendations for consolidation of government organizations. With this change, all government organizations that are consolidated in the province's financial statements are being included on a consistent basis. This change is also consistent with the recommendation in the Erik Peters report. In prior years, a special reporting status was accorded to the OEFC, due to the legislative structure in place, to ensure that OEFC's revenues are derived from the electricity ratepayers, not taxpayers. This legislative structure remains in place. I should also note that we have restated the results going to back to 1999-2000, consistent with this new treatment. That was the time that the OEFC was created.

In summary, four major improvements in accounting and financial reporting were implemented for the 2002-03 public accounts. These were the most significant changes in accounting implemented since 1993-94. They have moved the province's financial reporting closer to the accounting practised by corporations and other non-government organizations in Canada. From an accounting perspective, 2002-03 was the year that the province moved into the 21st century.

But that's not all. There may be more fundamental accounting changes to come for the province. In August 2003, the Public Sector Accounting Board recommended broadening the definition of government organizations to be included in the consolidated financial statements of governments for fiscal years commencing April 1, 2005. At present, government organizations included in the province's consolidated financial statements are those that are owned and controlled by the province and that are accountable to a minister of the government or directly to the Legislature for the administration of their financial matters and resources. Currently, in addition to provincial ministries, there are 27 government organizations included in the province's consolidated financial statements, as shown on page 61 of the annual report.

Under the revised definition proposed by the Public Sector Accounting Board, organizations that are controlled by the province are to be included in its consolidated financial statements commencing April 1, 2005. The criterion that organizations also be accountable to a minister of the government or directly to the Legislature for the administration of their financial affairs has been dropped. PSAB is proposing nine indicators of control for determining whether or not an organization should be included. Among the broader public sector organizations potentially impacted by this revised definition are the province's 160 hospitals, 815 long-term-care facilities, 72 school boards and 25 colleges of applied arts and technology. PSAB has specifically exempted municipalities from consideration.

In its 2003 annual report, the Office of the Provincial Auditor concluded that the two strongest candidates for inclusion under the revised definition are Ontario's colleges and school boards. The Provincial Auditor also concluded that universities did not meet the criteria for inclusion. The auditor went on to encourage an assessment of Ontario's hospital sector and its long-term-care facilities be completed.

There are significant implications for organizations included in the province's consolidated financial statements. These organizations would have to prepare their financial statements for consolidation on the basis of government accounting standards issued by the Public Sector Accounting Board. Currently, most of these organizations follow other accounting standards.

In addition, financial information would need to be provided by these organizations on the basis of the government's March 31 fiscal year-end. Currently, some of these organizations have other year-ends, such as school boards, which have an August 31 year-end.

Furthermore, these organizations would have to provide information and updates on the basis of the province's budgeting and financial reporting cycles. Each of these organizations in the province would have to implement changes in their financial systems and processes to meet these requirements.

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Given the number of organizations potentially impacted, implementing this recommendation of the Public Sector Accounting Board would be a significant undertaking in terms of both costs and time. We have suggested to the Public Sector Accounting Board that a complete cost-benefit analysis be completed prior to proceeding with this recommendation. In the interim, the Ministry of Finance continues to work with the Office of the Provincial Auditor in addressing this matter.

I'd like now to turn to best practices in terms of budgetary transparency and moving to outcomes or results-based budgeting. There are many ways for a government to ensure fiscal discipline. One of the most common methods is balanced budget legislation, but academic evidence has shown that balanced budget legislation alone is not enough. This is not to argue that the objective of a balanced budget should not be legislated, but what is required is a legal framework for transparency and accountability that can greatly enhance fiscal responsibility if it goes hand in hand with balanced budget legislation.

The public is demanding more transparency, not only from government but from all organizations, whether it be in the public or the private sector. They are demanding full, timely and relevant evidence upon which to base confidence in the province's finances. Government is looking at new ways to add confidence, including analyzing best practices from around the world. Ontario can learn a great deal from similar reforms in other jurisdictions, but care needs to be taken to ensure the viability of those reforms in Ontario. Some examples of this: In Australia, the government issues a pre-election report within 10 days of the call for a general election. New Zealand publishes a fiscal outlook with 10-year projections. Oregon presents non-financial information on 90 different indicators.

Governments everywhere are increasingly developing and reporting measures on public sector performance. These efforts are designed to focus attention on the results of public sector spending rather than simply on the amount of money spent. These efforts are designed to drive improvements in public sector services by including performance information in budgeting decisions. There are several examples of specific performance management frameworks in Ontario: for example, the hospital report cards and the municipal performance measurement program. We are looking at ways of expanding our use of performance information in budgeting in Ontario.

These are but a few examples of how the Legislature and government can better report to all its citizens on its activities and on its achievements.

Mr Gadi Mayman: Mr Chair and members of the committee, my name is Gadi Mayman. I am the interim CEO of the Ontario Financing Authority, OFA, which is the organization responsible for managing the province's debt.

I'm pleased to provide the committee with an update on the province's borrowing and debt management program. In 2003-04, total long-term public market borrowing requirements for the province in the Ontario Electricity Financial Corp, OEFC, which manages the debt and other liabilities issued by the old Ontario Hydro and guaranteed by the province, are a combined $22.7 billion. This amount includes $14.4 billion of debt maturities and redemptions and $5.6 billion from the projected deficit.

As of today, the OFA has completed $20.2 billion of this $22.7-billion requirement for 2003-04. While Canadian-dollar-denominated bonds have been the main source of funding for the province and OEFC in 2003-04, the OFA has successfully reduced interest costs by accessing foreign currency markets when favourable market conditions exist.

This fiscal year, the OFA has issued one euro-denominated bond and three US-dollar global bonds in addition to four foreign-currency euro medium-term notes, denominated in Australian dollars, Hong Kong dollars, Swiss francs and Japanese yen. The OFA maintains a flexible financing approach and will continue to monitor domestic and international markets, seeking out the most cost-effective borrowing opportunities.

The province borrows in any major capital markets where it's cost-effective to do so. In fact, the province's and OEFC's debt outstanding—the measure of all debt issued for provincial purposes and OEFC—consists of bonds issued in 10 different currencies across domestic, US, European and global markets.

The largest component of Ontario's debt outstanding is debt issued in Canadian dollars. The Canadian-dollar debt consists of over $112 billion in outstanding long- and short-term debt. Ontario's net debt, which represents the province's and OEFC's total liabilities, less financial assets, is projected to be $139 billion as of March 31 of this year.

The OFA takes a flexible and pragmatic approach to borrowing. Flexibility allows the OFA to take advantage of cost-effective financing opportunities, which is particularly important during periods of financial market volatility. The OFA will maintain its prudent debt management policies and practices to ensure that the province's debt portfolio is managed in the most cost-effective manner possible.

Refinancing maturing debt and bond redemptions remains the primary focus of the province's and OEFC's borrowing program. The province and OEFC have significant levels of maturing debt this fiscal year, at $13.3 billion, and over the next two years at $16 billion and $18.3 billion in 2004-05 and 2005-06 respectively. In order to minimize potential refinancing rate risk, the OFA is sensitive to the province's debt maturity profile when selecting the term for new debt issues. The OFA therefore aims for a balanced maturity profile by scheduling maturities for new issues into years that currently have lower levels of maturing debt.

The OFA manages the province's debt and liquid reserves prudently and cost-effectively. Annual financing and debt management plans are prepared by the OFA. Key factors which are taken into consideration include economic assumptions, interest rate forecasts, foreign exchange forecasts, target ranges for floating interest rate and foreign exchange exposures, and contingency plans for forecast errors.

We strive to be at the forefront of debt portfolio performance measurement. The cost-effectiveness of borrowing, debt management and investment activities are measured daily against benchmarks approved by the OFA's board of directors. This ensures management is aware of financial market volatility and obtains the necessary background intelligence to take immediate action.

As you can see from this slide, we are well within our exposure limits for both foreign exchange and interest rate exposure. You may be surprised on the foreign exchange side to see how small those numbers are, given how much we've borrowed in foreign currencies. The reason for that is that most times when the OFA issues debt in foreign currencies, it's converted back to Canadian dollars to remove that foreign exchange exposure.

Following the release of the Peters report in October, the Dominion Bond Rating Service, Standard and Poor's, and Moody's Investors Service all confirmed their AA ratings on the province. Ontario's current long-term credit ratings, as you can see from the slide, are all in the mid-AA range. Ontario remains the second-highest-rated province in Canada, behind only Alberta.

The Chair: That completes your presentation. We have a little less than an hour, so we are looking at about 18 minutes per caucus. We'll start with the official opposition.

Mr O'Toole: It's been a pleasure to get some real detail from the ministry people. I appreciate your ongoing work. I know Mr Baird will have more technical questions than I because he is the critic for finance, but I sort of have an appreciation for the implications for PSAB and I'm beginning to understand it. I think you've helped this morning.

There are a couple of things that I'm quite interested in. I'm just looking through some of the things each of the presenters said. I'm quite interested in the implications for the MUSH sector—the municipalities, schools and hospitals—under PSAB, and how we are going to, in compliance with Mr Peters, bring the public sector partners into the PSAB framework without a lot of unnecessary cost—that is, their fiscal year and all that stuff. We've seen now that the hospitals perpetually have been operated in a deficit, technically, and they get their grants too late. So every year when you write the cheque to the hospitals it's really to pay off the deficit. That's common practice, not a political statement here.

Is this going to be a one-year, in-year adjustment to bring them in line with the grants? We've committed to a three-year operating funding.

I'm also talking about the difficult communications for the now-government with school boards who are starting to realize that they have virtually no other source of revenue, so we own their debt. They had three school boards last year that had to be brought into compliance. You'll find you have more, because there's no accountability mechanism. They spend the money—and why wouldn't they?—for autism and things like that. I'm supportive, but how are you going to do it?

I think you understand the framework of what I'm talking about. How do you bring the MUSH sector into compliance with PSAB, and how is that going to show on the $139-billion accumulated debt? Are they in that number today? Are those MUSH sector people in the $139-billion debt? That may sound like a bit of a convoluted statement, but the province of Ontario doesn't spend the money. We only spend about—what?—I think $8 billion ourselves. The rest is spent by universities, colleges, hospitals etc. Hopefully you can untangle that one-year implication on the accumulated debt.

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Dr Christie: Let me attempt to do so, Mr O'Toole. The assets and the liabilities of the school boards, hospitals, universities, long-term-care facilities etc at the moment are not on our books because, as Gabe noted, they are not consolidated as part of our books. In terms of doing that, Gabe noted some of the challenges. Clearly the decision to do any of those has not been finalized. We have to look, in conjunction with the Office of the Provincial Auditor, at the merits of any of these sectors. In any case, this would not occur until the 2005-06 fiscal year, so there is some time to do that work and do the planning.

Perhaps I could ask Gabe to expand on that.

Mr Sékaly: I think the deputy noted the immense task this requires. All provincial governments across Canada are looking at this and speaking to the Public Sector Accounting Board in terms of the impetus and the rationale behind it. Clearly all governments want to increase accountability and transparency, and we have to discuss the way you do that with PSAB in terms of the reporting of the financial state of all these sectors. Whether that is consolidation to government's financial statements or another way of reporting on the activities of the sectors is still part of the discussions between ourselves, the auditor, and the Public Sector Accounting Board in other provinces as well. So that's a long way of saying there's still a lot of work to be done and seeing what is the objective of this recommendation. If the objective is to increase reporting to people, what is the best way of achieving that? Obviously, aligning fiscal years, aligning financial statements of that many organizations in Ontario with the province's, is a gargantuan, and could be an expensive, task. In other provinces it may not be, because they would not have the number of entities that we do.

Mr O'Toole: Just one comment before I give it to Mr Baird. Roughly 50% of our budget is health care. It would be my recommendation that you do that first. It looks like, in Bill 8, you're doing that. You're going to have the administrators of the hospitals reporting to the Minister of Health. That's a huge issue, big time, just the politics of it.

I'd defer the rest of my comments to Mr Baird.

Mr Sékaly: If I may, as well, I've brought copies of the second edition of a guide that may be helpful to you, which is a Guide to Financial Management Policies and Practices in Ontario.

Mr O'Toole: Is that the one we got last year?

Mr Sékaly: Yes.

Mr O'Toole: I've read it, but I'll be happy to—

Mr Sékaly: It's updated.

Interjections.

Mr Sékaly: It's just to explain to folks how our accounting works.

Mr Baird: You're giving us the guide that was put together that managers will use to govern the province?

Mr Sékaly: I'm giving you an updated—

Interjection.

Mr Sékaly: I'm not going to answer that.

Mr Baird: I've always been excited about the thought of being able to talk with friends on this side of the table as opposed to the other side of the table. I've been looking forward to this.

Let me say at the outset to you, Deputy, that you've got a very skilled team and we're very lucky to have the capable public servants at the Ministry of Finance.

I had some questions going back to comments the minister made. The minister said that everything is on the table and he wants a really informed dialogue with the people of Ontario, to get ideas and suggestions. Everything is on the table. Our caucus, on behalf of the 24 members of our caucus, put in an access-to-information request, which we got, but all the numbers were blackened on this. We wanted to know what the financial impacts of Bill 2 were, and we couldn't even find out for this year what raising the corporate income tax to 14% and the M and P rate to 12% would bring in, what impact the small business tax rate, currently at 5.5% and going to 4% by 2005, would have—cancelling the PIT reduction scheduled for January 2004, tobacco taxes etc. They were all blackened—I can show you here—basically saying they were budgetary information of the government.

These are now legislated tax increases in the province, from what they were to have been. Is there any reason why the committee wouldn't want to have that information, to know how much extra money raising taxes will bring in? I noticed the minister had a challenge out in the hall dealing with the $2.2 billion that his party had used during the election campaign. I think he's now quoting that these new tax measures will bring in $3 billion.

Dr Christie: I think the impact of the tax measures in Bill 2 was shown in the fall statement, and they're just being looked up at the moment.

Mr Baird: On January 21 we received a letter, and I'll give you the reference number if someone wants to look it up: it's G-03-0163-02. We got all this information and it was all blacked out. I know Mr Orazietti will want to know what revenue those tax increases will bring in. I was wondering, Deputy, if you might review the decision of Mr John Cannon, the coordinator, and provide this information—perhaps table it with the clerk of the committee—not just for the 2003-04 year but 2004-05, 2005-06 and 2006-07. I think the committee would want to have that information, and I know the minister would want us to have it. I assume this is an error. Would I be able to get that reported back?

Dr Christie: Mr Baird, I can look into that. I would point to page 60 of the economic outlook, which does give those numbers for 2003-04.

Mr Baird: Is that the cumulative number or the individual numbers?

Dr Christie: It gives them broken out.

Mr Baird: Why would your staff blacken them out, then? Could we get something in writing on that?

Dr Christie: Again, I'm not familiar with the document, so I'll look into it.

Mr Baird: With respect to tobacco taxes, the minister said in the House, when he tabled Bill 2, that the motivation for the increase in tobacco taxes was to discourage consumption—that was the public policy objective for doing it—and I read with great interest that the minister is going to count himself in as one of those individuals with a reduction.

For the revenue numbers on tobacco sales, when you're increasing tobacco taxes, how much of a reduction in sales did you anticipate, given that that was the public policy motive behind it?

Dr Christie: Normally, in developing those figures, we look at the literature, if you like, on the reaction of consumption to price. I think the literature I'm familiar with generally suggests that a 1% increase in price would be associated with about a 0.4% reduction in consumption.

Mr Baird: Did you budget that into your numbers?

Dr Christie: That's normally built in.

Mr Baird: Was it built in on the advice you gave to the minister?

Dr Christie: It was built into the numbers we used.

Mr Baird: You have budgeted for a decline in tobacco sales?

Dr Christie: In response to the price increase, yes.

Mr Baird: OK. Toby, do you want to continue?

Mr Toby Barrett (Haldimand-Norfolk-Brant): Did you also scope in along with that the change in illegal consumption of tobacco, because people do vote with their feet, so to speak, and purchase tobacco from illegal sources?

Dr Christie: It's tremendously difficult to measure, as you can imagine. That's essentially a kind of underground economy phenomenon, and it's extraordinarily difficult to measure and model and incorporate in a systematic way. Typically what's done in that regard, I think, is that we monitor activity, we monitor actions taken by the federal government and others; we compare notes with other jurisdictions; we try to get a handle on where that is and how significant it is and what kinds of actions can be taken to deal with it.

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Mr Barrett: So any deviation would probably be reported quarterly, whether you're above or below the projections?

Dr Christie: It's very difficult in the short term to anticipate what is happening or on a month-to-month basis to see what is happening to tobacco in response to a price change. Those price changes are often anticipated. There is inventory accumulation before the price increase and that is then run off afterwards. So it's hard to determine how much of any change is due to actual reductions, whether it's due to leakage into the underground economy or whether it's simply due to people using product that was stockpiled before the increase.

Mr Baird: I'd like to come back to access to information. We put forward another request—and I'll read the relevant section. I seek "any estimates of the cost of the implementation of the fall 2003 Liberal Party election platform initiatives as produced by the Ontario Ministry of Finance staff." Can I ask, have you or your staff costed out any document provided to you by the Liberal Party after the October 2 election?

Dr Christie: Not that I'm aware of, Mr Baird.

Mr Baird: Because the request was denied in whole.

Dr Christie: Obviously there would be certain elements of it that were part of the new government's platform and would have been looked at by ourselves or by the ministry. I'm not quite sure how to answer the question.

Mr Baird: In weighing these options—of increasing spending on part of the Ministry of Health budget, the environment, culture, what have you—would you not think it would be a good idea for all the members of this committee to have access to what those cost estimates were of commitments?

Dr Christie: Again, I'm not sure—I don't believe that a consistent set of such estimates exists. It's very difficult, as you'll understand. The cost depends critically on the nature of the design of the program. Those are often matters of detail. It also depends on the rate of implementation of the program. Without further details—

Mr Baird: If there is not a consistent, what about an inconsistent one? We put forward a request on December 3, received in the office on December 17 with 30 days to get back. What I want to do as a member of Parliament is to be able to say in the recommendations that we'll all consider, "Gee, this idea of capping class sizes in the early years at 20 students is going to cost a lot but boy, oh boy, is it worth it. I'm prepared to subdue other requests for new spending to match that." Or, "Gee, this promise on eliminating P3 hospitals has this effect." Would we be able to, as a committee, get the costing, however inconsistent, between ministries or between promise or public policy suggestion?

Dr Christie: If you have requested it under freedom of information, I don't think I'd go beyond that. As I said, I'm not certain of what exists, nor am I certain of what would be of any help to you.

Mr Baird: Well, it just was denied in whole by your ministry. Would we be able to get clarification on that? You can cite cabinet records or the economic interests of Ontario, but these are public policies that have been put forward to the people of Ontario and I think the people of Ontario who pay taxes would want to be in on that advice so that we can make responsible recommendations to the minister, to the government. Would you not agree?

Dr Christie: Again, I can only speak to the facts as we have them, and I can look into that and look into the nature of the request that was made.

The Chair: Thank you, and we'll move to Mr Prue.

Mr Prue: I'm going to continue in a little of the same vein. You made an excellent presentation for today. I tried to write as quickly as I could, but we don't have copies of it. I wonder, is this too a secret or can we have copies?

The Chair: Would you mind tabling copies of your presentation for all members of the committee?

Dr Christie: Yes, we can do that. If we don't have copies with us, we can—

The Chair: You'll provide them. Thank you.

Mr Prue: And the copies that you are going to provide to us would be generally available to the public so the public can see what our debt ratios are, how much money we have, changes in the nominal GDP and everything else you said? Nothing in there is some kind of state secret?

Dr Christie: No, and in fact most of it is contained in the background documents.

Mr Prue: I did find some of it here, but some of it was much newer. Some of it had been tweaked over the last couple of months.

Dr Christie: Yes, there have been some modest updates, but primarily the information is here.

Mr Prue: All right. Having said that, I have a number of questions. I don't remember—perhaps I had to step out very briefly—seeing what our debt ratio is. I have watched with some interest the debt ratio federally declining over the last number of years, so that although the debt still seems to be in huge billions and trillions of dollars, the actual debt to ordinary Canadians has declined to—I think 25% is the number that rings true. Can you tell me what it is in Ontario and whether or not it will be declining over the next four-year period, given the scenarios you've outlined.

Dr Christie: There are a couple of places in the information that have those numbers, but I would point you to pages 52 and 53 of the background document tabled in December. That shows our net debt as a per cent of GDP, which is at about 27.7% this year, down from a peak of 32.9% in 1999-2000.

Mr Prue: That is more or less consistent with what the federal debt ratio is too, as I remember.

Dr Christie: I don't recall the federal measure right offhand.

Mr Howell: I don't have it offhand.

Dr Christie: I think it's higher.

Mr Prue: It's higher than the federal—

Dr Christie: I think it's the other way around.

Mr Howell: We'll get that.

Mr Prue: You'll get that. OK. But at 27%, is this something that should cause concern to Ontario residents? I saw some grimaces when we saw the actual dollar amount up there. Is that anything that is cause for concern by your ministry?

Dr Christie: It's certainly the case that the debt level and the associated interest costs are matters that are a challenge, often, in budgeting. The interest cost is interest that needs to be paid, which is one of the reasons that a balanced fiscal position is something that governments across Canada have pursued vigorously over the last several years. I think, as Gadi's information noted, over the last few years our AA rating has been consistent with this sort of level. It is declining, and I think that continued decline is consistent with a strong financial position as measured by the federal government.

Mr Prue: I would agree generally, but going back to the year 2000-01 on that same chart, it was at 30.1%. What would happen to our economy, what negative things in the budget would that bring if we went back to that kind of ratio? I'm speaking in terms of, the options open to this government are to not balance the books or to maybe borrow money or to do other things for those 230 promises. What would be the consequences of sending it back there, just to where it was three years ago?

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Dr Christie: Clearly, the first impact would be substantially higher interest payments, which would over time accumulate. Because interest is the first thing you have to pay, it ends up competing for scarce budget dollars that would otherwise go to services. So that, I think, is probably the first impact. The second impact would be whatever the statement about the underlying fiscal policy of the government in question was in terms of the western economies that have been trying to get debt down. To say that we're going to target for higher debt would not be consistent with the fiscal practices that a lot of jurisdictions have taken as part of trying to manage a strong economy.

Mr Prue: My next question goes to the combined corporate tax rate. We saw that the combined corporate tax rate for Ontario is below that, I think, of every other jurisdiction in the Great Lakes states, and certainly much below the average. Would the return of a corporate tax rate to 15.5% from 14% hurt Ontario's competitiveness? That's sort of back where we were just a few years ago.

Dr Christie: Again, as the minister noted, competitiveness depends on a number of things and a number of facets of the tax system. As was noted, our corporate tax rates are now competitive.

Mr Prue: More than competitive. I mean, we are the lowest. If we were to raise those back up, is that a source of revenue this government could count on without damaging the economy?

Dr Christie: I can't comment on a specific tax increase. Certainly the government has indicated a desire to avoid such tax increases if possible. Again, in comparison with some other jurisdictions, France is lower; Sweden is lower. It really depends on the circumstance. One of the things we're seeing now is that with the significant appreciation of the dollar and the challenges it poses, anything that would put further costs on businesses that are trying to cope with the rapid appreciation of the dollar could be a challenge.

Mr Prue: You indicated that Ontario is losing manufacturing jobs because of the high Canadian dollar. Then there was some other discussion that if the dollar stays around 78 cents—I forget what that 78-cent reference was, but that's more or less where we are today in terms of competitiveness—will we continue to lose manufacturing jobs in 2004? We went from—what was it?—18% down to 17.5%. I think that was the number.

Dr Christie: Perhaps I'll ask Phil to comment.

Mr Howell: The effect of the dollar is certainly going to have an impact on manufacturing. It has already started. It's likely, as I said in my earlier remarks, that as companies respond to that reality, plus having the additional incentive to invest in productivity-enhancing

M and E investment—because much of that is imported and is therefore cheaper, with the higher dollar—there are likely to be impacts on manufacturing employment moving forward as part of the normal ebb and flow of businesses deciding on the appropriate mix of capital and labour that they have in their production processes.

Mr Prue: Mr Chair, how much time do I have? I have a couple of important questions.

The Chair: You have about six minutes.

Mr Prue: OK. Then I've got time just to add a little supplemental to one. Is there anything Ontario can do? I mean, these are world trends, Canadian trends. What can Ontario do about our high Canadian dollar? Nothing?

Mr Howell: A couple of things in response to that. It's certainly the case that the story around the dollar at the moment is primarily a story around what's happening to the American dollar relative to other currencies.

There are some things that governments can do, starting with the Bank of Canada ensuring that we don't enhance the appreciation of the dollar by having inappropriately high interest rates.

Mr Prue: I understand what Canada can do. I want to know what Ontario can do.

Mr Howell: In terms of what the province can do, you certainly want to recognize that you're in an environment where you don't want to be adding to other business costs as they grapple with the effects of the exchange rate. You want to also ensure that other factors that influence business decisions are in place. Those factors, certainly in terms of attracting investment in this kind of environment, are going to include things like ensuring appropriate infrastructure is in place, ensuring that where there are barriers to the movement of goods—for example, border-crossing situations and so on—you can certainly take a look at a wide variety of factors that can help businesses improve their ability to produce and get goods to market.

Mr Prue: My question on this one is a bit of a tough one, so I'm hoping it can all fit in. Assuming a balanced budget and no new increases in taxes of any kind for 2004-05, which is what we're being led to expect, my first question is, what kind of cut in government spending would have to take place, or in the alternative, what increase in non-tax revenues would have to take place, in order for this to happen?

Dr Christie: There were some figures included again in the fall statement. I think Gabe can point you to them.

Mr Sékaly: On page 42, and I went through it in my presentation, there's a chart there saying that if one wants to balance by 2004-05 on the spending side alone, total spending has to decline by 2.6% from this year's level, which is approximately $2 billion. If you want to balance by 2005-06, spending growth has to be on average 1.3% per year. If you want to balance by 2006-07, spending growth has to be on average over the three years 2.3% per year, versus what we had in the last four or five years of approximately 4.6%.

Mr Prue: Last fall, we were not in the same kind of economic situation we have. The last quarter has been kind of kind to us. Have these numbers changed any since last fall?

Mr Sékaly: These numbers actually came out in mid-December, so there has at this point in time not been a change.

Mr Prue: OK, so there's no change in that estimate. Has your ministry advised as to what kinds of cuts to the $2-billion budget would be most appropriate?

Dr Christie: I think the process that the government has indicated it is going to undertake in this regard is to engage in a series of discussions. The government has begun, for example, a consultation with the Ontario public service. The minister referred today both to his pre-budget process as well as to a larger process.

Mr Prue: I understand all that, but my question is—you're part of the public service too—have you given that kind of advice to date, where that $2 billion might be found? I know you won't tell me what you've said, but have you given that advice?

Dr Christie: I think you'll understand, Mr Prue, that the discussion of what advice may or may not have been given—

Mr Prue: I'm not asking for what advice; I'm just asking, have you advised where that money could be found?

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Dr Christie: We certainly, as part of our ongoing job as the Ministry of Finance, ensure that the minister and his colleagues understand where money is spent and how it is being spent.

Mr Prue: This has already been part of the minister's briefing and where he and his officials might be going, notwithstanding what we're going to go around the province and ask?

Dr Christie: As I said, what we do is make sure that the minister has information on how money is being spent. We track it as it goes. Any options that may be looked at by the government, and certainly any decisions the government would take, would be part of the series of consultations you referenced earlier.

Mr Prue: Do I still have time?

The Chair: About a minute.

Mr Prue: Good. OK, one last question. It's a very brief one, and it has to do with Bill 2. The original estimate was that was going to raise some $2.4 billion. It was actually $2.9 billion, and then there was a $500-million revenue shortfall that took it to $2.4 billion. Today the minister said that about $3 billion was being saved. Is that due to the fact that the revenue shortfall is now gone, or is that due to increased revenue in each of these line items?

Dr Christie: I'd have to check on that, Mr Prue. I don't have that information.

Mr Prue: Do you have any information that it is in fact $3 billion today?

Dr Christie: I don't have it.

The Chair: We'll move to the government caucus and begin with Mr Crozier.

Mr Crozier: Good morning. Can you tell me a couple of, I think, relatively easy things to begin with: What was the provincial debt in fiscal 1994-95 in round figures?

Dr Christie: In fiscal 1994-95, the net debt of the province was $90.7 billion, compared to the projected essentially $139 billion noted earlier.

Mr Crozier: OK. In eight years or so, the provincial debt has then gone up almost $50 billion.

Dr Christie: Between 1994-95 and 2003-04—that would be correct.

Mr Crozier: Yet we've been told that over that period of time, there were five balanced budgets. That must have meant there were some pretty significant deficits. Were those early in those eight years, or was it later?

Dr Christie: There were two main, let's say, trends, between 1994-95 and 1998-99. There were deficits in the province's books that caused the debt to grow to about $114 billion in 1998-99. Beginning in 1999-2000 there were surpluses, but the figures in the fall outlook note that with the changes made to the electricity sector, the government of the day took responsibility for about $20 billion in net terms of the stranded debt of the electricity sector that came on. So $20 billion of that $50 billion would be bringing on the electricity sector.

Mr Crozier: So the $90.7 billion doesn't include Hydro, but the $139 billion does, and it's about $20 billion.

Dr Christie: That's correct.

Mr Crozier: So the net result is—and I agree with having brought on the Hydro debt—that the debt did grow about $50 billion in the last eight years.

Could you help us a bit by giving us the figure as to what the hospitals', universities' and schools' debt figures were that they didn't have in 1995, I understand, because we simply gave them the money for what they were—can you tell me the year we started to have those sectors borrow the money and record their own debt, as opposed to the province, and what that debt might be today?

Dr Christie: I don't have a figure on the debt of those organizations. I'll ask Gabe to comment more on it. Depending on the sector, they may run deficits; they may pay them off the next year etc. So it's difficult to say as a matter of course.

Mr Crozier: I'm thinking as much about capital debt. In other words, what year was the decision taken to have capital debt recorded as debt of hospitals, universities and school boards as opposed to the way we used to do it; and, if you can, what has that debt amounted to since that time?

Dr Christie: The debt incurred by a hospital or school board has always been on their books and not ours for as long as we've been on the former cash accounting system, which probably started some time in the 1960s. There have been some changes, for example, to the funding formula for elementary and secondary schools in which, rather than being given a capital grant each year, they are given a payment for the amount of space they need and they can then use that to either refurbish space or acquire space etc.

Mr Crozier: But did they not have to go out and borrow money for capital expenditures and record it differently than they used to, or are you simply saying, "No, that's not the case"? I'm talking about this term "off-book debt," as my colleague Mr Phillips called it.

Dr Christie: As a result of the change in the way in which school capital was funded, there was more debt accumulated at the school board level than there would have been had it been all funded upfront by a grant.

The hospital system is quite variable, on a hospital-by-hospital basis. Perhaps I'll ask Gabe to expand on that.

Mr Crozier: I think you know what I'm getting at. I'm just getting at seeing if there's an increase in debt there that we all owe, so therefore would it increase that $50 billion; that's all. If we're not, that's fine.

Mr Sékaly: The Ontario Hospital Association has made the case—and we do mention it a little bit in the fall statement—that there has been an increase in what they call the accumulated working capital shortfall, which is basically an accumulation of operating deficits, so not the one for construction of capital. Their estimate is about $1.2 billion for that. Obviously, hospitals as well have capital debts as they construct new facilities. We do provide the bulk of the money through different capital grants, but the hospitals are responsible for raising a local share, so they may not have the local share upfront and they may take on debt for that purpose. I don't have a total number for that.

It's the same thing on the school board side. As Bob noted, the funding formula was changed and school boards are provided with per pupil grants for spaces, so they float a bond or get a loan and they get the money to service that through their annual grants from the province.

Mr Crozier: I won't belabour the point. I guess it's enough to say that over eight years the provincial debt has increased some $50 billion.

One short and final point: I know that you as a ministry, and all of you do it in a professional way—as you have just said, Mr Christie, you give advice on an ongoing basis to government. But I find it interesting that the information you've brought forward as a ministry today—and just simply tell me if it's a fair statement—would support the conclusion, if not line by line, albeit in total, that the former Provincial Auditor, Mr Peters, brought forward from arm's length, that being that the projected deficit, with no changes, would be $5.6 billion. So you've confirmed the figure that he brought forward in the fall.

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Dr Christie: Based on what he found, and changes since then, as we note, the $5.6 billion remains the projected deficit.

Mr Crozier: Thank you.

Mr Colle: Just briefly, Mr Deputy Minister, what does it cost the Ontario taxpayer every year to service that $139-billion debt?

Dr Christie: The outlook for this year for interest expense is $10 billion.

Mr Colle: It's $10 billion that goes toward interest payment. In terms of spending over the last eight years, either on an average year by year or over the eight years, how much did provincial spending go up?

Dr Christie: On average over the last four years, I believe it went up 4.6%. I don't have the—

Mr Colle: That was 4.6% every year?

Dr Christie: Yes, from 1999-2000.

Mr Colle: So in essence, about a 16%, 17% increase in spending over the last four years.

Mr Sékaly: In the fall economic statement, on pages 52 and 53 there's a table that provides that detail in terms of program spending. In 1994-95, for example, in terms of programs, not including capital or interest, we were spending $44.5 billion. In this fiscal year, the projection is $62.5 billion.

Mr Colle: So over the last number of years, the pattern has been to increase spending, to increase the debt, thus you're increasing more of your costs through the service charges, and then the other, parallel activity was that they were essentially forgoing revenues by tax cuts. Maybe Mr Howell, who is the economist, can say, if you're looking for advice to give other jurisdictions or to give us as we're looking at ways of perhaps managing this financial challenge here: What do you think about the previous government's strategy of in essence increasing spending, cutting taxes and increasing debt? Should we proceed down that route or is it possible to continue on that road to achieve any kind of financial stability?

Dr Christie: I think, Mr Colle, that—

Mr Crozier: Go ahead and answer.

Dr Christie: I don't think I ought to be passing any value judgment in that way.

Mr Colle: As an economist, I'm saying.

Dr Christie: One of Gabe's slides had a picture that illustrates some of the trends of the last few years specifically, and this is a graph that's on page 32 of the fall statement. It shows over the past three or four years very little growth in tax revenue, about half a billion dollars' growth in tax revenue, which is year in, year out what you can count on—it's not under somebody else's control, like federal payments—with about a $10-billion increase in program spending. A trend like that—obviously, spending growing faster than revenue will inevitably lead to a deficit.

Mr Colle: Just one other question, I guess of the assistant deputy minister, Mr Howell. Are you referring to the effect of relationships between the value of the Canadian dollar and manufacturing job growth? If you were to put another line on your graph to superimpose the introduction of NAFTA and the expansion of free trade, would you see almost a parallel series of lines, in other words the NAFTA growth and the dollar increasing in value? Would that almost be similar in terms of a growth trend?

Mr Howell: I'm not sure I quite understand.

Mr Colle: In other words, I'm trying to find out whether the expansion of free trade had as much to do with the increase in manufacturing jobs as did the greater value in the Canadian dollar as opposed to the American dollar.

Mr Howell: The introduction of NAFTA in Ontario actually gave Ontario a tremendous opportunity with manufacturing employment growth. In fact, through the second half of the 1990s and until fairly recently, Ontario was the only jurisdiction among G7 countries that was actually increasing manufacturing jobs in relative terms. Around the globe there has been a tendency for manufacturing sectors in developed economies to be losing ground as the service sector side of the economy grew. In fact, because of the increased access that we've had to North American markets, coupled with the fact that the dollar did decline through the 1990s, our manufacturing sector improved significantly.

Mr Colle: Was it more based on NAFTA than the value of our dollar?

Mr Howell: It's hard to disentangle the two effects. One thing is clear, though: There is still further rationalization and integration that will happen because of the NAFTA agreement. The extent and nature of that will be viewed in a different way by businesses now that the dollar is in the mid-70 cents than it was when it was at 62 or 63.

Mr Colle: So I guess the challenge is, as NAFTA sort of gets rationalized and those changes get stabilized, and then we've got the opposite effect of the dollar now increasing in value, what the impact will be on manufacturing jobs. The trend right now seems to be going in a negative direction for us in Ontario, as opposed to the last 10 years, when it was going in the opposite direction.

Mr Howell: That's correct. But again, the two to some extent are offsetting because there is still going to be future potential for Ontario businesses on the manufacturing side, if they can be competitive, if they can increase the amount of investment. In the last several years our businesses' machinery and equipment investment on a proportional basis has lagged that in the US. That's one of the reasons that our productivity lags the US. So to the extent that we can improve productivity, there will still be gains to come from the increased access that we have to the US market, even with a stronger dollar.

Mr Colle: So really the key is innovation, productivity, upgrading machinery and technology.

Mr Howell: And the good thing is that that machinery and equipment is cheaper as a result of the higher dollar.

Mr Colle: There's a silver lining in every cloud.

The Chair: Mr Peterson.

Mr Tim Peterson (Mississauga South): At one time, 3% unemployment was considered full capacity in the economy. I think for most of the last 25 years it was running at about 6%. Does this create a higher cost for all our social services? Is there any way to monetize that in terms of a program for us to reduce unemployment?

Dr Christie: I think that the higher unemployment rates that we've experienced for probably the last 20 or 25 years have had their costs associated with them.

Usually, when people think about how you get that core unemployment rate or structural unemployment rate down, the things that people think about are a better-educated work force, training or retraining of people so that their skills are relevant in an economy like ours with a large immigration flow, programs to ensure that new Canadians and new Ontarians have access both to the skills and the recognition of skills they may have required elsewhere, which are all things that I think can be helpful in reducing that structural unemployment rate. Those are the sorts of things economists typically point to.

Mr Peterson: Other countries, like the United States, have lower rates. Is that because they account for it differently or because they are better managers?

Dr Christie: The US has traditionally had a lower rate—I'll ask Phil to comment on the details. They've usually had a lower rate of labour force growth as well, so they haven't had to absorb the growing labour force we have, which may have had some effect. I'll ask Phil to deal with it.

Mr Howell: There are a lot of factors that go in, some of which are the ways in which rates are calculated. But there are a number of factors that affect what might be called the full employment rate of unemployment in an economy. What's interesting to note is that the gap over the past 20 years, in which the Canadian unemployment rate has been quite considerably higher than the US rate, has narrowed significantly, and we're a lot closer now than we were, say, in the mid-80s or the mid-90s. The US unemployment rate in December was 5.7%; ours was 6.7%. Gaps of 3% and 4% were quite common a decade ago.

The Chair: I want to—

Mr O'Toole: On a point of order, Mr Chair: [inaudible] the record to remain unclear on the reporting of the accumulated debt. I believe that Mr Crozier's inquiry and the response should indicate that in the first three years of government, we had a transitional deficit and the $20 billion—

The Chair: It's not a point of order.

Mr O'Toole: —so there was no $50-billion growth in the debt, and I want that on the record.

Interjections.

The Chair: Order. Thank you, gentlemen.

I want to thank the deputy minister and his staff for appearing before the committee for the last two hours. I appreciate your attendance on behalf of all committee members.

Interjections.

The Chair: Order.

I appreciate your being here this morning.

I have a few announcements for the committee, if you care to hear. The room will be made secure by the clerk, so you may leave your belongings here. As well, we are going to try to arrange for the bus charter to Niagara Falls to occur at 4:30 pm rather than the previously announced time, because of the weather.

With that, I would ask you to also come back to the committee room on time this afternoon so we can greet our presenters in a timely way and also allow staff to load the charter bus so we can go to Niagara.

We stand recessed until 1 pm.

The committee recessed from 1203 to 1311.

SCOTIABANK

The Chair: Our first presentation this afternoon will be by Scotiabank. Would you please come forward and identify yourselves for the members of the committee and for Hansard purposes. You have an hour, which can be made up of your presentation and questions, if you care.

Mr Warren Jestin: My name is Warren Jestin. I'm the chief economist at Scotiabank. With me is Mary Webb, one of our senior economist managers and a specialist on both the provincial economy and fiscal matters. I'd like to pass out, if I could, a copy of a report that we have prepared for the committee which outlines both our views on where the economy is going over the next year or more and also on the fiscal challenges that lie ahead. If I might just paraphrase parts of the report, then questions and answers would follow it up.

For the first time since the late 1990s, a synchronized global expansion is underway, with the US leading and China really coming on strong, throwing its weight into the economic expansion—very good news for Ontario, particularly the US economic expansion, which we expect to be 4.5% or perhaps even a little higher. China we expect to be growing roughly at 8% or so, which is roughly in line with where they have been over the past decade.

The good news comes in that expansion because of our very close linkages to the US economy, and with China improving as rapidly as it is, it's helped commodity prices, in particular the metals sector and the industrial side of production globally.

The improving economic prospects, particularly south of the border, will provide some support for Ontario because we're so closely linked into the US economy. In fact, we expect growth in Ontario to be roughly 2.5%. A significant part of our manufacturing sector will benefit from the growth. However, we still face a lot of headwinds in that sector from a rapidly appreciating Canadian dollar, competition from ultra-low-cost producers such as China and India and higher energy costs. Uncertainty surrounding timely cross-border access also clouds the horizon.

Looking at the household sector in Ontario, especially the demand for big-ticket items, we expect to be relatively buoyant this year, underpinned by low borrowing costs, discounting and other incentives. We believe the Bank of Canada is going to lower interest rates further. Our interpretation of their announcement last week is that they're concerned about the rising currency and they expect inflation to stay well below their 2% target. As a result, we expect at least another quarter percentage point decline in rates as we go into the spring.

We don't think there's going to be a significant change in longer-term mortgage rates or bond yields over the next year or so. There might be a slight upper trend in the second half of the year, but by and large we expect them to remain very, very low by historic standards.

At the same time, the need to cut costs to offset the impact of currency appreciation will temper job creation in the large export and hospitality sectors, taking the edge off consumer confidence. So while purchases of big-ticket consumer items and housing-related activity should be buoyant, in our view the rate of growth in overall spending is likely to remain fairly modest.

Business investment in the province is already picking up and should continue to do so as firms move to boost productivity and replace older equipment that was put in place in the lead-up to Y2K. Our stronger currency has not only increased the need to improve efficiency, but has significantly reduced the cost of imported capital equipment that can help accomplish this objective. Nevertheless, the upswing in spending will be dampened by cash flow constraints as currency appreciation cuts into the bottom-line performance. While non-residential construction will be held back by high vacancy rates, in many areas, spending will be supported by investment in the province's transportation infrastructures.

The bottom line here so far is that we expect consumer spending to be buoyant but to show little growth, and business investment, particularly machinery and equipment, to be picking up. Even with the buoyancy we're expecting in consumer demand and capital spending, however, provincial growth, in our view, will be hard pressed to reach much over 2.5% this year, lagging the 2.7% increase we expect for all of Canada. Another subpar performance, again falling slightly below the 3% national average, is expected in 2005.

With overall growth lagging by about half of what it was in the late 1990s, the current fiscal setting will not generate the revenues needed to repair provincial finances. The province will have to thoroughly overhaul the structure of both its revenues and expenditures to bring the budget back into structural balance. On a longer-term basis, the restoration of sound finances is an essential ingredient in protecting both our competitiveness and our standard of living.

The export sector accounts for roughly two thirds of provincial output and is highly geared to the US market. Over the past year, our currency has appreciated by over 20% against the US dollar, and it appears set to move above 80 cents in the months ahead.

Recently, we've had a depreciation of the currency, and other currencies have moved down against the US dollar. We do not expect that to be the dominant trend. In fact, we expect the currency not only to move above 80 cents but perhaps go into the low 80s—82 or 83—sometime over the balance of the year.

It's important to recognize that this isn't a phenomenon unique to Canada. The euro, the yen and the Australian dollar are also all appreciating rapidly and will continue to do so as global investors look at their overweight position in US dollar assets and decide to reposition themselves somewhat, given the huge American trade and fiscal deficits that in my view show no signs of going away over the next year to two years.

For the resource sector, the rise in commodity prices has provided an important offset to the revenue losses associated with currency appreciation. This is assisting a number of sectors in Ontario. However, although prices for petrochemicals and commodity grade plastics, also an important segment, have edged up, the margins in that sector are still being squeezed by currency appreciation, higher natural gas prices and low operating rates. It's a very mixed bag, even in the resource sector.

Unambiguously, however, I think the manufacturing sector is being squeezed. It accounts for the bulk of our exports. The manufacturing sector has virtually no pricing power because of increasingly intense competition from low-cost producers.

I'd like to point out a couple of things about the China factor that we increasingly hear about on the radio and TV and in the newspapers. China has now surpassed Japan and Mexico in terms of its share of US imports. I believe they will continue to increase market share over the next decade and also be moving rapidly up the value-added curve. Over one quarter of China's exports are now machinery and equipment, surpassing their share of textiles, clothing and footwear. With many Mexican firms recently hard hit by Chinese competition in the US market, that country may increasingly move into a higher value-added slot, stressing just-in-time delivery. This will bring many Mexican producers into greater competition with Ontario producers in the years ahead.

It's interesting to note that the Mexican peso is one of the few currencies that has actually lost against the US dollar; it's dropped about 25% against the Canadian dollar over the last 12 months. This is one of the indirect effects of increasing competition in the US marketplace from China. It's going to force other producers in areas that have been hurt to actually move into Ontario's market space.

Relentless profit pressures have triggered widespread action to crunch costs, leading to a net reduction of 65,000 workers on Ontario's manufacturing payrolls over the last 13 months or so. In this environment, private sector wage settlements in the province are coming under increasing pressure as well. With our currency likely to continue along an upward trajectory, crunching costs, downsizing, streamlining and consolidation will probably loom large in our manufacturing and export sectors through 2005. This is not a temporary phenomenon in my view.

In the motor vehicle sector, which accounts for nearly half of provincial exports, output is forecast to edge up slightly this year, offsetting roughly half of last year's decline. Our North American production is highly integrated, and these gains largely reflect a near-term buoyancy in demand for vehicles south of the border and the particular mix of products that we produce. Nevertheless, our industry is vulnerable to a near-term stalling out of US sales, because American households own newer cars and more cars than ever before. In statistical terms, for every 1,000 Americans of legal age to drive there are 1,016 licensed vehicles on the road. So the amount of pent-up demand there is not too great by any means.

On a longer-term basis, the challenge is to sustain our large share of North American vehicle production, which at 16% is twice our share of North American vehicle purchases at a time when international competition for assembly and parts facilities is greatly anticipated, particularly as producers build in the view that the currency isn't going to be in the 60s but may well be in the 80s. It changes fundamentally the decision-making process with respect to the location of plants.

On a brighter note, demand for high-tech equipment and information technology is reviving—very good news for Ontario—particularly for semiconductor and wireless equipment, as well as PC and server upgrades.

Activity in the financial sector is picking up with the rebound in capital markets globally, and stronger global economic prospects bode well for business services. Demand for scientific and technical personnel in key areas such as systems design has improved. As manufacturers and other industries outsourced their back-office functions, management and administration services also expanded, adding about 32,000 to provincial payrolls over the last year. So there's been some offset.

Nevertheless, the service sector is not immune to competition headwinds. Ontario must now compete with low-cost locations such as central Europe for film and TV production and may face increasing incentives from California. While our large and diverse hospitality industry has rebounded from the depths of the SARS crisis, cross-border traffic will inevitably be dampened by currency appreciation and increased travel delays and inconvenience. More generally, the risk of protectionism and reduced market access continues to cloud the horizon. In addition to trade disputes or restrictions affecting beef, wheat and lumber, there is considerable uncertainty about just-in-time access to the US market during periods of high terror alert status. For all industries in the province, ensuring a dependable, competitively priced supply of electricity also is essential.

Longer-term fiscal health also is a key competitive advantage, particularly at a time when the US is running such massive deficits. However, actions being taken to sustain Ottawa's surplus and regain control of provincial finances, whether it's here or Quebec or British Columbia, inevitably will impose a near-term drag on provincial performance. Much of the employment gains in 2003 reflected actions taken to deal with quality deficits in health care and education. This stimulus will be largely absent, in my view, over the next two years.

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Turning now to the fiscal issues: In the upcoming budget, the new government must set out a clear road map to eliminate a gaping deficit while restructuring spending to ensure that available funds are directed to programs and initiatives with the highest priority. The sheer size of the budget shortfall indicates that incremental adjustments and program fine-tuning are inadequate to ensure success. The task is made more difficult by the challenges confronting Ontario's electricity sector. That's a burden not faced by British Columbia and Quebec, which I mentioned are the two other major provinces seeking to rein in their substantial fiscal shortfalls.

After years of debt accumulation in the 1990s, Ontario's debt service burden also significantly exceeds the provincial average, and at an estimated 14.4% of budget revenues is more than double the comparable figure for BC. That's important because we compete for manufacturing, we compete in a number of areas, with other provinces such as BC and Alberta, which have much lower debt burdens.

The province's estimate of a $6.3-billion increase in net debt for fiscal year 2003-04 is expected to lift the debt service cost back above $10 billion, even with the lowest interest rates we have seen in a generation. Ontario must utilize this current window of opportunity with respect to low interest rates not only to rebalance the budget in the near term but to eventually begin reducing its substantial debt burden. Failure to do so would leave the province highly vulnerable to an eventual rise in borrowing cost that would ramp up already high debt service costs and significantly limit the government's ability to manoeuvre in what has become a rapidly changing and highly competitive global environment.

As to suggestions of how to do this: An aggressive plan to rebalance the budget over the next year, in my view, carries considerable risks for the provincial economy because of the pressing competitive adjustments already needed to deal with a soaring Canadian dollar. In our view, a three-year agenda to eliminate the $5-billion-plus shortfall, with clearly delineated annual performance benchmarks, is achievable in a slow-growth environment. If growth is higher than expected, the extra revenue should be used to shorten this time frame. Failure to stay within this time frame would risk pushing Ontario's debt burden further out of line with other competing jurisdictions.

We recommend also that the government consider a larger contingency reserve, particularly in the initial years, to provide an added measure of protection from unexpected setbacks. If unused, the deficit could be eliminated more quickly by applying this extra cushion.

Apart from the risks of more negative economic or financial market outcomes, there may be further surprises revealed by the ongoing effort to comprehensively assess extended government operations and liabilities, including audits of agencies and partners in hospitals, universities and colleges.

We applaud the official commitment to greater transparency and accountability, although the outcomes of all these factors—OPG issues and the like—are really not fully known at this time, so we believe that a higher contingency reserve is appropriate.

A pickup in provincial tax revenues would ease the process of fiscal repair. Several signs are already encouraging: the expectation of somewhat stronger real growth in Ontario after last year's very disappointing performance; the upswing in North American equity markets; the rebound in sales tax receipts from SARS-related setbacks last year; and the continued support to land transfer taxes from a buoyant housing market. A slightly stronger economy will raise the revenue impact of the government's tax adjustments. Nevertheless, the outlook for annual GDP growth in the 5% range over the next few years effectively caps the gains in revenue without further policy adjustments.

In the near term, our forecast for Ontario is slightly more cautious than the consensus, particularly for important variables such as wage and salary increases. In our view, with many corporations restructuring and the federal and provincial governments committed to holding the line on their payrolls, wage growth in 2004 and 2005 may fall short of the Ontario government's projected 4% rise in 2003 and beyond.

Ontario does not have Alberta's advantages—enormous resource revenues and a net asset revenue-generating position—to meet the expense of servicing the province's considerable population and industrial growth over the last seven years. However, it has inherited an enormous backlog of capital projects needed to sustain and improve our competitive advantage.

Closing this quality gap will require close co-operation with federal and provincial governments on funding, the elimination of red tape and actual project execution. I think this is a big area for potential improvement. Decades of delay in maintaining adequate spending on urban and regional infrastructure really do underline the need for fundamental reform. With Ottawa and Ontario municipalities already reassessing their expenditures for possible savings, a window of opportunity exists here to disentangle some of the program responsibilities and eliminate duplication.

In the upcoming period of intensive fiscal repair, key priorities lie in addressing the quality deficits in transportation, health care and education and placing the province's key social programs on a more sustainable track. Only then will the province have the flexibility to reduce debt and once again embark on new directions in tax reduction and spending initiatives.

I would be pleased to take questions on any of the issues we talked about.

The Chair: Thank you for your presentation. We have about 11 minutes per caucus. We'll start with the official opposition.

Mr O'Toole: Thank you very much, Mr Jestin and Mary, for your presentation to the committee. I'll be kind of brief. I'm asking these more perhaps as a critical comment, but I'm not an economist, so take it from where it comes.

I guess the first thing is just on the monetary issues, looking mostly at the federal jurisdiction, and the recent response on the interest-rate-to-the-dollar position and its impact on trade and balance of trade. You're putting in here that you're confident that an 80-cent dollar will prevail.

Mr Jestin: Or higher, yes.

Mr O'Toole: I would guess—and again, I'm not being contrary. It's tied to the second part of what I want to say, but I know all the experts are saying that. I think we've already hit that. We never hit the 80 number, and everybody was forecasting it. The anticipation has been there for the last quarter at least, maybe more. The feds now have looked at the interest rate policy and David Dodge has just recently announced a more aggressive reduction of the interest rate, which has a lot of implications with respect to recapitalizing the infrastructure, as well as the cost of debt itself, the cost of borrowing money for the province and other stakeholders. So I'm not supportive of that projection, which has profound implications, as we saw this morning with the ministry people. It's pretty important.

Tied to the second part, probably the Ontario economy—I'm putting this as a question. It's my sense that Ontario is about 30% of the population of Canada and about 50% of the economy of Canada. So tax competitiveness in the purest sense, that is, monetary policy as well as direct tax policy, is an extremely important control, both provincially and federally, which stimulates investment. Quick depreciation or whatever measures they want to take are important.

Am I correct in assuming, first, that the Ontario economy, which is an export-based economy—about 60% of our GDP is based on it—is well-positioned to maintain—because you said the feds have a surplus. There's an imbalance here on tax power, I suppose, because—and I think I'm right—about 50% of the total Canadian economy is Ontario. If that's the case, the policies, federally and provincially, have got to reflect a manufacturing, export-based economy. Yet the last bill that we debated in this very committee, Bill 2, ended up leveraging about $3 billion more, basically out of small business.

I like to read the Toronto Star because it is usually wrong, but it says, "The new Ontario Liberal government's cancellation of corporate tax cuts provided by the previous Conservative administration increased the company's taxes and future tax liability by $17.8 million." This is in the entertainment sector, which has been hard hit by SARS. What's your response to that in terms of the current trend? It seems this morning Mr Sorbara said he would not increase personal tax. Well, the only other way to sustain this structural deficit solution is to increase taxes on business.

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Mr Jestin: You've raised a large number of issues. The first one, I think, is fundamental. For Scotiabank, because we are a very large international bank, I travel quite extensively abroad. There has been a profound change in sentiment about the US currency in Europe, in Asia, within North America. Effectively, global investors are moving to diversify portfolios that for a long time were very heavily weighted by the US dollar. So there may be jaw-boning in Europe, there may be interest rate cuts here, but fundamentally the move away from purchasing US dollar assets will drive that currency lower. You've got to remember that the US has to borrow half a trillion dollars a year to keep its currency where it is and to keep bond yields down.

So number one, it would be nice for many industries in this province to have the currency take a breather, go down a little bit. I think you're going to find that the momentum, now that it has shifted—the sentiment of the shift will drive the currency higher. That's number one. I'm finding that businesses in Ontario and across the country are building that in.

The other issue, of course, is competitiveness. The shift in the currency over such a short period of time has had an enormous impact on our competitiveness. The shift in global market share toward lower-cost producers such as China and the like, and Mexico, for that matter, has also had an impact on our competitiveness because those economies are rapidly moving up the value-added curve. What we have to do in the province, both at the government level and at the industry level, is do our absolute best to improve productivity and sustain a low-cost environment.

Bringing your point more to what the government has done and what it can do, obviously tax-competitiveness is very important. It pales in comparison, the incremental changes, though, to shifts in currency of the magnitude I've been talking about. But that's not the only thing the government does to ensure a competitive position. Infrastructure, health care and education are all very important components. We have done an enormous job reducing taxes over the last few years, but I think in so doing we have created other problems that we also have to address. So I believe that the policy that is brought forward on a go-forward basis has to be much broader. I fundamentally believe—if you've heard me over the last 25 years in various committees, you'll know that at least I'm consistent on this one point—we have to balance the books and get debt down, because deficits are deferred taxes.

We cannot go on running deficits. We've been through that before. We've been there; we've done that. The pain involved in getting out of that particular problem I think is enormous, so I really very much support the thrust that is being put forward of first addressing the fiscal imbalance, then getting on with other things.

Mr O'Toole: I guess I appreciate being able to have an exchange with someone with your credentials. I suspect I'm supportive of the idea of not having a deficit yet, but what I saw this morning was some delayed attempt.

In fairness, we dealt this morning with the accumulated debt, which is about $139 billion. The opposition, Mr Crozier, tried to establish that it was a $50-billion add-on. If someone looked at it in any detail—perhaps Mary, who has also been here at many of these committees over the years—we had a transitional plan in 1995. We were running something in excess of an $11-billion deficit in the 1994-95 number. Our plan was about a three-year strategy to ease out of that. In fact, that was the case. So we had accumulated an additional debt as part of exiting from Howard Hampton's plan. Because he's here now, I just want to get that on the record too.

If you took that at $10 billion, $5 billion and $5 billion, that's about $20 billion. If you also took the $20 billion from the stranded debt from Ontario Hydro, that's $40 billion. If you took the accumulated erosion of infrastructure, not the least of which is health and education, that pretty well explains, in my view, the $50 billion—not that I agree with it, but you're right.

I guess I'm putting it in the form of a question. Going forward, we had a very aggressive plan on the Health Services Restructuring Commission which was underestimated by a large number. They said it was going to be about $1.5 billion to rebuild the 230 hospitals. That number, some people are saying, is in the order of $7 billion to really get it done. The restructuring of the university sector, which only comments on the previous decade of Liberal and NDP avoidance in investing in infrastructure—ie, the post-secondary investment—was in the order of $1.2 billion. That's in colleges and universities, not just the double cohort, to engage in modernizing our research and university facilities.

I'm putting to you the question. I understand the pressures to respond to popular sentiment, and those pressures are wages and benefits basically; about 85% of all the public sector budgets is wages and benefits. The expectation is there for more, year after year after year. I would love to see that happen too, but the structural deficit here is in that attitude that it's always more. Yet the real investments should be in infrastructure to become more competitive; that is, the universities, schools and hospitals. Can you respond to that broader kind of thing? Which is it: the payroll increase, or building infrastructure to create wealth for everyone? That's kind of what I'm saying.

I firmly believe that we have a structural deficit. One of the reasons is the imbalance between federal and provincial revenue-sharing agreements; even municipalities are in a similar boat. We're all in the same boat. My first question was to say that the federal government benefited by the increase in the GST and the healthy Ontario economy in the 1990s, and now they have a surplus. Part of that surplus is that imbalance I'm talking about, but I'm going back to our investments. We're committed to building infrastructure, which grows wealth and prosperity for everyone.

Maybe I've gone on a bit, but I did have 11 minutes. Can you comment on the general thrust of what I'm trying to—I've explained, I believe, the accumulated debt and I'm putting to you now, what are the right investments: infrastructure or payroll increases?

Mr Jestin: The important point of what you've been saying, of course: First of all, in the 1990s the US was on one of the strongest expansions in history, so we were able to ride that crest and accomplish a lot. In terms of government investment in infrastructure, a series of things that were put in place actually reduced the overall trend in spending at that time. Right now, quite honestly, we're not in a strong growth environment. We are in an environment where we've got a deficit and much weaker growth. So the real issue is how you prioritize these things. It seems to me, with our also battling a rising Canadian dollar, we have to, as job one, figure out a strategy of at least keeping or getting the fiscal house back in order. Number two is looking at the major areas of our economy—municipalities is one area, of course, health care, education, both the urban and the rural infrastructure—prioritize those items and see where we can improve competitiveness there. Within that context we have to identify programs we're spending the money on that simply don't work and get rid of them, because we simply don't have enough money for the infrastructure and all those other programs.

In terms of wage settlements and the like, I think the harsh reality is going to be that at the federal and provincial levels and within the business community, the pace of growth of overall wage settlements, including fringes, is going to be reduced in the next few years.

Mr Howard Hampton (Kenora-Rainy River): I had the benefit of hearing some of your presentation [inaudible] some of the economic projections you make, that any attempt to balance the budget quicker will likely cause some pain. I guess my first question is, can you elaborate on that and indicate what kind of pain that would be?

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Mr Jestin: That's a very important issue, and whether you do it over two years or three years, there is inevitably pain for someone in repositioning policy. If we were in an environment where growth was much stronger and where we weren't suffering the competitive fallout from a higher currency, I would have suggested that a much shorter time frame be involved.

But, inevitably, putting through policies that reposition a very large amount of spending—in the billions of dollars, really—at a time when the manufacturing sector and parts of the service sector are making big adjustments too, I think has the risk of pushing us from what I would call a slow-growth environment to one that might have no growth at all, which would undermine revenues and compound the fiscal problems that we have.

The government has a very fine balance here. Keeping the economy going is very, very important. In order to ensure that that occurs as we're making these other adjustments, I think you need a longer time frame. Quite honestly, we may be too pessimistic on this. If we are too pessimistic on the growth, you may be, as we pointed out in our report, able to shorten that time frame somewhat.

I think the most important thing is to lay out a timeline and stick to it. BC did this when they were going through major adjustments and lowering taxes a couple of years back. The minister there has steadfastly indicated that he will stick to that. I think we have to develop that type of timeline and, more importantly, prioritize our spending so that we actually eliminate some programs. That's a political issue, because it's not an economist who can say, "OK, this is the one you should do, rather than that one." It's as much a political issue as not.

I think it is possible over two years, if growth accelerates more or the Canadian dollar is lower than we anticipated. I think the third year gives a little bit of extra added cushion in case we're not pessimistic, or in case we may be too optimistic about what has happened.

Mr Hampton: A large part of your presentation deals with the value of the Canadian dollar. I take it from what you're saying that is a major headache.

Mr Jestin: For Ontario, which depends more on the US market than any other province and which faces competition across a broad range of industries from very low-cost producers, we think the currency is absolutely the most important wildcard in the outlook and has perhaps the biggest impact on our growth trend over the next couple of years, much more so than Alberta, where rising natural gas prices and oil have really skated the government onside and where the heritage fund actually leaves them in a net asset position. Here we're not in a net asset position. We have a higher debt service cost than the provincial average, even excluding Alberta.

Mr Hampton: As I understand it, the problem isn't so much with the Canadian dollar as it is with the American dollar. In fact, I gather investors look at not only the federal government's deficit in the United States, but the state government's deficit. Then they look at the trade deficit. All of that has resulted in a much lower value of the American dollar.

So, I guess, a simple question: How does Ontario have any control over an American dollar that seems to be headed south?

Mr Jestin: That's a very important point, because we don't have any control over it. We are forced to adjust to the reality. If you can turn bad news into good, our currency is likely to rise less against the US dollar than the European currency, the euro. That's not a big issue, because Europe doesn't really trade a whole lot with the US, and 87% of Canadian trade is with the US and 90% or more of our trade is. We have no control over that particular cost element. We can hope that there's more stability in the outlook, but the challenge is very clearly there.

With the most rapid appreciation of our currency in history, we have to be very fast on our feet in the private sector and relatively cautious in the public sector in making adjustments. When I say "cautious," it's not trying to do everything in one year. But at the same time we have to be aggressive in terms of reprioritizing our spending because, quite honestly, as our exchange rate goes up, we have to find ways of channelling our spending in areas that will boost our productivity and ultimately our overall standard of living.

Mr Hampton: If I can get you to look down the road a bit, if the American dollar continues to dive, the projections that you have given us here could actually worsen. In other words, if the American dollar continues to devalue and puts Ontario's manufacturers and exporters in an even more difficult position, that three years could become four years.

Mr Jestin: I'm quite confident, even in a slow-growth environment, that the tools are there to balance the books. It may well be that three years is a comfortable margin and that we can do it in somewhat less. The important point is to try to stick to the trajectory and not be too optimistic in our economic and financial market assumptions. I have a lot of confidence in our manufacturing sector and our tourist industry and other goods that are affected by the US dollar—that adjustments can be made. The biggest problem right now is that the adjustments have been forced on the Ontario private sector in such a short, short period of time. If we have time to adjust, I think our industries can really do quite well. We will move up the value-added curve. I've seen it time and time again in industries. In Canada, the forest products industry has continuously moved up the value-added curve as new and lower-cost competition came on board. I think we can do it here. We certainly have the productive labour force. I think we have flexibility in our management practices—much more so than in Europe. But we can't do everything all at once and expect to keep this economy growing at a healthy pace.

Mr Hampton: Much of your discussion is about the effect of, as I've tried to understand it, the projection in terms of lowering costs for government. How do you do that? Can you give us some examples?

Mr Jestin: You've got two issues there: lowering costs and boosting productivity. In the private sector, both are important. You can't cut and cut and cut and expect to remain in business forever. The productivity is the issue that I think is very important.

In the government sector, the immediate challenge is the excess spending over revenues. Inevitably, an adjustment has to be made, but also a prioritization of policy. Quite honestly, I don't know what's going to come out of the round table discussions that we're going to have. Hopefully it is ranking policies in terms of which are most important and which are farther down the overall list. Then the tough decision becomes actually doing the surgery on the low-priority items.

We've been at this, when you think of it, as a country since the 1970s. Every round of cuts and repositioning becomes tougher and tougher. It is not an easy issue. As an economist, I'm glad that I'm not responsible for making those decisions. It is a political issue. But inevitably I think the outcome of not doing it, of saying, "Hey, what's $5 billion here or there? We can do it for a few years," of that type of mentality, will lead to a far larger negative consequence for our standard of living than otherwise.

So a tough issue; prioritization is the key, and take the low-priority items and make the tough decisions to cut back that spending fairly dramatically.

The Chair: Mr Peterson.

Mr Peterson: We are going out to consult with people on better ways to spend the current money. You indicated you thought there should be elimination of red tape and, secondly, a fundamental reform in program execution and elimination of duplication. Did you mean between the levels of government or in our spending? Could you be more specific in helping us manage this money more efficiently?

Mr Jestin: I'd like to take a stab at that. Then Mary, who spends her life studying these things, may have some comments as well.

I think one of the key areas that has been extraordinarily frustrating over the years, and one we can make huge yards on with very little overall cost, is to streamline the processes involving three layers of government—whether it's urban transportation, whether it's within the GTA, setting up regional zones where you have a coordinated transportation policy and the like. We should pick the low-lying fruit first here. I think what we could do in that regard is (a) improve our efficiency and productivity, and (b) probably end up doing a lot of these initiatives at a far lower cost and in a faster time frame.

Mary, you may have some specifics.

Ms Mary Webb: I simply second what Warren has said. Whenever you're an outsider looking in at the government, you always see part of the picture and not all the picture. But there have certainly been areas like training, where perhaps there could be better coordination.

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In health care, there were some very interesting recommendations by both the Romanow and the Kirby commissions. Kirby in fact focused on how we could introduce incentives to create more efficient and effective service delivery.

Those things are very important moving forward. Ontario's pace is going to be facilitated because other provinces are trying new experiments, and so there really is a case of best practices developing here. But we simply have to think outside the box.

On the regulation side, I think some programs were underway—things like when some computer investments are completed for the province, a small or mid-sized business will have only one corporate number and not several.

Having said that, I did quite extensive work with the Ontario Chamber of Commerce. When we did an annual survey of our membership and asked them about provincial red tape, it never seemed to be getting less. I think it's really important that we somehow convey that.

The final thing would address Warren's point. For some issues, we have to develop new governance. We haven't worked out how to best service an urban region and the things like transportation that cut across municipal jurisdictions. We don't have an urban region in Canada that has figured that out. Probably the closest is the greater Vancouver region, but they've certainly had problems working at that skill too. So there are places here where the challenge is immense, but we have to do it, because if we don't, it's going to be one of the things limiting the province's growth in this global recovery.

Mr Peterson: I'm fascinated by your specific answer, and thank you very much. I think the problem with some governments is that we don't have enough small businessmen who could be more specific. Maybe we could work with the chamber of commerce and look at specific ways of correlating all the red tape and bureaucracy and forms. With the new efficiencies of the Internet etc, I think there could be some efficiencies achieved.

In the governance model, the Toronto City Summit Alliance is trying to bring together an example of a more coordinated way of managing an urban centre. Do you have any comments on that and on their recommendations?

Ms Webb: There are certainly some good points in it, as in the Smart Growth panel for central Ontario, which did have some excellent points—the fact that we have to manage the whole urban region pattern. But there's also been some very important municipal governance too. How do we raise the level of resources that can be accessed in governing these huge urban areas when they're larger than some of our provinces? When you look at municipal government, there is a shortfall in some areas on how to deal with this.

More than that, I think that people are willing to take cuts or take fee increases to bring what you pay closer in line with what you use if there's a definitive multi-year program going forward; in other words, for the greater Toronto area, if there was a specific multi-year plan for the next three to four years on how we were going to try to address transit and transportation. Those are very difficult things to move forward, but we're already down that road in terms of creating a transit authority. We're already down the road in a lot of other areas as well. It's simply a case of setting a specific path.

The Chair: Mr Orazietti.

Mr David Orazietti (Sault Ste Marie): I want to go back for a minute to the comment in here on page 2, moving to an 80-cent dollar.

Coming from a community like Sault Ste Marie, the natural resource based economy is extremely sensitive to fluctuations in the American dollar. Just to give you an idea, for some of the industries—for example, Algoma Steel and St Marys Paper—if the dollar moves up a cent, it's a million dollars a day in terms of increased costs and lost revenue. We're obviously very concerned about where we're going there.

I had an opportunity to meet with a number of the stakeholders in Sault Ste Marie [inaudible]. I'm listening to them as to what suggestions we could bring forward as a government, what particular policies may be helpful in terms of supporting our natural resource based economies in this province. I want to ask you, as an economist, what suggestions you could make to the natural resource sector of our economy in this province in terms of what strategies or steps they might take to improve their competitive position in this province and in the global economy. I follow that up with what policies would be beneficial to move forward from our government's perspective in assisting these industries in gaining advantages?

Mr Jestin: There are two points to make about the resource sector—it varies, of course, when you bring in steel and a variety of other things, and the forest products industry is another matter. But by and large, the resource sector in Canada has had to deal with adjustments, whether low costs or increasing low-cost competition globally, for the better part of the last century. They have become very efficient and effective and have moved up the value-added curve.

The reality is that if we're right on the particular currency there, in a US dollar market they get hit on their bottom line absolutely immediately, as does any other firm that sells in US dollars. You cannot get into transitional adjustment policies with respect to the industry, in my view, because they don't have a sunset, typically. You end up adding more and more layers of support. The key is to make sure transportation and communications are efficient, and that we don't follow policies now that ultimately lead to higher costs in terms of taxation in the future.

Where I think the adjustment is probably going to be the greatest is not in the resource sector; I think it is going to be in the manufacturing and tourist sectors of this economy. But the adjustment is going to be so fundamental that I think targeting specific industry groups for special assistance becomes not only a mug's game in terms of who gets what, but ultimately a self-defeating policy where we end up layering on more spending or special things and then have to clean house two, three or five years down the line.

Mr Orazietti: Are you suggesting that we simply allow the industries to take whatever course they're able to, based on market trends, or should we be looking at strategies or policies that will assist in transition or value-added approaches to some of the basic natural resources? I continually hear that come up in meetings with local manufacturers or natural resource sector producers. Are there government strategies that we should be embarking on that would help tap into value-added jobs or growth in that sector as opposed to—unless that's what you're saying?

Mr Jestin: I think the government's role in this is fairly clear; that is, in the areas of transportation efficiency, communication efficiency and information provision, we do have available at the federal level certainly, and in some other ways, links into various markets globally for marketing. The British use it in Canada, the Americans use it in Canada and we use it abroad.

What worries me is that we go down a transitional route where we start putting in subsidies for specific industries and actually make the problem we now have—a structural one that hopefully we'll solve in the next three years—not only longer lasting but more serious. I just don't think we have the financial resources to go beyond the basics of government in making things as efficient and with as little red tape as possible.

Mary may have a comment on that.

Ms Webb: We went through a somewhat similar restructuring period for Ontario industry in the first half of the 1990s where many of our industries over a very broad range were not quite ready to compete in NAFTA.

But the range was so broad that how would you help one industry or how would you decide which specific group of industries to help? Well, you couldn't. At the end of the day, it was moving to a low-tax, low-inflation environment and various other things setting the background environment that helped industry restructure.

You're right: There were winners and losers in that restructuring, but the province as a whole moved forward and certainly moved into a very robust period of growth and investment. There's no question that it's a difficult period, but we've seen our industry come through this before.

The Chair: Thank you very much for your presentation this afternoon. Your time has expired.

1400

C.D. HOWE INSTITUTE

The Chair: I would ask representatives of the C.D. Howe Institute to come forward, please, and if you would state your name for the benefit of the committee members and for Hansard.

Dr Jack Mintz: My name is Jack Mintz. I'm president and CEO of the C.D. Howe Institute. I'm also the Deloitte and Touche professor of taxation at the Joseph L. Rotman School of Management at the University of Toronto.

I hope all of you have a copy of my handout. I'm very pleased to come back before the committee in a relatively short period of time. I suppose you'll be hearing some of the same messages I gave last time, which have to do with Ontario's fiscal competitiveness.

What I thought I would do particularly is to review work that I've done with my colleague Duanjie Chen, with whom I've been working for many years now on looking at how taxation impacts on competitiveness of economies, not just here in Canada but worldwide.

What I will do is report to you some numbers that are based on a study I did for the Institute for Competitiveness and Prosperity, which is under the—I forget the name of the ministry. We used to call these things development. It is work that we have done, which is very comprehensive work, based on both theoretical and empirical work that started over 10 years ago. Some of it appeared in the report of the technical committee on business taxation at the federal level, which I had the privilege of chairing.

To begin, the work we've done in Ontario specifically looks at both taxes and subsidies on the cost of doing business in Ontario and in five competing US states. We looked specifically at California, Georgia, Illinois, Massachusetts and Michigan, which for various reasons are important competitors with Ontario in terms of the kinds of industries that are involved. In fact, none of them are really mining states, so the one area that these states would not include is a mining sector, which is important in Ontario, but not in these particular five jurisdictions.

The study actually includes a whole host of both taxes and subsidies that impact on labour and capital costs of businesses. They include personal income taxes, sales and excise taxes, health care subsidies, education subsidies, payroll taxes, pension and EI benefits, workers' compensation benefits, all with respect to labour. In the case of capital, it includes corporate income taxes, capital taxes, sales taxes and capital inputs, infrastructure subsidies, research and development tax credits and grants. These include both federal and provincial taxes and subsidies. So as you can see, this is a very comprehensive study that we have done for Ontario.

It also is based on the concept of trying to think about how taxes impact on the cost of doing business and how it might affect business decisions in terms of where to locate their production worldwide.

Conceptually, we measure what I call the marginal fiscal burden. You could have the cost of producing a particular product, let's say $5 for a widget, and when you add on all the taxes and subsidies, the cost of producing that product would be $6. We calculate the marginal fiscal burden as $1 divided by the costs, including taxes, which in this case would be $1 divided by six, which would be 17%. We've done this for what we call entrepreneurial businesses. These are businesses that are primarily controlled by manager-owners, for example, in the high-tech industry, but it also includes other industries, as well as what we call large companies that would be multinationals operating internationally.

If you look at page 4 of the handout, you will see that these are the overall estimates of the marginal fiscal burden and costs for Ontario and five US states. This includes again both taxes and subsidies. So we've taken into account health care and education subsidies as well as the taxes that are imposed in these various jurisdictions. As you can see, net of all subsidies of the fiscal effect of tax burdens in Ontario is about 25% of total costs. The next-highest one is in California, which is approximately 17.5%, 18%. Certainly there's a very significant disadvantage for businesses to locate production in Ontario, once taking into account all these different taxes and subsidies.

We've also broken these numbers down to show the fiscal burden by labour and for capital. In the case of Ontario, you can see that all the taxes on labour, net of education and health subsidies primarily and other benefits such as the benefit of the EI program and Canada pension plan etc, is close to 25% of the cost of using labour in Canada. In California, Arnold Schwarzenegger's state, the taxes net of subsidy account for almost 20% of the cost of labour. All this is for the year 2003, and the other states are lower in the United States.

I should mention that it's quite possible that a significant part of the burden of subsidies actually falls on workers themselves as opposed to the businesses, because businesses, in facing higher taxes themselves, might end up paying lower wages. So the taxes and the subsidies tend to fall more on workers as opposed to businesses. In that case, one may not be as concerned in terms of affecting the cost of doing business but one would certainly be concerned about the impact of the value of government services net of taxes to workers in Ontario.

The question is, why is the burden on labour so high in Ontario compared to the five jurisdictions? First of all, there are higher marginal personal income tax rates, especially applied to low-income levels, in Ontario compared to the United States. Second, we have higher sales and excise taxes. We have to remember that those affect work effort as well, because once you earn your income and pay your income taxes on that income, you have some money left over and then you go out and buy goods and services and you have to pay sales and excise taxes on those goods and services. It also includes higher payroll taxes net of benefits, such as employment insurance particularly, because the federal government runs a surplus on the program, where there are more contributions relative to benefits, and as well the Ontario employer health tax, which is also a tax that's imposed on hiring workers. Finally, the higher burden in Ontario relative to the US states is in part offset by health and education subsidies—primarily health subsidies—which does help lower that burden.

In effect, if you look at page 7 of my handout, you will see that we have broken down for the jurisdictions all the payroll taxes net of benefits, education subsidies, health care subsidies, personal income tax rates. By the way, the average is based on the distribution of workers, which we estimate by industry, and aggregate out the marginal tax rates, sales tax rates and also the combined effective rates. You can see that there's a much higher burden in terms of the taxes themselves, and then once you include the subsidies you get the overall rates that we estimate.

On page 8 we provide the marginal fiscal burden on capital for 2003. This does not include the federal cuts in corporate income tax that came about on January 1, 2004, including the first tranche of the reduction in capital taxes at the federal level, and it does not include the increase in the corporate income tax general rate in Ontario as a result of the Fiscal Responsibility Act.

As you can see, the effective tax rate in Ontario for capital—and this includes not just corporate income taxes, the rate as the way the base is defined, but also capital taxes and sales taxes and capital inputs and subtracting out infrastructure subsidies and research and development grants—the effective tax rate in Ontario, net any grants that are helpful to businesses, is significantly higher than what you find in the United States, really quite substantially higher, almost double what you find in the United States.

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Just to give you another picture, in the June Backgrounder issued by the C.D. Howe Institute that I authored with Duanjie Chen, I provide you with a comparison of Ontario for 2003 on page 9, effective tax rates on capital relative to other provinces. I should say that these numbers do not include infrastructure subsidies and research and development support from government, so as a result these numbers come out a little higher then what you'll find in the other table. Otherwise the numbers are basically the same.

The main point of this graph is to show that Ontario has the third highest effective tax rate on capital in 2003 compared to all the other provinces, certainly much higher than in United States, as I've mentioned. In fact, the only two provinces that have a higher effective tax rate on capital are Saskatchewan and Manitoba. Alberta has a low one, but I guess, quite surprisingly, you'll see that Newfoundland actually has the lowest one in Canada. There is, I guess, a desire to attract people to the Rock as much as possible.

So the question is, why is the burden on capital so high in Ontario? As pointed out in some of the literature that some people have mentioned, there is a lower statutory corporate income tax rate in Ontario, at least in 2003: three points for non-manufacturing and six points for manufacturing and processing income compared to the United States. That actually leads to a lower effective tax rate in Ontario compared to the five US states.

However, this is completely and more than offset by all the other things that are available in the United States. There are less generous depreciation allowances in Ontario, including bonus depreciation in the United States. There's less generous deduction for inventory costs in Ontario compared to the United States. In Ontario as well as Canada, we use first-in, first-out methods for evaluating inventories, which is the price of the oldest inventory stock that's first used to measure the cost of inventory, while in the United States companies can use LIFO, last in, first out; in fact, most do. That allows them to deduct the cost of inventories at a higher price in times of inflation.

Capital taxes in Ontario are substantially more than what you find in the US, although interestingly enough, Massachusetts has a very high capital tax. That's one of the reasons its effective tax rate on capital is higher than all the other US states.

There are higher sales taxes on capital inputs in Ontario, except for mining, for all industries. There are more generous infrastructure subsidies for many industries in the United States, especially for transportation and communications, which are sort of the new economy sectors.

Finally, research and development support is somewhat higher in Ontario compared to the US states, although it's not as generous as one thinks, because even though in Canada we have much higher tax support for research and development, the US tends to provide very significant expenditure support for research and development through defence, energy, environment and medical research programs. They lower the cost of research quite significantly for businesses in the United States.

Just to give you a little bit of a picture, if you look at page 11, you'll see a graph here which shows that the highest amount of capital investment as a percentage of gross domestic product in Canada can be found in Alberta, where it reaches well over 20% of GDP. As you can see, Ontario is below 10% and below the United

States, which is above 10%, and also below other provinces in Canada, not including Alberta. Ontario does very poorly when it comes to business investments in non-residential structures, machinery and equipment. That should be a very significant concern to this committee because, after all, productivity is very important, and the big beneficiaries of high productivity are workers because, to the extent that businesses are buying new capital equipment and investing in new structures, they are adopting the latest technologies, and this is extremely important in order to generate higher incomes that workers can get.

Before I say something about page 12, just of interest to this committee, since I was before you in December on the Fiscal Responsibility Act, my colleague and I have tried to model the impact of raising the general corporate income tax rate in Ontario from 12.5% to 14% as of January 1, 2004, and also the manufacturing, processing and resource corporate income tax rate, which went up from 11% to 12.5%. The overall impact of that tax change that Ontario brought in on January 1, 2004, was to raise the effective tax rate on capital by about a percentage point. In other words, the effective tax rate on capital would be about a percentage point less if Ontario did not go ahead with raising the corporate income tax rate as it did.

You might be interested in knowing what impact that has on capital investment in Ontario. Currently, the capital stock of businesses in Ontario is about $375 billion. Taking into account the responsiveness of capital investment to changes in the cost of capital that firms face, which would include taxes that are imposed on capital investments, the impact of raising that corporate tax rate is to have the long-run impact of lowering the capital stock in Ontario by $14 billion. That was the impact of that corporate income tax rate increase that we brought in on January 1, 2004: to reduce capital stock investment in the long run by $14 billion in Ontario. That is a very large amount. In fact, it is the sort of thing that will undermine productivity the most here in Ontario.

As I've mentioned, page 12 will give you—very quickly, these are the marginal fiscal burden on costs. They vary quite significantly across industries. I don't have time to go into all the differences, but I do want to point out that manufacturing is much more highly taxed net of subsidies in Ontario relative to the five US states. Also, if you look at communications and electrical power, there is a much higher fiscal burden in Ontario compared to the five US states. Those are where the very significant differences can be found.

We've also compared 2002 and 2003 for large corporations. This is taking into account all the numbers and methodologies that we've used. As you can see, going from 2002 to 2003 there was a slight reduction in the marginal fiscal burden, going from one year to the next. However, the reductions in the United States were actually more substantial than what was found in Ontario. In fact, there is an OECD study that came out in the fall looking just at the effective tax rate on capital, not looking at it as comprehensively as this work does. What it found is that even though Canada has been making progress in lowering business taxes, particularly on corporate investment and therefore encouraging more corporate investment, it has not been doing it as quickly as other OECD countries. In fact, the effective tax rate in Canada on a relative basis has increased, compared to other OECD countries. I often like to quip that if you look at corporate income tax rates in the world today, just the statutory rates, Ontario has the fifth-highest one among all OECD countries. The only countries higher are Japan, the United States, Germany and Italy. Every other country in the OECD has lower corporate income tax rates than Ontario, including all the Scandinavian countries such as Sweden, which is at 28% rather than 36%, as we are now in Ontario. So that gives you a bit of a picture that we are really out of whack with the rest of the world when it comes to our business tax burdens.

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We also did a similar estimate for entrepreneurial companies. These are companies owned by owner-managers. There, you can see again a significant disadvantage in Ontario relative to the five US states. In fact, that disadvantage got even bigger in 2003, primarily as a result of both faster write-offs for capital depreciation in the United States as well as a dividend tax cut in the United States that lowered the effective tax rate on entrepreneurial income.

Finally, just to show you what would happen if Ontario carried out a number of tax measures: First of all, if it lowered the corporate income tax rate, that would reduce the effective tax rate on capital by almost over one percentage point. Eliminating the capital tax would drive it down even further. Eliminating sales taxes and capital inputs, such as going to a value-added tax, would also lower the effective tax rate significantly.

Putting them all in place would result in a very sharp reduction in the effective tax rate on costs and would move Ontario much closer to the situation in the United States, especially if you eliminate the impact of bonus depreciation in the United States, which should expire in a couple of years, although one never knows what the US will be doing after that.

We also show the impact of eliminating the employer education and health tax on the cost of doing business, lowering personal income taxes across the board by 5%, as well as placing the Ontario corporate income tax, which is called a cash flow tax—I won't go into the details, as that would take some time, but I commend to you the report I prepared with Duanjie Chen for the Institute for Competitiveness and Prosperity.

I think that completes my remarks.

The Chair: Thank you very much. We have about 13 minutes per caucus for questions, and we'll start with the official opposition. Mr Barrett.

Mr Barrett: Just referring to page 13 in your presentation, the marginal fiscal burden on large corporations for the year 2002-03 is just over 25%. I compare that to Michigan next door at under 15%.

As we know, in December this government increased the Ontario corporate tax rate and planned to go to 14% from 12.5% now. Taking a look at the year 2004-05, what are these bar graphs going to look like with respect to our competitiveness with some of our neighbouring US jurisdictions?

Dr Mintz: The good news is that there are still some federal cuts to come into play; that is, the federal government will be eliminating the large corporations tax, which is a capital tax. That will lower to some extent the fiscal burden in Ontario as a result.

The 2004 numbers have a mixed result because the federal government is lowering the corporate income tax rate, the final tranche, two percentage points, or has lowered it on January 1, 2004. Effectively, the Ontario increase, going from 12.5% to 14%, just clawed back three quarters of the federal reduction that was to take place under the corporate income tax.

On the other hand, for manufacturing and processing income particularly, where there's no rate cut at the federal level, the increased tax rate going from 11% to 12.5% implies an additional burden on capital investments in manufacturing and processing incomes. So manufacturing is actually worse off in 2004 compared to 2003.

Mr Barrett: Further, you also do your analysis on labour for 2003. Again, Ontario has a marginal fiscal burden of just over 25%, and I compare that to Michigan at under 15%. The scheduled income tax reduction that was to come in this January will not occur. Again, a similar question: When you add up corporate taxes and scheduled personal income tax reductions that are not happening, it's about a $4-billion hit in what was announced in December with respect to essentially people paying more money to government. How is that going to affect the shape of your bar graphs in the coming year?

Dr Mintz: Again, there is one piece of good news—mind you, that's also true in the United States. We have indexation of income tax brackets in Canada now at the federal level and in the province, and that does reduce the marginal tax rate a little bit, to the extent that there are some workers who might be affected by that. But on the whole, I think what you'll see is that, at least for next year, there won't be much change in this graph. Ontario will certainly lack competitiveness. Of course, we know that in the United States there are significant deficits, and down the road the US will have to bite the bullet on either cutting back expenditures or raising some taxes, particularly in social security. That might reduce some of the differences in the very long run, but that's a very long run. We're talking about 10 years, and that's well beyond the next election here in Ontario.

Mr Barrett: Thank you.

Mr O'Toole: Thank you, Mr Mintz, for appearing before the committee. I want to compliment you on your ongoing work at the school of business, as well as under the direction—you are the president of C.D. Howe Institute, a research organization.

I am familiar with Roger Martin's report on investing for prosperity, which you participated in. I start on a very simple model of sort of trying to figure out which came first: the economy or the standard of living. I'm sort of stuck on that; perhaps it's too primitive a starting point. I think you create wealth and then you find a way of distributing the wealth. If I'm wrong, that's a simple question. You have to have the economy first.

I look at China now starting to develop an economy, and more people will have a full stomach. If I look at Russia and East Germany—not to criticize them—I think they consumed their infrastructure and ran it into the ground so it couldn't create wealth.

Am I wrong to assume that you have to have a strong economy to have a strong standard of living? Is that too simple?

Dr Mintz: No. I think it's very important to remember that the economy does matter a lot. In fact, Bill Clinton had it exactly right when he said, "It's the economy, stupid." He was exactly right about that.

I always like to make a comment to many of my colleagues, since I've worked in many countries around the world, especially on tax reforms in all sorts of countries, especially for many countries that get support from the World Bank and the IMF. The interesting thing I've always found in these countries is that you never find a first-class health care system or a first-class education system where an economy is poor. It's only in the rich economies that you get the best systems operating. I think something we always have to remember is that you cannot kill the goose that lays the golden egg. It's very important to remember that the economy matters a lot, and that in order for us to have the incomes to spend on both private and public services, the economy must do well.

Mr O'Toole: I have a couple of points. We've established the premise I'm coming from, and I hope the government is listening today. You make the argument about our trading jurisdiction; we're basically an export-based economy, a manufacturing economy. You've given us the implications for capital investment: $14 billion with the more recent change. That's a loss of investment to Ontario. So tax policy does matter and the economy does matter.

I guess I want not just to talk about the US. I'm looking at your chart on page 9. We are in Canada. We're a caring society—some would say much more caring than the United States, at least the Toronto Star would say that. I just look here, and I'm not surprised, because Alberta has this history—Ralph Klein is so mean-spirited, according to the press. But if I look at the two least competitive provinces—Saskatchewan is the least competitive, according to that chart, and Manitoba. They're both governed by the most well-intentioned people, the NDP. That's got to tell you something. There's a balance, I suppose, of good intentions—investing in the human standards—and trying to create some prosperity and taking advantage of your net value. If you look at Alberta, it's a resource-based economy and we're manufacturing, which is jobs and pretty much having a strong US marketplace, really. I guess in respect I look at other provinces, and you point out Newfoundland. That's the real trade-off here. We have public transit all over northern Ontario, with nobody in the buses. Obviously, Newfoundland just doesn't have the standards. They obviously don't have all the stuff we have in the GTA. I guess that's what we're stuck with.

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The government is looking at—technically, if you raise taxes, you're going to lower investment; you're going to lower the standard of living. I'll kind of leave that.

I'm going to find a question here, and that is on page 12. I'm quite serious here because you point out that in Ontario, compared to other jurisdictions, the big issue is electricity. On your chart on page 12 the implications for the cost of the fiscal burden in a market we know is poised for considerable—Dwight Duncan is trying to encourage investment here big time, because they don't have any money; that's clear. They're trying to get other people to come in. The tax rate there is 30.8%. What are the implications going forward to create more generation in Ontario, which we all agree we need? They're going to cut out the coal plants, which are, what, 26% of the base load. What could they do? What could we as an all-party committee do to advise the Minister of Finance on tax policy to encourage investment in the electricity sector?

Dr Mintz: First of all, let me say as a general point that I have strongly argued that it's very important to lower taxes on capital generally. In fact, if you look at many of the European countries, of which we know a number are high-tax countries in the sense of having very high tax-GDP ratios, the one thing the Europeans figured out is that you've got to have capital investment and you have to keep taxes on capital investment low. Sweden figured that out, Finland, Norway, Denmark, the Netherlands, the UK; I can go through a list of the countries. They have actually significantly lower taxes on capital investment than you find here in Ontario. That's because they know that productivity is absolutely critical, and that if you're going to get a higher standard of living, you must have capital investment because that's what creates jobs and that's how workers get higher incomes.

Mr O'Toole: Am I right to assume that capital tax is inelastic? Even if you're making nothing, you still pay tax on the capital.

Dr Mintz: I'm not talking about capital taxes. I'm using an economic term here. I'm including all taxes on capital investments, which means corporate income taxes, capital taxes, sales taxes and capital inputs, everything that impacts on capital investment. If you look at, for example, the Scandinavian countries, corporate income tax rates are 30% or lower. The Netherlands has relatively low corporate income tax rates too, but they also have a lot of benefits for investing in the Netherlands. That's why the Netherlands is such an attractive country for many multinationals to go to.

Mr O'Toole: So in the energy sector specifically—

Dr Mintz: And we know what has happened in Ireland. Low taxes on businesses led to a huge boom in capital investment, and with all that investment they made in educating their workers, that brought skilled labour to the workforce and businesses in Ireland; multinationals found that they also had some well-trained workers to hire. So it was a combined set of strategies that Ireland undertook that led it to be the fastest-growing economy among all OECD countries in the past 20 years. It's a remarkable story.

Mr O'Toole: In the few minutes I have left, the energy sector again—

Dr Mintz: I'd like to get back to that point.

Mr O'Toole: How about depreciation and those—

Dr Mintz: Yes, the write-offs for depreciation in utilities are not particularly generous. You have faster write-offs in the United States. Of course, capital taxes have a significant impact here as well, and also to some extent sales taxes. But in the United States there are actually quite large infrastructure subsidies toward transportation and communications, which have also driven the cost down.

Let me just make a very important point, though, about capital investments. Ontario has a real challenge when it comes to power generation and getting private sector investment interested here. The record over the past several years, where the government—and I'm saying government in general—has shifted between all sorts of different positions about what kind of power sector we're going to have here in Ontario, has discouraged many companies from coming to Ontario. In fact, there are many that have large cash flows available and they have decided to put their money in the United States because of the uncertainty here in Ontario. Ontario will get more investment, but it's going to have to have a set of fair policies where businesses feel they can compete on a fair basis here in Ontario; not against a monopoly that operates in power generation or in distribution. So there's a lot to do on the regulatory side here in Ontario to attract power generation.

Certainly the tax system doesn't help either. In fact, in some of the areas such as gas pipeline distribution, many businesses tend to put more money into the United States as a result of being able to earn a higher rate of return on their investments in gas pipeline distribution compared to Canada. That's because of a combination of both taxes and the way rate-of-return regulation operates in Canada relative to the United States.

Mr O'Toole: One final thing was the payments in lieu of—

The Chair: Thank you. We need to move on now, Mr O'Toole. We'll move to the NDP caucus.

Mr Prue: It's always interesting to listen to you. He's an interesting guy. He's smart too.

I'd like to get back to your central point here. Your argument is that Ontario has a higher fiscal burden and that we have to compete with the American states. I'm just wondering: In terms of that, you give examples like Massachusetts; you don't give examples like Mississippi or Louisiana or Alabama, places that have even lower—I don't think any of us want to be compared with them. Why don't you use those?

Dr Mintz: It's very simple. If you look at the major sectors here in Ontario, if you worry about high-tech and finance, Massachusetts is very important in certain sectors. If you worry about the car industry, clearly Michigan is very important in terms of what we're doing. If you look at something like furniture manufacturing and other types of manufacturing, Georgia is a very interesting state to look at because it's become quite an important competitor now. California, of course, is a very large state and also competes with us in the high-tech and a number of other industries.

These five, I have to admit, were picked for me to look at by the institute. They wanted me to look at them particularly, but I think they were good choices. I think these states really matter a lot to us. I'm a little less concerned about Alabama, to be honest with you.

Mr Prue: I wonder about those states because if you go to Kentucky, say, they have mining and we have mining here.

Dr Mintz: Actually, I would have picked Colorado.

Mr Prue: All right. There are parallels that could probably be drawn with any of them, but you picked five of the richer states.

Dr Mintz: I should mention that in my book that was published in 2001 by the C.D. Howe Institute, called Most Favored Nation, it actually provides a Canada-wide and US-wide comparison for all the industries. This is based on the year 2000. The book was published in 2001 but the data were brought up to the year 2000. You will find there was a significant fiscal disadvantage for businesses to locate in Canada as a whole relative to the United States as a whole, in all sorts of different sectors. Some of that has changed as a result of the business tax reductions and personal tax reductions that have occurred in Canada since the year 2000. However, the United States has cut even more deeply. In fact, we provided some numbers showing that the differentials weren't going to really be reduced that much between Canada and the United States. This is taking into account health care subsidies, education subsidies, infrastructure, everything.

Most people who have accused many of only looking at tax comparisons and ignoring the expenditure side of government I think have always been right, and now I've provided that kind of analysis. This is a quite unique analysis. You find this hardly anywhere in the world, never mind in Canada. So I think it's very helpful to really look at the whole picture.

Mr Prue: Again, I come back to what this government I think is going to do, or at least part of what they're going to do. They are looking for money. They are not about to lower corporate tax rates if that means they're going to have to cut a whole bunch of additional social programs. I'm wondering, in terms of your wanting to help industry or commerce, I can understand that, but at what cost to social programs?

Dr Mintz: First of all, we have to remember that governments are involved with all sorts of things besides health and education. We can go through whether everything is done as efficiently as it can be. For example, in education Ontario is a relatively big spender but our results, while improved, are still mediocre. I think there are some very good examples internationally, and I'll be speaking about education Wednesday morning at the Economic Club of Toronto.

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Mr Prue: I think we're all going to miss that one.

Dr Mintz: Oh, you're welcome to come.

Mr Prue: We'll be in London.

Dr Mintz: I will be talking about education, and I'll tell you that not enough money spent is not the problem in education. The problem is the way we run the system here in Ontario compared to what you find in far more dynamic districts around North America, especially Edmonton, Alberta. I think there are lots of things that could be considered.

Let me just make one very quick point, and that is that I'm a great believer in medium-term budgeting. I think one of the worst things we have done in Canada—and I'm not saying this just about Ontario; I'm including other governments in Canada—is that we do not focus enough on the medium term in terms of our budgeting practices. We're too short-sighted; we're only looking at the next year or two years down the road. Many countries around the world have medium-term budgeting processes. It allows you, over time, to make allocative decisions, both on the expenditure and tax sides, in a far more rational way because you can basically shift resources over time. It's hard to do it within a year. Certainly when you have a deficit I can understand why it would be very difficult to cut taxes today. But the question is, what's our five-year plan? What's our 10-year plan in this country, or in this province? I would suggest that we don't have one. Yet when you look at where we are today, we can miss, I think, a great opportunity for this coming decade if we don't think about where we want to be 10 years down the road. You can make a lot of very good decisions with a medium-term budgeting process that you can find used in many countries, like Australia, New Zealand and the United Kingdom, that we fail to use here.

Mr Prue: You made a statement—I tried to write it down but of course I can't write as fast as you can speak and I don't do shorthand—that, "You'll never find a first-class health or education system where you have a poor economy." That's more or less it. You also made the statement about Ireland, and I find that to be a pretty good example too, but some might argue reasonably that in Ireland the success wasn't so much in reducing the taxes on corporations but the fact that they went, in a really big way, into education. You can get a post-secondary education, a college or university education, virtually for free in Ireland. The person seeking the education pays nothing. Does that not too increase wealth?

Dr Mintz: I actually referred to that, but let me commend to you an article on Ireland written by Brendan

Walsh and—I forget his first name—Honohan that came out a couple of years ago in the Brookings journal. I think it's an excellent review of what happened in Ireland. If you go back to the early 1980s, Ireland had a very high unemployment rate. Of course, historically it has been a basket case among western countries and in Europe, and also it had very poor productivity and an out-migration of people who usually wanted to go either to the United Kingdom or the United States. What Ireland did was a set of strategies. What I would suggest is that it was no one strategy that worked as much as several strategies.

First of all, they had an open market with the European Union. They took the regional subsidies they got from the European Union and invested them in education where the level of education was very poor, unlike Canada today—we're actually one of the best education systems in the world, so we really can be proud of that—and they did encourage people to go into tertiary education, and they still provide free tuition for universities because they really want people to get educated. But they also knew that if you just educate people and there are no jobs, they'll go to the United Kingdom and the United States, so they had to create an atmosphere for jobs to be created in Ireland, and that's where the business tax cuts came in. So it was an overall set of strategies that worked, not any one element. But certainly business tax cuts were very important to generate investment in Ireland.

Mr Prue: Do I still have time? Good.

I put the question to you because Ireland is a good example of how private enterprise could create the jobs. But let's turn to Ontario for a second. There was a certain promise made by a political party to hire 8,000 nurses. We probably spend $100,000 an individual to train those people through high school and university and a nursing degree, and I don't think there are any jobs. I think a lot of them are going to be heading to the United States. Would that not create the same wealth if the government hired nurses for our hospitals and public institutions?

Dr Mintz: Let me comment just generally on the problem I think you're raising. It's certainly a worthwhile comment. Although I don't know all the details to confirm, let's say, the data, I will accept what you said as correct.

There's a serious problem in Ontario in terms of our education system, and that is that it's not sufficiently flexible or decentralized, I think, to deal with the kind of needs that are required by the labour market. If you use a very centralized approach to education, then what happens is that you will get this kind of mismatching that goes on, as your example illustrates. I do think that is an issue and I think that's something that's going to have to be addressed.

Mr Prue: Does a sufficient level of taxation to support public investment and education training and infrastructure also create wealth, or is it only the private sector that creates wealth? Because I've heard Tories say the public doesn't create wealth; the private sector does. I beg to differ sometimes.

Dr Mintz: I would agree with you that public investments can be important too. In fact, there's been some excellent work done by Bleaney and some colleagues that has been published in several journals now, looking at what impacts on growth rates of economies. What they find is that if governments invest in productivity-enhancing types of expenditures, then that will improve growth rates, and that would include infrastructure and education as examples. But when governments invest in, let's say, things that don't increase productivity in the economy, then certainly growth rates will not respond. Then of course the tax system—it's the opposite sort of thing. Taxes will have a negative impact on productivity, and there are some taxes that are worse than others. The worst taxes in terms of impacting on productivity are business taxes, capital taxes. Those are the ones that undermine productivity the most, and that's the lesson that the Scandinavian countries and the Netherlands have learned, that you don't want to hammer business capital investment in the country.

The Chair: We'll move to the government.

Mr Crozier: Mr Mintz, good afternoon. You're the second of three expert witnesses. My dilemma, and maybe that of others around this table, is to figure out who is the more expert. That's what I'm dealing with, although I will admit that you've come up to expectation because from my point of view—and this is just personally—had you come here and said that Ontario was doing a great job in any area other than in reducing taxes, I would have been shocked. I had no idea before today—and I'm going to try and find out more after this—about marginal fiscal burden. But I will say, in an admittedly very cynical way, I suppose if we had no capital tax, then we'd have no marginal fiscal burden and everything would be rosy.

I'll get to the serious point. Just two questions: One is, will capital always follow—and I mean globally—the lowest marginal fiscal burden? Secondly, why is it that governments—and I'll use two examples, George Bush and Harris-Eves—that have a mantra of lowering taxes as being the answer to it all are deeper in debt today than they were when they started?

Dr Mintz: First of all, just on your question about what determines capital investment, there's been a lot of studies done on capital investment, and the three most important determinants are: the size of the economy, or the size of the demand for products, and therefore businesses will respond with more investment to that; the cost of capital, which includes taxes that impact on the cost of capital—that will also have an impact on investment; and then there will be other things that will impact, such as public services for infrastructure and maybe a few other items that one might throw into some sort of regression, as economists like to call it, that they would do a statistical analysis to try to understand how capital investment gets impacted on.

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First of all, businesses will not move, necessarily, just to where the lowest tax rates are but businesses will be responsive to tax systems. Of course, some of their investment decisions will depend on the tax system itself. For example, if you're undertaking mining today, you'll look at northern Ontario. There are deposits there and you want to exploit them, therefore you would want to make investments in Ontario. On the other hand, if it's easier or less costly to invest in another jurisdiction, you may put your capital there first and wait down the road to when you want to develop the mining deposit in northern Ontario.

This is not to say that a jurisdiction with high taxes will drive out all capital investment. That's a silly argument to make. But it will have some impact on capital investment. The number that I gave in terms of the increased corporate income tax rates that were brought in for January 1, 2004, the $14-billion cost of that in terms of capital investment over time, is really based on economic studies that try to find how sensitive capital investment is to changes in the cost of capital.

On the second question, I seem to remember that when the Conservative government got elected in 1995, there was actually quite a large deficit.

Mr Crozier: It's $30 billion higher now.

Dr Mintz: That was debt. You said "deficit."

Mr Crozier: Debt; I'm sorry.

Dr Mintz: There's a big difference.

Mr Crozier: That's right. There is a big difference between deficit and debt, and thank you very much. Let's centre on debt.

Dr Mintz: OK. I agree, and in fact the debt did go up. But we have to remember they inherited a very large deficit at that time from the NDP government. They did cut back the deficit over a period, and then into a period of surpluses, and I guess the debate will continue on whether this year is a year of deficit brought on by the Conservatives or whether it's one the Liberals have tolerated. I'm not going to get into that debate.

Mr Crozier: Why not?

Dr Mintz: Certainly, I expect there is a deficit this year.

Mr Crozier: Why not?

Dr Mintz: Why? Because I'm not at first hand with the numbers, so I'm not going to comment on that.

The question is, are there jurisdictions that have cut taxes and, at the same time, do they end up running debts?

Noise from heat register.

Mr Colle: They didn't even fix the heating infrastructure.

Dr Mintz: That's costing a minute of your time.

Ah, finally.

Mr Crozier: You can take that time out of your answer to me too.

Dr Mintz: There's one infrastructure investment that maybe you do need.

Mr Colle: They never put money into the furnace and heating system even, the darn Tories.

Dr Mintz: There are countries that have cut taxes and actually have dealt with debt at the same time. Australia is a wonderful example of a country where you'll find that government's revenue as a portion of GDP is around a third—33%, 35%—of GDP. That's total revenue. They've undertaken very significant reforms where they've cut corporate income tax rates to 30%, broadened the tax base, got rid of some fast write-offs for businesses—I'm a strong believer in having low rates and broad bases for tax systems. Their net debt is only 5% of GDP today. They brought down their debt, over the past decade, by a tremendous amount. By the next few years, their net debt will be zero or negative, which is actually a phenomenal thing. So there are some wonderful examples.

Mr Crozier: There are. I wanted to know about Ontario vis-à-vis the US, but my colleagues have questions.

Mr Colle: Thank you, Professor, for coming back. I do remember your sober comment last time that we did the right thing in not proceeding with further tax cuts, given the immediate year-end deficit we're facing, no matter how big it is. I appreciate that candour.

The question I have is that in your discussions about the business burdens—and you talked about the marginal tax rate as a burden on business. I had a discussion last week with a constituent of mine who owns a biotech industry right in the heart of Toronto and they do some work on developing ultrasound technology etc. He said he hires people for his company on both sides of the border—in the United States and Canada. I was telling him about the financial choices we have to make. His message to me very clearly was, "Don't give me any cuts in my marginal tax rate or corporate taxes. Where you can help me be more competitive and to be profitable is by cutting my staffing costs and my payroll costs. The best thing you can do for me is ensure that there is first-quality health care available to the person I hire here in Canada, because if I hire two people doing the same job, one in Toronto and one in Connecticut, the person in Connecticut"—and this astounded me. He has to top up a salary in Connecticut by $24,000 American to give health care coverage to that employee and his or her family. He said that that's where he can in essence make a profit: if he can avoid that $24,000 American top-up cost for health care coverage.

So in looking at the pressures and the burdens on employers, given the health care levy and those other costs I know are there, what kind of incentive is it for a Canadian manufacturer or perhaps an American who is hiring Canadians to have that public health care side of the payroll covered by taxation? Have you ever quantified that in terms of the impact?

Dr Mintz: I think that's the main point of this work, that I do quantify that. That's the number on page 7. It's the health care subsidy, which is about 5% of gross wage costs. That's a very significant subsidy. That's taken into account in our numbers.

Let me just make a comment. It's very important not to go by anecdotal evidence alone. I don't know this particular biotech company you were talking to, but typically biotech companies don't pay corporate income taxes because they get a lot of fast write-offs for research and development expenditures. Sure, they're not worried about the corporate income tax; they don't pay it in a year. They're probably running tax losses or they can't use their tax credits. So obviously they're not going to be interested in having corporate rate cuts because it's of no benefit to them. Clearly they're going to be interested only in personal tax issues and subsidies going to business, and you're absolutely right: If Ontario runs a poor health care system, then even though there's this 4.9% subsidy, there may be a lot of incentive for people to be in the United States where the health care system runs better, even though employers have to pay for the cost of it. So you're absolutely right: It's important to run a good health care system.

I guess the question is, how are we going to make sure we're going to run a good health care system? We have to remember, we have been putting more and more money into health care year by year since the restrictions that governments put in in 1993, 1994 and 1995 in trying to curb some of the growth in health care expenses. But on average, health care has risen, per year, 7% over the past 20 years. In the past five years, it has risen 7% per year. That's faster than the growth in the economy. How much more and how much we keep putting into health care is going to be a very significant issue for the government.

I certainly understand that a new approach is going to be needed and a way of thinking about how to deal with these health care costs so that one can still run a very good, high-quality health care system, as we have been able to enjoy in Canada over many years.

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Mr Colle: On the other hand, on the American side, the escalation on the HMOs is double what Canada's increasing costs are. What I was struck by is the cost: US$24,000 to give someone basic health care coverage.

Dr Mintz: That number is not correct. It depends on the plan you pick in the United States. One has to look at that a little bit more carefully. The numbers I've seen are not nearly anywhere as high as $24,000, but it is significant in terms of employer costs and employee costs and in terms of the health care system. We know the health care system in the United States is a very high-cost system. It's gobbling up 15% of their GDP. So I'm not trying to say we should emulate the United States. In fact, I would argue that given the quality of the health care system in the United States, which runs well for those who can afford it but is not good for those who can't afford it—

Mr Colle: It's very expensive.

Dr Mintz: —it's a very expensive system.

We have been able to keep costs down to some extent in health care because we have run a more efficient health care system than the United States. But that's going to be the challenge. The challenge is going to be trying to deal with those costs over time, when we know it's having a huge impact on the share of provincial expenditures that are spent on programs, and at the same time the demands of the public in terms of having a health care system that's going to be there for them in order to deal with their pain and suffering.

Mr Colle: Just a last comment. It's interesting in the—

The Chair: Thank you, Mr Colle, and I thank you for your presentation this afternoon.

CANADIAN CENTRE FOR POLICY ALTERNATIVES

The Chair: I would ask representatives of the Canadian Centre for Policy Alternatives to come forward. Welcome. Good afternoon. If you would identify yourself for Hansard and the other members of the committee, we'd appreciate that. You have an hour for your presentation. That can be made up of a question period, if you so desire. You may begin.

Mr Hugh Mackenzie: For the record, my name is Hugh Mackenzie. I'm the co-chair of the Ontario Alternative Budget Working Group. It's a project of the Canadian Centre for Policy Alternatives. The Canadian Centre for Policy Alternatives is an independent policy analysis group based in Ottawa. It has branches in a number of provinces: Nova Scotia, British Columbia, Manitoba, Saskatchewan. The only formal presence of the CCPA in Ontario is the budget project.

I'll apologize in advance. If I look like I'm having trouble turning to the left, it has nothing to do with ideology; it has to do with the fact that I slept in a draft last night.

Mr Colle: Just as long as it isn't whiplash.

Mr Mackenzie: That's OK. I try not to get whiplash from that.

I've distributed a couple of documents that we've produced recently. The two of them really go together. One of them was released a couple of weeks ago. It basically attempts to think through the fiscal situation of the province, how we got to where we are, and to make some projections about what will happen if we don't do anything else between now and four years from now when the government's term in office ends.

The second piece is the piece which we've released today, which I hope will form the core of what we are talking about this afternoon, which lays out a proposal/suggestion to the government about how it might address the problems we've identified in the first piece. What I'd like to do—and I hope I can leave lots of time for questions, because I think that's the most important part of these exercises. Let me just start with the first one and take you through what I see as the highlights of the analysis of the fiscal situation.

Perhaps before I start getting into the details, I should just describe how it is that we go about doing this. I've constructed a model of the provincial budget which is driven off assumptions about the rate of inflation, the rate of real growth, interest rates, and it enables us to do projections off into the future of what is likely to happen under various assumptions about how expenditure grows and how the economy grows in general. You can factor in, for example, tax increases that have already been announced and that sort of thing.

In the analysis we did of the situation as it currently sits, let me try to point to a number of highlights. First of all, the deficit for this year. Mr Peters's analysis concluded that the deficit would be $5.6 billion. That number, $5.6 billion, has become what I sometimes call an iconic number in the sense that once Mr Peters put out $5.6 billion as the expected number for the deficit, that was probably what the deficit was going to be. I think if you look at what's happened as the various financial updates have been given, since then there have been some changes, some of them favourable, on the revenue side, most notably the tax cut rollbacks that the government announced in November.

But there is also a fair amount of flexibility on the expenditure side, because the government has identified, I think quite rightly, a number of accumulated deficits, if you want, the biggest one being the accumulated hospital deficits of over $1 billion, which the government is suggesting may be written off in fiscal year 2003-04. To the extent that those write-offs do take place, that will push the revenue side up. So I feel fairly confident in saying that when all the dust settles, at the next budget time the deficit will be $5.6 billion.

As I said, I don't have any quibble with the approach the government is taking to the accounting in this matter. The $1-billion deficit, for example, that's accumulated in the hospitals is clearly attributable to the policies of the previous government and, other things equal, I don't see any particular reason why the last fiscal year for which the previous government was responsible shouldn't be the fiscal year that carries the weight of getting rid of those deficits. There is no prospect in the finances of hospitals that they're ever going to generate surplus revenues to enable them to retire those debts. It would be, in my view, appropriate for the government to admit that the previous government's cuts had gone too far and write them off. Why not do it in this fiscal year to the extent that there's room to do that?

Looking forward, I think it's important to recognize that there are elements of the deficit the government has inherited that will not have an ongoing impact on the provincial government's finances. There are a number of these, and they're referred to in the little note that I put together. I just want to highlight two or three of them that are of some significance.

The most important is that obviously the numbers for this year only reflect three months of additional revenue from the tax measures that were announced by the Minister of Finance in November. On a full-year basis, there is approximately an additional $2 billion on the revenue side that comes into play, because we get a full year of revenue from the rollbacks of the corporate tax cuts and the tobacco tax increase.

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Secondly there's an amount, approximately $1 billion, that is incorporated in the estimates for 2003-04 that I would categorize as clearly non-recurring—at least we certainly wouldn't anticipate it recurring—and that's the roughly $1 billion in additional costs attributable to the SARS outbreak. We may have another random event like that, in which case there will be another random increase in spending, but those certainly aren't costs that are built into the funding base of the province. We can expect that that will go away as well.

Finally, there is again a fairly substantial number in the estimates for this year that relates to the negative impact on the province's finances of the hydro rate freeze. The hydro rate freeze impacts the budget in a couple of ways. The direct way it does is that as the accounts have been redrawn, the financial activities of the independent marketing organization get folded into the provincial budget; and to the extent that the cost of providing power exceeds the amount that people are paying for it, that negative amount gets factored into it.

Second, even with that, because a portion of the additional cost under the financing legislation was to be borne by Ontario Power Generation, it affected the profits of the crown corporations in the energy sector, and that in turn affects the government's revenues. We don't know yet what the end of the story will be with respect to the pricing of electricity. I think it's safe to assume that when the dust settles from those changes, the electricity sector will be generating enough revenue to balance off at least the cost of generating the power. That negative effect on the provincial budget that's happening this year will not recur. In the projections that I've done, I've simply assumed that when all is said and done, the impact of the electricity sector on the provincial budget will be neutral, as opposed to a negative of some several hundred million dollars in the past year.

When you take all those factors into account, you'll see in the chart that appears on page 12 I have a forecast that's based on consensus assumptions about economic growth. Those are the assumptions that were released as part of the December financial statement. To jump down to the bottom line, they show the small surplus in 2002-03, the $5.6-billion deficit projected for 2003-04 and a deficit of $2.2 billion for 2004-05. If you want to think about things in the framework that the government has invited us to think about these things, which I think is the right one—if you want to think about things in terms of structural deficits, the bottom line of the structural deficit is between $2 billion and $2.5 billion. In other words, when you take the $5.6 billion that we're sitting with right now and you factor out the things that are transitory, that are offset by revenue increases or will be addressed in changes in other policy like the hydro pricing policy, when you take all of those things out, you end up with an embedded deficit of something on the order of $2.2 billion.

I make the point that this is a bottom-line deficit because my view is that in fact the deficit that I forecast now, while it's an accurate reflection of what's happening on the strictly and narrowly defined financial side, is an understatement of the real deficit. It doesn't take into account the fact that in a number of areas of public spending the current levels of spending are unsustainable in the sense that they are unsustainably low. The education system, for example, will have a great deal of difficulty functioning at its current level of activity without a significant injection of capital. There has been a lot of attention to funding for infrastructure both at the provincial level and at the municipal level. I doubt that you'd find too many observers who would say that the current rate of capital spending in Ontario is sustainable. It just cannot be kept at that low a level and have us expect not to see even more obvious degeneration in the quality of public infrastructure in the province.

Be that as it may, we get an estimate of about $2.2 billion as the forecast deficit for 2004-05, and importantly, I think, when you use the economic growth assumptions that the government has used in its December statement and factor them against the $5.9 billion in new investments that were promised during the election campaign last fall, if nothing else happens, our forecast is that the government will be able to accomplish about 35% of the $5.9 billion in new investments that it promised over its term of office unless something is done to deal with the revenue side of the equation.

From our perspective, the size of the fiscal hole, if you want, that the government faces is not so much the $2.2-billion deficit next year if nothing else happens; the fiscal hole as far as we frame it is that compared with the promises for public services improvement that formed the core of the government's election campaign, there is a gap of on the order of $3.5 billion between what the government promised that it would be able to do during the life of its term of office and what the economic forecasts say the revenue system will generate.

That gets the story up to the point of the piece that we released this morning. Just to summarize the conclusions: The default, doing nothing going forward, we're looking at about a $2.2-billion deficit next year. Again, doing nothing more in the budgets except for the tax increases that have already been announced, going forward to the fourth year of the government's term, we're looking at the government only being able to achieve about 35% of the new investments that it has promised, assuming that the budget is balanced in the fourth year.

So in very simple terms, there are two conclusions out of this. One is that, basically, under no circumstances would it be reasonable to expect the budget to be balanced this year.

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Just to put this in perspective, again, default going forward, doing nothing other than looking at that deficit and deciding you've got to get rid of it by cutting spending, the degree of spending cut that would be required to balance the budget next year would be equivalent to the most stringent spending cut that the previous government implemented in any of its years in office. To say that that's inconsistent with what I suspect most people in the province thought the message of the election campaign was is a wild understatement.

I don't think anybody is prepared for, expecting or in fact willing to accept a rerun of the 1996-97 expenditure cutting exercise going into this government's first budget. So to the extent that action needs to be taken to address the deficit, in my view, clearly it has to be taken over a longer period of time than one year. Expecting to balance the budget in a single year would be irresponsible, given the state of public services in the province.

The second general conclusion, as I said, is that there's about a $3.5-billion gap on the revenue side between what the fiscal system of the province is likely to generate over the next three years and what the expenditure commitments are that flow from the platform.

Based on those conclusions, we have put together a suggested package of tax changes that we believe would enable the government to balance the budget over its term of office, recovering from the $5.6-billion deficit that it inherited, and in addition to that, deliver on the $5.9 billion in new investments that were promised in the election campaign.

The revenue package we're suggesting falls into two broad categories. The first is something that we call maximizing the revenue from the current tax system. It essentially involves identifying major tax expenditures, major tax loopholes, in the current tax system and closing them. Those fall into two key areas. One is in the corporate tax system.

One of the things that had a very low profile in the budgetary actions of the previous government but that actually accounted for a significant loss in revenue was an astonishingly large number of tax expenditures, new tax breaks provided for in the Ontario corporate income tax system. I counted them up a couple of nights ago. There were 56 separate new tax expenditure measures that were introduced into the provincial corporate income tax system. This is at a time when most people who think about corporate tax policy from a tax policy perspective are taking the position that tax expenditures in the corporate tax system are not very effective in delivering on the economic policy objectives that they're supposed to achieve. They weaken the fairness of the tax system and they're very expensive, the net conclusion being that the policy objective of the government ought to be to reduce these tax expenditures, not to increase them.

Just to amplify the point a little bit, when the Harris government took office there was, even at that time, somewhere in the range of $500 million to $800 million in tax expenditures, tax loopholes, basically, that existed in the Ontario tax system that did not exist in the federal corporate income tax system. So there was a lack of parallelism between the two corporate tax systems.

There are a number of issues that are raised by that lack of parallelism. It increases administrative costs for tax filers, because you've got two completely separate tax forms to fill out. Because you've got two separate tax systems, it forecloses the possibility that you might actually have—perish the thought—an agreement with the federal government to share the cost of collecting the tax and have only one tax administrative authority collecting the taxes instead of two.

But most important, there is substantial evidence to suggest that differences between the Ontario tax system and the federal tax system or between the Ontario tax system and neighbouring provincial tax systems are so insignificant from the perspective of the taxpayer that they have virtually no influence on the decision-making of the corporation. They cost the province money but they have very little influence.

There are some exceptions to those. In our proposal we identify those and suggest that they be dealt with separately. Those are the grants that support cultural industries, which until the Harris-Eves government took power had been delivered through a system of grants. Those were converted into tax credits, and we're suggesting that those be isolated and converted back into grants. From a tax policy perspective, delivering these benefits in the form of grants is much more effective. There is much greater accountability, it's much better targeted, and because the onus to demonstrate that you qualify is on the person who is applying for the grants, you are much more likely to get the activity you're supposedly subsidizing happening than when you deliver them through the tax system. The fundamental point about delivering things through the tax system is that the onus is on the tax authorities to demonstrate that you're not using it properly. My own very simple-minded view of these things is that if you're seeking to get a public benefit, you ought to be accountable for it and be prepared to justify your getting it.

The net effect of getting rid of the excessive tax expenditures that were introduced since 1996, while protecting the subsidies for the arts, culture and television industries and so on that are built into those, the net effect after you've protected those is about an $850-million saving in provincial revenue.

The second big item—this is obviously a controversial one and I expect we may have some discussion about it—is to get rid of the loopholes that are built into the employer health tax. The employer health tax contains a number of exemptions, the most expensive of which is the exemption for the first $400,000 in payroll. When Minister Nixon, back in the 1980s, first introduced the employer health tax as a replacement for the Ontario health insurance plan premiums, the exemption had a much lower threshold and the attempt was made to target it specifically to small businesses. Since then it's been drastically expanded in three respects. One is that in the initial formulation, it was a graduated tax, so that nobody got out of paying the tax entirely. There was a low rate and there was a higher rate. That got made significantly more generous. Second, the threshold was raised from $200,000 to $400,000 and it was converted to an exemption for the first $400,000 of payroll. When it was first introduced, the way it worked was that if your total payroll was less than a certain amount of money, you paid a lower rate. The previous government changed it to an exemption for the first $400,000 in payroll. The last thing they did is they completely exempted people who were self-employed. So the net effect is that if this is theoretically a tax measure designed to help small business, it's incredibly poorly targeted.

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To pick up on the point that was being discussed with Mr Mintz in your previous session, whether the value of the benefit from publicly funded health care insurance is $24,000 or $8,000 or $5,000 or $7,000, it is a huge advantage competitively to business in Ontario to have that employment cost covered largely through the tax system. We think it would be appropriate for that tax to be levied as a flat rate tax on all payrolls, regardless of the size of the payroll. That would generate an additional $1.1 billion in revenue if it were fully phased in.

The last piece of the puzzle on maximizing revenue from the existing tax system speaks to complaints that have been raised over and over again by the auditor about the extent and effectiveness of Ontario's enforcement of its own tax legislation. The most recent report got a fair amount of attention because the auditor found—the number isn't immediately in my head, but kind of a mind-boggling number of corporations in Ontario don't even bother to file income tax returns. On the retail sales tax side, there are legions of stories about the inadequacy of the audit procedures with the retail sales tax, where the retail sales tax is being collected but not remitted to the government. We think it would be reasonable—in fact, very conservative—to assume that a more aggressive approach to administering the current tax system would improve annual revenue by about $400 million.

One of the things that is kind of shocking, which has come out in the auditor's reports, is that the provisions of the provincial income tax that relate specifically to Ontario—the claims for the property tax credit, the sales tax credit, the Ontario tax reduction and various other things like that—aren't audited at all. The federal government's enforcement branch does not audit provincial provisions, and there is no capacity in Ontario to audit those provisions at all, period. When the federal government audits somebody's return, they don't bother to audit the provincial provisions. Nobody's doing it. I think an agreement with the federal government to have them extend their returns auditing to those provisions would generate a substantial amount of money.

The other piece of the proposal is on the personal income tax side. We believe the public opinion polls that say people would be prepared to pay higher taxes to improve public services are right. We believe the state of public services in Ontario at the moment is such that the kinds of new investments the government has promised, the $5.9 billion, would, over the term of office of the government, have a visible, positive impact on people's perceptions of the quality of public services in the province, and we believe that people are prepared to pay for that.

The other piece of the package we're proposing is a very modest increase, 2%, in each of the tax rates in the personal and corporate income tax systems. When I say a 2% increase in the tax rate, I'm not talking about two percentage points; I'm talking about increasing, for example, the bottom rate of income tax from 6.05% to 6.17%, and so on up the scale. If you increase all the rates proportionally in that way, you end up with a kind of progressive profile of the impact. We estimate that you generate about $1.25 billion in additional revenue from personal income and about $150 million in additional revenue on the corporate side.

In terms of individual impacts, for a taxpayer at the median income level—that's the level of income where half the taxpayers have incomes higher than that and half the taxpayers have incomes lower than that; that number is about $35,000, by the way—the measure we've proposed would cost about $50 or about $1 a week. At the average taxpayer's income, which is in the neighbourhood of $45,000 to $50,000 a year, we're looking at an additional cost of between $150 and $200; in other words, between $3 and $4 a week.

We believe, as I said, that the polls are correct. If you present people with a proposition that says we will be able to improve public services substantially and in a noticeable way, they would be prepared to pay more for that. In terms of how it relates to the tax cuts that have been put in place so far, it's about 15% of the personal income tax cuts that have been put in place in Ontario since 1996. So it's about $1 in $8 of the cuts.

In a nutshell, that's the proposal. We estimate that those measures together would generate about $3.75 billion. We're not making any suggestions as to the timing. Obviously, you wouldn't do all of it all at once. What we are saying, though, is that if the government's objective is to deliver on the $5.9 billion and have the province's fiscal situation fixed by the end of its term in office, then revenue measures on this order, implemented over the four-year term of office, would lead to a balanced budget by the end of the government's term of office and enable it to make those very necessary investments in public services.

The Chair: We have about eight minutes per caucus, and we'll start with the official opposition.

Mr Barrett: Mr Mackenzie, I appreciate the detailed technical papers you have distributed. You've raised the issues of the deficit and taxes and the issue of advice not to reduce government. During the election, when the issue of the deficit was raised, I know the Fraser Institute presented two choices at that time, very simple ways as I recall. One option was for government to cut taxes. We certainly see the federal Liberals in the process of doing this, and having done this in recent years as well; and secondly, finding efficiencies or savings in government, something we do see and have seen the federal Liberals involved in as well. Maybe just to reiterate what you have been presenting, you see these two options as totally out of consideration?

Mr Mackenzie: One of the great things about election campaigns is that they're not referenda. Everybody gets to sit around rooms like this endlessly afterwards discussing what they mean. I think that other people will have different views about what the messages out of the election were. As a careful observer of the election campaign myself, the message that got through to me was that the government was talking about a change in direction, a change in the approach to public services. We had a leader who became Premier who stood on public platforms and said he believed in public service, he believed in public services, he believed it was important that Ontario reinvest more money in public services, and I take that as the overriding commitment of the campaign. As a result, I see a suggestion that the deficit be addressed by hacking away further at public spending as a recipe for making a very bad situation much worse.

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I'm not the only person who's saying that. If you look at, for example, the work that the Toronto-Dominion Bank has done on investment in public infrastructure, Don Drummond points to a huge shortfall in capital spending at the municipal level and on physical infrastructure at the provincial level in Ontario. In the hospital sector, the fact that the hospitals, over the past few years, despite a great deal of pressure from the provincial government, have not been able to avoid accumulating a deficit of over $1 billion I think speaks volumes to that. We can see the consequences of budget restraint, budget cuts, in the education sector, both the elementary and secondary sector and the post-secondary sector.

In rhyming those off, I've rhymed off all of the major areas of public spending, so when I look at the services deficit that we're confronting and somebody suggests to me that we can solve the government's budgetary problems by cutting back on spending, my question is, where? We have been through a period of unrelenting cuts in public services over the last eight years. There isn't anything left.

Mr Barrett: OK. In paper number 1, referring to an increase in government spending on services, you indicate again it can't be done without both increasing taxes and running deficits, for at least part of its first term in office. I think [Inaudible] said running deficits right up until the last year—

Mr Mackenzie: Well, it could be. It depends on what decisions you made about the timing of the tax changes.

Mr Barrett: With respect to your call for increasing taxes—and we do know that as of last December we had an announcement of essentially a $4-billion-plus increase in the amount of money people will be sending to government under the Fiscal Responsibility Act—would you be advocating increasing taxes beyond this $4-billion announcement that was made for the coming fiscal year?

Mr Mackenzie: The $4 billion—that's the highest number I've seen attributed to it.

Mr O'Toole: It's $3 billion.

Interjections.

Mr Mackenzie: The short answer is, whatever your number is—I'll tell you what: I'll make a deal with you.

Mr Barrett: It's $4.13 billion.

Mr Mackenzie: I'll make a deal with you: My numbers are based on the assumption that the revenue measures are worth between $2.5 billion and $3 billion, so if it turns out that they generate $4 billion, as you say, then that will be good news, because it means that the government will only have to increase taxes by $2.4 billion, instead of $3.7 billion, to meet its spending.

Mr Barrett: To meet that $5.9 billion in promises.

Mr Mackenzie: The $5.9 billion, yes.

Mr Barrett: Can that be done without selling anything—

Interjection.

Mr Mackenzie: I'm not a big fan of—

Mr Barrett: The LCBO, TVO?

Mr Mackenzie: It seems to me that to suggest that the government's budgetary problems can be solved by selling off assets is to deny the underlying reality in the deficit. It is a structural deficit and you don't solve a structural deficit by selling off assets, just as in your own personal life if your outflow of money is greater than your salary, you don't solve the problem long-term by selling the lawn mower.

Mr O'Toole: I always appreciate your input, Hugh; very much so.

Mr Mackenzie: I just want to say, Mr O'Toole, that I was pleased to see you. I was hoping I wouldn't miss you.

Mr O'Toole: I was actually watching on television—

Interjection: Oh, yeah.

Mr O'Toole: No, I was. I'm quite serious. I wouldn't miss it for the world.

I want to put on the record very clearly, Mr Mackenzie, that you've exposed the rawness of it all. I really commend you on your paper number 1. It's an extremely good summary, and in it, it says that the centrepiece of the Liberal campaign was a package of public service investments conservatively estimated to add up to $5.9 billion over the term of four years in office. I think you've done a masterful job of uncovering the obvious.

Mr Mackenzie: That's my specialty.

Mr O'Toole: The fact is, though, no one, including Mr Phillips—the reason he's not finance minister is because he knew too. He was an extremely good finance critic, and he said in June and he said in the House that it was probably about $5 billion. Then you go on to sequentially kind of retell the story of history.

They've come up with the four standard procedures for excuses, really. Shock and dismay—gosh, they knew all along and then all of a sudden, the day of, you said the very minute of when the polls closed, "Gosh, this big problem emerged."

The second step is—

The Chair: Thank you, Mr O'Toole. Your time has expired. We'll move to the NDP.

Interjections.

The Chair: Come to order, Mr O'Toole.

Mr Prue: A number of questions. I'll see how many I can get in, in the eight minutes.

Mr Sorbara, the finance minister, was here this morning and he suggested, I think—because I was trying to read the entrails a little bit, some kind of Roman augur—that there would be no deficit and no tax increase option. That's really where he favoured going. That's his preferred solution for 2004-05. This would necessitate, as I see it, about a $2-billion cut in programs. Where do you think the government might make the cuts? I'm not asking you to make them, but if one were to make the cuts, we're trying to figure out where they could possibly be proceeding. He was not willing to elucidate on that point, nor were the civil servants who came after him. Where might those cuts be made to do the least damage to the economy?

Mr Mackenzie: It mystifies me, frankly. It would seem unusual, let me put it that way, if the cuts were to be found in health care, given the consensus about the importance of the health care system in the province. That accounts for a significant proportion of the provincial budget.

There is no suggestion that the elementary and secondary education system could tolerate further cuts in spending. In fact, that sector is counting on a continuation of the implementation of the Rozanski recommendations just to keep the system from falling apart. In post-secondary, the government has already frozen tuition, so it's hard to see how anybody's going to be able to justify not increasing the provincial government's expenditure on post-secondary education.

You go on in the social services area: We're working on social assistance rates that were cut by 20% and frozen in 1995. It's hard to see anything happening there.

The other big one is capital spending. Again, there's a consensus, pretty much across the spectrum, that capital spending is dangerously low.

So I don't have any good guesses. It may be that what the minister thinks they might do is treat next year as a temporary problem and sell off a bunch of assets for temporary relief.

Mr Prue: Is that what you see as the likely scenario here, selling off the LCBO, TVOntario, hydro? I don't know what else would generate that kind of money. Algonquin Park? I mean, what do you see?

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Mr Mackenzie: Far be it from me to plead the case of the previous government, but most of those properties are not new on lists of things that might be sold. Those are all things that the Harris and Eves governments looked carefully at selling themselves, and for their reasons decided not to proceed. I would assume the fact that the LCBO generates over $1 billion in revenue annually for the government might have had something to do with the fact that the previous government didn't sell it. The prospect for—

Interjection.

Mr Mackenzie: Yes, but Harris didn't sell it either. So it's inconceivable to me that anybody would pay enough money for the LCBO franchise to compensate on a capitalized basis for the loss of the revenue.

So I don't know. I can't put my finger on any big item.

Mr Prue: OK. You have suggested as one of the solutions that we raise personal income taxes by 2%. I understand that isn't from 27% to 29%. You gave the example, I think, of 6.07% to 6.15% at the lowest rate. You want to do that across the board. Do you not think that raising the higher levels could easily get as much money? I'm talking about the surtaxes. A surtax of 3% on those at $100,000 or more, a surtax of 6% on those at $150,000, would raise at least as much—possibly more—as across-the-board.

Mr Mackenzie: Because it's expressed as a percentage of the existing rate, the tax increase is a higher percentage of income as income goes up.

There are basically two reasons for the choice that we made. One of them is a practical political issue and the other is a more philosophical one.

The practical political question is that we're making these proposals in a sincere effort to get this government to implement them. We felt that a proposal that just taxed people in the highest income brackets frankly would not be taken seriously in the debate that I would assume is happening within the government right now.

There's also a philosophical reason for suggesting an across-the-board approach rather than taxing only high-income people, and that is that I really believe that one of the reasons why we got into the fix that we're in now is because governments basically got away with suggesting to people that there was no relationship between the services that they enjoyed and the taxes that they paid, that somehow taxes could be considered a burden on people that could be shed without having any negative impact on the services that we depend on.

I'm not the phrase-maker that Oliver Wendell Holmes was, but I guess the proposal to increase income taxes across the board is a way of expressing, in very concrete terms, Justice Holmes's observation—I'm paraphrasing now, because I don't remember it exactly—that "I pay my taxes willingly. Taxes are what I pay for civilization." I think the message that is inherent in the package that we put together is that we all benefit from public services—frankly, we all benefited to a greater or lesser extent from the tax cuts as well—and if we want to improve public services, we all should participate in the solution to the problem.

The Chair: Thank you. We'll move to the government side.

Ms Marsales: Mr Mackenzie, I've thoroughly enjoyed your practical approach to balancing the deficit. I have a question with respect to the suggestion of the 2% increase. One of the previous speakers identified a graph where individual incomes are falling against the rising values of real estate, and it could be suggested that personal debt right now is at an all-time high and a lot of it is being leveraged against increasing real estate values and can be somewhat suspect in terms of the long-term potential to have challenges down the road. Have you taken that into consideration in your analysis of the capacity?

Mr Mackenzie: As I pointed out, the proposal is structured in such a way that the impact at the low end of the income scale is extremely modest. The median taxpayer would pay $50 a year, a dollar a week. I think that's a pretty modest investment to be asked to make to share in the cost of what will be a fairly substantial improvement in the quality of public services. So it's taken into account to the extent that we've deliberately structured the proposal to be progressive, but we've also deliberately structured the proposal so that everybody is paying something.

Part of the change that I think we need to get our heads around is to stop thinking about everybody as taxpayers and start thinking about people as citizens again. Part of citizenship is contributing to the cost of paying for civilization. I know that's hopelessly abstract. It's interesting, when you talk to people who are advocates for low-income people, they don't like the idea of low-income households being wiped off the income tax rolls. They'd rather see the services that low-income people depend on improve.

One of the things that has always—this is an occupational hazard of mine because I spent several years as the executive director of the Ontario Fair Tax Commission looking at tax fairness issues. One of the things that is very hard to get across is that you can get deceived taking a partial approach to looking at the impact of government on people. To give you an example, one of the oddities of the record of the previous government is that under the previous government the income tax system actually became more progressive; that is, the relationship between taxes paid at the bottom end and taxes paid at the top end actually improved relatively speaking. The overall tax system, however, became less progressive because at the same time, the personal income tax dropped as a share of the total revenue of the government. I would be interested in engaging in the argument, but from my perspective, it almost goes without saying that the total effect of government on individuals, the distributive effect of government on individuals, when you take into account the spending side as well as the revenue side, was significantly regressive, the change was significantly regressive, between 1995 and 2004 even though, looking narrowly, the income tax system may actually have become more progressive.

So I think you have to look at the whole package, not just at the revenue side in general and not just at the income tax system in particular. I think that's the message people need to hear. The trick or the issue in figuring out what those poll results mean, when you ask people, "Would you be willing to pay higher taxes in order to see an improved health care system or an improved elementary and secondary education system?" the key to that syllogism, if you want, is persuading people that when they pay the extra taxes, there actually are going to be visible improvements in public services, that it's not just going to disappear into the pot.

That's one of the reasons why you see more and more people thinking about taxes that are at least notionally earmarked. The mayors were getting together last week and they were talking about earmarking gas taxes for public transit and roads, and there's a reason for that: Then people see a real connection, a direct connection, between the taxes they pay and the services they get. That's one of the reasons, frankly, why I like the employer health tax, because again, you say the name of the tax and it says medicare. People value medicare and so they understand why they're paying the tax.

The Chair: Thank you for your presentation and appearing before the committee this afternoon. We appreciate it.

Mr Prue: I wonder if I could just ask for unanimous consent. It's a fairly small item. Leah Casselman, who is the president of OPSEU, was scheduled for Thursday, not this Thursday but two weeks Thursday, two weeks Wednesday, whatever day it is; it's two weeks from now, in Toronto—

Mr Wilkinson: Tuesday or Wednesday.

Mr Prue: Tuesday or Wednesday, whatever it is. She is not available that day and has requested that she be heard in London on Wednesday. There are some vacancies where we have not been able to find the people; if she could have one of those slots, I would appreciate it, and I think she would too.

The Chair: Do I have unanimous consent? Agreed.

I want the committee members to understand that we would have to go past 4 o'clock of the day to do that.

Interjections.

The Chair: Would members please remain for a moment. I have some announcements.

We do have unanimous consent to sit past 4 of the clock in London to hear the deputant? Agreed? Agreed. Carried.

The bus, for members travelling by bus, will be in front of this building at 4:30 sharp.

This meeting stands adjourned.

The committee adjourned at 1603.

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Mr Tim Peterson (Mississauga South / -Sud L)
Mr Michael Prue (Beaches-East York ND)
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Also taking part / Autres participants et participantes
Mr John R. Baird (Nepean-Carleton PC)
Mr Howard Hampton (Kenora-Rainy River ND)

Clerk / Greffier
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Mr Larry Johnston, research officer,
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