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FAST FACTS

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Risky Business

With a promise “not to let this report gather dust”, Sam Katz released the final report of the Economic Opportunity Commission (EOC) late last week. The mandate of the Commission was to find ways of replacing the \$55 million in tax revenues that would be lost with the elimination of the business tax. The EOC was made up primarily of business representatives and their lobbyists. Letting lobbyists actually write public policy is not usually considered good governance. It is a little like implementing the fox’s ideas about how to guard your chickens, and the EOC is certainly a predictable product of its authors.

Prior to outlining their new initiatives, the report starts out by justifying the elimination of the business tax. What passes for evidence on this score is shockingly lightweight. Canadian Federation of Independent Business member surveys, which claim that, should the business tax be eliminated, their members would reinvest more money, are interspersed with quotes from businesses large and small, who universally, and unsurprisingly, insist on the advantages of eliminating the tax.

However, if the EOC had bothered to conduct a little actual research, it would have found that there have been a number of economic studies that attempt empirically to determine the impact of tax reductions on economic activity. A review of this literature would have revealed that a 1% decrease in total taxes paid by firms increases economic activity by a fairly modest 0.1 to 0.3%. Bearing in mind that the business tax makes up a very small proportion of the overall taxes paid by Winnipeg firms, the elimination of business tax is unlikely to result in a large increase in activity despite the hyperbole of the Mayor and the EOC authors. To make matters worse, the one piece of evidence that

the EOC presents actually harms its case rather than strengthens it. The EOC cites KPMG’s Competitive Alternatives Report 2006 to show that Winnipeg’s total municipal taxes are the second highest of major centres in Canada. The EOC uses a sample firm from the KPMG report that would pay a total of around \$250,000 in Winnipeg municipal taxes on yearly sales of \$17.6 million, so the business tax of approximately \$50,000 amounts to a tiny 0.3% of sales. Indeed, the very same KPMG report cited in this study ranks Winnipeg as one of the lowest cost locations in all of central North America. The 2004 KPMG report also points out that, overall, taxes make up a very small portion of business costs, at only 5 to 11% of costs for a manufacturing firm and 3 to 8% for non-manufacturing. So, the business tax is a very small component of total taxes, which are a fairly small component of total expenses, which is why they have little impact on investment decisions.

The Mayor’s claim that eliminating the business tax “will help attract new businesses, create jobs, help businesses expand and help prevent others from closing” is further undermined by the EOC’s claim that should the business tax be eliminated businesses in the city will owe more taxes to the other levels of government because they will no longer be deducting the business tax as a cost. For every dollar eliminated from the business tax, the Province will gain back 14 cents and the feds 22 cents. Businesses will only save 64 cents for every dollar of business tax eliminated, even further reducing the already tiny gains from the tax’s elimination.

Of course, the main task of the EOC is to find creative ways to make up the \$55 million that will vanish from the city budget. There are a large number of suggestions, but none of them could be described as particularly creative.



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***FASTFACTS* continued ...**

Items like selling off city golf courses, selling naming rights for public facilities, and renting advertising space on city land conveniently located along high density traffic routes, are predicted to either generate a little cash or save a few dollars, but most of the money (around \$45 million of the \$55 million total) comes from only five sources: public private partnerships (\$15-20 million), savings on labour costs (\$7 million), increasing the corporate property tax rate (\$5 million), allocating future revenue (\$10 million), and asking the province for more money (\$8 million). Let's look at each of these proposals.

Many of the suggestions involve engaging in public private partnerships (PPP), from meter reading to snow removal. The EOC recommends "contracting out any service that could be provided by outside suppliers", but it is especially keen on privatizing health and recreation facilities run by the City. Given the actual history of these kinds of partnerships in Canada, predicting any savings at all should be regarded as an exercise in optimism. John Loxley has just completed a nation-wide study of PPPs and found that they failed to deliver savings compared to services offered directly by the public sector. For example, using a PPP lease arrangement to construct the Charleswood Bridge added \$1.4 million (almost 10% of the total) to its cost. There may be no real evidence to suggest that PPPs will save the City any money, but it very nicely serves the interests of some of the city's businesses by opening up previously publicly run activities to private sector firms.

The EOC repeatedly claims that the city's wage bill is grossly inflated. Suggestions to remedy this situation range from drastically cutting the wages of lifeguards at public pools, to the use of volunteer labour in the libraries and zoo. The most important suggestion was to hold salary increases for workers in the City to the rate of inflation. Surely a business savvy mayor does not need an expensive commission to tell him that reducing salaries will save money. Perhaps the reason that it has not been implemented so far is that salaries at the City are not the result of a Mayoral decree, but are the result of the more democratic process of collective bargaining with a union unlikely to be enamoured of layoffs and wage restrictions.

City revenues will grow over time. As the value of property increases, so too will the revenue generated from an

unchanging tax rate. The EOC recommends setting aside either 25% of new revenue for three years or one-eighth of new revenue over six years to generate \$10 million. Of course, this is not actually finding ways to make up for the lost \$55 million. It is actually doing nothing. The revenue estimates are also based on an annual growth in City revenues of \$14 million, the average growth rate between 2001 and 2006. This period coincides with a particularly strong growth in City revenues. City revenue between 1995 and 2001 grew at a much slower rate. In order to generate the \$10 million projected, the property tax base must continue to rise at the recent, relatively rapid, rate rather than its more modest historical pace.

The EOC also recommends negotiating with the Province for a share of the Provincial Sales Tax rather than the current more fixed transfer. The likelihood of this suggestion actually coming to pass depends crucially on the good will of the Province. Moreover, despite the claims by the EOC that this was "not simply an exercise in asking another level of government for more funding", this is precisely what it is. Finally, as the business tax is eliminated, the EOC recommends a slight increase in the corporate property tax to raise another \$5 million. While replacing one business tax with another, albeit smaller, tax on business is certainly an ideal substitute from the perspective of those who oppose the tax elimination, it is an interesting suggestion given the EOC's repeated insistence on the detrimental impacts of any taxes on business.

The evidence in support of the business tax is not just unconvincing but is based on the stated positive intentions of those with the most to gain from its elimination. The narrow self-interest should be noted. The EOC's creative suggestions for replacing the business tax include: doing nothing, asking the province for more money, paying city workers less, and taxing business. Mayor Katz commended the Committee for coming in under budget. If this is an example of the money saving that we can expect at the City, it might be better to spend a few more dollars. Gathering dust might just be the EOC's most useful role.

- Ian Hudson

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