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# Ontario's Fiscal Reality

## Cup Half Empty or Half Full?

Hugh Mackenzie

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# Ontario's Fiscal Reality

## Cup Half Empty or Half Full?

THE MCGUINTY GOVERNMENT has been using the report of the Commission on the Reform of Ontario's Public Services, known as the Drummond report, to short-circuit an open, public debate about the value of public services and what Ontario needs to do to improve and protect them. This paper exposes the government's strategy and critically reviews the Drummond report's key premise: namely, that Ontario cannot afford to maintain its current level of public services because the province faces a dire fiscal crisis.

## Introduction

Since the last provincial budget was tabled in March 2011, Ontarians have been treated to a carefully orchestrated exercise aimed at foreclosing public debate about the future of public services.

Unlike the fiscal crisis narrative that has dominated 2012, the economic forecast tabled in the 2011 Ontario budget was relatively reassuring. It forecast steady progress towards eliminating the deficit, with balance to be achieved in 2017–18. There was no talk then about the need for austerity.

But with an election facing the province in the Fall, the government punted all of the critical issues to a commission headed by Don Drummond, a retired bank executive and federal public servant. For much of its existence,

the Drummond Commission operated under the radar, doing its work in private and popping up to the political surface through strategically timed public speeches from its chair. That changed as the calendar turned to 2012, as Ontarians were primed to "wait for Drummond" with frequent news leaks, hints of what was to come, and constant speculation as to when the report would be released.

By the time the report was released on February 15, 2012, its conclusions and major recommendations were hardly a surprise. At the heart of the 562-page report, featuring 362 recommendations, is its budgetary forecast, which predicts the fiscal equivalent of an Armageddon. In the absence of dramatic action, it claims Ontario's deficit will double to $30 billion by 2017–18, the government's target date for eliminating the deficit.

The key message: Ontario faces fiscal catastrophe unless we unleash major cuts to public services that just a few months ago — during the provincial election campaign — would have been unpalatable. If that sounds like a familiar refrain, it should. It is exactly what the Federal government was saying in 1995 when it imposed a wide range of drastic cuts in services and transfer payments and, in the process, radically altered the role of the federal government in Canadian society.

Perhaps the most revealing thing about the Drummond report is what isn't in it: any discussion of revenue generation. Taxes and other sources of revenue were explicitly off the table, a message that has been reinforced in repeated public statements from Premier McGuinty since the release of the report.

## Deconstructing Drummond's Fiscal Analysis

Drummond's fiscal analysis is based on an economic growth forecast which, while conservative, is at the low end of a range of credible estimates. However, the report's translation of that conservative forecast into ultra-pessimistic fiscal projections is based on additional assumptions about the relationship between the state of the economy and Ontario's fiscal performance that are without precedent in Ontario's economic and fiscal history. The report forecasts that revenue will grow more slowly than the economy; that expenditures will grow at a rate faster than that needed to preserve real, per capita spending (despite the current large deficit, and despite budgetary allocations that are smaller than that); and that the rate of interest paid by Ontario on its public debt will increase by more than half from today's rates.

These three key assumptions — that revenue growth will fall short of economic growth, that government expenditures will growing at a faster rate than both inflation and Ontario's population, and finally that interest rates will soon rise dramatically — are not credible in the current economic and fiscal context. Yet these three assumptions represent more than two-thirds of the $30 billion deficit forecast by Drummond in his report.

Even assuming that Drummond's initial conservative forecast for Ontario's economy is correct, replacing those subsequent fiscal assumptions with more reasonable (historically valid) assumptions reduces the forecast deficit from $30 billion to less than $10 billion.

So let's take history as our guide and assume that Ontario's deficit by 2017 (in a status-quo policy context) would be $10 billion. As the next section reveals, that is a fiscal challenge well within the province's range to wrestle down without launching Drummond's austerity assault on public services.

That is not the only problem with Drummond's scenario.

From the beginning of the exercise, the McGuinty government handicapped the Drummond commission by asking it to examine public service spending without considering innovations in how governments approach taxation in the modern era — an important question that will increasingly become relevant to governments at every jurisdictional level.

By excluding revenue from the debate, the Drummond exercise became a manipulative exercise which focused unjustifiably on just the spending side of the ledger. This approach ignores the social and economic costs of nearly a decade of tax cuts begun by the Conservative Harris government in 1996 — tax cuts that Ontario could not afford — and maintained ever since. The cost of this tax cut agenda in foregone fiscal capacity is estimated at a $16 billion loss every single year.

The political decision to exclude revenue also has a direct impact on Drummond's already questionable projections, which leave untouched the fiscal impact of scheduled ongoing corporate tax rate cuts valued at $2.1 billion a year in 2010–11 (rising to $3.2 billion by the end of the forecast period). Restoring the pre-McGuinty 14% corporate tax rate would shift the deficit projection further downwards, to an estimated $6.4 billion, bringing the prospect of a balanced budget within easy range — even under the pessimistic growth forecast assumed in the Drummond report.

## The Value of Public Services

Finally, and most tellingly, the McGuinty government is attempting to frame the debate so as to preclude any discussion of the benefit — even the economic benefit — that Ontarians receive from public services, or of the cost of dramatic reductions in those services. That is an extremely serious omission, both in the short term and in the long term.

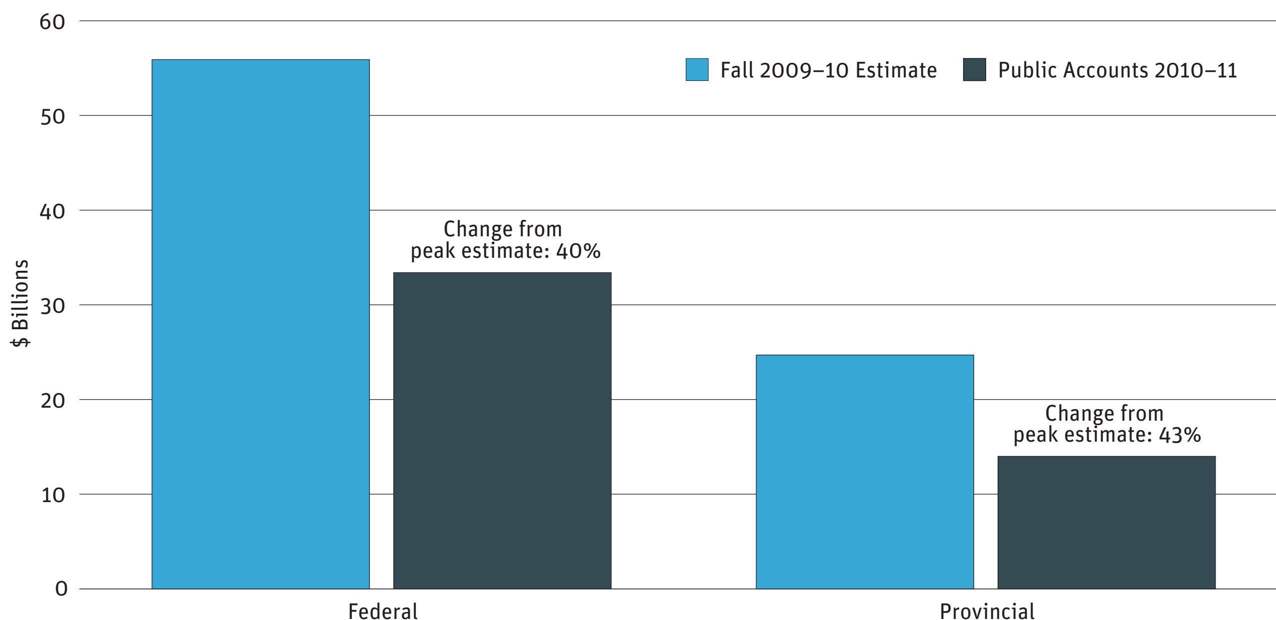
In the short term, cuts of the magnitude suggested by Drummond will impose a substantial fiscal drag on the provincial economy. Ontario's economy would grow more slowly as a result of the cuts contemplated in his report. Drummond may have ignored that fiscal drag in his report — there is no evidence in the report that it was taken into account — but Ontarians whose livelihoods would be affected won't have that luxury. Nor will they have the luxury of ignoring the costs they will bear as public services are reduced.

In the medium and long term, many of the service cuts Drummond has proposed run counter to clear evidence of the economic benefit Ontarians receive from public service. The economic benefits from early childhood learning have been extensively studied and are well documented. A dollar invested in nurturing young children pays itself back to society in spades. Recommendations to scale back investments in secondary and postsecondary education run counter to repeated studies pointing to education and training as keys to Ontario's economic future. How else can we compete in a globalized market? Even the current level of our investment in public infrastructure is widely acknowledged to be inadequate. Eventually, this generation of Ontarians will have to begin the work of repairing the water mains, sewage systems, roads, sidewalks and public buildings our parents and grandparents helped build. Challenges facing Ontario in the future, from climate change, to growing income inequality, to our aging population will require enhanced public service rather than weakened public service. These are priorities only governments can make real — corporations will never consider this among their list of to-dos. It's what Ontarians turn to their government to deliver: quality public services in their hour of need. It's also a deliverable fiscally within our reach.

## Ontario's "Fiscal Crisis" in Perspective

Ontario is not in economic crisis; it is dealing with the aftermath of the worst recession since the 1930s.

**FIGURE 1** Shrinking Deficits, Federal and Provincial



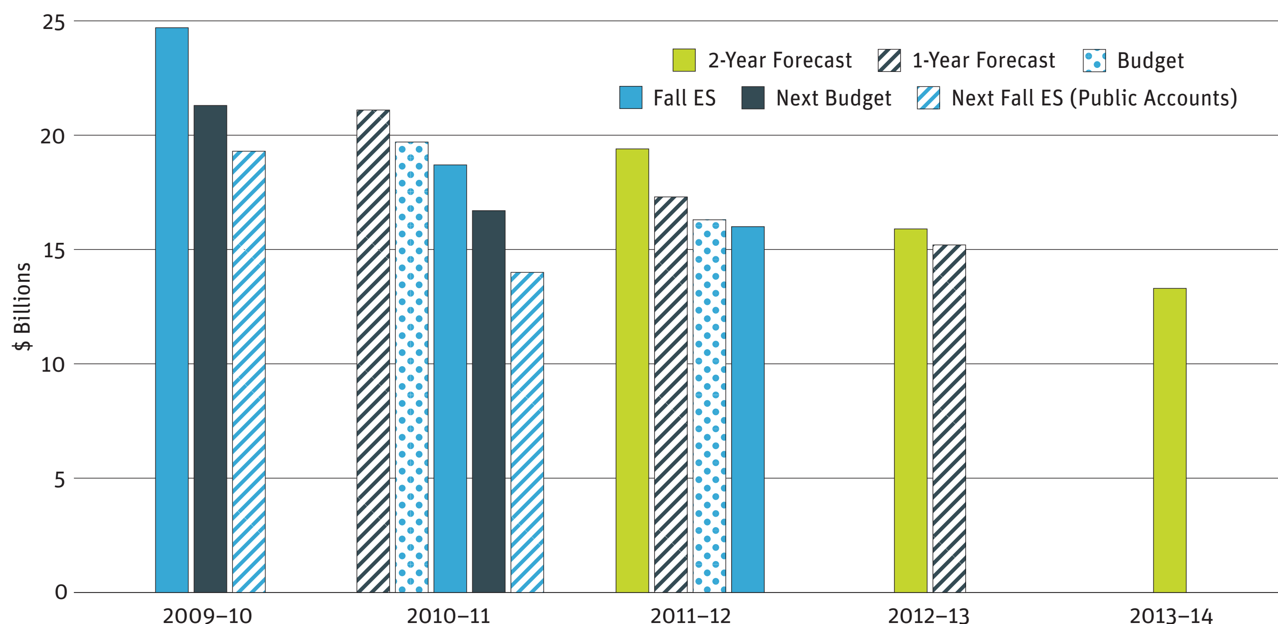

In 2010-11, the most recent fiscal year for which we have final audited numbers, Ontario's deficit was $14 billion. This change represents a dramatic improvement from the bottom of the fiscal cycle, in 2009–10, when the deficit was initially forecast to be $24.7 billion. It's an indicator of our economic health; our ability to bounce back.

*Figure 1* shows the path for the federal and Ontario deficits from their forecast peak in the Fall of 2009 for the 2009–10 fiscal year to the final public accounts for the 2010–11 fiscal year. The data show that the Ontario deficit has fallen by a greater percentage from its estimated peak than has the federal deficit.

The political spin, however, is dramatically different from this fiscal reality. The federal deficit is routinely described by the government itself as "well-managed" and "on-track". The federal government is even cautioned by independent analysts against reducing the deficit too quickly, given the fragile economic recovery. In contrast, the provincial deficit is described as a "crisis" by the government, Drummond, and others with a long-standing interest in downsizing government.

For its part, the Ontario government has consistently produced forecasts that have overestimated the deficit, heightening the atmosphere of crisis at

**FIGURE 2** Ontario's Deficit Forecasts: An Evolving Story




the time, and providing the basis for easy political wins when the actual deficit comes in much lower than the forecast. Despite the fact that the 2010–11 deficit came in at an official audited $14 billion, as of Fall 2012 the Ontario government was still projecting a deficit of $16 billion for 2011–12, declining only to $15.2 billion in 2012–13 and $13.3 billion in 2013–14. Why is the deficit expected to be larger in 2012–13 than it was two years earlier, despite continuing (albeit modest) economic recovery? This imparts an artificially high starting point to the deficit forecast, and Drummond's misleading fiscal assumptions (considered in detail below) compounds the problem.

Based on the Ontario government's record, these forecasts almost certainly overstate the situation. *Figure 2* shows how Ontario's out-year deficit forecasts have evolved over time. In practice, actual deficits have turned out to be much smaller than the initial alarmist forecasts of the government, casting further doubt on the current, artificial atmosphere of "fiscal crisis."

The chart shows that Ontario's forecasts for budget deficits have consistently declined as the forecast period gets closer to the actual.

The Fall 2009 forecast for the 2009–10 deficit was $24.7 billion; the actual was $19.3 billion, an improvement of $5.4 billion.

The 2010 budget forecast for the 2010–11 deficit was $19.7 billion; the actual was $14 billion — an improvement of $5.7 billion, only $1 billion of which had been reflected in the revised forecast presented in the Fall 2010 economic statement less than six months before the end of the fiscal year.

The 2009–10 two-year forecast was even further off the mark. In the Fall of 2009, the 2010–11 deficit was forecast at $21.1 billion. It turned out to be $14 billion — more than $7 billion lower than the initial estimate.

The Budget 2011 forecast for the 2011–12 deficit was $16.3 billion, made at a time when the government was forecasting 2010–11 at $16.7 billion. It turned out to be $14 billion.

This consistent practice of overstating the deficit in out-year forecasts is misleading in any year; it becomes all the more important the further out the forecasts are projected. And it is particularly important when considered in conjunction with the assumptions chosen for the forecast.

## Forecasting Armageddon: Drummond's Four Faulty Assumptions

The forecast scenario described in the Drummond report as the "status quo" scenario — the basis of the claim that Ontario is in fiscal crisis — is based on a fiscal projection to fiscal year 2017–18. To state the obvious, no one "knows" what the fiscal world in Ontario will look like in 2017–18. To try to get a picture of that world, assumptions have to be made about what will happen between now and then.

In any fiscal forecast, the key assumptions will concern the rate of growth of program expenditures, the rate of growth of revenue, and the change in the cost of servicing the public debt. Underlying each of these assumptions are other assumptions about the economy. At a high level, these include: the rate of economic growth, which affects revenue and influences expenditures, as well as the rate of interest, which affects the cost of servicing the public debt.

Drummond's forecast of economic growth is broken into two parts: the rate of real economic growth — that is, the rate of growth in the economy after adjusting for inflation — and the rate of inflation, which when added to the rate of real economic growth produces the total rate of nominal economic growth.

The real economic growth forecast, at 2% per year, is by all accounts on the low side. Assumed sustained economic growth of just 2% per year dur-

ing the "upswing" of the economic cycle would constitute, by far, the weakest economic cycle since the 1930s. For his inflation assumption, Drummond picks the Bank of Canada target rate for consumer price inflation of 2%. While that has been a reliable assumption over the past 15 years or so, many economists are predicting inflation may run ahead of that target as economic recovery progresses (especially in light of the extraordinary monetary policy initiatives which were implemented around the world in the wake of the global financial crisis).

While these assumptions, individually, are not outside the norm, Drummond translates them into a nominal growth forecast in a manner that is offside with general practice, and which artificially reduces the expected combined nominal growth. The consensus among Canadian economic forecasters is that, over the long term, nominal GDP inflation and CPI inflation will be the same. Drummond, however, assumes that nominal GDP growth will be only 1.9% above real GDP growth rather than the 2% rate of CPI inflation.

That unusual assumption reduces the nominal GDP forecast (crucial to the revenue forecast) by a fraction of a percentage point. But where Drummond really departs from the norm is in his translation of that already-pessimistic forecast of GDP growth into an even more pessimistic forecast of revenue growth. He assumes that provincial government revenue will grow at a much slower rate than the economy — 3.2%, rather than his nominal growth rate assumption of 3.9%. There is no precedent in Ontario's fiscal history for a negative gap between revenue growth and GDP growth over a sustained economic cycle, and in the absence of changes in tax rates. In fact, the trend in the province has been the opposite. Revenue base growth rates tend to run ahead of GDP growth rates.

Taken together, these two assumptions reduce revenue growth from what would be a normal conservative projection of 4% to 3.2% — a difference that, taken separately, contributes $7.4 billion to Drummond's $30 billion deficit forecast for 2017–18.

On the spending side of the ledger, Drummond's "status-quo" forecast of program expenditure growth, at 3.5% per year, assumes implicitly that real, per capita program spending in Ontario will increase at a rate of 0.5% per year. This is far in advance of the program spending forecast proposed by any of the three major Ontario political parties in the last election, and far in advance of the spending projections embedded in the government's latest budget and fiscal update. On what basis, therefore, can a "status-quo" forecast assume significant annual improvements in real public services — in a context in which all sides anticipate coming restraint? The underlying 0.5%

annual real per capita public services growth assumed in this scenario contributes another $5.3 billion to the forecast "status-quo" deficit in 2017–18.

These two assumptions are well documented in Drummond's report. A third critical assumption in the report, however, has not been widely examined. Increasing public debt interest costs make a significant contribution to the $30 billion deficit forecast in 2017–18. Those costs are forecast to increase from $9.7 billion in 2010–11 (Drummond's base year) to $19.5 billion in 2017–18, an average increase of more than 11% per year. This extremely pessimistic forecast reflects both his assumption that deficits will be much larger than expected in coming years (and hence the provincial debt grows much faster), and his assumption that the rate of interest on new government debt issues will increase dramatically.

In Drummond's analysis, the average blended rate of interest paid on Ontario's debt in 2010–11 is 4.3%. By the end of the forecast period, the average rate paid is 4.7%. For the blended rate to increase by this much, Drummond's forecast implicitly assumes that the interest rate on newly financed debt will average 5.3% — an increase of over half from the rates currently paid by the province on newly issued long-term bonds. This assumption is not credible, given that:

- Ontario's current borrowing cost is less than 3.5%;
- The U.S. Federal Reserve has pledged to keep interest rates near zero for at least another three years;
- Almost half of the 2017–18 stockpile of debt in Drummond's forecast is new debt financed at post-2010 interest rates; and
- Over the period between 2010–11 and 2017–18, billions of dollars of Ontario debt originally financed at high interest rates in the 1990s will be refinanced at lower rates.

Over the period 2010–11 to 2017–18, Ontario will refinance approximately $90 billion of the debt that was on the books in 2010–11. If the long-term portion of that debt is refinanced at current long-term interest rates, the cost of carrying the debt as it existed in 2010–11 will decline by $800 million a year. Including the cost of carrying the new debt added after 2010–11 at current rates the actual blended interest rate would be 3.8% in 2017–18, 0.9% lower than assumed in Drummond's forecast. That difference alone accounts for $3.7 billion of the 2017–18 deficit forecast.

Finally, Drummond's forecast arbitrarily adds $1.9 billion to the 2017–18 deficit to account for "contingencies". While contingency reserves are a normal part of fiscal planning, it is not normal to make an arbitrary addition to deficit numbers in a long-term forecast. This accounts for an additional $1.9 billion of the alarming $30 billion "status-quo" deficit that Drummond predicts for 2017–18.

Drummond takes four key liberties with the assumptions in his forecasts, each of which individually has a significant impact on the ultimate deficit forecast. Because of the feedback effects among the forecasts for revenue, expenditures and public debt interest, however, the impact of these three assumptions relative to normal assumptions amounts to a serious misdirection in forecasting.

The combined effect of these four far-fetched components in Drummond's forecasts adds $20.5 billion to the forecast deficit and accounts for more than two-thirds of the $30.1 billion deficit forecast in the "status quo" scenario in his report.

## The Revenue Side of Fiscal Policy

In the constrained context set by the McGuinty government for this exercise in justifying public services cuts, Ontario's self-imposed revenue gap is off the table. And so too is the adult conversation about taxes and public services that Ontario needs and in which this government continues to refuse to engage.

Ontario is still suffering the effects of the Harris government's attack on provincial fiscal capacity in the 1990s — part of a deliberate ideological attempt to reduce expectations of government by limiting its future fiscal options. At an annual rate, the lingering effect of those Harris tax cuts — even taking into account the introduction of the Liberal government's health premium in 2004 — is a reduction in fiscal capacity of $16 billion in annual revenue. Coincidentally or not, that's almost exactly what the deficit is currently projected to be for 2011–12.

At the time the Conservatives were defeated in 2003, Ontario's finances had not yet recovered from the Harris era's assault on the province's public services and fiscal capacity. The newly-elected McGuinty government inherited two substantial deficits: a fiscal deficit of $5.6 billion, as identified by former Auditor Erik Peters, and a public services deficit measured in the tens of billions of dollars. The services deficit was reflected in underfund-

ing of critical services like health care, elementary and secondary education and colleges and universities, as well as low-income households struggling under the weight of slashed social assistance benefits which were frozen for nearly a decade. Note, too, public infrastructure crumbling from more than a decade of neglect.

The identification in the Peters report of a substantial deficit at a time of relatively full employment and constrained public services indicates that the deficit was attributable to a revenue shortfall, and that the revenue deficit was structural, not cyclical. This is an important point to pause on, because neoliberal critics will argue against any government carrying a structural deficit, and yet the tax cut agenda has, in itself, created a structural revenue deficit in Ontario that remains unaddressed by this Liberal government.

Except for the introduction of the health premium, the McGuinty government did nothing to address this structural revenue deficit it inherited. After offsetting health premium revenue against the growth in the tax base, the structural deficit identified by Peters in 2003 still amounts to approximately $5.8 billion in 2011–12.

While the McGuinty government, to its credit, addressed some of the services deficits it inherited through expanded program spending, it has lived in denial of the fiscal capacity challenges it inherited, sticking with the "no tax increase" mantra that it repeats to this day.

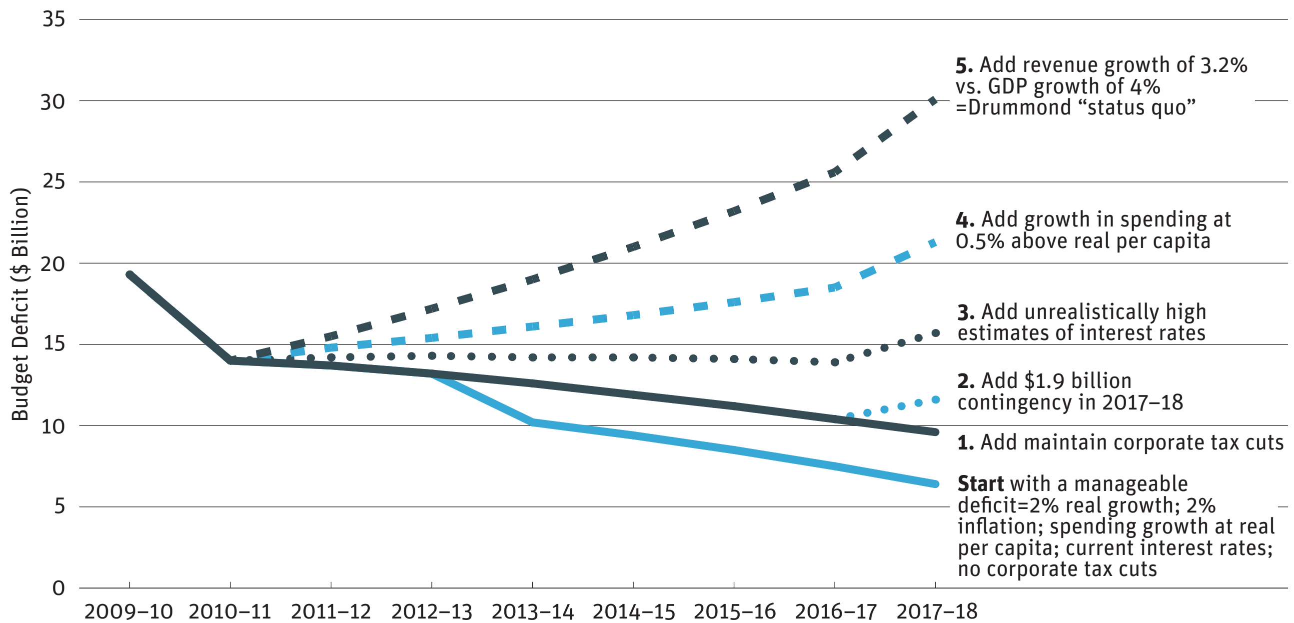
## What If the Glass is Half Empty?

Here is the striking conclusion of the preceding fiscal analysis: Even if we take Drummond's pessimistic forecasts for economic growth as given, and correcting for the four key flawed assumptions which serve to exaggerate his forecast deficit, Drummond's "status quo" economic forecast actually translates to a projected deficit for 2017–18 of $9.6 billion, not the $30.1 billion in his report.

Cancelling the McGuinty government's ill-timed and ill-advised corporate tax cuts and restoring rates to the pre-cut standard rate of 14% (valued at $2.1 billion on an annual basis when introduced in 2010–11 — increasing to $3.2 billion by the end of the forecast period — and built into the status quo forecast) results in an estimated forecast deficit of $6.4 billion in 2017–18.

This is the forecast that results from translating Drummond's own underlying, pessimistic forecast for the economy into a fiscal projection for Ontario, but using more reasonable assumptions for that translation. It does

**FIGURE 3** From Manageable Deficit to Fiscal Crisis in Five Easy Steps




**Summary of sources/assumptions** *Drummond Status Quo:* Real growth: 2%; CPI inflation: 2%; GDP inflation: 1.9%; Spending growth: 3.5%; Interest rate on new borrowing/refinancing (implicit): 5.3%. *Manageable Alternative:* CPI inflation: 2%; GDP inflation: 2%; Spending growth: 3%; Maintain real per capita public services spending; Restore general corporate tax rate to 14% effective 2012–13; Interest rate on new borrowing/refinancing: 3.5%.

not assume any improvement in Ontario's economic growth above Drummond's pessimistic outlook.

In Drummond's self-described "preferred" forecast, spending on provincial public services would be $23.9 billion lower than in the status quo forecast. With excess capacity predicted for the economy throughout the forecast period, that $23.9 billion will act as a fiscal drag on the economy equal to roughly 3% of the $811 billion forecast GDP for 2017–18. Even without considering the multiplier effects of public spending, a 3% impact over six years is equivalent to a reduction in Ontario's real growth rate of 0.5% per year over the forecast period. The difference between the rate of economic growth without the fiscal drag from spending cuts and the rate of growth including the fiscal drag from Drummond's recommendations translates to a change in fiscal position that is roughly equivalent to the $6 billion revised deficit forecast for 2017–18 discussed above. In other words, by avoiding the fiscal drag effects from major spending cuts, the government could actually achieve a balanced budget by 2017–18 (instead of the anticipated $6 billion deficit). However, the analysis below shows that even in a slow-

growth scenario — with the economic glass "half empty," so to speak — Ontario's deficit does not remotely constitute a "crisis."

*Figure 3* lays out, step by step, how the Drummond Report assumes its way from a manageable deficit to a fiscal crisis, in five easy steps. We propose a starting point of 4% nominal growth, 4% revenue growth (so revenue growth matches economic growth, as expected), 3% spending growth (preserving constant real per capita programs), current interest rates, and pre-cut corporate tax rates. This results in a $6.4 billion projected deficit for 2017–18. From this clearly manageable position, Drummond shifts to a prediction of "fiscal crisis,"step by step:

1. Stick with the cut in the corporate income tax rate from 14% to 10% over the forecast period — 2017–18 deficit grows to $9.6 billion.
2. Add a contingency allowance of $1.9 billion to the last fiscal year of the forecast period, a notable departure from normal practice in long-term forecasts — deficit grows to $11.6 billion.
3. Assume that interest rates on newly financed debt during the forecast period will average 5.3% rather than the current interest rate paid by Ontario on long-term debt of less than 3.5% — deficit grows to $15.7 billion.
4. Assume that program expenditures will grow at a rate 0.5% per year greater than the rate of population growth and inflation — deficit grows to $21.3 billion.
5. Assume that revenue will grow at only 3.2% per year compared with nominal economic growth of 4% — deficit reaches $30.1 billon.

Abandoning these unusual, unrealistic and consistently pessimistic assumptions produces a true "status-quo" deficit of only $6.4 billion for 2017–18. And, as discussed above, by avoiding the contractionary macroeconomic side-effects of major (and unnecessary) spending restraint, even that remaining deficit would be eliminated through stronger economic growth.

## Glass is Half Full

Contrary to the impression created by the government's framing of this deliberate "glass-is-half-empty" debate, public services do not simply give rise to costs; services also deliver public benefits. Some benefits are strictly

economic and easily measurable. For example, the impact of public services spending on the overall health of the economy is highlighted by the estimate of fiscal drag discussed above.

More to the point, as a society, we provide public services because we expect to get a benefit from them — whether those benefits show up directly in government revenue or not. We build public infrastructure that enables economic development. We invest in education to support social and economic progress in Ontario and because we believe people have a right to access the tools needed to get ahead. The government decided to invest in early learning because Ontarians were persuaded by the evidence that the social and economic benefits far outweighed the costs, and because we want to ensure our children have every opportunity to succeed.

Of course, it is important that our governments ensure Ontario continues to derive economic and social benefits from the public services it delivers. And, no doubt, among 362 recommendations there are many ideas in the Drummond report that would improve the balance between the costs and benefits of Ontario's public services — especially if those recommendations are made with the goal of improving the quality of service to Ontarians. But to make the implicit assumption that Ontario will "save" billions of dollars from the elimination of full-day kindergarten without considering the cost to Ontario of the foregone benefits from the program, is simply and blatantly wrong. To assume that we can force students to pay for the extra year of high school that Drummond so disparagingly refers to as the "victory lap" without having an impact on high school graduation rates or postsecondary participation is simply and blatantly wrong.

In a 2009 study, the Canadian Centre for Policy Alternatives found that Canadians, on average, receive benefits valued at over $17,000 per capita from public services (*Canada's Quiet Bargain: The Benefits of Public Spending*, by Hugh Mackenzie and Richard Shillington, Ottawa: Canadian Centre for Policy Alternatives). As simplistic as it sounds, if we cut back on public services, those benefits start to disappear. There is no free lunch. There is no cost-free public spending cut. There is no cost-free tax cut.

The significance of this point is underlined as we look at the critical issues we will be facing as a society in the years ahead: the aging of our population, climate change, growing income inequality, and the need to improve the education and skills of our workforce to compete in an increasingly productive growing economy. The issues are diverse; the responses required equally varied. Yet they have one thing in common: an effective re-

sponse to all of these issues requires improved public services rather than diminished public services.

## Restoring Fiscal Capacity

Ontario can no longer ignore the ongoing effects of having undermined its fiscal capacity in the 1990s and 2000s with tax cuts that we could not afford then and cannot afford now. The key questions, in this slow-moving aftermath of the 2008–09 recession, is how and when to address Ontario's fiscal capacity challenges?

First, when? The timing of efforts to restore Ontario's fiscal capacity has to be gauged carefully to the state of the economy. While tax increases don't have nearly the negative macroeconomic impact that expenditure cuts have, they can have a dampening effect if they're ill-timed. So while we should have a target for fiscal capacity improvement in mind, and gauge our deficit reduction strategy to that target, the timing should be opportunistic, based on the pace of Ontario's return to economic stability.

Second, how? It is tempting to assume that Ontario's fiscal problems can be addressed fully by imposing taxes that fall only on people we don't know. We must, however, resist that temptation because the public revenue stream was never built with that intention in mind. The argument for increasing marginal tax rates at the top of the income scale stands on its own merits: those who have more to contribute, who gain more from the benefits of economic growth, should be turned to in times of crisis, at minimum. A new top marginal tax rate 2% above the current rate applicable to incomes in excess of $250,000 would generate approximately $750 million. Similarly, while the case for restoring Ontario's corporate tax rate to the pre-cut 14% rate is compelling, further changes to restore balance between the taxation of income from capital and the taxation of income from employment, whether in corporate tax rates or in the taxation of capital gains and dividends, should be implemented at the federal level to avoid revenue loss from interprovincial tax competition.

These changes alone will not close the gap between fiscal capacity and our needs for public services. The responsibility of ensuring that the best public services are there for every future generation of Ontarians is a task that we all share.

We cannot succeed, however, if our governments keep declaring half of the conversation about taxes and public services off limits, as the McGuinty

government did when it instructed Don Drummond not to discuss revenue. We cannot succeed if our political leaders insist on pretending that there is a free lunch. That we can have tax cuts without paying a price in reduced services. Or that the improved public services we need can be paid for exclusively by people other than ourselves.

We need to have an adult conversation about taxes and public services. It won't be an easy conversation. It will call into question tax breaks and tax cuts that have been around for a long time and that were never an issue when we thought we could afford them. It will force tax cut advocates in the corporate sector in particular to balance their gains against the costs to our society and our economy of underinvestment in economic and social infrastructure. And it will require a careful balancing of concerns about the progressivity or regressivity of revenue sources against the benefits to be derived from increasing Ontario's fiscal capacity.

Public opinion polls suggest that Ontarians are ready for that adult conversation. In fact, they are already engaged in it. Despite the one-sided debate about public revenue favoured by our political leaders, tax cuts consistently rank far behind other issues among Ontarians' lists of concerns. And over and over again, Ontarians tell survey researchers that they personally would be prepared to pay higher taxes for better public services.

## Summary

Together, the McGuinty government and the Drummond Report have narrowed the field of debate over the future of public services in Ontario and orchestrated an atmosphere of crisis in a strategy designed to drive dramatic cuts to public services that would otherwise be unacceptable.

From the outset, in its 2011 budget, the government made it clear that in tackling the deficit, the revenue side of the fiscal equation was off the table. Not only was the legacy of lost fiscal capacity that it inherited in 2003 not open for debate, neither was the government's pointless and wasteful determination to cut provincial corporate taxes. That defined away a $16 billion a year problem — the fiscal legacy of the Harris tax cuts — and also embraced an additional $2 billion-plus hole in future fiscal forecasts (resulting from continuing corporate tax cuts).

It was also clear, right from the outset and reinforced in the Drummond process, that the only aspect of public services open for debate was their cost. No consideration was to be given to the benefits we receive from public

services. Full day kindergarten is expensive. The recommendations suggest we get rid of it, notwithstanding research demonstrating the huge payoff from investments in early learning. Students are taking five years to finish high school. The recommendation is to cut them off at four and make them pay if they want to stay longer, without even considering the implications of such a change for high school graduation rates or postsecondary participation rates — never mind the subsequent costs on all of society from poorer educational attainment.

Although the Drummond exercise ended up producing a massive report with hundreds of recommendations, its main role was to establish the atmosphere of financial crisis that is needed to create the political space for painful spending cuts.

To that end, the exercise began with a pessimistic economic forecast that implied a modest but manageable deficit persisting until 2017–18. From that base, step-by-step, it built that economic forecast into an unmanageable fiscal crisis.

That forecast of crisis is based on five key assumptions, each of which was carefully designed to inflate the 2017–18 deficit.

It assumed that Ontario's corporate tax cut plan would remain intact and on schedule, despite its growing impact on the province's fiscal capacity.

In a departure from the norm in long-term fiscal forecasts, it added a contingency amount of $1.9 billion to the projected deficit in 2017–18.

It assumed that debt service costs in Ontario would soar from their current rate of 3.5% for new debt to 5.3%.

It assumed that program spending would increase at a rate greater than the rate of inflation and population growth, creating a politically-inspired straw man on the expenditure side of the fiscal projection.

And most tellingly, it assumed that revenue would grow at a substantially lower rate than the already pessimistic assumed rate of growth of Ontario's economy — a development which, if it were to take place, would be without precedent.

Together, these five assumptions turned a $6.4 billion projected deficit in 2017–18 into a $30.1 billion catastrophe. More to the point, this manipulative exercise turned an issue that would go away by itself with even a modest improvement in growth rates (and would be readily manageable even without) into a steadily increasing deficit culminating in a fiscal crisis.

We do not have a fiscal crisis in Ontario. The province is recovering, more slowly than anyone would wish, from the worst recession to hit the world economy since the 1930s. It is coming to terms — along with much of the rest

of the developed world — with the likelihood that in the future the economy will grow more slowly than it did in the past. It is finally having to deal with the cumulative impact on Ontario's fiscal capacity of nearly two decades of unaffordable tax cuts. But Ontario is not in fiscal crisis.

The evidence tells us that the apocalyptic rhetoric surrounding Ontario's fiscal prospects is intended not to address Ontario's deficit but to foreclose the adult conversation we need to have in this province about the taxes we pay and the public services those taxes pay for.

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