OCC TAXATION AND FISCAL GOVERNANCE POLICIES

2011 - 2012

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AGENDA

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OCC TAXATION AND FISCAL GOVERNANCE POLICIES: 2011-2012

SOUND FISCAL MANAGEMENT IS FUNDAMENTAL TO ONTARIO'S GROWTH

Balancing revenues and expenditures is a challenge for governments. Ontario's relative fiscal position has deteriorated steadily over the past half decade. In 2002, Ontario had the second highest nominal Gross Domestic Product (GDP) per capita, behind Alberta, and a 7% advantage over the national average. By 2007, per capita GDP in Ontario had fallen to 2% below the Canadian average, or the equivalent of fourth place in the provincial rankings.

Ontario emerged from the recent economic downturn with the worst fiscal position of any province or territory in the country. For the 2010 – 11 fiscal year, the government posted a deficit of $14 billion. Although lower than originally projected, the deficit is expected to rise to $16 billion for 2010-11, and Ontario has maintained an eight year time table for eliminating its deficit, which most other provinces plan to do in five.

With many of Ontario's trading partners struggling to climb out of deficit and facing escalating debt loads, it is imperative that Ontario take concrete measures to immediately boost its fiscal position. Fiscal flexibility in the coming years will be critical to ensuring Ontario's ability to stimulate jobs and growth.

An additional reason for fiscal prudence in coming years is the projected demographic shift. The proportion of the population over 65 years of age is set to reach historic proportions, which will put unprecedented pressure on public services. Although seniors account for only 14 percent of Ontario's population, they currently make up 44 percent of total health care spending.

The government must embark on a continuous process of short-term actions and long-term planning to responsibly manage its balance sheets in the best interests of the province.

Judicious taxation policy is a key component of sound fiscal planning. Although taxes secure appropriate levels and quality of public services, they also have the potential to hamper economic activity and growth. A high tax burden alters the rate of return for business, affecting the willingness of firms to invest, hire, and expand. Complicated tax systems are burdensome and costly, creating a drag on economic productivity. In an increasingly borderless global marketplace, sound tax policies are integral to competitiveness.

For many years Ontario's tax regime made the province relatively unattractive compared to several competitor jurisdictions. Recently the government has taken steps to strengthen Ontario's competitive advantage through the implementation of more economically progressive taxation policies. As part of a fundamental shift in tax policy, the government has introduced a number of measures aimed at lowering taxes on production and investment, including:

- Elimination of the Capital Tax
- Reduction of the General Corporate Income Tax
- Reduction of the Corporate Minimum Tax
- Elimination of the Small Business Clawback
- Accelerated Capital Cost Allowance for manufacturing and processing equipment
- Introduction of the HST to reduce taxes on capital investments

These measures have steadily moved Ontario in the direction of a more equitable and open economy, positioning the province for sustained success in the global marketplace. However, given ongoing economic transition and competition from other jurisdictions, the government must continually ensure that Ontario's tax regime remains responsive to internal and external circumstances. Tax policies that have unanticipated effects must be rebalanced to maximize their effectiveness and efficiency.

Within a broader "rebalancing" perspective, the Ontario Chamber of Commerce has adopted a number of policies for tax and fiscal reform. Collectively and fully implemented in a timely manner, these policies have the potential to streamline Ontario's taxation system, improve its fiscal position, and support economic renewal in the province.

CLEARLY ARTICULATED STRATEGIES FOR DEBT AND DEFICIT REDUCTION

In the 2011 Budget, the Ontario Government announced improvements in its financial projections. Nevertheless it retained its original commitment to eliminate the deficit by 2017-18.

Ontario was able to emerge from the recent downturn with its economic fundamentals intact largely thanks to prudent fiscal management. Conventional wisdom suggests that the average business cycle is five to seven years. As such, a more prudent plan which provides for the built-in capacity to respond to future economic downturns would be to eliminate the deficit by fiscal year 2015-16, before the end of the current business cycle.

Achieving this goal would require the government to hold expenditure growth to less than 1.7 percent per year over 2012-16. This poses a formidable challenge given that health care spending, which accounts for 46 percent of the government's budget, is rising at a rate of five to seven percent per year, and is set to rise further as Ontario's population ages. In order to ensure a speedy return to surplus, the government has no alternative but to explore ways to reduce health care costs (see *Ontario's Deficit Management Strategy*, Appendix).

Reducing the duration of the deficit is also necessary to help lessen the upward pressure on Ontario's debt. Ontario's net debt is currently 33.5 percent of GDP, compared to 28 percent in 2003. With a debt level of $236.3 billion, ten cents out of every dollar the Ontario government earns currently goes towards interest payments. Debt servicing costs crowd out the available funding for public services and limit Ontario's ability to respond to mounting pressures such as an aging population and infrastructure renewal. In addition to its deficit management strategy, the Ontario Government needs to set specific targets for debt reduction and advance a clear plan for meeting those targets (see *Debt Reduction Targets for the Province of Ontario*, Appendix)

ACCOUNTABILITY OF MUNICIPAL GOVERNMENT SPENDING

In the wake of public service downloading, average municipal spending has grown by 40 percent over the last eight years. In spite of recent efforts to upload a greater share of program costs to the provincial level, there remains a significant gap between the services that Ontario municipalities must deliver and what they can afford. From 2003 to 2008, municipalities saw double digit spending growth on key services such as public health, water, waste diversion, and social housing. This has led to property taxes that are higher in Ontario than in any other province or territory, with businesses carrying the highest share of the burden.

With all levels of government facing growing cost pressures from an aging population, rising input prices and a sluggish global economy, efforts have been undertaken to deliver programs more efficiently. For example, the Ontario Government recently introduced the Broader Public Sector Accountability Act, a main thrust of which was a more open and competitive procurement process. The government subsequently announced the creation of a Commission on Broader Public Sector Reform to evaluate alternative models of service delivery that provide a greater return on taxpayer dollars.

Efforts by municipal governments to follow suit have been varied. Ottawa, Oshawa, Markham, Toronto and Sudbury have demonstrated leadership through the adoption of municipal auditor generals to enhance the quality of stewardship over public funds. This model has proven highly effective. In the case of Toronto, the return on every dollar invested by the Auditor General in 2008 was 560 percent. Oshawa's return on investment over a three year period was 331 percent (see *The Need for Provincially Mandated Municipal Auditor Generals*, Appendix).

In order to ensure the sustainability of government services and a competitive business environment, the provincial government should work to ensure the most efficient use of public funds through the introduction of mandatory accountability measures such as those already in use by provincial and municipal governments (see

Promoting Greater Local Accountability of Provincial Funds). For example, the government could require municipalities to guarantee:

- A competitive bidding process for the delivery of publically funded services which includes both the public and private sectors
- Access to public contracts by small businesses
- Municipal auditor generals for municipalities with populations over $100,000

These and/or similar measures will be necessary to ensure that government resources from all levels are spent on activities with the greatest economic gain.

REGULATED LABOUR COSTS FOR MUNICIPAL GOVERNMENT EMPLOYEES

Labour costs form a huge component of provincial and municipal government spending. Fifty-five percent of the Ontario government's operational budget is allocated to salaries and wages. At the municipal level, labour costs generally account for 60-80 percent of a city's operating budget.

In order to create greater parity between the public and private sectors in the wake of the recession, the provincial government froze the salaries of Members of Provincial Parliament and all non-unionized public-sector employees. The province stopped short of imposing a freeze on unionized public sector workers and did not extend the same treatment to municipalities.

As a result, municipalities are seeing compensation levels soar at the same time as the private sector strives to return to pre-recession growth rates. Municipalities are hindered by long standing contracts with unionized staff and a labour arbitration system for transit workers, police and firefighters that is arguably immune to local financial considerations. Elected municipal officials have little recourse other than to raise taxes and cut services (see *Provincial Labour Arbitration System* and *Managing Increasing Provincial/Municipal Labour Costs*, Appendix).

In order to help compete in the current economic climate, the provincial government must take steps to fix the current design of the provincial labour arbitration system and implement a comprehensive long-term public sector compensation restraint strategy.

INCOME REPLACEMENT FOR WORKERS IN TRANSITION

The federal Employment Insurance (EI) program plays an important role in Ontario's deficit management strategy. By ensuring a steady source of income for workers in transition, it maintains household consumption levels and prevents added pressure on Ontario's social assistance system.

Although all workers in Canada, no matter which province they live in, pay the same EI premiums, not all workers across the country are treated equally when it comes to the distribution of EI benefits. In 2007, only 30 percent of unemployed persons in Ontario received EI benefits, compared to an average of 58 percent in other provinces. That difference costs Ontario's unemployed $1.7 billion each year.

In order to rectify this situation and help Ontario stay on the track to recovery, the Government of Ontario must work with Ottawa to ensure that Ontario employees get the same Employment Insurance benefits as workers in other parts of the country.

CREATING TAX NEUTRALITY ACROSS INDUSTRIES

Ontario's fiscal sustainability relies on ongoing vigilance to monitor the impact of tax policies on economic growth. Progressive tax policies which do not unnecessarily penalize production and investment stimulate innovation and economic growth, which in turn lead to more jobs, a more robust tax base and higher revenues.

In a highly competitive world, the onus is on government to ensure not only the right level of taxation, but to design tax policies which create equal opportunities for all economic sectors and regions of the province. In situations where taxes result in differential treatment between sectors, there is a risk that government policy will stifle economic activities that could otherwise give rise to new and dynamic competitive advantages.

Ontario's Gasoline Tax Act is an example of a taxation policy that has an unequal economic impact. While the provision of fuel rebates for off-road commercial vehicles is a positive incentive for industry, this provision does not extend to "mixed road" vehicles that are legally licensed under Ontario's Highway Traffic Act. Companies in industries which rely on the transport of resources both on- and off-road must either undertake the hefty administrative burden of repeatedly licensing and un-licensing a vehicle, or pay higher taxes. This situation places these industries at a competitive disadvantage for no clear reason (see *Improving the Competitiveness of Ontario Industries through Fuel Tax Rebates for Off-Highway Road Transport*, Appendix).

Companies in the financial services sector currently face a similar predicament. While the move to a harmonized sales tax has led to a more progressive overall value-added tax structure, the current tax system imposes a greater burden on financial service firms by exempting services they provide from HST. As a result, companies are ineligible for input tax credits on purchases they make to supply those services. By allowing differential treatment of the financial services sector, the current system results in higher costs and a disadvantageous playing field for a key engine of Ontario's economy (see *Reforming the Taxation System on Ontario's Financial Services Industry*, Appendix).

In order to make Ontario's economy as conducive as possible to innovation and economic growth, the Government of Ontario must make every possible effort to achieve impartial treatment across all industries. The government should build on and strengthen its existing tax advantage through extending fuel rebates to the off-road portion of "mixed-road" transport and eliminating embedded taxes from the cost structure of the financial services industry.

ACCOUNTABILITY OF MUNICIPAL TAXES

The inconsistent application of taxes municipally further undermines the competitiveness of Ontario's tax system.

Under the current property tax system, each municipal and regional level of government sets its own tax rate, which varies by use/classification (residential, commercial, industrial etc.) as well as property value.

The Municipal Property Assessment Corporation (MPAC) assigns property classes and values for all properties in Ontario. MPAC appraisers assess many features of a property to arrive at a valuation. The 2010 Auditor General's report noted a wide variance in the determination of property values by MPAC, which results in arbitrary taxes on private sector activities.

There are additional factors which undermine the fairness of the rate-setting process. Provincial legislation specifies how much each class will pay using residential taxpayers as the baseline. However, municipalities determine how the revenue from property taxes is allocated. As such, the rates for commercial and industrial classes are often incongruent with the municipal government services those classes receive.

The tying of the provincial Business Education Tax to property valuation compounds these discrepancies. Not only does the amount of the education tax vary depending on the value of the property, but the rate varies from municipality to municipality in accordance with Ministry of Education funding levels.

In 2007 the Ontario government committed to decrease the variation in business education tax rates by working towards a maximum rate of 1.6 percent for the entire province by 2014. The government enacted an immediate ceiling on the education tax rate for all new construction projects. However, businesses across Ontario continue to report that property and education taxes are an impediment to investment and growth.

In order to ensure greater parity between regions, the Ontario government should provide regional authorities with the necessary structure to obtain accountability and fairness in the property-assessment and rate setting process. Such action would ensure that neighbouring municipalities within a region are not at a competitive disadvantage, while ensuring rates more closely approximate the value of services received by the private sector.

APPENDIX: POLICY RESOLUTIONS

Accelerate Reductions in the Business Education Tax

(Adopted May 2, 2009)

ISSUE

The Business Education Tax (BET) is a provincial tax levied at non-uniform rates in municipalities across Ontario. High BET rates are a key reason why businesses choose to relocate to other jurisdictions. As a result of Current Value Assessment (CVA), revenue-neutral adjustments in target BET rates have recently been introduced. Businesses in some Ontario communities are paying a significantly higher BET rate than other municipalities. When this discrepancy in BET rates occurs between neighbouring jurisdictions, the economically distorting effect of this tax is even more pronounced. Despite this unfair competitive disadvantage, schools in areas with higher BET rates do not receive additional funding to match the higher BET rates.

BACKGROUND

Businesses in all communities have reason to strongly support the Ontario government's 2007 initiative to reduce the wide variation in BET rates and their plan to implement a $540 million cut over the next seven years. This move, strongly advocated by the Ontario Chamber of Commerce, the Toronto Board of Trade and the Smiths Falls Chamber of Commerce, will reduce BET rates across 321 municipalities and lower taxes for over 500,000 Ontario businesses.

High property taxes are a key reason why many businesses relocate to other jurisdictions. For example, Toronto businesses face a BET rate that is 44 percent higher than the lowest rate in the Toronto region and 30 percent higher than the GTA average. A 2005 report from the Canadian Urban Institute commissioned by the Ontario Chamber of Commerce, the Toronto Board of Trade and the Toronto Office Coalition found that Toronto's high BET rate has contributed to the loss of over 100,000 jobs over the last 15 years. Similarly, many communities in Eastern Ontario, such as Smiths Falls, face BET rates that are disproportionately high compared to residential rates – a factor that seriously inhibits investment, job creation and business development. High tax rates are driving capital out and are creating a disadvantage when it comes to attracting new business ventures.

In the face of economic instability and a slowdown in the manufacturing sector, businesses continue to report that punitive property and business taxes are the single most damaging factor in terms of growth and investment. Reducing BET rates across Ontario will make our province a more competitive and attractive place to invest and create jobs. The case for accelerating the reduction of BET rates is as strong as the case for accelerating capital tax reduction. Ontario must address its BET policies and rates if it intends to maintain its identity as Canada's economic engine.

RECOMMENDATIONS

The Ontario Chamber of Commerce urges the Government of Ontario to:

1. Accelerate its planned cuts to the Business Education Tax; these cuts must result in real tax relief for Ontario businesses and go beyond revenue neutral adjustments to the Business Education Tax rates as a result of a Current Value Assessment
2. Implement a uniform Business Education Tax rate across the province; alternatively uniform Business Education Tax rates must be assessed on a regional basis, so as not to place neighbouring municipalities at a competitive disadvantage

Altering the Provincial Property Tax Structure to Encourage Growth and Development

(Adopted May 7, 2011)

ISSUE

The current formula in which property taxes are assessed is arbitrary and creates complexity and confusion for taxpayers – whether commercial, industrial, institutional, or residential. The tax system can be more efficient to create tax parity and encourage growth and development of communities.

BACKGROUND

Property tax is the oldest tax in Ontario. Despite its longevity, it is the most complex and criticized tax. Since its inception in the early 19th century, various governments of all stripes have struck committees to examine and develop recommendations to reform property tax. In every case, the proposed resolutions that were designed to change the system have been largely ignored.

The current property tax formula is based on a property's "current value" and it is the role of the Municipal Property Assessment Corporation (MPAC) to make that determination. There are seven different classes of property (established by the province) with different tax rates (set by the municipality) for each class; residential, multi-residential, commercial, industrial, pipeline, farm and managed forests.

The current system for assessing a property's value is arguably arbitrary. In addition to analyzing property sales in a community, it is the responsibility of an MPAC representative to assess the key features of a property including location, lot dimension, living space, age, renovations and quality of construction.

MPAC has been criticized in the past and most recently by the Auditor General regarding the variance in property assessment and actual sale value. The 2010 Auditor General's Report noted variances of 20 percent resulting from MPAC's failure to acquire up-to-date data from recent property inspections. It is obvious that this is not an efficient system for property tax assessment. Taking some responsibility away from MPAC and placing it in the hands of the local government would result in a fairer and more transparent tax structure.

Furthermore, with respect to the commercial and industrial classes, property tax rates are unfairly set. They do not reflect the services received by commercial and industrial classes. Businesses do not tend to reap the benefits of municipal taxes in the same way as homeowners. Most services and the education system that property taxes fund are dedicated to the residential rate payer rather than the other classes.

To address the problematic structure of the current method of property taxation, a review of other property taxation methods that have been implemented is required. We recognize and appreciate that property taxes are the primary source of operating revenue for municipalities and are used to finance local programs and services and believe that local government should have a fuller role in making property tax decisions within their municipality.

Land value taxation is an example of an alternative framework that is currently used. Land value taxation is the process of basing property tax on the value of land, not on the physical structure. All improvements made to the structure of the building would be disregarded. This leaves no room for arbitrary assessment of a structure's worth. It would be the role of the municipal government to determine the rate on different parcels of land. As it currently stands, property has a greater value than land. However, if the land value taxation model were introduced, in order to maintain the city's overall tax revenue, the tax on land must increase.

This system of taxation creates parity among property classes and eliminates inaccurate and arbitrary property assessments. It removes the many property classifications and leaves the tax to be determined solely by land value. This form of taxation has many benefits. With the current tax system, there is nothing to motivate an owner to make improvements to their property. With land value taxation, those who maintain and improve their properties will end up realizing a tax reduction. This taxation system would also reduce abandoned lots

and vacant structures and deter speculative land holding. Since owners will be paying the same amount of tax on a property whether they have a building or not, it will oblige land owners to develop or sell to someone who will. This will then stimulate construction, lead to increased jobs and result in more growth in the community. Land value taxation will move the tax burden from those who are contributing to the economy to those who are preventing growth and development.

This taxation system requires a strict assessment and policy from the local government and makes the municipality accountable for the rates they set. It is crucial to have zoning codes in place to prevent abuse of the system. Monitoring must take place to ensure that hyper-dense projects are not built. Land Value Taxation is a system that is popular in many parts of the world, including locations in Europe, Asia, Australia, and Mexico.

Regardless of what new method of property taxation is selected, it is imperative that the government look beyond our province and country when seeking alternative models for improvements to the property assessment system. It is time that change occurs with the policy framework for assessment delivery.

RECOMMENDATIONS

The Ontario Chamber of Commerce urges the Government of Ontario to:

1. Establish, within the next six months, a task force to research and develop alternative frameworks of property assessment with the goal of establishing a more efficient system
2. Consider establishing "opt out" clauses (as seen in the previous Ontario Property Assessment Corporation) within MPAC to allow municipalities to facilitate their own assessment functions using professional assessor

Debt Reduction Targets for the Province of Ontario

(Adopted May 7, 2011)

ISSUE

The growing debt of the Province of Ontario is of great concern to the business community, especially when it does not appear that there are specific targets and a timetable to reduce our debt, estimated to have grown to $236.5 billion by March 31, 2011.

BACKGROUND

While much of the government statements recently have concentrated on the issue of the deficit, which has also grown substantially and must be addressed, there must be specific targets for debt reduction and a clear plan to meet those targets. It is understood that there are always fiscal issues that must be reasonably dealt with during times of economic downturns. However, there must be real debt reduction during times of expansion, and this has appeared a much more difficult undertaking for the province.

Ontario's Finances 1990-2009			
Fiscal Year	Revenue ($ Millions)	Expenditure ($ Millions)	Provincial Total Debt ($ Millions)
2008-2009	90,472	96,881	176,915
2007-2008	97,122	96,522	162,217
2006-2007	90,397	88,128	157,311
2005- 2006(4)	84,225	83,927	155,332
2004-2005	77,841	79,396	156,801
2003-2004	68,400	73,883	148,733
2002-2003 (3)	68,891	68,774	138,696
2001-2002	66,534	66,159	136,708
2000-2001	66,294	64,392	134,694
1999-2000(2)	65,042	64,374	134,809
1998-1999	56,050	58,052	105,133
1997-1998	52,782	56,748	101,982
1996-1997	49,714	56,619	98,392
1995-1996	49,473	58,273	98,407
1994-1995	46,039	56,168	85,711
1993-1994	43,674	54,876	76,714
1992-1993	41,807	54,235	66,101
1991-1992	40,753	51,683	50,618
1990-1991	42,892	45,921	40,002

The Chamber requests that a Debt Reduction Timetable be presented with the next budget, outlining what specific steps will be made over and above the plans for deficit reduction. A lack of commitment to addressing the debt issue impairs our province's ability to prosper.

Without properly addressing this growing debt issue, future governments will have less ability to address critical growth and infrastructure challenges of the province.

RECOMMENDATIONS

The Ontario Chamber of Commerce urges the Government of Ontario to:

1. Adopt specific targets for debt reduction over the next 10 years and a clear plan to meet those targets
2. Outline the plan and timetable in the next provincial budget

Employment Insurance Benefits Fairness for Ontario (Northern Ontario as a Model)

(Adopted May 2, 2009)

ISSUE

The province's relative position has deteriorated steadily over the past half decade. In 2002, Ontario had the second highest nominal Gross Domestic Product (GDP) per capita, behind Alberta, and a seven percent advantage over the national-average level. By 2007, per-capita GDP in Ontario had fallen to two percent below the Canadian average, or the equivalent of fourth place in the provincial rankings and yet the unemployed in Ontario are short by $1.7 billion.

BACKGROUND

Workers in Canada, no matter which province they live in, pay Employment Insurance (EI) premiums, however, they are not treated equally when it comes to collecting EI benefits. While nearly 80 percent of workers in Newfoundland qualify for benefits when they lose a job, the figure in Ontario is closer to 25 percent.

In 2007, only 30 percent of unemployed persons in Ontario received regular EI benefits, compared with an average of 58 percent in other provinces. If an unemployed worker in Ontario received the average EI benefit that an unemployed worker in another province received, that worker would get $4,630 more each year. Last year the average unemployed worker in Ontario received $5,110 in regular EI benefits, while the average unemployed person in the rest of Canada received $9,070. That difference cost Ontario's unemployed $1.7 billion. The unemployed of Ontario have been short-changed $1.7B and Ottawa must address this discrepancy.

Ontario has seen some progress in the fairness campaign that Premier McGuinty has lead for more than three years. While the government addressed three of the four cornerstone grievances in the 2009 Federal Budget, employment insurance recipients in Ontario continues to receive approximately $4,000 less annually than those in other provinces. This is a fundamental inequality that remains for Ontarians.

Ontarians pay into EI and yet it is much tougher for Ontarians to collect EI when they lose their jobs, and their benefits run out sooner than in other parts of Canada. It makes absolutely no sense for Ontario workers to pay into a fund that provides generous support to the unemployed in other parts of the country when so many of those workers in Ontario can expect to get much less if they lose their jobs.

The Ontario Chamber of Commerce (OCC) took a leadership role in 2005 on the issue of equalization and other federal transfers to Ontario. It has published two reports on the issue of the fiscal imbalance: Fairness in Confederation Fiscal Imbalance: A Roadmap to Recovery, and Fairness in Confederation Fiscal Imbalance: Driving Ontario to "Have-Not" Status.

A website was launched by the OCC prior to the October 14, 2008 election to encourage voters to press candidates on the fairness issue (www.ActNowforOntario.com). ActNowForOntario.com provides compelling testimony to the unfair level of federal funding and federal representation for Ontario and how that directly affects every Ontarian. Facts are provided in videos on five issues: healthcare, unemployment insurance, immigration, representation and infrastructure.

RECOMMENDATION

The Ontario Chamber of Commerce urges the Government of Ontario to:

> Work with Ottawa to ensure that Ontario employees can get the same Employment Insurance benefits and job training as workers in other regions of Canada

Improving the Competitiveness of Ontario Industries Through Fuel Tax Rebates for Off-Highway Road Transport

(Adopted May 2, 2009)

ISSUE

Ontario's Gasoline Tax Act lacks the provision to rebate tax paid on fuel consumed in the commercial off-road portion of a "mixed-road" haul (a haul that includes both off-road travel and travel on the Queen's Highway). As a result, Ontario industries that rely on transporting resources both on- and off-highway are fully taxed through the Gasoline Tax Act, and are consequently placed at a competitive disadvantage.

BACKGROUND

In addition to the current economic challenges, increased global competition and high energy costs, increasing transportation costs pose significant operational challenges to Ontario's industries that rely on hauling raw materials from source to destination and in between.

In Ontario, tax is collected on fuel used in licensed vehicles at a rate of 14.7 cents per litre on gasoline, and 14.3 cents per litre on diesel fuel. This tax is imposed to cover the costs of maintaining the road network built by the Ontario government referred to as the Queen's Highway. Equipment or vehicles not licensed under Ontario's Highway Traffic Act, operated by any business, industry or institution, are exempt from paying the tax by purchasing tax-exempt (coloured) fuel. Licensed vehicles, required for "mixed-road" hauls that travel both on and off-road, are not permitted to use this tax-exempt fuel.

When trucks haul resources within the province, such as ore to refineries and wood to mills, a significant portion of fuel (estimated at 50 percent for forestry) is consumed while driving on off-highway access roads which are built and maintained by the respective industries. To realize a tax exemption for "mixed-road" hauls there are significant administrative, insurance-related and mechanical burdens, since it requires repeatedly licensing and un-licensing a vehicle. This is a highly inefficient process, making the likelihood of obtaining fuel tax exemption for the off-road portion of "mixed-road" hauls highly improbable.

The Alberta Fuel Tax Act, for example, provides tax exemptions and rebates on fuel used off-road for commercial purposes, specifically for its major sectors, oil and forestry. Known as Prescribed Rebates Off-road Percentages (PROP), the system provides for tax exemption and rebate percentages for "mixed-road" hauls. For example, fuel used in transporting logs from cut locations to mills and returning empty to the cut locations is subject to an 87 percent tax rebate.

Today's computerized and automated technologies, such as the Ground Positioning System (GPS), makes tracking on-road and off-road portions of any haul simple, accurate, transparent and cost-effective, and would allow Ontario industries to take advantage of fuel tax rebates that would enhance business competitiveness both nationally and globally.

RECOMMENDATIONS

The Ontario Chamber of Commerce urges the Government of Ontario to:

1. Establish methods to rebate fuel tax for the off-road portion of 'mix-road' hauls
2. Employ the use of current computerized and automated technologies to provide the exact rebate percentages applicable for each haul

Managing Increasing Provincial/Municipal Labour Costs

(Adopted May 7, 2011)

ISSUE

With the province striving to bounce back from the impacts of the economic downturn, the provincial government and municipalities are increasingly facing challenges in reducing operational budget costs due to increasing and uncontrollable labour costs. Ontario risks negative economic impacts if the provincial government does not develop a comprehensive public sector wage restraint strategy.

BACKGROUND

On March 25, 2010 Finance Minister Dwight Duncan first announced the Ontario Government's plan to introduce provincial legislation that would bring into effect public sector wage freezes. Bill 16 - Public Sector Compensation Restraint to Protect Public Service Act - passed May 18, 2010 outlined a two year wage freeze on non-unionized workers and a cap on compensation for unionized workers after contracts expire.[1]

While the Act, which would save an estimated $2 billion per year, set strict guidelines on freezes to wage rates, salary ranges, benefits, pensions and vacation time for provincial public sector employees, municipalities were left untouched as the government opted to urge municipalities to implement similar restrictions.[2]

With 55 percent of Ontario's operational budget allocated to salaries and wages, the provincial rate is comparable to municipalities' labour costs. 69 percent of Mississauga's 2011 operational budget is dedicated to wages and salaries.[3] Other examples include: Brampton with 59.3 percent,[4] Toronto 57 percent,[5] Oakville 51.23 percent,[6] and Hamilton with 47 percent.[7]

With the 2009 and 2010 increases in minimum wage, salary and wage increases driven by increases in costs of living and progression pay, municipalities too are struggling to control labour costs and are increasingly feeling the pressure of skyrocketing operational budgets.

In the summer of 2009, the City of Mississauga called on the Ontario government to intervene on municipal labour costs urging the province to enable legislation that would freeze all public sector wages and benefits for a one year period. With no assistance from the provincial government, the City of Mississauga was left with no option than to cordially ask unionized employees to consider a roll back from the 3 percent annual wage increase to 1.5 percent.[8]

Other municipalities such as Toronto also face limited options. Toronto's city councilors tabled discussions of wage freezes on mayor and city councilor salaries in hopes of setting an example for unionized workers to consider the same action. Hindered by long standing contracts with unionized staff and the inability to reopen signed contracts, many municipalities are left with minimal and ineffective measures to reduce labour costs.[9]

A provincial public sector wage freeze that includes municipalities would not be the first of its kind and is within the purview of the provincial government to regulate (as per the Municipal Affairs Act). In 1993, the provincial

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[1] Bill 16, Public Sector Compensation Restraint to Protect Public Services Act, c.26. s. 16, Ontario, 2011, cl6.
[2] Bill 16, Public Sector Compensation Restraint to Protect Public Services Act, c.26. s. 16, Ontario, 2011, cl7-8.
[3] City of Mississauga, 2011-2014 Business Plan & Budget, PowerPoint presentation for Public Open House, January 12, 2011, pg.10
[4] City of Brampton, Current Budget Overview, Brampton, 2010, pg. 11
[5] City of Toronto, Arena Boards of Management Operating Budget Analyst Notes, Toronto, 2011, pg 19.
[6] Town of Oakville, 2011 Budget Discussion: Executive Summary, Oakville, 2011, pg. 12.
[7] City of Hamilton, 2011 Budget: Process, schedule, pressures, PowerPoint Presentation for Committee of the whole, June 21, 2010 pg. 5.
[8] Contenta,S. "Mississauga seeks wage rollback" Toronto Star, July 4, 2009, http://www.thestar.com/news/gta/article/660841 (accessed on February 4, 2011).
[9] Ibid.

government introduced the Social Contract Act, which placed wage freezes on provincial and municipal employees alongside mandatory unpaid days of leave; the Act enforced a three year wage freeze for any public sector employee with a salary of $30,000 or higher and allowed for the reopening of collective bargaining agreements of public unions.[10]

While the Social Contract Act imposed stricter restrictions than the current wage freeze, it allowed both the provincial and municipal governments to reduce operational costs without laying off employees. Other provinces such as British Columbia and Manitoba also actively negotiated and implemented wage freezes with public sector unions. As well, the federal government enacted the Expenditure Restraints Act in 2009; the legislation included legislated rates of pay for employees of the federal government and its boards and agencies.[11]

The impact of increasing municipal labour costs has negative implications for business that bear a higher property tax rate relative to residential. With businesses still very much challenged by the impacts of the economic downturn and an increasingly competitive environment, tax relief is needed not tax increases. Furthermore, increases to municipalities' operational costs puts pressure on reducing or eliminating services or services related to infrastructure upon which businesses rely. The Ontario government must provide the necessary measures to assist municipalities in managing rising labour costs now.

RECOMMENDATION

The Ontario Chamber of Commerce urges the Government of Ontario to:

> Develop a comprehensive long-term public sector compensation restraint strategy that includes municipalities

[10] Bill 48, Social Contract Act, c.33. s. 32, 1993, cl.23-25.

[11] OPSEU "Response to Ontario Budget: Question and Answers about the Ontario government's wage freeze plan for public sector workers" OPSEU, 2010, http://www.opseu.org/campaign/ontariobudget2010/wage-freeze-q-and-a.htm (accessed on February 4, 2011).

Ontario's Deficit Management Strategy

(Adopted May 1, 2010)

ISSUE

Ontario's rising debt not only exposes the budget to the risk of higher interest rates, as was the case in the early 1990s, but it also creates an intergenerational shift of the tax burden.

Without a realistic plan to reduce the current deficit and ultimately the current level of debt, we will then be leaving that cumulative debt for future generations to resolve.

The Ontario Chamber of Commerce does not believe this is the prudent or responsible approach to managing Ontario's debt.

BACKGROUND

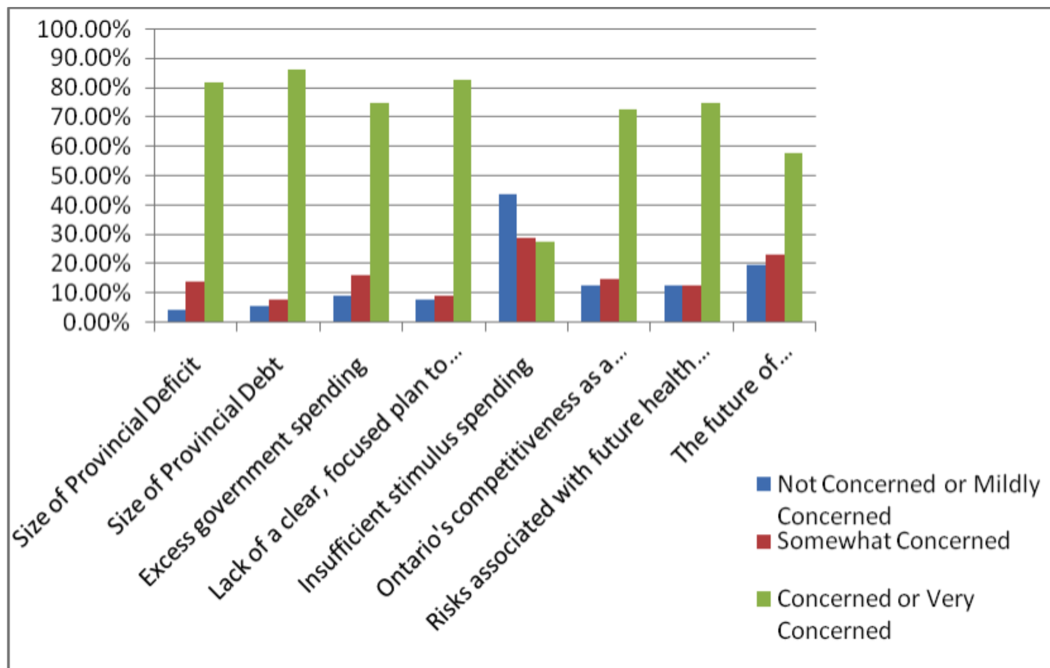
The Ontario Government is projecting deficits of $19.7 billion in 2010-2011 and $17.3 billion in 2011-2012. These projections reflect a reduction in anticipated revenue due to the recent weakening of economic conditions and the simultaneous increase in spending to offset some of the (temporary) effects of weaker private consumption and investment. (Note: The deficit to GDP ratio for 2010-2011 is now approximately 3.3 percent)

Ontario's total debt, which represents all borrowing without offsetting financial assets, is projected to be $212.4 billion as of March 31, 2010, compared to $176.9 billion as of March 31, 2009. Ontario's net debt, the difference between total liabilities and total financial assets, is projected to be $193.2 billion as of March 31, 2010, compared to $165.9 billion as of March 31, 2009. (Note: The net debt to GDP ratio for 2009-2010 is now approximately $34.1 percent)

In response to the severe recession, the Ontario government, (and other governments around the world), has relaxed fiscal policy by running significant deficits. While there are many arguments in favour of continuing to run relaxed fiscal policy during the coming fiscal year, it is imperative that the government move to credibly outline a plan to balance the budget by fiscal year 2015-16. Under the 2010 Budget, however, the current deficit will only be eliminated by the 2017-18 fiscal year.

One useful measure of the capacity to borrow and repay debt and, more broadly for the scope for national fiscal policy is the debt-GDP ratio. Provinces (or countries) with lower debt-GDP ratios are better able to sustain higher deficits (and thereby increase their debt-GDP ratio) during economic slowdowns. Conversely, provinces (or countries) with high debt-GDP ratios find themselves with the challenge of having to allocate a larger share of their budgets to debt service while having little room to borrow to finance additional deficits during future recessions.

While London's business community, for instance, is deeply concerned about the size of the projected deficits and the level of debt, they are equally concerned at the lack of a clearly articulated plan to balance the budget within a reasonable period of time. This concern is illustrated on the following chart where the size of the deficit, the size of the debt and the lack of a plan all received a similar score on a recent pre-budget survey.



The need for a credible and responsible plan is based on two principles. First, the business cycle is not dead. In order for the provincial government to maintain the option to respond to future downturns in the business cycle, it must move to, at the very least, balance its budget over the business cycle. (Over the good years, one needs to run a surplus to finance the deficit one expects to run over the bad years… thus "balance the books over the entire length of the business cycle.") Given that post-war business cycles have averaged five to seven years, this suggests that a minimal objective is a plan to bring the budget into balance within five years.

The second principle is that the ability to borrow at reasonable rates of interest depends critically upon the confidence of lenders. While it should be emphasized that the current Ontario debt load is manageable, it is important that the government credibly commit to a medium run fiscal plan that will maintain the Ontario debt-GPP ratio in a reasonable range over the next five years. This ensures that current credit ratings are maintained and prevents risk premiums from being added to the rate of interest attached to Ontario's debt.

An additional reason for fiscal prudence in the coming years is projected demographic changes. The most recent Ontario Population Projections[1] highlight two trends that put increased pressure on provincial budgets. First, the growth rate of adults aged 15-64 is projected to grow more slowly than over the past two decades. This will be a downward force on future nominal GDP growth rates, relative to the past 20 years.

The second key factor is the growth rate of those greater than 65 will be above historical averages, due to the aging of the baby-boomers and increased life expectancy. This will put increased pressure on future health care costs.

There is no avoiding the fact that any credible fiscal plan involves tough choices. Some simple calculations clearly illustrate these challenges. The 2009 Ontario Economic Outlook and Fiscal Review provide revenue and expense projections out to the 2011-2012 fiscal year.[2]

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[1] Ontario Ministry of Finance (2009). Ontario Population Projections: 2008-2036 Ontario and its 49 Census Divisions, Fall 2009: http://www.fin.gov.on.ca/en/economy/demographics/projections/demog09.pdf.

[2] Ontario Ministry of Finance (2009). 2009 Ontario Economic Outlook and Fiscal Review, http://www.fin.gov.on.ca/en/budget/fallstatement/2009/paper_all.pdf.

As a recent TD-Bank Financial Group report discusses, a reasonably optimistic growth rate of government revenues is on the order of 6 percent per annum.[3] Combining this with the previous fiscal projection for 2011-12, to balance the budget by 2015-16 the Ontario government would have to hold expenditure growth to less than 1.7 percent per year over 2012-2016.

This rough calculation highlights the urgent need for the government to outline realistic options to hold down expenditure growth. According to the 2010 Budget, however, expenditures will grow by an annual average rate of 5.1 percent to 2013 and by 1.9 percent from 2013 to 2018. The government has no alternative but to seriously explore ways of reducing the growth rate in health care expenditures – either by promoting efficiency "measures" or by allowing for more direct billing for some services. The government should not accomplish this goal by simply rationing health care.

These calculations also highlight the important role played by revenue growth. This further emphasizes that policies which help to increase the growth rate of GDP increases the sustainable level of future government expenditures. This implies that the government should stay the course on recent tax reforms which will help to increase investment and growth.[4] In addition, the government should avoid slashing expenditures on high return investments, such as key infrastructure, education and training given their direct link to levels of productivity and economic growth.

Now that federal/provincial stimulus initiatives are well underway and a time table for their implementation put in place, we believe that this is the most appropriate time to implement a defined formula for Ontario's provincial deficit strategy. In other words, Ontario needs a comprehensive and practical plan to eliminate the provincial deficit without jeopardizing a very fragile economic recovery.

RECOMMENDATIONS

The Ontario Chamber of Commerce urges the Government of Ontario to:

1. Establish a plan to eliminate the deficit by 2015-16
2. Provide an accurate accounting and recovery plan that will clearly communicate the government's intention to be in surplus by 2015-16, and will update this plan in all future budgets and economic statements
3. Maintain and improve Ontario's Net Debt to GPP (gross provincial product) ratios at better than the provincial average of the five provinces with the lowest ratios
4. Address the deficit through spending restraints but not reduce its deficit through cuts to existing municipal transfer payments, nor reducing investments in education and training and needed infrastructure that will promote our competitiveness and economic growth in the future
5. Enhance the efficiency of health care spending and provide detailed measures on how government will lower the growth rate of health care costs to three percent a year; government should also adopt international best practices at the strategic and operational levels of health care

[3] Ontario Ministry of Finance (2009). 2009 Ontario Economic Outlook and Fiscal Review, http://www.fin.gov.on.ca/en/budget/fallstatement/2009/paper_all.pdf.
[4] Mintz, Jack (2007). "2007 Tax Competiveness Report", CD-Howe Institute Commentary 254, September 2007.

Promoting Greater Local Accountability of Provincial Funds

(Adopted May 1, 2010)

ISSUE

Despite efforts to reduce spending and obtain greater efficiencies by some municipalities, the Ontario government continues to receive additional funding requests from some local governments. Unfortunately, given Ontario's fiscal position, there is little room – if any – for additional provincial transfers.

More importantly, however, not all municipalities endeavor to implement meaningful steps to reduce local public costs before making requests to the province. The Ontario Chamber of Commerce (OCC) believes that these municipalities have a spending problem, not a revenue problem, which should not be borne by taxpayers across Ontario.

BACKGROUND

Municipalities have long indicated that they struggle without adequate funds to meet increasing needs. There is no doubt that previous provincial downloading of services has increased the gap between the services that Ontario municipalities must deliver and what they can afford—even with recent efforts to upload more of the cost burden back to the provincial level. There is also no doubt as to the significant need for infrastructure renewal across Ontario.

Many municipalities, including the City of London, have over the years made significant steps in delivering more effective and efficient services to taxpayers without disproportionately increasing property taxes. That notwithstanding, local governments are required to make up for shortfalls primarily through property tax revenue to deliver essential programs such as social services. Unfortunately, property taxes are highly regressive and are disproportionally applied to those who employ Ontarians, but do not get to vote: businesses.

To tackle this funding challenge and limit property tax increases, some local governments have obtained cost savings through measures, such as value for money audits. The City of Toronto, for example, earned a 560 percent return on investment (ROI) on such audits in 2008, while the City of Oshawa earned an average of 331 percent over the last three years.

Although such audits are successful – relative to the funds invested to undertake them - they are not widely used. As such, regardless of property tax increases, new revenue sources (in the case of the City of Toronto) and value-for-money audits, some municipalities still find themselves significantly short of funds. According to a recent study by the Toronto Board of Trade, for example, the City of Toronto is well on its way to a $1.2 billion annual short fall, up from the current $382 million annual shortfall.

Despite continued needs for additional funds, some local taxpayers continue to face increased legacy costs and disproportionally higher public sector wages. Specifically:

- As of 2008, salaries, wages and employee benefits accounted for over 40 percent of total municipal operating expenditures – up from 36.7 percent in 2000; by contrast, London salaries, as a percentage of operating expenditures, only rose by 0.09 percent over the same period
- Adjusted for inflation, salary, wage, and employee benefit costs increased by 50 percent between 2000 and 2008

On average, spending across Ontario municipalities has grown by 40 percent in the last eight years (adjusted for inflation).

Ten years after the downloading of public services, some municipal governments continue to ignore viable options to improve their fiscal positions: reduce overall local government spending and undertake meaningful

efforts to obtain efficiencies with existing resources. Options to achieve these goals, which have eluded serious attention by some municipalities, include:

- Creating a competitive bidding process for the delivery of publically funded services which includes both the public and private sectors
- Reducing and/or freezing public sector wages until private sector wages catch up
- Addressing substantially large legacy costs within the public sector such as pension deficits
- Allowing small suppliers full access to public contracts
- Lowering the dependence on higher business property taxes relative to residential property taxes

The Ontario Chamber of Commerce is concerned that the avoidance by some municipalities to make much needed, difficult decisions to reduce spending and seek greater efficiencies with their local public funds comes at the expense of all taxpayers in Ontario. More importantly, the transfer of habitual local public sector cost increases by some municipalities to the rest of the province, ultimately, impedes Ontario's prosperity.

RECOMMENDATION

The Ontario Chamber of Commerce urges the Government of Ontario to:

> Freeze or limit provincial transfers to municipalities that do not undertake comprehensive, meaningful actions to reduce or limit spending, obtain efficiencies or act on recommendations by an Auditor General

Provincial Labour Arbitration System

(Adopted May 7, 2011)

ISSUE

The provincial labour arbitration system, particularly in relation to municipal services, is dysfunctional and requires significant reform.

BACKGROUND

The 2010 Ontario Budget indicated that in order to manage spending pressures and help redirect up to $750 million by 2011-12 to sustain public services like schools and hospitals, the compensation structures for all non-bargained employees in the Broader Public Sector and Ontario Public Service would be frozen for two years. All existing collective agreements will be honoured.

Municipalities are excluded; however, the province recommended they exercise restraint in order to address the provincial deficit.

The failure of the provincial government to impose wage freezes on unionized public sector workers is placing significant financial pressure on municipalities. Many large urban centers will be negotiating this year with transit workers, police and firefighters. Numerous contracts are expected to be settled through arbitration, a process that provides municipal governments with limited control over the outcomes.

Windsor Mayor Eddie Francis noted in a February 9, 2011 Globe and Mail article that he refuses to increase taxes to pay for decisions that are made by provincial arbitrators. Labour costs, including salaries and benefits, generally account for 60-80 percent of a city's operating budget.

Alok Mukherjee, chairman of the Toronto Police Services Board, also noted that the push by large forces to be the province's best paid is subsequently driving up wages. He observed a pattern of "leapfrogging" in this respect.

Mayors have called on the Ontario government to change arbitration rules which are unbalanced towards workers. Decisions by arbitrators do not incorporate an employer's capacity to absorb higher wages.

Windsor Regional Hospital CEO David Musyj directed correspondence to the provincial government last fall which indicated the arbitration system in Ontario to resolve collective agreements is totally broken. Musyj also noted that arbitrators ignore the province's economic situation and expensive contracts can create serious financial problems at public institutions.

The arbitration system also fails to recognize relative costs of living and other factors for the provision of services across Ontario. More importantly, the system erodes the capacity of elected officials to formulate local decisions for local issues.

RECOMMENDATION

The Ontario Chamber of Commerce urges the Government of Ontario to:

> Immediately revise the provincial labour arbitration system to correct current inequities and establish methodologies that incorporate a community's ability to pay for arbitrators and arbitrated settlements

Reforming the Taxation System on Ontario's Financial Services Industry

(Adopted May 7, 2011)

ISSUE

The hidden taxes on financial services such as credit, insurance and payment products; fund, debt and equity securities; and deposit and savings vehicles cascade through all sectors of the economy. The current system leads to tax being paid on tax, inappropriately raising the cost of doing business. The cumulative tax is a deterrent to investment and the inter provincial tax rules are too complex. This means reduced competitiveness of Ontario businesses, both domestically and globally.

BACKGROUND

The financial services industry is a critical engine for Toronto, Ontario and Canada's economies, driving employment growth, creation of high-value jobs and GDP. The Greater Toronto Region (GTR) is the heart of Canada's financial services industry (FSI), hosting 30 percent of FSI employees in the country. (In 2009, the sector contributed over 13 percent of GTR employment and over 20 percent of GDP, including indirect effects.) Toronto is home to:

- Two of the largest 10 global life insurers
- Three of the world's greatest 25 banks and Canada's largest five banking institutions
- The third largest exchange in North America after New York and Chicago
- Three of the top 50 global pension funds
- Seven of the top 10 investment dealers in Canada
- Four of the largest five investment management firms in Canada
- Three of the four largest property and casualty insurers in Canada

These numbers, and the integral role of financial services in the economy, suggest that strengthening and growing Toronto's FSI is paramount for the region's and province's economy. As financial services worldwide become increasingly competitive, it is imperative for Ontario's financial industry to remain strong. The health of the overall economy – and the financial well-being of individual Canadians – depends heavily on the soundness and competitiveness of the financial services industry due to its role in providing funding, capital, payment and insurance services that are important drivers of other sectors.

Financial services and manufacturing have historically acted as twin engines for the Ontario economy, with Ontario being one of the few jurisdictions in North America were both sectors have thrived. However, from 2003 to 2008, the manufacturing employment base in Ontario declined by 3.7 percent annually, driven at least partially by increased international competition. In the same period, financial sector jobs in the GTR, grew by 4.3 percent, contributing to an incremental $6.2 billion in GDP in the province, offsetting the 4 percent of GDP lost from manufacturing. To sustain growth of the financial services sector, and more importantly the industry sectors – including manufacturing – that the financial sector supports, sound taxation policies are needed.

The current tax system imposes a greater tax burden on financial service providers by exempting financial services from GST/HST. These providers are not entitled to input tax credits for the GST/HST they have paid on purchases made to provide the exempt services. The HST has increased the sales tax burden on the financial industry, adding hundreds of millions of dollars in new costs net of Ontario corporate tax reductions and the small quantity of provincial sales tax previously paid. This discourages new capital investment in Ontario relative to non-HST provinces, may encourage financial institutions to move some of their operations to these now lower-cost provinces and will promote in-sourcing of inputs.

The policy intent in moving to a value-added tax (VAT) regime in Ontario was to eliminate the cascading of sales taxes by removing the embedded tax from the supplier's cost base. In the case of an exempt supply, there is considerably more cascading of tax through to the final price of the exempt services for business, retail, and

to some extent zero rated financial services exports, making the Canadian financial sector and the many sectors that use financial services less internationally competitive.

The phasing in of general corporate tax rate reduction in Ontario from the current 14 percent to 10 percent as of July 1, 2013 was aimed at encouraging investment and productivity improvements in the province. However, the positive impact of these rate decreases will be at least partially mitigated by the impact of increased net sales taxes on the financial sector. Also, whereas the economic benefits of corporate income tax reductions and capital tax elimination are spread across the entire economy, the significant incremental costs of harmonization are concentrated on a few sectors.

The current exemption system for the taxation of financial services has negative consequences, not only for the financial services institutions and their shareholders, but also for businesses that should not be paying the sales tax embedded in their purchases. The main principle of a VAT is neutrality of tax treatment and yet the application of the GST and HST to financial services in Canada runs contrary to this in every way:

1. The same concept or value of consumption is not applied equally across all industries
2. All goods and services do not bear the effect of the VAT once – at the point of final consumption
3. The tax does not minimize changes in consumption decisions such as a bias toward in-house versus outsourcing or change in location of business – businesses supplying services that can be brought back in-house by the financial sector will therefore be hit harder than the broader economy that will bear cascaded tax
4. The anticipated reduction in administrative costs under a VAT does not apply to all industries equally – the new compliance measures for financial institutions have increased their administrative costs considerably

Canada's GST rules applying to financial services have been in place since 1990 when the GST was first implemented. Since then, business models and processes have changed, and important advances have been made in other countries on how to treat financial services under a VAT that are instructive for Canada. The GST was and is manageable because it is a national tax levied at a modest rate.

Applying a multi-rate second tier of tax at a higher rate in some provinces only, to what is essentially a national pool of saving/investments and credit, is contrary to the fundamental tax policy principles of taxpayer/investor equity, economic/geographic neutrality and compliance/administrative simplicity. Only four of the 130+ value-added tax (VAT) countries have a dual level of sales tax and of these, only Canada applies a variable rate at the provincial/state level.

As the issues are complex and impact financial services sectors in different ways, a multi-stakeholder review should be considered with representation from various financial industry sectors and business organizations at both the provincial and federal level. An improved sales tax regime enhances the efficiency of all sectors and strengthens Ontario's competitiveness. By virtue of its harmonization, Ontario now has a voice in the sales tax policy issue and should take the opportunity to support and participate in such a review.

RECOMMENDATIONS

The Ontario Chamber of Commerce urges the Government of Ontario to:

1. In cooperation with the federal government review and amend the taxation of the financial services industry and its services to ensure that all savings/investment, credit, insurance and payment services are taxed in a fair and consistent manner
2. Ensure that no level of taxation results in a tax on tax structure
3. Simplify tax rules to reduce administrative complexity in the application of taxes of businesses operating inter provincially

The Need for Provincially Mandated Municipal Auditor Generals

(Adopted May 1, 2010)

ISSUE

With the recent economic upheaval there is an ever increasing pressure on the part of municipalities in the Province of Ontario to deliver added value for stretched taxpayer dollars.

This pressure is of course felt at all three levels of government, but none more so than on the taxpayers of Ontario who have seen their taxes rise exponentially while their investments and job security continue to erode.

More oversight and more accountability demonstrate not only good leadership – they ensure a higher degree of competitiveness, cost effectiveness, and an appropriate return on investment.

BACKGROUND

The Municipal Act Amendments of January 1, 2007 conferred broader powers to municipalities coupled with the right to appoint accountability officers. One such accountability officer is the Auditor General (AG), which according to the Act reports to council and is responsible for assisting the council in holding itself and its administrators accountable for the quality of stewardship over public funds and for achievement of value for money in municipal operations. 2006, c. 32, Sched. A, s. 98.

The Auditor General conducts audits that assist municipal councils in achieving added value for taxpayers' dollars. Audits focus on efficiency and effectiveness of town operations and program delivery and on compliance with laws and regulations.

Subject to prescribed exceptions, all programs, activities and functions of municipal departments, local boards and any municipally-controlled corporations and grant recipients may be subject to audit by the Auditor General. These functions assure an added dimension of oversight and accountability in keeping with the "Broader Powers" of the amended Act but more importantly they provide the taxpayers of Ontario with a new confidence that is critical in today's turbulent economic environment.

What others are doing?

Ottawa, Oshawa, Markham and Sudbury each have demonstrated great leadership by appointing an Auditor General in their communities (Windsor has approved appointment of AG). Toronto has also appointed an Auditor General; although in Toronto's case, the appointment of an Auditor General is mandated by legislation. Ontario is not alone in this movement towards more open and transparent accountability.

Municipalities in the Province of Alberta including the City of Edmonton and the City of Calgary have an AG. Municipalities in the Province of Nova Scotia including the City of Halifax have appointed an AG while one AG is appointed for smaller municipalities. In Quebec, municipalities must appoint an Auditor General for municipalities whose population is 100,000 or greater.

Audit Models

In many Ontario municipalities there are two audit models presently being used: The External Audit Model and the Internal Audit Model.

The External Audit Model is mandatory for auditing of financial statements where the focus of the audit is to determine if the operations and financial position of the Municipality, (as reflected in its financial statements), has been fairly presented in compliance with Canadian GAAP. Funding for External Audits is generally set through a competitive bidding process.

The Internal Audit Model is comprised of employees. The Internal Audit Focus is on financial controls, compliance, auditing and providing internal consulting services to departments. Audits are generally limited to the municipality, unless local boards, corporations etc. request such an audit. In this case, there is no requirement for audit findings to be made public except if the Municipality makes this a requirement. Funding for this model is generally set annually by Council.

The Auditor General Model differs in that it has legislated powers, privileges and immunity that provide it with the tools necessary to conduct thorough audits with little or no external impediments. The Primary Role of the Auditor General is to assist Council to hold itself accountable for quality of stewardship over public funds and to achieve value-for-money in municipal operations. In this model the primary focus is on Value-for-Money Audits. This includes (Source: CICA Handbook) examining and reporting on the adequacy of management systems, controls and practices to ensure due regard to economy, efficiency and effectiveness; resource management with due regard to economy and efficiency; and effectiveness of programs, operations or activities.

What do Auditor Generals audit? Some samples of recent Audit Reports of Auditor Generals in Ontario Municipalities include: Fleet Operations Review; Management of Construction Contracts; Review of Parks and Recreation Revenue and Cash Control; Review of Sole Source Contracts; Review of procurement of goods and services; By-law Services – Compliance, Efficiency and Effectiveness.

<u>Why an Auditor General?</u>

The Municipal Act confers upon Auditor Generals certain powers, privileges and immunity and imposes certain obligations on audited entities. External and Internal Auditors have no legislated powers, privileges or immunity. Some of the powers, privileges, immunity and obligations provided for in the Municipal Act include; Duty to Furnish Information, Access to Records, No Waiver of Privilege, Powers of Examination and Duty of Confidentiality.

Immunity
Although the Municipal Act is permissive as to whether or not an Auditor General is an employee of the municipality, Auditor Generals that thus far have been appointed under the Municipal Act are not employees of the Municipality. Municipalities are generally cognizant of the need to ensure that the Auditor General is independent and perceived to be independent from those entities that are subject to audit. In this regard, Municipalities have, to varying degrees, followed best practices pertaining to preserving independence. One such practice is to ensure that the Auditor General is not an employee of the Municipality and that the Auditor General's budget is pegged at a specified percentage of the operating budget to avoid interference by Council from year-to-year with the Auditor General's budget.

Return on Investment (ROI)
There are both intangible and tangible returns on the investment that would be required to run an Auditor General Office. The intangible returns include enhanced public confidence and engagement.

The tangible return on investment includes costs savings, revenue increase, cost avoidance and protection of assets. In 2008, for every dollar invested by Toronto in its Auditor General Office the municipality obtained a return of $5.60 or 560 percent. In the City of Oshawa the average ROI for 2007, 2008, and 2009 (est.) is 331 percent. From a Provincial perspective, the government can move with much greater confidence to invest in those cities that have an Auditor General as opposed to those who do not.

<u>Issues with current Municipal Act</u>

The appointment of an Auditor General is not mandatory under the Municipal Act. A number of cities with a population of greater than 100,000 and with significant operating budgets have not appointed an Auditor General. Furthermore, the Municipal Act does not: (a) provide for a formula to determine what at a minimum should be the funding allocated to an Auditor General's office; and (b) that the Auditor General should be

independent and not be an employee of the Municipality. Since the Municipal Act is silent on these points a Municipality could appoint an Auditor General, but fail to put in place safeguards to ensure the Auditor General is independent and perceived to be independent.

RECOMMENDATION

The Ontario Chamber of Commerce urges the Government of Ontario to:

> Amend the Ontario Municipal Act to make mandatory the appointment of an Auditor General for Municipalities whose population exceeds 100,000 and:
>
> a. to expressly state that the Auditor General must be independent and not an employee of the Municipality
> b. to ensure municipalities provide for a budget for the Auditor General that would be no less than a specified fixed percentage of the municipality's operating budget
> c. that these amendments should be moved and brought into effect by 2012
> d. for municipalities whose populations are less than 100,000, the responsibility defers to the provincial auditor general

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