ONTARIO 360 – ECONOMIC COMPETITIVENESS – TRANSITION BRIEFING

Enhancing Ontario's economic competitiveness

Issue

What is economic competitiveness? There are various definitions used by different organizations and scholars.[1] The World Economic Forum, which has measured competitiveness among countries since 1979, defines it as "the set of institutions, policies and factors that determine the level of productivity of a country."[2]

Why does it matter? Competitiveness is closely linked to productivity and innovation and in turn greater wealth and higher living standards.[3] Competitiveness is thus a key ingredient of a pro-opportunity and growth agenda for Ontario.

The good news is that the province already exhibits many characteristics of a competitiveness strategy – including high levels of human capital, access to major markets, high-quality public infrastructure, well-respected post-secondary institutions, and so on. Still there is more work to be done to strengthen Ontario's long-term economic competitiveness especially in light of recent pro-growth tax and regulatory changes in Washington. The incoming government will thus need to develop a competitiveness strategy in order to enable more jobs, opportunity and prosperity.

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1 For a solid review of the literature – including competing definitions and perspective, see Christian Ketels, Review of Competitiveness Frameworks: An Analysis Conducted for the Irish National Competitiveness Council, March 2016. Available at: https://www.hbs.edu/faculty/Publication%20Files/Review%20of%20Competitiveness%20Frameworks%20_3905ca5f-c5e6-419b-8915-5770a2494381.pdf.

2 Oliver Cann, "What exactly is economic competitiveness?" World Economic Forum, September 27, 2017. Available at: https://www.weforum.org/agenda/2017/09/what-is-economic-competitiveness/.

3 Robert Atkinson, Competitiveness, Innovation and Productivity: Clearing up the Confusion, August 2013. Available at: http://www2.itif.org/2013-competitiveness-innovation-productivity-clearing-up-confusion.pdf.

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Overview

The Ontario government released a long-term economic outlook in 2017.[4] The report set out a clear-eyed assessment of relevant long-term trends such as an aging population, concentration of population in major centres, and an acceleration of new, disruptive technologies.

More importantly, though, it analyses the province's key strengths relative to its peers as well as provides some thinking about what policymakers must do to maintain and strengthen our competitiveness.

Ontario presently has a solid foundation for long-term economic competitiveness. There is insufficient space here to cover the full range of related policies that the current government and its predecessors have enacted to enhance provincial competitiveness and productivity. But some examples include: lowering the province's corporate tax rate, major investments in public infrastructure, and expanding access to post-secondary education.

This does not even account for the province's reputation for political stability or the quality of its public services or its pluralism and tolerance. As an example: A 2016 study by the Institute for Competitiveness and Productivity found that Ontario overperforms on measures of well-being beyond real GDP per capita.[5]

But it would be wrong to assume that the foundation is not without its cracks. There is certainly room for improvement – especially in light of the province's mediocre performance across a range of economic indicators.[6] Policymakers

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[4] Ontario Ministry of Finance, Ontario's Long-Term Report on the Economy, February 2017. Available at: https://www.fin.gov.on.ca/en/economy/ltr/2017/ltr2017.pdf.

[5] Institute for Competitiveness and Productivity, Looking Beyond GDP: Measuring Prosperity in Ontario, October 2016. Available at: https://www.competeprosper.ca/uploads/2016_WP_27_Looking_Beyond_GDP.pdf.

[6] Ben Eisen and Milagros Palacios, Ontario's Lost Decade: 2007-2016, Fraser Institute, March 15, 2018. Available at: https://www.fraserinstitute.org/sites/default/files/ontarios-lost-decade-2007-2016.pdf.

cannot neglect Ontario's underperformance in investment, employment, or wage growth.[7]

It is also important to remember that economic competitiveness is not a static policy objective. Competitiveness, by definition, is dynamic as jurisdictions strive to give themselves a policy edge in order to enhance productivity and promote investment and job creation. Ontario cannot rest on its laurels. Public policy must keep up with the dynamic global policy environment.

The need for reform

A new survey of its members by the Ontario Chamber of Commerce found that business confidence has continuously declined in the province in recent years.[8] These sentiments are consistent with long-term data on business investment in the province. Annual business investment is still below pre-recession levels and even that is distorted by the overheated real estate market which has obscured weaknesses in other parts of the provincial economy.[9]

This matters because business investment is a key indicator of a jurisdiction's long-term opportunity and prosperity. When businesses invest in new technologies and production processes and overall expansion, it spurs economic growth and raises living standards for workers. Higher productivity and higher wages go hand-in-hand.

The upshot is that one of the incoming government's biggest challenges will be strengthening the province's long-term competitiveness. Labour productivity is an essential condition for wage growth, social opportunity, and a vibrant and dynamic society. And, as the government's 2017 report on the

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[7] Mathew Lau, "Down and out in Ontario," C2C Journal, April 11, 2018. Available at: http://www.c2cjournal.ca/2018/04/down-and-out-in-ontario/.

[8] Ontario Chamber of Commerce, 2018 Economic Report, February 2018. Available at: http://www.occ.ca/wp-content/uploads/2018-Ontario-Economic-Report-8.pdf.

[9] Philip Cross, Ontario's One Cylinder Economy: Housing in Toronto and Weak Business Investment, Fraser Institute, 2017. Available at: https://www.fraserinstitute.org/sites/default/files/ontarios-one-cylinder-economy-housing-in-toronto-and-weak-business-investment.pdf.

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province's long-term prospects, puts it: "Labour productivity growth is a key driver of Ontario's prosperity and is projected to continue to grow at its long-term historical pace."[10]

How to move forward

What policies can the next Ontario government enact to exceed historic trends and super-charge competitiveness, productivity, and innovation?

Such a strategy ought to comprise a wide range of policies – including several that have been put forward by other *Ontario 360* contributors. Readers should consult our previous transition briefings on topics as broad as affordable housing to energy to commercialization to public transit in order to think about the various inputs and factors that inform and shape investment decisions.[11]

Here are three policy areas and recommendations that can hopefully find some combination of multi-partisan support and in so doing contribute to an overall agenda for Ontario's competitiveness.

1. *Reforming business taxation*

Taxation is not the only part of a pro-competitiveness agenda, but it is important that policymakers ensure that Ontario's business tax regime – including its rate structure and treatment of capital investment – does not come to diverge too significantly from competing jurisdictions.

Ontario has benefited from a multi-partisan focus on competitive business taxation for the past several years. The current government has lowered the provincial corporate tax rate from 14 percent in 2009 to 11.5 percent at present.[12] This has given Ontario the second lowest among the provinces.

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[10] Ontario Ministry of Finance, Ontario's Long-Term Report on the Economy, February 2017. Available at: https://www.fin.gov.on.ca/en/economy/ltr/2017/ltr2017.pdf.
[11] Ontario 360, 30-on-30. Available at: http://on360.ca/30-on-30/.
[12] The rate reduction was announced in the 2009 Budget with the plan to lower it to 10 percent in 2013. The government subsequently opted to keep it at 11.5 percent. Ministry of Finance, 2009 Ontario Budget. Available at:

The U.S. government has recently lowered its corporate rate by 14 percentage points to 21 percent. The combined federal/state rate in the U.S. is now roughly comparable to the combined federal/provincial rate in Canada.

But the U.S. rate reductions were matched with structural changes to the tax treatment of capital investment. U.S. business will now have full expensing which means that investments can be deducted from taxable income immediately rather than more gradually over the lifespan of the asset. Canadian tax policy expert Kevin Milligan refers to this policy change as "transformative" in a recent publication by the C.D. Howe Institute.[13]

The combined effect of the rate reduction and liberalized tax treatment of capital investment will markedly improve U.S. tax competitiveness. Ontario policymakers should therefore consider how best to respond.

One option is to lower the province's statutory rate from the current 11.5 percent. The province presently collects abut $15 billion per year in corporate tax revenues. A back-of-the-envelope calculation suggests that it would cost the government roughly $1.3 billion to lower the corporate tax revenue per percentage point. This almost certainly overstates the cost given that research shows that the marginal cost of public funds for corporate income tax is significant.[14]

An alternative that might have broader political support is to work with the federal government to implement full expensing of corporate investment. This approach may have more resonance from centre-left experts and voters because the tax relief would be conditional on corporate investment. An even

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http://www.archives.gov.on.ca/en/historical_documents_project/7-11/ONTARIO_2009_BUDGET.pdf.

[13] Kevin Milligan, "Ottawa's corporate taxation opportunity," Intelligence Memo (C.D. Howe Institute), February 15, 2018. Available at: https://www.cdhowe.org/sites/default/files/blog_Kevin_0214new.pdf.

[14] Bev Dahlby and Ergete Ferede, What Does it Cost Society to Raise a Dollar of Tax Revenue? The Marginal Cost of Public Funds, C.D. Howe Institute, March 2011. Available at: https://www.cdhowe.org/sites/default/files/attachments/research_papers/mixed//Commentary_324.pdf

narrower option would be to temporarily extend full expensing to trade-exposed sectors to level the playing field for the duration of the five-year, U.S. policy.[15]

2. *Regulatory reform*

The government's 2017 long-term economic study highlighted the need for regulatory modernization. It may seem wonky, but this could be a fruitful exercise – especially since one certainly hears anecdotally from businesses about the need for a review and reform of Ontario's regulatory system.

Any new regulatory reform would not be starting from scratch. It would build on the government's 2017 *Burden Reduction Act*. Recent efforts to achieve $100 million in regulatory savings are a step in the right direction.[16]

One worthwhile option to consider is adopting a "regulatory budgeting" model as enacted by the previous Liberal government in BC and the Harper government at the federal level. A regulatory budget essentially requires that any new regulations need to be offset by reforming or eliminating existing regulations of an equivalent economic cost – using a standardized costing model to measure the economic costs of regulations across the government. Departments are therefore responsible for weighing the benefits and costs of new regulations against existing ones and ultimately for setting out rules and regulations that minimized the cost burden on businesses and households.[17]

This is an important point: regulatory budgeting is neutral on de-regulation. It is principally about requiring greater prioritization and trade-offs than policymakers would otherwise consider. Think of it as much about creating the right institutional incentives and empowering officials to make smart, long-term

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[15] Avery Shenfeld, "The Elephant Rolls Over: Taxing Times for Canada?," CIBC Economic Insights, December 14, 2017. Available at: https://economics.cibccm.com/economicsweb/cds?ID=4330&TYPE=EC_PDF.

[16] Ontario Government, 2017 Paper Burden Reduction Report. Available at: https://www.ontario.ca/page/2017-burden-reduction-report.

[17] Sean Speer, Regulatory Budgeting: Lessons from Canada, R Street Institute, March 2016. https://www.rstreet.org/wp-content/uploads/2016/03/RSTREET54.pdf.

choices as it is about de-regulation. This is presumably why regulatory budgeting was enacted in BC by a Liberal government, has been maintained in Ottawa by the Trudeau government, and has some support among center-left scholars in Washington.[18]

A good example of related regulatory improvement from the federal level is the federal Department of Health has begun to allow regulated pharmacy technicians to oversee the transfer of prescriptions from one pharmacy to another– a task that was previously restricted to pharmacists. This regulatory change is estimated to save individuals and businesses approximately $15 million per year.[19] It shows that regulatory budgeting can help to incentivize sensible reforms rather than merely focusing on de-regulation.

3. Labour Reform

One area of labour reform worth pursuing in the name of competitiveness, productivity, and innovation is focused occupational licensing. The current regime may be well-intended – including compulsory certification or enhanced oversight, for instance – but there is growing evidence that these policies produce inadvertent consequences. The outcome is fewer qualified workers including skilled tradespeople in general, and further marginalizing some people from the mainstream economy in particular.[20]

The good news is that the current government is starting to revisit some of these questions. Its new Apprenticeship Strategy (referred to in Brian Dijkema's *Ontario 360* submission) may help to alleviate some of these problems. His recommendation to streamline registration for new apprentices is a no-brainer in this regard.

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[18] Ted Gayer, Robert Litan and Philip Wallach, Evaluating the Trump Administration's Regulatory Reform Program, Brookings Institution, October 2017. Available at: https://www.brookings.edu/wp-content/uploads/2017/10/evaluatingtrumpregreform_gayerlitanwallach_102017.pdf.

[19] See Treasury Board Secretariat, 2013-14 "Scorecard Report: Implementing the Red Tape Reduction Action Plan." enting the Red Tape Reduction Action Plan," Government of Canada, January 2015. http://www.tbs-sct.gc.ca/hgw-cgf/priorities-priorites/rtrap-parfa/report-rapport/2013-14/asr-fea-eng.pdf.

[20] Laura Dawson et al., Modernizing Ontario's Skilled Trades Apprenticeship and Training System Building New Opportunities Through Governance and Regulatory Reform, March 2015. Available at: http://rescon.com/reports/files/DAWSON-REPORT-OHBA-report.pdf.

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More complicated yet important reforms involve working with the unions and professional bodies to streamline and standardized the process – including possibly accelerating the timelines or liberalizing the rules and restrictions. Too often the current regime fails both serving the labour market's needs and the needs of individuals – including those looking for a second chance.[21] The incoming government should establish a review panel to make recommendations on how to reform the credentialing process to better meet labour needs and enable greater opportunity for underrepresented groups. Mr. Dijkema would make an excellent chair for such a panel.

Economic competitiveness matters. It will be among the most important issues facing Ontario's next government. An effective strategy will necessarily cut across various ministries and policy areas. This transition briefing has set out three – taxes, regulations, and occupational licensing – that ought to find some support across the political spectrum and move the province's economic competitiveness in the right direction.

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[21] John Howard Society, Reintegration in Ontario: Practices, Priorities, and Effective Models, 2016. Available at: http://johnhoward.on.ca/wp-content/uploads/2016/11/Reintegration-in-Ontario-Final.pdf.