RESEARCH REPORT

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Choose Change or Loose Change:

User Fees are <u>so</u> 20th Century

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Under fiscal pressure from all sides, Premier Dalton McGuinty's Ontario Liberal government has been floating a variety of suggestions for new sources of revenue that are not tax increases – or at least don't look like tax increases.

Faced with an inherited fiscal deficit, an election pledge to balance the provincial budget without raising taxes and pressing demands for new public investments to repair recent damage and build for the future, the government is showing interest in what otherwise would be politically problematic ideas, such as selling the province's liquor stores, expanding public-private partnerships and increasing electricity bills.

In this climate, it might be tempting to look to instituting new user fees or increasing existing charges for government services as a way of squaring the vicious fiscal circle. But a closer look at the experience of Ontarians from 1995-2003 makes clear that this path is much too well worn to be offered as "choosing change" from the previous government's discredited record.

In fact, the burden of increased user fees and other charges that proliferated during the Conservative era of Mike Harris and Ernie Eves will have outweighed the benefits of provincial income tax cuts for many ordinary Ontario families. It's difficult to be precise about the exact impacts, because one of the great advantages of user fees from the provincial government's point of view is that many are hidden away on municipal bills or payments to use school facilities or higher licence fees, rather than presented in a lump sum each year on budget day, as is the case for provincial tax hikes or cuts. The user fees and other charges do show up in aggregate, however, in Statistics Canada's surveys of revenues and expenditures by sector.[1]

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1 The current study builds on the excellent work over the past eight years of economist Hugh Mackenzie and others in the Ontario Alternative Budget project. OAB reports, fact sheets and technical papers are at http://www.policyalternatives.ca/oab/index.html.

Local governments in Ontario, to take an example, reported $1.28 billion more from "sales of goods and services" – a catch-all category that would encompass many of the increased user fees – in 2002 than in 1995. This was an increase of 37.3 per cent, far outpacing the 15.1 per cent inflation over the same seven-year period. For the average Ontario household, this would mean an additional $303.10 when you add up all the extra fees, higher water bills and the like – not including property taxes, which are a separate category.

Table: Increase in various user fees and taxes, 1995 to 2002, Ontario.

	000s	per household	000s constant 2002 dollars	per household constant 2002 dollars
provincial fees, etc.	$1,380,000	$327.09	$1,179,000	$279.37
local govt fees etc.	$1,279,000	$303.10	$759,000	$179.91
post-secondary tuition	$999,000	$236.95	$841,000	$199.48
post-secondary fees and other revenue	$664,000	$157.49	$471,000	$111.81
health and social service fees	$944,000	$223.77	$700,000	$165.91
school board fees, etc.	$151,000	$35.79	$118,000	$28.20
property taxes, schools & local	$2,309,000	$547.22	($-44,000)	($-10.43)
total	$7,726,000	$1,831.41	$4,024,000	$954.25

Source: Statistics Canada, Government Revenues and Expenditures, CANSIM Tables 385-0002 through 385-0009.

Looking at colleges and universities, $999 million more flowed in tuition revenue in 2002 than in 1995, an increase of 95.8 per cent. Here the average of $236.95 per household is not as helpful, since post-secondary tuition clearly has a much more targeted impact on students and their families, rather than the population at large. Statistics Canada reports that the average undergraduate tuition at an Ontario university increased by $2,465 from 1995 to 2002, as the institutions made up for drastic budget cuts in the early years of the Harris government[2]. Thus, for a student or her family, the increased cost of tuition alone was likely to overshadow the benefits of the trumpeted income tax cuts.

To get a better sense of the relative impacts of tax cuts and user fees, it is helpful to look in more detail at a few representative fictional families, and consider how their finances would have been buffeted since the 1995 triumph of the Common Sense Revolution.

Take for example a family of three – a single parent and two children, with income of $38,000 in 2003.[3] Because of the Harris government's tax cuts, they would pay $1,490.43 less than if the 1995 tax levels were still in place. On the other side of the ledger, the average Ontario household's share of the various user fees and property tax increases is $1,831.14. Without knowing a lot more about our fictional family, it's not possible to know if this net loss of $340.71 accurately describes their situation. But a key objection to shifting the burden of public services from income taxes to user fees is that the fees are far less likely to be calibrated to the family's ability to pay, however determined.

Of course many families diverge dramatically from the mean. A family of four earning $54,000 – roughly the median household income for Ontario – with one full-time university student among them, is likely to be paying $2,465 more for undergraduate tuition in 2003 than in 1995. After dropping the per-household share of the tuition burden from the overall averages to avoid double-counting, this family could be facing $4,059.46 in total extra user fees including higher tuition – while benefiting from a $1,439.80 tax cut on the combined income.

Even someone with income as high as $75,000 a year could find most of his or her tax cut chewed away by higher costs, if for example this person were helping an elderly relative pay soaring nursing home fees, which increased by $1,518 between 2002 and 2003. That individual's tax cut would be $3,677.60, only a small amount more than the combination of the higher nursing home fees and the range of other increased fees and local taxes he or she would be facing.

This is not to say no one benefited from the Conservative income tax cuts. Someone making $200,000 a year will have pocketed $9,248.10 in tax cuts, far more than he would be likely to have had to pay out in various fees.

In total, the different categories of fees, tuition, revenues from sales of government services and the like show an increase, in constant dollars, of about $4 billion by 2002, while the Ontario Alternative Budget estimates the annual cost of the personal income tax cuts at

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[2]Statistics Canada, The Daily, Aug. 12, 2003, and Nov. 8, 1995.

[3]The average Ontario income for a female lone parent family in 2000 was $38,110.

$10.8 billion. For that matter, if increased user fees completely offset the tax cuts, presumably we wouldn't observe universities, municipalities and school boards desperately squeezed for funds and forced to reduce services they were able to find money for a few years ago. But even if the accumulated burden of user fees doesn't equal the total tax cut, it is clear that this is an avenue that has been firmly identified with the Conservative government's approach and cannot qualify as "choosing change."

So what to do? Where will the money come from if not from fees? The new Liberal Ontario government, despite its very public commitment to raise no taxes, will need to take a very close look at the costs and benefits of financing significant public investments from general revenues, especially the progessive income tax.

To focus on the university sector alone, there is growing evidence that the Ontario public would be amply repaid for many years into the future if it made the public investments needed to – at the very least – match what competing jurisdictions are doing. One significant recent study, by the Ontario Task Force on Competitiveness, Prosperity and Economic Progress (chaired by Roger L. Martin of the Rotman School of Management at the University of Toronto) concluded that a failure to invest enough in universities is a key factor explaining Ontario's lagging prosperity.[4]

The task force study determined that Ontario's total investments in university education of $425 per capita fell well short of the $875 per capita average in the "peer group" – 14 U.S. states plus Quebec. The study estimated that this shortfall was responsible for $965 per capita out of the total $4,119 per capita "prosperity gap" Ontario suffers.

In other words, by investing $450 per capita more than Ontario does in universities, the "peer group" produces $965 per capita more in GDP at purchasing power parity prices – the statistic used to represent general standard of living. The implication is that any new investments in Ontario universities could be expected, in time, to produce more than "double your money back" for the province's overall economy – an estimated rate of return of nearly 215 per cent.

There have been several other attempts to quantify the economic return from university investments. Although none were as sweeping or comprehensive as the task force report, they do suggest that its striking results are not out of line with reality. A study commissioned by the Council of Ontario Universities in May 2001 (using statistics from 1998), found that the provincial government's $2.1 billion spending on universities produced $3.2 billion in direct and indirect returns to the provincial treasury, including graduates' incremental tax

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4 Institute for Competitiveness and Prosperity, "Second Annual Report: Investing for prosperity, November 2003. Located at: http://www.competeprosper.ca/task/ar2003.pdf

payments and direct expenditures by the institutions, but not counting the full array of benefits to provincial GDP.

Looking at many of the same issues from a different perspective, the impact of the Conservative government cuts to university funding is spelled out in stark detail in "University Funding Cuts: Shortchanging Ontario Students," issued in 2002 by the Canadian Centre for Policy Alternatives.[5] The authors conclude that funding shortfalls have left Ontario Universities financially crippled and students burdened under much higher tuition and other costs.

For Ontario to fully catch up to the "peer group" jurisdictions could not be accomplished overnight. But the task force analysis suggests that meeting shorter-term goals – such as raising the province's support for universities just to the average of the other nine provinces (as Premier McGuinty has committed to do) – could produce very significant returns, both to Ontario citizens and to government coffers.

For example, if Ontario increased its transfers to universities by $500 million, the task force analysis suggests that the province's GDP could eventually increase by $1.07 billion as a result. Because combined revenues of Canadian governments run at 37.3 percent of GDP (source: OECD Economic Outlook No. 72, December 2002) this would return about $399 million to government coffers. The Ontario government alone could expect $128 million in increased revenues.

Universities are by no means the only area where additional public investments could be expected to yield ample returns. More generally, the Ontario task force study finds that public sector structural investment in Ontario lags behind the U.S. counterparts, with Ontario's public sector investing 1.5 percent of GDP on structural capital while the comparable U.S. investment was over 1.8 percent.

The government's own projections, in the December 2003 Economic Outlook and Fiscal Review, suggest that economic growth on its own will not produce enough revenues even to eliminate the provincial deficit, let alone support new investments. Meanwhile, the scope for squeezing significant resources out of cuts to existing spending will be very limited, both practically and politically. On the revenue side, the Ontario Alternative Budget has put forward a balanced package of closed loopholes and modest increases in tax rates that is projected to generate a total of $3.75 billion to fund new initiatives.[6] This kind of approach would support real, positive change and is well worth the government's consideration.

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[5] Hugh Mackenzie and Mark Rosenfeld, "University Funding cuts: Shortchanging Ontario Students, Canadian Centre for Policy Alternatives, April 2002.

[6] Hugh Mackenzie, "Meeting the Need: Rebuilding Ontario's Ability to Pay for Public Services," Canadian Centre for Policy Alternatives, January 2004.

Altogether, the evidence from different perspectives is all pointing in the same direction: the new Liberal government will find the case building for using the progressive tax system, rather than hidden charges or downloaded fees, to finance profitable investments in our future. The government's first budget, expected in late April or early May, should provide an indication of whether this case has been heard strongly enough to outweigh the public commitment to hold the line on taxes.