

**REFLECTIONS ON THE OCTOBER 2 PROVINCIAL ELECTION
IN ONTARIO**

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The Liberal Victory

Last Thursday the Liberal party under Dalton McGuinty won a decisive victory over the Conservative government, which had been led by Ernie Eves since Mike Harris left provincial politics in the spring of 2002.

The Liberals had last formed a government at Queen's Park in 1985-90. They were followed in office by the New Democratic Party (NDP), Canada's social democratic party, which unexpectedly formed a government in 1990 with only 37.6% of the vote. The Liberals started both the 1995 and 1999 election campaigns ahead in the polls, only to fall behind to the Conservatives under Mike Harris. The 1999 campaign was Mr. McGuinty's first as Liberal leader.

Mike Harris was the first Ontario party leader since the 1960s to form two consecutive majority governments, in 1995 and 1999. His party emerged out of the political wilderness in 1995 on the strength of the *Common Sense Revolution*, a neo-conservative party platform which emphasized tax cuts as the key to prosperity and growth.

I don't intend to bore – or amuse – you with a detailed recounting of the highs and lows of our recent election campaign. Instead, I want to highlight an elemental theme in the Liberals' campaign, which is perhaps of relevance to an American audience. And that is:

The Liberals managed to persuade the voters -- and in particular the middle-class, suburban voter, the Conservatives' core constituency -- that they could be trusted with the public purse. The Liberals have assumed the mantle of fiscal probity previously worn by the Conservatives. The new Liberal government can be trusted to continue the Conservatives' policy of maintaining Ontario as a relatively attractive location for businesses, employers and taxpayers.

The Conservatives' Promised Tax Cuts & The Liberal Response

If you have followed our recent election campaign at all, no doubt you will have noticed that for many commentators, a key factor in the Conservatives' defeat was their failure to turn the election into a referendum on the virtue of a further round of tax cuts. In their

March election budget, and subsequently in the electoral platform *The Road Ahead*, the Conservatives promised:

- ?? to complete the previously announced, multi-year 20% reduction in personal income taxes (on top of the 30% reduction introduced by the Conservative government in its first term, 1995-99);
- ?? to complete the previously announced, multi-year reduction in the general corporate income tax, to 11% for 2004, 9.5% for 2005, and 8% for 2006;
- ?? to complete the previously announced, multi-year reduction in the corporate income tax rate for manufacturing and processing firms, to 10% for 2004, 9% for 2005 and 8% for 2006;
- ?? to complete delivery of the previously announced Equity in Education Tax Credit, which, when fully implemented in 2006, would provide a tax credit of up to \$3,500 per student for parents who send their children to “independent” (i.e., private schools);[?]
- ?? to increase the threshold at which taxpayers became subject to an existing income surtax;
- ?? to cut the capital tax by 10% in 2004;
- ?? to eliminate the provincial portion of property taxes (which goes to fund education) for senior citizens; and
- ?? to permit home-owners to deduct from their taxable incomes the first \$5,000 of mortgage interest paid.

[?] A word of explanation is in order here. In the Conservatives’ first term (1995-99), the government implemented a number of personal and corporate income tax cuts, most notably a 30% personal income tax cut. In the 1999 budget, the government announced its intention to implement a multi-year schedule for future, staged cuts. On the personal income tax side, the 1999 budget introduced a 5% tax cut, as the first step towards a 20% income tax cut. In the 2001 budget, the promised tax cut schedule for personal (that is, the remaining 15%) and corporate income tax cuts was finally presented in detail. This multi-year schedule was to commence in 2002. However, in the 2002 budget, the government announced that because of deteriorating economic conditions, it was postponing the start-year of the schedule to 2003, with the exception of the scheduled cut to the small business tax, which went ahead as planned. The 2002 budget also postponed the original schedule for the implementation of the tax credit for parents with children in private schools. Thus, many of the 2003 tax cuts promised by the Conservatives were not new and had already been announced before, in the 2001 budget; and should have already been implemented anyway, starting in 2002.

The Liberals, on the other hand, resolutely refused to offer any significant tax breaks at all. Their strategy on this issue was neatly captured in the soundbite repeated by Mr. McGuinty throughout the campaign, in the media, on the hustings, in the Liberal TV ads, and during the September 23 televised party leaders' debate: "I'm not going to cut your taxes. But I'm not going to raise them either."⁷

The Liberals declared that if elected, they would roll back the Conservatives' personal and corporate tax breaks scheduled to go into effect in 2004; roll back the private school tax credit; cancel the education property tax break for seniors; and not raise the threshold at which the income surtax went into effect.

Mr. Eves vainly pointed out that if the Liberals cancelled the income tax cuts already legislated by his government, then, in effect, the Liberals were raising taxes. Indeed, under the terms of the Conservative government's *Taxpayer Protection Act*, which states that the cancellation of a previously announced tax cut constitutes a tax increase, the Liberals were required to publicly declare that if elected, corporate income tax rates would indeed rise, because the rates would revert to the higher levels in place before the Conservative government's cuts; and that the Conservatives' promised cuts to the personal income tax and small business corporate tax would not go ahead.

Why did the tax cut issue fail to catch on with the voters, as the Conservatives had anticipated? Among other factors, the Liberals were able to craft a platform projecting an image of fiscal credibility, while the Conservatives squandered their reputation as sound fiscal managers.

The Liberal Platform: "Choose Change"

The Liberals devised a package of spending promises largely directed at the concerns of the middle class, but firmly presented within the context of a commitment to fiscal prudence. Throughout the campaign, Mr. McGuinty blasted the Conservatives for their

⁷ The Liberals did promise that if they won the election tobacco taxes would rise to the "national average."

tax break “gifts” and “hand outs” to big corporations and private schools, promising to retain this revenue in public hands for reinvestment in essential public services – health care, the schools, universities, strategic industries, and environmental measures. The details of Liberal policy in these areas need not concern us here. What is noteworthy in the platform is the all-pervasive emphasis on fiscal moderation:

- ?? the Liberals proclaimed that in drawing up the platform, they were “guided by one overriding principle: we will, at all times, act responsibly in our management of your tax dollars;”
- ?? the Liberal budget plan purported to balance the budget through the next four years, with no tax increases;
- ?? the budget plan was based on the same fiscal projections employed by the Conservative government’s March budget; and
- ?? the budget plan’s assumptions and projections were validated by two well-respected economists and a forensic accountant, enabling Mr. McGuinty to proclaim throughout the campaign that his platform (unlike the Conservatives’) was fully costed by independent experts.

Over and over again, the Liberal platform promised that a Liberal government would balance the budget; abide by the Conservative government’s balanced budget law, the *Taxpayer Protection Act*; and not raise taxes.

Despite their reputation for fiscal prudence, the outgoing Conservative government in fact added over \$20 billion to the provincial public debt. The Liberals promised that they would not add to the debt. Moreover, they would pay down the debt as conditions allowed, with any budgetary surplus going entirely to debt repayment.[?]

On the campaign trail, Mr. McGuinty emphasized continually that a Liberal government could not promise to be all things to all people; was committed to balancing the budget; was intent on managing scarce public resources prudently; and would not raise Ontarians’ taxes. With much fanfare, he signed the “pledge” promoted by the Canadian Taxpayers’

[?] In the Conservatives’ first full fiscal year in office (1996-97), 16 cents out of every dollar spent by the province went to public debt interest payments; in 2003-04, it will be 12 cents.

Federation, promising that if elected, he would never raise taxes without the explicit consent of the Ontario voters; and that his government would never run deficits.

The Conservative Record

For the first time since 1995, the Liberals were in a position to poke holes in the Conservatives' reputation as sound fiscal managers:

- ?? In the 2002 budget (Mr. Eves' first as Premier), the government felt compelled to postpone the start-date of its previously announced multi-year schedule of personal and corporate income tax cuts, from 2002 to 2003. This required a formal amendment to the government's much publicized *Taxpayer Protection Act*, which declared that the postponement of a previously legislated tax cut constituted a tax increase. The amendment was necessary to circumvent the Act's requirement that a tax increase (as defined) had to be preceded by a referendum. Needless to say, the negative publicity around the debate on this amendment damaged the government's image as a sound fiscal manager.
- ?? To put it bluntly, the Eves government mismanaged the Conservatives' long-planned transition to an open market in electricity.[?] For most of the 20th century, the Ontario manufacturing sector enjoyed a competitive advantage thanks to cheap electricity delivered by the government's vertically integrated monopoly, Ontario Hydro. However, in the 1980s Hydro began to experience increasingly huge cost over-runs, largely brought on by its expensive nuclear power-building program. In the midst of the early 1990s recession the NDP government imposed a rate freeze and drastically downsized the corporation. The new Conservative government, appalled at the dimensions of Hydro's debt, resolved to privatize the system. In 1998, when Hydro was broken up into separate generation (OPG) and distribution (Hydro One) companies, Hydro's total debt amounted to \$38 billion.

A few months after the electricity market was opened to competition in May of last year, prices began to skyrocket, and by November the government succumbed to consumer complaints and froze the retail price at 4.3 cents a kilowatt hour. This is considerably lower than the wholesale price which is still subject to market forces. The difference has to be subsidized by the government, and is added to the \$20 billion or so of stranded debt left over from the break-up of Hydro. Meanwhile, any hopes the government still entertained of enticing the private sector into the market to build desperately needed new sources of supply, after the retail price became subject to political manipulation, were completely dashed when Mr. Eves cancelled yet another integral element in the original

[?] Ontario gets roughly 41% of its electricity from nuclear power, 26% from coal or oil, 24% from water, 7% from natural gas, and 1% from alternative power sources (2001 figures).

privatization plan, which was to force the OPG to systematically deprive itself of its generating assets in order to foster competition and encourage more private sector participation. (Mr. Eves had already cancelled plans to sell shares in Hydro One). And finally, the artificially low, frozen retail price makes a mockery of the government's belated, half-hearted conservation program.

In short, the province now faces a supply crisis, is saddled with an aging, expensive infrastructure, and has thoroughly alienated the private sector players the original privatization plan was intended to attract into the market to fix the problem. The OPG and Hydro One simply do not have the resources to build the new power plants we need, without assistance from private capital.

- ?? The government's March budget, which was designed to carry the Conservatives into the election campaign, was a political as well as policy disaster. The government violated centuries of parliamentary tradition by delivering the budget outside of the Legislature, in a suburban auto parts training facility, where the Conservatives could control the broadcasting of the Minister of Finance's budget speech unencumbered by the formal procedures of the Legislature. This provoked a storm of protest from constitutional experts, the opposition parties, the media, and not least from the Speaker of the Legislature, himself a Conservative MPP, who commissioned a legal opinion purporting to demonstrate that the budget presentation was unconstitutional.⁷

The budget itself promised to cut taxes and balance the budget, by selling \$2.2 billion in public assets and achieving \$800 million in savings. However, nowhere did the budget clearly identify which assets were to be sold, or how the government realistically expected to save \$800 million after eight-plus years of government retrenchment. Further, private sector forecasters immediately pounced on the revenue assumptions underlying the budget. The result was that by mid-summer, the bond rating agencies were openly contradicting the Minister of Finance and projecting a \$2 billion budget deficit.

⁷ Which raises the question of how could the government have been so foolish? Mr. Eves had previously promised that the budget would be presented before the start of the fiscal year on April 1, to placate the schools, universities and hospitals which for years had had to suffer from budgets under Premier Harris presented long after the fiscal year had begun, making it impossible for them to engage in rational planning. For instance, in previous years some hospitals had been forced to lay off staff to finance the borrowed money they had been compelled to secure, to tide themselves over until the provincial government finally released their funding long after the start of their fiscal year. However, this commitment by Mr. Eves posed a political problem for the Conservatives in 2003, an election year. If the Legislature was summoned earlier than usual in March in order for the budget to be delivered, the Conservative party would lose control of its options: for example, the option of an election call in the spring, which would require shutting down the Legislature shortly after it resumed, a move reeking of political expediency. On the other hand, the Conservatives did want to showcase a balanced budget with tax cuts for the electorate. The solution? Deliver a budget, but without the Legislature sitting.

- ?? The Conservatives failed to learn from this negative reaction, compounding their problems by releasing an electoral platform suffering from the same weaknesses. The platform promised to balance the budget in part by finding *another* \$700 million in internal savings, again not identified. How did the government expect to save another \$700 million, on top of the \$800 million in still unidentified savings already promised in the spring? Among other things, by appointing a task force to identify “waste and inefficiency” in the bureaucracy—this from a government which had already been in power for eight-plus years!
- ?? Because the Conservatives refused to acknowledge the possibility that their revenue assumptions were unrealistic, and that a more realistic costing would reveal that the province was actually running a deficit, they could not credibly counter the Liberals’ boasting that their platform had been submitted to an independent audit and was “fully costed.” Now the Liberals appeared to be the sober, sensible option for voters suspicious of politicians who make unrealistic promises they cannot afford to implement without running up a deficit or raising taxes, once ensconced in office.
- ?? Just before the televised party leaders’ debate on September 23, the Fraser Institute, a right-of-centre think tank, released a study which shredded the financial premises of the Conservative campaign, and estimated that the province was now running a \$4.5 billion deficit. The study also effectively refuted the premises of the Liberals’ fiscal plan – but the optics favoured the Liberals. What the media emphasized was not the critique of the front-running Liberals, but that here was a *right*-wing think tank, attacking its natural political ally, the Ontario Conservative party (after all, you’d *expect* the Fraser Institute to go after Liberals); that the author of the study was none other than the same economist who had costed and certified as credible the Conservatives’ famous *Common Sense Revolution* campaign document, back in 1994; and finally, that former Conservative Premier Mike Harris himself was now an associate with the Fraser Institute!
- ?? After years of tax-and-spend liberalism in the 1980s and early 1990s, one of Mike Harris’ most effective gibes with his middle-class constituency was to condemn his opponents for catering to “special interests.” But now it was Mr. Eves who appeared to be cynically throwing tax dollars at reliable party supporters. In the 1999 budget, the government had promised to eventually cut the education portion of the residential property tax by 20% across the board; the first 10% of this cut was implemented immediately. However, the government never managed to implement the remaining 10% cut. Instead, in the 2003 budget, this promise was transmuted into a tax break for only one group of residential property taxpayers – seniors, who were perceived to be more inclined to vote Conservative. Moreover, this tax break was regressive, in that there was no ceiling imposed on the level of property tax paid to which the tax break was to apply. Thus, rich, retired businessmen living in Toronto’s most exclusive neighbourhoods were in a position to reap thousands of dollars of savings, on the property taxes they paid on

their multi-million dollar homes. The media had a field day listing the home addresses of affluent Conservative supporters who were to benefit.

Finally, the “Equity in Education Tax Credit,” or the tax break for parents with children in independent schools, was easily portrayed as a sop for the wealthy whose children attended the province’s elite private schools. In fact, the principal target of this policy was another important Conservative constituency, the Christian schools favoured by many party supporters in rural and small-town Ontario.[?]

The Liberals and the International Economy

Tucked away in the long version of the Liberals’ platform is a declaration of support for the global economy. A Liberal government would aggressively pursue new foreign direct investment, and assist the private sector in cracking global markets. The Conservative government was attacked for failing to make any effort to diversify Ontario exports away from the U.S. market (which last year took 93% of the province’s exports).

The Liberals argue that a tax freeze – that is to say, no more tax cuts – is acceptable, because corporate tax rates in Ontario are already internationally competitive. The province cannot afford a new round of tax cuts, in part because the revenue is needed for “strategic investments” in the public services which help to make the province an attractive location for investors, employers and professionals: a skilled labour force; up-to-date infrastructure; a clean and safe environment; and medicare, which gives local employers something of an advantage vs. the American competition.

In other words, what makes Ontario an attractive economic location is not just lower taxes than the competition. Footloose investors and well-paid professionals are also looking for the provision of certain public goods, which only government can provide.

Thus, there is a trade-off between lower taxes and the supply of public goods necessary for the province’s prosperity. If the tax cuts are too deep, they endanger the

[?] The tax credit was also attractive to members of the Jewish community, who have long complained, with some justification, that it is unfair for the Canadian constitution to guarantee public funding for Catholic schools, but not for any other religious tradition. Indeed, the tax credit promised to sow confusion among Liberal ranks for this reason, until Mr. McGuinty insisted that his party oppose it during the campaign.

government's ability to provide crucial public services. Therefore, it is only necessary for the province's tax rates to be more or less in the same ballpark as the competition, before the government concentrates instead on providing the needed public services.

This view of economic policy is certainly closer to the world-view prevailing at Queen's Park under the previous Liberal (1985-90) and NDP (1990-95) governments, than under the Harris-Eves Conservative government. While the Conservatives certainly embraced government's role in financing essential public services, their rule was characterized by a single-minded fixation on tax cuts as the prime policy instrument for attracting and retaining international capital. Year after year, the Conservative government produced budgets which purported to demonstrate that taxes in Ontario were being driven down inexorably to internationally competitive (and in particular, American) levels.

However, there is a crucial difference between the McGuinty Liberals and their pre-1995 predecessors. The new Liberal government's proposed trade-off between taxes and public services will be established at much lower tax levels than prevailed pre-1995. Remember, when the Liberals proclaim they are going to freeze taxes – no more tax cuts, but no tax increases, either – they are effectively endorsing every round of personal and corporate income tax cuts implemented by the Conservatives, prior to the final round promised in 2003.[?]

Now, I certainly concede that the Liberals' claim that under their platform, corporate tax rates will remain more or less competitive is likely dubious. Indeed, one of our leading tax policy experts, Professor Jack Mintz, persuasively argues they will not.^{**} However, the point to be made here is that the central thrust of the Liberal position – that for the time being at least, further tax cuts would endanger the province's fiscal ability to deliver the public goods crucial to economic success – most definitely struck a chord with the

[?] With the corporate income tax cuts of 2003 rolled back to their pre-2003 levels (i.e., to 2001 levels); the personal income tax cuts scheduled to go into effect on January 1, 2004 cancelled; and with no adjustment in the income threshold at which the income surtax cuts in.

^{**} Jack Mintz, "The Ontario Liberals' billion-dollar budget hole," *The National Post*, 23 September 2003. Of course, many of the claims the Conservative government made in defence of its tax cuts were also somewhat dubious, as Professor Mintz and other experts demonstrated.

voters, and indeed, some elements in the business community. The Toronto Board of Trade, for example, had become a vociferous supporter of greater public spending on the City's infrastructure, which was sadly neglected by the outgoing Conservative government.⁷

The Future Direction of Liberal Economic Policy

Once it became obvious during the campaign that the Liberals were going to win, the party's platform was subjected to intense scrutiny in the media, which concluded that the Liberals' numbers likely do not add up. If indeed, it is the case that the province is running a multi-billion dollar deficit, then it will be impossible for the Liberal government to deliver on the many of its spending commitments, at least in the near future.

However, I think the point to be stressed here is better put with reference to the left-of-centre critics of the Liberals, rather than by the many establishment critics who are now busy dissecting the weaknesses in the Liberal platform's economic numbers. As Linda McQuaig, one of our better-known commentators and critical authors recently pointed out in the generally pro-Liberal *Toronto Star*, the Liberals' absolutely explicit commitment to balanced budgets and tax freezes will impose a fiscal straightjacket on the new government, which will dictate the general boundaries within which it can make policy.^{**} No matter how large the deficit bequeathed to the Liberals by Mr. Eves, Mr. McGuinty will not be able to evade the terms under which the voters have consented to his installation in office. The Liberals became electable precisely because it appeared to

⁷ The Liberals promised to divert 2 cents per litre of the existing provincial gasoline tax to the municipalities, to be spent on infrastructure. They estimated this would generate an additional \$312 million a year for cash-starved local governments. In yet another example of their political ineptitude, the Conservatives promised instead to empower municipalities to impose new taxes on gasoline, hotel and parking spaces – but such increases (or any other tax increase) had to be approved by a majority of the voters in a referendum. The result? The municipalities (including many Conservative mayors) vociferously attacked the referendum requirement as imposing an insurmountable barrier to their accessing needed new revenue sources, while the Liberals gleefully pointed out that the Conservatives were proposing *new* taxes!

^{**} Linda McQuaig, "Tax cutters tie McGuinty's Hands," *Toronto Star*, 28 September 2003.

the broad middle-class that they could be trusted not to raid the public treasury once in power, just as the Mike Harris Conservatives were trusted in 1995 and 1999.