Intelligence MEMOS

From: Benjamin Dachis

To: Ontario's new government

cc: Governments across Canada

Date: July 12, 2018

Re: **Business Property Tax Cuts Can be a Secret Weapon**

Your government has committed to reducing taxes and increasing the competitiveness of Ontario business. Lower taxes on business mean more investment, making workers more productive and businesses more competitive.

An interesting story emerges when we combine two metrics the C.D. Howe Institute has developed in recent years. On the one hand, take total business investment per worker by province over the five-year period from 2013 to 2017. Next, the marginal effective tax rate (METR) on investment. The METR is the measure of the wedge between the rate of return a company needs to earn before taxes to satisfy investors and what it must earn to pay both investors and taxes. The Institute's METR includes taxes such as corporate income taxes, retail sales taxes, and provincial property and land transfer taxes. It also includes the property and land transfer taxes (if applicable) in the largest municipality in the province.

A one-point increase in the METR is correlated with a 3 percent decrease in investment per worker (see figure). A few years ago, we took a look at the relationship and found a similar result.

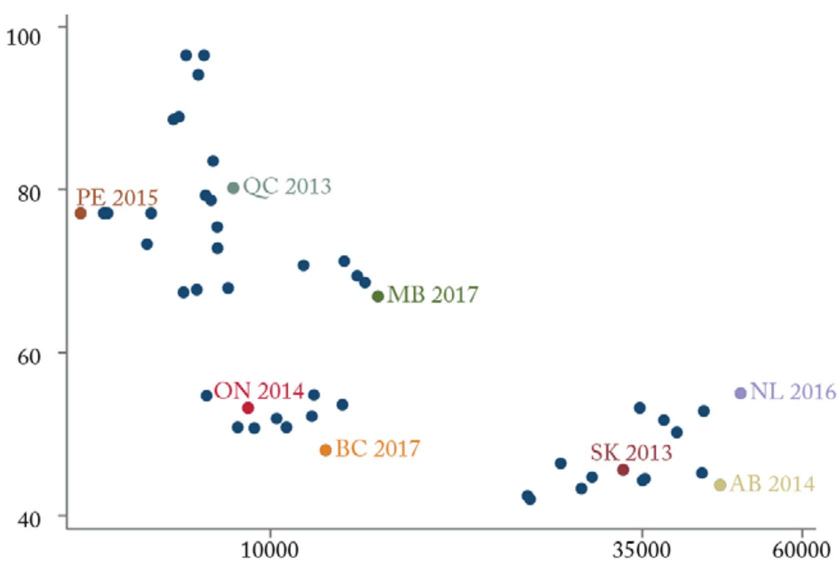
Many factors other than current tax rates affect investment. Booms and busts in natural resources drive investment in a sector. Even if we control for the fact that energy prices changed over this period (that is, using a regression analysis with the Bank of Canada's annual energy price index), the relationship between taxes and investment still holds. To be fair, the correlation could run backwards: provinces with high resource revenues, and therefore investment, might be able to keep taxes on business low. However, the relationship still holds if we exclude the energy-producing provinces of Newfoundland, Alberta, and Saskatchewan.

So, what would a lower METR mean in practice for workers in Ontario? Cutting the provincial corporate income tax by one percent, as the government has promised, would reduce the METR by a little under a point. The resulting increase in investment, applied to the 2017 investment per worker numbers of a little under $9,000 would be about $215 per year. Nothing to sneeze at.

The province could generate even more investment per worker with a major cut in the provincial business property tax. Cutting business property taxes wouldn't have nearly the same fiscal cost either. Indeed, increased investment and property values mean lowering high property and corporate income taxes can have little cost to the treasury. Cutting the widely divergent rates across the province to the lowest rate in a major urban area (Halton Region) would lower the METR in Ontario by 3.4 points. The result would be a 10 percent increase in investment per worker: over $900 more investment per worker.

In real terms, that would amount to a new aerial surveying drone for every single worker in the province. Or a brand new laptop. Every year. That kind of investment for every worker would go a long way to boosting the productivity of workers, and the competitiveness of Ontario businesses.

Provincial Marginal Effective Tax Rates and Investment per Worker, 2013-2017



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Source: Author's calculations from Robson, Jacobs, and Dachis (2017) and Found and Tomlinson (2017). Thanks to Jacob Kim for compiling this data.