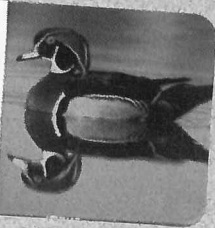


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Discussion Paper on the Rationale for a Resource Revenue Retention Mechanism for Northern Ontario

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Summary

The existing property based municipal tax structure does not provide an adequate assessment base for Northern Ontario communities to meet their costs. Further, this structure does not reflect the contribution of the North's resource based communities to the wealth of Ontario and Canada and does not allow for the Northern municipalities to fully benefit from the mining and forest industries that they support.

This has resulted in the North becoming dependant on Provincial payments of one sort or another for the last ninety years. Moreover, while there are significant revenues generated to the Province of Ontario through the North's logging and mining activities, there has never been any formal, ongoing recognition or acknowledgement that the Provincial funding assistance provided is not a gift. It is simply a return of a small portion of the resource taxes paid on resources removed by Northerners from the North. What is needed is a mechanism by which some of the revenue generated by the exploitation of natural resources in the North can be held in the North and used to support the very communities that provide the support and services to allow that resource exploitation to take place.

Northeastern Minnesota has addressed this issue through the development of a state legislated Taconite Production Tax on all iron mining activities within the geographic area known as the Iron Range. Revenue generated through the tax is redistributed within the Iron Range under a series of programs and investments in support of the local economy.

The Government of Ontario has shown a preference for the simplicity and efficiency of block funding. The Taconite Tax is a model for block funding based on production from a specific geographic region. Ontario is also encouraging municipalities to move toward becoming self-sufficient and self-sustainable. It has embraced the principle of simpler, more understandable government. Disentanglement of the revenue raised on resources from that raised by other Provincial taxes, and a return of an adequate portion of that revenue to the communities that generated it, would be a significant tool to use in achieving both of these goals.

The Taconite Tax gives a model that may help Northern Ontario capitalize on an opportunity for change, without increasing the tax pressure on industry. It presents an effective way to tax a resource based economy and it has had 56 years of experience in determining the best practices to follow in doing so. The Taconite Tax provides a simple, understandable, clear and transparent picture of where the revenue is collected and where it is invested. This encourages accountability at all levels. Finally, legislation controls both the collection and the distribution of the Taconite Tax giving distinct advantages for long term budgetary and strategic planning. It also gives opportunity for public debate and examination before changes are made.

Background

Communities in Northern Ontario face service costs significantly higher, than those in Southern Ontario. The reasons for these higher costs, as set out in the report Fairness and Equality for Our North by the Federation of Northern Ontario Municipalities and the Northwestern Ontario Municipal Association, are as follows:

- a large geographic area (7.6 times the size of Southern Ontario);
- a scattered population (100 times lower population density than in Southern Ontario); and
- severe climatic conditions.¹

Northern Ontario communities also face significant challenges in raising the revenues needed to meet these higher service costs. Among the challenges are the following:

- diminished opportunities to exploit economies of scale due to the large area and low densities;
- exposure to the boom and bust economic cycles of resource based economies;
- a lack of adequate assessment when based solely on property taxes; and
- an inability to fully benefit from the mining and forest industries.²

Property based tax systems do not adequately recognize the contribution of the North's resource based communities to the economic wealth of Ontario and Canada, and do not provide sufficient means to northern communities to prosper. Northern resource based communities have relatively few people and a relatively small property tax base compared with the value of what is produced from local resources.

¹ Federation of Northern Ontario Municipalities and Northwestern Ontario Municipal Association, Fairness and Equality for Our North (August 1997), 1.

² Federation of Northern Ontario Municipalities and Northwestern Ontario Municipal Association, 1.

Both mining and forestry are high value added industries. At \$184,000.00 per employee in 1994, the value added ratio per employee for mining was almost twice that for the manufacturing sector as a whole.³ This is an admirable achievement for the industry and for the economies of Ontario and Canada. But for the resource based municipalities in the North it means less employment than is needed in the manufacturing plants in the south, less homes for employees, less local business to serve employees and less real property taxes to collect.

Ultimately this means Northern municipalities must deal with higher service costs while having access to less potential for revenue. Property taxes, and service or user fees, are simply insufficient as tools to fund municipalities and their services in the North's resource based economies.

Yet Northern Ontario communities are necessary for the continued development of Northern Ontario's resources.

This fact has in the past been recognized by governments. In 1908 municipalities were given the right to impose local income tax up to 1/3 of the value of the Mines Profit Tax. But by 1936 that was abolished. Since then the North has had realty taxes, mining revenue payments, per capita grants, general support grants, Resource Equalization Grants, Northern Support Grants and block funding.

Furthermore, "Along with the implementation of the new unconditional grants, the Honourable John White, Treasurer, 1973, introduced a new provincial tax on mining companies profits call the Ontario Mining Tax. A connection between the Northern Support Grant, the elimination of capitalized mining revenue payments and the new Ontario Mining Tax appears to be evident. The Ontario Mining Tax was implemented to fund new northern support grants."⁴

This constantly changing diorama of adjustment measures has been

³ Ernst & Young, for Ontario Mining Association, The Economic and Fiscal Contribution of the Mining Industry in Ontario (October 1996), 19.

⁴ Federation of Northern Ontario Municipalities and Northwestern Ontario Municipal Association, 4.

replaced by the permanent Community Reinvestment Fund, the temporary Transition Fund and the temporary Heritage Fund. This constant shifting of policies on how to make payments to Northern resource communities suggests two things:

- that the payments to Northern municipalities are obviously necessary; and,
- that there has never been any formal, ongoing recognition or acknowledgement that the Provincial funding assistance provided to Northern communities is not a gift. It is simply a return to them of a small portion of the resource taxes paid on resources removed by Northerners from the North.

Resource Revenue Retention Mechanisms

The value to the Province of Ontario from logging and mining activities is significant. In 1994 Provincial revenues from these two activities were as follows:

- Stumpage and License Fees to the Province were \$180 million on timber sales of \$12 billion. This related to \$6 billion in exports and contributed positively \$3 billion to the balance of trade.⁵
- Mining payments to the Province were \$198.5 million on total revenues of \$4.3 billion.⁶

Even this cursory examination shows that the Province of Ontario gains significant direct revenues from Forestry and Mining activities (in 1994 in excess of \$378 million). This does not even begin to take into account indirect revenues in the form of personal or corporate income taxes. However, as discussed previously, Northern municipalities have not been

⁵ Ontario Ministry of Natural Resource.

⁶ Ernest & Young, for Ontario Mining Association, 5, and 41.

able to "capitalize on the full potential of these wealth generating industries as these industries operate mainly outside municipal boundaries [on unorganized lands - a Northern anomaly] or underground, where they cannot be fully taxed by municipalities."⁷ Yet Northern Ontario communities are necessary for the continued development of Northern Ontario's resources.

What is needed is a mechanism by which some of the revenue generated by the exploitation of natural resources in the North can be held in the North and used to support the very communities that provide support and services to allow that resource exploitation to take place.

Key to the success of such a mechanism are the following conditions:

- that it provide a clear and transparent connection between where the revenue comes from and where it is spent. In other words that it provides a clear and transparent connection between the resource based communities that produce the wealth for the Province, and the resource based communities that have retained a fair share of that wealth to enable them to survive and to develop a future for themselves; and,
- that it provide revenue to Northern municipalities in a predictable and stable form that would allow for long term planning and action by both municipalities and industry.

Northeastern Minnesota began addressing these same issues in 1941. The structures that they have developed are worth examination in any effort to deal with the future of Northern Ontario's resource based communities.

The economy of Northeastern Minnesota, also called the Iron Range, is largely dependant on iron mining and specifically the production of taconite for the steel industry. The Minnesota State Legislature imposes a Taconite Production Tax on all iron mining activities within the

⁷ Federation of Northern Ontario Municipalities and Northwestern Ontario Municipal Association, 8.

geographic area known as the Iron Range. Revenue generated through the Taconite Production Tax is redistributed within the Iron Range area under a series of programs and investments in support of the local economy (see figure 1). In total \$90,512,836 (U.S.) will be distributed in 1997.⁸

Taconite Production Tax

1997 Distribution - Net \$90,512,836

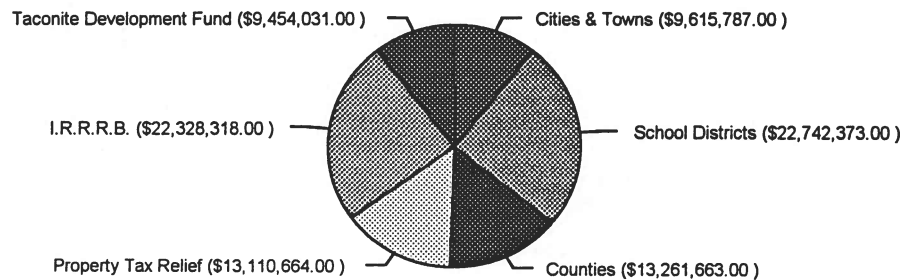


Figure 1

Some of the lessons that can be learned from the Taconite Production Tax model are the following:

- it shows how a specific geographic region can be moved away from a complete dependence on a property based system of taxation for the raising of local revenues;
- it provides a clear and transparent connection between where the revenue comes from and where it is spent. Currently it is extremely difficult, without a major

⁸ Minnesota Department of Revenue, Minnesota Mining Tax Guide, September 1997.

investigation, to find out exactly how much tax is being collected on resource development in the North and what percentage of that is being returned to the North. This liability is apparent from a comparison, for example, of the Ontario Mining Association's Ernst & Young report on The Economic and Fiscal Contribution of the Mining Industry in Ontario or the Provincial Ontario's Mineral Score publication, to the Minnesota Mining Tax Guide;

- as both the distribution and the collection of the Taconite Tax are established by State legislation, local municipalities know, by law, essentially how much they are going to receive for municipal purposes, for education purposes, for economic development and for tax relief;
- the Taconite Tax is market based and market driven. The tax rate is indexed to the Gross National Product Implicit Price Deflator published by the U.S. Department of Commerce;⁹
- the taxable production in any given year is based on the average production over three years. This takes the peaks and valleys out for both producers and beneficiaries;
- the model recognizes the need for and provides appropriate allocations for: economic development; research and development within the iron mining industry; educational funding; environmental protection and rehabilitation; property tax relief; and, the regional nature of resource development.

The Government of Ontario has shown a preference for the simplicity and efficiency of block funding. The Taconite Tax is a model for block funding based on production from a specific geographic region. Ontario is also encouraging municipalities to move toward becoming self-sufficient and self-sustainable. It has embraced the principle of simpler, more

⁹ Minnesota Department of Revenue.

understandable government. Disentanglement of the revenue raised on resources from that raised by other Provincial taxes, and a return of an adequate portion of that revenue to the communities that generated it, would be a significant tool to use in achieving both of these goals.

The Taconite Tax is a working model demonstrating how to tax resources to the benefit of both industry and local communities. However, the model need not be accepted absolutely and it would take serious study to adopt it to Ontario. The Ontario Fair Tax Commission for one has recommended that a new mining tax be established, but that it be based on cash flow. This and other recommendations should be considered as part of the investigation that will have to be made if Ontario is to pursue a resource revenue retention mechanism for the North.

Conclusions

Northern Ontario municipalities are expected to compete successfully with the South and with their U.S. and international counterparts. As a result, they need to have a secure and adequate tax base which recognizes their unique circumstances as a resource based economy. There is a need for equivalency for the municipalities of Northern Ontario if they are to be a positive part of the future. There is a need for equivalency, not sameness.

Northern Ontario has largely been treated the same as the rest of the Province and it has not worked. That is, it has not provided a pragmatic and workable basis for Northern communities to become self-sufficient and self-sustainable. This is because the North is a resource based rather than a property or manufacturing or population based economy. Consequently, Northern communities, without an appropriate tax base have been forced to rely on an unpredictable system of government grants. This in turn has deprived these communities not only of sufficient capital for growth (grants, as "gifts" tend to be limited to "needs" rather than the development of aspirations). It has also deprived them of the financial stability and revenue predictability that is necessary for effective long term planning and growth. Northern municipalities, no less than industry, require a reasonable income and a stable legislative and regulatory environment.

The Minnesota Taconite Production Tax model, adapted for Northern Ontario's specific circumstances, gives the potential for developing equivalency with Southern Ontario as well as competing U.S. and international jurisdictions. It also offers the potential to further develop regional thinking and partnerships in the North by providing the tools needed to plan sustainable development and economic diversification. Northern Ontario would ultimately be able to diversify its economy and build upon the core of the resource sector.

The Taconite Tax gives a model that may help Northern Ontario capitalize on an opportunity for change, without increasing the tax pressure on industry. It presents an effective way to tax a resource based economy and it has had 56 years of experience in determining the best practices to follow in doing so. The Taconite Tax provides a simple, understandable, clear and transparent picture of where the revenue is collected and where it is invested. This encourages accountability at all levels. Finally, legislation controls both the collection and the distribution of the Taconite Tax giving distinct advantages for long term budgetary and strategic planning. It also gives opportunity for public debate and examination before changes are made.

Next Steps

As stated above, even with a general consensus as to its value, adopting a resource revenue retention mechanism for Northern Ontario would take serious study and consultation before it could be designed and implemented.

What is needed to advance this possibility is a commitment from key groups to participate in further investigating this opportunity for the North. Participants in this process need to include the following: the Ministry of Northern Development and Mines as the lead Provincial Ministry for Northern Ontario; the municipalities of Northern Ontario through their regional associations the Federation of Northern Ontario Municipalities and the Northwestern Ontario Municipal Association, the natural resource industries, and the economic development agencies active in the North.

What is also needed is the implementation of an immediate answer to the

fiscal problems being faced by Northern municipalities. The Federation of Northern Ontario Municipalities and the Northwestern Ontario Municipal Association in their report Fairness and Equality for Our North have laid out an action plan that addresses those immediate needs. If implemented by the Province of Ontario, this would return the municipalities to a position of stability and allow them and others the time needed to examine alternatives.

