The Ontario Alternative Budget 2002

The phantom fiscal crisis

Technical Paper #3

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Summary

Contrary to claims coming from Government sources of a potential $3 to $5 billion deficit for 2002-3, Ontario cannot reasonably be said to be in fiscal crisis.

Based on the latest budget projections for 2001-2 and the economic forecasts tabled by the government at the Finance and Economic Affairs Committee of the Legislature in February, we forecast a budget deficit for 2002-3 of approximately $600 million. That deficit would turn into a $600 million surplus if the Government were to suspend the corporate tax cuts planned to take effect in 2002-3.

Even using the lowest current economic forecasts for 2002 and 2003 and revising downwards estimates for 2001-2 cannot generate a deficit even close to the $5 billion that has been repeatedly cited by the Government as a possibility for 2002-3. In fact, the most extreme of those pessimistic assumptions results in a forecast deficit that would fall within the range of typical budget contingency reserves, if the tax cuts were suspended. The 2001-2 budget included a total of $1, 654 million in contingency reserves ($1 billion as a general reserve and $654 million in a Management Board Contingency Fund).

Reports on job creation for the first three months of 2002 suggest that, if anything, the forecasts for economic growth presented to the Standing Committee in February are somewhat conservative.

At this point, there is clearly no basis for the claim that Ontario faces a fiscal problem such that it will be unable to provide new funding to forestall the impeding crises in health and education funding in Ontario.

A politically convenient myth — Ontario is facing a fundamental fiscal crisis that can only be resolved through drastic expenditure cuts

In his fall economic statement and fiscal update, the former Minister of Finance Jim Flaherty made no substantial changes in revenue projections, and miraculously, arrived at exactly the same figure for the projected surplus as had been projected in the budget.

Almost immediately after that statement, however, the Chair of Management Board began circulating a doomsday forecast for 2002-3 of a $5 billion deficit.

Despite this number having circulated around the Government for several months now, however, no evidence has been provided to date to justify a figure anything like $5 billion as the size of the "problem" facing the government in the year 2002-3.

Indeed, the 3rd quarter update of Ontario Finances tabled in February makes relatively modest changes in forecasted revenue, and repeats the 2nd quarter miracle by projecting a surplus identical to that projected at budget time in May of 2001 — $140 million.

In the testimony of the Minister before the Finance and Economic Affairs Committee, the Government declined to offer a forecast of revenue for 2002-3.

Using a detailed model of Ontario's revenue sources, we explored the implications for 2002-3 of the forecasts currently accepted by the Government and analyzed three potential contingencies that could have a material impact on the outcome:

- The possibility that revenue forecasts for 2001-2 might be overstated, resulting in a reduced revenue base for 2002-3;
- Lower-than-forecast economic growth in 2002; and
- More rapid than anticipated expenditure growth for 2002-3 compared with 2000-1

We also considered the potential revenue gain that would result from suspending forecast corporate income tax cuts.

The base case

In the base case or starting point for the analysis, we assumed that the Government's fiscal forecast for 2001-2 is accurate, and that economic growth in 2001 and 2002 turns out to be as presented by the Government as the consensus private sector forecast in its presentations on February 27, 2002. [1]

We assumed that the Federal Government corrects its $400 million over calculation of capital gains tax revenue remitted to Ontario in 2002-3. We also assumed that the $1.2 billion on corporate tax cuts forecast for 2002-3 are implemented, and that program expenditure would increase at the rate of inflation.

In the base case, we would expect a budget deficit for 2002-3 of approximately $600 million.

Suspending the tax cuts reverses the deficit to a surplus of $600 million.

Reduction in forecast revenue for 2001-2

Throughout fiscal year 2001-2, the Government has resisted any dramatic change in its estimated revenue for 2001-2. Even after the events of September 11, 2001, and despite the fact that all forecasts of growth for 2001 and 2002 were revised downwards, only relatively minor changes were made to the May 2001 Budget's forecasts of revenue.

We developed a revision to the May 2001 budget forecasts using now-current estimates and forecasts of economic growth and inflation in 2001 and 2002. This revision suggests total revenue approximately $900 million lower than was forecast in May 2001.

This revenue shortfall can be accommodated within the reserves still carried on the books as of 3rd Quarter Ontario Finances. So even in a worst case scenario, the Government faces little risk of a deficit in 2001-2.

However, a reduced revenue base for 2001-2 has a direct impact on forecast revenue for 2002-3, reducing it by approximately $1 billion.

Leaving other parts of the base case unchanged, that would produce a deficit of about $1.6 billion for 2002-3. Without tax cuts, the deficit would be reduced to $400 million.

Lower-than-forecast growth in 2002 and 2003

A collapse in growth for 2002 – no longer very likely, given recent economic news – would reduce forecast revenue by $600 million, and push the forecast deficit for 2002-3 to about $1.2 billion, assuming the government goes ahead with the forecast tax cuts. Setting the cuts aside would produce a rough balance.

Expenditures increasing at greater than the rate of inflation

The base case assumes program spending increases at the rate of inflation. Assuming a higher rate of growth — 5% growth in health spending and 3% in everything else – adds only about $400 million to budget pressures.

Compared with the base case, the deficit would increase to $1 billion with the tax cuts in place. Suspending the tax cuts would result in a forecast $200 million surplus.

Summary of analysis

The government's fiscal situation, in summary, is shown in Table 1.

The worst case scenario for contingencies not under the Government's control would combine a downward revision in the 2001-2 revenue base and drastically reduced growth estimates for 2002 and 2003. That combination of events produces a forecast deficit of $1 billion – an amount less than the amount of the contingency reserves normally included in the budget.

Indeed, if the Government were prepared to allow its contingency funds to serve their intended purpose – as insurance against unexpected negative impacts on the

Table 1

	Budget position in 2002-3	Comment
Budgetary position given current fiscal projections for 2001-2 and current forecasts of growth for 2002 and 2003	$0.6 billion surplus	Assumes Federal Government error in capital gains payments to Ontario corrected (revenue loss of $400 million); assumes program spending increases at the rate of inflation.
Government implements forecast corporate tax cuts.	$1.2 billion reduction in revenue	Under the government's control
Lower growth in 2002-3	$0.6 billion reduction in revenue	Extremely unlikely
Expenditure grows in excess of inflation.	$0.4 billion increase in spending	Under the government's control; could be managed without a deficit tax cuts suspended
Revenue for 2001-2 turns out to have been substantially overestimated.	$1.0 billion reduction in forecast revenue for 2002-3	Unlikely now given likely strength of 1st quarter 2002 recovery

budget, current government forecasts, leave the government enough fiscal room to increase spending in excess of inflation in order to begin to address public services deficits. Provided, of course, that it is prepared to suspend implementation of the corporate income tax cuts forecast for 2002-3.

Conclusion

Clearly, there is no $5 billion problem, unless the Government is planning a further round of substantial corporate tax cuts that it hasn't told us about. There is no looming catastrophe that justifies statements designed to induce panic. Unless the Government is planning another self-inflicted fiscal wound.

Indeed, if the Government is really as committed as it says it is to renewing public services damaged by the excesses of the Harris era, there is more than enough fiscal room to make a good start on a very big job.

The last thing Ontario needs right now is another round of punishing public service cuts to pay for another round of wasteful and unnecessary tax cuts.

Endnotes

1 Ontario began the Fiscal Year 2001-2 planning cycle with an official forecast for real growth in 2001 of 2.8%; by budget time, it had been revised downwards to 2.2%, with a forecasted rebound to 3.5% in 2002. These figures compared with its reported private sector averages of 2.3% in 2001 and 3.6% in 2002. In its fall economic statement, the Government did not reveal a revised planning forecast, but reported private sector average forecasts of 1.1% for 2001, 1.3% for 2002 and 4.3% for 2003. In its presentation to the Standing Committee on Finance and Economic Affairs in February, 2002 the Government again did not produce its own forecast but reported private sector averages for 2001 at 1.0%; 2002 at 1.3% and 2003 at 4.4%.

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