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Ontario Has Options

Alternative fiscal paths for the 2019 budget

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Ontario Has Options

Alternative fiscal paths for the 2019 budget

Executive summary

Ontarians are experiencing cuts to essential public services and social supports.

The Doug Ford government's justification for service cuts, funding reductions and policies that restrict access to services is always the same: Ontario is in a financial crisis. A big, scary financial crisis that must be addressed at any and all costs. Even if the cost is long-term harm to Ontarians.

It doesn't have to be this way. Ontario has options.

A close analysis of the province's finances reveals that the PC government is using financial fearmongering as a cover for an agenda to reduce the role of government.

The 2018 Economic Outlook and Fiscal Review inflated the province's deficit by $7.8 billion from the 2018 budget. The Ford government used misleading indicators to present deficit and debt trends in the outlook, making them look worse than they really are. And, there's the old trick of disingenuously comparing public debt with household debt—one of this government's favourites.

With this combination of contested accounting, misleading analysis and announcements that lack the level of detail we expect from our government, there is very little factual information available on the current state of Ontario's finances.

This analysis uses the Financial Accountability Office of Ontario's (FAO) economic and budget forecasts as a base case. This base case assumes services are maintained as program spending grows with inflation and demand. It captures the Ford government's policy decisions in 2018, including tax cuts, and it assumes that taxes will not be increased. The result is a growing deficit that, while not as frightening as the government would depict it to be, could risk the financial sustainability of public services.

Cutting public services is not a viable solution; the well-being of Ontarians depends on them. Cutting services *and* taxes, as this government has done, is even less viable.

This paper outlines two options that would maintain and enhance services in Ontario over the next four years while reducing the deficit and the debt-to-GDP ratio.

- Both alternatives include the 3.5% annual spending increase required to maintain current service levels, which costs $4.7 billion in 2019–20, rising to $5.9 billion by 2022–23.
- Both alternatives include service expansions that were included in the province's 2018 budget, which the Ford government has since fully or partially cut. These would require program spending increases of $2.4 billion in 2019–20, growing to $3.8 billion by 2022–23.

Three complementary measures can generate the revenues necessary for the alternative fiscal path, namely: (1) reversing the Ford government's tax cuts; (2) increasing corporate tax rates; and (3) increasing either Ontario sales tax or personal income tax rates.

- The proposed package of measures that includes personal income tax increases would increase total revenues by $8.5 billion in 2019–20, rising to $9.2 billion by 2022–23. Over this period, Ontario's deficit would fall from $12.3 billion to $9 billion. The debt-to-GDP ratio would fall from 40.6% to 39.1%.
- The package that includes an HST increase would increase total revenues by $11 billion in 2019–20, rising to $11.9 billion by 2022–23. The deficit would fall from $12.3 billion to $7 billion over this period. The debt-to-GDP ratio falls from 40.6% to 37.7% over the same period.

These options show it's possible to maintain and enhance public services while decreasing the deficit and the debt-to-GDP ratio, so long as Ontario begins to address its longstanding revenue problem.

Introduction

The Ontario government has been using an alleged financial crisis to justify service and funding cuts.

These have included the following: cap-and-trade-funded programs, such as school and social housing repairs; unrestricted access to prescription drugs for children and youth; the Child Advocate's office; the Anti-Racism Directorate; the expert panel to end violence against women; approved increases in social assistance rates; supports for Indigenous and racialized students; services for Franco-Ontarians; supports for children living with autism; education funding for primary and secondary school students; new university campuses; financial aid for university students; and funding for the Ontario Arts Council, the Ontario Trillium Foundation and the College of Midwives of Ontario.

This list seems to grow longer every week. And the upcoming 2019 Ontario budget will likely bring more and deeper cuts—all cast in the name of fiscal balance and deficit reduction.

The first section of this paper presents an argument the CCPA Ontario has repeatedly made: the Ontario government is using financial fearmongering as cover for an agenda to privatize public services and reduce the role of government.

Using the fiscal and economic forecast prepared by the Financial Accountability Office of Ontario (FAO) as a starting point, the second section shows two options for a path toward balance. Both of these options maintain and enhance public services while reducing the deficit and starting to curb Ontario's debt.

If the Ford government is concerned about Ontario's deficit and debt, it has options other than gutting public services.

Financial fearmongering

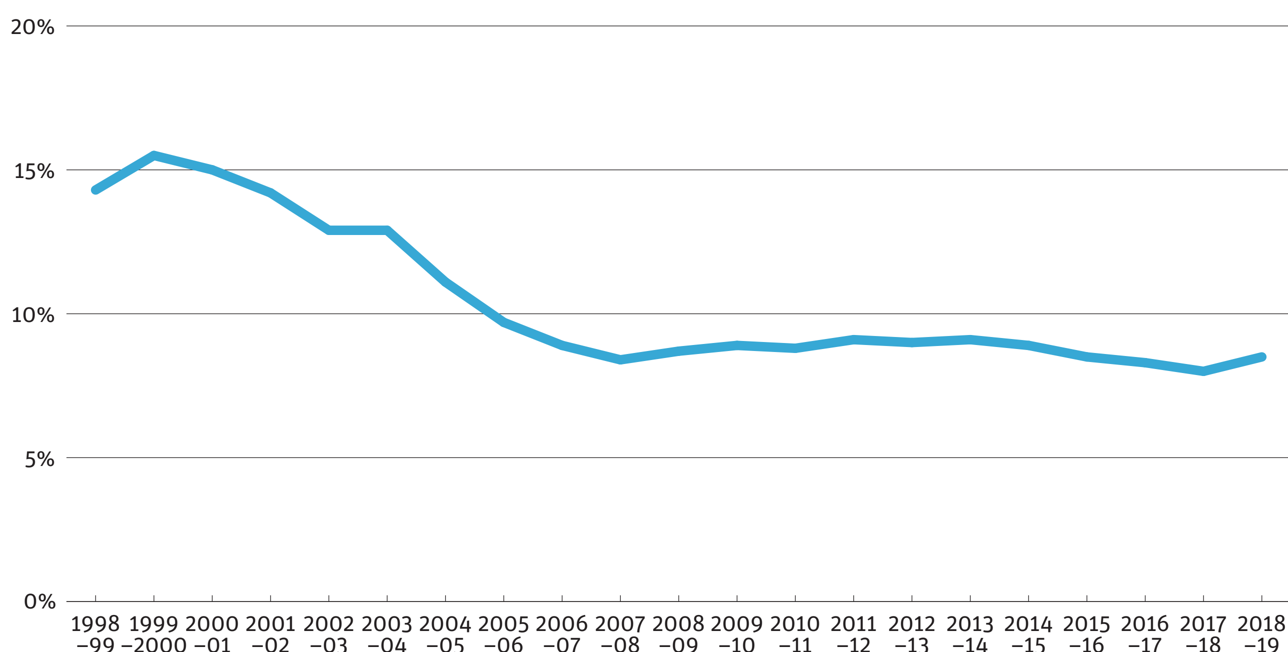
The Ford government's financial fearmongering is a three-part stunt: inflate the deficit, use misleading indicators to present deficit and debt figures, and disingenuously compare public debt with household debt. Let's unpack these financial and rhetorical tricks.

The government's 2018 Economic Outlook and Fiscal Review estimated a deficit of $14.5 billion for 2018–19, which is $7.8 billion higher than the 2018 budget estimated. This higher deficit included contested treatment of public pension assets and the Fair Hydro Plan, and spending increases the Ford

government seems to have no intention of implementing.[1] This contested figure will be a starting point for the 2019 budget. A larger deficit provides cover for bigger cuts to programs.

The outlook also described debt-servicing costs as the fourth-largest budget item, costing the province "$1.4 million an hour." That sounds like a large number, but it's important to see these numbers in context. In 2018–19, 8.5% of Ontario's government revenue was forecast to go to debt-servicing costs. As *Figure 1* shows, debt service as a share of revenue remains lower than it has been in the past 20 years (largely due to low interest rates). In contrast, debt servicing took up 15.5% of Ontario's 1999 budget.[2]

FIGURE 1 Interest on Debt-to-Revenue Ratio



Source Ontario Financing Authority, Ontario 2018 Budget, 2018 Ontario Economic Outlook and Fiscal Review

The outlook also included a chart showing rising net debt per capita. Again, that looks like something that should be of grave concern. But once again, we need to put that chart into context. Debt as a share of GDP (the debt-to-GDP ratio)—not net debt per capita—is the most widely used measure of the size and sustainability of government debt, because it puts large figures into perspective and accounts for the impact of economic and population growth and inflation.

The outlook showed that the debt-to-GDP ratio rose from 32.4% in 2009–10 to 40.5% in 2018–19. Debt-to-GDP levels typically increase after recessions as economic activity slows, revenues fall and the need for government services rises. This is exactly what happened in Ontario after the 2008–09 recession, just as it did in other jurisdictions.

There is no consensus among economists about the ideal debt-to-GDP ratio or how quickly (or whether at all) it should be reduced during a period of economic growth. The current prolonged period of low interest rates has caused a fundamental rethinking of traditional concerns about the negative economic impacts of government debt.[3] This means that the Ford government's characterization of the province's debt is out of step with mainstream economic thinking about the economic impact of government debt.

Finally, the Ford government fuels concerns about debt and deficit with the obfuscation that public debt is somehow equivalent to household debt. Instinctively, it might seem to make sense that if personal debt is bad, then so is public debt. It may appear to make sense, but it's wrong.

Individuals and families manage debt over a single lifecycle. It's prudent for them to take on debt early in that cycle, to pay for education or to purchase a home. Later on, ideally, they will move from borrowing to saving for retirement. Governments do not face the same lifecycle constraints. In fact, they have a responsibility to continue borrowing and investing for future generations. Each generation of taxpayers takes on some of the costs for providing services to previous generations as well as their own and future generations.

Furthermore, governments have the power to tax. They also manage their borrowing in much more sophisticated ways than households. For these reasons, financial markets consider governments the most reliable borrowers, resulting in much lower interest rates and borrowing costs for governments than for private borrowers.

The Ford government's fearmongering about Ontario's debt and deficit is clearly overblown.

FAO base case

Because Ontario's fall 2018 Outlook did not include the customary four-year fiscal outlook, we are using the FAO fall forecasts as our base case for this paper.

TABLE 1 FAO Base Case

Macroeconomic indicators ($ millions)	2018	2019	2020	2021	2022
Nominal GDP	$858,000	$891,000	$926,000	$962,000	$999,000
Real GDP growth	2.2%	2.1%	2.0%	1.9%	1.9%
GDP inflation	1.6%	1.8%	1.9%	2.0%	2.0%
Nominal GDP growth	3.8%	3.9%	3.9%	3.9%	3.9%
Household consumption	4.3%	3.9%	3.8%	3.8%	3.8%
Budgetary transactions ($ millions)	**2018-19**	**2019-20**	**2020-21**	**2021-22**	**2022-23**
Revenues	$149,400	$152,200	$158,800	$165,200	$171,300
Program spending (includes 3.5% annual increase to maintain service levels)	$149,200	$153,900	$159,400	$165,200	$171,100
Debt service	$12,500	$13,400	$14,400	$15,600	$16,600
Budget balance (surplus/deficit)	-$12,300	-$15,100	-$15,000	-$15,500	-$16,400
Net debt	$348,300	$371,500	$397,500	$425,400	$451,900
Budgetary indicators					
Revenues / GDP	17.4%	17.1%	17.1%	17.2%	17.1%
Program spending / GDP	17.4%	17.3%	17.2%	17.2%	17.1%
Budgetary balance / GDP	-1.4%	-1.7%	-1.6%	-1.6%	-1.6%
Debt / GDP	40.6%	41.7%	42.9%	44.2%	45.2%
Debt service/revenues	8.4%	8.8%	9.1%	9.4%	9.7%

Sources FAO Fall Economic and Budget Outlook

The FAO's forecasts assume that public services will keep up with inflation and demographic changes. It estimates that maintaining service levels constant over the next four years (2019–2023) requires program spending to grow at an average annual rate of 3.5%.[4]

The FAO's forecasts also include tax cuts and spending reductions included in the Ontario Economic Outlook and Fiscal Review.

In sum, our base case assumes a trajectory where services are maintained as program spending grows with inflation and demand, and it includes the Ford government's policy decisions in 2018 as well as an assumption that taxes will not be increased.

The result is a large and growing deficit—rising from $12.3 billion in 2018–19 to $16.4 billion by 2022–23.

The alternative paths presented below show that Ontario has other options.

Alternative paths for the 2019 budget

This paper outlines two options that would maintain and enhance services in Ontario over the next four years while reducing the deficit and the debt-to-GDP ratio. Draconian spending cuts are not the only option for Ontario's 2019 budget, so long as the province begins to address its longstanding revenue problem.

Maintain and enhance public services

CCPA's alternative fiscal path maintains current levels of public services by including the assumed spending increases in the base case. We then go further by reinstating the service expansions included in the 2018 budget, which requires additional program spending.

Maintaining current service levels

The FAO's estimated 3.5% annual spending increase required to maintain service levels varies by program area. For example, health requires a 4% annual increase, education needs 3.4%, and children's and social services need 3.3%.[5] Maintaining these service levels would cost $4.7 billion in 2019–20, rising to $5.9 billion by 2022–23.

Enhancing services

The 2018 budget included service expansions that the Ford government has since fully or partially cut. It is beyond the scope of this paper to assess whether these expansions were the best policy options (at the time, CCPA research contrasted them with proposals from other parties[6]). For our purposes, we'll take them as the minimum, previously approved service expansions. They include the following:

- Reintroducing both the revenues and spending from the cap-and-trade program—the carbon pricing system recycles revenues generated from permit auctions into climate-related investments and programs.[7]
- Health measures: Providing expanded drug and dental coverage (OHIP+ expansion for seniors, OHIP+ for children and youth already covered by private insurance) and spending on mental health and addictions.
- Maintaining the promised 9% rate increase in social assistance over three years.

- Expanding publicly funded early childhood education for 2.5- to 4-year-olds.

These service expansions require program spending increases of $2.4 billion in 2019–20, growing to $3.8 billion by 2022–23.

The combination of maintaining existing service levels while expanding some services means that program spending would increase from $149.2 billion in 2018–19 to $174.9 billion by 2022–23. This $25.7 billion spending increase would support and enhance public services.

Revenue measures

Three complementary measures can generate the revenues necessary for the alternative fiscal path, namely: (1) reversing the Ford government's tax cuts; (2) increasing corporate tax rates; and (3) increasing either Ontario sales tax or personal income tax rates.

1. Reversing the Ford government's tax measures would increase revenues by $3.3 to $3.4 billion in each of the next four years. This would include the following:

- Reintroducing revenues from the cap and trade program.
- Reinstating progressive tax measures included in the 2018 budget: tightening limits on income sprinkling by extending the tax on split income rules to adult family members who are not active in the business; phasing out the small business limit on a straight-line basis for Canadian-controlled private corporations that earn between $50,000 and $150,000 of passive investment income in the taxation year; closing tax loopholes for Canadian financial institutions by introducing two measures to address the use of sophisticated financial instruments and structured share repurchase transactions to realize artificial tax losses; and closing a loophole for the Employer Health Tax (EHT) by following the eligibility criteria for the small business deduction for the EHT exemption for small businesses.[8]
- Reversing tax cuts announced in the fall, namely those paralleling federal corporate income tax reductions and the LIFT tax credit.

2. Increasing corporate tax rates by two percentage points would generate $2.4 billion in additional revenues in 2019–20, rising to $2.8 billion by

2022–23. This increase would still leave Ontario rates half a percentage point below where they were in 2010, when the last rate reduction took place.

3. Increasing personal income tax rates or the Ontario sales tax as outlined in the following two options.

Option 1: Personal income tax increase

Table 2 details personal income tax rate (PIT) increases from zero to two percentage points, depending on income levels. These changes would make the overall tax system slightly more progressive.

TABLE 2 Proposed PIT rate increase

Taxable income brackets	Proposed rate increases	Applicable surtax rate	Rate increases including impact of surtax
$0 up to $43,852	none, remains 5.05%	none	none
Over $43,852 up to $87,063	from 9.15% to 10.00%	no surtax	0.85%
		20% surtax	1.02%
		56% surtax	1.33%
Over $87,063 up to $150,000	from 11.16% to 12.12%	56%	1.50%
Over $150,000 up to $220,000	from 12.16% to 13.44%	56%	2%
Over $220,000	from 13.16% to 14.40%	56%	2%

Sources SDPD/M Ontario tax table for 2019 and authors' calculations

As *Table 3* shows, these PIT rate increases would generate $2.8 billion in additional revenues in 2019–20, rising to $3.1 billion by 2022–23. Combining the PIT increase with the first and second revenue-generating options (reversing tax cuts and increasing corporate tax rates) would increase total revenues by $8.5 billion in 2019–20, rising to $9.2 billion by 2022–23.

TABLE 3 Option 1, Actions

Revenue measures

	2019-20	20202-21	2021-22	2022-23
Reversing Ford government measures ($ millions)				
Reinstating cap and trade	1,700	1,700	1,700	1,700
Employer Health Tax	45	45	45	45
Parallel fed measure—Income sprinkling	15	15	15	15
Parallel fed measures—Small Business Limit	145	160	160	160
Parallel fed measures—closing tax loopholes	225	230	230	230
Reverse corporate tax reduction	800	800	800	800
Reverse LIFT tax credit	420	400	380	360
Subtotal	**3,400**	**3,400**	**3,300**	**3,300**
Increasing revenues ($ millions)				
Corporate tax increase	2,400	2,500	2,700	2,800
Personal income tax rate increase	2,700	2,900	3,000	3,100
Subtotal	**5,100**	**5,400**	**5,700**	**5,900**
Total revenue increase	**8,500**	**8,800**	**9,000**	**9,200**
Increase in program spending ($ millions)				
Cap-and-trade programs	1,310	1,120	1,130	1,160
Health initiatives	810	1,320	1,460	1,370
Growth rates of social assistance	280	290	300	310
Child care programs	0	930	960	987
Total program spending increase	**2,400**	**3,700**	**3,800**	**3,800**

Sources Ontario 2018 budget, FAO Fall Economic and Budget Outlook , SPSD/M, and authors' calculations
Note Totals may not add due to rounding

Table 4 shows that in Option 1 Ontario's deficit would fall from $12.3 billion in 2018–19 to $9 billion by 2022–23. The ratio of debt service costs to revenues would remain below 9%. The debt-to-GDP ratio would fall from 40.6% to 39.1% over the same period.

TABLE 4 CCPA Option 1, Summary

Revenues ($ millions)	**2018-19**	**2019-20**	**2020-21**	**2021-22**	**2022-23**
FAO forecast	$149,400	$152,200	$158,800	$165,200	$171,300
Reverse changes in fall economic statement		$3,400	$3,400	$3,300	$3,300
Increase corporate and personal income taxes		$5,200	$5,400	$5,700	$5,900
Total	**$149,400**	**$160,800**	**$167,600**	**$174,200**	**$180,500**
Program spending ($ millions)					
FAO forecast (includes 3.5% annual increase to maintain service levels)	$149,200	$153,900	$159,400	$165,200	$171,100
Enhance services (by re-introducing program expansions included in the 2018 Budget)		$2,400	$3,700	$3,800	$3,800
Total	**$149,200**	**$156,300**	**$163,100**	**$169,000**	**$174,900**
Debt service	$12,500	$13,200	$13,400	$14,100	$14,600
Budget balance (surplus/deficit)	-$12,300	-$8,700	-$8,900	-$8,900	-$9,000
Net debt	$348,300	$349,600	$363,100	$376,700	$390,300
Budgetary indicators					
Revenue/GDP	17.4%	18.0%	18.1%	18.1%	18.1%
Program spending/GDP	17.4%	17.5%	17.6%	17.6%	17.5%
Budgetary balance/GDP	-1.4%	-1.0%	-1.0%	-0.9%	-0.9%
Debt/GDP	40.6%	39.2%	39.2%	39.2%	39.1%
Debt service/revenues	8.4%	8.7%	8.4%	8.5%	8.5%

Sources Ontario 2018 budget, FAO Fall Economic and Budget Outlook , SPSD/M, and authors' calculations
Note Totals may not add due to rounding

Option 2: Increase Ontario sales tax

An increase of 1.5 percentage points to the HST rate would generate $5.2 billion in additional revenues in 2019–20, rising to $5.8 billion by 2022–23. As *Table 5* shows, combining the HST increase with the first and second revenue-generating options (reversing tax cuts and increasing corporate tax rates) would increase total revenues by $11 billion in 2019–20, rising to $11.9 billion by 2022–23.

TABLE 5 Option 2, Actions

Revenue measures

	2019-20	20202-21	2021-22	2022-23
Reversing Ford government measures ($ millions)				
Reinstating cap-and-trade	1,700	1,700	1,700	1,700
Employer Health Tax	45	45	45	45
Parallel fed measure—Income sprinkling	15	15	15	15
Parallel fed measures—Small Business Limit	145	160	160	160
Parallel fed measures—closing tax loopholes	225	230	230	230
Reverse corporate tax reduction	800	800	800	800
Reverse LIFT tax credit	420	400	380	360
Subtotal	**3400**	**3400**	**3300**	**3300**
Increasing revenues ($ millions)				
HST increase	5,200	5,400	5,600	5,800
CT increase	2,400	2,500	2,700	2,800
Subtotal	**7,600**	**7,900**	**8,300**	**8,600**
Total Revenue Increase	**11,000**	**11,300**	**11,600**	**11,900**
Increase in program spending ($ millions)				
Cap-and-trade programs	1,310	1,120	1,130	1,160
Health initiatives	810	1,320	1,460	1,370
Growth rates of social assistance	280	290	300	310
Child care programs	0	930	958	990
Total program spending increase	**2,400**	**3,700**	**3,800**	**3,800**

Sources Ontario 2018 budget, FAO Fall Economic and Budget Outlook , SPSD/M, and authors' calculations
Note Totals may not add due to rounding

Table 6 shows that in Option 2 Ontario's deficit would fall from $12.3 billion in 2018–19 to $7 billion by 2022–23. The ratio of debt services to revenues drops slightly to 8.3% while the debt-to-GDP ratio falls from 40.6% to 37.7% over the same period.

TABLE 6 CCPA Option 2, Summary

Revenues ($ millions)	2018-19	2019-20	2020-21	2021-22	2022-23
FAO forecast	$149,400	$152,200	$158,800	$165,200	$171,300
Reverse changes in fall economic statement		$3,400	$3,400	$3,300	$3,300
Increase HST and Corporate taxes		$7,600	$7,900	$8,300	$8,700
Total	**$149,400**	**$163,200**	**$170,100**	**$176,800**	**$183,300**
Program spending ($ millions)					
FAO forecast (includes 3.5% annual increase to maintain service levels)	$149,400	$153,900	$159,400	$165,200	$171,100
Enhance services (by re-introducing program expansions included in the 2018 Budget)		$2,400	$3,700	$3,800	$3,800
Total	**$149,400**	**$156,300**	**$163,100**	**$169,000**	**$174,900**
Debt service	$12,500	$13,400	$13,800	$14,700	$15,300
Budget balance (surplus/deficit)	-$12,300	-$6,500	-$6,800	-$6,900	-$7,000
Net debt	$348,300	$345,200	$355,400	$365,900	$376,400
Budgetary indicators					
Revenue/GDP	17.4%	18.3%	18.4%	18.4%	18.3%
Program spending/GDP	17.4%	17.5%	17.6%	17.6%	17.5%
Budgetary balance/GDP	-1.4%	-0.7%	-0.7%	-0.7%	-0.7%
Debt/GDP	40.6%	38.7%	38.4%	38.0%	37.7%
Debt service/ revenues	8.4%	8.2%	8.1%	8.3%	8.3%

Sources Ontario 2018 budget, FAO Fall Economic and Budget Outlook , SPSD/M, and authors' calculations
Note Totals may not add due to rounding

Conclusion

Cuts to public services are coming fast and furious, breaking the Ontario PC Party's promise to balance the books without reducing services. This was never a feasible promise.

Ontario has the second-lowest per capita program spending of all provinces. The previous government put its foot down hard on the brakes between 2010–11 and 2017–18, with program spending growing at a rate below both inflation and population growth over that period. Public services and public servants are stretched to their limits. As a result, searches for inefficiencies will come up empty-handed and budget cuts will have palpable negative effects on communities.

It doesn't have to be this way. As this paper has shown, it's possible to maintain and enhance public services while decreasing the deficit and the debt-to-GDP ratio, so long as the province begins to address its longstanding revenue problem.

Technical appendix

This analysis uses the FAO's Fall Economic and Budget Outlook as its base case, as the Ontario government did not provide a medium-term forecast in its fall 2018 Economic Outlook and Fiscal Review.

The revenue estimates from changes to personal income tax rates and reversal of the LIFT tax credit were estimated using Statistics Canada's Social Policy Simulation Database Model (SPSD/M) 27.0. The assumptions and calculations underlying the simulation results were prepared by Ricardo Tranjan and the responsibility for the use and interpretation of these data is entirely that of the authors.

The estimate for the increases in corporate taxes and the HST is based on the authors' calculations using revenue forecasts from the FAO's Fall Economic and Budget Outlook.

Revenue estimates for reinstating the tax changes from the 2018 budget are also based on estimates from the FAO outlook.

These estimates do not include multiplier impacts on revenues, expenditures or economic activity. This is a limitation on these results.

Notes

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5 Ibid. p.19.

6 See Trish Hennessy, Ricardo Tranjan, Sheila Block. March 2018. Ontario budget throws down the election gauntlet; and, April 2018. Ontario's high-stakes election campaign: parties going "all in". Canadian Centre for Policy Alternatives, Ontario.

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8 Ontario. 2018. *A Plan for Care and Opportunity: 2018 Ontario Budget*, p. 291.

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