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The State of Ontario's Finances

Cutting through the fog ahead of the 2019 budget

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IT'S BUDGET SEASON again in Canada. In advance of the Ford government's first Ontario budget, we took a look at the fiscal implications of the government's actions so far, and the contradictions between those actions and repeated declarations on the need for fiscal prudence.

The 2019 Ontario budget will reveal where this government is in fact taking public services and finances. Simple arithmetic tells us that you cannot balance budgets — much less reduce government debt — by reducing revenues and only cutting spending on programs that focussed on marginalized communities. Either the government will have to make draconian spending cuts that will harm public services that most Ontarians rely on, or they will have to break their tax cut promises, or they will increase the debt by incurring larger deficits.

Does Ontario have a spending problem?

Last August, EY Canada won a provincial contract to perform a line-by-line review of the previous 15 years of government spending. It did not include the detailed analysis that would normally constitute a line-by-line review, it was instead an ideological exercise aimed at painting the former Liberal government as out of control spenders.[1]

For example, the EY Canada review states that total real public spending in Ontario increased by 55% over the past 15 years. But the data show spending growth accelerated during the Great Recession and then flatlined for four years between 2012 and 2016. Contradicting the out-of-control spending arguments, the report shows that spending as a share of GDP declined over the period.

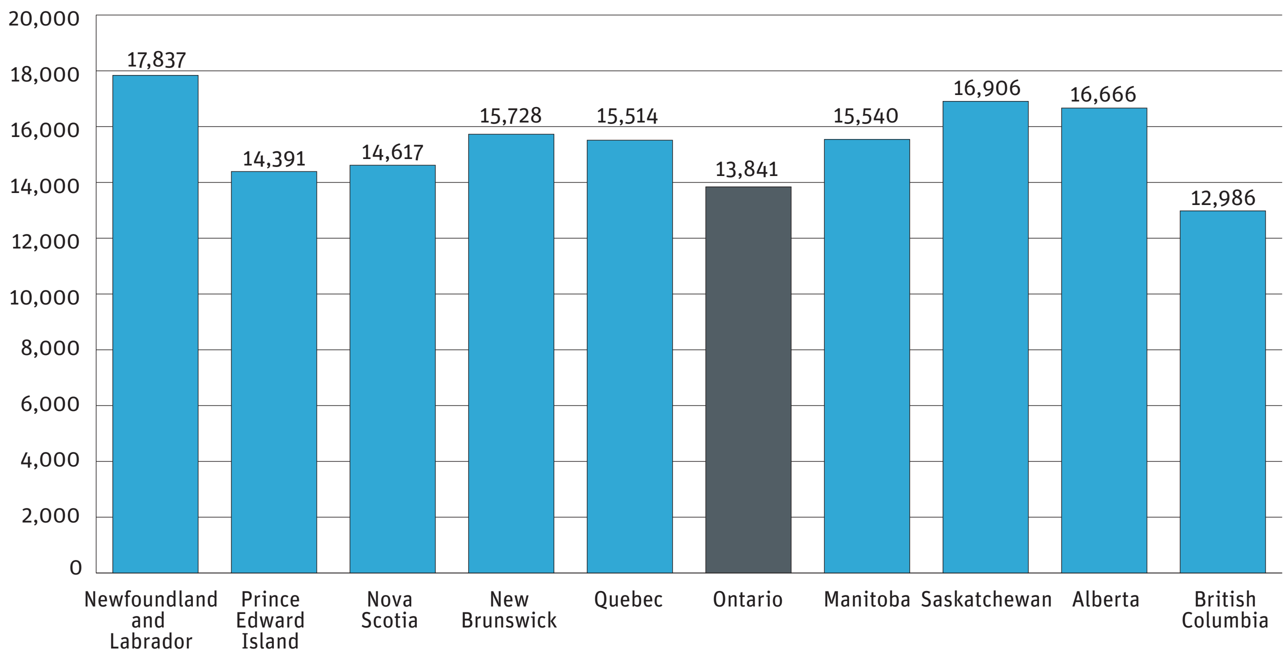
The government has announced a series of spending cuts since being elected last spring. These include reductions in the increase in social assistance rates (from 3% to 1.5%); changes to OHIP+ coverage; the cancellation of a promised French language university and other new campuses; cutbacks to approved increases in child care subsides, funding for the Ontario Arts Council and Indigenous arts programs; and, to education funding that was largely targeted to marginalized students.

While these cutbacks will do real harm, their impact on the province's finances don't get close to meeting the government's objectives. The Financial Accountability Office of Ontario (FAO) has provided some guidance on the depth of the spending cuts that will be required to bring the budget into balance. Getting the deficit to zero over four years, without increasing taxes, would require reducing program spending growth to 1.2%. This is below inflation and population growth and would be the slowest average growth in program spending since the mid-1990s. Restraining total spending to this extent requires reducing real spending per person by $850 (or 8%) by 2022–23.[2]

Chart 1 below compares combined provincial and local spending per capita for all provinces. Showing provincial spending this way provides a better interprovincial comparison as spending responsibilities differ by level of government across Canada. As we can see, in 2016, at $13,841 Ontario had the second lowest spending per capita of all provinces.

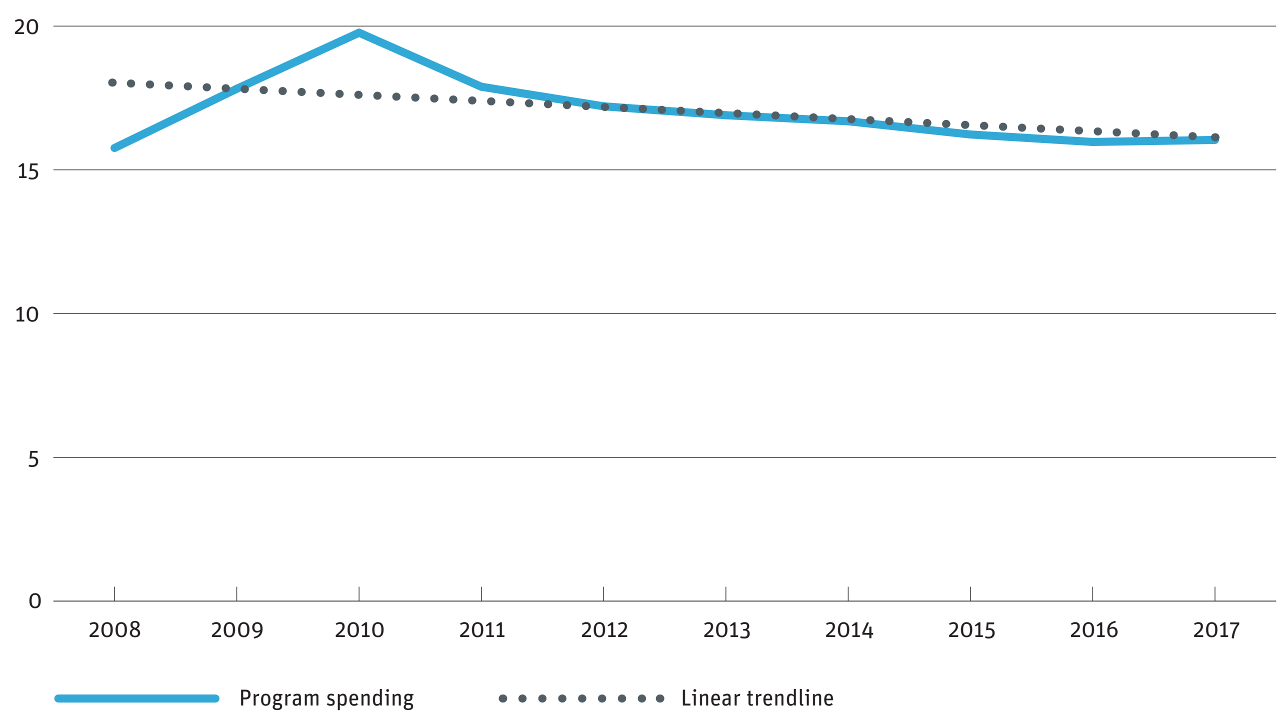
Chart 2 shows Ontario program spending as a share of GDP between 2008 and 2017. In 2008, before the onset of the recession, program spending was at 15.8% of GDP; it rose during the recession, and by 2017 it was back down to 16%.

CHART 1 Local and provincial spending per capita, 2016



Source Statistics Canada calculations are based on data from CANSIM tables 051-0001 and 385-0042.

CHART 2 Ontario: Program spending as a share of GDP: 2008–2017



Source Author's calculations from Statistics Canada tables 10-10-0017-01 and 36-10-0221-01

Ontario's revenue problem

Ontario does have fiscal problem, but it isn't primarily a problem of spending or debt or deficits. It is a revenue problem. *Chart 3* shows that Ontario has the second lowest provincial and local revenues per capita of all the provinces ($13,722 per person in 2016).

Chart 4 shows Ontario's own source revenues as a share of GDP between 2008 and 2017. It shows that the revenues raised by the province have been stable as a share of economic activity, rising by 1 percentage point over the period.

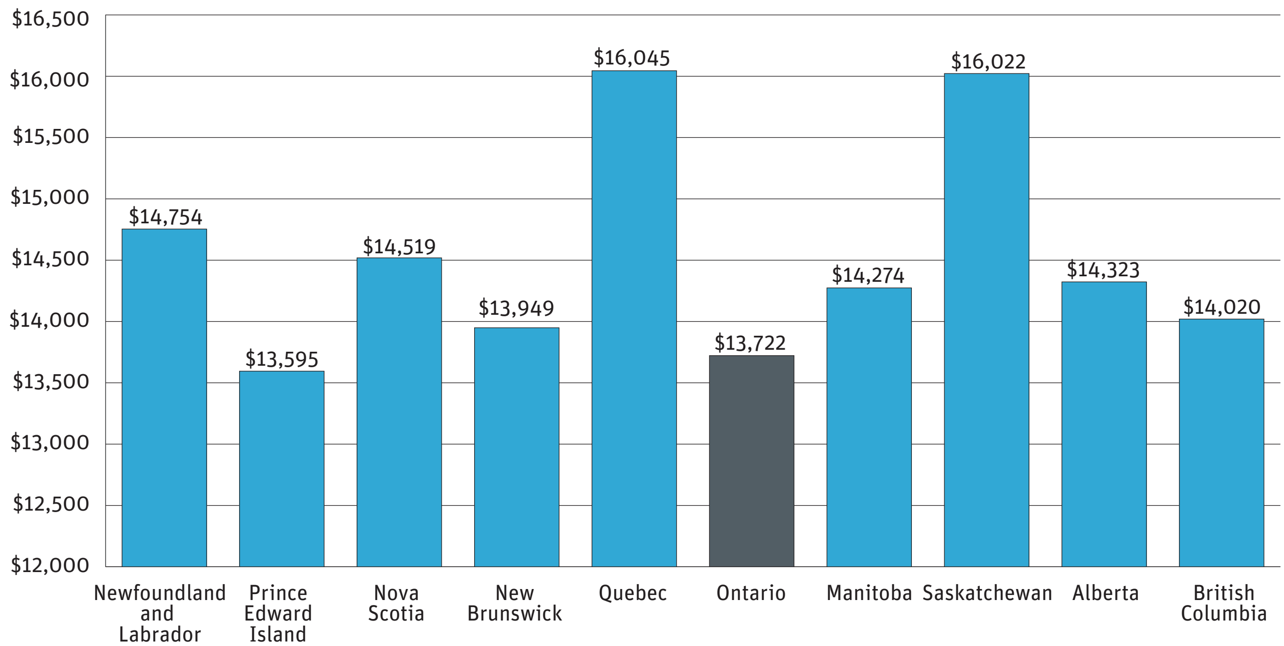
The Ford government's cancellation of Ontario's cap-and-trade program has had the biggest impact on the province's finances in its mandate. In addition to the environmental impacts, ending cap-and-trade will result in revenue losses that far exceed savings from getting rid of programs funded by the carbon trade system (e.g. Ontario Green Fund). FAO estimates losses of $7 billion over four years versus savings of $4 billion — a net loss of $3 billion.[3]

But revenue reductions do not end with the cap-and-trade system. In the fall fiscal update, the Ford government announced it would make the following additional revenue-losing changes:

1. Reversing measures in the 2018 budget that increased taxes on high-income earners and on passive investments, which will reduce personal income tax (PIT) revenues;
2. Making changes to corporate taxes that parallel recently announced federal corporate tax relief, which will reduce corporate tax revenues; and
3. Creating a low income (individuals and families) tax credit — in lieu of the planned increase to the minimum wage (cancelled by the Ford government last year) from $14 to $15/hour — which will also reduce PIT revenues.

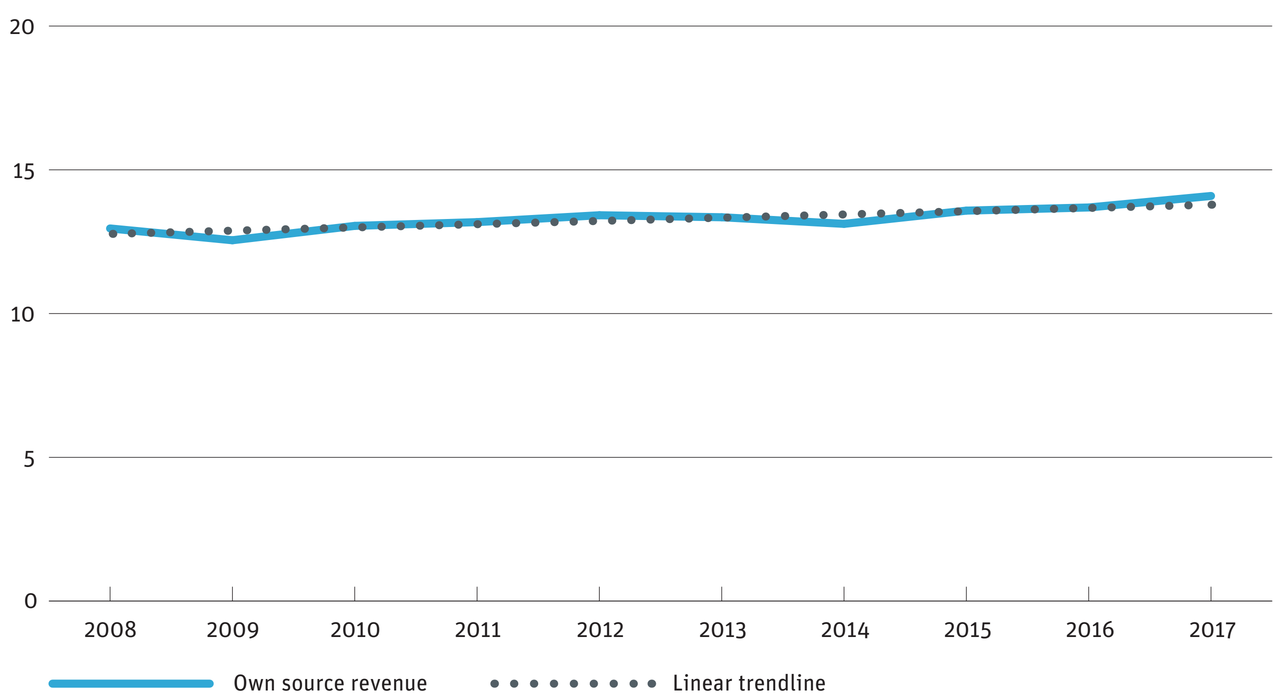
Where do these changes leave the province's coffers? The FAO estimates that the policy decisions of this government will reduce revenues by $2.1 billion in 2018–19 and an annual average of $3.7 billion over next four years.[4] Moody's cited the substantial drop in revenues as one of the reasons for downgrading Ontario's credit rating in December.[5]

CHART 3 Provincial and local revenues per capita, 2016



Source Statistics Canada, calculations are based on data from CANSIM tables 051-0001 and 385-0042

CHART 4 Ontario: Own source revenue as a share of GDP: 2008–2017



Source Authors' calculations from Statistics Canada tables 10-10-0017-01 and 36-10-0221-01

Is Ontario facing a deficit crisis?

The Ford government's Independent Financial Commission report contended that the deficit was larger than what had been estimated in the 2018 budget.[6] The panel recommended that the former Liberal government's Fair Hydro Plan costs should be on the provincial books ($2.4 billion), public sector pension assets should be off the books until the provincial auditor general and Ministry of Finance can agree on how they should be treated ($2.7 billion), and the savings from unspecified program spending cuts should come off the books ($1.4 billion). This resulted in a $6.4 billion increase in expenses, and therefore a deficit of $15 billion.

The government's fall fiscal and economic update set the budget deficit for the current year at $14.5 billion, cautioned about the potential impacts on the Province's finances of rising interest rates, and argued for cutbacks in expenditures and a refocusing on deficit and debt reduction.[7]

Unlike previous ones, however, the Ford government's fiscal update did not include a medium term fiscal outlook. It also did not include a plan to balance the budget or reduce the debt. Instead, this year's report set out a series of tax cuts that will, in effect, increase both the debt and annual provincial deficits.

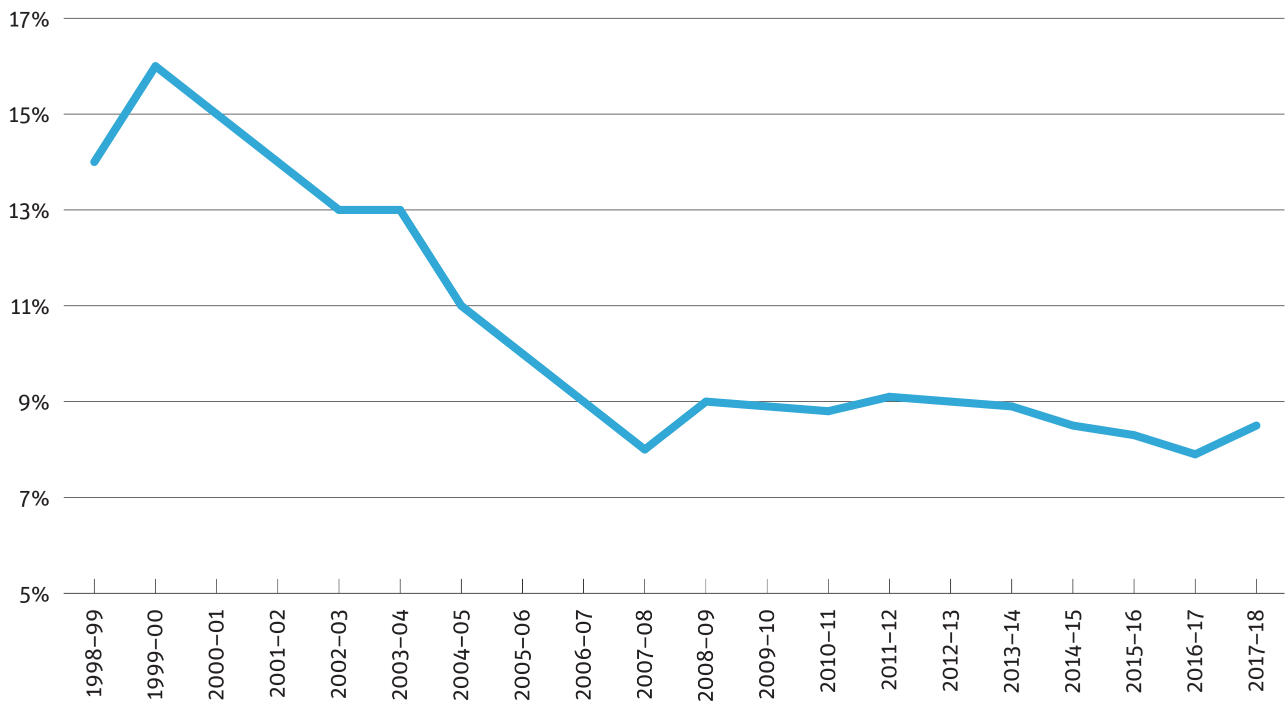
The government's framing of public debt as equivalent to household debt is a gross mischaracterization. Families manage debt over a life cycle. It is prudent early in that cycle for families or individuals to take on debt, perhaps to pay for education or to purchase a home. Later on, ideally, individuals or families will move from borrowing to saving for retirement.

Governments do not face the same life cycle 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. We are all always paying it off and paying it forward.

Furthermore, higher levels of borrowing that might be risky for individuals or families are prudent for governments, since risk is spread across the whole population. Financial markets find governments to be extremely reliable borrowers for this reason, and due to their ability to tax; as a result, governments can borrow at much lower interest rates than households.

The fiscal and economic update raised concerns about debt service costs being the fourth largest budget item. In 2018–19, 8.5% of Ontario's government revenue was forecasted to go toward debt financing. As *Chart 5* shows, debt service as a share of revenue is now lower than it has been in at least 20 years — due, in large part, to low interest rates. In 1999, debt servicing took up 16% of Ontario's budget, almost double what it is today.

CHART 5 Interest on debt as a share of revenue: Ontario 1998–99 to 2017–18



Source Ontario 2018 Budget and Fiscal and Economic Update

Conclusions

While the Ford government has announced that balancing the budget and reducing the province's debt is a top priority, its actions so far belie these words. The government has reduced revenues rather than increase them. Its spending cutbacks have been harmful to the environment, to marginalized Ontarians and to the population at large — without being large enough to fulfil their promise.

The Ford government has not articulated a plan that will balance the province's budget into balance. Or how it will keep its conflicting promises of tax cuts, bringing the budget into balance and maintaining public services. They have not articulated a plan, a time frame, or what spending cuts they will implement and how large they will be.

Keeping their promises on tax cuts, and deficit and debt reduction will require draconian cuts to services.

This would harm Ontarians. A better path to balance is to increase revenues.

Notes

1 For an analysis of this report see: CCPA-ON, "Frame job: Ontario's review of the books is an ideological exercise," *Behind the Numbers* (a CCPA blog), September 25, 2018.

2 Financial Accountability Office of Ontario. 2018b. pp. 15–16.

3 Financial Accountability Office of Ontario. 2018a. *Cap and Trade: A Financial Review of the Decision to Cancel the Cap and Trade Program*. p. 8.

4 Financial Accountability Office of Ontario. 2018b. *Economic and Budget Outlook, Fall 2018*. pp. 15–16.

5 The Canadian Press, "Moody's downgrades Ontario's credit rating, citing deficit, revenue cuts under Doug Ford," December 14, 2018.

6 For an analysis of that report see: Sheila Block, "Forced perspective: Fedeli's framing sets the stage for deep cuts," *Behind The Numbers* (a CCPA blog), September 21, 2018.

7 For an analysis of the fiscal and economic update see: CCPA-ON, "Ontario Economic Update: Financial fearm Source: Ontario Financing Authority, Ontario 2018 Budget: Budget Papers; A Plan for the People — 2018 Ontario Economic Outlook and Fiscal Review, Background Papers. ongering act II," Behind the Numbers (a CCPA blog), November 15, 2018.

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