

The Ontario Alternative Budget 2002

**The Money is There:
Pre-budget Fiscal Update**

Technical Paper #6

by Hugh Mackenzie

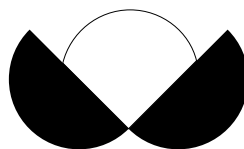


Canadian Centre for
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Ontario Alternative Budget
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Technical paper # 6
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Memo to Premier and Minister of Finance: there is no fiscal crisis; it's time to change the script

The rapid rebound of the Ontario economy from its 2001 slump has destroyed the last vestige of support in the numbers for the Ontario Government's pre-budget claim of poverty.

The atmosphere of fiscal crisis, so carefully cultivated by the Government since December 2001, has no foundation.

The three to five billion dollar "problem" that was making the rounds within government over the winter never existed. No amount of tinkering with the numbers could make a forecast deficit come even close to \$3-5 billion.

Major financial institutions continue to revise upwards their Ontario forecasts upwards for 2002 and 2003. It is clear that Ontario will have enough flexibility next year to take the first steps towards repairing the damage to public services as promised in Premier Eves' first Speech from the Throne.

Revenue estimates based on recent chartered bank economic forecasts for Ontario show "fiscal room" for \$2 billion in expenditures on public services repair this year, and a further \$3 billion next year.

While additions to Ontario's revenue base are relatively small, compared with the more than \$12 billion reduction in Ontario's fiscal capacity created by personal and corporate income tax cuts, they do represent an opportunity to begin the task of rebuilding weakened public services.

Tackling the Harris legacy of public services deficits will be an enormous challenge. We see the evidence every day. School boards are being forced to contem-

plate deficit funding, after years of cutbacks imposed by the provincial funding formula. Colleges and universities are unprepared for the arrival of the double-cohort of high school students created by the elimination of grade 13. Public infrastructure is deteriorating. Environmental protection requires significant new investment. Hospital deficits must be addressed.

The impact of seven years of cutbacks shows up in the overall statistics as well. Since the first fiscal year of the Conservative Government in 1995-6, provincial public services spending has dropped from 15.1% of our economy to 12.1% — a reduction in our commitment to public services of 20% in just six years.

The fiscal "crisis"

Beginning shortly after Finance Minister Flaherty's fall economic statement, rumours began to circulate within the Government about a looming fiscal crisis in 2002-3, citing a potential \$3-5 billion potential deficit.

The Government never presented any evidence to support this claim. A March analysis of the province's fiscal situation by the Ontario Alternative Budget Working Group in February showed that even the most extreme negative assumptions for growth in 2002 and 2003 could not generate a deficit even close to that amount.¹

That was in March. Since then, all of the major financial institutions in Canada revising upwards their growth forecasts for Canada and Ontario in the 2nd quarter of 2002. It is now clear that the economic environment for the 2002-3 budget has reversed itself.

The spring 2002 provincial forecasts published by the five largest chartered banks average 3.2% growth for Ontario in 2002 and 3.9% in 2003.²

In effect, bank forecasters have moved forward by about a year their estimate of the timing of Ontario's recovery from the 2001 recession.

That change in outlook has a profound impact on the fiscal situation faced by the Government of Ontario leading into the 2002-3 budget.

Using these revised forecasts, and assuming no changes in tax rates beyond those that have already taken effect, Ontario's revenue base will increase by at least \$2.2 billion in 2002-3 compared with 2001-2. Allowing for a reserve of \$1 billion, and taking into account anticipated debt service cost reductions as high-interest debt from the early 1990s begins to mature, results in an estimated \$2 billion in additional "fiscal room" for 2002-3 compared with 2001-2.

With the budget clearly headed for a modest surplus for 2001-2, this means that the Conservative Government has at least

\$2 billion available to tackle the most urgent of public services needs, with the promise of a further \$3 billion available for 2003-4.

Ontario's weakened revenue base

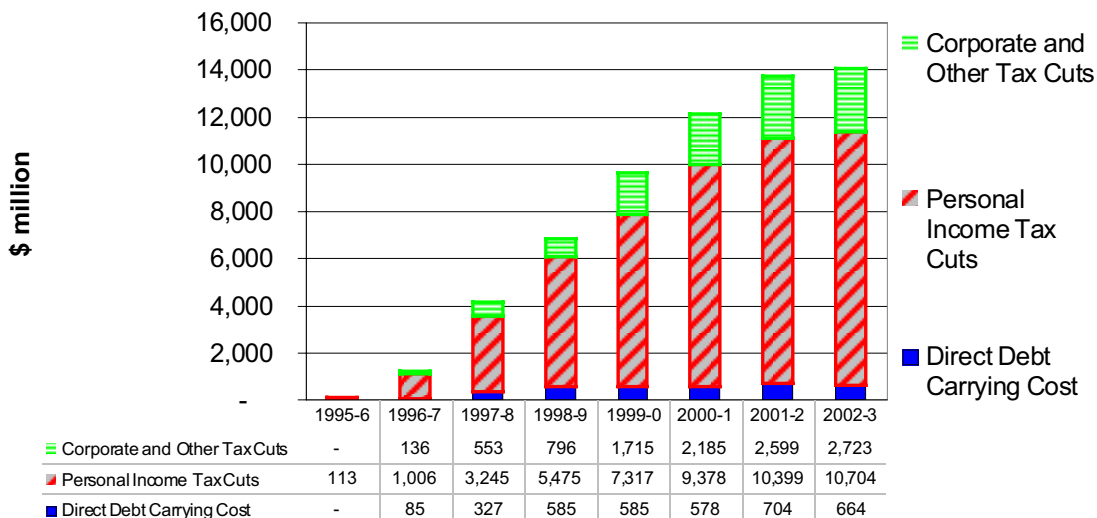
A recent estimate by the Federal Department of Finance puts the impact of provincially-initiated corporate and personal income tax cuts at \$12.3 billion for 2002-3.³ The Ontario Alternative Budget estimates the impact of all Ontario tax cuts, including corporate property tax cuts and employer health tax cuts, at \$13.4 billion.⁴

Whichever figure is used, the impact of six years of tax cuts first policies on Ontario's ability to deliver public services is obvious.

In the absence of this policy of deliberately destroying Ontario's revenue base, we would not be facing a public services crisis in this province. Ontario's revenue base would be more than \$12 to \$13 billion higher in 2002-3 than is currently forecast. And had the Government not chosen to cut

Annual Tax Cut Impact on Fiscal Capacity in Ontario

Debt Carrying Cost and Revenue Loss



taxes before balancing its budget, debt servicing costs would be lower by nearly \$700 million.

Tax choices for 2002-3

Our estimate of \$2 billion in fiscal room for 2002-3 assumes no changes in the structure of the tax system.

Depending on the choices made by the Government on the revenue side, that fiscal space could either be cut in half, or increased to \$3 billion.

On the negative side, we estimate that corporate and personal tax cuts announced previously could consume as much as \$1 billion of the additional revenue generated by Ontario's economic recovery. Proceeding with those cuts would leave the Government with little to allocate to public services renewal beyond what has already been announced publicly.

On the positive side, the Government is in a position to generate as much as \$1 billion in new revenue through increased taxation of tobacco sales. Ontario is in the embarrassing position of being one of the lowest tobacco tax jurisdictions in North America, despite having attempted to join lawsuits in the United States over the health impacts of tobacco consumption.⁵

Increased revenue from tobacco taxation would add to the Government's fiscal room for 2002-3 and provide a revenue base for further improvements to health funding.

Public services in Ontario – what the overall numbers say

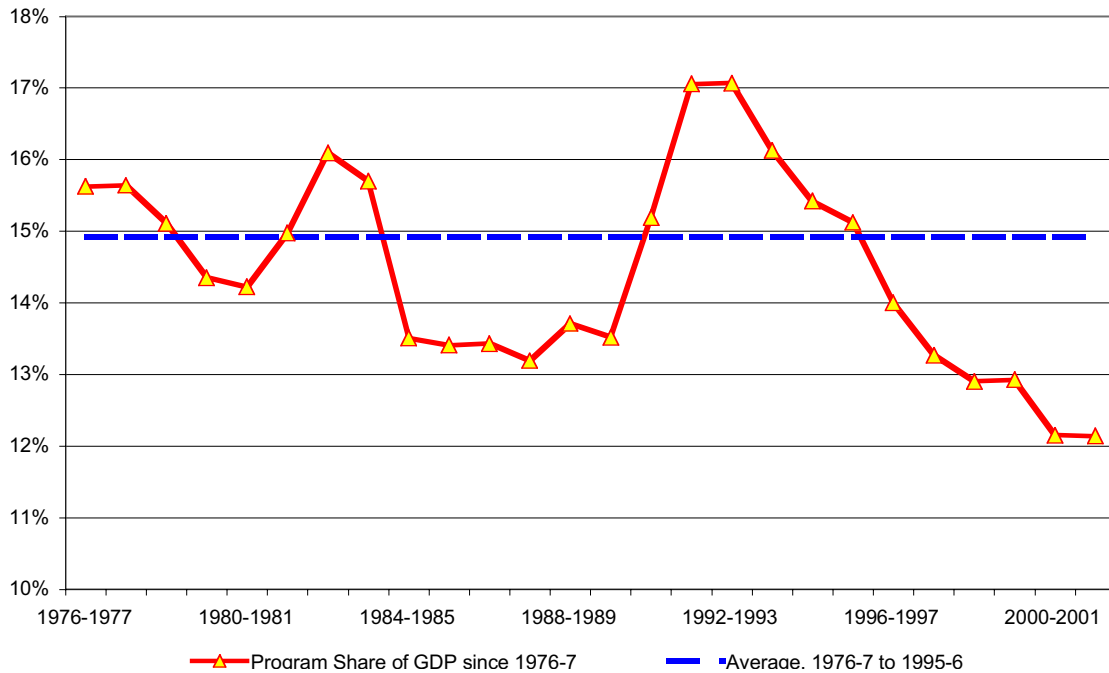
There are many voices to tell the story of the impact of public services cuts on Ontarians:

- working families, who no longer have access to child care;
- a generation of elementary and secondary school students who have paid the price for the hundreds of millions in real resources cut from the budgets of public and catholic school boards;
- half a million college and university students, many of whom will graduate under a mountain of debt created by tuition increases;
- health care system users, the victims of the Government's failed experiment in hospital restructuring;
- local government leaders who know from their own budgets that local services restructuring was anything but revenue neutral;
- people in rural areas of the province who think twice every time they turn on the tap;
- the poor, too many of whom have to choose between feeding the kids and paying the rent.

But few people, as individuals, experience the full impact of the cuts. That's where the overall numbers come in. Those numbers show that, since 1995-6, the first year of the Harris Government, public services spending on program and capital dropped from 15.1% of our economy to 12.1% in 2001-2. Nearly 20% of the provincial public economy has been wiped out.

Public services now make up a smaller share of our economy than at any time in the past 25 years. Over the generation before the election of the Harris Conservatives in 1995, and under provincial governments of all three political parties provincial public services accounted for an average of 14.9% of the provincial economy.

Program and capital spending as a share of Ontario GDP



Budget choices for 2002-3

It is a truism that budget making is about making choices. This year, the choices facing the Ernie Eves Government and its new Minister of Finance are exceedingly clear.

The rebound in the economy has given the Government the opportunity to make a small but significant start on the job of repairing the damage those years caused to Ontario's vital public services.

That is the minimum Ontarians should expect from a Premier whose first Throne Speech touted his Government as a "new" government committed to reviewing and renewing public services.

The other option is to stick to the tried and true formula. Ignore the calls for reinvestment. Proceed mechanically with tax cuts for which there is no need, and now, very little demand. Stay in fiscal crisis mode, hiding behind excessively pessimis-

tic economic forecasts. And call into question the Government's commitment to the words of the Throne Speech.

Endnotes

- ¹ Mackenzie, Hugh "The Phantom Fiscal Crisis", Ontario Alternative Budget Technical Paper #3, Canadian Centre for Policy Alternatives, April 2002
- ² CIBC World Markets Inc., Provincial Outlook May 1, 2002; Scotiabank Group, Global Economic Research, Provincial Forecast Update, May 2002; RBC Financial Group, Provincial Forecast, Spring 2002; Bank of Montreal, Economics Department, Economic Prospects for Canada's Provinces, May 2002; TD Economics, Provincial Forecast, April 2002; See Appendix I for data.
- ³ Source : Provincial estimates and Finance Canada estimates, unpublished back-grounder to The Fiscal Balance in Canada: The Facts, January 2002, Department of Finance Canada.
- ⁴ Mackenzie, Hugh "The Phantom Fiscal Crisis", op cit.
- ⁵ Gerry Phillips, MPP, Treasury Watch Vol. 5 No. 2, June 2002

Appendix I – Chartered Bank Provincial Forecasts, Spring 2002

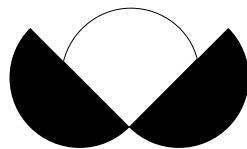
2nd quarter 2002 forecasts Ontario

Growth

	2001	2002	2003
<i>BMO</i>	1.0%	3.7%	5.1%
<i>CIBC</i>	1.0%	3.1%	3.2%
<i>RBC</i>	1.0%	3.7%	3.7%
<i>Scotia</i>	1.3%	3.1%	3.5%
<i>TD</i>	0.9%	2.6%	4.0%
<i>Average</i>	1.0%	3.2%	3.9%

CPI

<i>RBC</i>	3.1%	1.3%	1.3%
<i>BMO</i>	3.1%	1.4%	1.7%
<i>TD</i>	3.1%	1.0%	2.2%
<i>Average</i>	3.1%	1.2%	1.7%



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