The Ontario Alternative Budget 2003

Coming home to roost:
Ontario pre-"budget" analysis

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Summary

The continuing controversy over the Eves Government's decision to turn the release of the provincial budget into a private PC Party campaign event has rightly focused public attention on the comtempt that this scheme shows for democratic process and public debate. After all, nothing is more important as an indicator of a government's prioirities than its budget. Nothing is more critical as a measure of confidence in a government than its budget. But the controversy has also served to deflect attention away from the underlying critical issues facing the province — the very issues whose debate the Government is trying to avoid by, in effect, privatizing the budget process.

Those underlying issues are indeed critical for the economic and social future of the province.

In its pre-event preparations, the Government has been setting up a pre-election scenario in which it has it both ways — appearing to be addressing critical issues in public services while at the same time putting the Government back on the tax cut track — in short, a classic election budget in which there are no tough choices or trade-offs.

Spin aside, however, the numbers show that even with higher-than-expected revenues for 2002-3 and a windfall from the Health Care Accord, Ontario does not have the money to pay for both tax cuts and even a token commitment to revitalizing public services in the next fiscal year.

The Government’s much-hyped renewed commitment to public services is both narrow and shallow. Beyond health care and education, the Government has had virtually nothing to say about funding deficits that threaten basic public services. Even in health and education, the commitments have been guarded. Commitments on health care have been coupled with threats about sustainability. Commitment in principle to implement the Rozanski recommendations has been accompanied by numbers that don’t even come close to that target. And the Government’s vague commitment to double-cohort funding for colleges and universities is already doomed to be too little, and too late.

So the assertion that the Government is covering all the spending bases only holds if the field doesn’t include public infrastructure, water, housing, child care, social services or even a gesture towards justice for social assistance recipients.

Our status-quo (no tax system changes; no expenditure changes) projections indicate revenue growth for 2003-4 of $4.8 billion, with a further dividend of $300 million from reduced debt service charges.

To meet its health and education commitments and merely to tread water in other areas of public services — keeping up with inflation — will increase spending by an estimated $3 billion in 2003-4.

That leaves roughly $2 billion both to cover $2.1 billion in announced or expected tax cuts and to address massive unmet funding needs in areas like water quality, public infrastructure, housing, child care and social assistance.

It won't work. It comes down to the same choice. Tax cuts — this time more tightly targeted to high-income individuals and corporations than ever — or public services.

The government's pre-event set-up

Everything that the Ontario Government has done on the fiscal front since Ernie Eves was elected leader of the Conservative Party a year ago has been designed to set up this week's controversial election budget event.

The process began in earnest in May 2002. The key fiscal measure in the 2002-3 Budget — the one-year delay in the implementation schedule for its planned corporate and personal income tax cuts — was designed to create fiscal room for 2003-4, rather than for 2002-3. Most of the (positive) revenue impact of delaying the cuts from January 1, 2003 to January 1, 2004 is in 2003-4, not 2002-3. Estimates of economic growth were kept extremely conservative, and revenue estimates based on those growth assumptions — particularly for personal and corporate income tax — were scaled back even further.

Our analysis shows that the government is reaping substantial dividends from three sources:

- Budgetary measures that delayed the implementation of costly tax cuts from January 1, 2003 to January 1, 2004;
- Revenue certain to run substantially ahead of deliberately understated budget-time forecasts; and
- A substantial, and flexible source of untied funding from the Federal Government flowing from the February Health Care Accord.[1]

Our estimates show revenue for 2002-3 $400 million higher than forecast in May 2002, even after taking $2 billion out to reflect the failed sale of Hydro One.

This revenue gain, combined with a limited draw-down of reserves, will provide

Table 1
Average of current forecasts, 5 largest chartered banks

	2002	2003	2004
Inflation	2.0%	2.5%	2.0%
Real Growth	3.7%	3.2%	3.5%

Table 2
Forecast with no change in expenditures or tax system

	2001-2	2002-3	2003-4
Program + capital	54,413	57,083	57,083
Public Debt Interest	8,509	8,309	8,015
Ontario Hydro	589	589	589
Reserve	0	934	1,000
Total Revenue	63,886	66,915	71,772
Budget Deficit (-) / Surplus (+)	375	0	5,086

enough revenue to support the Eves Government's 2002-3 education funding increases. Indeed, our estimates for 2002-3 indicate that $1 billion in year-end revenue may be available for pre-funding of 2003-4 budget commitments.

But the real benefit from the Government's careful construction of its 2002-3 budget comes in 2003-4, when the combined effect of these factors produces a gain in revenue of $4.8 billion.

While that looks very positive for the Government, both the minimal expenditure commitments it has made and the tax cuts that are anticipated in this budget are big-ticket items.

Projections of revenue and expenditures, 2002-3 and 2003-4

Revenue projections for this analysis use the Ontario Alternative Budget model of the provincial revenue system, and are based on the most recent projections for real growth and inflation from the five largest chartered banks.

The status-quo projection takes into account the impact of economic growth and the scheduled flow of funds under the Health Care Accord, but otherwise makes no assumptions about the budget.

It shows a gain in revenue of approximately $4.8 billion between 2002-3 and 2003-4, consisting of $3.3 billion from economic growth, $1.2 billion from the Health Care Accord and $0.3 billion in increased CHST transfers flowing from the September 2000 Federal-Provincial agreement.

That, along with a projected $300 million reduction in public debt interest charges, establishes the fiscal room of just over $5 billion within which we project the Government can operate in the next fiscal year.

Expenditure projections assume that the Government will continue to implement the Rozanski recommendations, as laid out in his report. That means delivering the first year of the three-year phase in of remedial funding to update funding benchmarks to 2002-3, making the remaining new investments recommended in the report, and providing new funding to keep benchmarks current for 2003-4 — a total of $1.2 billion in new funding for elementary and secondary education.

These projections also allow for an increase of 4% in operating funding for post-secondary institutions (in addition to inflation) to address the enrolment increase for the double-cohort.

Health expenditures are assumed to increase at twice the rate of inflation.

Table 3
2003-4 Expenditure Forecast

	2002-3	2003-4	*$ increase*	*% increase*
Health	25,492	26,704	1,212	4.8%
Education	9,254	10,454	1,200	13.0%
Colleges	3,591	3,820	229	6.4%
ComSoc	7,814	8,000	186	2.4%
Other	8,921	9,133	212	2.4%
TOTAL	55,072	58,111	3,039	5.5%

Table 4
Tax Cuts as of January 2003

	2002-3	2003-4
Corporate rate reductions		
General	112	474
M&P	50	211
Small Business	10	41
Corporate total	172	726
Personal		
1st stage surtax	304	1,260
Private School Tax Credit	30	142
Personal Total	334	1,402

Table 5
Forecast including tax cuts and expenditure changes

	2001-2	2002-3	2003-4
Program + capital	54,413	57,083	60,192
Public Debt Interest	8,509	8,309	8,015
Ontario Hydro	589	589	589
Reserve	0	428	1,000
Total Revenue	63,886	66,409	69,643
Budget Deficit (-) / Surplus (+)	375	0	(152)

All other expenditures are assumed to increase at the rate of inflation.

Table 3 summarizes the expenditure projections.[2]

Revenue projections assume that the Government will reinstate its previously-announced schedule of corporate tax rate reductions; increase the private school tuition tax credit from 10% to 20%; and proceed with the next stage of its personal income tax program, the elimination of the first level (20%) of Ontario's personal income surtax (formerly known as the Fair Share Health Levy).

Table 4 summarizes the costs of the key elements of the tax cuts.

Based on these assumptions, the outlook for 2003-4 is for a deficit of approximately $150 million. The results are summarized in Table 5.

Unmet needs

The share of our economy accounted for by public services has been drastically reduced in Ontario. Cutting back on the role of Government was one of the key features of the Harris Government's so-called common sense revolution, and was presented as central to its deficit reduction strategy.

That much is well known. However, the decline in pubic services' role in the economy has continued long after the budget balance turned from deficit to surplus.

Provincial spending on public services has been declining steadily as a share of our economy since 1992-3, when it hit its recession peak of 17.1%. By the time of the election of the Harris Government in 1995, the share had already dropped to 15.1%, the 25-year long-term average in Ontario.

In the election year of 1999-2000, the year of the first budget surplus, the share had dropped to 12.9%. And since the budget was balanced, the share has dropped still further, to 11.8%.[3]

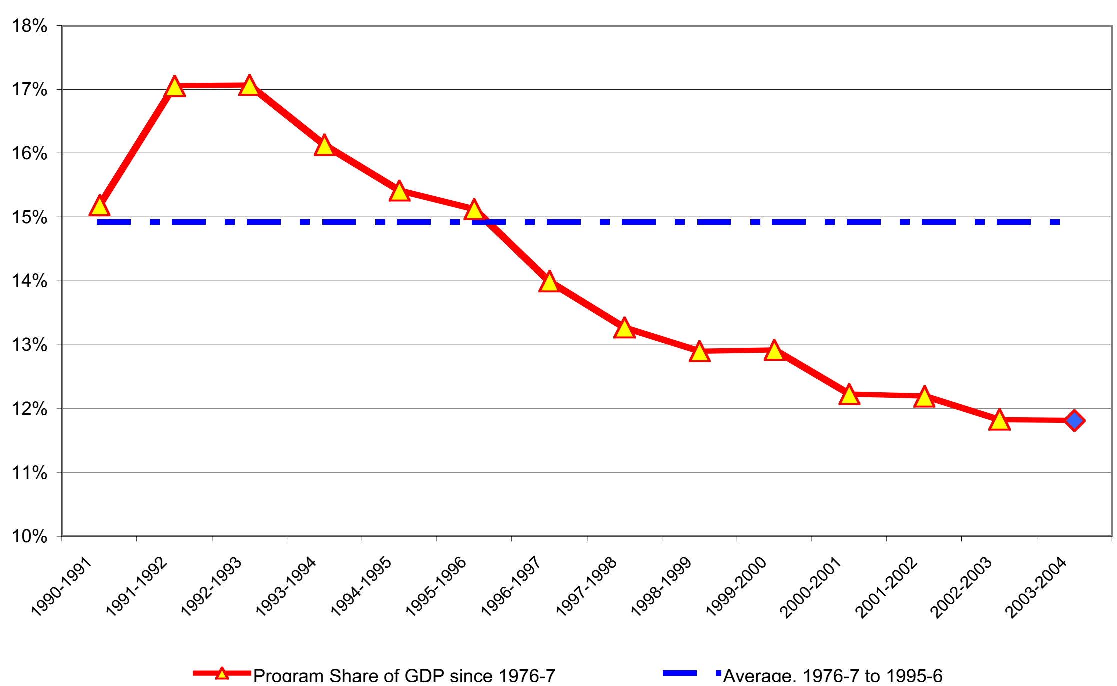
The consequences of this decline are evident in our embattled system of public services; the corresponding public services deficit is substantial.

In health care, the forward projections behind this analysis make no specific allowance for health care beyond meeting cost pressures on the existing expenditure base. Essentially, our health care projection amounts to status quo, after increased costs (at about 1.5 times the rate of inflation) and population growth are taken into account. Specifically, they do not provide for needed new investments in primary care reform, home care and drug coverage.

In elementary and secondary education, a study by the Canadian Centre for Policy Alternatives estimates that, when the recommendation to keep benchmark funding current through annual updates is taken into account, the total cost of Rozanski's recommendations over four years is approximately $3.5 billion. Approximately $3 billion of that would have to be provided for in the three budgets beginning in 2003-4.[4] Full implementation of Rozanski's recommendations, immediately, would cost roughly $2.0 billion. Our projection follows Rozanski's phase-in, allocating $1.2 billion for this year.

The impact of the Government's policy of shifting post-secondary education finance from provincial grants to student tuition is a smouldering issue that has, in recent weeks, been obscured by concerns about the ability of colleges and universities to absorb the double cohort created by the elimination of grade 13. The Government will face increased pressure to address this issue in the coming months, as attention continues to be focused

Program and capital spending as a share of Ontario GDP



on access to post-secondary education. Our projection is limited to the double-cohort issue.

Study after study highlights a large and growing backlog in maintenance and construction of physical infrastructure — roads, highways and sewer and water facilities. The price tag for the province as a whole runs into the billions. For example, in the GTA alone, a recent review for the Toronto City Summit Alliance pegs the shortfall in funding for transportation at $800 million per year. Another study for the TCSA estimates costs of renovating and maintaining sewer and water infrastructure in the GTA at $120 per capita per year for the next several decades.

The situation with respect to homelessness and the lack of affordable housing continues to worsen. In the years since the incoming Housing Minister confidently predicted that the Government's policies would result in substantial growth in the affordable housing stock, we have lost 45,000 units of affordable housing. The cancellation of Ontario's leading-edge social housing program cost the province the opportunity to build another 82,900 affordable homes. Meanwhile, The Toronto Disaster Relief Committee is preparing to add the 300th name to its list of homeless people who have died in Toronto. The Government will inevitably face pressure to contribute more to addressing the affordable housing issue than its pathetically inadequate gesture of eliminating the sales tax on building materials.

The Kimberley Rogers inquest highlighted the savage impact of cuts in welfare benefits on the most vulnerable individuals in our society. A 22% cut followed by a seven-year freeze in benefits is neither politically nor morally sustainable.

Although the Walkerton Inquiry has had an impact on provincial water regulations, the Government has not as yet addressed the fiscal implications. The Walkerton Inquiry attributed a portion of the blame for the disaster directly to cuts in the operating funds of the Ministry of Environment. And it recommended system upgrades that will cost billions of dollars, and are well beyond the fiscal capacity of many of the municipalities that now bear the responsibility for water treatment.

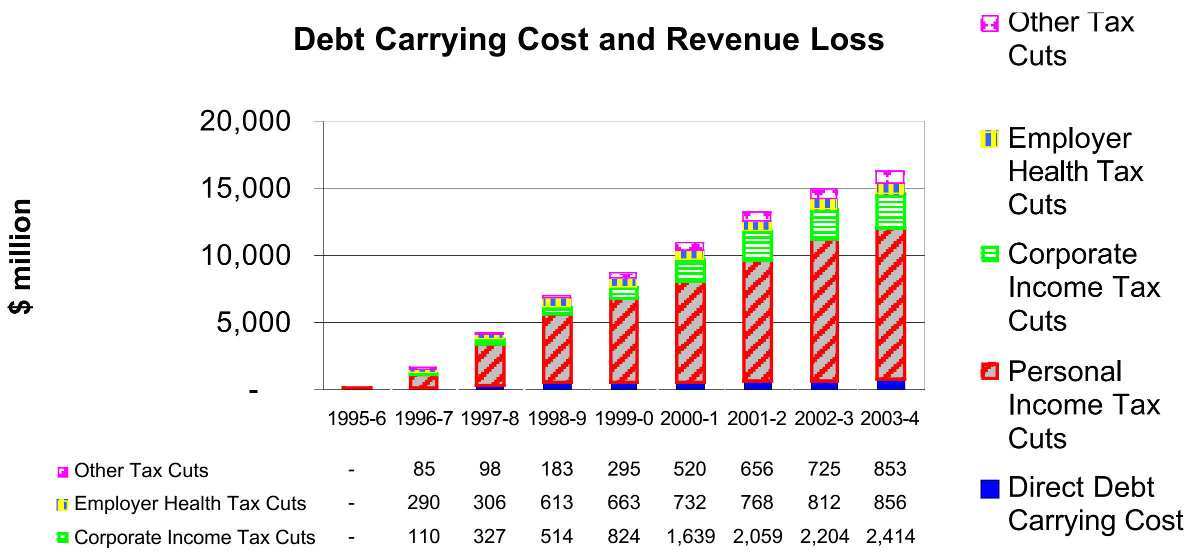
The projections also make no allowance for provincial actions to address a wide array of municipal finance issues

- infrastructure funding,
- the maintenance backlog in the downloaded social housing stock,
- transit funding,
- the exposure of local budgets to cyclical fluctuations in economic activity,
- the unfunded provincial policy of reducing the share of commercial and industrial taxation in local government revenues — a policy that is having dramatic negative effects in budget flexibility in many large urban areas of the province, most notably Toronto.

Reduced fiscal capacity

In concert with its decimation of the expenditure side of Ontario's public economy, the Government has wiped out a substantial proportion of our revenue base.

An estimate by the Federal Department of Finance puts the impact of provincially-initiated corporate and personal income tax cuts at $13.2 billion for 2003-4. [5]The Ontario Alternative Budget estimates the impact of all



	1995-6	1996-7	1997-8	1998-9	1999-0	2000-1	2001-2	2002-3	2003-4
Other Tax Cuts	-	85	98	183	295	520	656	725	853
Employer Health Tax Cuts	-	290	306	613	663	732	768	812	856
Corporate Income Tax Cuts	-	110	327	514	824	1,639	2,059	2,204	2,414
Personal Income Tax Cuts	109	998	3,096	5,059	6,236	7,392	9,050	10,467	11,331
Direct Debt Carrying Cost	-	111	353	608	608	622	659	732	768

Ontario tax cuts, including corporate property tax cuts and employer health tax cuts and the $700 million carrying cost for borrowing to pay for tax cuts, at $15.4 billion.

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 at least $13 billion higher in 2003-4 than is currently forecast. And had the Government not chosen to cut taxes before balancing its budget, debt servicing costs would be lower by nearly $700 million.

Options for the fiscal squeeze of 2003-4

For 2003-4, the Government faces a political squeeze. Its determination to get back to the Harris-era old time tax cut religion will leave it without the resources needed to meet the expenditure commitments it has already made, in health and education, much less address funding deficits in virtually every significant area of public service that have emerged in the Harris era.

The Government has a limited range of options available to it.

- Back off on the tax cut schedule;
- Renege on its Rozanski and double-cohort education spending commitments;
- Institute a new round of health care cuts;
- Freeze all spending outside health and education;
- Move spending commitments out of fiscal year 2003-4 either by funding them in advance, in 2002-3, or delaying them until 2004-5;
- Include another major asset sale in revenue projections for 2003-4;
- Front-end-load its use of the Health Care Accord's short term funding; and/or

- Declare a one-time-only revenue windfall from the introduction of full accrual accounting.

Of the available options, the latter four are the most tempting, because they would have the least political impact.

Even with tax cuts taking effect January 1, 2003, there may be as much as $1 billion in unspent reserves.[6] This could be used to provide advance funding in fiscal year 2002-3 for 2003-4 budget initiatives. It could also back-end-load a portion of its elementary and secondary education funding commitment for the 2003-4 school year (which does not coincide with the province's fiscal year).

With respect to asset sales, the Government has already hinted that the Hydro asset sales may not be dead, and could include projected revenue from the disposal of Hydro facilities in its 2003-4 budget.

The Health Care Accord includes nearly $1 billion as Ontario's share of a fund that has already been set aside by the Federal Government, and is available to be drawn down at Ontario's discretion. Federal forecasts suggest a 3-year drawdown in a 2:2:1 ratio, but the Federal Government has also indicated that the funds are available at provinces' request.

And based on data tabled by the Federal Department of Finance in background documents to the February, 2003 budget, Ontario could expect to generate a one-time-only windfall by changing its system of accounting from modified accrual to full accrual.

Conclusions

It has become almost trite to observe that the hallmark of the Government of Premier Ernie Eves has been the need to deal with the chickens coming home to roost from the devastating and ill-considered policies of the Harris era.

That shows up most clearly in the budget, ever more tightly squeezed as the Provincial Government is called upon, in crisis after crisis, to restore spending cuts. First up was health. Recently, attention has turned to elementary and secondary education. But there is a long list of candidates for the next funding imperative. And years of tax cuts, implemented without the revenue to pay for them, has left the Province with very little fiscal flexibility.

With well over a billion dollars in renewed federal investments for health care coming into the province this year, and no accountability mechanism to ensure that health care is the beneficiary of that transfer of funds, it is entirely possible that the Federal Government will have unwittingly funded the province's next round of personal income tax cuts just in time for a provincial election.

If the Government survives to implement a budget for 2003-4, we can expect to see continued neglect of important areas of public services and full use of every budget trick available to the government, all put to the service of the Conservatives' ideological fixation with tax cuts.

These are important issues, deserving of public debate and discussion in a serious public forum. The fact that the Premier is avoiding that debate by making the so-called budget a private PC Party campaign event may change the venue, and it will certainly taint whatever message is delivered, but it will not make the underlying issues go away. And ultimately, it will fail in its attempt to control the debate over those issues.

Endnotes

1 In these projections, the assumption is made that Ontario will draw the funds down at the rate suggested in the Federal Budget (2:2:1 over the next three fiscal years). As noted below, however, the terms under which the funding is made available permit provinces to draw the funding down either more quickly or more slowly, as they see fit.

2 Expenditures for 2002-3 are drawn from the most recent figures reported in Ontario Finances (2nd Quarter 2002-3). The figure for elementary and secondary education spending represents the portion funded from the Provincial Consolidated Revenue Fund. It does not include revenue from the provincial property tax for education, which is transmitted directly from municipalities to school boards. In allocating the entire increase in school board funding required to phase in the Rozanski recommendations to the Consolidated Revenue Fund, we are implicitly assuming that the provincial property tax will remain the same and the share of education funded from property taxes will be reduced as a result. One consequence of this assumption is that the percentage increase in provincial spending shown in this table is substantially higher than the overall percentage increase in funding for school boards. The percentage increase in funding for school boards is approximately 8.5%.

3 Sources: Ontario Budgets, 10-year reviews, various years.

4 Recent piece-by-piece announcements by the Government provide for $300 million in new funding for 2003-4. However, until the total is made available, it is impossible to determine whether or not this funding meets the targets implied by Rozanski's recommendations. The amounts announced to date make up about 25% of that target for 2003-4. See "Adding Rozanski", Hugh Mackenzie, Canadian Centre for Policy Alternatives, January 2003.

5 Source : Provincial estimates and Finance Canada estimates, unpublished backgrounder to The Fiscal Balance in Canada: The Facts, October 2002, Department of Finance Canada.

6 As of September 2002, Ontario Finances reported $1 billion in the general reserve, $832 million in the reserve for Management Board and $92 million in a capital reserve. Even allowing for the $500 million in announced elementary and secondary education funding, the impact of reinstating the private school tax credit and other smaller funding announcements, it would be reasonable to assume that at least $1 billion remains available at the end of fiscal year 2002-3.

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