



# Ontario Alternative Budget 2005 Technical Paper #2

## Budget outlook 2005: Avoiding the obvious

*By Hugh Mackenzie*

It's not often that a government declares in advance that its budget is going to contain nothing to address its most pressing fiscal problems, but that's exactly what happened in the week before Ontario's 2005 budget when the Premier and the Minister of Finance declared that there would be no revenue increases in the budget.

But in a very strange budget year, it's not surprising. It's hard to know where to begin.

In the 2004 Budget, the Government projected a deficit for 2004-5 of \$2.2 billion. But it turned out, on closer inspection, that the \$2.2 billion was achieved with the help of an accounting entry of \$3.9 billion related to electricity restructuring, and that the real underlying deficit was \$6.1 billion.

For much of the fall of 2004, the official line from the Government was that its fiscal options were severely limited because out of control health expenditures were eating up the provincial budget. While that's actually not true, it did serve the Government well in the lead-up to its negotiations with the Ontario Medical Association, and it became the government's mantra in its responses to advocates for increased spending in other areas.<sup>1</sup>

Then the Premier suddenly discovered that Ontario is being short-changed by the Federal Government to the tune of \$23 billion a year, and launched his well-publicized crusade. The fact that gap about which Ontario has a legiti-

mate claim isn't anything like \$23 billion still hasn't slowed him down, although it won't have any impact on next year's budget, no matter what happens.<sup>2</sup>

In March, the Minister of Finance announced that he actually wasn't going to count the accounting entry as revenue for 2004-5, and that the deficit was actually going to be more than \$6 billion in 2004-5. That put him in the awkward position of having to say, accurately, that the deficit never was \$2.2 billion in the first place, and that therefore the increase in the forecast to \$6 billion plus wasn't really a problem. Which is pretty close to saying that I was misleading you last May, but now I'm not.

However you cut it, Ontario looks as if it is in a pretty big fiscal hole. And according to the government's leaders, increasing the province's own-source revenue is not on the table as a potential solution.

That's too bad, because increasing revenue is both the obvious and the only solution to the government's fiscal problems. And the government's efforts over the past few months to attribute its fiscal problems to health spending and/or the province's bad deal from the Federal Government amount to an attempt to deflect public attention away from the obvious – this province isn't generating enough revenue from its own sources to pay for the public services we need.

## What lies behind Ontario's fiscal problems?

In his campaign for “fiscal justice” from the Federal Government, Dalton McGuinty has invited comparisons between Ontario and other provinces. He is constantly citing the fact that Ontario's spending is below the national average in key public policy areas like postsecondary education and health, and even with that low spending, Ontario is struggling with a massive deficit.

But what about the revenue side of the equation?

According to Statistics Canada, Ontario's own-source revenue per capita (i.e. excluding Federal Government transfers) is tied with PEI's as the lowest in the country. In 2004, Ontario's revenue per capita was \$5,614. The national average excluding Ontario was \$6,897. Ontario's own source revenue would be 23% higher if it matched the average per capita of the other provinces.

The same conclusion emerges with even more force if you look at own source revenue relative to GDP. Ontario's own-source revenue is 13.4% of its GDP. That ratio puts it in a virtual tie with Alberta for the lowest own source revenue in Canada relative to provincial GDP. If Ontario's revenue matched the GDP ratio of the other provinces – 17.4% — its revenue would be nearly 30% higher.

The fiscal implications are dramatic. If Ontario had been at the average of own source revenue per capita in the other provinces, it would have generated an additional \$15.9 billion a year in revenue in 2004. More than enough revenue to eliminate the deficit. More than enough revenue to pay for the Government's ambitious election spending platform.

If Ontario were to raise revenue from its own sources at the same share of GDP as the other

provinces, it would generate \$20.5 billion in additional revenue.<sup>3</sup>

If Ontario were raising revenue from its own sources at the same rate as other provinces, and there were still a fiscal problem in this province, Ontario might have something to complain about in its financial relationships with the Federal Government. But the numbers say Ontario's gap between service needs and revenue is its own problem to solve.

## It's the tax cuts, stupid

Where did the revenue gap come from? Again, there isn't any mystery here. The tax cuts introduced by the Harris and Eves governments between 1996 and 2003 would have reduced Ontario's revenue potential by \$15.5 billion in 2004-5, had some of those cuts not been cancelled. Even after some of the cuts were cancelled, and some of the missing revenue recovered through the McGuinty Government's so-called Health Premium, Ontario is still dealing with the loss of more than \$12.2 billion a year in revenue as the lingering legacy from the Conservatives' eight years in power.

The tax cuts explain Ontario's fiscal problems. They also explain why health care costs appear to be increasing as a share of provincial revenue. Health care costs are increasing as a share of actual provincial revenue. But if you add the cost of the tax cuts back into Ontario's revenue base, the numbers look completely different. Health care costs would actually be declining as a share of provincial revenue, without the tax cuts.

We know what the problem is. We know why we have it. And yet the McGuinty Government continues to ignore the obvious, trying to deflect our attention everywhere but to the real problem, and focusing on everything but the real solution.

## Where does that leave us for this budget?

Having refused steadfastly to confront reality, the Minister of Finance has no alternative but to resort to illusion. He has taken the stage. He has shown his audience that there is nothing in his hat. Now he has to wave his magic wand, and pull out a rabbit.

In the world of illusion, Minister Sorbara has some things to work with. First, in its most recent fiscal projections, the government was still counting against revenue nearly \$2 billion in reserves that had barely been touched in the first nine months of 2004-5. That will provide some flexibility for 2004-5.

Second, the government's continuing overestimate of its public debt interest costs will provide an additional cushion, both in 2004-5 and in the remaining years of its mandate.

Third, the four-year projections tabled by the Minister of Finance in May 2004 and revised in his November fiscal update assume a decline in transfer payments from the Federal Government in areas other than health – an assumption that, based on the current state of federal-provincial fiscal relations, is patently unreasonable.

Finally, just to make things interesting for provincial budget watchers, we are in for yet another accounting change. Effective for the new fiscal year, the budgets of Ontario's hospitals will be consolidated into the provincial

budget. While that will have no real impact, it will have the effect of making the coming year's numbers look different, and it will increase the number of moving parts the Minister has to work with in putting together his budget story.

These four factors add up to a considerable degree of flexibility in the hands of the Minister as he puts together his budget for 2005-6 and his projections to the end of the government's mandate.

What we can be sure of is that he will present budget projections that meet the government's official political targets. What we don't know is how he will cobble together the numbers to do it.

We'll all have to wait until he waves his magic wand on May 11, 2005.

*Hugh Mackenzie is Co-Chair of the Ontario Alternative Budget Working Group and a CCPA Research Associate.*

## Endnotes

- <sup>1</sup> See Ontario Alternative Budget 2005 "The Real Fiscal Imbalance", CCPA April 2005 pp. 6-7 for a discussion of health spending increases relative to GDP and revenue.
- <sup>2</sup> See Mackenzie, Hugh "Dalton McGuinty's Fiscal Problems", CCPA April 2005 for a deconstruction of Dalton McGuinty's \$23 billion fiscal imbalance claim.
- <sup>3</sup> Data sources: Statistics Canada, CANSIM tables 384-0002 (GDP); 385-0001 (Revenue) and 051-0001 (population).



Canadian Centre for Policy Alternatives  
410-75 Albert Street, Ottawa, ON K1P 5E7  
tel: 613-563-1341 fax: 613-233-1458  
email: [ccpa@policyalternatives.ca](mailto:ccpa@policyalternatives.ca)  
<http://www.policyalternatives.ca>