



Ontario Alternative Budget, Technical Paper #1 2005, January 2005

HIGHLIGHTS

Contrary to the government's claims that it is struggling to meet its budget forecast for a \$2.1 billion deficit in 2004-5, Ontario is actually headed for a very modest deficit this year, and could easily run a surplus. An analysis of the Government's November 2004 Economic Statement reveals that:

- Revenue for 2004-5 has been underestimated by as much as \$1 billion.

Projecting revenue based on the consensus economic forecasts in the 2004 Economic Statement produces an estimate of revenue \$1 billion higher than the government's current public forecast. This change affects both the current year and the remaining three years of the projection period.

- Anticipated expenditures for the remainder of 2004-5 have been overstated by including as expenditures the full amount of the contingency and reserve funds established at budget time (over \$2 billion) despite the fact that the total draw-down of those funds in the first six months of the year was only \$24 million.
- Debt servicing costs have been overestimated, both in 2004-5 and in the full 4-year projection – by as much as \$500 million in 2004-5, rising to more than \$2 billion by the end of the 4-year projection period.

November Statement projections imply increasing average debt servicing costs, despite the fact that current government borrowing rates are below the current average debt servicing cost, and despite the fact that a substantial amount of debt is due to be refinanced at lower interest rates over the next four years. The Government's projection implies an increase in average debt servicing costs from 6.6% to 6.9% by 2007-8; the OAB alternative calculation shows average debt servicing costs declining from 6.6% to 5.6% over the same period.

- Transfers from the Federal Government have been understated in the last two years of the 4-year projection, by more than \$1.1 billion.

The Government's projection shows Federal Government transfers increasing by only \$1 billion from 2004-5 to 2007-8. Working backwards from the known schedule of health transfer increases agreed to by the First Ministers in September 2004, this implies a reduction in transfers for purposes other than health of \$1.3 billion in 2006-7 and \$1.1 billion in 2007-8. Making the conservative assumption that non-health transfers will remain fixed, this suggests that Ontario is understating potential Federal transfers by more than \$1 billion in the third and fourth years of the projection period.

- The budgetary reserve for years after 2004-5 has been increased by \$500 million, thereby disguising a \$500 million fiscal capacity increase after 2004-5.

Ontario traditionally maintains two types of reserves and contingency funds: an overall budgetary reserve of \$1 billion; and contingencies within the capital and operating budgets. In 2004-5, the government held \$965 million in contingency funds in its operating budget and \$150 million in its capital budget.

By increasing the overall budget contingency by \$500 million after the first year of its four-year projection, the Government is distorting comparisons over that period to the extent of \$500 million.

Taking these factors together, the Government's plan actually points to a cushion of more than \$4 billion a year by the 4th year.

The Government will clearly need this additional cushion to meet its services renewal commitments. By the end of 4-year projection in the November 2004 Financial Statement, Ontario's program and capital spending as a share of GDP will have dropped to 12.2% -- a level lower than all but one of the Harris-Eves years in government.

Even without increasing tax rates, the Government has the potential to raise substantial additional revenue – enough to enable it to meet its campaign commitments to rebuild public services, and more.

The introduction of the Health Premium in 2004 raises an additional \$2.4 billion a year – most of it from lower- and middle-income taxpayers. In this context, it is extremely difficult to justify maintaining the exemptions and other loopholes in the Employer Health Tax. Making the Employer Health Tax a flat tax on all payrolls in Ontario would generate additional revenue of \$1.1 billion a year.

Ontario's corporate income tax contains many tax loopholes, credits and exemptions that the Federal corporate income tax does not include. Some of these exemptions are substitutes for grants as economic incentives in areas like film and television production and publishing, and should be continued or increased, in one form or another. Others accomplish little, other than to reduce Ontario's fiscal capacity. Harmonizing Ontario's corporate income tax with the Federal corporate income tax – even after allowing for increases in film and television credits – would generate an additional \$800 million a year.

In addition, there is clearly potential for restoring some of the fiscal capacity lost during the Harris and Eves years. The Federal personal income tax includes a step-up in rates for incomes over \$100,000. Ontario's does not. Each increase in rates of 1% above the current top marginal rate for income over \$100,000 would generate \$600 million in increased fiscal capacity.

With respect to corporate taxes, Federal Government documents clearly show that corporate tax rates are now lower than the rates applicable in competing jurisdictions in the United States. This is a race that it does not make sense for Ontario to be winning. Re-setting Ontario's corporate tax rates at their 2000 level would generate an additional \$1.25 billion. Reverting to 2000 rates would result in an increase in the general corporate tax rate from 14% to 15.5%; the manufacturing and processing rate from 12% to 13.5%; and the small business rate from 5.5% to 8%.

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