Fedeli **Focus on Finance**

ONTARIO'S FALL ECONOMIC STATEMENT: NO PLAN TO BALANCE

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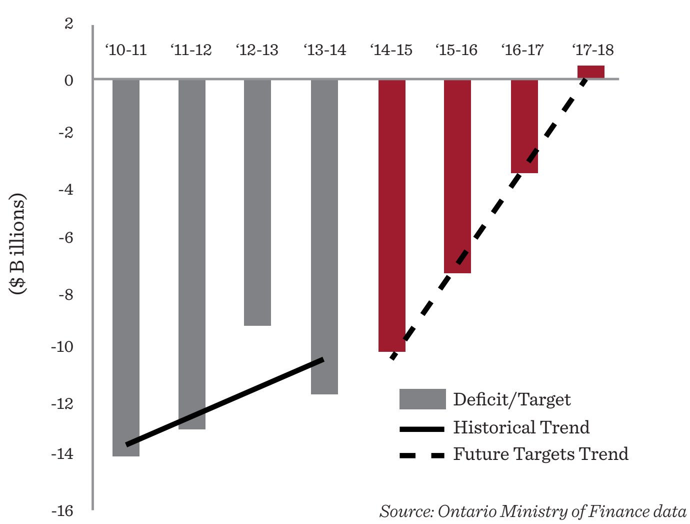
Last week's Fall Economic Statement, and the supporting comments by the Liberal government, went further than ever before in revealing the shift away from taking action to balance the budget that began when Kathleen Wynne replaced Dalton McGuinty as premier.

It is clearer than ever that the government has no plan to balance the budget, and for the first time, the government spoke openly about the possibility of not meeting even its own modest deficit reduction targets.

It's important to remember how we got here. When the government first faced deficits after the 2008 financial crisis, it announced a set of targets for returning to a balanced budget, taking a full ten years before planning to balance in 2017-18. It did not, however, announce any plan for how those targets would actually be met. Critics observed that the announced plan delayed serious restraint to close the fiscal gap until the last few years of the plan, but the government asked for trust.

Ontario Deficit Trends



Until 2012, the McGuinty government refused to recognize that serious changes in policy would be required to close Ontario's unprecedented fiscal hole. But after the 2011 election, the McGuinty government began to acknowledge that it wasn't going to make it to a balanced budget – ever – on the track it was following. Most importantly, the Drummond Report concluded that at current course and speed, rather than balancing, "the deficit would more than double to $30.2 billion in 2017–18 and net public debt would reach $411.4 billion, equivalent to just under 51 per cent of the province's GDP." (Drummond Report, page 2)

The Drummond Report laid out a series of recommendations, all of which had to be implemented (or alternatives found) in order to meet even the 2017-18 target to balance. The government rejected some of Drummond's recommendations out of hand and turned away from the toughest measures.

It did begin to experiment, very tentatively, with a few restraint measures it had previously insisted were unnecessary, mainly by passing a legislative freeze on teacher pay, and circulating a draft bill to enforce a broader public sector wage freeze. But it still refused to lay out a specific plan for how to balance, or to acknowledge what specific restraint measures would be required.

After Kathleen Wynne replaced Dalton McGuinty as premier in 2013, the government's brief flirtation with restraint ended. The 2013 budget proposed a deficit that actually represented an increase over the previous year's deficit, from $9.8 billion to $11.7 billion. The government dropped the draft wage freeze bill, made unilateral concessions to undo the legislated teacher wage freeze, and stopped even talking about a wage freeze policy (see *Fedeli Focus on Finance Volume 1: Number 1* for more detail). The years with deficit targets that required real restraint were getting ever closer, yet the government was moving to less restraint, not more.

Budget 2013 did not present a plan to balance

Based on the 2013 budget, the Ontario PC Caucus calculated what spending restraint the government's targets implicitly required. Working from the expenditure totals presented in the budget, the analysis showed that even if the government achieved aggressive restraint in health, education, social services and justice, it would still need to cut everything else by 30 per cent in order to realize its balanced-budget target of 2017.

These deep, across-the-board cuts would target ministries such as transportation, environment and municipal affairs and housing. We called this "the hole" in the government's fiscal plan, because there was never any explanation given for where these savings would be found. Each year as revenue projections are revised downward, the hole gets bigger and bigger if the government plans to balance the budget on schedule.

No Plan to Balance

	2012	2013	2014	2015	2016	2017
Total Revenue	**114.2**	**116.8**	**120.5**	**124.9**	**130.1**	**134.4**
Expense						
Health	47.8	48.9	49.8	50.8	N/A	N/A
Education	22.4	24.1	24.6	24.8	N/A	N/A
Post Secondary and Training	7.4	7.7	7.8	7.8	N/A	N/A
Children's and Social Services	13.8	14.3	15.0	15.2	N/A	N/A
Justice	4.0	4.1	4.1	4.1	N/A	N/A
Other	18.3	17.8	17.0	16.1	N/A	N/A
Total Programs	113.6	117.0	118.3	118.8	118.8	118.0
Interest on Debt	10.4	10.6	11.1	12.2	13.4	14.5
Total Expense	124.0	127.6	129.5	131.0	132.1	132.4
Reserve	-	1.0	1.2	1.2	1.5	1.5
Surplus/(Deficit)	**(9.8)**	**(11.7)**	**(10.1)**	**(7.2)**	**(3.5)**	**0.5**

Sources: 2013 Ontario Budget Pages 109 and 209

2013 Fall Economic Statement

Since real restraint would have to start within the next two years, the Fall Economic Statement was an opportunity to finally lay out the measures that would actually be required to achieve the more aggressive spending restraint needed for the last four years of the balanced budget targets. Instead, the government announced no new restraint measures at all, and hid the implications of this for the deficit outlook.

> *Ontario's revenues are more than $5-billion lower than projected since the 2010 Budget.*
>
> *-Ontario Finance Minister, November 7, 2013*

THE FOUR MAIN TAKEAWAYS FROM THE GOVERNMENT'S 2013 FALL ECONOMIC STATEMENT ARE:

1. **The economic assumptions upon which the province's finances are based have gotten significantly worse – particularly for 2013 and 2014.**
2. **The government plans to embark on a massive, second-round of debt-financed stimulus spending.**
3. **Despite the weaker economy, the government insists that revenue for this year will be virtually exactly the same as projected in the budget.**
4. **The government refused to provide the 3-year spending and revenue outlook traditionally included in the Fall Economic Statement, to hide the impact of a weaker economy and planned spending after March 2014.**

The table below outlines the changes in economic assumptions since the budget. Note that what matters to government revenue is nominal growth in the economy. This means you must take into account both the 0.2 percent drop in real GDP growth and the 0.4 percent drop in the Consumer Price Index.

Also note that economic growth for next year has been revised downward, which explains why this year's Fall Economic Statement differs from previous years in that it does not contain a Medium-Term Outlook. Primarily, this implies the government does not want to restate the projections for next year, where the government is expecting a further reduction in revenue and increase in spending.

TABLE 2.6 Changes in Ministry of Finance Key Economic Forecast Assumptions: ***2013 Budget Compared to 2013 Fall Economic Statement (FES)***

(Per Cent Increase)

	2013p		2014p		2015p	
	2013 Budget	2013 FES	2013 Budget	2013 FES	2013 Budget	2013 FES
Real Gross Domestic Product	1.5	1.3	2.3	2.1	2.4	2.5
Nominal Gross Domestic Product	3.0	2.5	4.1	3.8	4.2	4.3
Retail Sales	2.5	1.9	3.8	3.8	3.8	3.8
Housing Starts (000s)	61.0	59.0	60.0	58.0	65.0	65.0
Primary Household Income	2.8	2.9	3.9	3.6	4.2	4.4
Compensation of Employees	2.8	2.9	3.7	3.7	4.3	4.2
Net Operating Surplus - Corporations	3.3	(3.6)	5.0	4.6	4.0	4.2
Employment	1.2	1.5	1.4	1.4	1.5	1.6
Job Creation (000s)	83	104	98	97	107	114
Consumer Price Index	1.5	1.1	2.0	1.8	2.0	2.0
Key External Variables						
U.S. Real Gross Domestic Product	2.1	1.6	2.7	2.6	3.1	2.9
WTI Crude Oil ($ US per Barrel)	94	99	98	98	99	96
Canadian Dollar (Cents US)	98.0	97.4	99.5	96.5	100.0	97.0
3-month Treasury Bill Rate[1] (Per Cent)	1.0	1.0	1.2	1.1	1.9	1.9
10-year Government Bond Rate[1] (Per Cent)	2.0	2.3	2.6	3.0	3.2	3.3

p = Ontario Ministry of Finance planning projection.

[1] Government of Canada interest rates.

Sources: Statistics Canada, Canada Mortgage and Housing Corporation, Bank of Canada, U.S. Energy Information Administration, U.S. Bureau of Economic Analysis, Blue Chip Economic Indicators (October 2013) *and Ontario Ministry of Finance.*

And yet despite the slowdown in the economy, almost none of these changes affect the government's revenue projections. Consider the accuracy required to come within 0.0094 percent of your original revenue projection, when personal income taxes are expected to be $700-million lower, sales taxes $250-million lower and health premiums $70-million lower. The Federal government's Fall Economic Update showed the same slowing economy, and therefore showed $1.3 billion lower revenue than projected in its budget. If Ontario's revenue declined the same percentage as federal revenue, the deficit would have increased from $11.7 billion to $12.3 billion.

TABLE 3.1 2013-14 In-Year Fiscal Performance

($ Millions)

	Budget Plan	Current Outlook	In-Year Change
Revenue	**116,845**	**116,834**	**(11)**
Expense			
Programs	116,983	116, 970	(13)
Interest on Debt	10,605	10,605	-
Total Expense	**127,588**	**127,575**	**(13)**
Reserve	1,000	1,000	-
Surplus (Deficit)	**(11,743)**	**(11,741)**	**2**

Note: Numbers may not add due to rounding.

In fact, the in-year change for the 2013 deficit projection from the budget plan to the current outlook is a mere $2 million ($11.743 billion compared to $11.741 billion). Similarly, consider the accuracy required to come within 0.02% of this year's budget deficit projection, despite being off by billions of dollars when the auditor general reviews the actual results. The government has a demonstrated pattern of over-estimating its deficit projections in the budget, slightly revising those figures 6 months later and then "outperforming" their targets by 20-40 percent in the end.

Comparison of Original Budget Projections, Fall Economic Statements and Public Accounts Actuals

($ Millions)

	Original Projection	Fall Economic Statement	Actual	Difference btwn Original & FES	Difference btwn Original & Actual
2009	14,100	24,716	19,262	75.29%	36.6%
2010	19,690	18,656	14,011	-5.25%	-28.8%
2011	16,316	15,994	12,969	-1.97%	-20.5%
2012	15,153	14,371	9,220	-5.16%	-39.2%
2013	11,743	11,741	???	-0.02%	???

Source: Ontario Ministry of Finance, annual budgets, public accounts and fall economic statements, 2009 to 2013

No balanced budget plan

The most glaring omission from this year's Fall Economic Statement was the Medium-Term Outlook. That is a conspicuous change from normal practice, given that these projections are usually contained in this document.

2011 FALL ECONOMIC STATEMENT

TABLE 6. Medium-Term Fiscal Plan and Outlook
($ Billions)

	Actual	Projected Outlook		
	2010–11[1]	2011–12	2012–13	2013–14
Revenue	**106.7**	**108.3**	**111.3**	**116.3**
Expense				
Programs	111.2	114.0	114.9	117.0
Interest on Debt[2]	9.5	10.1	10.6	11.7
Total Expense	**120.7**	**124.1**	**125.5**	**128.7**
Reserve	–	0.2	1.0	1.0
Surplus/(Deficit)	**(14.0)**	**(16.0)**	**(15.2)**	**(13.3)**
Net Debt	214.5	238.4	261.8	281.8
Accumulated Deficit	144.6	160.6	175.7	189.1

2012 FALL ECONOMIC STATEMENT

TABLE 3.6 Medium-Term Fiscal Plan and Outlook
($ Billions)

	Actual	Projected Outlook		
	2011–12	2012–13	2013–14	2014–15
Revenue	**109.8**	**113.0**	**116.6**	**121.6**
Expense				
Programs	112.7	115.8	117.0	117.9
Interest on Debt[1]	10.1	10.6	11.2	12.3
Total Expense	**122.7**	**126.4**	**128.2**	**130.3**
Reserve	–	1.0	1.2	1.5
Surplus/(Deficit)	**(13.0)**	**(14.4)**	**(12.8)**	**(10.1)**

2013 FALL ECONOMIC STATEMENT

(NO MEDIUM-TERM FISCAL PLAN PRESENTED)

The Fall Economic Statement was also the first acknowledgement, albeit implicit, that the Liberal fiscal plan isn't working. In his address to the Legislature, Minister Sousa made it clear his government's priority is to continue to spend.

> *However, should global economic conditions falter, causing revenue growth to fall further, our priority is clear – this government will continue to protect investments in jobs and families* ***ahead of short-term targets.***
>
> *-Ontario Fall Economic Statement 2013*

The government is saying they are going to continue to spend, when in fact the implication of their own budget targets – as shown earlier – is that they have to reduce spending growth across the board, and make 30% cuts in smaller ministries.

THEN:

> *"Ministries should be given seven-year spending targets regardless of the degree of overall spending restraint."*
>
> *-Drummond Report, page 95*

NOW:

> *"In the fall update, the government reiterated its commitment to return to budgetary surplus in fiscal 2017-18, but did not include a fleshed-out fiscal plan to get there."*
>
> *-TD Economics, November 7, 2013*

WHAT OTHERS ARE SAYING:

"As we have indicated in past budget commentaries, the task of taming expenditures will not get any easier in the years ahead." - RBC Economics, November 7, 2013

"In the wake of the financial crisis, the state of California has been something of a poster child for fiscal dysfunction, with years of budget deficits, service cuts and public-sector job losses. By some measures, though, the Canadian province of Ontario's fiscal situation is worse than California's, according to Moody's Investors Service." - The Wall Street Journal, November 6, 2013

Conclusion

The current government has said the economy will be worse. It has acknowledged it might not meet its targets due to continued stimulus spending. And then, suspiciously, it has refused to provide the standard information showing what the planning assumptions are for revenue and spending beyond the current year. Our conclusion is that the government is hiding the truth, because these figures would demonstrate the province is not on track to balancing the budget by 2017-18.

Key Questions

What is the effect of the slowing economy on the government's current revenue, spending and debt projections for the next 3 years?

Why did the government deviate from the normal practice of including this information in the Fall Economic Statement?

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