Ontario: 2019–20 Budget

BALANCING THE BOOKS ON THE BACK OF SPENDING RESTRAINT

- **The Ontario PC administration's maiden budget (*Budget*) outlines a return to balance by fiscal year 2023–24 (FY24). The FY19 deficit was reduced further to $11.7 bn[1] from the previous estimate of $13.5 bn.**
- **As expected, the plan relies on expenditure restraint and targets modest annual declines in debt levels. Borrowing requirements were revised higher in FY19 to $39.6 bn, and are forecast to ease each year thereafter.**
- **Key policy developments included the introduction of a tax credit for childcare expenses and further details of provincial accelerated depreciation measures to stimulate business investment.**
- ***Budget* provides a reasonable path to balance. The pace of consolidation is unlikely to undermine Ontario's economic expansion, and a declining debt path should engender some market confidence.**

The Ontario PC administration's maiden budget outlines a return to balance by fiscal year 2023–24 (FY24). The FY19 deficit was reduced further to $11.7 bn (from a forecast of $13.5 bn in the November 2018 *Fall Economic Statement* (FES). A fiscal shortfall of $10.3 bn was outlined for FY20, with a gradual erosion of red ink thereafter expected to culminate in a surplus of $300 mn in FY24 (chart 1, p.2). The Government's conservative approach with respect to growth and revenue estimates, along with a $1 bn forecast reserve, provides a comfortable buffer.

The plan targets a modestly declining debt path. A net debt-to-GDP ratio of 40.2% is now anticipated for FY19—lower than the 40.8% rate outlined as of the first quarter—with an increase to 40.7% in both FY20 and FY21 expected to give way to a gradual reduction to 38.6% by FY24 (chart 2, p.2). *Budget* forecasts an accumulated deficit-to-GDP rate at 40.6% by FY22. It also proposes a new *Fiscal Sustainability, Transparency and Accountability Act* (FSTAA) that would introduce reporting requirements on the debt reduction strategy and symbolic sanctions against missed reporting deadlines. This anchor, while modest, should engender some market confidence, while also balancing the need for flexibility to adapt to evolving economic conditions.

The modest/conservative and even pace of consolidation—at an average of about one-third of a percent of nominal GDP—should not undermine growth. The economy continues to perform solidly. In fact, we estimate 2019 GDP growth in the order of 1¾ % versus the government's forecast of 1.4%, before settling around potential thereafter. Low unemployment, strong job creation, and high population growth should help offset the impact of consolidation; furthermore, a number of growth-enhancing measures should provide a partial near-term offset. At this mature stage of the economic cycle, it is appropriate to put emphasis on rebuilding fiscal buffers against future downside shocks.

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Updated Fiscal Forecast
$ millions except where noted

	FY19	FY20	FY21	FY22
Personal Income Tax	35.0	36.6	38.2	39
Corporations Tax	15.2	15.2	15.7	16.3
Harmonized Sales Tax	27.9	28.1	28.9	29.9
Ontario Health Premium	3.8	4.0	4.2	4.4
Other Taxes	21.7	22.2	22.8	22.3
Tax Revenue	**103.6**	**106.1**	**110**	**111.9**
Gov't Business Ent. Income	4.9	5.8	6.2	6.9
Other Non-Tax Revenue	17.4	16.8	17.2	17.6
Total Own-Source Rev.	**125.9**	**128.7**	**133.2**	**136.4**
Federal Transfers	25.0	25.5	26.6	27.2
Total Revenue	**150.8**	**154.2**	**159.8**	**163.7**
Health	62.2	63.5	64.6	65.3
K-12 Education	29.1	29.8	29.8	30.1
Post-Secondary Education	12.1	11.4	11.5	11.7
Social Services	17.0	16.7	16.5	16
Other Program Spending	29.6	28.8	29.5	30.7
Total Program Spending	**150.0**	**150.1**	**151.9**	**153.8**
Debt Service	12.5	13.3	13.7	14.4
Total Expenditure	**162.5**	**163.4**	**165.6**	**168.2**
Reserve	1.0	1.0	1.0	1.0
Surplus (Deficit)	**(12.7)**	**(10.3)**	**(6.8)**	**(5.6)**
Net Debt	**343.4**	**359.5**	**372**	**382.4**
Long-Term Borrowing	**39.6**	**36.0**	**32.8**	**31.5**
Annual Change, %				
Personal Income Tax	*6.4*	*4.6*	*4.4*	*2.1*
Corporations Tax	*-2.6*	*0.0*	*3.3*	*3.8*
Tax Revenue	*3.9*	*2.4*	*3.5*	*1.9*
Total Own-Source Rev.	***0.1***	***2.2***	***3.5***	***2.4***
Federal Transfers	*0.6*	*2.0*	*4.3*	*2.3*
Total Revenue	***0.1***	***2.3***	***3.6***	***2.4***
Health	*5.5*	*2.2*	*1.7*	*1.1*
K-12 Education	*0.5*	*2.4*	*0.0*	*1.0*
Post-Secondary Education	*8.9*	*-6.1*	*1.1*	*1.7*
Social Services	*2.0*	*-2.2*	*-1.0*	*-3.0*
Other Program Spending	*11.0*	*-2.8*	*2.6*	*4.1*
Total Program Spending	*5.4*	*0.1*	*1.2*	*1.3*
Total Expenditure	***5.3***	***0.6***	***1.3***	***1.6***
Memo Items, %				
Own-Source Rev./ GDP	14.8	14.8	14.7	
Program Spending/ GDP	17.7	17.3	16.8	
Budget Balance / GDP	-1.5	-1.2	-0.8	
Net Debt/GDP	**40.4**	**41.4**	**41.2**	
Debt Service/ Revenue	8.3	8.6	8.6	

Sources: Ontario Finance; Statistics Canada; nominal GDP forecasts: Scotiabank Economics.

[1] Figures reported in Canadian dollars unless otherwise stated.

The fiscal plan rests on significant expenditure restraint. Assumptions are ambitious: balancing the books by FY24 will require average program spending increases of just 1% per annum, well below the government's forecast 2% annual CPI inflation over that time. Newly announced initiatives, particularly in health and education, mask effective real cuts across the board with health, education, children's and social services, and justice spending to decline in real terms by 0.4%, 0.8%, 4.1%, and 4%, respectively, via streamlining and efficiency measures. Such spending restraint has not been attained in Ontario since FY96–99, when program spending fell by 0.3% per year amid a period of austerity (chart 3). Ontario already has among the lowest programing spending (as a percentage of GDP), while strong population growth will put pressure on spending levels.

Growth-enhancing measures will be integral to achieving a balanced budget over the medium term. *Budget* provides some steps in this direction including enhanced funding for public transit, capital cost allowances for business mirroring federal incentives, a cut in payroll taxes (through reduced Workplace Safety and Insurance Board premiums), and modest initiatives to connect workers to jobs. It also provides more generous childcare tax credits targeting low and middle-income households that should enhance female labour force participation.

Other big ticket 'savings' for business, including keeping the minimum wage at $14 per hour and canceling the cap-and-trade carbon tax, will not likely translate into material improvements. Red tape reduction initiatives continue to feature prominently but the impact on real activity is less clear. Meanwhile, the government intends to launch targeted consultations with a view to reforming industrial electricity pricing—an important constraint to Ontario business, but a lofty goal.

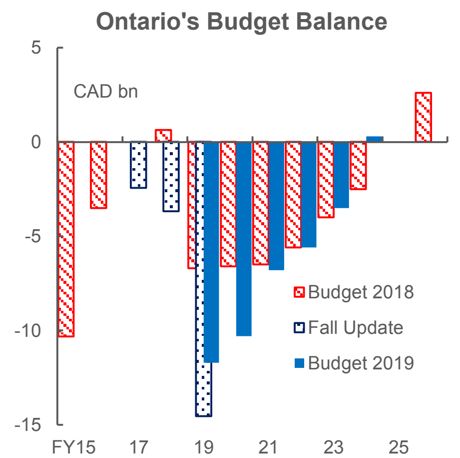
Ultimately, the proof is in the pudding. *Budget* provides a reasonable, yet ambitious path to balance. One year into its mandate, the Government has demonstrated early progress in tackling the deficit with reductions in the order of $3.3 bn in FY19. A significant portion of savings that underpin the path to balance involves streamlining or efficiencies yet to be defined. Greater transparency in the debt reduction strategy and its assumptions should help ensure that any future windfall from conservative growth and revenue assumptions are not substituted for expenditure constraint.

BUDGET HIGHLIGHTS

The new Ontario Childcare Access and Relief from Expenses (CARE) tax credit will supplement the existing Child Care Expense Deduction. As of January 1st, 2019, CARE offer families relief on childcare expenses of up to $6,000, $3,750 and $8,250 for children under 7 years old, children aged seven to 16 years old, and severely disabled children, respectively. The credit offers a deduction rate of 75% for family incomes of $10,000 per year or less, which is gradually reduced to a full phase-out for incomes over $150,000 per annum. Foregone revenues vis-à-vis the credit are expected to total $390 mn in each full fiscal year. The move will be complemented by funding of $1 bn to be directed towards the creation of 30,000 child care spaces over the next six years.

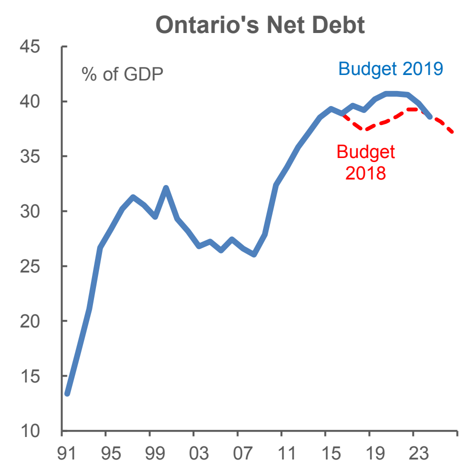
As announced yesterday, the Province will contribute $11.2 bn towards the estimated $28.5 bn cost associated with four large transit projects in the

Chart 1



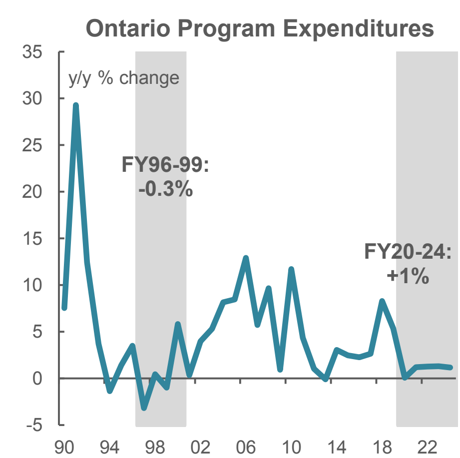
Sources: Scotiabank Economics, Ontario Finance.

Chart 2



Sources: Scotiabank Economics, Ontario Finance.

Chart 3



Sources: Scotiabank Economics, Finance Canada, Ontario Finance.

Greater Toronto Area (GTA)—more than twice the $5 bn initially committed. It noted further funding for subways in the GTA under various streams of the Federal Government`s infrastructure plan.

With respect to improving business competitiveness, the key measure was the new *Ontario Job Creation Investment Incentive*. The *Incentive* parallels measures implemented at the federal level in November 2018 that allow firms to accelerate the pace at which they depreciate capital outlays; Ontario had already earmarked funds for this purpose as of the FES. Over the next six years, it is expected to provide a combined $3.8 bn in corporate tax relief, with a peak in FY20 at $1.1 bn. Deduction rate changes and timelines are exactly the same as the federal measure. The Province estimates that the measure will lower Ontario's marginal effective tax rate (METR) from 16% in 2018 to 12.6% in 2019, and incite $7–10 bn in new business investment.

***Budget* outlined a number of other plans in respect of support for business competitiveness.** The Government affirmed its commitments to reduce red tape by 25% by 2020, maintain corporate income tax deductions for small- and medium-sized enterprises, and cut the general corporate income tax rate for small businesses by 8.7%. The Province anticipates that the former initiative will generate savings on compliance costs of $400 mn on an ongoing basis. It also reaffirmed its opposition to the federal carbon pricing plan and support for reducing provincial trade barriers. Ontario will re-orient its immigrant admissions criteria to support smaller communities and attract technology sector workers.

Ontario's Economic Assumptions
annual % change except where noted

Scotiabank Economics, March 7, 2019	18	19f	20f
Canada—Real GDP	1.8	1.5	2.0
U.S.—Real GDP	2.9	2.4	1.8
Ontario—Real GDP	1.9	1.6	1.7
Nominal GDP	3.0	2.1	4.0
Employment	1.6	1.3	0.7
Housing Starts,000s	79	75	72
T-bills,3-mos,%*	1.4	1.8	2.2
Cda Bonds,10-yr,%*	2.1	2.0	2.4
Cdn Dollar, US¢*	78.0	76.5	80.5
WTI Oil,US$/bbl*	65	58	62
Ontario Finance	**18**	**19f**	**20f**
U.S.—Real GDP	2.9	2.5	1.8
Ontario—Real GDP	2.2	1.4	1.6
Nominal GDP	3.4	3.4	3.4
Employment	1.6	1.3	1.0
Housing Starts,000s	79	73	72
T-bills,3-mos, %*	1.4	1.8	2.2
Cda Bonds,10-yr, %*	2.3	2.1	2.6
Cdn Dollar, US¢*	77.2	76.0	77.3
WTI Oil,US$/bbl*	65	58	61

* Annual averages. Sources: Ontario Finance, Statistics Canada, Scotiabank Economics.

The Government will allot $40 mn over the next three years to bolster the competitiveness of the key Ontario auto sector. That funding will emphasize items such as programs to support the adoption of new technologies, export diversification, and training for unemployed and at-risk workers.

The Government reiterated its commitment to the roll-out of a *Housing Supply Action Plan*, announced in the November 2018 Fall Economic Statement with the objective of improving housing affordability vis-à-vis construction of more homes. Consultations have concluded and legislation on the *Plan* is still expected by spring 2019.

Borrowing requirements for FY19 were estimated at $39.6 bn—higher than the $33.3 bn as of the Province's third quarter update—and are expected to ease over the course of the planning horizon as the deficit narrows. The bulk of the FY19 increase is attributable to a rise in cash and cash equivalents, and requirements are thereafter projected to decline to $31.5 bn by FY22. The Province continues to search for efficiencies in its borrowing program. On this front, it noted that it had stopped sales of Ontario Savings Bonds due to low sales and elevated administrative costs, as well as its intent to diversify its investor base away from the current high concentration of Canadian dollar-denominated debt.