

2010 Ontario Budget

Summary: The worst economic recession since the early 1990s necessarily means larger deficits and higher debt levels even if government does not engage in stimulus measures. When countercyclical measures are taken during the recession deficits and debt are larger still, but what matters is that the deficit and debt plan does not leave a structural deficit legacy. The 2010 Ontario Budget sets out a plan to eliminate the deficit and reduce debt in eight years.

A shorter time horizon than eight years is the primary focus for most and in the near term, the 2010/11 plan bottom-line target looks achievable especially considering the \$2.7 billion set aside for contingencies and a reserve. The 2011/12 plan has a smaller buffer and a \$3 billion spending cut as its main feature. There is a risk of a revenue shortfall in 2011/12 since the economic outlook is more uncertain. All of these projections will be updated in the Fall Economic Statement to be released in October.

Fiscal Plan: The provincial government budget deficit is projected at \$21.3 billion in the current fiscal year, declining to \$19.7 billion in fiscal 2010/11, \$17.3 billion in 2011/12, and to \$15.9 billion in the following year. In the extended outlook, the deficit is eliminated in 2017/18. Net provincial debt rises each year until 2016/17. A reserve of \$0.7 billion is set aside in 2010/11 for unforeseen events affecting revenue or expenses. This is set a \$1.0 billion per year thereafter.

Medium Term Fiscal Plan and Outlook, (\$ Billions)

	Interim	Plan	Outlook	
	2009/10	2010/11	2011/12	2012/13
Revenue	96.4	106.9	107.7	112.0
Expense				
Programs	108.8	115.9	112.9	114.3
Interest on Debt	8.9	10.0	11.1	12.5
Total Expense	117.7	125.9	124.1	126.9
Reserve	–	0.7	1.0	1.0
Surplus/(Deficit)	-21.3	-19.7	-17.3	-15.9
Net Debt	193.2	220.0	245.0	267.8
Accumulated Deficit	134.6	154.3	171.6	187.5

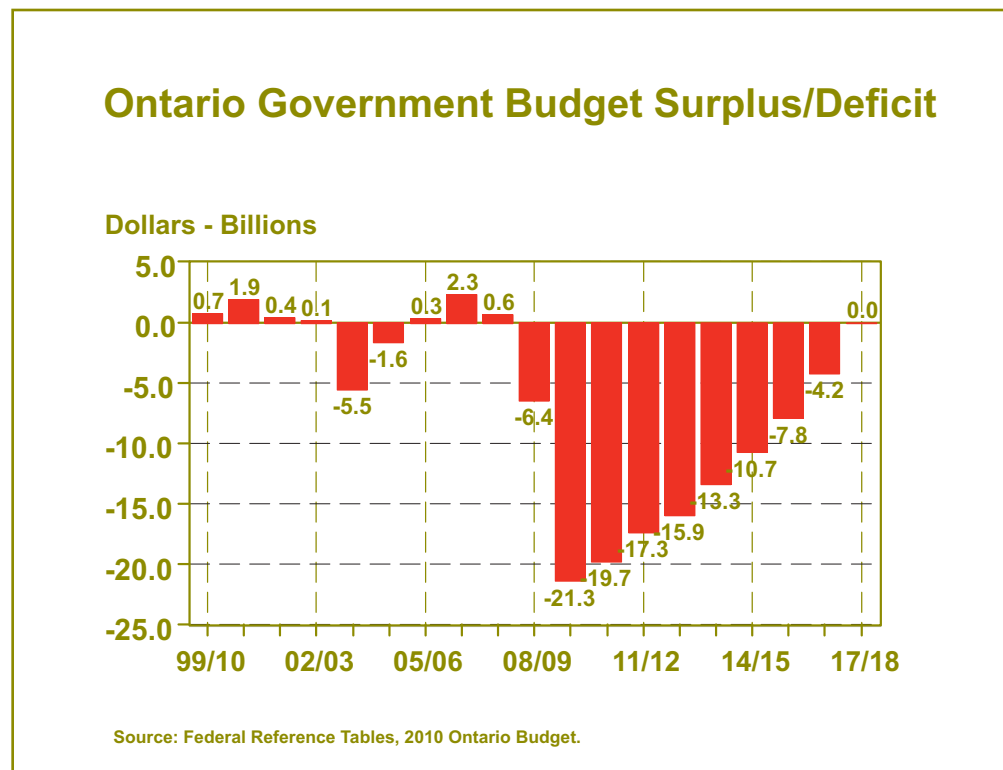
Source: 2010 Ontario Budget Papers



Ontario's Fiscal Recovery Plan, (\$ Billions)								
	Plan	Medium-Term Outlook		Extended Outlook				
	10-11	11-12	12-13	13-14	14-15	15-16	16-17	17-18
Revenue	106.9	107.7	112.0	117.6	123.4	129.6	136.1	142.9
Expense								
Programs	115.9	112.9	114.3	116.5	118.7	121.0	123.3	125.7
Interest on Debt	10.0	11.1	12.5	13.3	14.4	15.4	15.9	16.2
Total Expense	125.9	124.1	126.9	129.9	133.2	136.5	139.3	141.9
Reserve	0.7	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Surplus/ (Deficit)	-19.7	-17.3	-15.9	-13.3	-10.7	-7.8	-4.2	0.0

Source: 2010 Ontario Budget Papers

Analysis: The lower deficit in 2010/11 hinges largely on a near 11% increase in revenue while in 2011/12 a decline in program spending is the critical assumption behind the lower deficit in that fiscal year. More on revenue and spending comes in following sections.



Economic Forecast: The budget forecast incorporates a moderate growth profile through to 2013 with slightly stronger growth in 2011 than in 2010. Real GDP growth forecasts are equal to the private-sector average in 2011 to 2013 and slightly lower in 2010. Job growth in 2010 is 1.1% with no change in the unemployment rate.

Higher interest rates are expected along with a slightly higher exchange rate at 98 US cents while oil prices edge higher to about \$US 88 in 2013.

Ontario Economy 2008 to 2013						
	Actual		Projection			
	2008	2009	2010	2011	2012	2013
Real Gross Domestic Product	-0.5	(3.4e)	2.7	3.2	3.2	3.0
Personal Consumption	2.6	0.3e	2.2	2.5	3.0	2.7
Residential Construction	-2.3	(8.0e)	4.0	3.3	4.0	2.2
Non-residential Construction	-6.3	(10.7e)	1.3	6.2	7.1	7.4
Machinery and Equipment	1.3	(16.7e)	4.7	8.1	7.9	7.1
Exports	-6.3	(14.5e)	5.0	4.4	4.5	4.5
Imports	-2.8	(14.4e)	6.7	4.4	3.7	3.8
Nominal Gross Domestic Product	0.4	(3.5e)	4.4	5.0	5.3	5.0
Other Economic Indicators						
Retail Sales	3.5	-2.5	3.9	4.6	4.7	4.6
Housing Starts (000s)	75.1	50.4	58.0	60.0	70.0	72.0
Personal Income	3.8	(0.4e)	3.3	4.3	4.8	5.0
Labour Income	4.2	(0.9e)	2.7	4.6	5.2	5.4
Corporate Profits	-14.5	(38.8e)	31.0	10.5	9.0	5.5
Consumer Price Index	2.3	0.4	1.9	2.1	2.0	2.0
Labour Market						
Employment	1.4	-2.4	1.1	2.1	2.3	2.0
Job Creation (000s)	94	-161	73	139	155	138
Unemployment Rate (Per Cent)	6.5	9.0	9.1	8.5	7.6	6.8
Key External Variables						
Crude Oil (\$ US per Barrel)	99.6	61.8	82.1	85.7	86.9	87.9
U.S. Real Gross Domestic Product	0.4	-2.4	3.1	3.0	3.4	3.2
Canadian Dollar (Cents US)	93.7	87.6	96.0	97.5	98.0	98.0
3-month Treasury Bill Rate	2.3	0.3	0.6	2.2	3.5	4.3
10-year Government Bond Rate	3.6	3.3	3.7	4.2	4.8	5.1

Source: 2010 Ontario Budget Papers. Per cent change except where indicated. e = estimate () negative

Analysis: The main focus of an economic forecast in a government budget is nominal GDP rather than real or inflation-adjusted GDP, however the private-sector forecast for nominal GDP is not available. The 2010 Budget's forecasts of nominal GDP growth are somewhat different than Central 1's beginning with a 3.5% contraction in 2009 compared to 3.9% in Central 1's forecast. In 2010, the budget uses 4.4% growth while it is 3.6% in our forecast and in 2011 it is 5.0% versus 4.3%, respectively. The source of difference in 2009 and 2010 is price inflation while in 2011 the difference is in real GDP growth which is forecast at 3.2% in the budget compared to 2.3% in our forecast. Real GDP growth in 2011 is lower in Central's forecast due to a higher Canadian dollar which results in lower export growth than the budget's forecast.

While it is rather imprecise to use a single number to project total government revenue, the difference in nominal GDP growth in 2010 and 2011 amounts to about 1.5% which could translate to about \$800 million less revenue than projected using the budget's sensitivities metric.

The personal and labour income forecasts for 2010 and 2011 are higher than Central 1 forecasts and the difference likely revolves around compensation levels or average wages/salaries and possibly hours worked. The difference in labour income growth is considerable especially in 2011 and could result in about \$1 billion less personal income tax revenue should Central's forecast be closer to actual. Labour income contracted 1.0% in 2009 and the budget projects 2.7% and 4.6% growth in 2010 and 2011, respectively. Exiting the early 1990s recession, labour income growth was modest until 1997.

The corporate profit 2010 growth forecast of 31% compares to 21% in Central's forecast and is high relative to forecasts for Canada as a whole. According to the sensitivities table, this difference could mean about \$500 million less in corporation tax revenue in 2010.

Revenue: Total revenue jumps 10.9% in 2010/11 compared to a small decline in 2009/10, which came on the heels of a 6.4% drop in 2008/09 when the recession first hit. The single largest contributor to the revenue gain in 2010/11 is federal cash transfers which rise 27.4% or \$5.1 billion and comprise almost one-half of the total projected increase of \$10.5 billion. The own revenue sources contributing to 2010 revenue are corporations tax up 37% or \$2.0 billion, personal income tax up 7.9% or \$1.9 billion, and sales tax up 9.8% or \$1.7 billion.

In 2011/12, total revenue increases less than 1% largely on less federal transfers as infrastructure stimulus spending winds down and remaining smaller portion of the HST transition payment is absorbed. Taxation revenue increases 4.6% or \$3.3 billion led by a 6.3% increase in sales taxes is the first full year of the HST.

Medium-Term Revenue Outlook, (\$ Billions)				
Revenue	Interim	Plan	Outlook	
	2009/10	2010/11	2011/12	2012/13
Taxation Revenue	65.8	71.6	74.9	79.3
Personal Income Tax	24.0	25.9	26.7	28.3
Sales Tax	17.4	19.1	20.3	21.4
Corporations Tax	5.4	7.4	8.0	9.4
Education Property Tax	5.7	5.3	5.3	5.2
Ontario Health Premium	2.7	2.9	3.0	3.2
All Other Taxes	10.5	10.9	11.6	11.9
Government of Canada	18.6	23.7	21.5	21.1
Income from GBEs	4.1	4.2	4.4	4.6
Other Non-Tax Revenue	8.0	7.4	7.0	7.0
Total Revenue	96.4	106.9	107.7	112.0

Source: 2010 Ontario Budget Papers. GBE – Government Business Enterprises

Analysis: The risk to the 2010/11 and 2011/12 revenue forecasts are mainly in taxation revenue should corporate profits and labour income underperforms relative to budget expectations. There is less risk to the sales tax revenue projection. The 2012/13 personal income tax revenue growth forecast is also on the high side, relative to Central's forecasts for labour income, though corporate profits are below.

Tax Measures: Though announced in *Ontario Budget 2009*, the major tax change is the introduction of the Harmonized Sales Tax (HST) on July 1, 2010, replacing the Retail Sales Tax (RST) and combining it with the federal Goods and Services Tax (GST). Other tax measures such as reductions in personal and corporate income tax rates were introduced in the 2009 budget.

The Ontario Property Tax Credit is converted to the Ontario Energy and Property Tax Credit effective in the 2010 tax year providing about \$500 million annually in tax relief.

2010 Budget introduces a Northern Ontario Energy Credit to help offset higher energy costs. Northern residents who are household maintainers are for an annual income-tested credit of up to \$130 for a single person and up to \$200 for a family.

A three-year Northern Industrial Electricity Rate Program provides electricity price rebates of two cents per kilowatt-hour to qualifying large northern industrial facilities that commit to an electricity efficiency and sustainability plan.

Spending: Total spending rises 6.9% or \$8.1 billion in 2010/11 and follows a 13.9% jump in the previous fiscal year when the recession first hit and included a one-time auto sector support of \$4.0 billion. *2010 Budget* includes a \$1.8 billion operating contingency fund and a capital contingency fund of \$0.2 billion for 2010/11. No contingency funds are present in the remaining years of the fiscal plan.

The 2010/11 expense budget includes a projected year-end savings of \$1.2 billion reflecting anticipated under-spending due to factors such as program efficiencies and changes in project startups and implementation plans.

Health care is the largest single expenditure and grows 6.0% or \$2.6 billion in the coming fiscal year and slows to 4.1% or \$1.9 billion in 2011/12. Postsecondary and training spending receives a capital projects stimulus injection and a \$310 million increase in operating grants for a total gain of 12.8% or almost \$1 billion.

Interest on the public debt grows at a double-digit pace to 2012/13 reaching a projected \$12.5 billion due to higher interest rates and a larger debt.

Program spending is kept to 2010/11 levels or below in the medium term as part of the government's expenditure management plan. Spending in 2011/12 declines slightly due to a 24.1% or \$5.3 billion drop in other programs and a return to pre-stimulus spending in the postsecondary budget line.

To control spending, the government is extending the salary freeze of Members of Provincial Parliament as well as a freeze for non-bargaining political and Legislative Assembly staff. More significantly, a freeze on compensation in the public sector for all non-bargained employees will come into effect. It is estimated these measures will save up to \$750 million in two years. Also, the fiscal plan provides no funding for incremental compensation increases for any future collective agreements.

Medium-Term Expense Outlook, (\$ Billions)				
	Interim 2009/10	Plan 2010/11	Outlook	
			2011/12	2012/13
Programs				
Health Sector	43.5	46.1	48.0	49.5
Education Sector	20.6	21.4	22.3	23.0
Postsecondary and Training Sector	7.2	8.1	7.1	7.0
Children's and Social Services Sector	13.1	13.9	14.2	14.7
Justice Sector	3.9	4.4	4.6	4.7
Other Programs	20.5	22.0	16.7	15.5
Total Programs	108.8	115.9	112.9	114.3
Interest on Debt	8.9	10.0	11.1	12.5
Total Expense	117.7	125.9	124.1	126.0
Source: 2010 Ontario Budget Papers				

Analysis: The \$2 billion contingency funds in 2010/11 provide a reasonable buffer against unforeseen developments and weaker economic conditions leaving the spending target achievable. However in 2011/12, there is no contingency fund amid a more uncertain economic outlook since a possible U.S. economic slowdown cannot be ruled out. The range or dispersion in private sector forecasts typically increases with the forecast time horizon.

Reductions in program spending are rare on the historical record and in 2011/12 it hinges mainly on the other program expenses line to deliver the target. This budget line includes those year-end savings and various one-time spending on infrastructure, tax harmonization, contingencies, and other non-core spending typically with little wage or salary implications. A reduction in 2011/12 will almost certainly occur but the *2010 Budget* does not outline details beyond 2010/11.

Since nominal or current dollar program spending is not increasing in 2011/12 and 2012/13, spending in real or inflation adjusted dollars is down in both years. When further adjusted for population growth, real per capita program spending is down by about 3% per year, which has a dampening effect on economic growth. Since government spending at all levels is under similar pressures, it is likely the G component in the macro equation is a weak or negative contributor to growth in 2011 and 2012.

Capital Spending: Government spending on infrastructure climbs 28.7% to \$16.3 billion in 2010-11 of which \$13.2 billion is funded by the province. Transportation receives the largest portion as does transfers to municipalities and universities under the short-term stimulus investment budget line.

2010/11 Infrastructure Expenditures				
Sector	Total Infrastructure Expenditures 2009–10 Interim	2010/11 Plan		
		Investment in Capital Assets	Transfers and other Infrastructure Expenditures	Total Infrastructure Expenditures
Transportation	4,509	4,438	472	4,909
Health	2,605	2,376	153	2,529
Education	1,960	1,803	98	1,901
Water/Environment	505	41	306	348
Municipal and Local Infrastructure	464	34	493	527
Justice	271	641	29	670
Other	760	697	384	1,082
Short-Term Stimulus Investments	1,627	697	3,679	4,376
Subtotal	12,702	10,728	5,614	16,342
Less: Other Partner funding	514	464	–	464
Total Excluding Partner Funding	12,188	10,264	5,614	15,878
Less: Flow-Throughs	1,120	487	2,179	2,666
Total Provincial Expenditures	11,068	9,776	3,435	13,212

Source: 2010 Ontario Budget Papers

Analysis: Budgeted spending is at a high water mark in 2010/11 and declines thereafter though the 2010 Budget does not provide capital spending projections beyond that year. The economic recovery is presumed to take a firm hold after 2010 diminishing the need for further government stimulus.

Provincial Debt: Total debt, which represents all borrowing without offsetting financial assets, is projected to be \$212.4 billion at the end of 2009/10, compared to \$176.9 billion in 2008/09. Total debt rises each year on the medium term outlook to \$289.3 billion in 2012/13.

Net debt is the difference between total liabilities and total financial assets. The broader public sector's (BPS) net debt is now included in the Province's net debt. BPS organizations include hospitals, school boards and colleges. Net debt is projected to be \$193.2 billion at 2009/10 and includes BPS net debt of \$11.6 billion. At the end of 2008/09, net debt was \$165.9 billion, including \$10.6 billion related to the BPS. In 2012/13, net debt rises to \$267.8 billion.

The net debt-to-GDP ratio increases in tandem with the projected deficits and reach a peak in 2014/15 according to the extended outlook.

Medium-Term Outlook Net Debt and Accumulated Deficit, (\$ Billions)				
	Interim	Plan		
	2009/10	2010/11	2011/12	2012/13
Total Debt	212.4	238.4	265.1	289.3
Cash and Temporary Investments	-17.5	-13.8	-13.8	-13.8
Total Debt Net of Cash and Temporary Investments	194.9	224.6	251.3	275.6
Other Net (Assets)/Liabilities	-13.2	-15.5	-17.6	-19.2
Broader Public Sector (BPS) Net Debt	11.6	10.9	11.4	11.4
Net Debt	193.2	220.0	245.0	267.8
Non-Financial Assets	-58.7	-65.7	-73.5	-80.3
Accumulated Deficit	134.6	154.3	171.6	187.5
Net Debt as a per cent of GDP	34.1	37.2	39.4	40.9
Accumulated Deficit as a per cent of GDP	23.7	26.1	27.6	28.6

Source: 2010 Ontario Budget Papers

Analysis: Higher debt levels during and following an economic recession is a normal cyclical occurrence and not necessarily a sign of a structural deficit, though the distinction between the two can be blurred at times. Since Ontario's economy was hard hit by the recession, revenues declined and expenditures increased resulting in the largest deficit in years, though smaller than in the early 1990s. Net debt levels relative to the size of the economy are climbing after declining to the mid-20% range in 2007/08. Bond rating agencies downgraded Ontario's bonds last October and likely will maintain though rating following this budget.

Non-Tax Measures:

Financial Services: Establish a Financial Services Leadership Council consisting of major financial-sector CEOs and government leaders to guide the work of the Toronto Financial Services Alliance (TFSA) with the goal of improving the sector's competitiveness.

In conjunction with the federal government and others put in place a Canadian Securities Regulator located in Toronto.

Along with the credit union sector, Deposit Insurance Corporation of Ontario and Financial Services Commission of Ontario address emerging issues and support the sector's growth and competitiveness.