Ontario Budget 2018
March 29, 2018

Deficits by choice

Overview
In his budget address, Minister Sousa approvingly quoted Joe Biden who said “show me your budget, and I’ll tell you what you value”. He might have added “and what you don’t”. Ontario’s 2018 budget may value many things, but fiscal discipline is not high on the list. After 10 years chasing a balanced budget and doubling the province’s net debt, the government has laid out a plan for six more years of deficits as it prepares to face the voters this summer. True to its title, A Plan for Care and Opportunity, Budget 2018 finds new money for care of all sorts, from health care, to mental health, to senior care to childcare. The bill for all this new spending totals $20 billion over the next three years and will saddle the province with a rising burden of debt as a share of the economy through 2021-22.

Revenues
Over the first three years of the 8-year fiscal plan, Budget 2018 projects total revenues to grow at an average rate of 3.0%, somewhat below its growth rate over the past five years. The government can thank a growing economy for some of this bounty. After a strong 2017, Ontario’s economy is forecast to continue to grow but at a more moderate rate. Compared with Budget 2017 however, the budget identifies a number of factors which together are subtracting over $1 billion per year from forecasted revenues including a weakened housing market, increased economic uncertainty, and a smaller than expected personal income tax base. This means that last year’s balanced fiscal plan was at risk even before the addition of massive spending initiatives. It also means more cash is needed to fund the budget’s ambitious goals and the government is making up some of the distance with a host of tax measures. A reworked Provincial Income Tax replaces the existing surtax with a new set of tax brackets which hike taxes modestly at the upper end of the income distribution and are expected to raise $0.3 billion per year. The government also hopes to boost revenues by expanding the number of firms paying the Employer Health Tax, closing a number of ‘tax loopholes’, and by selling out of carbon allowances. While the general trend in taxation is upwards, small businesses got some relief through a cut in their tax rate earlier this year and the government is also rolling out a number of tax credits related to innovation. In all, the measures in Budget 2018 will amount to $0.8 billion per year of new revenue by 2020-21.

Expenses
The key driver of Ontario’s renewed deficit is a 6.1% jump in program expenditures budgeted for 2018-19. This follows an outsized 5.8% increase in 2017-18. Over the next three years, expenses are scheduled to rise by 4.3% per year on average. This money is pouring into a wide range of new initiatives. Over the next three years the budget lays out $4.3 billion for health, mental health and addiction services, including the expansion of OHIP+ for seniors and coverage for prescription drugs and dental costs. Budget 2018 also includes support for people with disabilities ($1.8 billion), independent living for seniors ($0.7 billion), and in what may be the budget’s flagship program, affordable childcare ($2.2 billion). Spending on the last point is concentrated in 2020-21 (the last year for which de-
tails are offered) as the government implements free pre-school for children starting at age 2½ until kindergarten. Worryingly the budget gives no indication of this programs’ cost, or how it will be paid for, beyond 2020-21. These initiatives, plus many others, are budgeted to cost $20.3 billion over three years.

**Budget Balance**
The upshot of the government’s vast new spending program with only limited new revenues is the return of deficits. Revised estimates show a budget surplus of $0.6 billion in 2017-18 due almost entirely to the removal of a reserve for that year that went unneeded. Starting in 2018-19 and inclusive of a $0.7 billion reserve, the province expects deficits of $6.7 billion, $6.6 billion and $6.5 billion over the next three years – what it calls the “medium-term plan”. These deficits represent between 0.7% and 0.8% of GDP and are roughly one-third as large as the deficits immediately following the financial crisis when measured in those terms. The province will make no real effort to close its deficit over this period. Reductions in the deficit begin in earnest in 2021-22 when the “recovery plan” kicks in with a gradual lessening of the shortfall until balance is achieved in 2024-25 to be followed by a $6.2 billion surplus in 2025-26. Under this fiscal plan, by 2024 Ontario will have had just one surplus – last year’s – in 16 years despite a thriving economy.

**Capital Spending**
The province intends to spend $182 billion over the next 10 years on infrastructure including $79 billion on public transit. In March, the province secured $8.3 billion in federal funding over 10 years to be allocated to municipalities for further infrastructure investments. The budget highlights spending for the GO network, various rapid transit projects in and around Toronto and Ottawa, and an initial investment of $11 billion for a high-speed rail link between Toronto and Windsor.

**Debt and debt service**
Ontario’s net debt is projected to be $308 billion on March 31, 2018, somewhat lower than forecast in last year’s budget. Going forward, that sum will rise rapidly to $360 billion by 2020-21. As a share of GDP, the province’s debt peaked in 2014-15 at 39.3% and is now 37.1%. Thanks to renewed deficit financing, the province’s net debt-to-GDP ratio will drift up to 38.9% in 2021-22 before beginning to decline once more in subsequent years. With this plan, the government is walking away from last year’s commitment to reducing the net debt-to-GDP ratio to 35% by 2023-24. Debt service costs are expected to climb steadily from $12 billion last year to nearly $17 billion by 2025-26. According to government calculations, a 1 percentage point rise in interest rates raises the cost of debt service by $0.3 billion per year.

Ontario’s 2017-18 borrowing program raised $33.9 billion a substantial portion of which was pre-borrowed for 2018-19. Thanks in part to renewed deficits and an ambitious capital investment plan the province’s borrowing plans are substantial and growing rapidly. The province is looking to raise $31.7 billion in 2018-19 followed by $36.7 billion in 2019-20 and a further $41.3 billion the year after. As in previous years, the province will borrow about two-thirds of its requirements in Canadian dollars.
**Our Take**

After a long road back to a balanced budget, Ontario is once again facing many years of deficits. Starting with a balanced budget in 2017-18 and an economy at cruising speed, a return to deficit is, as Minister Sousa admits, a matter of choice. The cumulative deficit over the coming three years totals $19.8 billion, approximately equal to the cost of the government’s newly announced initiatives ($20.3 billion) over the same period. While the government offers a ‘recovery plan’ showing a return to budget balance, there are no details on how they will achieve it. This is concerning since so much spending – especially on childcare – kicks in late in the fiscal plan. Without further efforts, six more years of deficits may be optimistic. What is worrying about this plan is not just its robust spending plans; it is the form those plans take. Most of the measures announced in Budget 2018, from health to childcare to enhanced income supports, are recurring entitlements. It makes the government’s choice fraught with risk: if Ontario is running large deficits when the economy is performing at capacity, what happens if a recession comes along? A pre-existing deficit and an elevated debt burden will limit the government’s ability to respond and virtually guarantee a rapidly deteriorating fiscal situation.

**Ontario’s fiscal plan**

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<tbody>
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<td><strong>Total revenues</strong></td>
<td>150.1</td>
<td>152.5</td>
<td>157.6</td>
<td>163.8</td>
<td>169.5</td>
<td>174.9</td>
<td>180.4</td>
<td>186.5</td>
<td>192.9</td>
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<tr>
<td><strong>Total expenditures</strong></td>
<td>149.5</td>
<td>158.5</td>
<td>163.5</td>
<td>169.6</td>
<td>174.4</td>
<td>178.2</td>
<td>182.2</td>
<td>185.8</td>
<td>189.6</td>
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<tr>
<td><strong>Program spending</strong></td>
<td>137.5</td>
<td>145.9</td>
<td>150.4</td>
<td>155.8</td>
<td>159.5</td>
<td>162.7</td>
<td>166.0</td>
<td>169.3</td>
<td>172.7</td>
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<td><strong>Interest on public debt</strong></td>
<td>12.0</td>
<td>12.5</td>
<td>13.1</td>
<td>13.8</td>
<td>14.9</td>
<td>15.5</td>
<td>16.3</td>
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<td>16.9</td>
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<td><strong>Reserve</strong></td>
<td>-</td>
<td>0.7</td>
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<td><strong>Surplus/(Deficit)</strong></td>
<td>0.6</td>
<td>(6.7)</td>
<td>(6.6)</td>
<td>(6.5)</td>
<td>(5.6)</td>
<td>(4.0)</td>
<td>(2.5)</td>
<td>0.0</td>
<td>2.6</td>
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Source: Ontario Ministry of Finance