Fiscal Policy and Tracking in a Post 2017 Budget Context

Office of the Budget
MINISTRY of FINANCE

TBS

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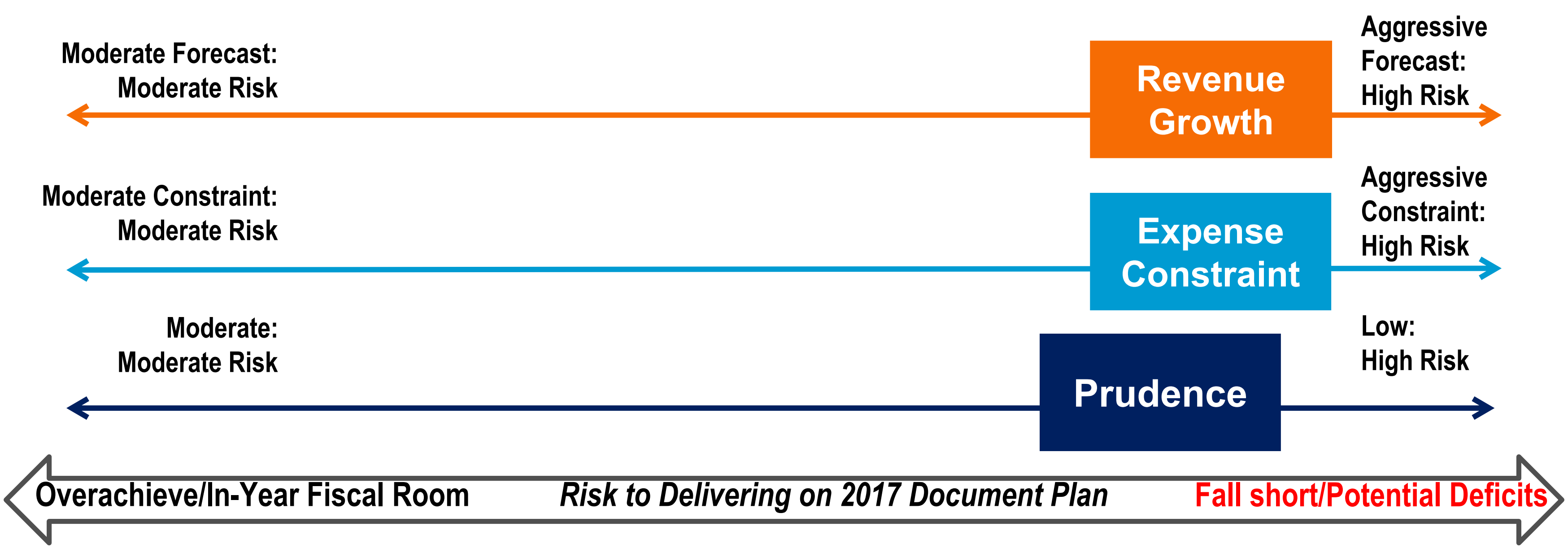
Purpose

- Provide a brief recap of the key variables that underpin the fiscal architecture of the 2017 Budget.
- Provide the overarching fiscal framework and objectives to guide fiscal tracking and decision making in 2017–18 and over the medium-term.
- Provide an overview of the strategies to help operationalize the achievement of fiscal targets through:
  - Progress on revenue generating strategies;
  - In-Year Expenditure Management;
  - Program reviews; and
  - Supporting transformation initiatives.

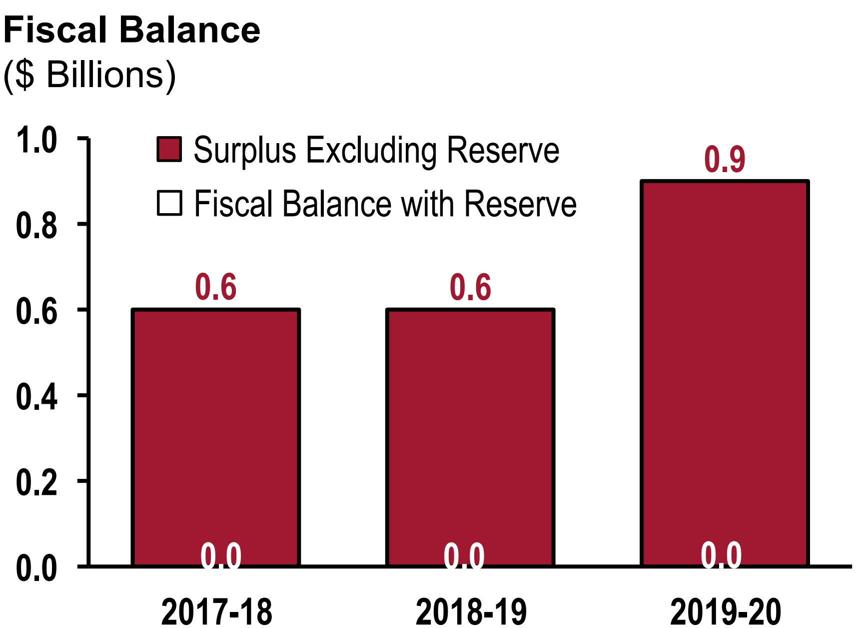
Current Fiscal Environment

- While the 2017 Budget delivers on a balanced budget, the underlying fiscal architecture and assumptions are strained, particularly in 2018-19 and 2019-20 – making the plan vulnerable to risk.
  - **The government is being scrutinized/questioned** on the reasonableness of revenue assumptions and robustness of expenditure management plans, and the application of accounting standards
  - **This risk is heightened in areas where potential impacts can be predicted**, but are not being reflected.
- It is also important to note that this fiscal architecture mix **runs the risk of not being able to adjust to adverse events post-Budget** – providing limited room for error, reduced flexibility for unforeseen (or known downside risks) and potential further investments.
- A robust **post-Budget implementation plan and in-year expenditure management strategy** is required.



Recapping the 2017 Budget Fiscal Architecture

2017 Budget Fiscal Targets



Net Debt-to-GDP			
	2017-18	2018-19	2019-20
Outlook	37.5%	37.3%	37.2%
Targets	• 35% in 2023-24 • 27% in 2029-30		

Historically low reserve of $0.6 billion in 2017–18 and 2018–19, $0.9 billion in 2019–20.

Key Revenue Assumptions (2017–18 to 2019–20)

- The forecast assumes **revenue growth continues at a stronger pace than would normally be forecast given the economic outlook** and removes prudence from the nominal GDP forecast as well as assumes a modest slowing of the housing market.
- Assumes **High-Yield Tax assumptions** of $1.3 billion in 2017–18, $1.8 billion in 2018–19, and $2.2 billion in 2019–20, and zero PIT tax planning.
- Includes **Revenue Integrity Targets** of $0.1 billion in 2017–18, $0.2 billion in 2018–19, and $0.4 billion in 2019–20.
- Assumes no year-over-year decline in **Equalization Payments in 2018-19 (flat-lined at $1.4 billion)**.
- Potential accounting impacts that amount to $0.5 billion in 2018–19 and 2019–20.

Key Expense Assumptions (2017–18 to 2019–20)

- **Net increase in program expense of $16.4 billion over three years** compared to the *2016 Budget* to invest in every sector and increase overall average spending growth from **1.9% to 2.9%** -- with a particular focus on **health and education.**
- However, overall program spending **remains constrained** – continues to decline as a share of GDP; overall growth slower than inflation+population.
- **Contingency Funds** at $0.6 billion in 2017–18; grows to $1.8 billion in 2019–20 (including set aside for MoFwd Outside the GTHA of $0.7 billion)
- **Year–end Savings** targets of $1.2 billion in 2017–18 and 2018–19, and $1.1 billion in 2019–20.
- **Program Review Savings** targets of $750 million in 2018–19 and 2019–20.
- Limited **Interest-on-Debt** prudence over the outlook.

Shifting Fiscal Policy for Balanced Budgets

Deficit Reduction Focus

Fiscal Targets:

- Declining year-over-year deficit
- In-year overachievement on deficit target

Revenue:

- Prudent in the face of recovering economy and unstable outlook
- Tax policy and other measures to strengthen growth

Expense:

- Constrained allocations supported by savings targets, compensation freezes, and ongoing transformation
- Limited and focused new investments

Prudence:

- Larger contingency and reserve to help overachieve on fiscal target, and fund future investments /compensation pressures

Balanced Budgets Focus

Fiscal Targets:

- No directionality; flat-lined around zero
- In-year underachievement potentially tolerable, but cannot be “structural” in nature
- Focus on net-debt-to-GDP targets

Revenue:

- Prudence is proportional to certainty of economic outlook and support for investments
- Policy and other measures to support growth, and to ensure integrity of base revenue

Expense:

- Allocations need to reflect cost and demand of current programs, while promoting modernization, transformation and a sustainable cost curve
- More room/ flexibility for new investment/ repurpose existing funding

Prudence:

- Contingency only there for unforeseen costs
- Reserve to be reduced proportional to forecast uncertainty, and/or create room for investment

Integrating Information Flow and Fiscal Strategy

- The Province's fiscal position – at any point in time – is dependent upon:
  - Information on key drivers of revenue and expense (e.g. economic indicators, spending cost drivers, etc.);
  - Year-to-date flows or assessments of revenue and expense; and
  - Government decisions that impact revenue and/or expense (e.g. TB and Cabinet approvals, federal-provincial agreements, etc.).
- Ensuring evidence-based fiscal decision-making to support the balance of often conflicting priorities is highly dependent on these fiscal information flows, and balancing the relative uncertainty about the implications of that information on expected year-end fiscal positioning to inform spending or other fiscal decisions.
- While government decisions can provide more certainty in terms of impacts on the fiscal plan, information on the revenue forecast generally only becomes most certain towards the end of the fiscal year (December/January). Similarly, while ministries may estimate significant risks early on in the fiscal year, they have tended to be managed down as the year unfolds.
  - As a result, while fiscal information is available on a regular basis, deciding what impact it has on the overall fiscal position of the Province will involve trade-offs and balancing of risk.
  - This is particularly important in the context of the current fiscal year – 2017-18 where ministry implementation and spending plans are already underway.

Potential Fiscal Building Blocks for 2017-18

- In order to balance the government's fiscal policy and other objectives for the upcoming fiscal year, there are a number of building blocks that can help provide a framework for fiscal planning moving forward.

Fiscal Policy Principle #1: Manage Down Risk

- Landing as close as possible to balanced budgets leaves little flexibility to deviate from the underlying fiscal architecture. As such, landing as close to balance as possible needs to be supported by both ***management strategies*** to avoid the risk of falling into deficit (i.e. in-year expenditure management, program review, and revenue integrity) as well as a strategic approach to address any potential upside.
- The approach to maintain balance in 2017–18 will differ from those in the out years.

2017–18 (plan year)

- Fiscal plan projects a surplus of $600 million should all revenue and expense assumptions hold.
  - A rigorous in-year management strategy is under development to help meet underlying fiscal assumptions. The Contingency Fund will not be available for new initiatives.
  - Similarly, the allocation of any potential surplus funds in-year will need to consider how those funds could be used (e.g., help address pressures or use in-year flexibility to pull-forward out-year commitments) and the ability to flow these funds in a timely manner.

Potential Fiscal Building Blocks for Out Years

2018–19 and beyond (out years)

- Projections for out years become more concrete as PRRT wraps up, additional revenue information is known, and planning commences for the 2018 Document process.
- Although managing the fiscal architecture for the out years remains more flexible as there is more time to plan for and make adjustments, the current assumptions built into the fiscal plan carry a significantly higher degree of risk.
    - An important component to help manage risk and ensure fiscal targets are achieved can be done through the setting of ministry preliminary allocations in the Fall 2017.
    - At that time, any potential surplus funds can also be set as fiscal room for 2018 Document initiatives; or alternatively, expenditure management strategies can be applied to help ensure targets are met.

Fiscal Policy Principle #2: Support Other Fiscal Anchors

- In addition to maintaining balance, the government has set an interim net debt-to-GDP ratio target of 35 per cent by 2023–24 and 27 per cent by 2029–30. Reporting and monitoring progress on this target will be required.

Potential Fiscal Building Blocks cont'd

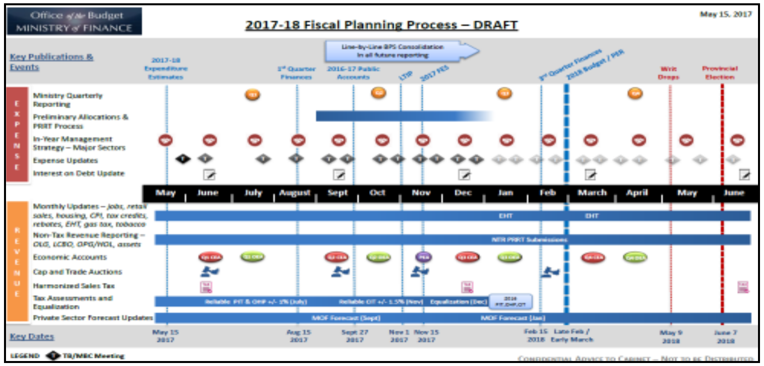
Fiscal Policy Principle #3: Transparent and Credible Fiscal Plan

- The Auditor General is expected to continue to criticize the government over its accounting treatment of net pension assets and potentially other issues, such as the electricity cost refinancing component of the Fair Hydro Plan.
- In addition, the 2018 Budget will also be a Pre-Election Report, which will be reviewed for reasonableness by the Auditor.
- The FAO is also expected to continue to scrutinize the province's plan to maintain balance, suggesting instead, that the province will remain in deficit over the outlook.
- Accounting changes will take effect in the 2016–17 Public Accounts, reflecting the revenues and expenses of BPS organizations on a line by line basis and in all public reporting thereafter. Though the change will be fiscally neutral, it will impact sector growth rates and any year-over-year comparisons will be to restated numbers.
    - For example, compared to what was published in the 2017 Budget, line by line restatements result in 0.9 percent increase in average annual growth in Postsecondary Education and Training (from 2.5 percent to 3.4 percent) which outpaces growth in the Health Sector (restated at 3.2 percent from 3.3 percent published in the 2017 Budget).

Tools to Guide Fiscal Policy Decision-Making

1. *Gantt Chart*

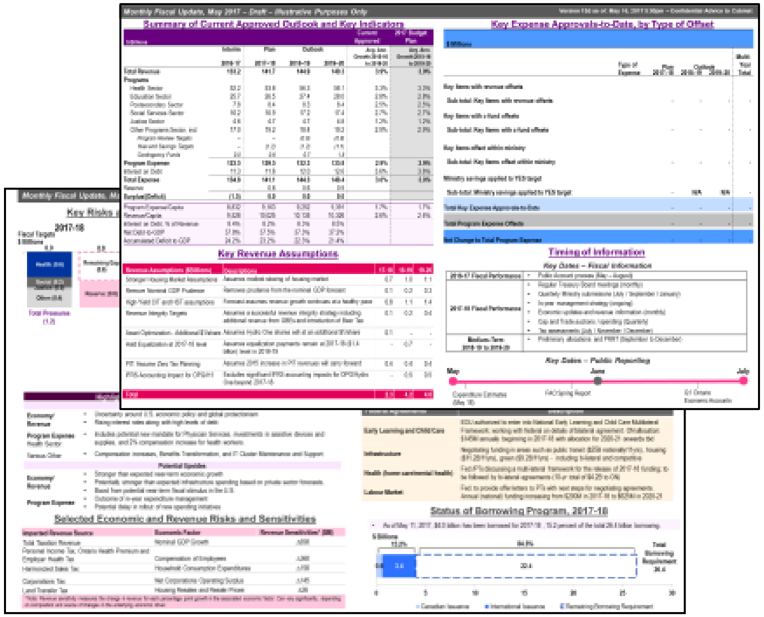
- Used to educate decision-makers about the key sources of fiscal information inputs, the timing of information flows, major milestones in reporting, and other key events that will be important from a fiscal planning perspective.



2. *Fiscal Monitor*

- Placemat will be used to prepare regular updates on the fiscal plan, including:

  a) Revenue Updates
  b) Key Expense Approvals
  c) Economic Indicators
  d) Status of Key Fiscal Targets
  e) Status of Capital Projects
  f) Status of Federal Agreements
  g) Status of Ontario's Borrowing Program
  h) Key Risks to the Fiscal Plan



Strategies to Support the Achievement of Fiscal Targets

1. Key **revenue generating strategies** and progress to date to achieve targets over the outlook.

2. A robust **in-year expenditure management** strategy to meet year-end savings targets in 2017-18.

3. A systematic and strategic **program review,** focussed on ministry programs/spending, to meet targets in 2018-19 and 2019-20, and to improve sustainability and enhance value-for-money.

4. Separate from the program review, support/initiate outcome-focused and user-centered program and sector **transformation initiatives** that capitalize on opportunities for innovation.

TO BE UPDATED

Key Revenue Strategies and Progress to Date

1. Revenue Integrity [Placeholder]
   - Enhance data analytics to address high-risk areas for underground economic activity; pilot a program to identify businesses using electronic sales suppression technology; and, launch a campaign to inform the public of the risks and liabilities of the underground economy.
   - Undertake a thorough policy and legislative review of all taxes, including those shared with the federal government, to eliminate loopholes.
   - Enhance partnerships with the Canada Revenue Agency through the creation of specialized audit teams. Enhance Ontario's ability to address underground economic activity through information sharing legislation and strengthened administration of existing laws.
2. Housing Market
   - [PLACEHOLDER for update on non-resident speculation tax]
   - [PLACEHOLDER for update on land transfer tax]
3. GBEs ??

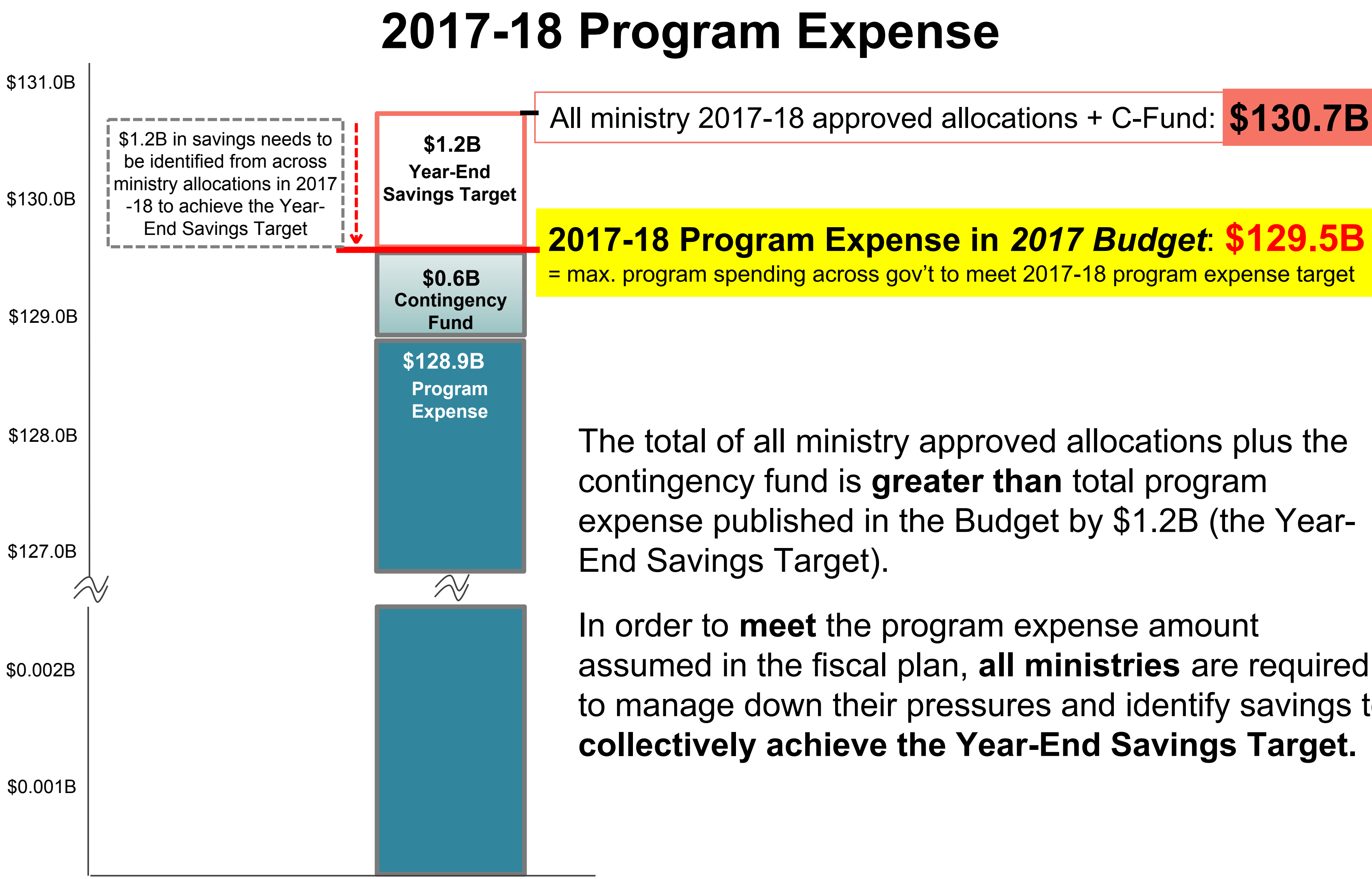
TO BE UPDATED

Key Revenue Strategies and Progress to Date

4. Hydro One Share Price Assumption
    - $130 million built into plan assuming H1 shares sell at an additional $1/share. Final tranche sold May 17 and the target was met.

5. Cap and Trade Program
    - On March 22, 2017, the province held its first auction of greenhouse gas allowances, generating $472 million in proceeds. The results of the first auction exceeded MOECC's forecast by over $114 million. Three more auctions are scheduled this year (next one is June 6) -- proceeds for 2017-18 are forecast to be $1.8 billion.

1. In-Year Expenditure Management Approach



The total of all ministry approved allocations plus the contingency fund is **greater than** total program expense published in the Budget by $1.2B (the Year-End Savings Target).

In order to **meet** the program expense amount assumed in the fiscal plan, **all ministries** are required to manage down their pressures and identify savings to **collectively achieve the Year-End Savings Target.**

1. In-Year Expenditure Management Approach

- **Improve forecasting** for large, demand driven programs/initiatives, e.g., health, education, social assistance, energy and advanced education and skills development:
  - Enhance understanding of the robustness of the methodologies used to develop forecasts; and
  - Expand engagement through more open dialogues with ministries to improve tracking of associated pressures and savings.
- **Track rate of implementation** of new initiatives more closely, including that of major infrastructure projects.
  - Ministries remain responsible for continued delivery of their commitments, including those outlined in their mandate letters.
- **Proactively identify** emerging program and policy **risks**.
- **Direct ministries to hold back a percentage (e.g., 5%) of internal discretionary spending** (e.g., salaries and wages, employee benefits, transfer payments and other direct operating expenses).

2. Program Review

- PRRT uses a multi-year approach to planning and allocating government resources, looking across government to find the best way to deliver services. It lays the groundwork for decision-making that uses evidence to inform choices and to improve outcomes.
- An **enhanced approach to a line-by-line review** of all government base programs will be integrated into the PRRT process.
- These will be scheduled over a defined period (4 years is proposed). More robust **data in ministry programs** will be gathered to provide a foundation.
- Reviews may identify opportunities for strategic or transformation initiatives.
- MOI is developing a plan to **transform the infrastructure planning process** over a three-year time frame, beginning in 2017-18. This includes:
    - Working with ministries to strengthen internal asset management planning processes;
    - Developing a cross sector prioritization framework to provide a systematic approach to capital decision-making, with the first phase of this informing the 2018-19 PRRT process; and
    - Releasing a Long-Term Infrastructure Plan by fall 2017.
- **Horizontal reviews of common functions (Functional Reviews")** undertaken to support the $750M savings targets in 2018-19 and 2019-20.

3. Transformation Initiatives

- Building off of the PRRT process, the proposed approach for the Transformation work stream will focus on longer-term improvements to achieving better program outcomes and benefits to citizens. The objectives are to:
  - Improve outcomes and user experience;
  - Improve efficiency and system effectiveness; and
  - Promote opportunities for innovation.

- It will not focus on the shorter-term cost saving objectives of the other two streams (in-year expenditure management and program review).

- It will harness resources to drive both large-scale sector changes and smaller scale initiatives (within and/or between ministries). This approach would:
  - Drive implementation on existing transformation
  - Promote use of new technology and service delivery models for larger-scale sector change
  - Refine existing programs through targeted evaluations
  - Use small-scale/low-cost interventions to improve effectiveness (e.g., Behavioural Insights)

- These will aim to accelerate current transformation initiatives to drive their implementation, and initiate new ones to address emerging opportunities.