Fiscal Policy and Tracking in a Post 2017 Budget Context

Office of the Budget
MINISTRY of FINANCE

TBS

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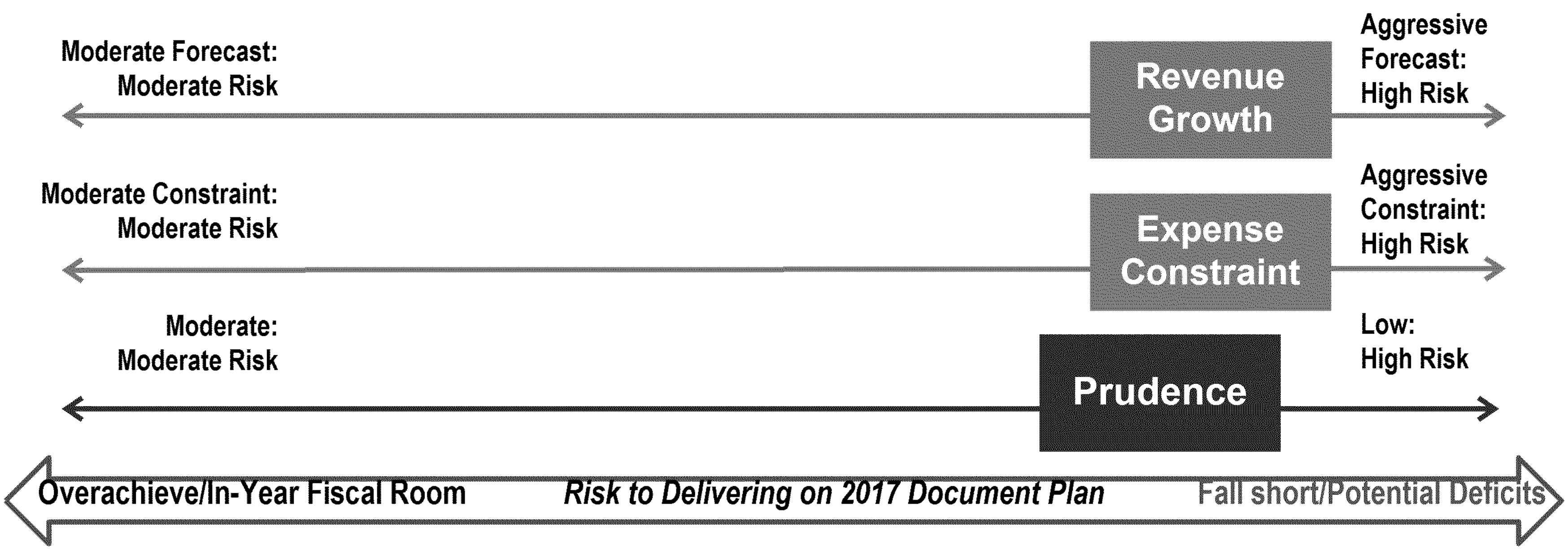
Purpose

- 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.

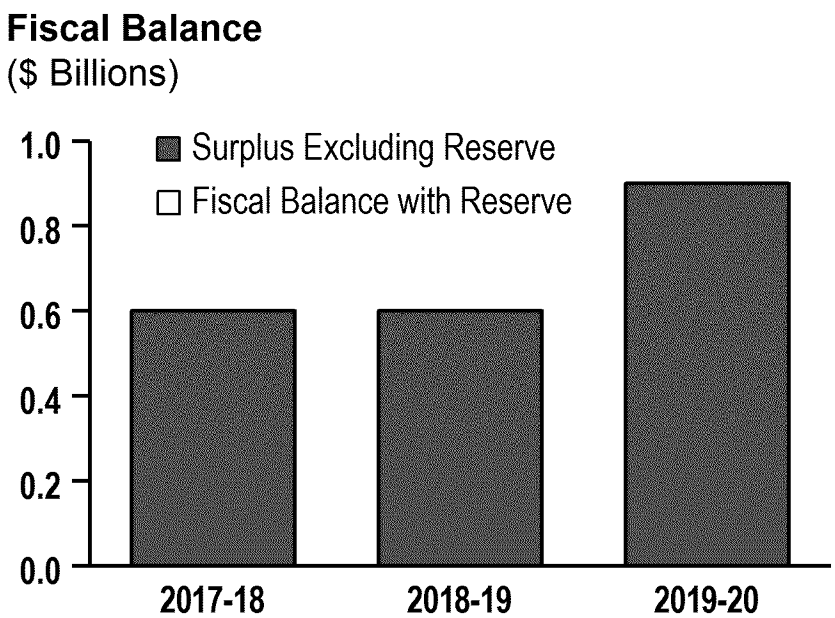
Current Fiscal Environment

- 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 management strategy** is required.



Recapping the 2017 Budget Fiscal Architecture

2017 Budget Fiscal Targets



Net Debt-to-GDP

	2016-17	2017-18	2018-19	2019-20
Outlook	37.8%	37.5%	37.3%	37.2%
Targets	▪35% in 2023-24 ▪27% in 2029-30			

- Ratio peaked in 2014-15 at 39.1%
- 1% change in the GDP would impact ratio by ~0.5 percentage points.

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	Balanced Budgets Focus
Fiscal Targets: ▪ Declining year-over-year deficit ▪ In-year overachievement on deficit target	**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: ▪ Prudent in the face of recovering economy and unstable outlook ▪ Tax policy and other measures to strengthen growth	**Revenue**: ▪ Reduced prudence in recognition of a strengthening economic outlook and to support investments ▪ Policy and other measures to support growth, and to ensure integrity of base revenue
Expense: ▪ Constrained allocations supported by savings targets, compensation freezes, and ongoing transformation ▪ Limited and focused new investments	**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: ▪ Larger contingency and reserve to help overachieve on fiscal target, and fund future investments /compensation pressures	**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 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 out-year assumptions built into the fiscal plan carry **a significantly higher degree of risk than 2017-18**.
  - 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.
  - For example, an additional $2 billion investment in capital can increase the net debt-to-GDP ratio by ~0.2 percentage points.

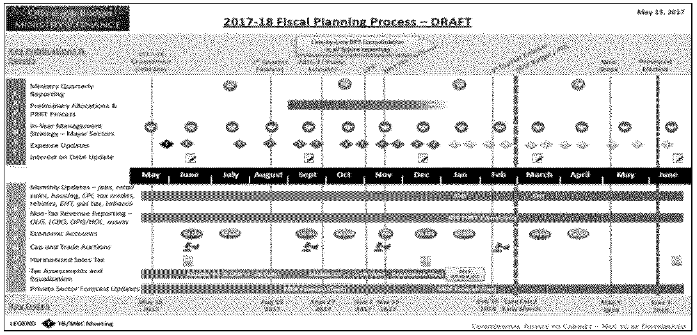
Potential Fiscal Building Blocks cont'd

Fiscal Policy Principle #3: Transparent and Credible Fiscal Plan

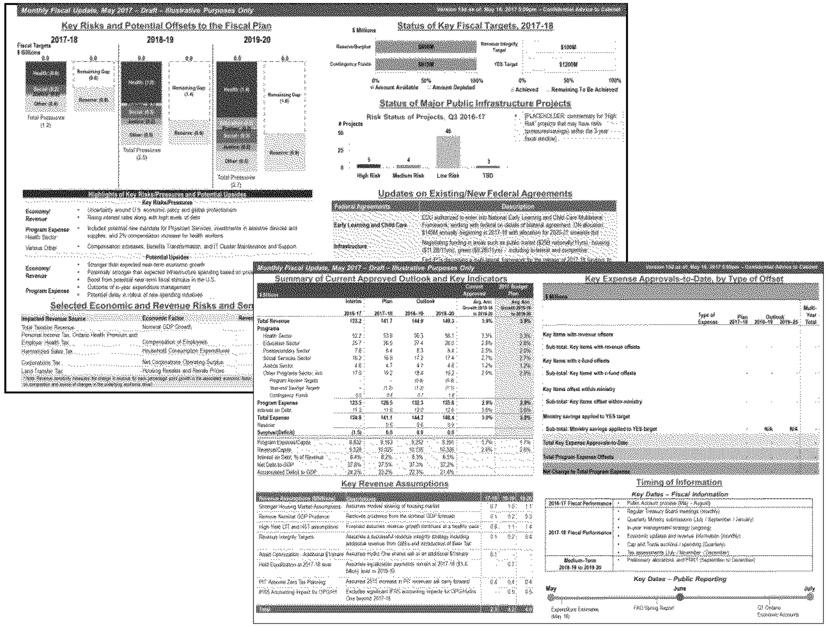
- The Auditor General is expected to continue to criticize the government over its accounting treatment of net pension assets and potentially other issues, such as the electricity cost refinancing component of the Fair Hydro Plan.
- In addition, the 2018 Budget will also be a Pre-Election Report, which will be reviewed for reasonableness by the Auditor.
- The FAO's 2017 Spring Outlook continued to suggesting that, while balance in 2017-18 may be within reach, the province will likely return to, and remain in, deficits 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 inform decision-makers of 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. A robust **in-year expenditure management** strategy to meet year-end savings targets in 2017-18.

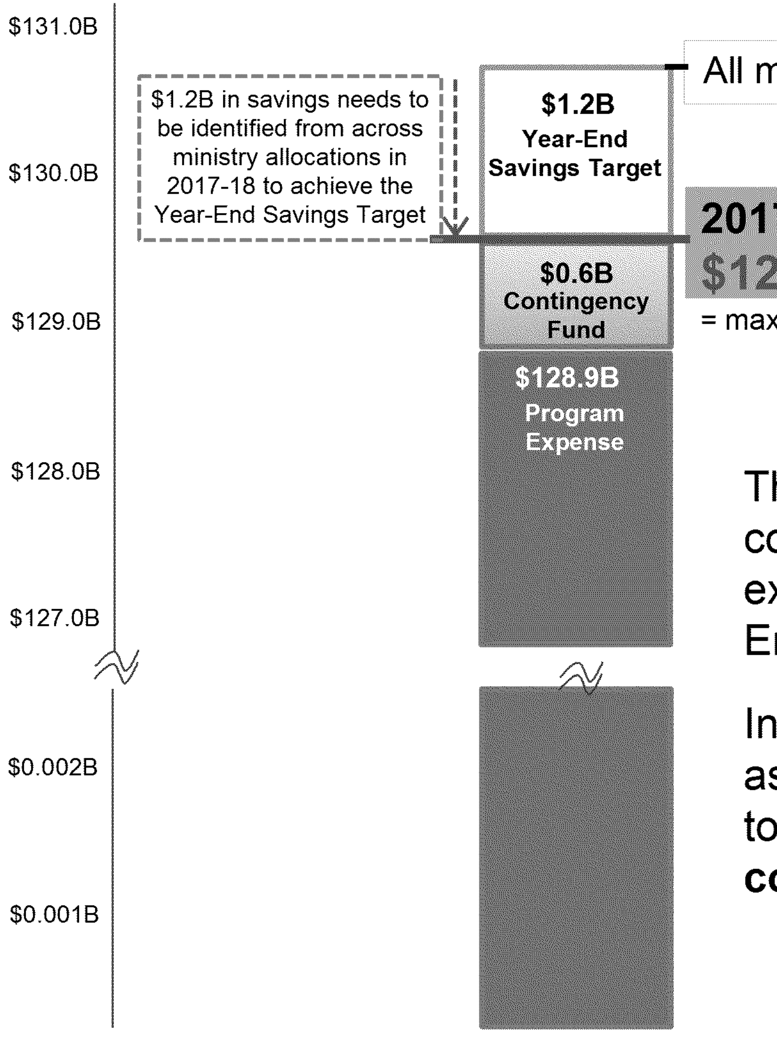
1. A systematic and strategic **program review,** focussed on ministry programs/spending, to meet targets in 2018-19 and 2019-20, and to improve sustainability and enhance value-for-money.

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

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

1. In-Year Expenditure Management Approach

2017-18 Program Expense



All ministry 2017-18 approved allocations + C-Fund: **$130.7B**

2017-18 Program Expense in *2017 Budget*:
$129.5B
= max. program spending across gov't to meet 2017-18 program expense target

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

- Initiate a multi-year **enhanced approach to a line-by-line review**, integrated into the PRRT process, to:
  - Identify opportunities for efficiency improvements, including savings and cost avoidance, supported by evidence;
  - Drive focus on Sustainability and Improved Outcomes; and
  - Identify new strategic initiatives and opportunities for transformation.
- The reviews will be based on a foundation of a robust program inventory and include both vertical and horizontal reviews to drive strategic and operational efficiencies.

More Robust Data	Refine the existing PRRT program inventory to: ▪ Provide a better line of sight into government's base spending / programs. ▪ Establish the underlying logic model for ministry programming. ▪ Identify opportunities and prioritize reviews.
Vertical Reviews	Review programs within a ministry (small), or a sub-component of a ministry (for bigger ministries with multiple line of business) to assess: ▪ Relevance, alignment and fit ▪ Relative performance of programs that are intended to achieve the same/similar outcomes for the same client group ▪ Opportunities for efficiencies (cost avoidance, savings)

2. Program Review

Horizontal Reviews	Look at how the same client group is supported through multiple ministries. Assess relative performance of these programs, their impacts, and explore opportunities to streamline supports.
Functional Reviews	Focus on common functions across government to explore opportunities for benchmarking, improvement/efficiencies. ▪ IT, Procurement, Agencies, Facilities/Realty ▪ Inspections/Enforcement

2017-18 as the Foundation Year:

- Summer 2017: Initiate a number of review under each stream, with results feeding into the 2018 Budget, to:
  - Realize savings towards the $750M target; and
  - Pilot different approaches to undertaking the reviews, so that the most effective approaches can be scaled up when the multi-year reviews get underway starting in 2018-19.
- 2017 Fiscal Economic Statement highlights reviews being undertaken and how the approach will be scaled up
- 2018 Budget: Results of the reviews are showcased & details provided regarding the reviews that will be done in 2018-19 (or a multi-year schedule, if desired).

3. Transformation Initiatives

A Deeper Look Into The Workstream

Purpose:

- Focus on longer term projects that focus on an **improvement to outcomes**; not the cost saving's focus of the other two streams

What Is the Solution?

- Building on the foundations of PRRT, the proposed approach for the Transformation work stream will focus on the following objectives:
    - Improve outcomes and user experience;
    - Improve efficiency and system effectiveness; and
    - Promote opportunities for innovation.

Challenges with Current Model:

- Leading successful transformational change is complex. The current approach to policy/program development has a number of challenges and can limit ability to succeed in achieving major change, including:
    - Linear process with limited ability to test, pilot and iterate
    - Siloed approach to development and delivery
    - Change enabling resources not used in integrated, strategic way

How will this be Achieved?

- Projects will reflect government priorities and have reasonable expectations of providing better outcomes for citizens.
- Initial focus will pilot and test new approaches to find out what works – aim to establish repeatable processes and methodologies
- Intent is to scale up new approaches where evidence demonstrates that the approach improves outcomes and / or enhances service experience.
- The idea is to impact both existing and future opportunities by harnessing existing resources in a more integrated and strategic way to leverage impact and help ministries drive major changes.

3. Transformation Initiatives

Resources and Enablers to Support Transformation

There is an opportunity to leverage existing assets within our central agencies

MOF	TBS	CO	MGCS
• Office of Economic Policy • Tax Policy • Tax and Benefits Administration	• Open Government • OPCD • Transformation Office • I&IT Services • Central Resources Unit • Internal Audit • CoE for Evidence Based Decision Making • Behavioural Insights Unit • Labour Relations	• CO Policy • Policy Innovation Hub • Digital Government	• Transformation Consulting Group • Service Design Review Team

3. Transformation Initiatives

Timeline:

Proposed early milestones

Phase 1: Ideation		Phase 2: Prototyping			Phase 3: Iteration		Phase 4 Finalize
June	July	Aug	Sept	Oct	Nov	Dec	Jan

July
- Further develop approach with Central Agencies
- Conduct "table top" exercise
- Identify 1st pilot project
- Assemble partners and affected ministries to solve

Sept
- Test approach with identified project
- Cycles of prototyping and testing
- Central agency resources deployed to support

Nov
- Continue to refine proposal by testing, evaluating and learning

Jan
- Seek final approvals
- Prepare announcement for 2018 Document

4. Key Revenue Strategies and Progress to Date

1. **Revenue Integrity**

- Strategy includes enhancing data analytics to identify and address high-risk areas for underground economic activity; piloting a program to identify businesses using electronic sales suppression technology; and, launching a campaign to inform the public of the risks and liabilities of the underground economy.
- Strategy also includes undertaking a thorough policy and legislative review of all taxes, including those shared with the federal government, to eliminate loopholes.
  - For example, the review will include analysis of methods by which some employers avoid paying the Employer Health Tax, to ensure tax relief is targeted to smaller employers.
- A report on the federal tax expenditure review, focusing on tax planning through private corporations, is expected June 2017. As a result of the common tax base, federal policy changes could significantly increase provincial revenue.
  - However, federal changes that reduce tax benefits for incorporated professionals may be opposed by physicians.

Progress-to-date

- Enhanced Ontario's ability to address underground economic activity through information sharing legislation and strengthened administration of existing laws.
- Created specialize audit teams with the Canada Revenue Agency (CRA).
- Finalized a Service Level Agreement (SLA) with the CRA to fund additional underground economy specialist teams first announced in the 2016 Ontario Budget.
- Currently negotiating an Ontario Extended Services Agreement (OESA) with the CRA to replace the expiring fee-for-service agreement to address aggressive international tax planning and the underground economy.
- Working with the CRA to identify additional opportunities for enhanced audits, joint initiatives and information sharing.

4. Key Revenue Strategies and Progress to Date

2. **Housing Market**
   - As of the end of business day on June 8, 2017, the Ministry of Finance has received 51 Non-Resident Speculation Tax (NRST) payments totalling approximately $5.7 million. It is expected that any new revenue from the NRST will be offset by an expected decrease in Land Transfer Tax revenue that will likely be the result of a cooling of the housing market brought on by the housing strategy.
3. **GBEs**
   - Work with GBEs to monitor revenues and identify additional sources of revenue through potential new programs or changes to provincial charges
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**
   - To date, the province has held two auctions of greenhouse gas emission allowances:
     - First auction on March 22, 2017, fully sold out, generating $472 million in proceeds. The results exceeded MOECC's forecast by over $114 million.
     - Second auction on June 6, 2017, fully sold out, generating $504 million in proceeds. The results exceeded MOECC's forecast by over $146 million.
   - Three more auctions are scheduled this fiscal year (next one is September) -- proceeds for 2017-18 are forecast to be $1.8 billion.