2017 Document: Fiscal Plan Context

Office of the Budget
MINISTRY of FINANCE

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OFFICE OF ECONOMIC POLICY
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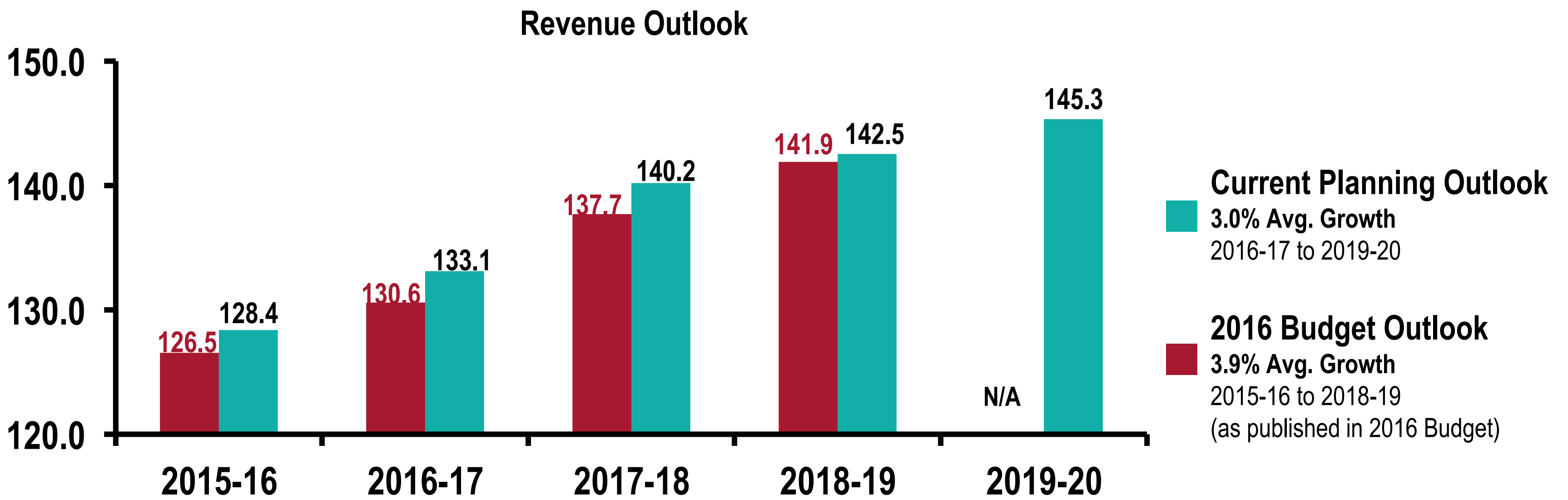
Purpose

- Review the **current fiscal challenge** in light of the government's **fiscal anchors**.
- Outline the **potential tools** that could support the achievement of the government's fiscal objectives and key investments.

Evolution of the Fiscal Plan and Current Challenge

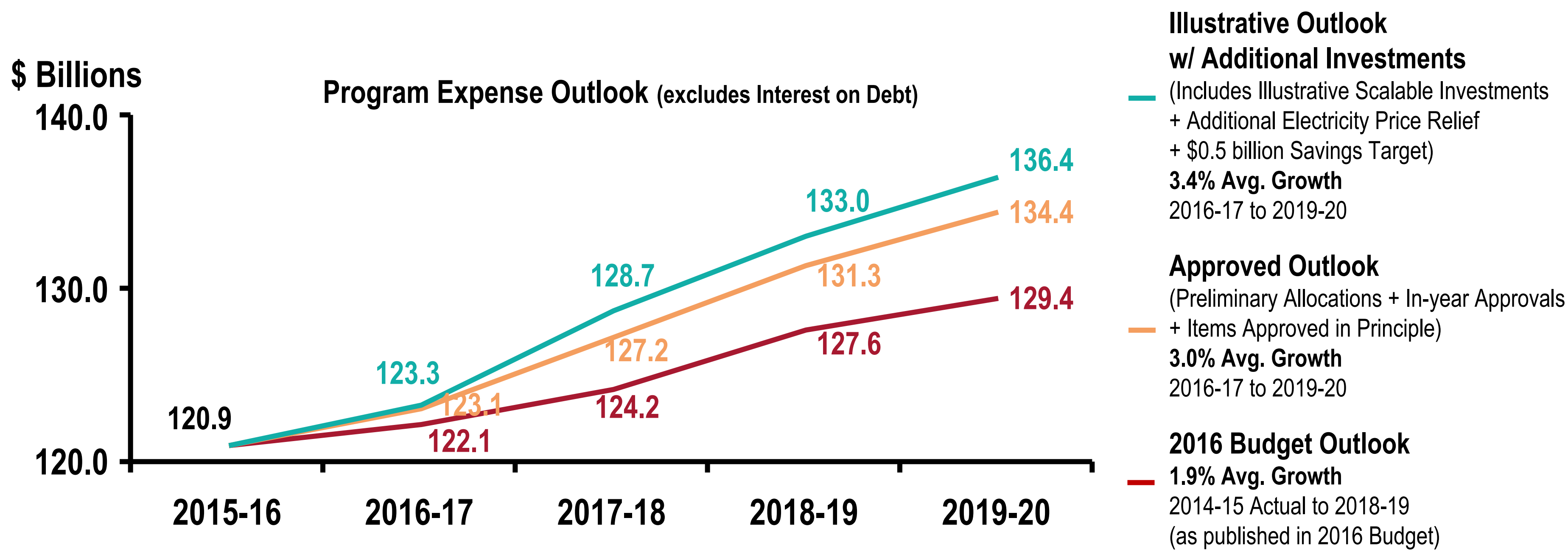
Fiscal Context – Revenue Growth – 2016 Budget to Current



Key Revenue Changes since the 2016 Budget

- Higher than forecasted taxation revenue by $2.3 billion in 2017-18 and $2.9 billion in 2018-19, partially offset by:
  - Lower projected equalization by $(0.9) billion in 2017-18 and $(1.6) billion in 2018-19.
  - Lower Cap and Trade proceeds projection of $0.1 billion in 2017-18, rising to $0.5 billion in 2019-20. Note that expense outlook also reflects these changes.
  - IFRS accounting impact from the consolidation of OPG and Hydro One of $0.4 billion in 2017-18, rising to $0.7 billion by 2019-20.
- Lower earnings from sale of Hydro One and re-profiling final tranche from 2018-19 to 2017-18, resulting in a $0.1 billion decrease in 2017-18, and a $0.7 billion decrease in 2018-19.

Fiscal Context – Expense Growth – 2016 Budget to Current



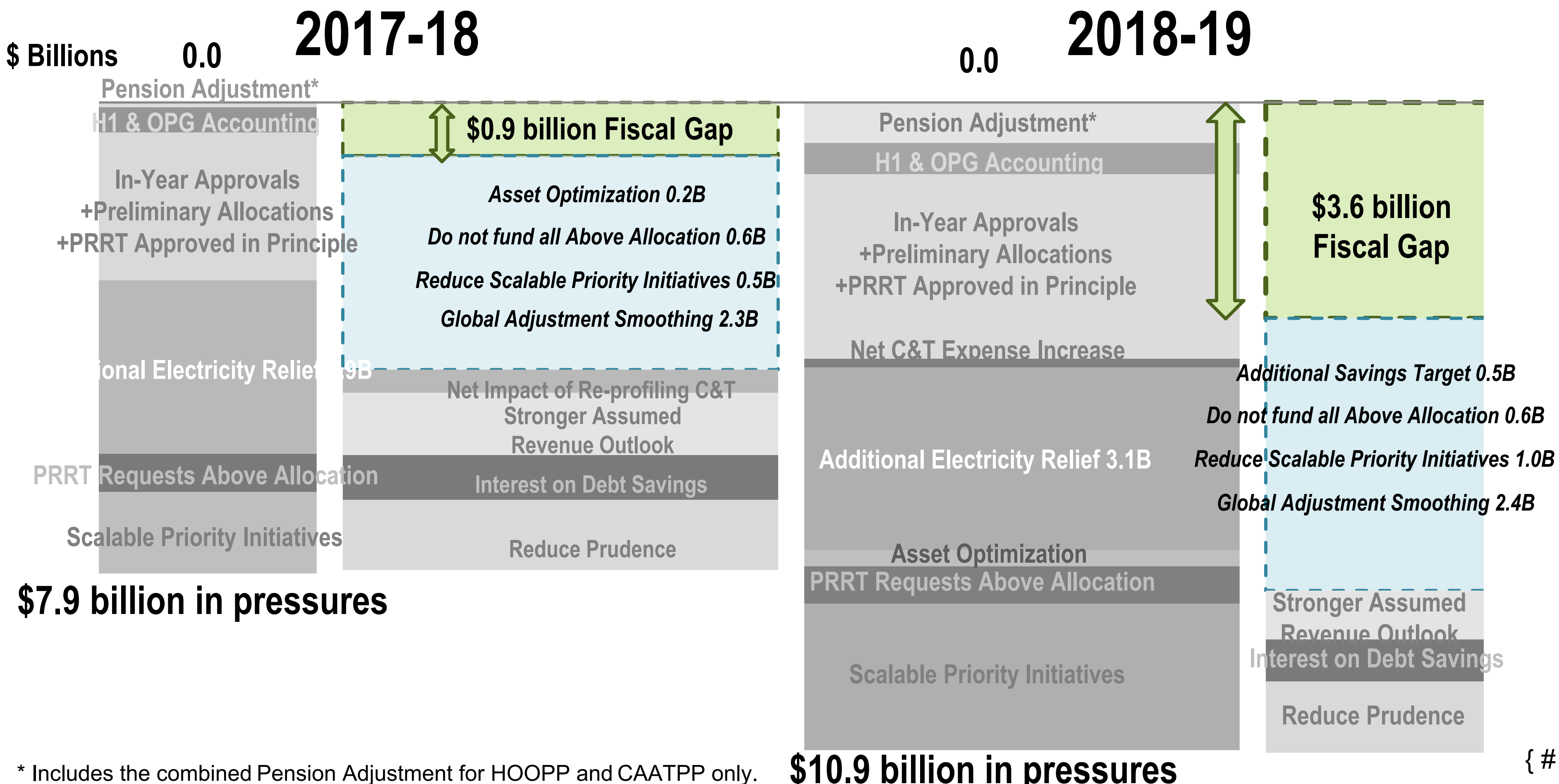
	2015-16	2016-17	2017-18	2018-19	2019-20
Interest on Debt	11.0	11.4	11.7	12.4	12.6
Reserve	-	0.4	0.7	0.8	1.0

Key Drivers of Expense Growth since the 2016 Budget

- Since the 2016 Budget, preliminary allocations, other new expense approvals, including the Electricity Cost Relief announced in the fall, and recent PRRT decisions, grow to **$4.2 billion by 2019-20**.
- Potential scalable priority initiatives could amount to about $1.8 billion by 2019-20.
- Potential additional Electricity Cost Relief of $0.8 billion by 2019-20 (pending accounting treatment).
- Assumes additional savings targets of $0.5 billion in 2018-19 and 2019-20.

The Fiscal Challenge

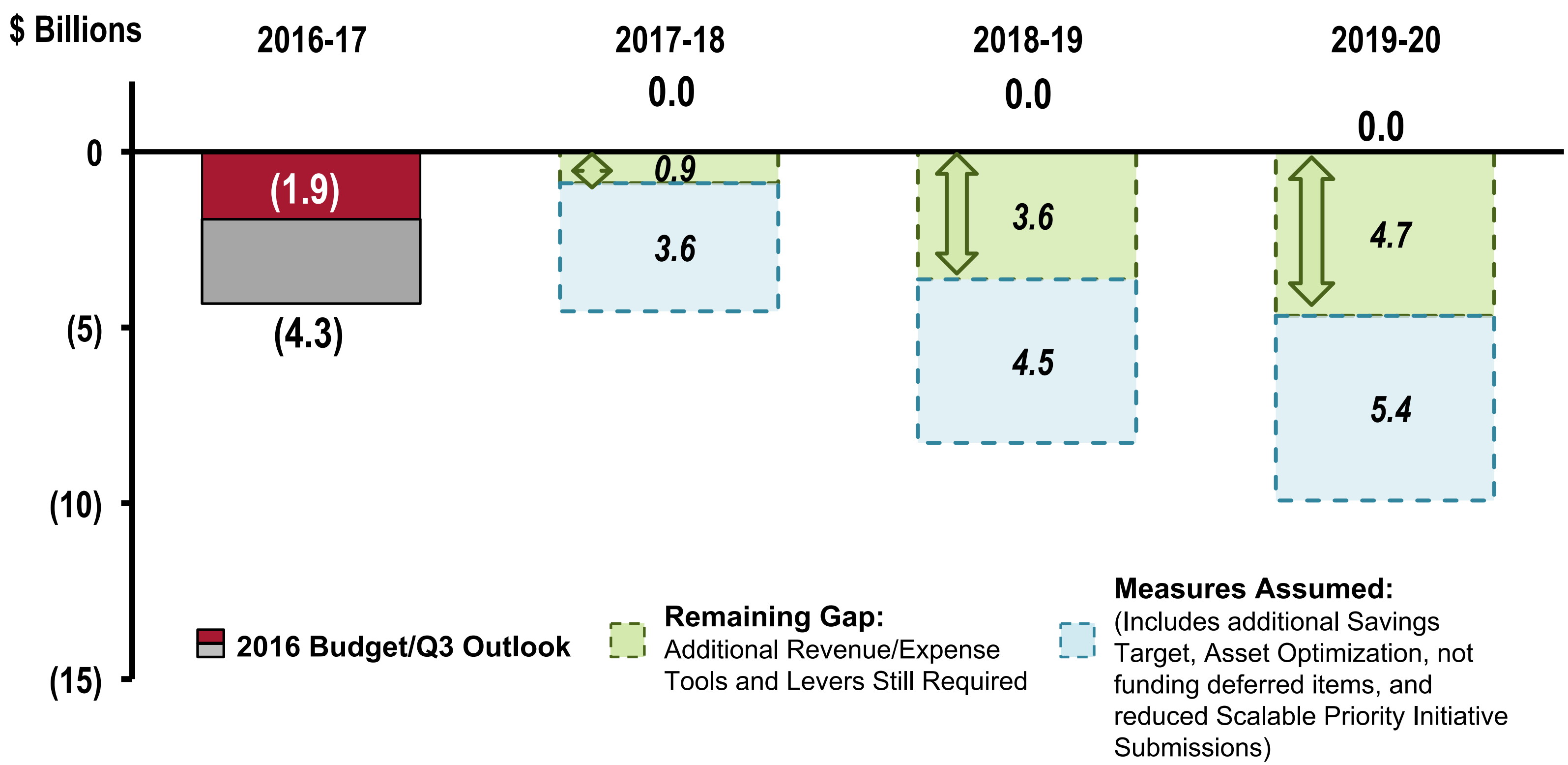
- The 2016 Budget outlined a plan to balance the budget in 2017-18 and remain balanced in 2018-19, however **changes since the Budget have created a gap compared to the government's fiscal targets.**
- In order to accommodate fiscal pressures in 2017-18 and 2018-19, a number of tools have been taken on.



* Includes the combined Pension Adjustment for HOOPP and CAATPP only.

Assessing and Addressing the Fiscal Challenge

- Without additional effort, the fiscal gap is **$0.9 billion in 2017-18, $3.6 billion in 2018-19, and $4.7 billion in 2019-20**.
- Continuing to assume fiscal anchors of **balanced budgets** over the forecast horizon **will require identifying additional revenue or expense tools/levers** to address the fiscal challenge**.**



Other Factors That Could Further Impact the Gap

Revenue

- Revisions to economic outlook
- Potential revisions to cap-and-trade proceeds based on auction results in 2017.
- Adjustments to the government's asset optimization strategy
- Remaining 2015 CIT & PIT tax assessment information and ongoing tax receipts from provincially administered taxes
- PRRT updates (revised revenue outlooks from ministries, agencies and government business enterprises)
- Implications of Federal Budget

Expense

- 2017 Document initiatives / PRRT Deferred
- Labour settlements
- Interest on debt forecast updates
- Alignment of climate change investments with available proceeds
- Impact of expense pressures that ministries have been asked to manage
- Pension Expense Updates

Accounting risks:

- Further updates to accounting Framework for OPG and Hydro One (IFRS)

Prudence

- Build the reserve back up to mitigate adverse impacts to the fiscal plan
- Resetting the contingency funds to accommodate expense risks and pressures

- Potential improvement to gap
- Potential improvement or deterioration to gap
- Potential deterioration to gap

Approaches to Closing the Gap

Potential Tools to Achieve Fiscal Targets

Achieving balance while making new investments will require significant spending constraint or revenue generation, particularly in 2018-19 and 2019-20. Some potential revenue and expense tools include:

Revenue

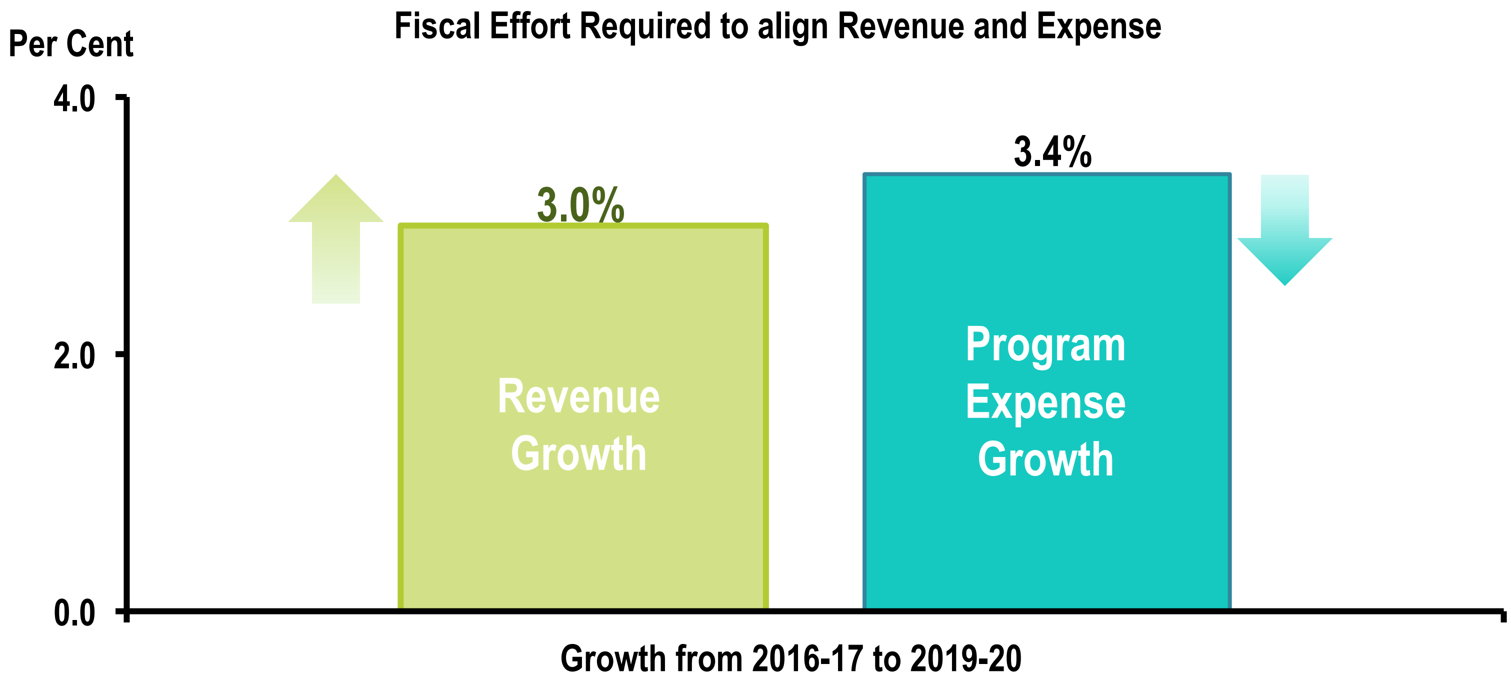
- Several revenue tools could be considered to close the fiscal gap, including:
  - Targeted **tax changes**
  - **Non-tax revenue**
  - Strategy on **revenue integrity**
- Engagement with the **federal government** to maximize federal funding.

Expense

- A **systematic program review process** with the goal of identifying savings that would materialize beginning in 2018-19.
  - **Savings targets for ministries** taking into account the overall allocation, current mandate commitments, and non-discretionary pressures.
  - **Costing reviews** where services are offered by multiple ministries **to identify the most effective mode of delivery.**

Managing Revenue and Expense Growth

- Over the medium-term outlook, program expense growth exceeds revenue growth in each year.
- Achieving a balanced plan over the outlook period and providing room for investments will require significant fiscal effort to either constrain program spending and/or increase revenue, so that revenue and expense are more aligned, particularly in 2018-19 and 2019-20.
- This will require the consideration of all viable revenue and expense tools/levers.
- An ongoing mismatch between revenue and expense growth results in a structural deficit.



Key Takeaways

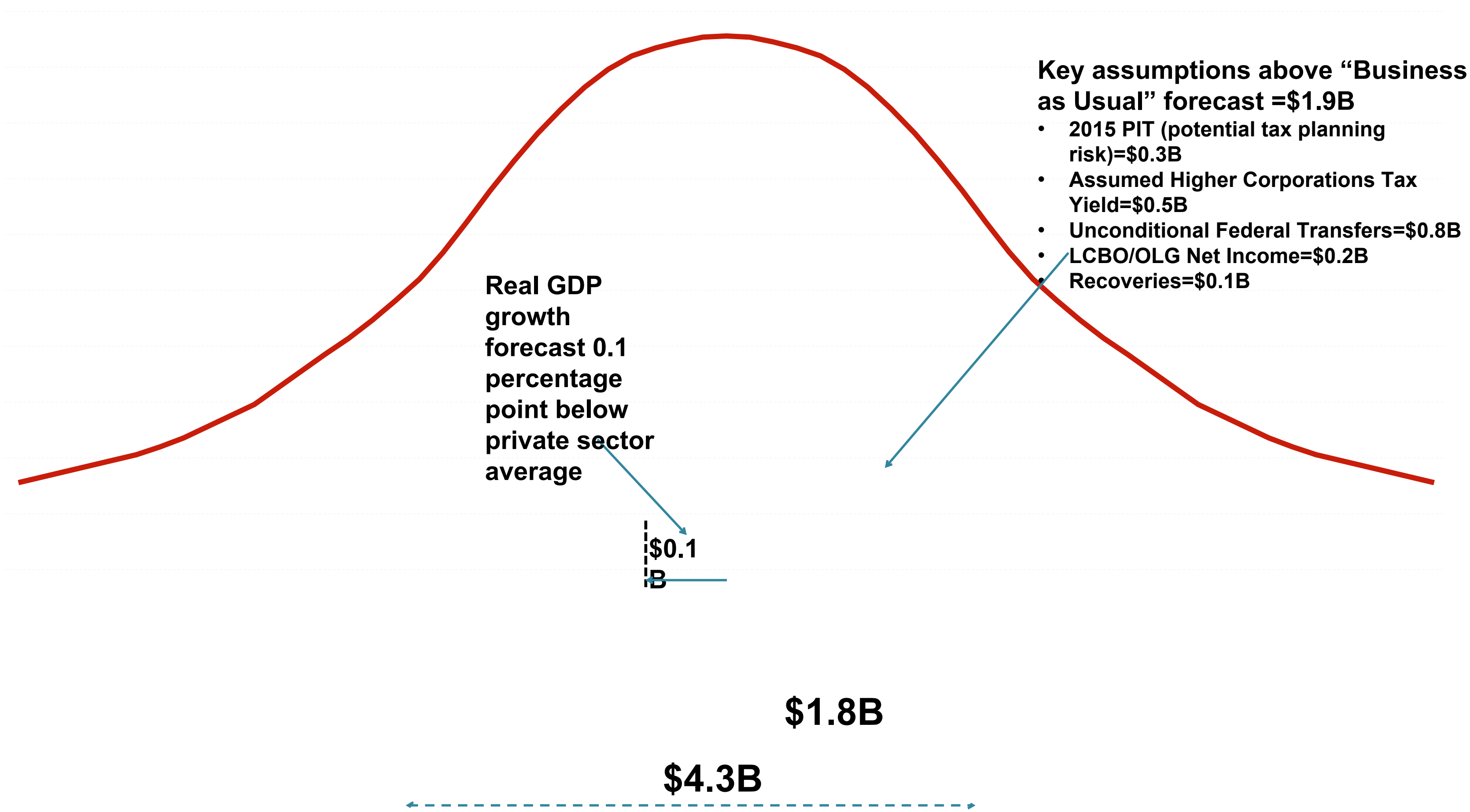
- The **2017 Document** approach will need to **reconcile** the commitment to **balance** with the desire to make **investments in priority areas**
- **Achieving fiscal objectives** while investing in new priorities will **require** the consideration of all **viable revenue and expense tools**
  - Success of a **Program Review** exercise will require the buy-in and **commitment of** all **Cabinet** members to constrain program spending
- Regardless of tools taken on, **not all priorities can be funded** as part of the **2017 Document** – this will require **choices and trade-offs** about what to **fund now** and what can be considered as part of the 2018 Document.

Appendix

Program Expense Growth

$ Billions	16-17	17-18	18-19	19-20	20-21	Avg. Annl 15-16 to 19-20	Avg. Annl 16-17 to 19-20
2016 Budget Program Expense	**122.1**	**124.2**	**127.6**	**129.4**	**131.6**	1.7%	1.9%
Annual growth	1.0%	1.7%	2.8%	1.4%	1.7%		
Change in pension accounting	0.0	0.1	0.7	0.8	0.8		
In-year changes and allocation adjustments	0.9	1.9	1.8	2.7	3.0		
Preliminary Allocations Outlook	**123.1**	**126.2**	**130.1**	**132.9**	**135.4**	2.4%	2.6%
Annual growth	1.8%	2.5%	3.1%	2.2%	1.9%		
Expenses with revenue offsets and other changes		0.6	0.5	0.2	0.2		
Approved-in-principle above Preliminary Allocation		0.3	0.7	1.3	1.3		
Outlook with Approved-in-Principle		**127.2**	**131.3**	**134.4**	**136.9**	2.7%	3.0%
Annual growth		3.3%	3.3%	2.4%	1.9%		
Scenario 1: Scalable Initiatives (Illustrative)		0.9	1.5	1.8	1.8		
Outlook including Scalable (Illustrative)		**128.0**	**132.8**	**136.1**	**138.8**	3.0%	3.4%
Annual growth		4.1%	3.7%	2.6%	1.9%		
Deferred Items		0.6	0.3	0.3	0.3		
Outlook including Deferred Items		**128.6**	**133.1**	**136.4**	**139.1**	3.1%	3.5%
Annual growth		4.5%	3.5%	2.5%	1.9%		
Scenario 2: Scalable Initiatives (High-end options)		1.4	2.5	3.2	3.7		
Outlook including Scalable (High-end)		**128.5**	**133.8**	**137.6**	**140.6**	3.3%	3.8%
Annual growth		4.5%	4.1%	2.9%	2.2%		
Deferred Items		0.6	0.3	0.3	0.3		
Outlook including Deferred Items		**129.1**	**134.1**	**137.9**	**141.0**	3.3%	3.9%
Annual growth		4.9%	3.8%	2.9%	2.2%		

Broad Range of Risks Around Current 2017-18 Revenue Outlook



Current Revenue Outlook

Current Outlook						
$ Billions	**2015-16**	**2016-17**	**2017-18**	**2018-19**	**2019-20**	**Avg. Growth**
Total Taxation Revenues	91.8	94.8	98.3	103.1	107.1	*3.9%*
Government of Canada Transfers	22.9	24.5	26.2	25.7	24.6	*1.8%*
Government Business Enterprises	4.9	5.2	5.1	5.4	5.7	*3.7%*
Other Non-Tax Revenues	8.8	8.6	10.5	8.4	8.0	*-2.2%*
Total Revenues	**128.4**	**133.1**	**140.2**	**142.5**	**145.3**	*3.2%*
Nominal GDP Growth(%)	4.9	4.5	4.1	4.1	4.1	*4.2%*

Note: average growth rates are calculated from 2015-16

Key Assumptions Built in Revenue Outlook

2015 PIT (potential tax planning risk)	–	0.7	0.7	0.7	0.7
Stronger 2015 HST	–	0.8	0.5	0.5	0.5
Assumed Higher Corporations Tax Yield	–	0.3	0.5	0.7	0.7
Equalization Forecast	2.4	2.3	1.4	0.7	0.7
Public Transit Infrastructure Fund (PTIF)	–	–	1.1	0.4	–
Unconditional Federal Transfers					
- Infrastructure, Homecare, Training	–	0.1	0.8	1.3	0.0
IFRS for HOL and OPG	–	0.0	-0.4	-0.5	-0.7
Debt Retirement Charge ends 2018-19	0.9	0.6	0.6	0.0	0.0
Asset Optimization (Net Impact)	0.9	1.0	1.0	-0.1	-0.4
Cap and Trade Proceeds Assumptions	0.0	0.0	1.8	1.4	1.4

- **Taxation revenues**, reflecting the current economic forecast, are projected to grow at 3.9% over the 2016-17 to 2019-20 period. This is roughly in-line with the average nominal GDP growth of 4.2% over the same period.
- **Government of Canada Transfers** are based on existing federal provincial agreements including public transit infrastructure fund, new strategic investment funds and revised assumptions for unconditional federal transfers including infrastructure, homecare and training.
- **Net income of Government Business Enterprises** are based on 2016 Budget projections, adjusted upwards for mid-year improvement in OLG and LCBO, and also for OPG and IFRS Consolidation risks.
- **Other Non-Tax revenues** are based on 2016 Budget outlook projections for Ministry and Government Organizations, updated for asset optimization and cap & trade proceeds, as well as for recoveries of prior- year-expenditures and new NTR offsets.

Variance from 2016 Budget

Current Outlook:Change from 2016 Budget Outlook				
$ Billions	**2015-16**	**2016-17**	**2017-18**	**2018-19**
Total Taxation Revenues	1.1	3.0	2.3	2.9
Government of Canada Transfers	0.0	-0.2	0.4	-0.9
Government Business Enterprises	0.6	0.2	-0.2	-0.3
Other Non-Tax Revenues	0.2	-0.5	-0.1	-1.0
Total Revenues	**1.8**	**2.5**	**2.5**	**0.6**

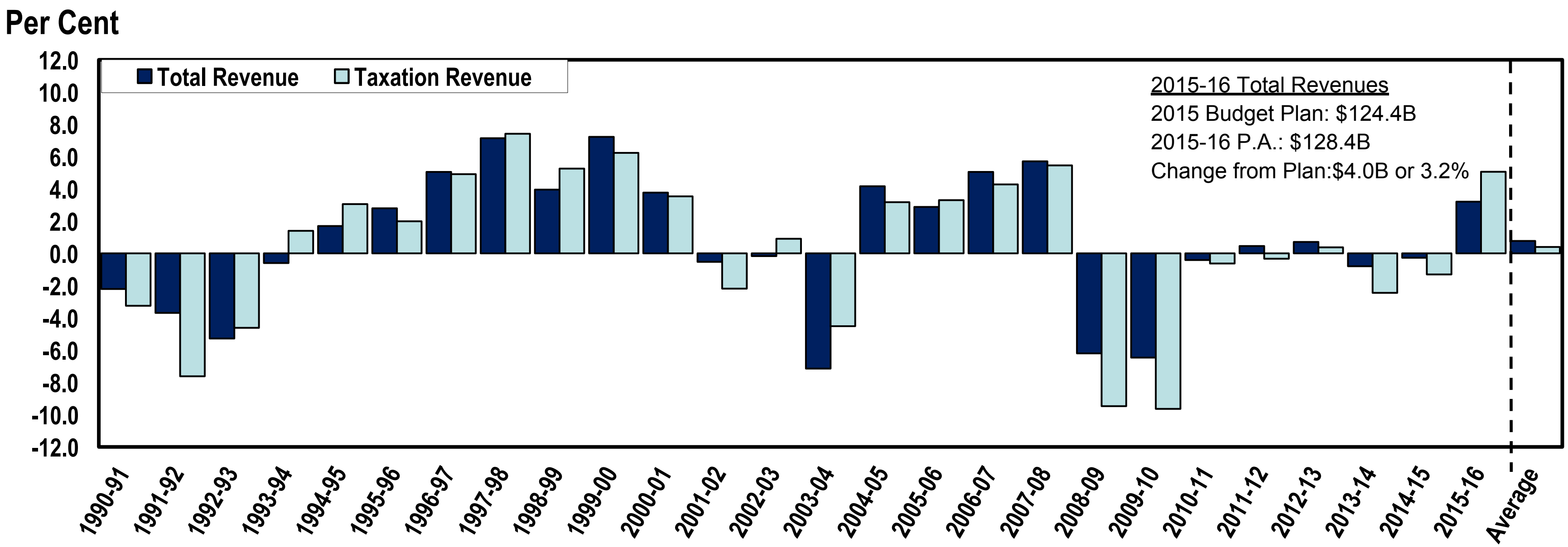
Taxation Revenues:
Reflects stronger economy. Consistent with higher nominal GDP projection due to upward revision to growth in 2014 to 2016.

Government of Canada Transfers:
Mainly due to lower Equalization revenues resulting from Ontario's stronger economic and revenue outlook. This is partly offset by public transit infrastructure fund.

Government Business Enterprises:
Mainly due to higher-than-projected net income for 2016-17 and 2017-18 and lower in 2017-18 and 2018-19 due to IFRS related consolidation adjustment

Other Non-Tax Revenues:
Largely due to updated forecast related to asset optimization, cap and trade proceeds, and miscellaneous revenues (mainly recoveries of prior year expenditure)

Revenue Variance – From Budget Plan to Actual*



* Adjusted for reporting or accounting changes that affected revenues between Budget Plan and Actual

- Actual revenue results for a fiscal year are released in the Public Accounts about 16-17 months after the Budget Plan.
- Over the past 26 years, Plan to Actual variances have averaged +0.8% for total revenue and +0.4% for taxation revenue.
  - This relatively small under-estimate of revenues in the Budget Plan largely reflects some modest prudence built into the Budget economic forecast.
  - Although the average variance is relatively small in any given year, it can be significant (up to +/- 10% over the past 26 years).
  - The total variance from plan in 2015-16 reflects $1.5 billion higher net revenues from Hydro One ownership broadening while all other tax and non-tax revenues are $2.5 billion higher than plan.
- Post-recession from 2010-11 to 2014-15, variances have been relatively small.
  - The dollar variance from Plan averaged -$0.1 billion, or -0.1 per cent for total revenues, and -$1.2 billion or -1.4 per cent for taxation revenues.
  - In absolute terms, the dollar variance from Plan averaged $0.6 billion, or 0.5 per cent for total revenues and $1.3 billion or 1.6 per cent for taxation revenues.