

# Ontario's Economy and Public Sector Fiscal Analysis: An Overview

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# Outline

- Economic Context
  - Canada & World Overview
- Federal Budget
  - Ottawa's Fiscal Plan and Ontario
- Ontario's Economy
  - Ontario's Economic Dilemma
- Ontario Budget
  - Not the Drummond Report You Were Looking For?
  - Analysis
- Questions

# Economic Overview

- World economy appears to be on the mend but the situation is still precarious – ongoing Eurocrisis.
- Canada doing as well as can be expected under the circumstances but large public and private debt burden.
  - *“Toronto-Dominion Bank economist Craig Alexander, for example, said in a recent forecast that he believes the debt-to-income ratio among Canadians could climb to about 160 per cent, the level that caused such trouble for the U.S. and Britain.”* Globe & Mail, April 17, 2012
- Canadian housing prices a concern.
- U.S. economy showing signs of life but still burdened by large amount of debt, fiscal drag.

# World Output

	Actual		<i>Projections</i>		
	2009	2010	2011	<b>2012</b>	<b>2013</b>
World	-0.7	5.3	3.9	3.5	4.1
United States	-3.5	3.0	1.7	2.1	2.4
Germany	-5.1	3.6	3.1	0.6	1.5
France	-2.6	1.4	1.7	0.5	1.0
Italy	-5.2	1.8	0.4	-1.9	-0.3
Spain	-3.7	-0.1	0.7	-1.8	0.1
UK	-4.9	2.1	0.7	0.8	2.0
<b>Canada</b>	<b>-2.8</b>	<b>3.2</b>	<b>2.5</b>	<b>2.1</b>	<b>2.2</b>
Japan	-6.3	4.4	-0.7	2.0	1.7
China	9.2	10.4	9.2	8.2	8.8
India	6.8	10.6	7.2	6.9	7.3
Brazil	-0.6	7.5	2.7	3.0	4.1
Mexico	-6.2	5.5	4.0	3.6	3.7

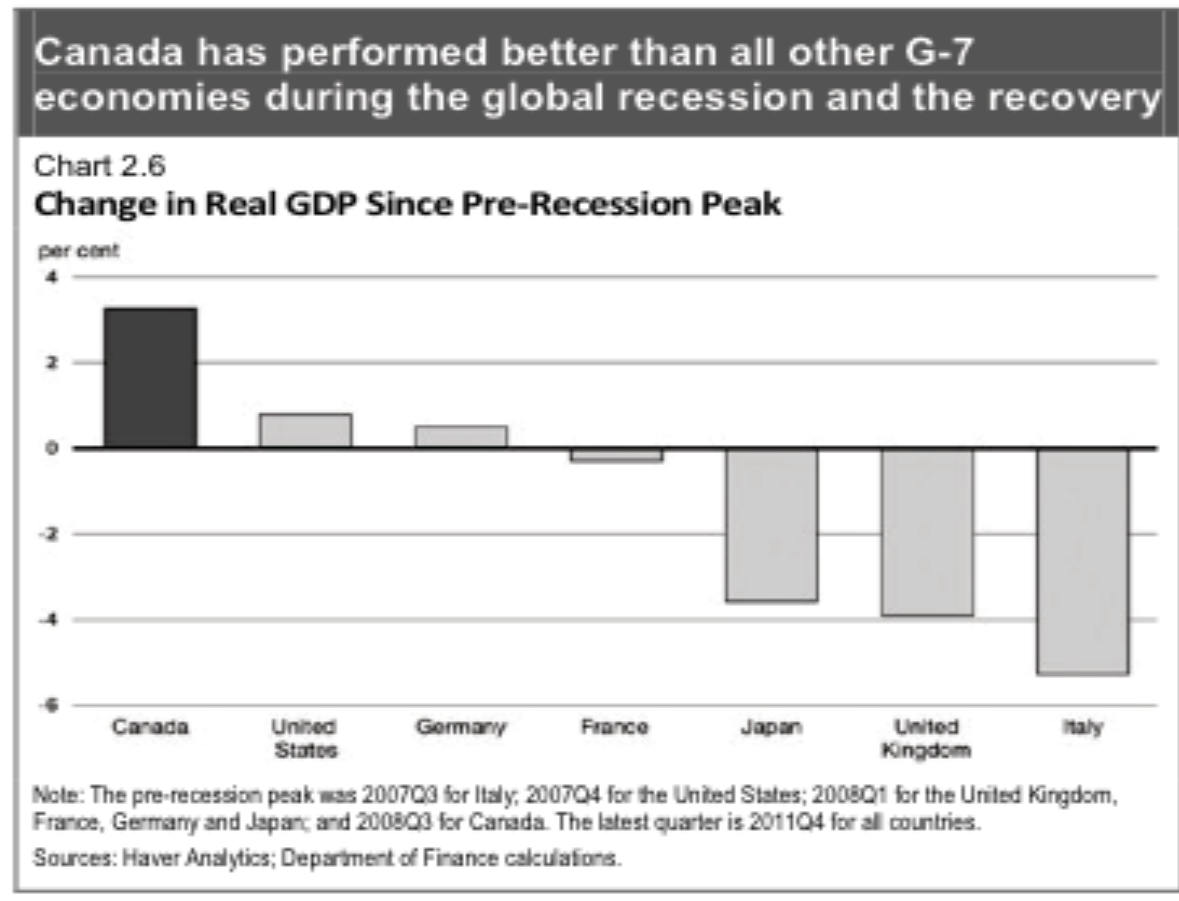
Source: IMF World Economic Outlook September 2011 & April 2012



# Recent Indicators: Canada

- Real Annual GDP Growth: **+1.7%** (Jan 2012)
- New Vehicle Sales: **+15.5%** (Feb 2010)
- Unemployment Rate: **7.2%** (March 2012)
- Retail Trade: **+4.7%** (Jan 2012)
- Residential Building Permits: **+11.7** (Feb 2012)
- According to IMF, Canada's economy grew 2.5 percent in 2011 and will grow 2.1 percent in 2012. According to the IMF: *"External threats are the main risk, while household debt and high house prices are the main domestic concern."*

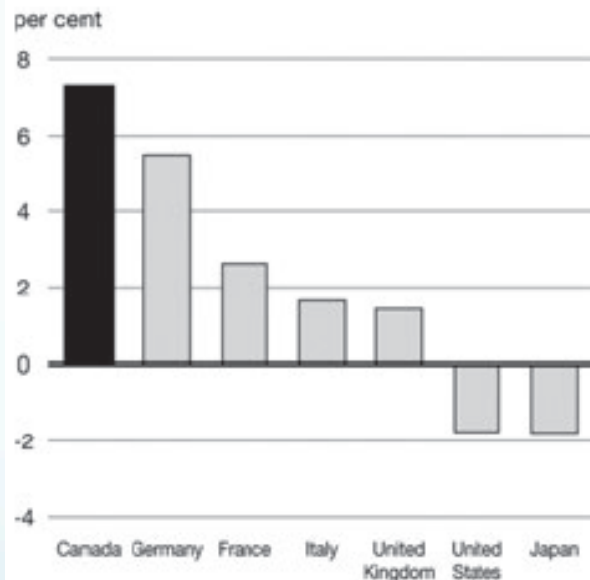
# Relative Performance



# Other Indicators Also Favorable When Comparing

Chart 2.7

## Growth in Employment From 2006 to 2011

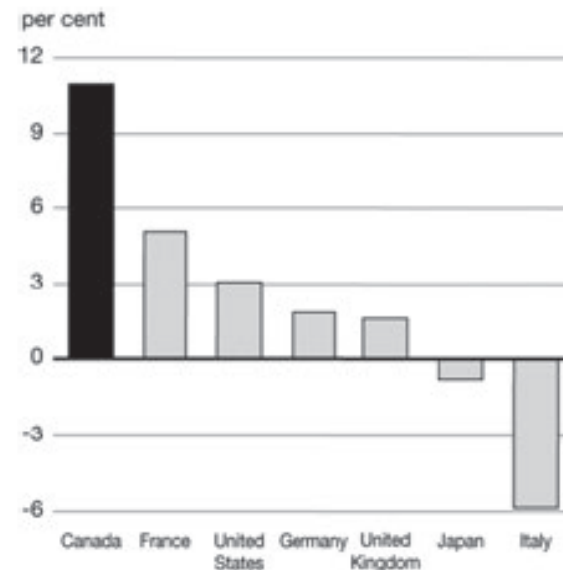


Note: 2011 employment data for France are the average of 2011Q1 through 2011Q3.

Note: Base year for calculations is 2005.

Sources: Haver Analytics; IMF; Department of Finance calculations.

## Growth in Real per Capita Disposable Income From 2006 to 2010



Note: This chart shows gross personal per capita disposable income deflated by the Consumer Price Index.

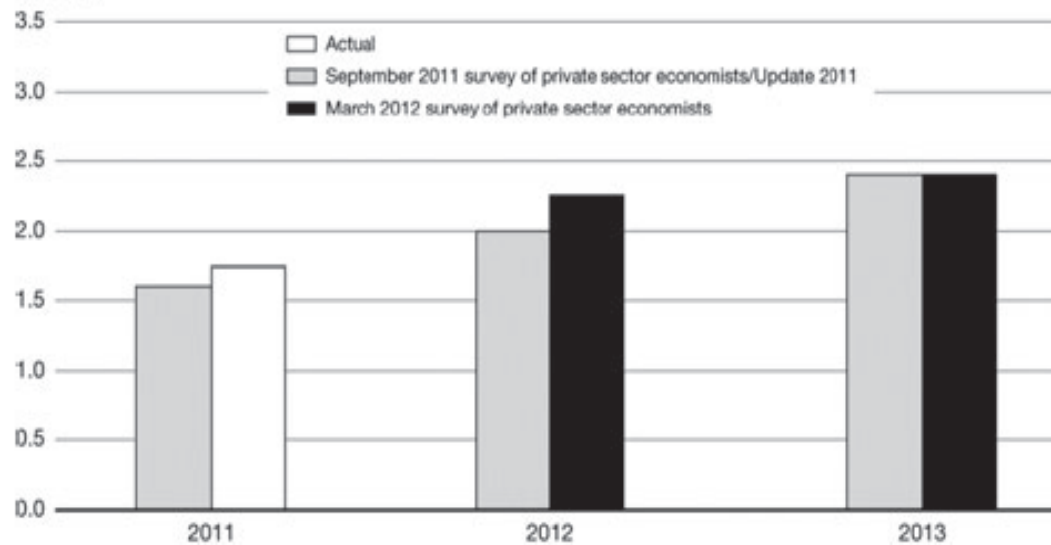
# US Economy Recovering Slowly

## Economists continue to expect modest U.S. growth

Chart 2.4

### U.S. Real GDP Growth Outlook

per cent



Sources: U.S. Bureau of Economic Analysis; September 2011 and March 2012 Department of Finance surveys of private sector economists.

# Federal Budget

# Federal Finances...reliance on revenue growth

Table 6.4  
**Summary Statement of Transactions**  
billions of dollars

	Projection						
	2010–2011	2011–2012	2012–2013	2013–2014	2014–2015	2015–2016	2016–2017
<b>Budgetary revenues</b>	<b>237.1</b>	<b>248.0</b>	<b>255.0</b>	<b>270.4</b>	<b>285.5</b>	<b>300.0</b>	<b>312.5</b>
Program expenses	239.6	241.9	245.3	249.4	253.9	261.7	268.6
Public debt charges	30.9	31.0	30.8	31.1	33.0	34.9	36.1
<b>Total expenses</b>	<b>270.5</b>	<b>272.9</b>	<b>276.1</b>	<b>280.6</b>	<b>286.9</b>	<b>296.6</b>	<b>304.7</b>
<b>Budgetary balance</b>	<b>-33.4</b>	<b>-24.9</b>	<b>-21.1</b>	<b>-10.2</b>	<b>-1.3</b>	<b>3.4</b>	<b>7.8</b>
Federal debt <sup>1</sup>	550.3	581.3	602.4	612.5	613.9	610.4	602.6
<b>Per cent of GDP</b>							
Budgetary revenues	14.6	14.4	14.3	14.6	14.7	14.8	14.8
Program expenses	14.7	14.1	13.8	13.4	13.1	12.9	12.7
Public debt charges	1.9	1.8	1.8	1.7	1.8	1.8	1.8
Budgetary balance	-2.1	-1.5	-1.2	-0.6	-0.1	0.2	0.4
Federal debt	33.9	33.9	34.4	33.2	31.6	30.1	28.5

Note: Totals may not add due to rounding.

<sup>1</sup> The projected level of federal debt for 2011–12 includes an estimate of other comprehensive income, as well as estimated transitional adjustments related to enterprise Crown corporations' adoption of International Financial Reporting Standards.

# Federal Deficit

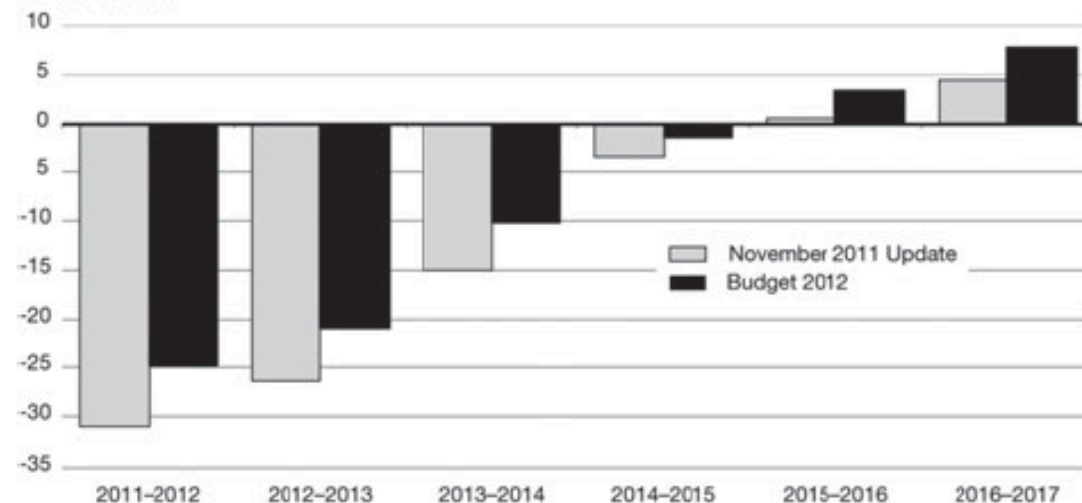
Government remains on track to return to balanced budgets over the medium term

Chart 6.1

## Projected Budgetary Balance

November 2011 Update versus Budget 2012

billions of dollars



Source: Department of Finance.

# Federal Economic Vision & Ontario

- Federal vision can be summarized as a “*sustainable Canada*”.
- Two dimensions:
  - 1. Securing the public finances
    - Balancing budget
      - 9.7 billion dollars reduction in program spending over the next three years (total spending still rises but slower than revenue)
    - Restricting growth of individual and governmental transfers (eg. Raising OAS age to 67 by 2023; new health transfer formula)
  - 2. Long term economic growth policies:
    - Smaller government
    - Export market diversification away from US
    - Natural resource development especially in West



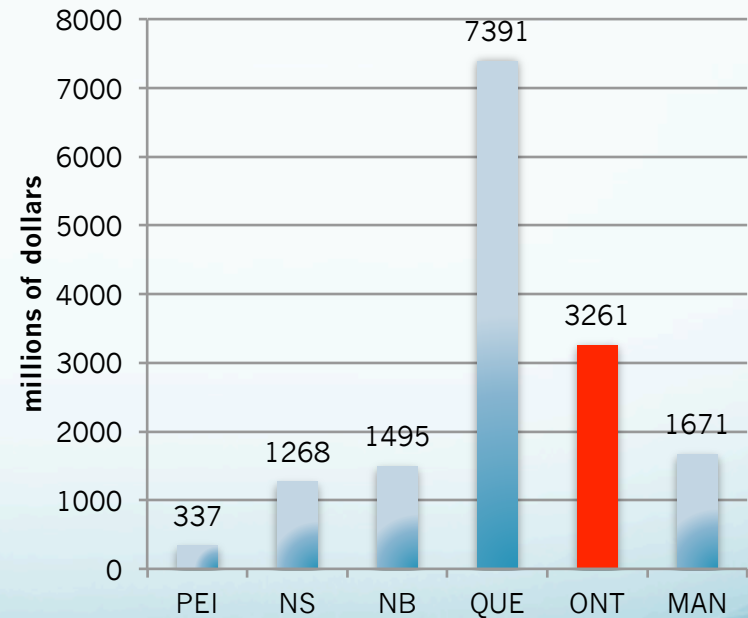
# Implications for Ontario

- Economic power in Canada shifting West as a result of natural resource & commodities sector – will keep dollar high.
- An even more decentralized federation with a health transfer funding growth floor. A stable funding source with provincial freedom to experience diverse outcomes.
- Equalization – Ontario's current equalization surge a result of funding formula with heavy weight on natural resources. This will change.

# A Sign of Changing Times

- Ontario has become more transfer dependent
- About 20 percent of its revenues now from federal transfers.
- Ontario became an equalization receiving province in 2009.
- In 2012-13, Ontario will get 3.3 billion dollars in equalization.

**Equalization Receiving Provinces in 2012-13**  
(Source: Department of Finance)



# Ontario's Economy

# Recent Indicators: Ontario

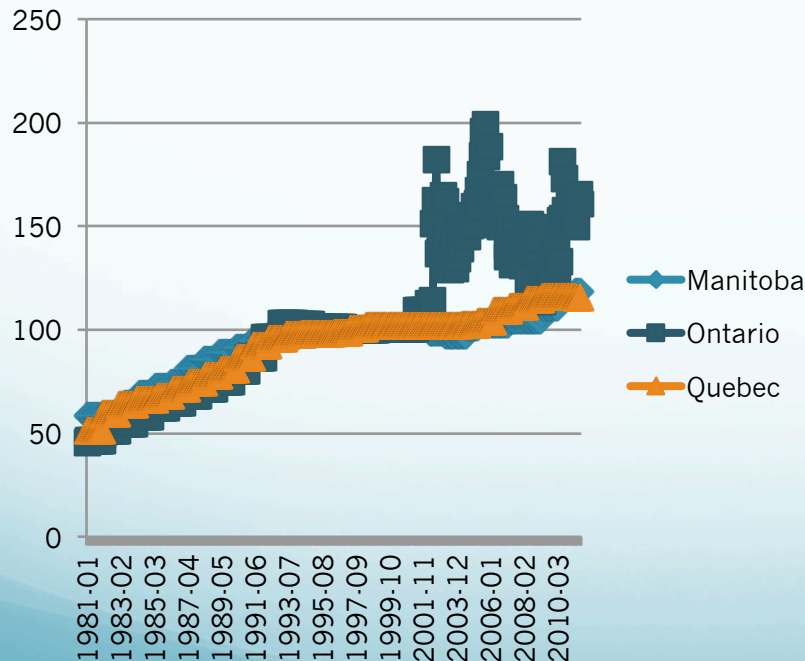
- Real GDP Growth: -3.2% in 2009, +3.0 in 2010, +1.8% in 2011 (estimate) and projected at **1.7%** in 2012.
- Unemployment Rate: **7.4%** (March 2012)
- New Vehicle Sales: -8.4% in 2009, +8.1% in 2010 & **2.4%** in 2011.
- Retail Trade: -2.5% in 2009, +5.4% in 2010 & **+3.0%** in 2011
- Total Building Permits: -13.9% in 2009, +28.6% in 2010, **-0.4%** in 2011 (Canada up 2.1%)

# Ontario Economy

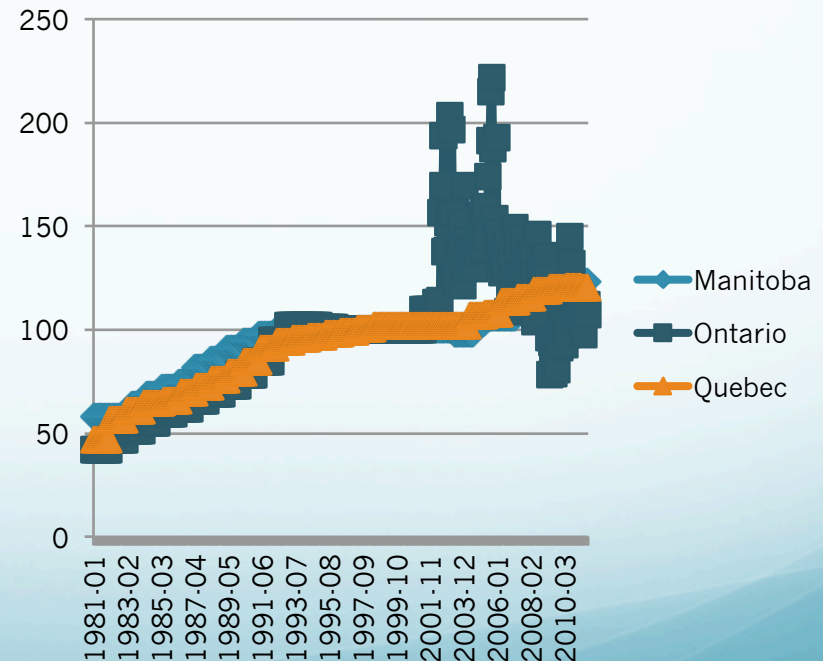
- Economy appears to have recovered most of the jobs lost during recession but growth meager. Economy seems to be slowing.
- Long term economic issues
  - Productivity growth flat
  - High public debt and deficit levels
  - Continued weakness in auto sector
  - High Canadian dollar & weak U.S. economy
  - Structural changes in Ontario manufacturing
  - High energy costs – electricity – costs rising again

# Electricity Cost Comparisons

**Electric Power Selling Price  
Index for Amounts Below  
5000Kw, 1981-2011 (Source:  
Statistics Canada)**



**Electric Power Selling Price  
Index for Amounts Above  
5000kw, 1981-2011 (Source:  
Statistics Canada, 1997=100)**



# Can a Natural Resource Boom Save Ontario?

- Quebec – Plan Nord aims to develop its north as a mining resource frontier. Revenues from mining royalties are expected to help balance its budget.
- Ontario – Northern Growth Plan and Ring of Fire. Do not appear to be going anywhere fast due to:
  - Provincial land and development policies
  - High energy costs
  - A deficit and need for transport infrastructure
  - Property right issues with First Nations

# **Ontario's Dilemma is Economic and Fiscal**



# Per Capita Output Growth Weak

- Ontario real per capita GDP is approximately where it was in 2000.
- Real per capita output grew 19 percent from 1990 to 2000 but only grew 2 percent from 2000 to 2010.

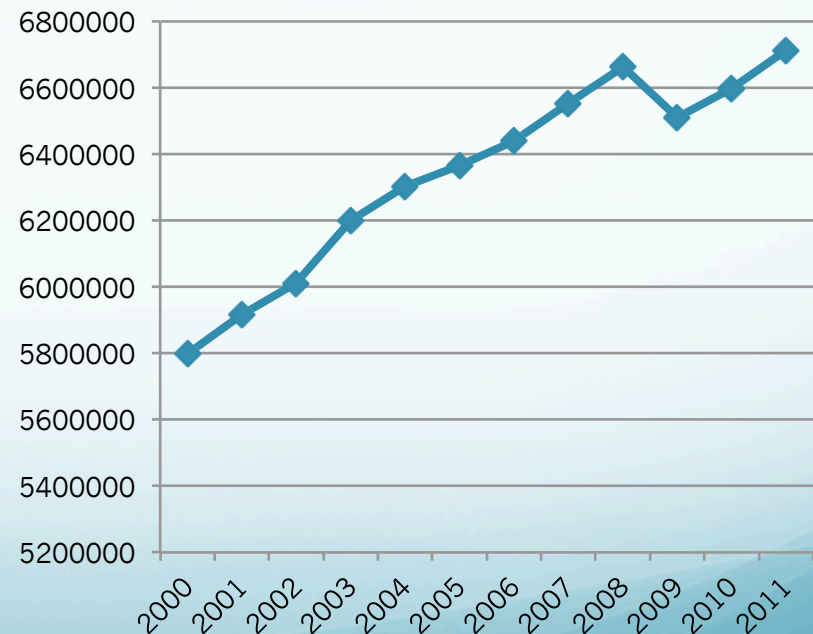
**Ontario Real Per Capita GDP: 1981-2010** (Data Source: Statistics Canada)



# Employment has begun to recover from recession

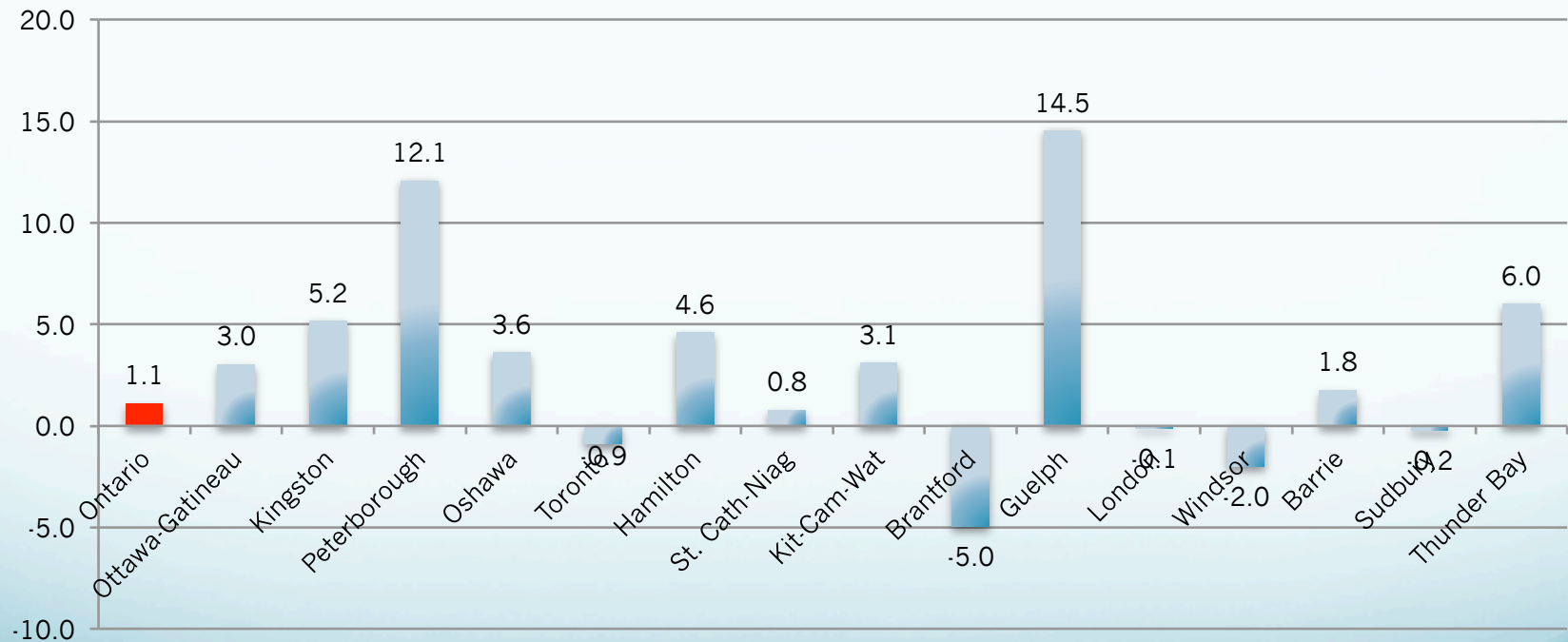
- From 2000 to 2008, employment in Ontario grew 16 percent
- From 2008 to 2011 employment grew 0.8 percent.
- Employment has grown faster than real output reflecting productivity problems.

**Average Annual Monthly  
Total Employment: Ontario  
2000-2011**(Data Source:  
Statistics Canada)



# Regional Employment Growth Variation

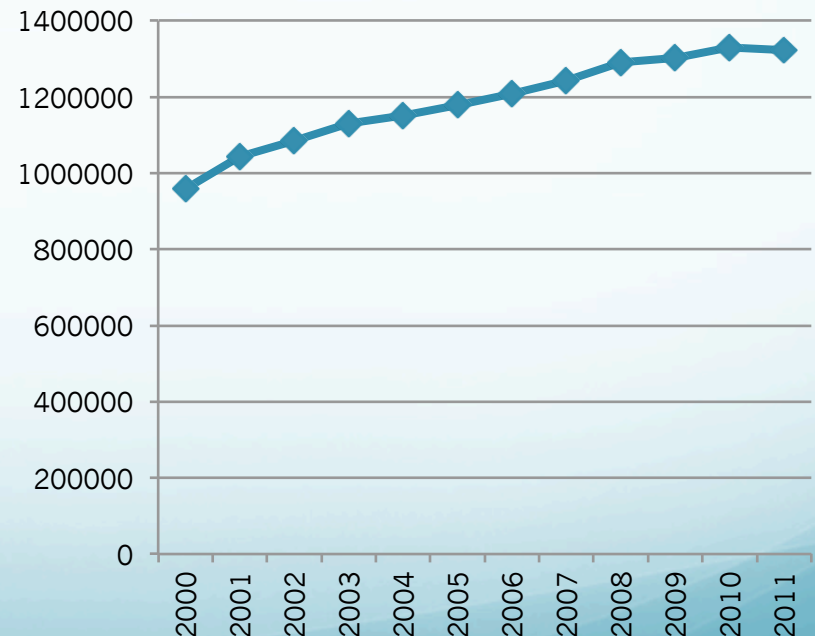
**Employment Growth(%) in Major Ontario Centres,  
January 2011-January 2012 (Data Source: Statistics  
Canada)**



# Public sector employment has grown over last decade

- Public sector employment in Ontario from 2000 to 2011 grew 38 percent.
- Recession saw slowdown in public sector employment.

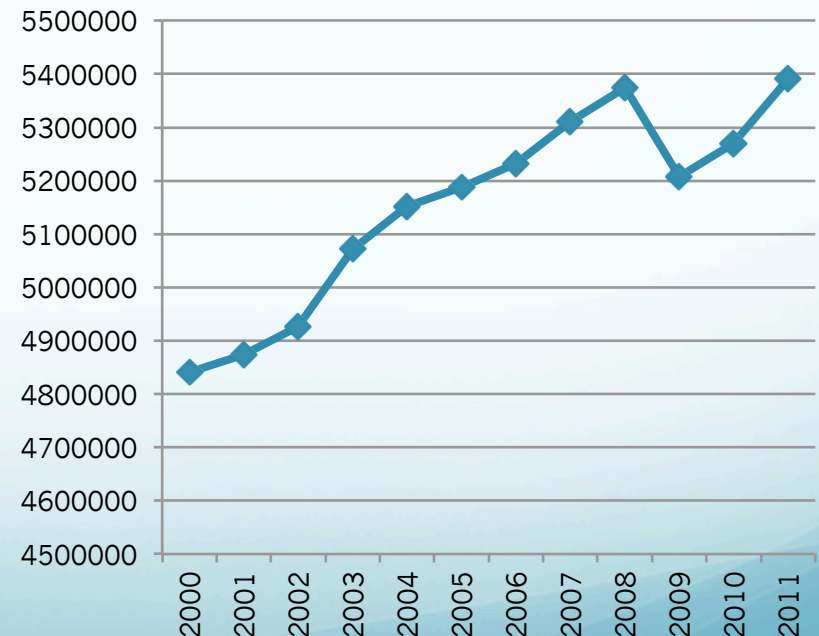
**Average Annual Monthly Public Sector Employment: Ontario 2000-2011 (Data Source: Statistics Canada)**



# Private sector employment has grown over last decade but not as quickly

- Private sector employment from 2000 to 2011 grew 11.4 percent.
- From 2008 to 2011, private sector employment only grew 0.3 percent.

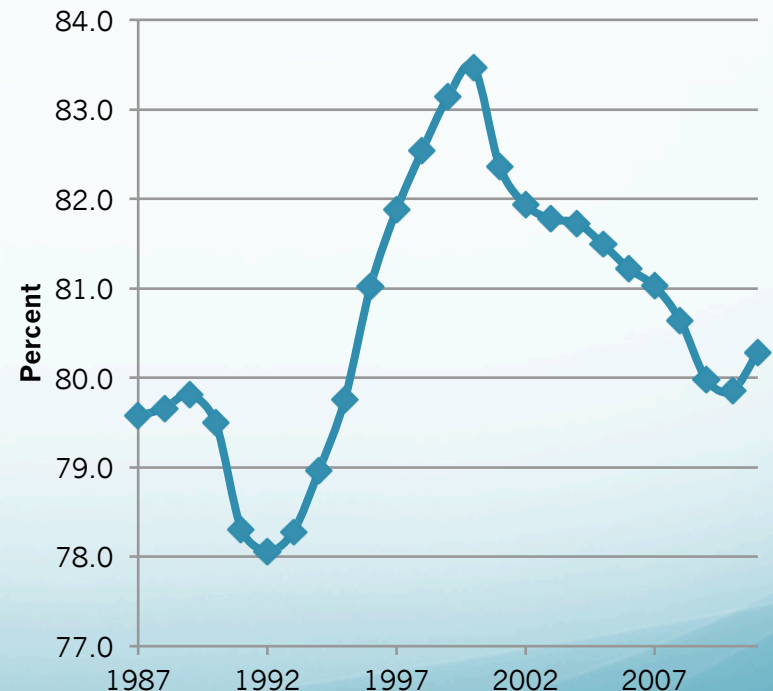
**Average Annual Monthly Private Sector Employment: Ontario 2000-2011 (Data Source: Statistics Canada)**



# Private sector employment share in decline since 2000

- Ontario's private sector employment as a share of total employment rose from 78 to 83.5 percent from 1992 to 2000.
- Since 2000, has declined to 80.3 percent.

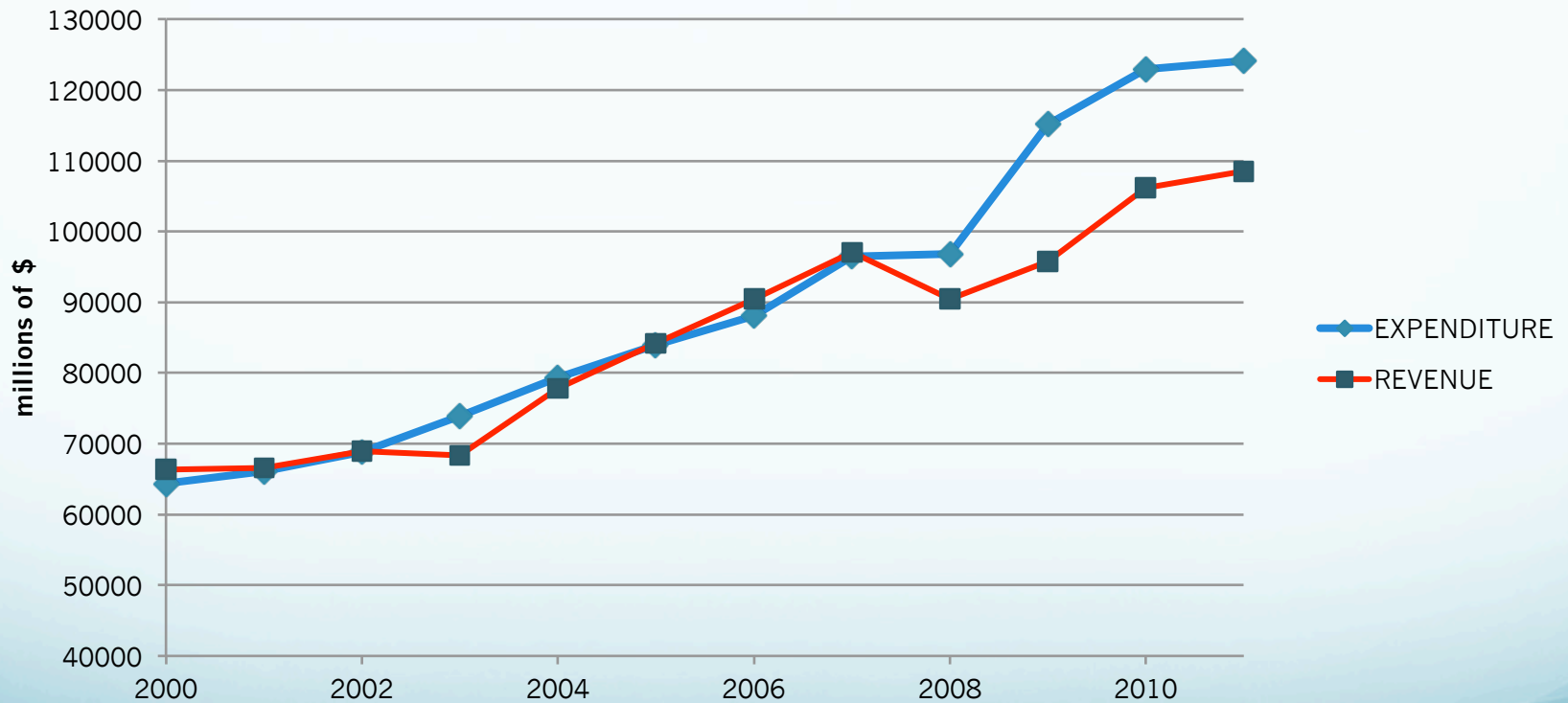
**Private Sector Share of Employment in Ontario:  
1987-2011**



# **FISCAL DILEMMA**

# The Situation to Date

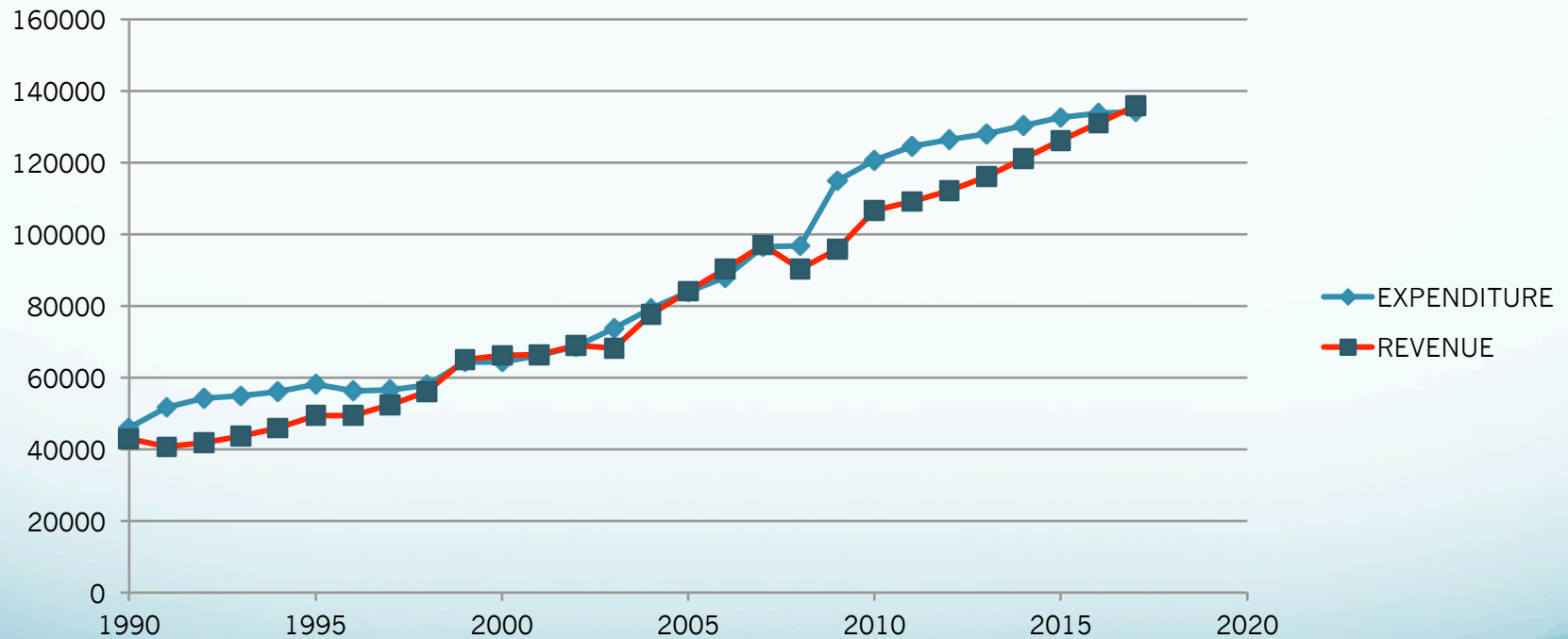
## Ontario Government Revenues and Expenditures: 2000-2011





# Forecast from the 2012 Budget

## Ontario Provincial Government Revenues and Expenditures: Actual 1990-2011 and Forecast 2012-2017



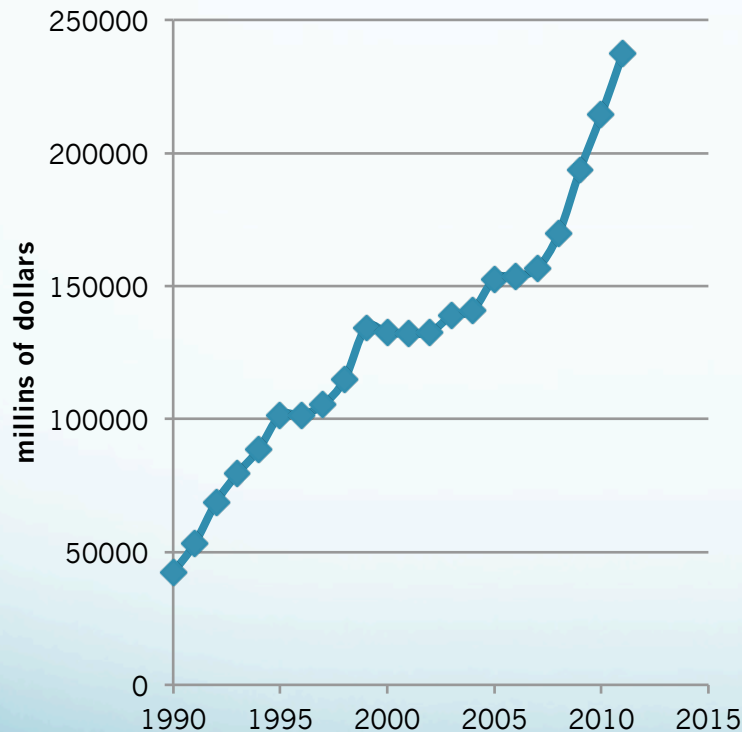
# Ontario's Deficit

**Ontario' Deficit: Actual 1990-2011 and Forecast 2012-2017**



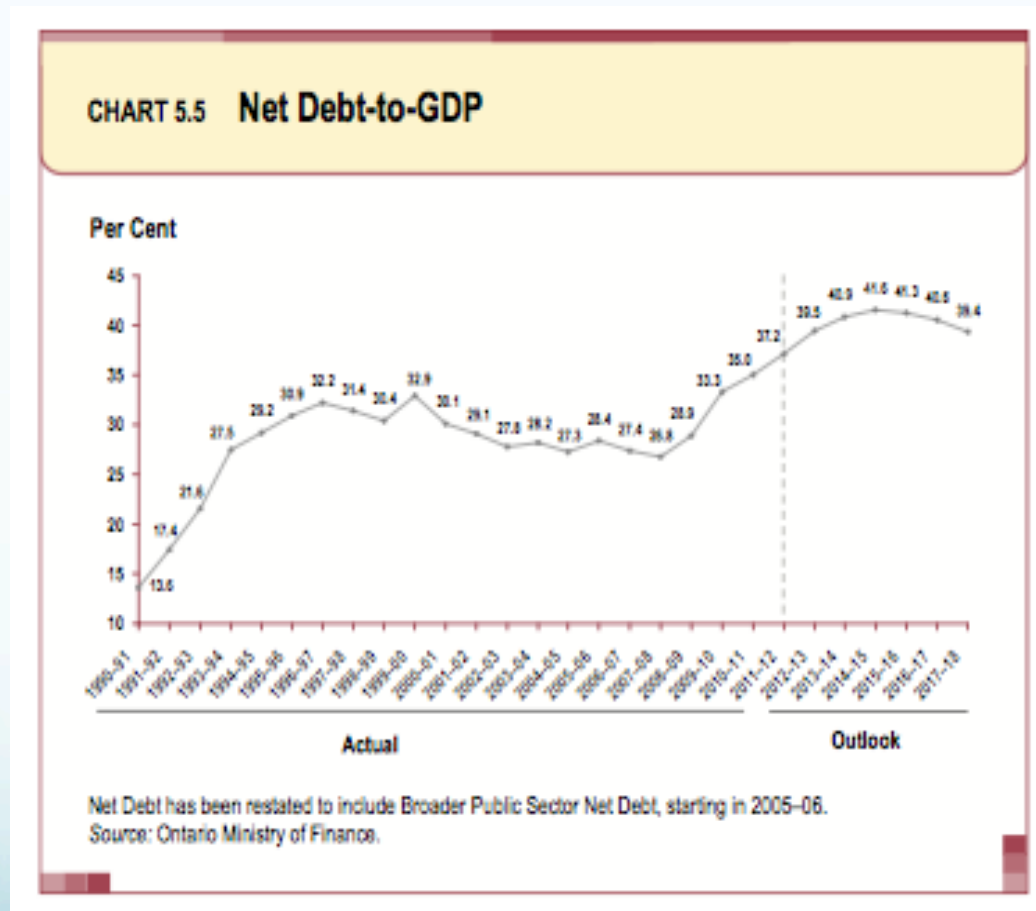
# Ontario's Net Debt (1965-2011)

**Ontario's Net Debt:  
1990-2011**



- Ontario's net debt was 1.6 billion dollars in 1965, 39 billion in 1989, 214.5 billion in 2010
- Ontario's net debt is projected to be 237.6 billion dollars in 2011.
- Until budget is balanced, another 44.5 billion dollars in accumulated deficits will be added. Net debt projected at 297 billion in 2014.

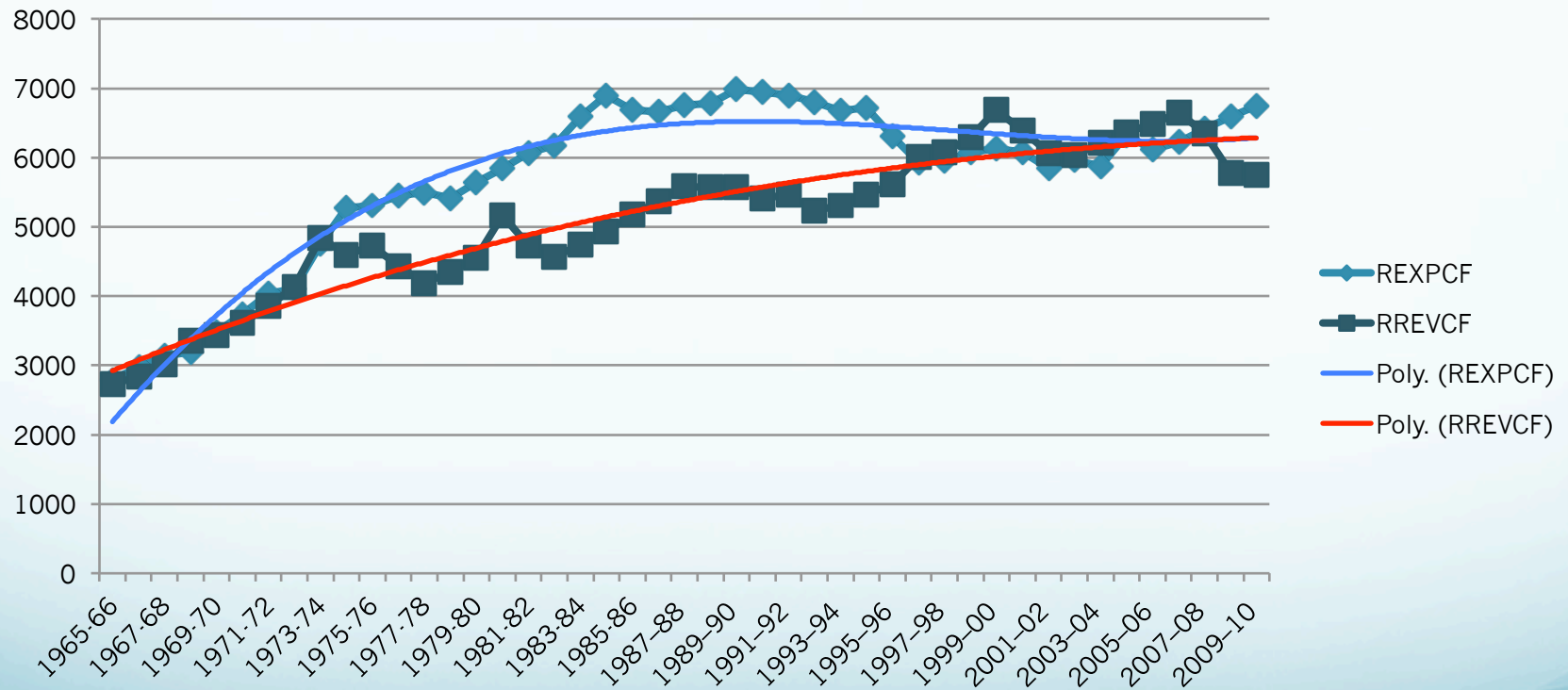
# Ontario Debt to GDP Ratio: 1990-2011 Actual & Forecast



# **Comparing Ottawa and Queen's Park on Fiscal Sustainability**

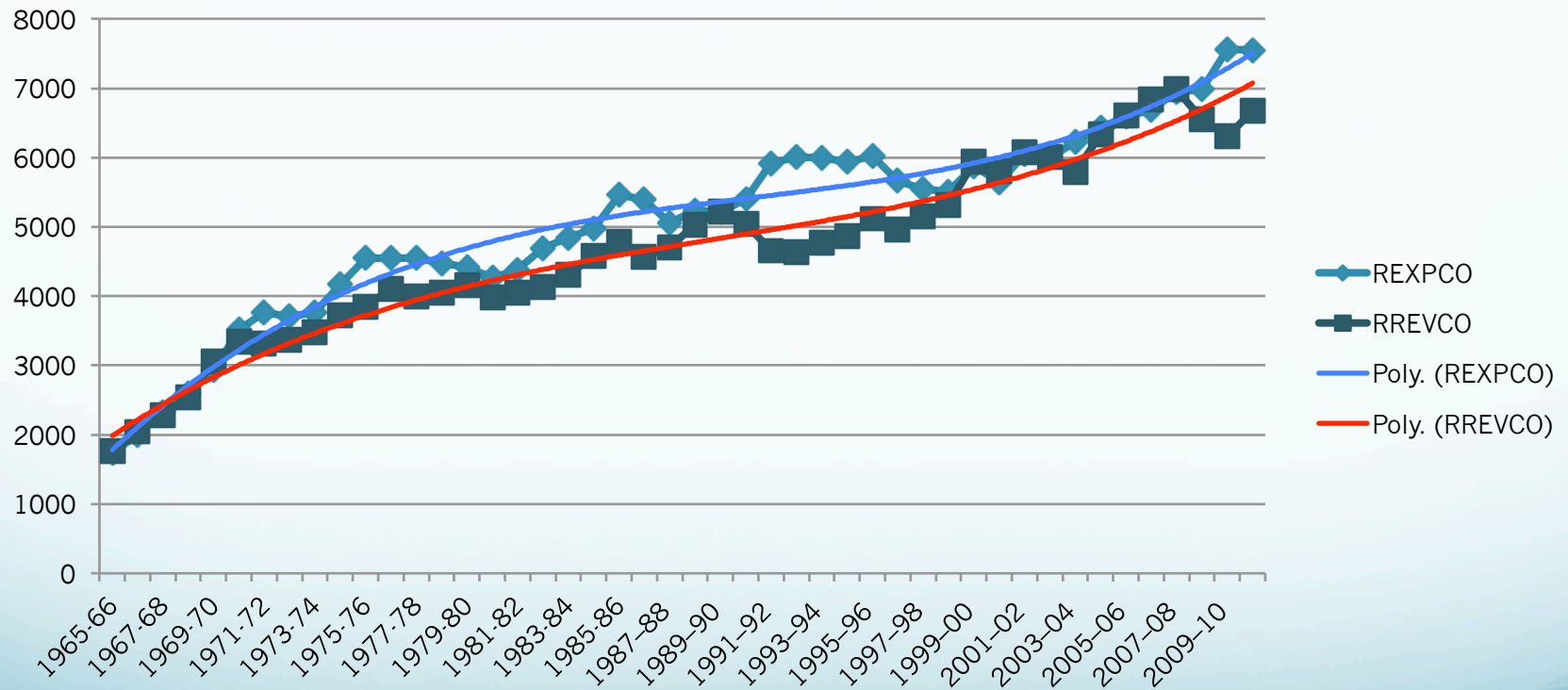
# Federal

## Real Per Capital Federal Government Revenues and Expenditures, 1966-2010 (2002 dollars)



# Ontario

## Real Per Capita Ontario Provincial Government Revenues and Expenditures, 1966-2011 (2002 dollars)



# Ontario Economic Performance & Projections (Source: Ontario 2012 Budget)

**TABLE 2.9 The Ontario Economy, 2010 to 2015**  
(Per Cent Change)

	Actual		Projection			
	2010	2011	2012	2013	2014	2015
<b>Real Gross Domestic Product</b>	3.0	1.8e	1.7	2.2	2.4	2.5
Personal Consumption	3.6	2.1e	1.8	2.4	2.5	2.5
Residential Construction	8.3	5.1e	(1.1)	1.0	2.2	2.3
Non-residential Construction	(1.6)	5.6e	3.0	4.1	4.0	2.9
Machinery and Equipment	15.2	19.8e	6.3	5.3	5.5	5.6
Exports	7.5	1.9e	2.8	3.5	3.9	3.9
Imports	13.3	1.8e	1.8	3.0	3.2	3.1
<b>Nominal Gross Domestic Product</b>	5.3	4.2e	3.4	4.1	4.2	4.3
<b>Other Economic Indicators</b>						
Retail Sales	5.4	3.0	3.0	3.7	3.9	4.2
Housing Starts (000s)	60.4	67.8	64.0	63.0	69.0	71.0
Personal Income	4.2	3.0e	2.9	3.7	4.2	4.3
Labour Income	3.9	3.4e	3.2	4.2	4.3	4.3
Corporate Profits	19.1	13.8e	4.0	4.6	4.9	5.1
Consumer Price Index	2.5	3.1	1.7	2.0	2.0	2.0
Employment	1.7	1.8	0.9	1.3	1.5	1.6
Job Creation (000s)	108	121	59	89	103	108
Unemployment Rate (Per Cent)	8.7	7.8	7.7	7.4	7.0	6.7
<b>Key External Variables</b>						
U.S. Real Gross Domestic Product	3.0	1.7	2.3	2.6	3.0	3.0
WTI Crude Oil (\$ US per Barrel)	79.4	95.1	100.2	103.8	106.5	108.6
Canadian Dollar (Cents US)	97.1	101.1	98.0	101.0	102.5	102.0
3-month Treasury Bill Rate <sup>1</sup>	0.6	0.9	0.9	1.4	2.4	3.4
10-year Government Bond Rate <sup>1</sup>	3.2	2.8	2.2	2.8	3.8	4.5

e = estimate.

<sup>1</sup> Government of Canada interest rates (per cent).

Sources: Statistics Canada, Canada Mortgage and Housing Corporation, Bank of Canada, U.S. Bureau of Economic Analysis, *Blue Chip Economic Indicators* (March 2012), New York Mercantile Exchange and Ontario Ministry of Finance.



# Ontario Budget: Expense Outlook

**TABLE 2.21 Summary of Medium-Term Expense Outlook**  
(\$ Billions)

	Interim 2011–12	Plan 2012–13	Outlook 2013–14 2014–15		Average Annual Growth 2011–12 to 2014–15
<b>Programs</b>					
Health Sector	47.3	48.4	49.4	50.3	2.1 %
Education Sector <sup>1</sup>	23.3	23.9	24.1	24.5	1.7 %
Postsecondary and Training Sector	7.3	7.5	7.7	7.7	1.9 %
Children's and Social Services Sector	13.7	14.1	14.4	14.8	2.7 %
Justice Sector <sup>2</sup>	4.0	4.0	4.0	4.0	0.4 %
Other Programs <sup>2</sup>	18.9	17.9	17.4	16.6	–4.3 %
<b>Total Programs</b>	<b>114.5</b>	<b>115.8</b>	<b>117.0</b>	<b>117.9</b>	<b>1.0 %</b>
Interest on Debt	10.1	10.6	11.2	12.3	6.9 %
<b>Total Expense</b>	<b>124.6</b>	<b>126.4</b>	<b>128.2</b>	<b>130.3</b>	<b>1.5 %</b>

<sup>1</sup> Excludes Teachers' Pension Plan.

<sup>2</sup> Reflects a realignment of expenditures associated with the government real estate portfolio.

*Note:* Numbers may not add due to rounding.

# Spending Analysis

- Total spending expected to rise 4.6 percent between 2011/12 and 2014/15 (124.6 to 130.3 billion \$)
- By Spending Area
  - Health 6.3% (2.1% p.a.)
  - Education 5.2% (1.7% p.a.)
  - PSE & T 5.5% (1.9% p.a.)
  - Social Services 8.0% (2.7% p.a.)
  - Justice 0.4%
  - Other Programs -12.2% (-4.3% p.a.)
  - Debt Interest 21.8% (6.9% p.a.)

# Re Education

- **Drummond Report notes:**
  - Since 2002–03, student enrolment declined from 1,997,000 to 1,877,000, a decrease of 6.0 per cent.
  - Despite decline of 120,000 students, teachers and non-teaching staff increased by 24,000 in Ontario's publicly funded schools.
  - If teaching and non-teaching staff had declined since 2002–03 proportionally to the decline in enrolment, by 2010-11 there would be 35,000 fewer teaching and non-teaching staff in Ontario's schools
  - Combination of increased funding and declining enrolment has led to a 56 per cent increase in per-pupil funding from \$7,201 in 2002–03 to \$11,207 in 2011–12.

# Recall the Drummond Key Education Recommendations

- Cancel full-day kindergarten program
- Raise classroom sizes in elementary schools to 23 from 20; junior schools to 26 from 24.5; and secondary schools to 24 from 22
- Phase out 70 per cent of 13,800 non-teaching staff by 2017-18
- Encourage secondary schools with low attendance to expand to a Grades 7-12 model
- Scrap 25 per cent of money allocated for textbooks and classroom supplies
- Consider raising the retirement age for teachers. Currently, the average teacher retires at 59 after 26 years of service and collects a pension for 30 years

# 2012 Budget Not Quite the Drummond Report

- Remember the summary figures?
  - *Accordingly, we recommend the following annual changes in program spending out to 2017–18:*
  - Health care — plus 2.5 per cent;
  - Education — plus 1.0 per cent;
  - Post-secondary education (excluding training) — plus 1.5 per cent;
  - Social programs — plus 0.5 per cent; and
  - All other programs — minus 2.4 per cent.

# Was Drummond Simply The Bogeyman?

- 562 pages and 362 recommendations
- “Rumours” of 30% across the board cuts prior to report release
- The Drummond Report as a “worst case scenario”?
- Report was not “as bad” as the rumours.
- Implementation as laid out in budget relatively less severe on education and social services sector. Slightly harder on health and all other programs.





# But things will be *much tighter* in Education

- Budget proposals:
  - a two-year wage freeze, with no incremental increases on the salary grid
  - a freeze on banked sick days accumulated as of August 31, 2012, with future gratuity payout, upon retirement, at the employee's salary rate in effect as of August 31, 2012.
  - filing a valuation of the Ontario Teachers' Pension Plan in 2012, and securing through negotiation the future viability and solvency of the plan
  - Close underutilized schools; merge boards
  - BUT: "The government will not consider merging public and separate school boards, in keeping with constitutional requirements."

# As well.....

- Some aspects of the Drummond Report are being quietly implemented – “evidence based decision making”
- Example: “Productivity teams” are being dispatched in June to study government departments and provide suggestions for efficiencies.
- Universities – several are apparently being subjected to an “audit” of activities.
- Compensation will be a major target-in education makes up 75% of expenses.



# Ontario Budget: Revenues

**TABLE 2.12 Summary of Medium-Term Outlook**  
(\$ Billions)

Revenue	Interim 2011–12	Plan 2012–13	Outlook	
			2013–14	2014–15
Taxation Revenue	75.2	78.8	81.1	84.7
Personal Income Tax	24.2	25.8	27.2	28.7
Sales Tax	20.9	21.1	22.1	23.3
Corporations Tax	9.4	10.8	10.2	10.5
Ontario Health Premium	2.9	3.1	3.3	3.4
Education Property Tax	5.6	5.6	5.7	5.7
All Other Taxes	12.2	12.4	12.6	13.1
Government of Canada	21.4	21.8	23.0	23.5
Income from Government Business Enterprises	4.4	4.1	4.4	5.3
Other Non-Tax Revenue	8.3	7.6	7.6	7.5
<b>Total Revenue</b>	<b>109.3</b>	<b>112.2</b>	<b>116.1</b>	<b>121.0</b>

Starting in the 2012 Budget, revenue and expense have been restated to reflect a fiscally neutral reclassification of a number of tax expenditures as described in Section F of this chapter.

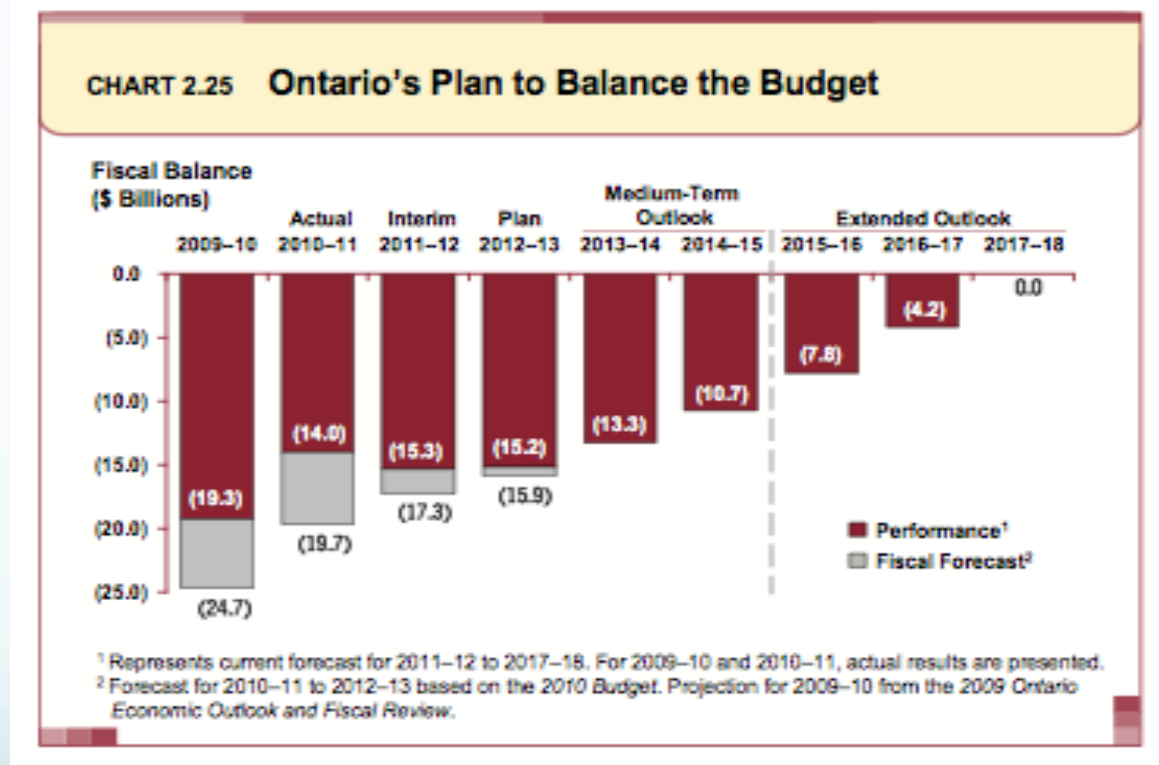
Note: Numbers may not add due to rounding.

# Revenue Analysis

- Total revenue expected to rise 10.7 percent between 2011/12 and 2014/15 (109.3 to 121 billion \$)
- By major category
  - PIT 18.6%
  - PST/HST 11.5%
  - CIT 11.7%
  - Federal Transfers 9.8%

# Ontario's Plan to balance the books relies on revenue rising faster than spending ...

## Ontario's Deficit Plan



# Analysis-I

- Ontario economy recovering slowly – long term productivity and income growth a real concern.
- Interest rates a major risk given – a 1% rise in interest rates can add billions in additional government spending as well as deal a blow to housing sector and consumer spending given personal debt levels.
- Value of Canadian dollar high which also harms export sector.
- Government energy policy still a concern – high electricity rates.
- Northern economic development in “Ring of Fire”

# Analysis -II

- Health and education sectors are still a government priority but...After years of high growth, expenditure growth restraint is the order of the day.
- Ontario government's approach to deficit in 2012 budget involves slowing expenditure growth to allow revenues to catch up.
- Provincial government political situation a major variable on all these fiscal projections.

# Ontario as Argentina?

- Argentina once had the highest per capita income in the world but never fully recovered from the shift in beef markets.
- Ontario has similarly been shocked from its traditional position within the Canadian federation. Recovery is still an option.
- Ontario has a serious economic productivity problem brought about by high electricity and energy costs, a reliance on automobile manufacturing, dependency on US export market, appreciation of the Canadian dollar and a political culture focused on process, bureaucracy and regulation rather than economic fundamentals.
- Can Ontario recover: YES.

# Questions