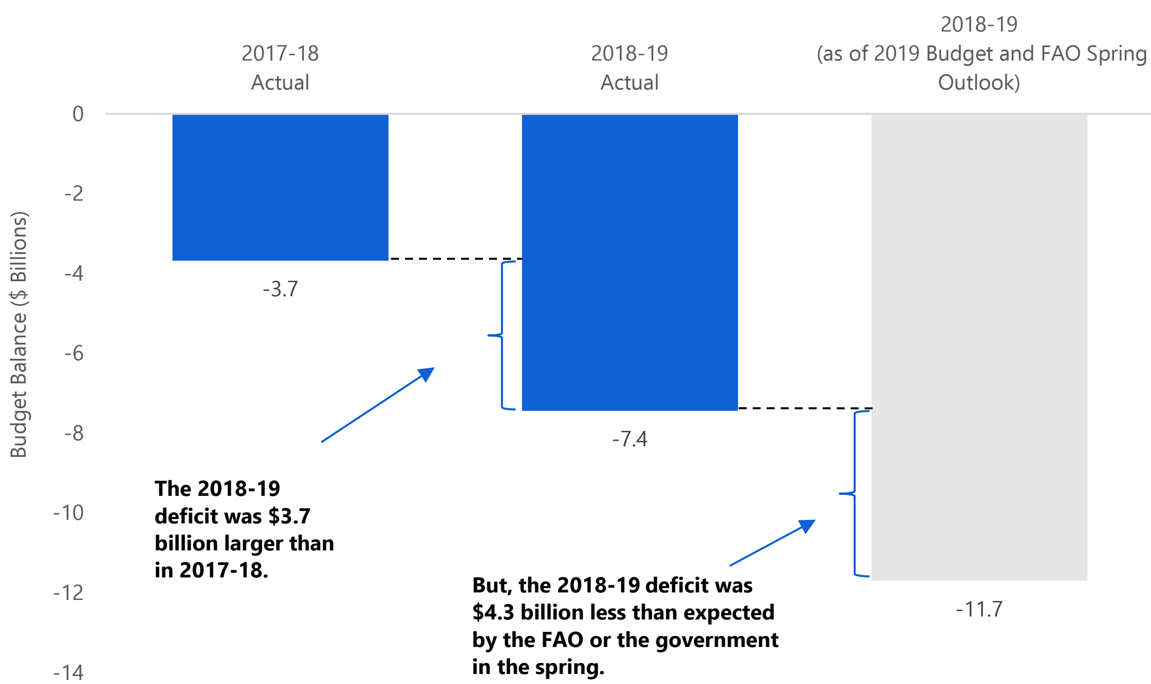
Understanding Ontario's 2018-19 Deficit

According to the Public Accounts of Ontario, the Province recorded an actual deficit of $7.4 billion in 2018-19, double the 2017-18 deficit of $3.7 billion. The actual 2018-19 deficit also turned out to be significantly lower than the $11.7 billion deficit projected by both the FAO and the government at the time of the 2019 Ontario Budget.

This note examines the underlying factors behind the relatively large $3.7 billion year-over-year deterioration in the 2018-19 deficit, and shows that this sharp rise was largely the result of policy choices by both the previous and current governments – including the cancellation of the cap and trade program and higher spending on electricity subsidies.

The note also looks at the unusually large $4.3 billion improvement in the actual 2018-19 deficit from the 2019 budget projection,[1] which was largely the result of unexpectedly strong revenues.

Ontario's deficit rose by $3.7 billion in 2018-19, but was $4.3 billion lower than the budget projection



Source: 2018-19 Ontario Public Accounts and 2019 Ontario Budget.

[1] The 2019 budget refers to the prior year (2018-19) as the 'interim estimate'.

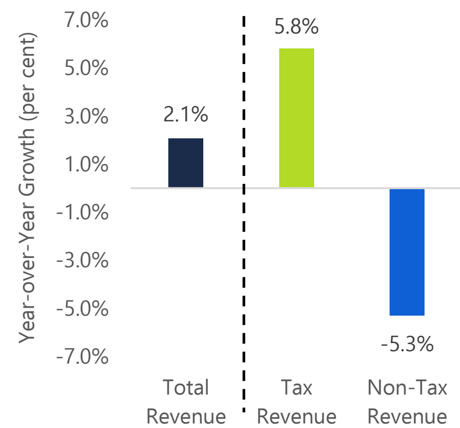
Examining the year-over-year increase in Ontario's 2018-19 deficit: spending increases outpaced revenue, doubling the deficit

In 2018-19, Ontario recorded a budget deficit of $7.4 billion, double the 2017-18 deficit of $3.7 billion. The relatively sharp increase in the deficit was the result of modest revenue growth, combined with a relatively large increase in program spending. Policy decisions by both the current and previous governments contributed to the slow increase in revenues as well as the rise in spending last year.

Policy decisions weakened revenue growth

Ontario's total revenues increased by a modest 2.1 per cent in 2018-19, the result of a surprisingly strong 5.8 per cent increase in tax revenues offset by a 5.3 per cent decline in non-tax revenues. The decline in non-tax revenues reflected a number of policy decisions that included the loss of revenue from the cancellation of the cap and trade program, the end of the debt retirement charge, fewer asset sales, and a one-time reduction in Hydro One's net income.

A decline in non-tax revenue offset the surprisingly strong tax revenue growth in 2018-19

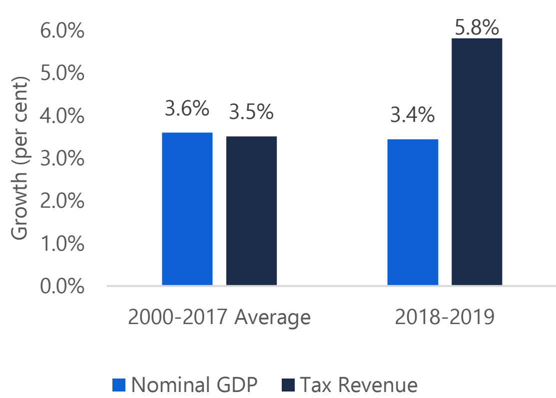


Source: Ontario Public Accounts and FAO.

Tax revenue growth was unexpectedly strong

Tax revenue gains typically reflect economic growth. From 2000 to 2017, tax revenues grew by 3.5 per cent per year on average, in-line with 3.6 per cent average growth in nominal GDP.

Surprisingly strong tax revenues in 2018-19



Source: Ontario Public Accounts and FAO.

However, in 2018-19, tax revenues increased by 5.8 per cent (or $5.8 billion), well ahead of the estimated 3.4 per cent growth in nominal GDP.

The higher-than-expected growth in tax revenue was primarily due to much stronger corporate income tax revenues than anticipated. Personal income tax also showed surprising strength in 2018-19, rising 7.5 per cent. These increases were partly offset by a decline in land transfer taxes due to a softer resale housing market.

Government policy decisions reduced non-tax revenues in 2018-19

Non-tax revenue[2] declined by 5.3 per cent (or -$2.7 billion) in 2018-19, driven by several key policy decisions by both the previous and current governments.

In July 2018, the Province ended the cap and trade program, which raised revenue through the auction of emissions allowances to fund spending on greenhouse gas reduction initiatives. The end of the cap and trade program led to a $1.9 billion decline in 2018-19 revenues compared to 2017-18.[3]

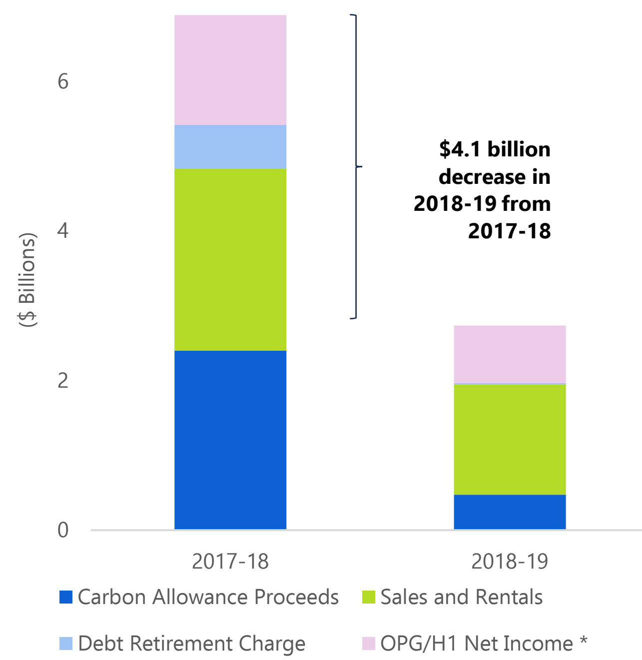
As part of the Province's partial sale of Hydro One, the government sold 20 per cent of Hydro One's equity in 2017-18,[4] temporarily boosting sales and rental revenue in that year. Fewer asset sales in 2018-19 resulted in a $0.9 billion reduction in sales and rentals revenue when compared to 2017-18.

A further consequence of Hydro One's partial sale was an Ontario Energy Board ruling that resulted in a one-time $0.4 billion reduction in the Province's revenue received from the corporation in 2018-19.[5]

In addition, the Debt Retirement Charge[6] was removed from non-residential electricity bills on March 31, 2018, which permanently lowered non-tax revenue by $0.6 billion beginning in 2018-19.

Taken together, these four non-tax revenue streams declined by **$4.1 billion** in 2018-19. This more than offset a $1.4 billion increase in other non-tax revenue sources, leading to a $2.7 billion decline in overall non-tax revenues in 2018-19. See Appendix A for further details.

Policy decisions lowered 2018-19 non-tax revenues



* Note: This includes the net income of Ontario Power Generation, Hydro One and Brampton Distribution Holdco Inc.

Source: Ontario Public Accounts and FAO.

[2] This includes transfers from the federal government, income from government business enterprises, and other non-tax revenues, such as service fees.
[3] The FAO estimated that cancelling Ontario's cap and trade program added $841 million on net to the 2018-19 deficit, because the Province gave up the revenue but did not cancel all the spending programs. Also, the Province sustained "wind-down" costs and several of the cancelled spending programs funded infrastructure projects that will not provide immediate savings to the Province. See the FAO's 2018 report "Cap and Trade: A Financial Review of the Decision to Cancel the Cap and Trade Program".
[4] The FAO estimates the secondary offering in 2017-18 generated about $0.7 billion in revenue. See the FAO's 2018 report on the partial sale of Hydro One for more details.
[5] The partial sale of Hydro One created a $2.8 billion deferred tax asset. The Ontario Energy Board (OEB) ruled that 38 per cent of this gain should be allocated to ratepayers. Hydro One's appeal of the OEB's decision in Divisional Court was unsuccessful. This resulted in an $867 million payment from Hydro One to ratepayers in 2018-19, temporarily lowering its net income (see the 2018-19 Public Accounts, page 78). As the government owns 47 per cent of Hydro One, the net impact on the Province's deficit was approximately $400 million. See the FAO's 2018 report on the partial sale of Hydro One for more details.
[6] The Debt Retirement Charge (DRC) was a charge payable on electricity consumed in Ontario and replaced a portion of debt servicing costs previously included as part of electricity bills before the restructuring of the former Ontario Hydro. The government ended the DRC on residential bills as of January 1, 2016.

Electricity subsidies a key factor behind strong spending increase in 2018-19

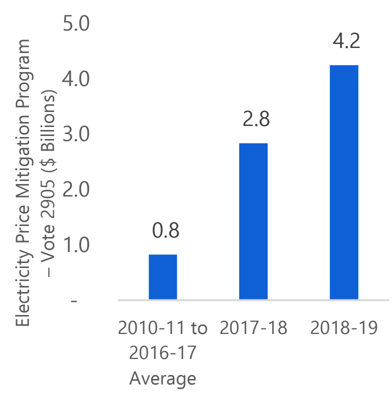
Program spending increased by 4.5 per cent (or $6. 4 billion) in 2018-19, with each of the five largest ministries recording significantly higher spending on a year-over-year basis.

Ministry Expense	2017-18 ($ millions)	2018-19 ($ millions)	y/y change ($ millions)	y/y growth (per cent)
Program Spending	142,363	148,751	6,388	4.5%
Health and Long-Term Care	59,066	61,511	2,445	4.1%
Education *	28,998	30,425	1,427	4.9%
Community and Social Services	12,264	12,767	503	4.1%
Advanced Education and Skills Development	11,104	11,869	765	6.9%
Energy	3,496	4,899	1,403	40.1%
of which: Electricity Cost Relief Programs	*2,834*	*4,242*	*1,407*	*49.7%*
All Other Ministries	27,435	27,280	-155	-0.6%
Interest on Debt	11,903	12,384	481	4.0%
Total Expense	154,266	161,135	6,869	4.5%

* Education expense includes the Ontario Teacher's Pension Plan.
Source: 2018-19 Ontario Public Accounts and FAO.

Notably, Ministry of Energy expenditures increased at the fastest rate, largely due to the sharply higher cost of electricity subsidies. The government spent $4.2 billion subsidizing electricity prices in 2018-19, an increase of almost 50 per cent from $2.8 billion in 2017-18. [7]

The cost of electricity subsidies reached $4.2 billion in 2018-19



Source: Ontario Public Accounts and FAO.

Spending by the Ministry of Health and Long-Term Care increased by 4.1 per cent (or $2.4 billion) in 2018-19. This was mainly driven by funding increases for hospitals[8] and higher expenditure for Drug Programs that reflected the introduction of OHIP+.[9]

Education spending grew by 4.9 per cent in 2018-19, an increase of $1.4 billion.[10] Increased funding for school boards was the largest driver of education spending, along with spending for childcare and early years programs.[11]

Spending in all other ministries declined by $0.2 billion in 2018-19, mostly due to lower spending in Indigenous Relations and Reconciliation, Environment and Climate Change, and the Treasury Board Secretariat.[12] See Appendix B for further details.

[7] This increase reflects the first full-year fiscal impact of the Fair Hydro Plan (FHP) provisions, which was introduced on July 1, 2017. These costs are consistent with the Auditor General's recommended accounting treatment of the FHP. Many of the FHP's provisions began on July 1, 2017 and had a partial impact in the 2017-18 fiscal year. In addition, higher electricity generation costs and electricity demand in 2018-19 increased the required subsidy to satisfy the FHP's commitment to limit electricity bill increases to the rate of inflation. See the FAO's "An Assessment of the Fiscal Impact of the Province's Fair Hydro Plan".

[8] Spending by Local Health Integration Networks (LHINs, vote item 1411) increased by $1.2 billion in 2018-19, and hospital funding accounts for two-thirds of LHIN spending. See the FAO's "Expenditure Estimates 2019-20 Ministry of Health and Long-Term Care".

[9] OHIP+ added to Ontario drug programs expenditures in 2018-19. See the FAO's 2019 "Ontario Health Sector" report for more details.

[10] This includes spending for the Ontario Teacher's Pension Plan.

[11] Total expense in the Elementary and Secondary Education Program (vote 1002, which provides financial support to school boards) increased by $1.0 billion in 2018-19.

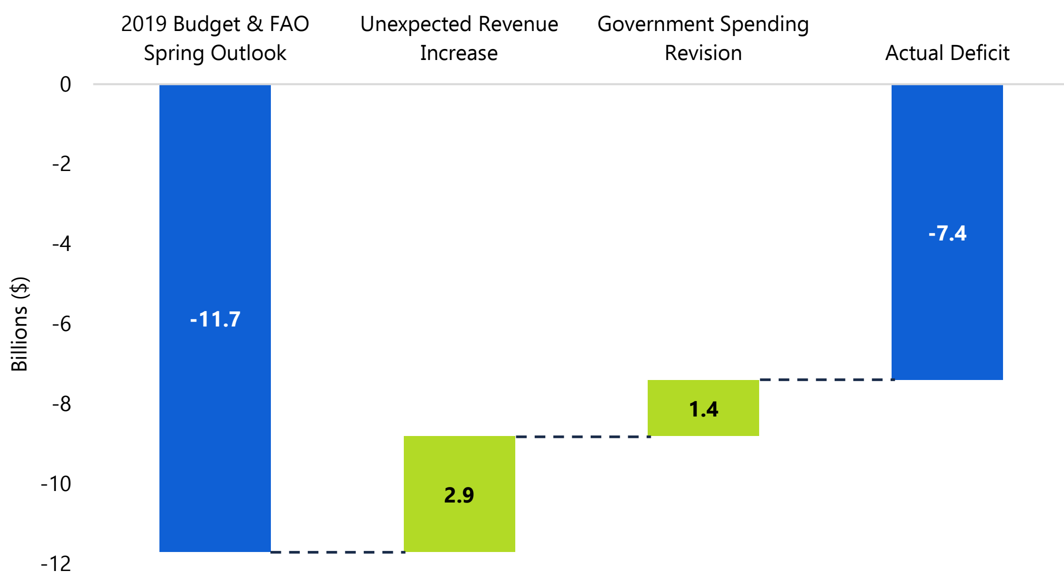
[12] In 2017-18 the Province recorded a $1.1 billion one-time settlement in Indigenous Relations and Reconciliation, which led to a $900 million decline in 2018-19 spending.

Comparing Ontario’s actual 2018-19 results with the 2019 budget projection: unexpectedly strong revenues and lower spending reduced the deficit

The FAO’s Spring 2019 Economic and Budget Outlook projected an $11.7 billion deficit for 2018-19, consistent with the interim deficit reported in the 2019 Ontario Budget. However, the 2018-19 Ontario Public Accounts reported an actual budget deficit of $7.4 billion last year, $4.3 billion lower than projected by both the FAO and Ontario government.

The unusually large[13] $4.3 billion improvement in the deficit, compared to the spring projection, was the result of $2.9 billion in higher revenues – in large part a sharp jump in corporate tax revenues – combined with $1.4 billion in lower program spending than projected in the 2019 budget.

Unexpectedly high revenue and government spending revisions improved Ontario’s 2018-19 deficit



Source: 2018-19 Ontario Public Accounts and FAO.

Three revenue sources accounted for most of the $2.9 billion increase relative to the FAO projection. Corporations tax for 2018-19 was $1.4 billion (or 9.3 per cent) higher than anticipated, personal income tax was $0.4 billion higher, while income from government business enterprises was $0.6 billion above expectations.

At the same time, total spending in the 2018-19 Public Accounts was $1.4 billion lower than planned at the time of the 2019 budget, primarily due to lower than planned spending in Health and Long-term Care, Education, Environment, as well as unspent contingency funds.[14]

[13] The change in the 2018-19 deficit from the interim estimate in the 2019 budget to the actual as reported in the Public Accounts was the largest over the past decade on a consistent accounting basis.

[14] The unspent contingency fund allocation resulted in lower Treasury Board spending (Vote Item 3404). Lower spending in Health was mainly driven by lower transfer payments to LHIN’s (Vote Item 1411), while lower spending in Education was mainly driven by lower school board transfers (Vote Item 1002) and lower spending in the childcare and early years program (Vote Item 1004).

With the release of the Public Accounts showing a deficit of $7.4 billion in 2018-19, the government has significantly overachieved on the 2019 budget's projection of an $11.7 billion deficit, largely as a result of unexpectedly high revenues. However, the extent to which this overachievement will carry-forward to future years is uncertain.

The government will be releasing an updated fiscal plan, incorporating the 2018-19 final results, in the upcoming 2019 Fall Economic Statement, scheduled for release on November 6.

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About the FAO

Established by the Financial Accountability Officer Act, 2013, the Financial Accountability Office (FAO) provides independent analysis on the state of the Province's finances, trends in the provincial economy and related matters important to the Legislative Assembly of Ontario. Visit our website at http://www.fao-on.org/en/ and follow us on Twitter at https://twitter.com/InfoFAO.

Appendix A: Revenue by Source

	2017–18 Actual $M	2018–19 Actual $M	y/y change $M	y/y growth Per cent
Taxation				
Personal Income Tax	32,900	35,381	2,481	7.5%
Sales Tax	25,925	27,808	1,883	7.3%
Corporations Tax	15,612	16,606	994	6.4%
Employer Health Tax	6,205	6,544	339	5.5%
Education Property Tax	5,883	6,171	288	4.9%
Ontario Health Premium	3,672	3,819	147	4.0%
Land Transfer and Non-Residential Speculation Tax	3,174	2,761	-413	-13.0%
Gasoline Tax	2,701	2,709	8	0.3%
Tobacco Tax	1,244	1,241	-3	-0.2%
Fuel Tax	760	774	14	1.8%
Beer and Wine Tax	601	603	2	0.3%
Electricity Payments-In-Lieu of Taxes	494	435	-59	-11.9%
Ontario Portion of Federal Cannabis Excise Duty	–	19	19	
Other Taxes	552	653	101	18.3%
Total Tax Revenue	**99,723**	**105,524**	**5,801**	**5.8%**
Transfers from Government of Canada				
Canada Health Transfer	14,359	14,852	493	3.4%
Canada Social Transfer	5,314	5,451	137	2.6%
Equalization Payments	1,424	963	-461	-32.4%
Labour Market Development Agreement	672	719	47	7.0%
Infrastructure Programs	1,065	605	-460	-43.2%
Social Housing	419	394	-25	-6.0%
Direct Transfers to Hospitals, School Boards and Colleges	314	390	76	24.2%
Home Care and Mental Health	116	329	213	183.6%
Workforce Development Agreement	234	296	62	26.5%
Indian Welfare Services Agreement	274	281	7	2.6%
Early Learning and Childcare	122	160	38	31.1%
Bilingualism Development	85	85	-	0.0%
Legal Aid - Criminal	64	64	-	0.0%
Youth Criminal Justice	52	53	1	1.9%
Labour Market Agreement for Persons with Disabilities	63	-	- 63	
Other	283	448	165	58.3%
Total Transfer Revenue	**24,860**	**25,090**	**230**	**0.9%**
Income from Investment in Government Business Enterprises				
Ontario Lottery and Gaming Corporation	2,487	2,464	-23	-0.9%
Liquor Control Board of Ontario	2,207	2,276	69	3.1%
Ontario Cannabis Store	-6	-42	-36	600.0%
Ontario Power Generation Inc./Hydro One Ltd.	1,464	772	-692	-47.3%
Total Government Business Enterprise Income	**6,152**	**5,470**	**-682**	**-11.1%**
Other Revenue				
Fees, Donations and Other Revenues from Hospitals, School Boards and Colleges	8,309	9,237	928	11.2%
Vehicle and Driver Registration Fees	1,912	1,991	79	4.1%
Sales and Rentals	2,450	1,477	-973	-39.7%
Other Fees and Licenses	819	861	42	5.1%
Carbon Allowance Proceeds	2,401	472	-1,929	-80.3%
Royalties	290	251	-39	-13.4%
Independent Electricity System Operator Revenue	210	227	17	8.1%
Power Supply Contract Recoveries	185	173	-12	-6.5%
Local Services Realignment	138	138	0	0.0%
Net Reduction of Power Purchase Contracts	74	41	-33	-44.6%
Electricity Debt Retirement Charge	593	15	-578	-97.5%
Miscellaneous	2,478	2,733	255	10.3%
Total Other Revenue	**19,859**	**17,616**	**-2,243**	**-11.3%**
Total Revenue	**150,594**	**153,700**	**3,106**	**2.1%**

Source: Schedule 1 in the 2018-19 Ontario Public Accounts, pages 92 and 93. 2017-18 numbers have been re-stated.

Appendix B: Expense by Ministry

	2017–18 Actual ($M)	2018–19 Actual ($M)	y/y change ($M)	y/y growth (Per cent)
Ministry				
Accessibility Directorate of Ontario	19	18	-1	-5.3%
Advanced Education and Skills Development	11,104	11,869	765	6.9%
Agriculture, Food and Rural Affairs	989	1,066	77	7.8%
Attorney General	1,686	1,714	28	1.7%
Board of Internal Economy	296	371	75	25.3%
Children and Youth Services	4,116	4,419	303	7.4%
Citizenship and Immigration	44	100	56	127.3%
Community and Social Services	12,264	12,767	503	4.1%
Community Safety and Correctional Services	2,523	2,678	155	6.1%
Economic Development and Growth/Research, Innovation and Science	898	890	-8	-0.9%
Education	27,339	28,747	1,408	5.2%
Teachers' Pension	1,659	1,678	19	1.1%
Energy	3,496	4,899	1,403	40.1%
Environment and Climate Change	715	560	-155	-21.7%
Executive Offices	55	50	-5	-9.1%
Finance	845	954	109	12.9%
Interest on Debt	11,903	12,384	481	4.0%
Municipal Partnership Fund	506	510	4	0.8%
Power Supply Contract Costs	191	173	-18	-9.4%
Francophone Affairs	6	6	0	0.0%
Government and Consumer Services	569	567	-2	-0.4%
Health and Long-Term Care	59,066	61,511	2,445	4.1%
Indigenous Relations and Reconciliation	1,208	289	-919	-76.1%
Infrastructure	1,739	1,766	27	1.6%
International Trade	47	39	-8	-17.0%
Labour	303	308	5	1.7%
Municipal Affairs and Housing	1,368	1,479	111	8.1%
Natural Resources and Forestry	851	838	-13	-1.5%
Northern Development and Mines	744	826	82	11.0%
Senior Affairs	27	32	5	18.5%
Status of Women	27	22	-5	-18.5%
Tourism, Culture and Sport	1,582	1,545	-37	-2.3%
Transportation	4,452	4,713	261	5.9%
Treasury Board Secretariat	187	182	-5	-2.7%
Employee and Pensioner Benefits	1,442	1,165	-277	-19.2%
Total Expense	**154,266**	**161,135**	**6,869**	**4.5%**

Source: Schedule 4 in the 2018-19 Ontario Public Accounts, page 98. 2017-18 numbers have been re-stated.