

# **ANNEX II**

## **Ontario's Finances**

---



---

## Introduction

In October 2003, the Premier-designate asked former Provincial Auditor, Mr. Erik Peters, to conduct an independent review of the Province's finances. The *Report on the Review of the 2003-04 Fiscal Outlook*, released that same month, confirmed that Ontario faced a potential deficit of \$5.6 billion for 2003-04. This report also identified risks to the fiscal outlook of up to \$1 billion that could cause the potential deficit to worsen by year-end.

While the Province's finances are complex, the source of the deficit is clear. Provincial spending has been growing much more quickly in recent years than revenue. In the last three years, program spending has increased by over \$10 billion, while tax revenues have increased by half a billion dollars. As a result, Ontario now faces a structural deficit that threatens the ability of the Province to balance the budget and to provide acceptable levels of services to the public into the future.

The current government has repeatedly stated its intention to pursue an agenda of improving public services, measuring the results of improved services, and placing such key sectors as health care and education on a sound financial footing, in a fiscally responsible manner. In light of the severity of the current fiscal situation it inherited, the government will need to make difficult fiscal choices and trade-offs.

This annex:

- **Section I:** Provides an overview of Provincial finances;
- **Section II:** Outlines the nature of the fiscal challenge facing the Province and the need for a sustainable fiscal policy;
- **Section III:** Provides the fiscal outlook for the Province for 2003-04, including highlights of Ontario's 2003-04 revenue and expense outlook; and
- **Section IV:** Provides a medium-term fiscal projection for the Province, assuming no further policy changes, as well as high-level options for balancing the budget.

---

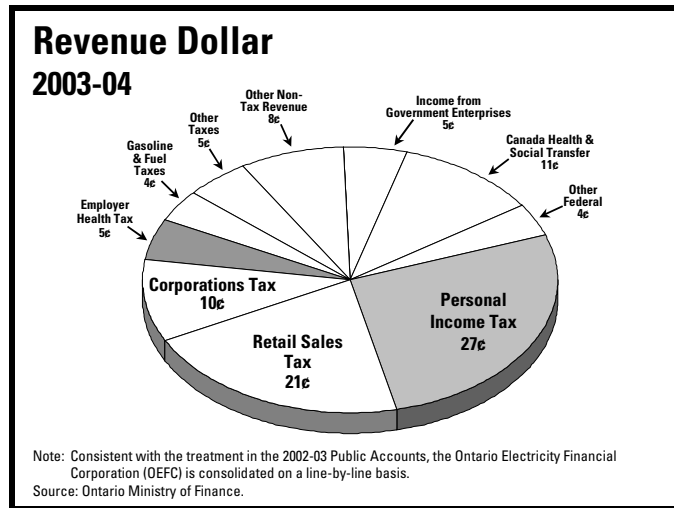
## Section I: Overview of Provincial Finances

### STRUCTURE OF ONTARIO'S FINANCES

#### **Composition of Revenue**

Ontario's total revenue in 2003-04 is forecast to be \$69.5 billion. Major categories of Provincial revenues include Taxation, Income from Government Enterprises, payments from the Government of Canada and Other Non-Tax Revenues.

Taxation revenues comprise the largest category of revenue for the provincial government. Of the \$69.5 billion in Provincial revenue expected in 2003-04, \$49.9 billion or about 72 per cent is expected to be derived from taxation revenue. Three revenue sources within this category—Personal Income Tax, Retail Sales Tax and Corporations Tax—account for 58 per cent of total revenue. The Province also collects a number of other taxes such as Gasoline and Fuel Taxes, Tobacco Tax, Employer Health Tax and Land Transfer Tax.

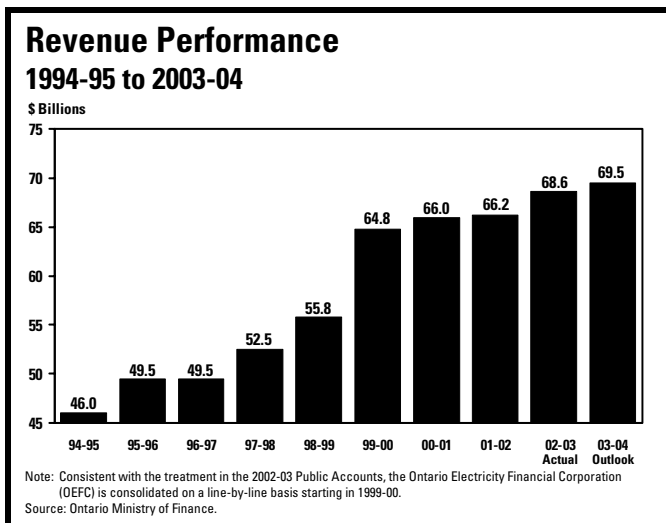


In 2003-04, the Province is forecasting payments from the Government of Canada totalling \$10.3 billion. The federal government makes most of these payments through the Canada Health and Social Transfer (CHST), which supports a number of areas of Provincial spending, notably health care, post-secondary education and social services. Federal transfers represent 15 per cent of Ontario's revenue forecast for 2003-04.

Income from Government Enterprises, including the Liquor Control Board of Ontario and the Ontario Lottery and Gaming Corporation, is forecast to be \$3.4 billion this year. These revenue sources represent 5 per cent of total Provincial revenue.

In 2003-04, the Province expects to collect \$5.9 billion in Other Non-Tax Revenue. These revenues cover a wide range of government activities and are largely from fees, permits, sales and rentals, and reimbursements for services the Province provides. Other Non-Tax Revenues represent 8 per cent of total Provincial revenue in 2003-04.

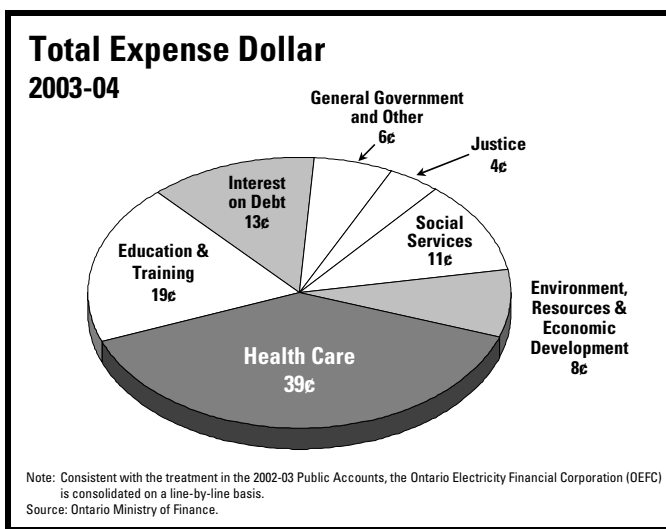
The revenue performance chart highlights growth in total revenue from 1994-95 to 2003-04. After increasing dramatically in the second half of the 1990s, due in part to strong economic growth, revenue growth has weakened in recent years. This reflects slower economic growth since 2000 and the impact of tax cuts.



### Composition of Expense

In 2003-04, it is estimated that total Provincial expense will amount to \$75.2 billion. About 70 per cent of all Provincial spending is on social programs including health, education and social services, with the balance allocated for economic development, justice, interest costs on the debt, and other government activities.

While the Province supports a wide range of services to the public, funding for health care and education accounts for the largest share of spending. In 2003-04, health care spending at \$29.0 billion is expected to account for 39 per cent of total Provincial spending. Education and Training, which includes Provincial spending in support of school boards and provincial grants for colleges, universities and training, totals \$14.2 billion or 19 per cent. Funding for social services including children's services, Ontario Works, and the Ontario Disability Support Program, represents \$8.2 billion or 11 per cent.

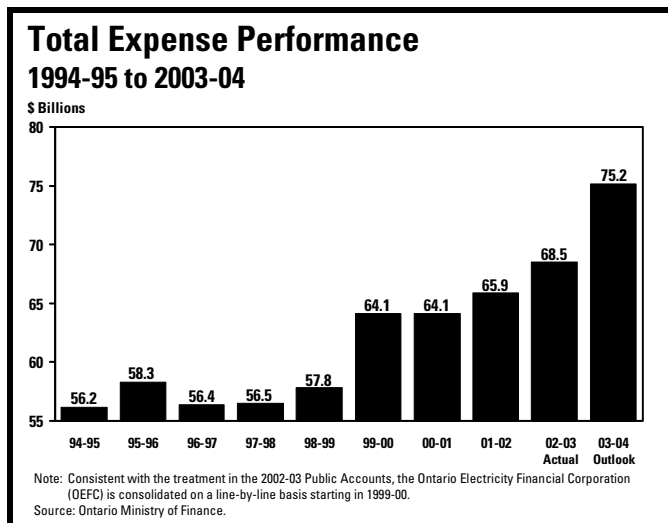


In 2003-04, Provincial spending on the environment, resources and economic development will comprise \$5.9 billion or 8 per cent of total spending. This total also includes spending on government priorities such as transportation, agriculture and energy. The Justice sector, including the Ministry of the Attorney General and the Ministry of Community Safety and Correctional Services, represents \$2.9 billion or 4 per cent of Provincial spending.

General Government and Other comprises ministries such as Management Board Secretariat and the Ministry of Finance that take a central or corporate role in providing government services and policy advice. In 2003-04, General Government spending at \$4.9 billion is expected to account for 6 per cent of total Provincial expense.

In 2003-04, interest costs on Ontario's net debt, estimated at \$139 billion, will amount to \$10 billion, or 13 per cent of total spending.

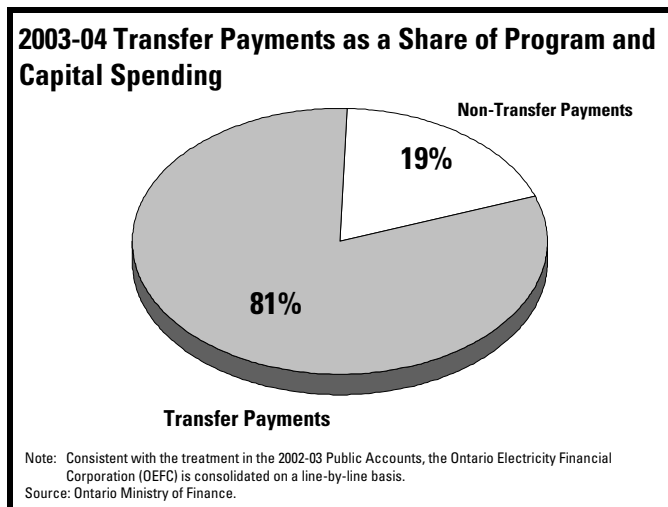
The expense performance chart highlights growth in total spending from 1994-95. Total spending has increased dramatically in recent years.



**Provincial Expense: Transfers and Direct Spending**

More than 80 per cent of total Provincial spending, excluding interest on debt, is in the form of transfer payments to organizations and individuals. Provincial transfer payments support key organizations and agencies within the broader public sector, such as hospitals, school boards, colleges and universities, as well as individuals who receive payments such as social assistance or the Guaranteed Annual Income System (GAINS).

Non-transfer payment spending, including Provincial spending for programs and services delivered directly by the Ontario government itself, such as courts, correctional services and policing services provided by the Ontario Provincial Police, represents the remaining 19 per cent of Ontario's spending on programs and capital.



In 2003-04, the five largest transfer payment programs alone will account for about \$33 billion or more than half of Ontario's program spending.

<b>Ontario's Five Largest Transfer Payment Programs</b>	<b>2003-04 (\$ Billions)</b>	<b>Per cent of Program Spending</b>
Operation of Hospitals	10.5	16.8
School Board Operating Grants	9.4	15.0
OHIP Payments to Physicians and Practitioners	6.8	10.8
Ontario Disability Support Program and Ontario Works	3.8	6.1
Drug Programs*	2.8	4.5
<b>Total</b>	<b>33.3</b>	<b>53.3</b>

\* Drug Programs includes \$2.3 billion in Ministry of Health and Long-Term Care and \$0.5 billion in Ministry of Community and Social Services.

Note: Numbers may not add due to rounding.

Source: Ontario Ministry of Finance.

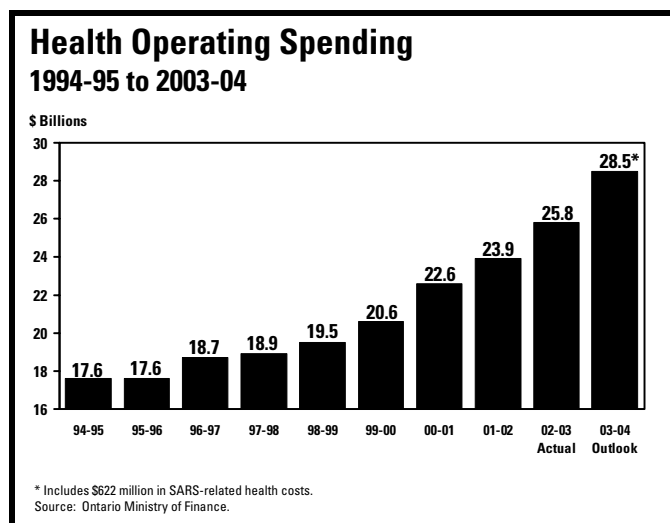
## RECENT TRENDS AND COST DRIVERS IN PROVINCIAL SPENDING

### **Rising Health Care Costs**

While increasing demands exist in many program areas, the single most significant source of upward pressure on Provincial spending is health care. Increasing demands for health care services and rapidly rising costs are affecting all provinces in Canada. Over the past five years, Ontario's health care operating spending has increased at an average annual rate of about 8 per cent. This is twice the rate of growth in total Provincial spending, excluding health care, of about 4 per cent during the same period.

As a result of this rapid growth, health care has been consuming an increasing share of Provincial spending. In 1994-95, total health care spending accounted for 32 per cent of Provincial spending and this year, health care will account for 39 per cent.

Health care now accounts for 46 per cent of Provincial program spending, excluding capital and interest on debt, clearly illustrating the extent to which increased health care costs are limiting options in other program areas. The composition of Provincial program expense by sector can be found in the tables and graphs section to this annex.



The cost of providing health care services is driven by many factors including the demographic pressures of an aging population, labour costs and rapid technological change. Ontario's seniors currently make up close to 13 per cent of the population, but account for about 50 per cent of Provincial health spending.

Demographic trends indicate that the proportion of the population aged 65 and over will increase significantly in the future. Over the next 25 years, the seniors' population in Ontario is expected to rise from 1.5 million in 2003-04 to almost 3.2 million in 2028. A shortage of health professionals in Ontario and other jurisdictions, combined with the highly labour-intensive nature of health care delivery, has resulted in upward wage pressures in recent years. These shortages are most acute in nursing and certain medical specialties. In addition, new technologies and better diagnostic procedures, which improve the quality and length of life, are placing additional costs on the health care system.

### **Compensation Costs**

The programs and services delivered by the provincial government and Ontario's broader public sector (BPS) are provided by a variety of people, including doctors, nurses, teachers and civil servants. More than 80 per cent of Provincial spending, excluding interest on debt, is in the form of transfer payments to individuals and BPS partners, such as hospitals, schools, colleges and universities. Furthermore, within major areas of the broader public sector itself, typically about 75 per cent of operating costs are related to salaries and benefits.

As a result, compensation costs and wage settlements are key cost drivers and have a substantial impact on both the finances of BPS partners and the Province.

### **Examples of Potential Compensation Costs**

<b>Sector</b>	<b>Cost of 1% salary increase</b>	<b>Size of Sector</b>
OHIP Payments to Physicians	\$58 million	Over 21,000 physicians in Ontario, comprising 10,000 family doctors and 11,000 specialists.
Hospital Nurses	\$34 million	Over 40,000 nurses in hospitals.
Elementary and Secondary School Staff	\$115 million*	Over 180,000 staff including teachers, principals, administrators, support and maintenance staff.
Ontario Public Service	\$45 million	Over 60,000 public servants.

\* One per cent increase to salary benchmarks in Student-Focused Funding formula.

Source: Ontario Ministry of Finance.

Depending on the magnitude of upcoming wage settlements, higher compensation costs could produce upward pressures on Provincial finances directly and on the broader public sector, which may rely on Provincial financial support.

---

## **Section II: The Need for a Sustainable Fiscal Policy**

While governments and households are dissimilar in many ways, both must live within their means. A household that spends more each month than it takes home in pay can get by for a while by running down savings or borrowing from a line of credit. Governments can do the same. But for both, what works in the short run may lead to problems in the long run. Savings accounts run out, eventually limits on lines of credit are exhausted, and carrying costs increasingly eat into budgets.

The only sustainable approach in the long run both for households and for governments is to keep spending in line with income. Aligning spending and revenue as closely as possible, and including prudent measures such as a budgetary reserve to help ensure that a fiscal plan can accommodate unexpected shocks, creates a sustainable fiscal policy. This is the way that governments live within their means.

This approach is good for governments, its transfer partners and for citizens. Hospitals, school boards and other organizations that rely on Provincial transfers can plan better, because their funding is more likely to be predictable and stable. Ontarians can feel more confident because the prudence built into the plan will help their government avoid pressures for tax increases, additional borrowing or service cuts if conditions change suddenly and adversely.

By recognizing the need to keep spending in line with revenue, a sustainable fiscal policy is based on the premise of a balanced budget. Deficits are funded through borrowing, and rising government debt eventually affects everyone. While governments can generally borrow at relatively low interest rates, interest costs reduce amounts available to governments for other spending. Chronic deficits seriously weaken a government's ability to provide programs and services.

The challenge for governments everywhere in the developed world is to meet the needs of citizens as pressures grow for more health care and better education. At the same time, there is an expectation that taxes will not increase and governments will avoid deficits.

This has led to a shift in the way that governments operate: increasingly, the focus is on the results of spending. This shift recognizes that it is not just how much that is spent that matters. It is equally important to measure what the spending has achieved for society as a whole, in terms of key outcomes such as literacy and numeracy rates.

---

## ONTARIO'S FISCAL IMBALANCE

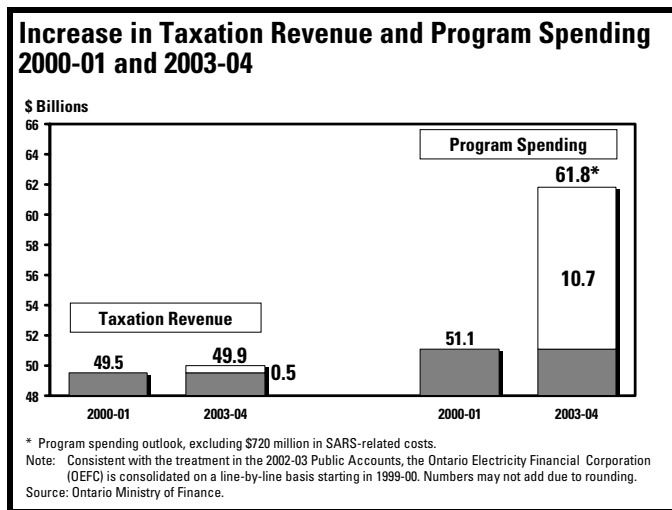
As noted, the Peters Report identified a potential deficit of \$5.6 billion for 2003-04. Many of the factors that produced this \$5.6 billion deficit are structural, or permanent in nature, and unless action is taken will affect the Province for years to come.

The rapid growth in spending in recent years, combined with the impact of tax cuts on base revenue growth, has produced a fiscal situation that is not sustainable. This year the results of these past policies are clear: the Province is spending considerably more than it collects in revenue. To put it simply, the Province is not living within its means.

The Province earns revenue in different ways: taxation revenue, fees and licences, earnings from Provincially owned enterprises, and transfers from the federal government. Of these sources, taxation revenues, such as Personal Income Tax and Retail Sales Tax revenues, are the largest and best support for ongoing Provincial spending on necessary programs and services.

In 2000-01, when Ontario's budget was balanced, taxation revenues at \$49.5 billion, were almost equal to Ontario's program spending of \$51.1 billion. Since 2000-01, however, tax revenues have increased marginally by half a billion dollars as the impact of a slowing economy on Provincial revenue was further aggravated by Provincial tax cuts. Over the same period, spending on Provincial programs increased by over \$10 billion.

While these past spending increases were often for priorities—higher spending on health care, for example—the Province's revenue base could not support these higher levels of spending and tax cuts at the same time. By 2003-04, Provincial spending and the Province's tax base were fundamentally and structurally misaligned.



---

---

## Section III: 2003-04 Fiscal Outlook

### 2003-04 FISCAL SUMMARY

Ontario is currently projecting a deficit of \$5,621 million for 2003-04. The current fiscal outlook for 2003-04 reflects changes in the accounting treatment of the Ontario Electricity Financial Corporation (OEFC) consistent with the recently released 2002-03 Public Accounts and the recommendation of the Peters Report, as well as the impact of recent revenue and expense measures announced by the government that are highlighted in the appendix to this annex.

---

#### 2003-04 Fiscal Outlook (\$ Millions)

	Actual 2002-03	Outlook 2003-04	Change	
			\$ Millions	Per cent
<b>Revenue</b>	68,609	69,532	923	1.3
<b>Expense</b>				
Programs	56,922	62,554	5,632	9.9
Capital	1,876	2,574	698	37.2
Interest on Debt	9,694	10,025	331	3.4
Total Expense	68,492	75,153	6,661	9.7
<b>Surplus / (Deficit)</b>	<b>117</b>	<b>(5,621)</b>	<b>(5,738)</b>	<b>--</b>

Note: Consistent with the treatment in the 2002-03 Public Accounts, the Ontario Electricity Financial Corporation (OEFC) is consolidated on a line-by-line basis.

Source: Ontario Ministry of Finance.

- Total revenue is projected at \$69,532 million in 2003-04, up \$923 million from the 2002-03 level. This increase is primarily due to higher federal payments and a modest increase in tax revenue, partially offset by lower income from government enterprises and other non-tax revenue.
- Total expense in 2003-04 is projected at \$75,153 million, an increase of \$6,661 million from the 2002-03 level of \$68,492 million. This increase in expense is primarily due to higher levels of spending for health care, education, the post-secondary sector and infrastructure.

## 2003-04 REVENUE OUTLOOK

Revenue is projected to be \$69,532 million in 2003-04, an increase of \$923 million from last year's level of \$68,609 million. The increased revenues this year are primarily due to higher transfers from the federal government and a small increase in taxation revenues.

Revenue by Source (\$ Millions)	Actual 2002-03	Outlook 2003-04	Change	
			\$ Millions	Per cent
Taxation Revenue				
Personal Income Tax	18,195	18,600	405	2.2
Retail Sales Tax	14,183	14,550	367	2.6
Corporations Tax	7,459	7,215	(244)	(3.3)
All Other Taxes	9,714	9,582	(132)	(1.4)
Total Taxation Revenue	49,551	49,947	396	0.8
Government of Canada	8,894	10,264	1,370	15.4
Income from Government Enterprises	3,942	3,434	(508)	(12.9)
Other Non-Tax Revenue	6,222	5,887	(335)	(5.4)
<b>Total Revenue</b>	<b>68,609</b>	<b>69,532</b>	<b>923</b>	<b>1.3</b>

Note: Consistent with the treatment in the 2002-03 Public Accounts, the Ontario Electricity Financial Corporation (OEFC) is consolidated on a line-by-line basis.

Source: Ontario Ministry of Finance.

- The 2003-04 Taxation revenue forecast is based on the consensus economic forecast presented in Annex I, and tax collection and assessment information available through the end of October 2003. Total taxation revenues are expected to be \$396 million, or 0.8 per cent higher than in 2002-03.
- Personal Income Tax (PIT) revenues are projected to grow only 2.2 per cent in 2003-04. While underlying PIT revenue growth is consistent with current estimated wages and salaries growth, the 2003-04 PIT total has been adjusted downward, based on recent 2002 assessment information obtained after the 2002-03 Public Accounts were finalized, to correct for an overestimate of past PIT revenues.
- Retail Sales Tax (RST) revenues are expected to grow 2.6 per cent in 2003-04. This relatively modest growth reflects the underlying consensus economic forecast for 2003 retail sales growth and the estimated impact of tax measures during 2003-04.
- Corporations Tax (CT) revenues are expected to decline 3.3 per cent in 2003-04. This is primarily due to weaker net receipts in respect of past years than previously estimated. The underlying CT revenue base growth is consistent with the outlook for corporate profits growth of 11.5 per cent in 2003.

- 
- All other sources of taxation revenue combined are expected to decline by 1.4 per cent in 2003-04, reflecting tax collections to date and the 1.7 per cent pace of real economic growth expected for 2003.
  - Federal Payments are expected to increase by \$1,370 million in 2003-04. This is the result of increased federal support for a wide range of Provincial programs and policy initiatives, largely in the health care sector, and \$330 million in federal SARS relief.
  - Income from Government Enterprises is expected to decline by \$508 million in 2003-04. This is largely due to the lower combined net income expected from Ontario Power Generation Inc. (OPG) and Hydro One Inc. (HOI) resulting from lower electricity demand and the August 2003 blackout. The net income of the Ontario Lottery and Gaming Corporation (OLGC) is expected to decline in 2003-04 as gaming activity was adversely affected by SARS, the August blackout, security-related border crossing slowdowns, the depreciation of the U.S. dollar and increasing cross-border competition.
  - Other Non-Tax Revenues are expected to decline by \$335 million in 2003-04. This is largely due to one-time revenues included in 2002-03, such as the fee earned in the Bruce Nuclear Plant transaction.

## 2003-04 EXPENSE OUTLOOK

The expense outlook at \$75,153 million in 2003-04 is up \$6,661 million from the level recorded in 2002-03. Increased spending was concentrated in health care, education, the post-secondary sector and infrastructure.

<b>Expense by Sector</b>				
<b>(\$ Millions)</b>				
	<b>Actual</b>	<b>Outlook</b>	<b>Change</b>	
			<b>2002-03</b>	<b>2003-04</b>
Programs				
Health Care	25,758	28,507	2,749	10.7
Education	9,236	10,127	891	9.6
Post-Secondary Education	3,471	3,996	525	15.1
Social Services	7,821	8,154	333	4.3
Justice	2,955	2,814	(141)	(4.8)
Other Programs	7,681	8,956	1,275	16.6
<b>Total Programs</b>	<b>56,922</b>	<b>62,554</b>	<b>5,632</b>	<b>9.9</b>
Capital	1,876	2,574	698	37.2
Interest on Debt	9,694	10,025	331	3.4
<b>Total Expense</b>	<b>68,492</b>	<b>75,153</b>	<b>6,661</b>	<b>9.7</b>

Note: Consistent with the treatment in the 2002-03 Public Accounts, the Ontario Electricity Financial Corporation (OEFC) is consolidated on a line-by-line basis.

Source: Ontario Ministry of Finance.

- In 2003-04, health care program spending will be \$28.5 billion, an increase of \$2.7 billion from the previous year's level of \$25.8 billion. Within the health care budget, major areas of spending include \$10.5 billion in operating support to Ontario's 154 hospitals and \$6.8 billion in OHIP payments to physicians and other service providers. The remaining \$11.2 billion in health care spending supports a wide range of services, including funding for drug programs, long-term care facilities and community services and SARS-related health costs.
- Education spending will be \$10.1 billion this year, an increase of almost \$900 million from the 2002-03 level of \$9.2 billion. This level of funding includes \$9.4 billion in Provincial grants to school boards for elementary and secondary education, including \$71 million for the 2003-04 fiscal year portion of a recently announced \$112 million initiative to provide supports for students from low-income and single-parent families and recent immigrants. In the 2003-04 school year, total funding for school boards, including education property tax revenues that flow directly to school boards, will increase to \$15.4 billion.

- 
- Provincial support for training programs and Ontario's 43 provincially funded post-secondary education institutions, will amount to \$4.0 billion in 2003-04, an increase of over \$500 million from last year. This funding includes \$0.8 billion in operating grants to colleges and \$2.1 billion in operating grants to universities, as well as \$0.3 billion for student financial assistance through the Ontario Student Support Program, scholarships and bursaries. In addition, \$0.3 billion will be spent on apprenticeship and skills training programs.
  - In 2003-04, spending on social services will be \$8.2 billion, an increase of \$333 million from last year. This includes \$3.8 billion to provide financial assistance to 190,000 individuals and families through the Ontario Works program as well as financial and employment assistance to 220,000 persons with disabilities and their families through the Ontario Disability Support program. In addition, approximately \$1.0 billion is spent to provide various specialized community supports such as counselling and behaviour intervention to 48,000 individuals with developmental disabilities. Other major components of spending in the social services sector include \$1.0 billion on child protection services delivered by 52 children's aid societies.
  - The Justice sector, comprising the Ministry of the Attorney General and the Ministry of Community Safety and Correctional Services, will spend \$2.8 billion in 2003-04. This funding will support the operation of 40 provincial jails and detention centres, housing an average of about 8,700 offenders each day, and the supervision of another 80,000 offenders serving sentences in the community. Other key justice sector programs and services include legal aid and victims' services, the funding of about 5,000 Ontario Provincial Police officers across the province and the operation of over 250 courts, prosecuting about 500,000 charges a year.
  - In 2003-04, spending on all other Provincial programs will be \$9.0 billion. This represents an increase of \$1.3 billion from the 2002-03 level, and is mainly due to the establishment of a \$625 million Contingency Fund in 2003-04, consistent with recommendations from the Peters Report, and an increase of \$233 million in Provincial retirement benefits costs.
  - Ontario's capital expense will amount to \$2.6 billion in 2003-04. Capital spending includes \$1.5 billion in capital transfers to partners such as hospitals, community health and long-term care facilities, and municipalities; \$0.3 billion for repairs and maintenance and other capital investments; as well as \$0.8 billion for amortization costs on major Provincial tangible capital assets (mainly highways and buildings).

---

---

**Other Potential Liabilities**

Since the release of the Peters Report, a number of other potential liabilities have come to the attention of the government. These liabilities may have an impact on the 2003-04 deficit but were outside the scope of Erik Peters' mandate and as such, any fiscal impact of these potential liabilities is not reflected in the \$5.6 billion deficit outlook he confirmed.

The government is currently reviewing these potential liabilities to determine how best to deal with these issues in a fiscally responsible manner. The table below provides a few examples of potential liabilities that have been identified to date.

<b>Potential Liability</b>	<b>Fiscal Impact</b>
Hospitals Accumulated Working Capital Shortfalls	up to \$1.2 billion
Pension Benefits Guarantee Fund (PBGF)	up to \$500 million
Potential Writedown of Pickering "A" Assets	up to \$500 million
2002-03 Children's Aid Societies' Deficits	up to \$25 million

Source: Ontario Ministry of Finance.

---

---

## Section IV: Medium-Term Fiscal Projection

This section outlines a fiscal projection for the Province over the medium term to 2006-07. The fiscal projection indicates that difficult choices will need to be made in order to balance the budget and put into place a sustainable fiscal policy and framework for the long term.

The medium-term fiscal projection for Ontario is based on a “no policy change” outlook that assumes no further changes to the current tax structure beyond those already announced or to existing programs and services.

Other key assumptions incorporated into this projection:

- Revenue growth into the medium term is based on a projection of the economy that uses the average of private-sector forecasts for Ontario. As of December 2003, the current consensus forecast for real GDP is 3.1 per cent in 2004, 3.6 per cent in 2005 and 3.3 per cent in 2006.
- The revenue outlook does not include any further tax changes beyond those already announced by the government, including the cancellation of corporations and personal income tax cuts, and the private schools tax credit, as well as the announced increase in tobacco taxes.
- The expense outlook into the medium term assumes program spending growth of about 5 per cent, in line with experience in recent years, and that capital spending is maintained at \$2.5 billion annually. Interest on debt costs increase to reflect the estimated impact of ongoing deficits.

---

### Potential Medium-Term Fiscal Projection – “No Policy Change”

(\$ Billions)

	Outlook	Projection		
	2003-04	2004-05	2005-06	2006-07
Revenue	69.5	73.5	77.9	81.7
Total Expense	75.2	77.2	81.4	85.2
Less: Reserve	--	1.0	1.0	1.0
<b>Surplus / (Deficit)</b>	<b>(5.6)</b>	<b>(4.7)</b>	<b>(4.5)</b>	<b>(4.5)</b>

Note: Numbers may not add due to rounding.

Source: Ontario Ministry of Finance.

This “no policy change” projection for Ontario indicates large deficits over the medium term, unless action is taken to restore the Province’s finances. Assuming current interest rate projections, each \$1 billion in deficit adds about \$50 million in annual interest charges, diverting scarce resources from other areas of spending such as health care and education.

The government has clearly indicated that this deficit track is not sustainable or acceptable.

## REVENUE BY SOURCE

Assuming no further federal or provincial taxation policy changes beyond those already announced, Ontario revenues are projected to continue to grow over the next three years by an average growth rate of 5.5 per cent. The table below outlines the medium-term revenue projection consistent with the current consensus economic forecast.

<b>Revenue by Source</b>				
<b>(\$ Billions)</b>				
	<b>Outlook</b>	<b>Projection</b>		
		<b>2003-04</b>	<b>2004-05</b>	<b>2005-06</b>
Taxation Revenue				
Personal Income Tax	18.6	20.0	21.6	23.1
Retail Sales Tax	14.6	15.5	16.6	17.6
Corporations Tax	7.2	8.2	8.6	9.0
All Other Taxes	9.6	10.1	10.6	10.9
<b>Total Taxation Revenue</b>	<b>49.9</b>	<b>53.8</b>	<b>57.3</b>	<b>60.7</b>
Government of Canada	10.3	10.1	10.6	10.7
Income from Government Enterprises	3.4	3.7	4.0	4.2
Other Non-Tax Revenue	5.9	5.9	6.0	6.0
<b>Total Revenue</b>	<b>69.5</b>	<b>73.5</b>	<b>77.9</b>	<b>81.7</b>

Note: Numbers may not add due to rounding.

Source: Ontario Ministry of Finance.

- Taxation revenues, representing on average nearly 74 per cent of total revenues, are projected to grow at an average annual rate of 6.7 per cent over the next three years.
- All three of the major tax sources—Personal Income, Corporations, and Retail Sales Taxes—are expected to contribute to this growth with strength expected in jobs, wages and salaries, retail sales and corporate profits. The medium-term projection reflects measures proposed in the Fiscal Responsibility Act, introduced on November 24, 2003.
- Payments from the Government of Canada are projected to average almost 14 per cent of total revenues over the next three years, consistent with current federal-provincial transfer arrangements and funding formulas. This projection does not include any potential increases such as Ontario's share of the additional \$2 billion Canada Health and Social Transfer funding, which is contingent on the level of the federal 2003-04 surplus, as these amounts will not be confirmed until late in 2004.
- Projected growth in Income from Government Enterprises and Other Non-Tax Revenues are consistent with expected economic growth over the medium term. The projection for Other Non-Tax Revenue does not include any extraordinary asset sales.

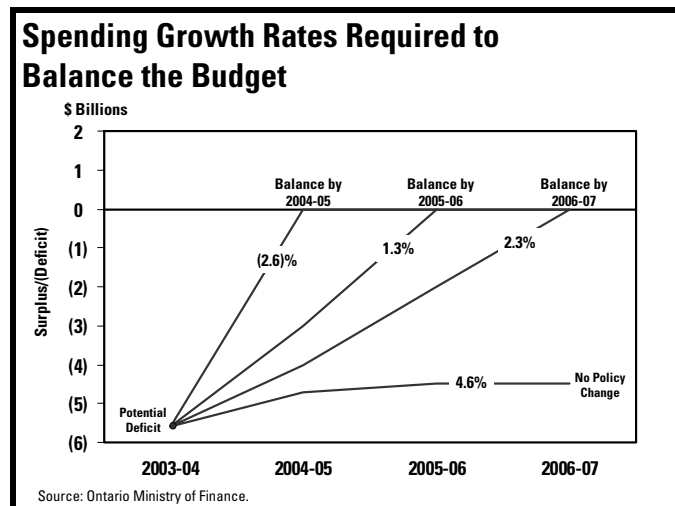
- 
- Recent preliminary indications from Ontario Power Generation Inc. (OPG) suggest that there may be a substantial risk to the net income of OPG in the medium term. This substantial risk could potentially negatively impact both Income from Government Enterprises and Electricity Payments-In-Lieu of Taxes in the government's medium-term revenue outlook by a combined \$250 million to \$900 million a year between 2004-05 and 2006-07.

## BALANCING THE BUDGET: THE IMPACT OF SPENDING GROWTH

Revenue growth from a growing economy alone will not be sufficient to balance the budget if spending growth continues at current rates. As outlined earlier, the potential “no policy change” deficit would remain at about \$4.5 billion for the next three years unless spending growth can be reduced.

The chart below shows that given the current revenue outlook over the medium term, spending would have to be cut in order to balance the budget by 2004-05. Balancing by 2005-06 or 2006-07 would require much slower spending growth than in recent years.

- To balance the budget in 2004-05, total spending would actually have to decline by 2.6 per cent from the projected 2003-04 level, excluding the impact of \$720 million in SARS-related expenses in 2003-04. Provincial spending has declined year-over-year only once in the past ten years, with a 3.3 per cent decline in 1996-97.
- Balancing the budget by 2005-06 or 2006-07 is possible as long as spending growth is more moderate than in recent years. To balance by 2005-06, spending growth would have to be held to a maximum of 1.3 per cent on average for the next two years. Balancing by 2006-07 requires spending growth to be held to an average of 2.3 per cent a year for three years.
- The “no policy change” scenario assumes total spending growth of about 4.6 per cent on average, which reflects historical growth patterns consistent with the past five years, and interest on debt costs associated with ongoing deficits.



The government has indicated that it will consult widely with the public and stakeholders on how to best deal with the fiscal challenges ahead. As well, the government will review all non-tax revenue mechanisms to ensure a stronger revenue base that will fund the transformation of key government services.

While these fiscal scenarios serve to illustrate the many difficult choices facing the government as it plans for a balanced budget, it should be noted that these scenarios use planning assumptions only. These underlying assumptions could be materially altered by government decisions and advice, including advice received through the forthcoming public consultation process. It is expected that as a result of public consultations, the eventual outcome could differ substantially from the scenarios presented in this section.

---

## **Conclusion**

Ontario currently faces a deficit of at least \$5.6 billion in 2003-04. Based on reasonable revenue projections and the recent experience in Provincial spending growth, Ontario faces an ongoing structural deficit into the medium term, unless firm action is taken.

The government is determined to restore the Province's finances to a sustainable fiscal path, one that provides for health care, education and other services that the people of Ontario expect while ensuring that the government lives within its means. Only by eliminating the deficit can Ontario's programs and services be sustained and funded adequately in the long term.



---

---

## **Annex II Tables and Graphs**

---

---



**Statement of Financial Transactions  
(\$ Millions)**

**Table 1**

	<b>1999-00</b>	<b>2000-01</b>	<b>2001-02</b>	<b>Actual 2002-03</b>	<b>Outlook 2003-04</b>
<b>Revenue</b>	64,804	66,044	66,249	68,609	69,532
<b>Expense</b>					
Programs	48,222	51,146	53,647	56,922	62,554
Capital	4,887	2,123	1,890	1,876	2,574
Interest on Debt	11,027	10,873	10,337	9,694	10,025
<b>Total Expense</b>	<b>64,136</b>	<b>64,142</b>	<b>65,874</b>	<b>68,492</b>	<b>75,153</b>
<b>Surplus / (Deficit)</b>	<b>668</b>	<b>1,902</b>	<b>375</b>	<b>117</b>	<b>(5,621)</b>
<b>Net Debt</b>	<b>134,398</b>	<b>132,496</b>	<b>132,121</b>	<b>132,647</b>	<b>138,970</b>
<b>Accumulated Deficit</b>	<b>134,398</b>	<b>132,496</b>	<b>132,121</b>	<b>118,705</b>	<b>124,326</b>

Note: Consistent with the treatment in the 2002-03 Public Accounts, the Ontario Electricity Financial Corporation (OEFC) is consolidated on a line-by-line basis starting in 1999-00. Expense and revenue totals for prior years have been restated to reflect the new accounting treatment. Net debt represents the difference between liabilities and financial assets. Accumulated deficit represents net debt adjusted for tangible capital assets.

Revenue (\$ Millions)	Table 2	
	Actual 2002-03	Outlook 2003-04
<b>Taxation Revenue</b>		
Personal Income Tax	18,195	18,600
Retail Sales Tax	14,183	14,550
Corporations Tax	7,459	7,215
Employer Health Tax	3,589	3,705
Gasoline Tax	2,306	2,310
Fuel Tax	682	695
Tobacco Tax	1,183	1,310
Land Transfer Tax	814	835
Electricity Payments-In-Lieu of Taxes	711	532
Other Taxes	429	195
	<b>49,551</b>	<b>49,947</b>
<b>Government of Canada</b>		
Canada Health and Social Transfer (CHST)	7,346	7,093
CHST Supplements	191	577
Health Reform Fund	-	387
Diagnostic/Medical Equipment	-	193
Social Housing	525	643
Infrastructure	62	285
Other Government of Canada	770	1,086
	<b>8,894</b>	<b>10,264</b>
<b>Income from Investment in Government Business Enterprises</b>		
Ontario Lottery and Gaming Corporation	2,288	2,065
Liquor Control Board of Ontario	939	1,048
Ontario Power Generation Inc. and Hydro One Inc.	717	318
Other Government Enterprises	(2)	3
	<b>3,942</b>	<b>3,434</b>
<b>Other Non-Tax Revenue</b>		
Reimbursements	1,111	1,208
Electricity Debt Retirement Charge	889	979
Vehicle and Driver Registration Fees	982	933
Power Sales	635	611
Sales and Rentals	560	571
Other Fees and Licences	606	531
Liquor Licence Revenue	530	477
Royalties	304	225
Miscellaneous Other Non-Tax Revenue	605	352
	<b>6,222</b>	<b>5,887</b>
<b>Total Revenue</b>	<b>68,609</b>	<b>69,532</b>

Note: Consistent with the treatment in the 2002-03 Public Accounts, the Ontario Electricity Financial Corporation (OEF) is consolidated on a line-by-line basis.

**Operating Expense  
(\$ Millions)****Table 3**

<b>Ministry</b>	<b>Actual 2002-03</b>	<b>Outlook 2003-04</b>
Agriculture and Food	613	661
Attorney General	1,057	1,060
Board of Internal Economy	146	169
Children's Services	2,171	2,314
Citizenship and Immigration	53	63
Community and Social Services	5,650	5,840
Community Safety and Correctional Services	1,898	1,754
Consumer and Business Services	177	177
Culture	330	278
Economic Development and Trade	247	315
Education	8,998	9,787
Teachers' Pension Plan (TPP)	238	340
Energy	144	130
Environment	232	274
Executive Offices	20	20
Finance - Own Account	1,092	1,222
Interest on Debt	9,694	10,025
Community Reinvestment Fund	622	649
Electricity Consumer Price Protection Fund	665	292
Power Purchases	786	918
Health and Long-Term Care	25,758	27,885
SARS-related Health Costs	-	622
Intergovernmental Affairs	6	6
Labour	123	120
Management Board Secretariat	172	336
Retirement Benefits	102	335
Contingency Fund	-	625
Municipal Affairs	636	684
Native Affairs Secretariat	16	15
Natural Resources	454	530
Northern Development and Mines	73	74
Office of Francophone Affairs	3	4
Public Infrastructure Renewal	33	35
Tourism and Recreation	135	228
Training, Colleges and Universities	3,471	3,996
Transportation	801	796
<b>Total Operating Expense</b>	<b>66,616</b>	<b>72,579</b>

Note: Consistent with the treatment in the 2002-03 Public Accounts, the Ontario Electricity Financial Corporation (OEFC) is consolidated on a line-by-line basis. Preliminary allocations by ministry, pending finalization of the realignment of government ministries currently under way.

**Capital Expense  
(\$ Millions)****Table 4**

<b>Ministry</b>	<b>Actual 2002-03</b>	<b>Outlook 2003-04</b>
Agriculture and Food	68	1
Attorney General	43	31
Community and Social Services	23	13
Community Safety and Correctional Services	66	55
Consumer and Business Services	1	1
Culture	42	65
Economic Development and Trade	21	46
Education	10	16
Energy	46	47
Environment	13	15
Finance	8	11
Health and Long-Term Care	339	504
Management Board Secretariat	3	-
Municipal Affairs	20	188
Native Affairs Secretariat	2	3
Natural Resources	72	91
Northern Development and Mines	391	356
Public Infrastructure Renewal	4	169
Capital Contingency Fund	-	114
Tourism and Recreation	55	55
Training, Colleges and Universities	71	100
Transportation	578	693
<b>Total Capital Expense*</b>	<b>1,876</b>	<b>2,574</b>

\* Capital expenses includes transfers for capital purposes, the amortization of major tangible capital assets owned by Provincial ministries, repairs, maintenance and other, including the capital contingency fund. Consistent with the recommendation of the Public Sector Accounting Board (PSAB), the cost of acquisition or construction of major tangible capital assets owned by the Province is amortized to expense over their useful lives.

Note: Preliminary allocations by ministry, pending finalization of the realignment of government ministries currently under way.

**Schedule of Net Investment in Capital Assets  
(\$ Millions)**

**Table 5**

	2003-04 Outlook			Total
	Land and Buildings	Transportation Infrastructure	Government Organizations' Capital Assets	
Acquisition/Construction of Major Tangible Capital Assets	133	1,042	346	1,521
Amortization of Provincially Owned Major Tangible Capital Assets	(110)	(546)	(163)	(819)
<b>Net Investment in Capital Assets*</b>	<b>23</b>	<b>496</b>	<b>183</b>	<b>702</b>

\* Starting in 2002-03, major tangible capital assets owned by Provincial ministries (land, buildings and transportation infrastructure) are accounted for on a full accrual accounting basis. Other tangible capital assets owned by Provincial ministries will continue to be accounted for as expense in the year of acquisition or construction.

**Ten-Year Review of Selected Financial and Economic Statistics**  
(\$ Millions)

	<b>1994-95</b>	<b>1995-96</b>	<b>1996-97</b>
<b>Financial Transactions</b>			
Revenue	46,039	49,473	49,450
Expense			
Programs	44,505	46,163	45,136
Capital	3,831	3,635	2,612
Interest on Debt	7,832	8,475	8,607
Total Expense	56,168	58,273	56,355
<b>Surplus / (Deficit)</b>	<b>(10,129)</b>	<b>(8,800)</b>	<b>(6,905)</b>
<b>Net Debt</b>	<b>90,728</b>	<b>101,864</b>	<b>108,769</b>
<b>Accumulated Deficit</b>	<b>90,728</b>	<b>101,864</b>	<b>108,769</b>
Gross Domestic Product (GDP) at Market Prices	311,096	329,317	338,173
Personal Income	260,671	271,397	276,303
Population—July (000s)	10,818	10,950	11,083
Net Debt per Capita (dollars)	8,387	9,303	9,814
Personal Income per Capita (dollars)	24,096	24,785	24,930
Total Expense as a per cent of GDP	18.1	17.7	16.7
Interest on Debt as a per cent of Revenue	17.0	17.1	17.4
Net Debt as a per cent of GDP	29.2	30.9	32.2

Note: Consistent with the treatment in the 2002-03 Public Accounts, the Ontario Electricity Financial Corporation (OEFC) is consolidated on a line-by-line basis starting in 1999-00. Expense and revenue totals for prior years have been restated to reflect the new accounting treatment. Net debt represents the difference between liabilities and financial assets. Accumulated deficit represents net debt adjusted for tangible capital assets.

Sources: Ontario Ministry of Finance and Statistics Canada.

Table 6

1997-98	1998-99	1999-00	2000-01	2001-02	Actual 2002-03	Outlook 2003-04
52,518	55,786	64,804	66,044	66,249	68,609	69,532
45,304	46,557	48,222	51,146	53,647	56,922	62,554
2,451	2,215	4,887	2,123	1,890	1,876	2,574
8,729	9,016	11,027	10,873	10,337	9,694	10,025
56,484	57,788	64,136	64,142	65,874	68,492	75,153
<b>(3,966)</b>	<b>(2,002)</b>	<b>668</b>	<b>1,902</b>	<b>375</b>	<b>117</b>	<b>(5,621)</b>
<b>112,735</b>	<b>114,737</b>	<b>134,398</b>	<b>132,496</b>	<b>132,121</b>	<b>132,647</b>	<b>138,970</b>
<b>112,735</b>	<b>114,737</b>	<b>134,398</b>	<b>132,496</b>	<b>132,121</b>	<b>118,705</b>	<b>124,326</b>
359,353	377,897	409,020	440,708	452,923	478,112	501,061
289,537	304,652	321,702	347,427	359,783	372,444	385,852
11,228	11,367	11,506	11,685	11,898	12,097	12,238
10,041	10,094	11,681	11,339	11,104	10,965	11,356
25,787	26,801	27,959	29,733	30,239	30,788	31,529
15.7	15.3	15.7	14.6	14.5	14.3	15.0
16.6	16.2	17.0	16.5	15.6	14.1	14.4
31.4	30.4	32.9	30.1	29.2	27.7	27.7

## RISKS AND SENSITIVITIES TO THE FISCAL PLAN

**Selected Risks and Sensitivities to the Fiscal Plan – The Ontario Economy and Revenue** **Table 7**

<b>Item</b>	<b>2003-04 Assumption</b>	<b>Sensitivities</b>
Real Economic Growth <sup>1</sup>	1.7 per cent real GDP growth in 2003	\$0.6 billion per percentage point of growth.
<b>Composition of Economic Growth Examples:</b>		
Wages and Salaries	4.0 per cent growth in 2003	One percentage point change, other things equal, changes revenues by \$0.3 billion, mainly Personal Income and Employer Health Taxes.
Personal Consumption Expenditure	3.8 per cent real growth in 2003	One percentage point change, other things equal, changes revenues by \$0.1 billion, mainly Retail Sales Tax.
Corporate Profits	11.5 per cent growth in 2003	Two percentage points change, other things equal, changes revenues by \$0.1 billion, mainly Corporations Tax.
Ontario Population Share	38.7 per cent of Canada-wide population in 2003	Three-tenths of a percentage point change in population share would change Federal Payments by \$0.1 billion.
2002 Personal Income and Corporations Tax return processing	2002-03 revenues overestimated by \$0.3 billion based on tax return processing data received after 2002-03 Public Accounts finalized	Risk to the current 2003-04 revenue outlook of +/- \$0.6 billion from further 2002 tax return processing.
Data applied in federal funding formulas	Federal payments outlook fully consistent with current demographic, economic and tax assumptions	Could partially offset changes in tax revenues. Changes also possible based on other data. Current risk of +/- \$0.3 billion.

1. This response would hold "on average" and could vary significantly depending on the composition of change in income and expenditures.

## RISKS AND SENSITIVITIES TO THE FISCAL PLAN

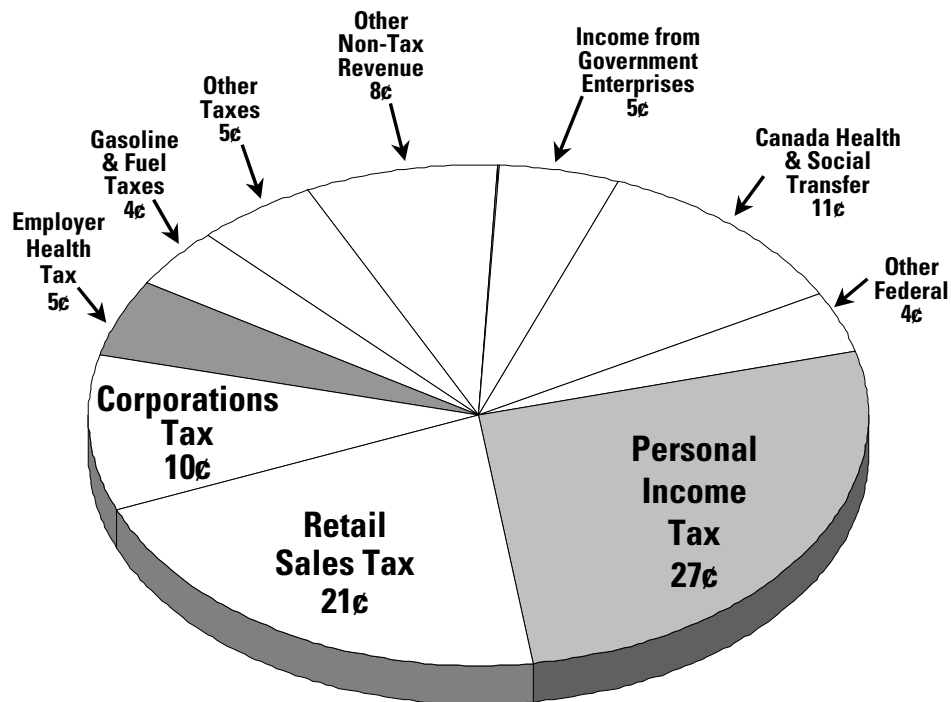
**Selected Risks and Sensitivities to the Fiscal Plan – Expense**

**Table 8**

<b>Program</b>	<b>2003-04 Assumption</b>	<b>Sensitivities</b>
Hospitals	Annual growth of 7.8 per cent	Average annual growth was almost 10 per cent from 1999-00 to 2002-03. One per cent change in hospital funding: \$105 million.
Drug programs	Annual growth of 10.4 per cent (in health portion)	One per cent change in utilization of all drug programs: \$28 million.
Long-term care community services/ home care	Over 15.6 million hours of homemaking and support services	One per cent change in hours of homemaking and support services: \$4 million.
	7.9 million nursing and professional visits	One per cent change in nursing and professional visits: \$5 million.
Long-term care facilities	Almost 69,500 long-term care facility beds	Annual average operating cost per bed in a long-term care facility is over \$30,000. One per cent change in number of beds: \$21 million.
Elementary and secondary schools	Almost 2 million average daily pupil enrolment	One per cent enrolment change: \$150 million.
College students	155,000 full-time students	One per cent enrolment change: \$7 million.
University students	275,000 full-time students	One per cent enrolment change: \$19 million.
Ontario Works	190,000 average annual caseload	One per cent caseload change: \$15 million.
Ontario Disability Support Program	220,000 average annual caseload	One per cent caseload change: \$21 million.
Judicial system	2.9 million adult inmate days per year	Average cost \$150 per inmate per day. One per cent change in inmate days: \$4 million.
Interest on debt	Average borrowing cost of 5.4 per cent for new financing	100 basis points change in borrowing costs for new financing: \$45 million.

---

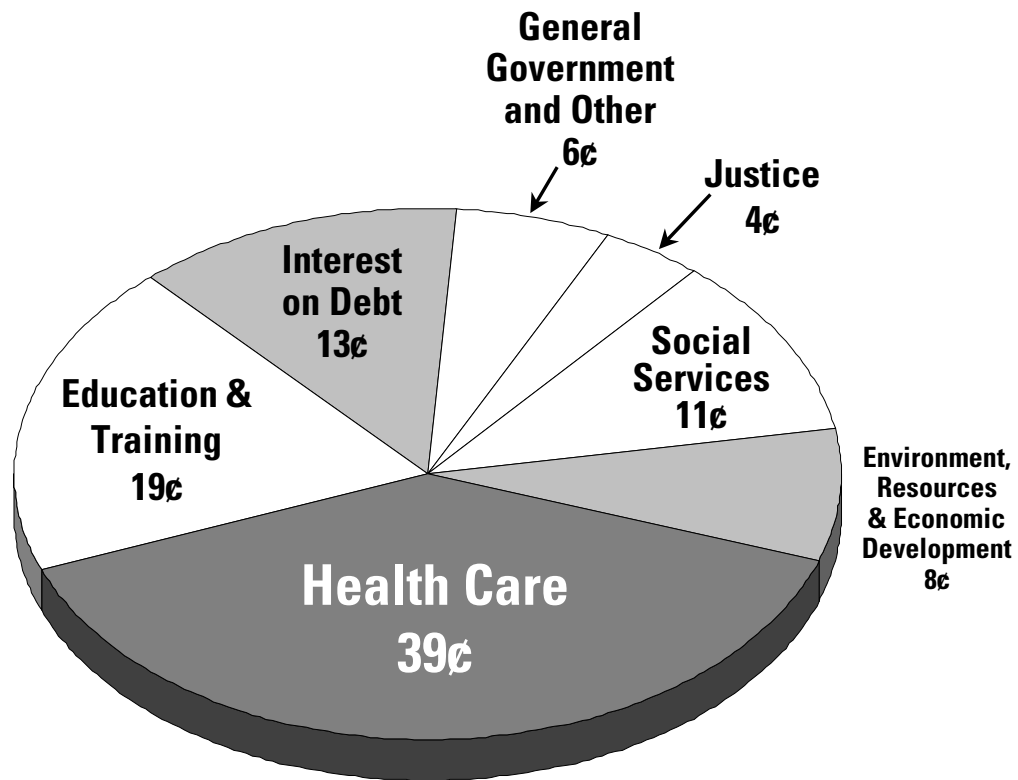
# Revenue Dollar 2003-04



Note: Consistent with the treatment in the 2002-03 Public Accounts, the Ontario Electricity Financial Corporation (OEFC) is consolidated on a line-by-line basis.

---

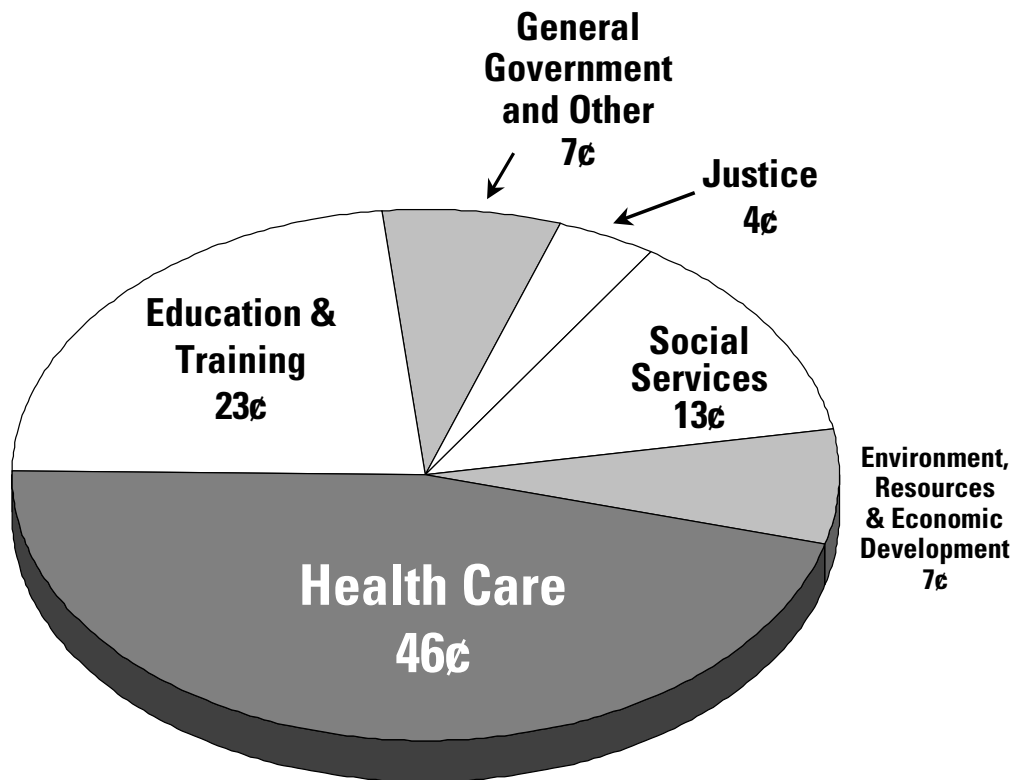
# Total Expense Dollar 2003-04



Note: Consistent with the treatment in the 2002-03 Public Accounts, the Ontario Electricity Financial Corporation (OEFC) is consolidated on a line-by-line basis.

---

# Program Expense Dollar 2003-04



Note: Consistent with the treatment in the 2002-03 Public Accounts, the Ontario Electricity Financial Corporation (OEFC) is consolidated on a line-by-line basis.

## **Annex II Appendix**

---

## MAJOR CHANGES FROM ERIK PETERS' REPORT

<b>Major Changes from Erik Peters Report</b>	<b>2003-04 \$ Billions</b>
<b>2003-04 Deficit Outlook – As Reported October 29, 2003</b>	<b>(5.6)</b>
<b>Revenue</b>	
Federal SARS relief – reflected as revenue, consistent with Provincial financial statements	0.3
Ontario Electricity Financial Corporation (OEFC) Income – as per 2002-03 Public Accounts treatment	2.1
Tax Measures – impact of cancelling Equity in Education Tax Credit (EiETC), reductions in Personal Income Tax (PIT) and Corporations Tax rates, and elimination of first-tier on PIT surtax	0.4
Increased Tobacco Taxes – as announced November 24, 2003	0.1
Lower Revenue forecast – impact of weaker 2002 tax assessments	<u>(0.5)</u>
<b>Add: Total Change in Revenue Outlook</b>	<b>2.4</b>
<b>Expense</b>	
SARS costs – treatment consistent with Provincial financial statements	0.3
Ontario Electricity Financial Corporation Expense – as per 2002-03 Public Accounts treatment:	
Impact on interest on debt	1.2
Impact on other expense	1.5
Seniors' Property Tax Rebate – impact of cancelling	(0.4)
Establish Contingency Fund	<u>0.6</u>
<b>Less: Total Change in Expense Outlook</b>	<b>3.1</b>
<b>Add: Electricity Sector</b>	<b>0.7</b>
OEFC net income (increase in stranded debt) allocated to revenue, interest on debt, and expense – as per 2002-03 Public Accounts treatment	
<b>Current Deficit Outlook</b>	<b>(5.6)</b>

Note: Numbers may not add due to rounding.