

October 19, 2017

The FAO's
Long-Term Budget Outlook

Media Statement

Good morning.

My name is David Wake. I am Ontario's Integrity Commissioner and have been appointed the Financial Accountability Officer on a temporary basis.

Today, the FAO released a *Long-term Budget Outlook* for Ontario. The report is a projection of the Ontario economy and the Province's fiscal position over the next thirty years.

The *Long-term Budget Outlook* is the first of what will be regular publications assessing the budget implications of Ontario's long-term demographic and economic outlook. These long-term reports will complement the FAO's semi-annual *Economic and Fiscal Outlook* reports which focus on the province's medium-term finances.

Over the next three decades, Ontario will experience major shifts in its population and economy, as the large baby boom cohort transitions from work into retirement and eventually into old age. Without significant changes to Ontario's fiscal policy, the FAO's projections suggest that the province will face substantial long-term budgetary challenges.

I will ask the FAO's Chief Economist, David West, to provide an overview of the report's highlights.

The FAO's Long-Term Projection

Thank you Commissioner Wake.

Let me begin by focusing on the good news.

Consistent with other economic forecasters, the FAO projects continued, steady growth for Ontario's economy over the long-term. We expect this growth will be supported by solid, on-going gains in labour productivity and by growth in Ontario's workforce. By 2050, our projection implies that total income per person will be 40 per cent higher than it is today, after adjusting for inflation. That is, we expect Ontario will continue to be a successful and prosperous province.

Of course, demographics will play a key role in shaping Ontario's long-term outlook.

The baby boom generation will be between 55 and 75 years of age by 2020 and gradually transitioning into retirement. The steady departure of baby boomers from the workforce will contribute to slower economic growth over the next 15 years.

More moderate growth in the economy will limit the growth in Ontario's revenues.

At the same time, the aging baby boom cohort will place greater demands on Ontario's health care system, increasing the pressure on government spending.

The coming demographic changes will both lower revenue growth and raise spending pressures. Without an adjustment to Ontario's fiscal policy, these demographic changes will lead to increasing budget deficits and higher levels of provincial debt.

In the absence of a fiscal policy response by future governments, the FAO projects that Ontario's net debt-to-GDP ratio would reach 63 per cent by 2050, significantly above today's ratio of around 40 per cent.

Importantly, Ontario's debt burden would not be expected to stabilize at this elevated level, but would continue rising at an accelerated pace into the future.

High levels of public debt increase debt interest payments – money which could otherwise be used for priority programs like health and education. An elevated level of debt also limits the Province's ability to respond to unforeseen future events, including recessions.

Ontario's 27 Per Cent Debt-to-GDP Target

In recognition of the need to reduce Ontario's debt burden, the current government committed to lowering the Province's net debt-to-GDP ratio to the pre-recession level of 27 per cent. In the 2017 Budget, the government projected that this 27 per cent target would be achieved by fiscal year 2029-30.

However, based on the FAO's projection, Ontario's debt-to-GDP ratio will be a full 10 percentage points above the 27 per cent target by 2030, largely the result of on-going deficits through the 2020s.

Achieving the government's 27 per cent debt-to-GDP target in the face of the coming demographic transition will require significant changes to Ontario's fiscal policy. Specifically, the FAO estimates that beginning next year the Province would need to permanently raise revenue or lower spending by the equivalent of \$6.5 billion (or 0.75 per cent of GDP).

To provide some dramatic examples, a \$6.5 billion dollar change in the budget balance is roughly equivalent to:

- eliminating funding for about 40 per cent of the Province's hospitals, or
- raising the HST rate by 2 percentage points, or
- a 25 per cent increase in federal transfers.

A fiscal adjustment of this size would result in annual budget surpluses over the next decade, and reduce Ontario's debt burden. This would create the fiscal room necessary to accommodate the budget impact of the coming demographic transition and would help ensure stable long-term finances for the Province.

An important conclusion of our report is that Ontario will need more than just balanced budgets over the next decade to lower the debt-to-GDP ratio to 27 per cent by 2030.

Ontario's Difficult Fiscal Choices

But, convincing Ontarians of the need for continued and significant fiscal restraint - beyond just balancing the annual budget - would be challenging for any Ontario government.

Since the demographic pressures on the budget will not intensify until the mid-2020s, it will be tempting to postpone or even ignore the difficult fiscal policy changes required to stabilize or reduce Ontario's debt burden.

However, if the Province delays raising revenue or reducing spending, Ontario's net debt would continue to accumulate. This will make it even more costly to meet the Province's debt targets in the future.

If these difficult fiscal changes are postponed, the burden of stabilizing Ontario's public finances would be increasingly – and arguably unfairly – shifted from the baby boom generation to younger Ontarians.

The significant challenges associated with achieving the 27 per cent debt target might prompt future governments to adopt a more modest target. An alternative target might be to maintain Ontario's debt-to-GDP ratio at its current level of about 40 per cent.

This alternative target would require smaller fiscal changes in the near term. However, it would not be sufficient to avoid increasing deficits over the projection, and would not stabilize the Province's finances in the long term.

The government's 27 per cent debt-to-GDP target is a fiscally prudent goal for the province. Reducing Ontario's debt-to-GDP ratio to 27 per cent by 2030 will enable the government to absorb the coming demographic pressures and prevent rising deficits leading to a large build-up of debt.

Summary

This is the FAO's first Long-Term Budget Outlook. The main conclusions in today's report echo those of our previously released Economic and Fiscal Outlook reports.

Eliminating future budget deficits and lowering Ontario's debt burden will require either higher revenues or lower spending.

Without government action, Ontario's debt burden will continue rising into the future, limiting the Province's ability to respond to unforeseen future crises. The longer the government delays fiscal policy changes, the more expensive it will be for future Ontarians.

To be clear, these are not exact predictions of budget outcomes over the next thirty years. Instead, they are the likely future outcomes if government policies continue on their current path.

Of course, long-term projections involve significant uncertainty. Technological developments, climate change or other global issues could have unexpected implications for Ontario's economy and the Province's fiscal position over the coming decades.

However, current and future governments should not use this uncertainty as a reason to ignore the very real long-term budget challenges that lie ahead.

Thank you.

We are happy to take questions.