



Revised PBO Outlook and Assessment of the 2013 Update of Economic and Fiscal Projections

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The mandate of the Parliamentary Budget Officer (PBO) is to provide independent analysis to Parliament on the state of the nation's finances, the government's estimates and trends in the Canadian economy; and upon request from a committee or parliamentarian, to estimate the financial cost of any proposal for matters over which Parliament has jurisdiction.

Following the publication of PBO's Economic and Fiscal Outlook Update 2013, Finance Canada released its 2013 Update of Economic and Fiscal Projections. This report updates PBO's economic and fiscal outlook to include recent policy decisions and the updated Public Accounts of Canada 2013. This report also compares Finance Canada's projections with PBO's and discusses the assumptions and methodologies that drive their similarities and differences.

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Summary

This report updates PBO's Economic and Fiscal Outlook Update 2013 (EFOU 2013) to reflect budgetary decisions announced in Finance Canada's 2013 Update of Economic and Fiscal Projections (Update 2013). It also provides an assessment of risks to the Government's medium-term fiscal plan and compares the Government's updated long-term projections with PBO's Fiscal Sustainability Report 2013 (FSR 2013).

PBO has updated its economic projection to include spending restraint announced in Update 2013 (Section 1). PBO expects GDP to be \$2 billion per year lower, on average, than projected in EFOU 2013. Finance Canada's outlook in Update 2013 remains stronger than PBO's outlook, despite average annual downward revisions of \$11 billion from 2013 to 2017 relative to Budget 2013.

PBO has updated its fiscal outlook to include decisions announced in Update 2013 and the latest information in the Public Accounts of Canada 2013. Most significantly, these include \$7.2 billion in savings in direct program expenses achieved by freezing operating budgets and increasing the assumption of lapsing budgetary authorities over the outlook; an estimated \$4.2 billion in additional revenues from maintaining Employment Insurance (EI) premium rates higher than necessary to balance the EI operating account in 2015 and 2016; and \$2.0 billion in prospective asset sales over 2014-15 and 2015-16.

As a result of the revised economic outlook, policy decisions, and the latest fiscal data, PBO has increased its outlook for budgetary surplus in 2015-16 to \$4.6 billion and has revised its likelihood of achieving budgetary balance in 2015-16 to 65 per cent (Section 2).

The measures and assumptions in Update 2013 have introduced considerable uncertainty to the fiscal plan (Section 3). If direct program expenses savings and sales of public assets do not materialize as planned, and if the Governor in Council reduces EI premium rates in 2015 and/or 2016, most if not all of the \$4.6 billion surplus PBO projects in Update 2013 for 2015-16 will be eliminated.

Direct program expenses savings have been the primary measure to improve the fiscal outlook in successive budgets following the recession. Little information has been provided to assess service impacts, the likelihood of achieving spending targets, and whether short-term restraint will require higher spending in future years.

The Treasury Board of Canada Secretariat has rejected PBO's requests for information which is necessary to analyze the approximately \$10 billion of budgetary authorities which went unspent in each of the past three years.¹ The Government has failed to provide a concrete explanation for historical and projected revisions to these lapses, which were responsible for roughly \$3.6 billion of the unexpected improvement in the budgetary balance in 2012-13 and which account for a significant portion of the Government's budgetary improvement going forward. Parliamentarians may wish to directly request this information from the Government.

The Government could increase transparency by publishing the fiscal impact of the EI premium rate freeze in 2015 and 2016 relative to the premium rates which would have been set following improvements in the EI operating account since Budget 2013. Further, uncertainty in the fiscal plan could be reduced by clarifying if Governor in Council discretion will be used to set rates lower in 2015 and 2016 if the EI operating account improves as projected.

Finally, Finance Canada's long-term sustainability projections in Update 2013 were broadly similar to those in PBO's FSR 2013 (Section 4). Finance Canada no longer provides an estimate of fiscal room as it did in its 2012 report. Parliamentarians would benefit if Finance Canada's long-term economic and fiscal projections included an estimate of federal fiscal room along with a broader assessment of subnational governments and the impact of changes to intergovernmental agreements on provincial fiscal sustainability.

¹ See http://www.pbo-dpb.gc.ca/files/files/IR/Response_009.pdf, http://www.pbo-dpb.gc.ca/files/files/IR/Info_Request_009B.pdf, and http://www.pbo-dpb.gc.ca/files/files/IR/Response_IR009B.pdf.

1 Update of medium-term economic projections

In its 2013 Update of Economic and Fiscal Projections (Update 2013), Finance Canada revised down its outlook for nominal gross domestic product (GDP) relative to Budget 2013, equivalent to an average annual reduction of \$11 billion from 2013 to 2017. This reflected lower GDP inflation, which was projected to be essentially equivalent to total Consumer Price Index (CPI) inflation over the projection, despite the assertion that the private sector expectation for GDP inflation is consistent with broadly flat commodity prices over the forecast horizon.² Annex A provides a comparison of the private sector average projection in Budget 2013 and Update 2013.

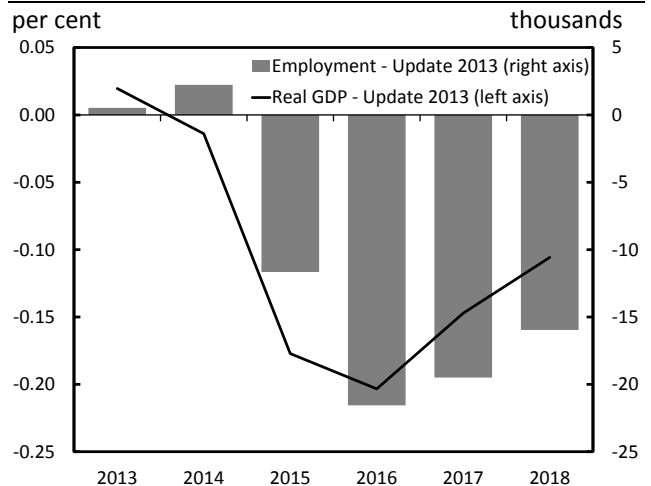
Despite this downward revision, the outlook for GDP in Update 2013 was much stronger than in PBO's Economic and Fiscal Outlook Update 2013 (EFOU 2013). This is a result of PBO's lower average annual projection for both real GDP growth (2.0 per cent versus 2.3 per cent) and GDP inflation (1.7 per cent versus 1.8 per cent) relative to Finance Canada's over the 2013 to 2018 period. As a result, the projected level of GDP in Update 2013 was \$27 billion higher annually, on average, than in EFOU 2013. Even after the risk adjustment to GDP in Update 2013, its level remains \$9 billion, on average, above the projected level of GDP in EFOU 2013 from 2013 to 2018. This is consistent with PBO's evaluation that the risk in the average private sector forecast is to the downside. Annex B provides a comparison of the private sector average projection in EFOU 2013 and Update 2013.

The difference in the PBO and Finance Canada GDP projections was likely the result of different projections of the impacts of weakening commodity prices and government spending reductions on output and prices. In the case of government

spending reductions, Update 2013 recognized that deficit reduction measures in the U.S. may have a negative impact on growth, but did not acknowledge that spending restraint measures in Canada may hamper economic activity.

Update 2013 restrained direct program expenses by freezing operating budgets and raising the amount of lapsing budgetary authorities. This amounted to cumulative savings of \$7.2 billion over the projection horizon. Using the fiscal multipliers used by Finance Canada in Budgets 2009 and 2010, PBO has projected that the level of real GDP will be 0.2 per cent lower in 2016 than would be the case in the absence of these measures (Figure 1-1). As a consequence, PBO has also projected that the level of employment will be approximately 22,000 net jobs lower in 2016 than would have been the case in the absence of the savings measures contained in Update 2013. Taking into account these impacts, the revised PBO economic outlook is presented in Table 1-1.

Figure 1-1
Estimates of the economic impacts of Update 2013 changes to spending levels



Source: Office of the Parliamentary Budget Officer.

Note: The estimated impacts on real GDP and employment do not take into account any offsetting impacts from changes to interest and exchange rates. Impacts are expressed relative to PBO's EFOU 2013 projection.

² GDP inflation is a function of the prices of final consumption expenditure and gross fixed capital formation, as well as the terms of trade (the price of exports relative to imports), the latter of which is strongly influenced by changes in commodity prices. Flat commodity prices would suggest that the projection of the terms of trade would be weaker than that of CPI inflation, implying the projection of GDP inflation should be lower than that of CPI inflation, which would reduce the level of GDP over the projection, consistent with the PBO projection.

Table 1-1

Revised EFOU 2013 economic projection following changes to spending levels in Update 2013

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|-------|-------|-------|-------|-------|-------|
| Real GDP growth (%) | 1.7 | 2.0 | 2.4 | 2.6 | 2.0 | 1.5 |
| Nominal GDP growth (%) | 2.9 | 3.4 | 4.0 | 4.5 | 4.0 | 3.5 |
| Nominal GDP level (billions of dollars) | 1,873 | 1,937 | 2,014 | 2,105 | 2,190 | 2,268 |
| Unemployment rate (%) | 7.2 | 7.3 | 7.0 | 6.6 | 6.3 | 6.2 |

Source: Office of the Parliamentary Budget Officer.

2 Update of medium-term fiscal projections

PBO is required to update its Economic and Fiscal Outlook annually for the fourth week of October.³ EFOU 2013 was released before the Government published Update 2013 and the Public Accounts of Canada 2013. PBO can now project a revised medium-term fiscal outlook which includes the budgetary measures from Update 2013 and updated public accounts data. A summary of PBO's revised fiscal outlook is provided in Table 2-1. Further details of the outlook for revenues and expenses are provided in Annex C, and the impact relative to EFOU 2013 is provided in Annex D.

Table 2-1

Revised medium-term fiscal outlook

| billions of dollars | 2012- | 2013- | 2014- | 2015- | 2016- | 2017- | 2018- |
|--------------------------|--------------|--------------|-------------|------------|------------|------------|------------|
| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
| Budgetary revenues | 256.6 | 267.7 | 280.7 | 296.5 | 308.5 | 318.6 | 331.2 |
| Program expenses | 246.4 | 253.0 | 253.8 | 260.3 | 269.7 | 277.6 | 284.7 |
| Public debt charges | 29.2 | 29.8 | 30.5 | 31.6 | 33.9 | 36.3 | 39.0 |
| Total expenses | 275.6 | 282.8 | 284.3 | 292.0 | 303.6 | 313.9 | 323.7 |
| Budgetary balance | -18.9 | -15.2 | -3.5 | 4.6 | 5.0 | 4.7 | 7.5 |
| Federal debt | 602.4 | 617.6 | 621.1 | 616.6 | 611.6 | 606.9 | 599.4 |

Source: Office of the Parliamentary Budget Officer.

PBO's revised outlook for budgetary revenues is higher in 2015-16 and 2016-17 due to a higher Employment Insurance (EI) premium rate projection than assumed in EFOU 2013 (see Box 1). PBO has decided to use the Government's planning assumption of higher EI premium rates than

³ According to the September 29, 2011 Standing Committee of Finance motion that "the PBO provide an economic and fiscal outlook to the Committee the fourth week of October and April of every calendar year and be available to appear before the Committee to discuss its findings shortly thereafter."

necessary to balance the EI operating account. This decision is based on additional details of the rate freeze which were released in Economic Action Plan 2013 Act, No. 2 (Bill C-4) and statements by the Minister of Finance to the House of Commons Standing Committee on Finance in meeting No. 10 of the 41st Parliament, 2nd Session.

Box 1: PBO's EI premium rate assumption

PBO has assumed the rate in 2015 and 2016 will be frozen at \$1.88 per \$100 of insurable earnings according to subsection 66(1.1) of the *Employment Insurance Act*, as amended by Bill C-4. This is despite Finance Canada's and PBO's projections that the EI account will be in surplus in 2015. In 2017, the premium rate is assumed to be reduced to the rate that balances revenues and expenses over the 7-year period beginning that year. Accordingly, PBO has revised its rate projection as follows:

| | 2014 | 2015 | 2016 | 2017 | 2018 |
|------------------|------|------|------|------|------|
| EI premium rates | 1.88 | 1.88 | 1.88 | 1.54 | 1.54 |

Section 66.32 of the amended *Act* provides that the Governor in Council can change the premium rate on the joint recommendation of the Minister of Employment and Social Development and the Minister of Finance. This discretion makes projecting EI revenues for fiscal planning purposes difficult.

Customs import duties are also lower by an average of \$0.5 billion per year, as the outlook now includes an approximate impact of tariff reductions from the Canada-European Comprehensive Economic Trade Agreement (CETA). Update 2013 did not publish a costing of the CETA against a status quo baseline.

Other revenues are higher by \$0.5 billion in 2014-15 and \$1.5 billion in 2015-16 as they incorporate the Government's planning assumption for provisional sales of General Motors shares and other public assets such as Ridley Terminals and the Dominion Coal blocks.

Remaining revenue differences are attributable to PBO's revised economic outlook.

PBO's outlook for program expenses is lower over the projection as a result of incorporating the Government's latest projection of direct program expenses, which included new savings from a two-year operating expenses freeze and a revised outlook for lapsing budgetary authorities, infrastructure spending, and refundable tax credits. Direct program expenses were reduced by \$7.2 billion in total over the horizon, with almost \$2.7 billion falling in 2015-16 (Table 2-2). The increase in 2013-14 reflects the \$2.9 billion transfer of disaster assistance for the Alberta floods and Lac Mégantic.

Table 2-2

Further direct program expenses restraint

billions of dollars

| | 2013-2014 | 2014-2015 | 2015-2016 | 2016-2017 | 2017-2018 | 2018-2019 |
|------------------------|-----------|-----------|-----------|-----------|-----------|-----------|
| Budget 2013 (restated) | 119.8 | 117.4 | 118.6 | 120.5 | 122.7 | 125.1 |
| Update 2013 | 120.7 | 115.4 | 115.9 | 119.0 | 121.4 | 124.5 |
| Change | 0.9 | -2.0 | -2.7 | -1.5 | -1.3 | -0.6 |

Source: Finance Canada.

Note: Budget 2013 expenses have been restated to reflect the reclassification of interest owed to taxpayers.

Public debt charges are lower compared to EFOU 2013 due to the improved budgetary balance projections and updated public accounts data on unfunded pension liabilities and other non-market debt.

In total, PBO has increased its estimated surplus in 2015-16 to \$4.6 billion, due mostly to three changes: higher savings in the revised outlook for direct program expenses, higher EI premium revenues from the rate freeze, and asset sales. The surplus rises to \$7.5 billion by 2018-19. PBO has revised the likelihood of achieving budgetary balance in 2015-16 to 65 per cent.

PBO estimates that with the measures in Update 2013, the Government's structural budgetary balance—i.e. the balance if economic activity were at trend—will improve from a deficit of \$8.0 billion in 2012-13 to a deficit of \$6.5 billion in 2013-14 (Table 2-3). The structural balance is estimated to reach a surplus of \$3.8 billion by 2014-15, and to remain in surplus thereafter. The structural surplus falls in 2017-18 when the EI premium rate is reduced to the 7-year breakeven rate.

Table 2-3

Updated structural balance

billions of dollars

| | 2012-2013 | 2013-2014 | 2014-2015 | 2015-2016 | 2016-2017 | 2017-2018 | 2018-2019 |
|--------------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| Budgetary balance | -18.9 | -15.2 | -3.5 | 4.6 | 5.0 | 4.7 | 7.5 |
| Structural balance | -8.0 | -6.5 | 3.8 | 7.1 | 4.1 | 1.8 | 4.5 |
| Cyclical balance | -10.9 | -8.7 | -7.3 | -2.6 | 0.8 | 2.9 | 3.0 |

Source: Office of the Parliamentary Budget Officer.

Note: Asset sales are treated as non recurring one-time payments and are added to the cyclical balance.

The rapid improvement in the Government's structural balance from 2012-13 to 2014-15 is mainly the result of spending restraint, which decreases direct program expenses (the largest category of expenses) while revenues continue to grow.

Contributing also to the speed of recovery of the structural balance are stable public debt charges, due partly to two recent balance sheet developments (these were known and incorporated in EFOU 2013). The expected repayment of principal from the insured mortgage purchase program in 2013-14 and 2014-15 will reduce federal debt by roughly \$50 billion, effectively freezing public debt charges between 2012-13 and 2014-15. The Government also increased cash reserves over the last two years as part of the Prudential Liquidity Plan (PLP). The PLP was completed earlier than expected and will no longer contribute to the accumulation of debt and debt charges, as it had over 2011-12 to 2012-13.

3 Risks to the budgetary outlook

The outlook provided in Update 2013 depends crucially on projected spending restraint, flexibility in the *Employment Insurance Act*, and prospective asset sales.

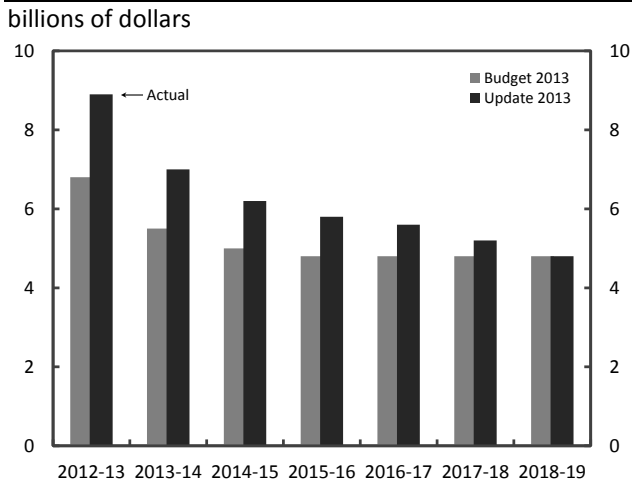
Spending restraint

The improvement in the budgetary balance outlook in Update 2013 and prospect for surplus in 2015-16 relies largely on a significantly reduced outlook for direct program expenses. Direct program expenses savings over the outlook is primarily the result of a two-year operating freeze expected to save \$0.6 billion in 2014-15 and \$1.1 billion in 2015-16

and a revised outlook for lapsing budgetary authorities over the years 2013-14 to 2017-18.

Lapsing authorities are the annual amount by which departments underspend their voted expenditure ceilings. Lapses in 2012-13 were much higher than anticipated in Update 2012 and Budget 2013, and Finance Canada’s assumption going forward was increased (Figure 3-1). The increase in the assumption for departmental lapses is responsible for \$1.0 billion of the \$2.7 billion improvement in Finance Canada’s outlook for direct program expenses in 2015-16.

Figure 3-1
Revisions to Finance Canada’s projection of lapsing budgetary authorities



Source: Finance Canada.

Treasury Board of Canada Secretariat refused access to relevant data and information regarding the amounts it budgets for programs and departments.⁴ While high-level figures are published annually in the Budget, the Government's Estimates (Part I, II, and III) do not reflect actual budgeted amounts. As such, it is impossible for PBO to assess the reasonableness of the lapse outlook for Parliament.

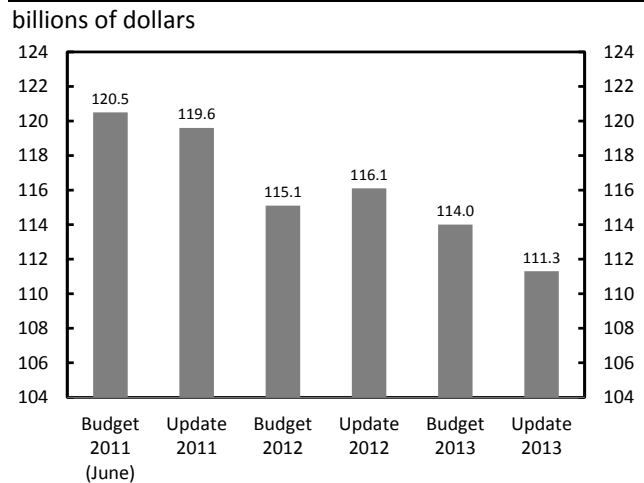
There is some risk that unspent authorities from short-term restraint could be profiled to later years—either formally, through the Operating Budget Carry Forward, which permits departments

to use unspent operating funds the following year, or by pushing spending closer to the voted expenditure ceiling. This could result in smaller lapses and higher direct program expenses than expected.

Alternatively, there is also risk that lapses could be higher than assumed over the outlook. Although this would result in an improved budgetary balance, sustained underspending could affect government performance indicators and service levels.

Direct program expenses restraint has been the primary fiscal consolidation measure following the 2008-09 recession, with cuts projected to total nearly 0.5 per cent of GDP in 2015-16 over successive fiscal plans since Budget 2011 (Figure 3-2).

Figure 3-2
Direct program expenses outlook for 2015-16



Source: Finance Canada.

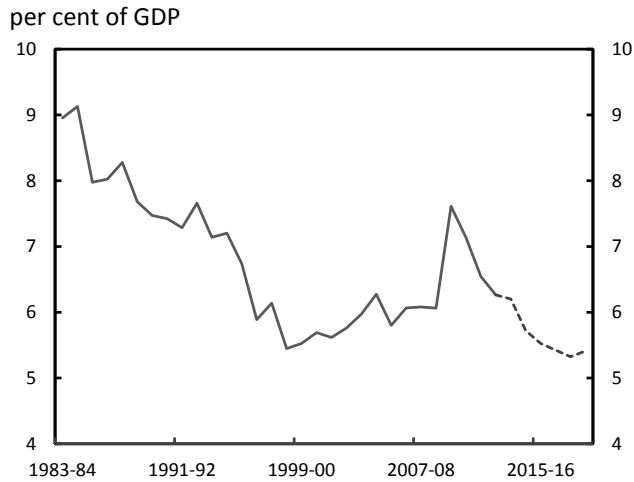
Note: Direct program expenses have been adjusted for accounting reclassifications and are presented on Budget 2012 terms.

In total, the revisions to the expenses outlook published in Update 2013 will bring direct program expenses to the lowest point in recent history as a share of GDP by 2016-17 (Figure 3-3). Given the limited experience of such a low level of federal spending in the economy, the prospects for success and sustainability of the budgeted expenses restraint is difficult to assess.

⁴ See http://www.pbo-dpb.gc.ca/files/files/IR/Response_009.pdf, http://www.pbo-dpb.gc.ca/files/files/IR/info_Request_009B.pdf, and http://www.pbo-dpb.gc.ca/files/files/IR/Response_IR009B.pdf.

Figure 3-3

Direct program expenses, 1983-84 to 2018-19



Sources: Finance Canada; Office of the Parliamentary Budget Officer.
 Note: Expenses have been reconciled to the accounting classification in Budget 2012.

EI premium rates in 2015 and 2016

Proposed changes to the *Employment Insurance Act* have introduced considerable uncertainty in the fiscal plan.

Bill C-4 sets rates in 2015 and 2016 at \$1.88 per \$100 of insurable earnings, but also provides the Governor in Council with discretion to set different rates “in the public interest.”

According to the latest projections of the EI operating account cumulative balance by both PBO and Finance Canada, setting premium rates at \$1.88 in 2015 and 2016 results in higher rates than would have been set prior to Bill C-4. This adds significant revenues to fiscal year 2015-16 and 2016-17.

As it is not clear under which circumstances the Governor in Council would reduce premium rates, PBO has assessed the potential fiscal impact of the two most likely alternative premium rate scenarios relative to the current outlook of \$1.88 in both years.

In the first scenario, the Governor in Council reduces rates to the level which is just high enough to balance the forecast EI operating account. PBO estimates this would be \$1.81 in 2015 and \$1.59 in

2016.⁵ The fiscal impact of this scenario reduces the surplus in 2015-16 by \$1.8 billion in 2015-16 and by \$3.0 billion in 2016-17 (Table 3-1).

Table 3-1

Scenario 1: reduce rates to balance the EI account

per \$100 of earnings, unless otherwise specified

| | 2014-2015 | 2015-2016 | 2016-2017 | 2017-2018 | 2018-2019 |
|-------------------------------------|-----------|-----------|-----------|-----------|-----------|
| Bill C-4 premium rate | 1.88 | 1.88 | 1.88 | 1.54 | 1.54 |
| Scenario 1 premium rate (breakeven) | 1.88 | 1.81 | 1.59 | 1.58 | 1.58 |
| Fiscal impact (billions of dollars) | -0.2 | -1.8 | -3.0 | 0.4 | -0.2 |

Source: Office of the Parliamentary Budget Officer.
 Note: Premium rates are set and projected on a calendar-year basis and fiscal impact is estimated on a fiscal-year basis.

In the second scenario, the Governor in Council reduces the rate to \$1.83 in 2015 and \$1.78 in 2016, according to the 5-cent reduction limit in subsection 66(7).⁶ The Governor in Council then reduces the rate further to the 7-year breakeven rate in 2017, which PBO estimates would be \$1.56. The fiscal impact of this scenario reduces the budgetary surplus by \$0.9 billion in 2015-16 and \$1.0 billion in 2016-17 (Table 3-2).

Table 3-2

Scenario 2: reduce rates subject to 5-cent maximum

per \$100 of earnings, unless otherwise specified

| | 2014-2015 | 2015-2016 | 2016-2017 | 2017-2018 | 2018-2019 |
|-------------------------------------|-----------|-----------|-----------|-----------|-----------|
| Bill C-4 premium rate | 1.88 | 1.88 | 1.88 | 1.54 | 1.54 |
| Scenario 2 premium rate | 1.88 | 1.83 | 1.78 | 1.56 | 1.56 |
| Fiscal impact (billions of dollars) | -0.2 | -0.9 | -1.0 | 0.2 | -0.1 |

Source: Office of the Parliamentary Budget Officer.
 Note: Premium rates are set and projected on a calendar-year basis and fiscal impact is estimated on a fiscal-year basis.

To provide certainty for federal fiscal planning and for the planning of employers and employees, the annual premium rate setting framework of the *Employment Insurance Act* should be clarified.

⁵ The rate in 2015 is the forecast breakeven rate that eliminates the cumulative account deficit and balances revenues and expenses in 2015. The rate set in 2016 and subsequent years is the 7-year breakeven rate.

⁶ Although the 5-cent limit remains, the Governor in Council can set rate decreases in excess of the limit if it considers it in the public interest.

Further, it would be useful if the Government would publish a full costing of the EI premium rate freeze compared to the status quo (i.e. the premium rates which would have been set prior to the rate freeze in 2014 and prior to Bill C-4, after considering the improvements in the EI operating account since Budget 2013). This should report not only the revenue the Government expects to lose in 2014-15 (the Government announced it expects to lose \$660 million in calendar year 2014), but also the revenue it expects to gain in 2015-16 and 2016-17.

PBO estimates the rate freeze decreases revenues in 2014-15 by \$0.5 billion, and increases revenues by an additional \$1.0 billion in 2015-16 and \$3.1 billion in 2016-17 compared to the status quo. The Government's projections of premium rates and the EI operating account balance in Update 2013 suggest it estimates an even greater revenue gain.

Asset sales

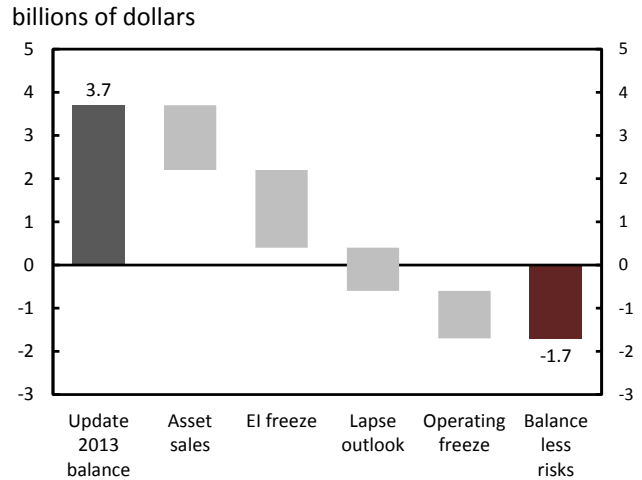
The outlook in Update 2013 also relies on potential gains on future asset sales, including the Government's holdings of General Motors shares, Ridley Terminals, and Dominion Coal Blocks. PBO has added the Government's estimate of prospective asset sales to its outlook, although PBO has been provided with insufficient information to assess the likelihood and potential value of the sales. Asset sales contribute \$1.5 billion of the Government's expected \$3.7 billion surplus in 2015-16.

Combined effect on budgetary balance 2015-16

The direct program expenses operating freeze (\$1.1 billion), revisions to the outlook for lapsing authorities (\$1.0 billion), the freeze of EI rates at higher than necessary rates in 2015 and 2016 (estimated to provide an additional \$1.8 billion in 2015-16), and sales of public assets (\$1.5 billion) account for a total of \$5.4 billion of the Government's projected budgetary balance in 2015-16 (Figure 3-4).

Figure 3-4

Risks to the Government's outlook in 2015-16



Sources: Finance Canada; Office of the Parliamentary Budget Officer.

If direct program expenses do not materialise as planned, if a Governor in Council decision is made to reduce EI premiums, and if sales of public assets are delayed or do not occur, most if not all of the \$3.7 billion surplus the Government projects for 2015-16 would be eliminated.⁷ The implications are similar for PBO's projected \$4.6 billion surplus.

4 Long-term economic and fiscal projections

Following the 2012 Fall Report of the Auditor General of Canada, Finance Canada published its first long-term economic and fiscal projections for the federal government in Economic and Fiscal Implication of Canada's Aging Population in October 2012.⁸ PBO welcomes Finance Canada's update of its long-term economic and fiscal projections included in Update 2013.

The following section presents a comparison of PBO's and Finance Canada's long-term economic and fiscal outlooks, as presented in PBO's Fiscal Sustainability Report 2013 (FSR 2013) and Update 2013, as well as recommendations to further improve fiscal sustainability reporting.

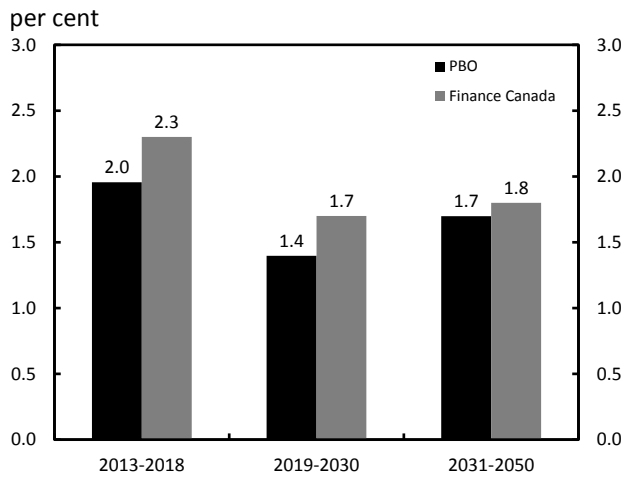
⁷ This does not take into account the Government's \$3 billion downward risk adjustment to revenues.

⁸ See http://www.oag-bvg.gc.ca/internet/docs/parl_oag_201210_07_e.pdf and <http://www.fin.gc.ca/pub/eficap-rebvp/eficap-rebvp-eng.pdf>.

Demographic and economic projections

PBO and Finance Canada both use Statistics Canada’s medium-growth population scenario for projecting demographics. The projected ratio of working-age Canadians (aged 15-64) to those aged 65 and over is the same for both PBO and Finance Canada through 2050.⁹ PBO and Finance Canada also both use a growth accounting model to determine real GDP growth as a function of growth in labour supply (total hours worked) and growth in labour productivity. PBO’s and Finance Canada’s real GDP growth projections are compared in Figure 4-1.

Figure 4-1
Comparison of average annual real GDP growth projections



Sources: Finance Canada; Office of the Parliamentary Budget Officer.
Note: Growth rates are rounded to the nearest tenth of a percentage point.

PBO’s lower real GDP growth projection is because labour productivity growth is assumed to be 1.1 per cent throughout the projection horizon, which is on average 0.2 percentage points lower than Finance Canada’s assumption. Further details of the differences between real GDP growth projections are given in Table 4-1.

Table 4-1

Comparison of real GDP growth projections and components

| per cent | | | |
|------------------------|-------------|-------------|-------------|
| PBO | 2013-2018 | 2019-2030 | 2031-2050 |
| Real GDP growth | 2.0 | 1.4 | 1.7 |
| Labour supply growth | 0.9 | 0.3 | 0.6 |
| Labour Productivity | 1.1 | 1.1 | 1.1 |
| Finance Canada | | | |
| 2013-2018 | 2019-2030 | 2031-2050 | |
| Real GDP growth | 2.3 | 1.7 | 1.8 |
| Labour supply growth | 1.0 | 0.4 | 0.6 |
| Labour Productivity | 1.3 | 1.3 | 1.2 |
| Difference | | | |
| 2013-2018 | 2019-2030 | 2031-2050 | |
| Real GDP growth | -0.3 | -0.3 | -0.1 |
| Labour supply growth | -0.1 | -0.1 | 0.0 |
| Labour Productivity | -0.2 | -0.2 | -0.1 |

Sources: Finance Canada; Office of the Parliamentary Budget Officer.

Fiscal projections

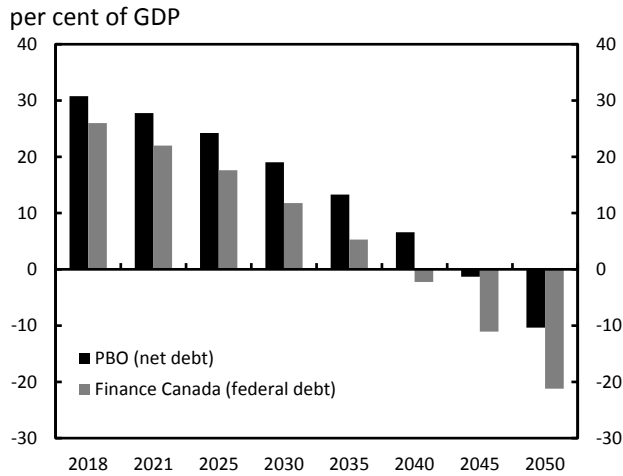
PBO’s assessment of long-term fiscal sustainability is on a calendar year basis using the net debt concept from Statistics Canada’s Government Finance Statistics (GFS), based on the Canadian System of National Accounts. On the other hand, Finance Canada reports the federal debt (accumulated deficit) on a fiscal year Public Accounts basis. Furthermore, Finance Canada’s medium-term economic and fiscal projection is based on Update 2013 and includes data available up to and including November 8, 2013 whereas PBO’s FSR 2013 medium-term fiscal projection is based on April EFO 2013 updated with data up to July 5, 2013. FSR 2013 also includes policy measures announced up to September 1, 2013, which excludes the announcement of the three-year freeze of EI premium rates.

Figure 4-2 compares PBO’s projection of net debt to Finance Canada’s projection of federal debt. PBO projects net debt to return to a net asset position in 2045. Finance Canada projects federal debt to reach an asset position slightly earlier, by 2040-41 (Finance Canada reports projections of federal debt at 5-year intervals).

⁹ Statistics Canada’s medium-growth population scenario is available at: <http://www.statcan.gc.ca/pub/91-520-x/91-520-x2010001-eng.pdf>. Both Finance Canada and PBO have updated their projections to reflect the most recent population data available.

Figure 4-2

Comparison of federal government debt



Sources: Finance Canada; Office of the Parliamentary Budget Officer.
 Note: PBO projections are on a National Accounts basis; Finance Canada projections are on a Public Accounts basis.

PBO assumes that budgetary revenues (consisting of income and excise taxes, EI premiums, and other revenues) grow in line with GDP after 2017, once the economy returns to its potential output. This results in a constant share of 14.5 per cent of federal revenue relative to GDP. Similarly, Finance Canada assumes that all tax revenues, including personal income tax, corporate income tax and Goods and Services Tax revenues grow in line with GDP after 2018-19. Additionally, the \$3-billion risk adjustment to revenues applied in 2018-19 is also assumed to grow in line with GDP beyond that year.

Finance Canada’s lower federal revenue to GDP projection is a result of its lower medium-term projection for personal income taxes, GST/HST, and EI revenues (Table 4-2).

PBO’s and Finance Canada’s assumptions for projecting federal program expenses are also similar, except for children’s benefits. PBO assumes children’s benefits grow in line with the population below 18 and nominal GDP growth, while Finance Canada assumes that children’s benefits grow with the population below 18 and inflation. This difference in assumption explains Finance Canada’s slightly lower program expense projection relative to PBO’s projection (Table 4-2).

PBO projects the effective interest rate on federal debt to be 4.5 per cent in 2018, gradually increasing to 4.9 per cent by 2022, and constant thereafter. Finance Canada assumes that the initial stock of federal debt is subject to an effective interest rate that grows from about 4 per cent in 2018-19 to 5 per cent by 2027-28 and remains constant thereafter. The difference in the interest rate explains PBO’s slightly higher public debt charges relative to GDP in comparison with Finance Canada’s projection.

Table 4-2

Comparison of long-term fiscal outlooks

per cent of GDP

| PBO | 2018 | 2025 | 2030 | 2040 | 2050 |
|----------------------|------|------|------|------|------|
| Revenues | 14.5 | 14.5 | 14.5 | 14.5 | 14.5 |
| Program expenditures | 12.6 | 12.9 | 12.9 | 12.8 | 12.6 |
| Public debt charges | 1.8 | 1.5 | 1.2 | 0.6 | -0.3 |
| Budgetary balance | 0.1 | 0.1 | 0.4 | 1.1 | 2.2 |

| Finance Canada | 2018-19 | 2025-26 | 2030-31 | 2040-41 | 2050-51 |
|----------------------|---------|---------|---------|---------|---------|
| Revenues | 14.4 | 14.4 | 14.4 | 14.4 | 14.4 |
| Program expenditures | 12.4 | 12.6 | 12.5 | 12.3 | 12.0 |
| Public debt charges | 1.6 | 1.4 | 1.2 | 0.5 | -0.4 |
| Budgetary balance | 0.4 | 0.4 | 0.8 | 1.6 | 2.8 |

| Difference | 2018-19 | 2025-26 | 2030-31 | 2040-41 | 2050-51 |
|----------------------|---------|---------|---------|---------|---------|
| Revenues | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Program expenditures | 0.2 | 0.3 | 0.4 | 0.5 | 0.6 |
| Public debt charges | 0.2 | 0.1 | 0.0 | 0.1 | 0.1 |
| Budgetary balance | -0.3 | -0.3 | -0.4 | -0.5 | -0.6 |

Sources: Finance Canada; Office of the Parliamentary Budget Officer.

Additional comments on fiscal sustainability reporting

Finance Canada’s update of long-term economic and fiscal projections is a welcome contribution to the discussion of the demographic challenges facing the Canadian economy. However, the report falls short of the Government’s Budget 2007 commitment to provide a “comprehensive fiscal sustainability and intergenerational report” and only partially fulfills the recommendations of the Auditor General. PBO encourages parliamentarians to request Finance Canada to fully comply with the Auditor General’s recommendation to “provide from time to time an analysis for all governments combined, including the

federal, provincial, and territorial governments, to give a total Canada perspective.”¹⁰

Additionally, PBO would have greater ability to assess the long-term sustainability of the nation’s finances and the Government’s projections if Finance Canada’s future publications include a more detailed methodology discussion, including an estimate of federal fiscal room, which was missing in the latest projections.¹¹

¹⁰ See Chapter 7, p. 23, available at: http://www.oag-bvg.gc.ca/internet/docs/parl_oag_201210_07_e.pdf.

¹¹ See footnote 10, p. 48, available at: <http://www.fin.gc.ca/pub/eficap-rebvpc/eficap-rebvpc-eng.pdf>.

Annex A

Table A-1 – Comparison of Budget 2013 and Update 2013 economic outlooks

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|--|-------|-------|-------|-------|-------|-------|
| Real GDP growth (%) | | | | | | |
| Budget 2013 | 1.6 | 2.5 | 2.6 | 2.4 | 2.3 | |
| Update 2013 | 1.7 | 2.4 | 2.6 | 2.4 | 2.3 | 2.2 |
| <i>difference</i> | 0.1 | -0.1 | 0.0 | 0.0 | 0.0 | |
| GDP inflation (%) | | | | | | |
| Budget 2013 | 1.7 | 2.1 | 2.0 | 2.0 | 2.0 | |
| Update 2013 | 1.3 | 1.8 | 2.0 | 2.0 | 2.0 | 2.0 |
| <i>difference</i> | -0.4 | -0.3 | 0.0 | 0.0 | 0.0 | |
| Nominal GDP growth (%) | | | | | | |
| Budget 2013 | 3.3 | 4.7 | 4.7 | 4.4 | 4.3 | |
| Update 2013 | 3.0 | 4.2 | 4.6 | 4.5 | 4.4 | 4.3 |
| <i>difference</i> | -0.3 | -0.5 | -0.1 | 0.1 | 0.1 | |
| Nominal GDP level (billions of dollars) | | | | | | |
| Budget 2013 | 1,878 | 1,966 | 2,058 | 2,149 | 2,241 | |
| Update 2013 | 1,875 | 1,954 | 2,044 | 2,136 | 2,229 | 2,324 |
| <i>difference</i> | -3 | -12 | -14 | -13 | -12 | |
| 3-month treasury bill rate (%) | | | | | | |
| Budget 2013 | 1.0 | 1.3 | 2.2 | 3.3 | 3.8 | |
| Update 2013 | 1.0 | 1.1 | 1.8 | 3.1 | 3.7 | 4.0 |
| <i>difference</i> | 0.0 | -0.2 | -0.4 | -0.2 | -0.1 | |
| 10-year government bond rate (%) | | | | | | |
| Budget 2013 | 2.1 | 2.8 | 3.5 | 4.1 | 4.6 | |
| Update 2013 | 2.3 | 3.1 | 3.5 | 4.1 | 4.6 | 4.8 |
| <i>difference</i> | 0.2 | 0.3 | 0.0 | 0.0 | 0.0 | |
| Exchange rate (US cents/C\$) | | | | | | |
| Budget 2013 | 98.9 | 100.7 | 100.9 | 99.3 | 98.8 | |
| Update 2013 | 97.3 | 96.8 | 97.2 | 98.0 | 97.7 | 98.1 |
| <i>difference</i> | -1.6 | -3.9 | -3.7 | -1.3 | -1.1 | |
| Unemployment rate (%) | | | | | | |
| Budget 2013 | 7.1 | 6.9 | 6.7 | 6.5 | 6.4 | |
| Update 2013 | 7.1 | 6.9 | 6.6 | 6.4 | 6.3 | 6.2 |
| <i>difference</i> | 0.0 | 0.0 | -0.1 | -0.1 | -0.1 | |
| Total CPI inflation (%) | | | | | | |
| Budget 2013 | 1.3 | 2.0 | 2.0 | 2.0 | 2.0 | |
| Update 2013 | 1.2 | 1.8 | 2.0 | 2.0 | 2.0 | 2.0 |
| <i>difference</i> | -0.1 | -0.2 | 0.0 | 0.0 | 0.0 | |
| US GDP growth (%) | | | | | | |
| Budget 2013 | 1.9 | 2.9 | 3.1 | 3.0 | 2.8 | |
| Update 2013 | 1.6 | 2.9 | 3.1 | 3.1 | 2.9 | 2.7 |
| <i>difference</i> | -0.3 | 0.0 | 0.0 | 0.1 | 0.1 | |

Source: Finance Canada.

Annex B

Table B-1 – Comparison of November 2013 revised PBO outlook and Update 2013 economic outlooks

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|--|-------|-------|-------|-------|-------|-------|
| Real GDP growth (%) | | | | | | |
| November 2013 Revised PBO Outlook | 1.7 | 2.0 | 2.4 | 2.6 | 2.0 | 1.5 |
| Update 2013 | 1.7 | 2.4 | 2.6 | 2.4 | 2.3 | 2.2 |
| <i>difference</i> | 0.0 | 0.4 | 0.2 | -0.2 | 0.3 | 0.7 |
| GDP inflation (%) | | | | | | |
| November 2013 Revised PBO Outlook | 1.3 | 1.4 | 1.5 | 1.9 | 2.0 | 2.0 |
| Update 2013 | 1.3 | 1.8 | 2.0 | 2.0 | 2.0 | 2.0 |
| <i>difference</i> | 0.0 | 0.4 | 0.5 | 0.1 | 0.0 | 0.0 |
| Nominal GDP growth (%) | | | | | | |
| November 2013 Revised PBO Outlook | 2.9 | 3.4 | 4.0 | 4.5 | 4.0 | 3.5 |
| Update 2013 | 3.0 | 4.2 | 4.6 | 4.5 | 4.4 | 4.3 |
| <i>difference</i> | 0.1 | 0.8 | 0.6 | 0.0 | 0.4 | 0.8 |
| Nominal GDP level (billions of dollars) | | | | | | |
| November 2013 Revised PBO Outlook | 1,873 | 1,937 | 2,014 | 2,105 | 2,190 | 2,268 |
| Update 2013 | 1,875 | 1,954 | 2,044 | 2,136 | 2,229 | 2,324 |
| <i>difference</i> | 2 | 17 | 30 | 31 | 39 | 56 |
| 3-month treasury bill rate (%) | | | | | | |
| November 2013 Revised PBO Outlook | 1.0 | 1.0 | 1.4 | 2.8 | 4.0 | 4.2 |
| Update 2013 | 1.0 | 1.1 | 1.8 | 3.1 | 3.7 | 4.0 |
| <i>difference</i> | 0.0 | 0.1 | 0.4 | 0.4 | -0.3 | -0.2 |
| 10-year government bond rate (%) | | | | | | |
| November 2013 Revised PBO Outlook | 2.3 | 3.2 | 3.8 | 4.5 | 5.2 | 5.3 |
| Update 2013 | 2.3 | 3.1 | 3.5 | 4.1 | 4.6 | 4.8 |
| <i>difference</i> | 0.0 | -0.1 | -0.3 | -0.4 | -0.6 | -0.5 |
| Exchange rate (US cents/C\$) | | | | | | |
| November 2013 Revised PBO Outlook | 97.3 | 96.5 | 96.6 | 96.0 | 95.6 | 94.6 |
| Update 2013 | 97.3 | 96.8 | 97.2 | 98.0 | 97.7 | 98.1 |
| <i>difference</i> | 0.0 | 0.3 | 0.6 | 2.0 | 2.1 | 3.5 |
| Unemployment rate (%) | | | | | | |
| November 2013 Revised PBO Outlook | 7.2 | 7.3 | 7.0 | 6.6 | 6.3 | 6.2 |
| Update 2013 | 7.1 | 6.9 | 6.6 | 6.4 | 6.3 | 6.2 |
| <i>difference</i> | -0.1 | -0.4 | -0.4 | -0.2 | 0.0 | 0.0 |
| Total CPI inflation (%) | | | | | | |
| November 2013 Revised PBO Outlook | 1.0 | 1.7 | 1.9 | 2.0 | 2.0 | 2.0 |
| Update 2013 | 1.2 | 1.8 | 2.0 | 2.0 | 2.0 | 2.0 |
| <i>difference</i> | 0.2 | 0.1 | 0.1 | 0.0 | 0.0 | 0.0 |
| US GDP growth (%) | | | | | | |
| November 2013 Revised PBO Outlook | 1.6 | 2.7 | 3.4 | 3.6 | 3.3 | 2.6 |
| Update 2013 | 1.6 | 2.9 | 3.1 | 3.1 | 2.9 | 2.7 |
| <i>difference</i> | 0.0 | 0.2 | -0.3 | -0.5 | -0.4 | 0.1 |

Source: Office of the Parliamentary Budget Officer; Finance Canada.

Annex C

Table C-1 – Updated PBO fiscal outlook

| | 2012- 2013 | 2013- 2014 | 2014- 2015 | 2015- 2016 | 2016- 2017 | 2017- 2018 | 2018- 2019 |
|-----------------------------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| Income taxes | | | | | | | |
| Personal income tax | 125.7 | 132.6 | 141.4 | 149.1 | 156.8 | 163.7 | 170.2 |
| Corporate income tax | 35.0 | 34.2 | 34.2 | 37.1 | 40.1 | 43.0 | 45.0 |
| Non-resident income tax | 5.1 | 5.6 | 5.8 | 6.1 | 6.5 | 6.8 | 7.1 |
| Total income tax | 165.8 | 172.4 | 181.4 | 192.3 | 203.5 | 213.6 | 222.3 |
| Excise taxes/duties | | | | | | | |
| Goods and Services Tax | 28.8 | 30.9 | 32.2 | 33.5 | 34.9 | 36.2 | 37.4 |
| Custom import duties | 4.0 | 4.1 | 4.5 | 4.9 | 4.6 | 4.7 | 4.9 |
| Other excise taxes/duties | 10.8 | 10.8 | 10.7 | 10.6 | 10.5 | 10.6 | 10.5 |
| Total excise taxes/duties | 43.6 | 45.9 | 47.4 | 49.1 | 50.0 | 51.5 | 52.8 |
| El premium revenues | 20.4 | 21.6 | 22.7 | 23.6 | 23.3 | 20.4 | 21.4 |
| Other revenues | 26.9 | 27.7 | 29.2 | 31.6 | 31.7 | 33.1 | 34.6 |
| Total budgetary revenues | 256.6 | 267.7 | 280.7 | 296.5 | 308.5 | 318.6 | 331.2 |
| Major transfers to persons | | | | | | | |
| Elderly benefits | 40.3 | 41.8 | 44.0 | 46.5 | 49.1 | 51.8 | 52.6 |
| Employment Insurance benefits | 17.1 | 17.0 | 18.4 | 19.2 | 19.7 | 20.0 | 20.3 |
| Children's benefits | 13.0 | 13.1 | 13.2 | 13.4 | 13.6 | 13.7 | 13.9 |
| Total | 70.3 | 71.8 | 75.7 | 79.1 | 82.5 | 85.5 | 86.8 |
| Major transfers to OLG | 58.4 | 60.5 | 62.7 | 65.3 | 68.2 | 70.7 | 73.4 |
| Direct program expenses | 117.7 | 120.7 | 115.4 | 115.9 | 119.0 | 121.4 | 124.5 |
| Public debt charges | 29.2 | 29.8 | 30.5 | 31.6 | 33.9 | 36.3 | 39.0 |
| Total expenses | 275.6 | 282.8 | 284.3 | 292.0 | 303.6 | 313.9 | 323.7 |
| Budgetary balance | -18.9 | -15.2 | -3.5 | 4.6 | 5.0 | 4.7 | 7.5 |
| Federal debt | 602.4 | 617.6 | 621.1 | 616.6 | 611.6 | 606.9 | 599.4 |

Source: Office of the Parliamentary Budget Officer.

Annex D

Table D-1 – Changes to PBO’s fiscal outlook since EFOU 2013

| | 2012- 2013 | 2013- 2014 | 2014- 2015 | 2015- 2016 | 2016- 2017 | 2017- 2018 | 2018- 2019 |
|-----------------------------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| Income taxes | | | | | | | |
| Personal income tax | 0.0 | 0.0 | -0.1 | -0.3 | -0.3 | -0.3 | -0.2 |
| Corporate income tax | 0.0 | 0.0 | 0.0 | -0.1 | -0.1 | -0.1 | 0.0 |
| Non-resident income tax | 0.0 | 0.1 | -0.1 | -0.3 | -0.2 | -0.3 | -0.3 |
| Total income tax | 0.0 | 0.1 | -0.3 | -0.7 | -0.6 | -0.6 | -0.6 |
| Excise taxes/duties | | | | | | | |
| Goods and Services Tax | 0.0 | 0.0 | 0.0 | -0.1 | -0.1 | -0.1 | 0.0 |
| Custom import duties | 0.0 | 0.0 | 0.0 | 0.0 | -0.5 | -0.5 | -0.4 |
| Other excise taxes/duties | 0.0 | -0.1 | 0.0 | 0.1 | 0.0 | 0.1 | 0.1 |
| Total excise taxes/duties | 0.0 | 0.0 | 0.0 | 0.0 | -0.5 | -0.4 | -0.4 |
| El premium revenues | 0.0 | 0.3 | 0.5 | 1.0 | 1.7 | -0.6 | 0.0 |
| Other revenues | 0.0 | 0.0 | 0.6 | 1.7 | 0.5 | 0.6 | 1.0 |
| Total budgetary revenues | 0.0 | 0.5 | 0.8 | 2.0 | 1.0 | -1.0 | 0.1 |
| Major transfers to persons | | | | | | | |
| Elderly benefits | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Employment Insurance benefits | 0.0 | -0.3 | 0.2 | 0.3 | 0.3 | 0.3 | 0.3 |
| Children's benefits | 0.0 | 0.0 | -0.1 | -0.1 | -0.1 | -0.2 | -0.2 |
| Total | 0.0 | -0.3 | 0.1 | 0.2 | 0.3 | 0.1 | 0.1 |
| Major transfers to OLG | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | -0.1 | -0.1 |
| Direct program expenses | 0.0 | 0.9 | -1.9 | -2.4 | -1.0 | -0.6 | 0.4 |
| Public debt charges | 0.0 | 0.2 | 0.5 | -0.2 | -1.5 | -2.8 | -1.9 |
| Total expenses | 0.0 | 0.9 | -1.3 | -2.4 | -2.3 | -3.3 | -1.4 |
| Budgetary balance | 0.1 | -0.4 | 2.1 | 4.4 | 3.3 | 2.3 | 2.5 |
| Federal debt | 0.0 | 0.4 | -1.7 | -6.0 | -9.3 | -11.6 | -14.1 |

Sources: Office of the Parliamentary Budget Officer.

Note: The change in other revenues and direct program expenses partly reflects an updated projection of interest owed to taxpayers based on information unavailable in EFOU 2013.