SPECIAL REPORT
TD Economics

October 7, 2014

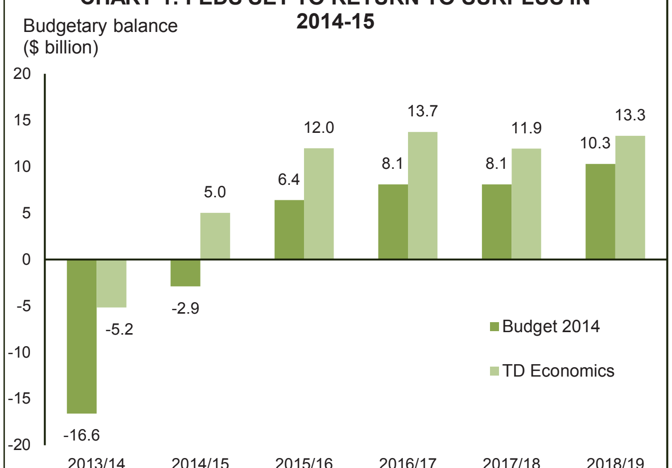
THE TROUBLE WITH SURPLUSES
AN EXAMINATION OF THE FEDERAL FISCAL OUTLOOK

Highlights

- As has become the broad consensus among economists and commentators, Canada's federal government's books are poised to tip into surplus in fiscal 2014-15. We estimate a surplus of around $5.0 billion this year, a considerable improvement from the $2.9 billion deficit projected in Budget 2014. This improved showing is on the back of a better-than-expected hand-off from fiscal 2013-14 as well as stronger economic growth than forecast in Budget 2014.
- TD Economics projections show that the government will have around $56 billion in cumulative surpluses over the next 5 years to divvy up across tax cuts, new spending and/or debt reduction. We also expect that the government will easily meet its stated 25% debt-to-GDP target over the forecast.
- While this surplus room may seem substantial at first blush, it pales in comparison to those in the 1990s, when an improved global economic environment and falling interest rates led substantially larger surpluses. Case in point, in the 1999 Fall Update, the federal government at the time projected a surplus of 2% of GDP after five years, about three times our current 5-year forecast.
- As such, the government will need to manage expectations for revenue reductions or spending increases. For instance, we project that introducing the government's 2011 election commitments will chew through nearly $20 billion by fiscal 2019-20, or about one-third of the projected total surplus. Promises of tax relief will compete with pressure for new spending and reduced debt. Tough choices will need to be made.

It has become accepted wisdom that the federal government will return to surplus in fiscal 2014-15 – one year earlier than expected in Budget 2014. By our estimate, the government is on target to ring up black ink of about $5.0 billion in the year ending on March 31st, owing to both a better starting point coming out of fiscal 2013-14 and stronger near-term economic growth than was expected at the time of the budget. Looking ahead, the federal government's surplus is set to rise further over the next several years, yielding a cumulative total of $51.0 billion between fiscal years 2015-16 and 2018-19 (Chart 1). This is about $19 billion higher than the cumulative surplus of $32.9 billion published in Budget 2014.

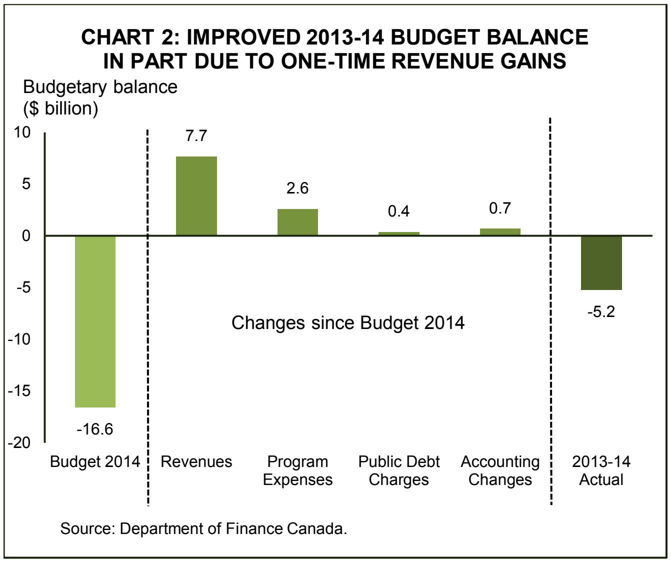
CHART 1: FEDS SET TO RETURN TO SURPLUS IN 2014-15



Sources: Deparment of Finance Canada, TD Economics.

For the Canadian federal government, the return to a budget surplus will mark the culmination of a 7-year strategy that began with the recessionary stimulus program in 2009 followed by a measured and targeted plan to slay the deficit. Canadians may think that much of the hard work is in the rearview mirror. However, past experience in Canada shows that decisions on how to divvy

Derek Burleton, VP & Deputy Chief Economist, 416-982-2514
Randall Bartlett, CFA, Senior Economist, 416-944-5729
Diarra Sourang, Economic Analyst, 416-982-2559



up emerging budget surpluses across tax cuts, spending increases and debt reduction is hardly a walk in the park. Complicating matters is the fact that the wiggle room available to the federal government for new measures will likely pale in comparison to that enjoyed in the 1990s. Indeed, our analysis shows that merely implementing some of the government's campaign promises would likely gobble up a large portion of the available surplus room. Tough decisions will thus be required.

A lot has changed since Budget 2014

With the release of the February 2014 budget – a document that featured another dose of spending restraint – the government announced it was within spitting distance of a balanced budget. Although the government projected a deficit of $2.9 billion in the year ending on March 31st, 2015, the budget assumptions included the traditional $3 billion in prudence (for economic risks) that, if not used, would effectively result in a razor-thin surplus. Beyond this year, surpluses (net of the prudence factor) were expected to grow from about $6.4 billion in fiscal 2015-16 to $10.3 billion in fiscal 2018-19. Still, with surpluses not yet in the bank, Budget 2014 reserved discussion of how to allocate them until this year's Fall Fiscal Update or next spring's pre-election budget.

Since the budget, the near- and medium-term outlook for federal finances has improved. First, last year's fiscal performance appears to have turned out better than the government had assumed at the time of the February budget. Second, several forecasters – including TD Economics – have been marking up their near-term growth projections to reflect recent better-than-expected economic data.

Fiscal 2013-14 reaps $11.4 billion windfall

With the release of the federal government's 2014 Annual Financial Report (AFR), we now have the definitive final estimate of the Government of Canada's budget numbers for fiscal 2013-14. And it's a good news story to say the least.

According to the AFR, the budget deficit came in at $5.2 billion in 2013-14, a marked improvement of $11.4 billion over the $16.6 billion shortfall projected in Budget 2014 (Chart 2). Much of the outperformance reflected higher revenues than projected at the time of the budget (+$7.7 billion). At the same time, both program expenses (-$2.6 billion) and public debt charges (-$0.4 billion) came in lower than expected. The lower program expenses projection was due to $2.8 billion in savings from direct program expenses (i.e., all programs excluding transfer payments to individuals, businesses and other governments) – one of the few remaining areas of discretionary spending. This said, some of the better revenue and expenditure numbers were the result of one-time factors which will not flow through to later fiscal years.[1]

Economy has been moving in the government's favour

In addition to the improved starting point, the near-term budget forecast is poised to benefit from a more favourable near-term economic environment than projected at the time of the February budget (Table 1). Canadian economic growth has rebounded since the spring, leaving nominal GDP – the broadest measure of the tax base – on track to rise above budget forecasts by about $17 billion in the current year. Roughly speaking, this windfall – which reflects both stronger gains in real output and higher GDP inflation – would translate into about $2.6 billion in additional revenue than was expected at the time of the budget.

Despite the upgrade to the near-term growth outlook, TD's economic growth forecast beyond 2015 remains lower than in Budget 2014, reflecting our below-consensus view. Longer-term economic growth expectations are heavily influenced by opinions on structural drivers such as an aging population as well as Canada's productivity performance. Still, even with our somewhat more conservative view stretching beyond the next few years, our estimate for nominal GDP levels in 2018 is still in line with that shown in Budget 2014.

It is important to note that the GDP estimates used in our

Table 1: Economic Assumptions for Canada Annual, percent change (unless otherwise indicated)						
Calendar Year	2014	2015	2016	2017	2018	2019
Real GDP						
February 2014 Budget	2.3	2.5	2.5	2.3	2.2	--
TD Economics	2.4	2.7	2.4	2.1	1.8	1.7
Nominal GDP						
February 2014 Budget	3.9	4.5	4.5	4.4	4.2	--
TD Economics	4.6	4.4	4.3	4.1	3.8	3.7
Nominal GDP ($ billion)						
February 2014 Budget	1,952	2,040	2,132	2,226	2,320	--
TD Economics	1,969	2,055	2,144	2,232	2,316	2,393
3-Month T-Bill Rate						
February 2014 Budget	1.0	1.5	2.7	3.6	4.0	--
TD Economics	0.9	1.2	1.9	2.8	3.0	3.1
10-Year Gov't Bond Yield						
February 2014 Budget	3.0	3.5	4.1	4.6	4.8	--
TD Economics	2.3	3.0	3.6	4.0	4.1	4.2
Sources: Department of Finance Canada, TD Economics, Statistics Canada, Bank of Canada.						

fiscal forecast also build in the government's conservative practice of shaving $20 billion from nominal GDP growth annually. We have opted to mirror this approach in our projections, since this prudence factor is effectively deemed to be "off limits" from a budget planning perspective, with any unused amount of this cushion directed towards debt reduction. Subtracting this tally from nominal GDP reduces planning revenues by about $3 billion per year. Since uncertainty surrounding fiscal 2014-15 has been reduced as the year progresses, we assume that the government cuts this year's margin in half to $10 billion in its upcoming Fall Update (Chart 3).

In addition to an improved near-term growth outlook, the government's books are poised to benefit from lower interest rates, both in the near term and over the next five years. There is a growing chorus of forecasters that believe that while interest rates are set to rise over the next few years, they will increase to levels that are lower than previously believed (see Divergent Views on Neutral Interest Rates). As shown in Table 1, short- and longer-term borrowing costs are 0.5-1 percentage point lower throughout the forecast horizon compared with the assumptions included in Budget 2014.

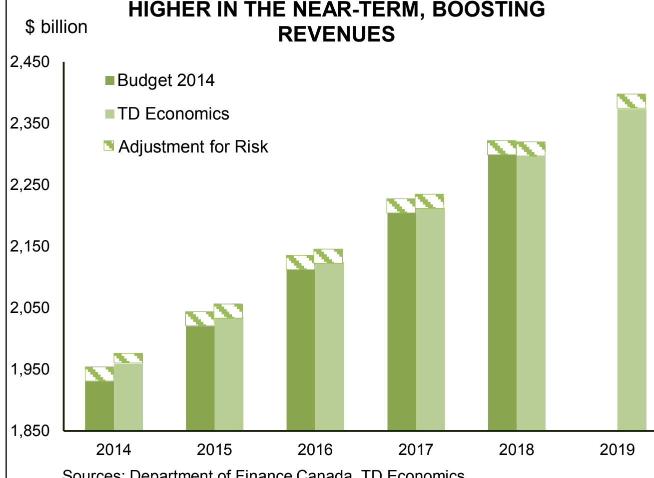
Cumulative surpluses of $71.2 billion through fiscal 2019-20

Based on these assumptions, we present our 6-year status-quo fiscal forecast in Table 2. Given that the upcoming budget will add one year to the medium-term forecast horizon, we have extended our projections to include fiscal 2019-20. The government is on track to see its surplus jump from about $5.0 billion in fiscal 2014-15 to $12.0 billion beginning in fiscal 2015-16. Total cumulative surplus room on a status-quo basis is expected to be $71.2 billion through 2019-20. Consistent with this profile, the federal debt-to-GDP ratio would fall to 22.4% in fiscal 2019-20, bettering the government's 25% target by 2021 announced by the Prime Minister last year.

Relative to the 2014 budget, we expect higher cumulative revenues from 2014-15 to 2018-19 (+$17.0 billion), complemented by lower cumulative program expenses (-$6.0 billion) (see Annex A for a detailed projection of revenues and Annex B for a detailed projection of expenses). While the revenue projection is higher, on the whole, than in Budget 2014, the extent of outperformance is expected to fade gradually over time in line with our lower expectation for longer-term economic growth. We are also projecting public debt charges to be lower over these same years than in Budget 2014, for a cumulative difference of $3.0 billion lower over five years. This reflects our lower interest rate profile, higher status-quo surpluses and lower borrowing requirements.

The surplus is expected to rise over the forecast horizon in all but one year – fiscal 2017-18. Indeed, in Budget 2014, a likewise pull-back in the surplus is projected. This decline can largely be related to assumptions by TD Economics and the Department of Finance (DOF) surrounding Employment Insurance (EI) premium rates in 2017 (see Annex C for a detailed projection of EI premium revenues and expenses).

CHART 3: RISK-ADJUSTED NOMINAL GDP HIGHER IN THE NEAR-TERM, BOOSTING REVENUES



Sources: Department of Finance Canada, TD Economics.

Table 2: TD Economics September 2014 Federal Fiscal Forecast Summary (C$ billion, unless otherwise specificed)	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Budgetary Revenues	**282.2**	**298.0**	**311.2**	**320.0**	**332.1**	**344.4**
Program Expenses	249.2	256.1	265.3	273.9	284.6	295.8
Public Debt Charges	28.0	29.9	32.1	34.2	34.1	33.4
Total Expenses	**277.2**	**286.0**	**297.5**	**308.0**	**318.8**	**329.2**
Budgetary Balance	**5.0**	**12.0**	**13.7**	**11.9**	**13.3**	**15.2**
Federal Debt	606.9	594.9	581.1	569.2	555.9	540.7
Per cent of GDP						
Budgetary Revenues	14.2	14.4	14.4	14.3	14.3	14.3
Program Expenses	12.5	12.4	12.3	12.2	12.2	12.2
Public Debt Charges	1.4	1.4	1.5	1.5	1.5	1.4
Budgetary Balance	0.3	0.6	0.6	0.5	0.6	0.6
Federal Debt	30.5	28.8	26.9	25.4	23.9	22.4

Sources: TD Economics, Department of Finance Canada.

While the decision surrounding EI rates is ultimately at the discretion of the Finance Minister, the current legislation requires that premium rates for employees and employers be set at levels sufficient to allow the EI Operating Account to break even over the following seven years. Partly reflecting the government's decision to freeze EI premium rates over the next three years, the surplus in the EI operating account is poised to rise to about $4.4 billion in 2016. We have adopted the DOF's budget assumption that once the freeze expires, premiums will be reduced to their estimated break-even level of $1.47 per $100 of insurable earnings for individuals ($2.06 for employers), well down from the current rates of $1.88 and $2.63 respectively.

The Trouble with Surpluses: What to Do with Them?

With the government poised to return to surplus, debate has already started to heat up about how the fiscal room should be deployed over the next several years. The main options open to the government are reducing taxes, increasing spending and/or reducing the nation's debt.

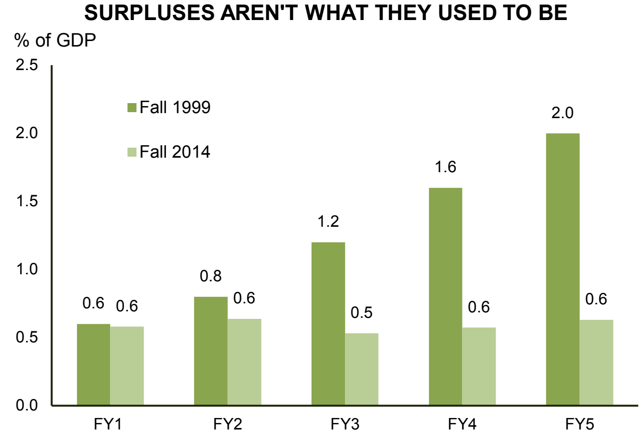
In order to put the current projected surpluses into some context, it helps to look back to the last time the federal government emerged from a string of budget deficits in the late 1990s. In its 1999 Economic and Fiscal Update, the federal government issued status-quo projections that revealed a sea of surplus black ink that was expected to reach $23 billion, or 2% of GDP, by the end of the 5-year planning horizon (Chart 4). The cumulative total expected over the 5-year horizon at the time was $67 billion. In the end, the government had even more resources at its disposal as the mix of booming economic growth, declining debt and falling interest rates had created a virtuous cycle of rising surpluses and falling debt.

Ultimately, the government during that period elected to spread out the benefits. The federal debt dropped by almost $45 billion between fiscal 2000-01 and 2004-05 alone. Significant tax relief measures were delivered, led by a reduction in personal and corporate taxation rates. EI premium rates were cut and parental benefits enhanced. The tax cut measures cost nearly $85 billion in foregone revenues over the 5-year period; 15% of that amount was attributable to the EI premium cuts. On the spending side, the government proceeded with a boost to Canada Health and Social Transfer to the provinces (+$21 billion), Equalization Payments (+$1.5 billion), new investments in research and education (+$3.4 billion) among several other initiatives.

Fast forward to today. TD's 5-year cumulative surplus forecast beyond 2014-15 is slightly lower than that projected in the 1999 Economic and Fiscal Update. However, this only amounts to about 0.6% of GDP 5 years out, or about one third of the expectation in the 1999 Update (Chart 4). Moreover, the chance of the same virtuous cycle kicking in that led to even higher surpluses appears relatively small. Interest rates are already low and the upside for Canadian economic growth appears quite limited. As such, the government will need to be more targeted on how it allocates the future windfall.

Election platform promises would gobble up much of the room

CHART 4: FISCAL PROJECTIONS SHOW SURPLUSES AREN'T WHAT THEY USED TO BE



Sources: 1999 Economic and Fiscal Update, TD Economics.
Note: The horizontal axis refers to each fiscal year following the release of the Fall Update. For example, 'FY1' refers to both 2000-01 and 2015-16.

Table 3: Costing Proposed Policy Measures (C$ billion)						
Fiscal Year	**15-16**	**16-17**	**17-18**	**18-19**	**19-20**	**Total**
Budgetary balance	**12.0**	**13.7**	**11.9**	**13.3**	**15.2**	**66.2**
Total Election 2011 Policy Commitments	**-3.6**	**-3.8**	**-4.0**	**-4.2**	**-4.4**	**-19.9**
Income-splitting	-3.0	-3.2	-3.3	-3.4	-3.5	-16.4
Doubling TFSA	-0.3	-0.4	-0.4	-0.5	-0.6	-2.3
Doubling CFTC	-0.1	-0.1	-0.1	-0.1	-0.1	-0.3
AFTC	-0.2	-0.2	-0.2	-0.2	-0.2	-1.0
Final budgetary balance	**8.4**	**10.0**	**8.0**	**9.2**	**10.8**	**46.3**

Sources: TD Economics, Department of Finance Canada, Office of the Parliamentary Budget Officer, C.D. Howe Institute, Canadian Centre for Policy Alternatives.
Note: TFSA = Tax Free Savings Account; CFTC = Children's Fitness Tax Credit; AFTC = Adult Fitness Tax Credit

The government has already sent out a strong signal as to which way it is inclined to allocate the surpluses. In a speech in September, Prime Minister Stephen Harper reiterated his commitment to the policy proposals outlined in the Conservative Party of Canada's 2011 election platform. These proposals are shown in Table 3, and most are of a targeted nature.

Of particular interest among these proposed policies is the income-sharing (commonly referred to as 'income splitting') proposal for families with dependent children under the age of 18. This proposal would allow couples with dependent children under the age of 18 to share up to $50,000 of their income for tax purposes. While views on the merit of this proposal differ, the estimates of the fiscal cost of income splitting are relatively consistent at around $3 billion in 2015.[2] As a result, from 2015-16 to 2019-20, income splitting is expected to subtract about $16.4 billion from our projected cumulative budget surplus over that period.

Other measures outlined in the 2011 Conservative Party election platform include a doubling of the Tax Free Savings Account contribution limit to $10,000 from $5,000, a doubling of the Children's Fitness Tax Credit to $1,000 from $500, and the introduction of an Adult Fitness Tax Credit of up to $500. These measures are expected to have a cumulative cost of about $3.5 billion in total.[3] Combined, the election platform promises would absorb about one third of the available surplus room over the next 5 years.

Broad based relief comes with a big price tag

Alternatively, the federal government could consider more broad-based tax relief, such as lowering personal income tax rates for individuals. However, as Table 4 shows, a major challenge to implementing broad-based tax cuts is the large price tag involved. Specifically, the cumulative cost of reducing each of the four federal personal income tax (PIT) rates by 1 percentage point would be a sizeable $35 billion over five years, equivalent to more than half of the available fiscal room. Keep in mind that costs could be reduced by, for example, phasing in the measure over time or targeting low income earners. Still, even cutting the lowest PIT rate would cost about $16 billion in foregone revenues over the 5-year period.

Another tax measure that the government could consider would be to reduce the corporate income tax rate from 15% to 14%. If this change was introduced at the beginning of the 2015-16 fiscal year, it would have a total cumulative fiscal impact of around $14.7 billion. Further reducing the Goods and Services Tax (GST) is another option available to the federal government for tax relief. A reduction in the GST from 5% to 4%, all else equal, would have a cumulative fiscal impact of about $36.7 billion between 2015-16 and 2019-20 – far from chump change.

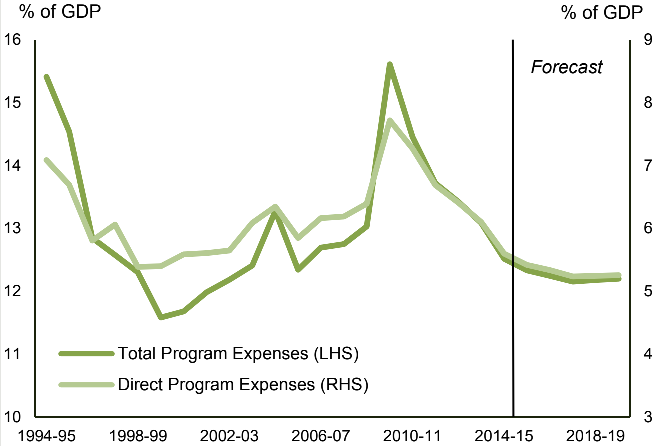
Beyond reducing marginal tax rates directly, the federal government could also consider expanding existing tax credits, such as the Working Income Tax Benefit (WITB). This low-income targeted measure, which provides incentives for low-income individuals to both enter and increase attachment to the workforce, has been viewed as the most progressive among a broad suite of tax measures introduced by the current federal government. According to the Parliamentary Budget Officer, the estimated current cost of the WITB is $1.3 billion.[4] If the government implemented another boost to the WITB similar to its 2009 budget measure, we estimate the cumulative fiscal impact would be an additional $2.7 billion between fiscal 2015-16 and 2019-20.

As we discuss on page 4, any moves to provide tax relief are assumed to be on top of the Small Business Job Credit and Employment Insurance premium rate cuts beginning

Table 4: Cost of reducing marginal tax rates by 1 ppt (C$ billion)						
Fiscal Year	**15-16**	**16-17**	**17-18**	**18-19**	**19-20**	**Total**
Total	**-6.4**	**-6.7**	**-7.0**	**-7.3**	**-7.6**	**-34.8**
Lowest	-2.9	-3.0	-3.1	-3.2	-3.3	-15.5
Second	-2.7	-2.8	-2.9	-3.0	-3.1	-14.3
Third	-0.3	-0.3	-0.3	-0.4	-0.4	-1.7
Highest	-0.6	-0.6	-0.6	-0.7	-0.7	-3.2

Sources: TD Economics, Office of the Parliamentary Budget Officer.
Note: ppt is an abbreviation for percentage point

CHART 5: GOVERNMENT SPENDING MOVING TO SOME OF THE LOWEST ON RECORD



Sources: Department of Finance Canada, TD Economics, Statistics Canada.

in 2017, the cost of which are already embedded in our forecast. The setting of EI rates are already up to the discretion of the Minister, but pressure to slash premiums for all employees and employers is likely to intensify once the freeze on premiums ends in 2017 and surpluses in the EI Operation Account accumulate even further. According to our calculations, reducing premium rates to levels provided in Budget 2014 should provide cumulative tax relief of around $18 billion from 2016-17 to 2019-20 to employees and employers.

Calls to increase spending may be hard to ignore

Beyond these measures, the federal government could face pressure to increase spending after several years of significant spending restraint. TD Economics expects direct program expenses to contract by 1.4% per year on average from fiscal 2010-11 through 2015-16 (Chart 5). The largest year of restraint is 2014-15, when a 3.8% reduction is expected.

Experience has shown that periods of significant restraint are followed by mounting pressures to re-invest once surpluses re-emerge. Case in point, reductions in spending of a roughly similar magnitude in the 1990s proved unsustainable. After reaching a trough in the late-1990s, program expenses as a share of GDP began to increase steadily, with the peak reached during the 2008-09 recession. In fact, over the decade prior to the recession, program expenses increased at an annual average of 5.8%, while direct program expenses rose by an average of 6.3% annually.

The 2014 budget built in a modest rate of growth in direct program spending of around 2.7% per year between fiscal 2015-16 and 2019-20. If they instead elected to add an additional percentage point per year over that period – bringing up the average tally to 3.7% annually – the cumulative additional cost would run at around $6.3 billion over the five years.

The federal government will undoubtedly also face the insistence of some of the provinces to "share the wealth" by increasing transfers. This was evident at the recent First Ministers' meeting, where provincial leaders called on the federal government to maintain the 6% annual health funding escalator beyond fiscal 2016-17. In 2011, the federal government announced that it would reduce annual health transfers to the higher of nominal GDP growth or 3% annually in 2016-17 and beyond. The cumulative cost of maintaining the 6% escalator through fiscal 2019-20 would be around $4 billion.

There are also likely to be pressures from the provinces to address other perceived challenges in the transfer system. For example, recent changes to the distribution of the health transfer to an equal per capita basis was not well received by provinces that have slower growing but more rapidly ageing populations. Additionally, there remains ongoing debate across the federation about equalization reforms that allow for the exclusion of 50% of resource revenues in determining fiscal capacity and the perceived arbitrary nature in which some aspects of the federal transfer system are applied.

Debt reduction another option

There will be many Canadians that support allocating an important share of surpluses towards the national debt. Benefits include additional fiscal flexibility that paying down debt provides as well as the more immediate benefit of the so-called 'fiscal dividend', that is "the relief that gradually shrinking debt-servicing costs would provide in the federal budget".[5] This virtuous cycle of debt repayment suggests there may be some benefit to paying down the debt beyond what is currently planned, thereby providing additional fiscal room for tax reductions or spending increases in the future.

The government's highlighted debt measure will rise dollar-for-dollar in years where a deficit is recorded and fall dollar-for-dollar with a surplus. By adopting more conservative GDP assumptions than private sector forecasts, the government is effectively targeting about $3 billion in annual debt reduction in years where no major unforeseen developments knock the economy and budget off track.

In the current fiscal year, the government's debt-to-GDP ratio is set to edge down to 30.5%, down from its recent peak of around 33% in the aftermath of the financial crisis. Any international comparison shows that Canada stacks up favourably relative to other countries in terms of debt burdens, although factoring in the provinces in the debt tally takes some of the shine away from the country's standing.

With the country's debt burden already quite low and interest rates already plumbing the depths, a case could be made that directing surpluses towards further debt reduction would generate fewer benefits than applying surpluses to other productive uses. Consider two scenarios: (a) where all of TD Economics' projected surpluses are directed towards debt reduction (the 'status quo' scenario) and (b) where the government allocates all of $70-odd billion in planned surpluses to tax cuts and new spending and targets a balanced budget each year. In the first scenario, the debt-to-GDP ratio would fall to 22.4% by fiscal 2019-20, only modestly lower than the 25.3% debt-to-GDP ratio in the balanced budget scenario. In both cases, the government would meet its longer-term target to reduce the ratio to 25% by 2021. The fact of the matter is that most of the heavy lifting is carried out by a rising denominator (i.e., GDP) than falling numerator (i.e., the debt). Other organizations have echoed the view that the federal government will meet its 25% debt-to-GDP by 2021 target easily while having the fiscal room to increase spending or reduce taxes.

Our simple illustrations only hold if debt reduction fails to trigger the same virtuous cycle as that which took place in the 1990s. However, the fact that the level of debt and borrowing rates are already considerably lower than twenty years ago, while the government's credit rating is markedly better, will mute the extent to which the same cycle can kick in.

More room could be made available

While Canada's federal fiscal situation will remain the envy of many governments and prospects have brightened further recently, the government will undoubtedly face relatively limited resources to meet surging demands. As such, tough choices will have to be made and there will be the ongoing need to look for options to free up further resources.

While hardly an exhaustive list, some options that could be considered include:

- The government could consider adopting private sector average forecasts in its budget planning and do away with its conservative approach of building prudence into budget forecasts. While this suggestion is made with some reservation and is most definitely not an invitation to return to an era of fiscal recklessness, using the $3 billion or so in revenues that would potentially be freed up could be directed to improving tax competitiveness or other areas that could boost productivity.
- The government has put in place significant machinery to find savings within government. Despite a return to a surplus era, the process of re-allocating savings from areas of lower priority to those of higher priority should be ongoing.
- As already noted, fiscal room could be created by phasing in measures and/or delaying some of the pledges made during the 2011 election campaign.

Bottom Line

Debate will soon shift from how best to eliminate a deficit to how best to allocate emerging surpluses. TD's status-quo fiscal forecasts show that around $71 billion in surpluses will accumulate over the next 6 years. However, a closer look at the cost of options at the government's disposal demonstrates how quickly these surpluses can be spent. Therefore, despite the excitement that will come with a return to budget surplus after seven lean years, the government will need to temper expectations about the amount of fiscal capacity it is likely to have, and make difficult choices about how to spend it.

Derek Burleton, VP & Deputy Chief Economist
416-982-2514

Randall Bartlett, CFA, Senior Economist
416-944-5729

Diarra Sourang, Economic Analyst
416-982-2559

Annex A: Overview of Federal Revenue Outlook

Table A: Federal Revenue Outlook (C$ billion)	Actual / Estimated		Projection					
	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Income taxes								
Personal income tax	125.7	130.8	139.2	147.7	156.3	162.3	168.0	173.9
Corporate income tax	35.0	36.6	39.4	40.7	42.4	44.1	45.7	47.3
Non-resident income tax	5.1	6.4	5.8	6.1	6.6	7.0	7.3	7.8
Total income tax	165.8	173.8	184.4	194.5	205.3	213.4	221.0	229.0
Excise taxes and duties								
Goods and Services tax	28.8	31.0	32.6	33.9	35.3	36.7	38.0	39.4
Custom import duties	4.0	4.2	4.4	5.0	4.7	4.9	5.1	5.4
Other excise taxes/duties	10.8	10.9	11.4	11.4	11.4	11.5	11.5	11.5
Total excise taxes/duties	43.6	46.1	48.5	50.4	51.5	53.2	54.7	56.3
Total tax revenues	**209.3**	**219.9**	**232.8**	**244.9**	**256.8**	**266.5**	**275.7**	**285.3**
Employment Insurance premiums	20.4	21.8	22.6	23.6	23.1	19.6	20.3	21.0
Other revenues	26.9	30.0	26.7	29.5	31.3	33.8	36.1	38.1
Total budgetary revenues	**256.6**	**271.7**	**282.2**	**298.0**	**311.2**	**320.0**	**332.1**	**344.4**
Share of GDP								
Personal income tax	6.9%	6.9%	7.0%	7.1%	7.2%	7.2%	7.2%	7.2%
Corporate income tax	1.9%	1.9%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%
Non-resident income tax	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%
Total tax revenues	11.4%	11.6%	11.7%	11.8%	11.9%	11.9%	11.8%	11.8%
Employment Insurance premium	1.1%	1.1%	1.1%	1.1%	1.1%	0.9%	0.9%	0.9%
Other revenues	1.5%	1.6%	1.3%	1.4%	1.5%	1.5%	1.5%	1.6%
Total budgetary revenues	14.0%	14.3%	14.2%	14.4%	14.4%	14.3%	14.3%	14.3%

Sources: Department of Finance Canada, TD Economics.

Annex B: Overview of Federal Expenses Outlook

Table B: Federal Expenses Outlook (C$ billion)

	Actual / Estimated		Projection					
	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Major transfers to persons								
Elderly benefits	40.3	41.8	44.1	46.5	49.1	51.8	54.6	57.7
Employment Insurance benefits	17.1	17.3	17.5	18.0	18.5	19.1	19.7	20.4
Children's benefits	13.0	13.1	13.2	13.3	13.5	13.7	13.8	14.0
Total	70.3	72.2	74.8	77.8	81.1	84.6	88.2	92.1
Major transfers to OLG								
Canada Health Transfer	28.6	30.5	32.4	34.3	36.4	38.0	39.5	41.1
Canada Social Transfer	11.9	12.2	12.6	13.0	13.3	13.7	14.2	14.6
Fiscal arrangements	19.7	19.8	19.4	20.1	20.8	21.7	22.5	23.1
Gas Tax Fund	2.0	2.1	2.0	2.0	2.1	2.1	2.2	2.2
Other major transfers	1.5	0.0	0.2	0.2	0.1	0.1	0.0	0.0
Alternative payments for Standing programs	-3.4	-4.2	-3.7	-3.9	-4.1	-4.3	-4.5	-4.7
Total	58.4	60.5	62.9	65.7	68.6	71.3	73.9	76.3
Direct program expenses	117.7	115.9	111.5	112.6	115.6	118.0	122.6	127.4
Total program expenses	**246.2**	**248.6**	**249.2**	**256.1**	**265.3**	**273.9**	**284.6**	**295.8**
Public debt charges	28.9	28.2	28.0	29.9	32.1	34.2	34.1	33.4
Total expenses	**275.1**	**276.8**	**277.2**	**286.0**	**297.5**	**308.0**	**318.8**	**329.2**
Share of GDP								
Major transfers to persons	3.8%	3.8%	3.8%	3.8%	3.8%	3.8%	3.8%	3.8%
Major transfers to other levels of government	3.2%	3.2%	3.2%	3.2%	3.2%	3.2%	3.2%	3.2%
Direct program expenses	6.4%	6.1%	5.6%	5.4%	5.4%	5.3%	5.3%	5.3%
Total program expenses	13.4%	13.1%	12.5%	12.4%	12.3%	12.2%	12.2%	12.2%
Public debt charges	1.6%	1.5%	1.4%	1.4%	1.5%	1.5%	1.5%	1.4%
Total expenses	15.0%	14.6%	13.9%	13.8%	13.8%	13.7%	13.7%	13.6%

Sources: Department of Finance Canada, TD Economics.

Annex C: Overview of the Employment Insurance Operating Account Outlook

Table C: Employment Insurance Operating Account Projections (C$ billion)								
	Actual / Estimated		Projection					
	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
EI premium revenues	20.4	21.8	22.6	23.6	23.1	19.6	20.3	21.0
EI benefits	17.1	17.3	17.5	18.0	18.5	19.1	19.7	20.4
	2012	2013	2014	2015	2016	2017	2018	2019
EI Operating Account annual balance	1.0	2.7	3.4	3.8	4.4	-1.0	-0.9	-0.9
EI Operating Account cumulative balance	-8.1	-5.4	-2.0	1.8	6.2	5.3	4.4	3.5
Projected premium rate (per $100 of insurable earnings)	1.83	1.88	1.88	1.88	1.88	1.47	1.47	1.47

Sources: Office of the Chief Actuary, Department of Finance Canada, TD Economics.

ENDNOTES

1 One-time factors affecting the budget balance in 2013-14 relative to the Budget 2014 estimate include accounting changes ($0.7 billion), lower cost associated with Alberta flood relief than expected ($1.2 billion), higher non-resident income tax revenues than expected due in part to large one-time assessments relating to the current and prior years ($0.9 billion), the gain realized by the Canada Development Investment Corporation on the Government's sale of 30 million shares of General Motors common stock in September 2013 ($0.7 billion), the gain on the March 27, 2014 sale of Macdonald House, a Canadian High Commission property in London ($0.6 billion), and the increase in net foreign exchange revenues and foreign exchange gains ($0.5 billion). The total revenue impact of one-time factors is therefore around $4.6 billion.

2 See Income Splitting in Canada: Inequality by Design, Centre for Canadian Policy Alternatives, January 2014 and Income Splitting for Two-Parent Families: Who Gains, Who Doesn't, and at What Cost?, C. D. Howe Institute, October 2011

3 Estimates of the increase in the limit of the Tax Free Saving Account and Children's Fitness Tax Credit are based on information contained in the 2012 and 2013 Tax Expenditures and Evaluations reports. Estimates of the Adult Fitness Tax Credit a based on: Cost Estimate of an Adult Fitness Tax Credit, Office of the Parliamentary Budget Officer, September 2013.

4 See Revenue and Distribution Analysis of Federal Tax Changes: 2005-2013, Office of the Parliamentary Budget Officer, May 2014.

5 See The Paradox of the Fiscal Dividend: The Bigger It Looks, the Smaller It Gets, William Robson, C.D. Howe Institute, October 1997.