Fedeli **Focus on Finance**

Burning the furniture to heat the house

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Ontario

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Burning the furniture to heat the house

If you read previous editions of Focus on Finance, you're well aware

we've been warning that the government's aim with selling off Hydro One and other assets was not to pay for transit and infrastructure, but rather to make their massive deficit look smaller. The Fall Economic Statement (FES), introduced 11 days late, according to the province's Fiscal Accountability Legislation, provides proof the government is doing exactly that.

So Nice, They Counted It Twice

The government is claiming they will reduce the deficit in 2015-16 from $8.5 billion to $7.5 billion. They achieved this number by booking the proceeds from the sale of Hydro One as revenue. This is proved by the quote on page 100 which reads: "This increase (in revenue) largely reflects the government's progress on its asset optimization strategy related to the recent Hydro One initial public offering." On page 101, the government breaks down its extra $1.245 billion in revenue, with $155 million coming from traditional taxes and $1.09 billion coming from (the sale of) Hydro One.

This issue will expose the clear and deliberate plan the government implemented to facilitate the sale of Hydro One, and put that revenue towards reducing the deficit. It was a long and convoluted plan, implemented over a full year, all to achieve that one goal. These pages will tie-in the government's 2015 budget, their surprise Finance Bill 144, and the Fall Economic Statement.

It started with the Premier, standing under a massive banner which read BEER IN GROCERY STORES, where she announced the sale of Hydro One.

Days after the 2015 budget was presented, we received a binder with 45 schedules. It was there we learned that all oversight of Hydro One was going to be eliminated. There would be no further access under Freedom of Information, for the Auditor General, Financial Accountability Officer, Ombudsman, and several other Officers. This was designed to make it virtually impossible for anyone to get accurate information on the details of the Hydro One sale.

The first piece of the puzzle was the development of the Trillium Trust. In the 2014 budget, the government established the Trust to hold the funds from the sale of assets. But the Bill actually states they may put a portion of proceeds into the Trust. We tried to close this loophole, but the government voted against our amendments. This was the first step necessary in putting the asset proceeds straight into revenue – not into infrastructure, as claimed.

The next piece was exposed when we compared the 2014 and the 2015 budgets. Both budgets announced the same $130 billion in infrastructure expenditures. In the 2014 version, only $3.1 billion over 4 years was projected from the sale of assets. That included $1.1 billion from the sale of the government's GM shares in the first year, $1 billion for 2015/16, and $.5 billion for each of the next 2 years.

There was NO mention requiring funds from the sale of Hydro One.

The 2015 budget painted a different picture – it now needed the sale of Hydro One to make the numbers fly – even though the original $130 billion budget had already included enough money for the infrastructure. This was the most obvious indicator of the government's true intentions – they would in essence put the sale proceeds into transit and infrastructure, and take the existing budgeted transit money out and use that to lower the deficit.

"So overly optimistic were Finance Minister Charles Sousa's predictions this week in his Fall Economic Statement, they belonged at Canada's Wonderland, not Queen's Park. They're products of some fantasy world, a kingdom of plastic mountains and mechanical unicorns where every wish, however ridiculous, comes true for a while. The trouble is, when you leave, you're back in the real world."

– Waterloo Record Editorial, Nov. 28, 2015

This brings us to the final piece required – swapping out that money. Without any prior notice, the government put forward Bill 144 – a 167-page Finance Bill. Oh, it had all kinds of issues covered – from horse-racing to tobacco. But there was one tiny sentence buried in the book that revealed what the entire book was simply a cover for. Page 162, Schedule 22, Section 7, Item (1) refers to Authorized Expenditures of proceeds from asset sales, and reads… *To reimburse the Crown for expenditures relating to the construction or acquisition of infrastructure.*

That single sentence was why the entire Bill was created. It was the final piece needed to be able to use proceeds from the sale of Hydro One to reduce the deficit and attempt to balance the budget.

Sadly, as everyone knows, this doesn't actually balance the budget – it just falsely inflates revenue, while there are assets to sell. It doesn't tackle the systemic operating deficit. What happens when you run out of things to sell?

$8 billion hole in the budget

Before the Fall Economic Statement came out, we saw the release of the Financial Accountability Officer's (FAO) report on the economic and fiscal outlook of Ontario. The report concluded there is a substantial risk that the government will *not* balance the province's books by 2017-18. In fact, he stated that if the current revenue and spending patterns continue, we can expect that year's deficit to reach $3.5 billion. If spending grows to 3%, expect the deficit to hit $7.4 billion – either way – it will not be balanced.

The number one concern of the Financial Accountability Officer was that the government had overestimated its revenue projections, thereby making it nearly impossible to balance the budget by 2017-18. The FAO estimated the nominal Gross Domestic Product to only grow by 3.0% instead of the 2015 budget's projection of 4.3%. The government's own Fall Economic Statement confirmed the FAO's suspicions.

Page 95 reveals that nominal GDP will only grow by 2.9% – almost exactly what the FAO estimated. The FAO stated revenues should then be $123.4 billion vs. the government's budget of $124.4 billion. But in the Fall Economic Statement, which came out only three weeks later, instead of lowering the revenue to match the FAO's, the government used an even higher revenue number of $125.6 billion!

The FAO also said the 2015 budget was overstating its revenue projections for each year. He encouraged the government to adjust their revenue projections to reflect this lack of future revenue. Again, instead of following the advice of the Financial Accountability Officer, the FES actually has revenues drastically increasing. The FAO also stated that everything would have to go "perfectly" for the government to achieve budget balance by 2017-18. The readjusted revenue forecast for this year is the first indication that things are not going perfectly.

This chart shows the differences between what the Financial Accountability Officer is forecasting vs. the government's numbers ... there's an $8 billion hole in the budget!

Fiscal Year	FAO Revenue Projection	FES Revenue Projection	Difference (in billions)
2015-16	$123.4	$125.6	$2.2
2016-17	$127.4	$129.5	$2.1
2017-18	$131.6	$135.3	$3.7
Total:	$382.4	$390.4	$8.0

With these new revenue projections, it is impossible for the government to both spend the Hydro One proceeds on infrastructure and balance the budget.

That means the government may proceed on several scenarios:

1. Use roughly $8 billion of the Hydro One proceeds to plug the revenue hole and attempt to balance the budget without spending the money on infrastructure.

2. Use the proceeds from Hydro One to spend on infrastructure and leave an $8 billion revenue gap.

3. Use the Hydro One proceeds to spend on infrastructure and raise enough taxes to fill the equivalent $8 billion revenue gap.

4. Combine the above options by both spending some proceeds from Hydro One on infrastructure, some on the revenue gap, and raising taxes to fill the rest.

In essence, the government will have to break one of its two key promises (infrastructure spending or budget balance) in order to fulfill the other – or raise taxes – or cut spending dramatically.

While the Finance Minister continues to insist in the Legislature that the government is "controlling our spending", the Fall Economic Statement reveals 19 ministries are projected to spend more than the previous fiscal year.

Will Cap and Trade leave us Cap in Hand?

The Hydro One sleight of hand isn't the only accounting trick the government appears ready to employ to make the deficit appear lower. On page 106 of the Fall Economic Statement, the government revealed they intend to use proceeds from a cap-and-trade system to balance the budget.

Medium-Term Revenue Changes since the *2015 Budget*

TABLE 3.12 Summary of Medium-Term Revenue Changes since the *2015 Budget*

($ Billions)

	Current Outlook 2015–16	Medium-Term Outlook 2016–17	2017–18
***2015 Budget* Total Revenue**	**124.4**	**129.4**	**134.4**
Source of Change			
Tax Revenue Base	0.0	0.1	0.1
One-Time Revenue Changes	0.6	0.0	0.0
Slower Economic Growth	(0.5)	(0.3)	(0.4)
Increased Revenues from Asset Optimization	1.1	–	–
Preliminary Projected Cap-and-Trade Proceeds	–	0.3	1.3
Total Changes since the *2015 Budget*	**1.2**	**0.1**	**1.0**
***2015 Ontario Economic Outlook and Fiscal Review* Total Revenue**	**125.6**	**129.5**	**135.3**

Note: Numbers may not add due to rounding.

The section reads, under other non-tax revenue: "a preliminary estimate of the revenues that are expected to arise from the auctioning of cap-and-trade allowances beginning in 2017." This is verified by a graph on page 107 that denotes the total amount of revenue to be gained from cap-and-trade will be $1.6 billion by 2017-18.

So far, there's been no firm commitment from the government that, like in other jurisdictions, Ontario's cap-and-trade plan will be revenue-neutral for taxpayers.

"The document also reveals for the first time how much money the government hopes to raise from a new cap-and-trade scheme that will be phased in in 2016. It expects to raise $300 million that year and $1.3 billion the next"
– National Post, November 27, 2014

Jobs – A Vanishing Act

The government's Fall Economic Statement also reveals they have quietly reduced its expectations for job creation and growth, despite continuing bravado and rhetoric to the contrary.

2015 Budget – 78,000
FES – 46,000
Difference – Down 32,000

2016 Budget – 93,000
FES – 78,000
Difference – Down 15,000

2017 Budget – 99,000
FES – 93,000
Difference – Down 6,000

Some other tidbits to keep you up at night

Some of the other bottom line numbers in the FES are, quite frankly, startling and are likely to get notice in the financial community:

Debt to GDP is now over 40%.

Debt/person is over $21,000.

Interest on debt will rise to nearly $13 billion by 2017-18; almost 10% of total government spending.

And contrary to the government's claims, the Fall Economic Statement shows federal transfer payments were actually UP.

Conclusion

The government continues to show that it can't be trusted to provide Ontarians with the truth about our fiscal situation, and is continuing to provide an inaccurate picture of the province's finances.

Key Questions

Why is the government using Hydro One sale proceeds to reduce the deficit when it said it wouldn't?

Why has the government left itself a loophole to take money out of the Trillium Trust to reimburse the Crown?

Why has the government passed a Bill that allows them to re-imburse the Crown for infrastructure monies already paid out?

Will the government use Cap-and-Trade funds in a similar way they use the Hydro One sale proceeds to make its books look better than they really are?

Will the government commit to making Cap-and-Trade revenue-neutral for taxpayers?

If you would like to read previous issues of Focus on Finance, please go to www.fedeli.com or email us and we'll add you to our electronic mailing list.

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