Fedeli **Focus on Finance**

Sifting Through the Numbers

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Ontario

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Sifting Through the Numbers

At the end of last month, the Financial Accountability Officer (FAO) released his *Spring 2017 Economic and Fiscal Outlook*.

The first sentence of his release says it all. "Based on our analysis, the FAO is projecting continued Ontario budget deficits over the next five years."

The report from Stephen LeClair provides the FAO's current economic forecast and an assessment of the province's fiscal outlook. It incorporates information from the 2017 Ontario Budget, Ontario's Economic Accounts, Statistics Canada, and internal FAO resources.

The FAO added that because of a one-time boost in non-tax revenue, for the current fiscal year he projects an improvement in the deficit. "But beginning next year, the FAO projects a steady deterioration in Ontario's budget deficits due to moderating revenue growth combined with higher expenses."

The Economic Outlook

The FAO's economic outlook provides the foundation for his fiscal projections. Ontario saw its real GDP growing 2.7% in 2016. For 2017, the FAO forecasts real GDP to rise by 2.4%. He also, like the consensus outlook of private economists, anticipates growth will moderate slightly over the next four years, with average annual gains of 2%.

But he addresses the risks to this economic forecast; one we shared in last month's issue of *Focus* entitled *Trump Bump or Trump Slump?* The policy direction of the U.S remains uncertain. He feels "This uncertainty could deter Ontario business investment, hurting the province's economic prospects." In addition, he feels that Ontario's surging housing market continues to be a major concern. In 2016, investment in residential housing accounted for a record high of 8.3% of Ontario's nominal GDP. In 1989 it soared to 8.2%, only to tumble to 4% by 1996. The FAO concluded "A sharp correction in housing prices could reverberate beyond the housing market and lead to broader, economy-wide impacts."

The Fiscal Outlook

For 2017-18, the government has committed to balancing the budget. But the FAO says the budget will benefit from "a $3 billion boost in one-time non-tax revenues this year." He describes these as "temporary revenues" and they include "an increase in federal transfers for infrastructure, additional sales of public assets, including the recent sale of Hydro One, and additional one-time cap-and-trade proceeds." He warns "However, beginning next year, the growth in tax revenues is projected to be moderate, while the boost from one-time non-tax revenues will end."

On the expense side, the FAO projects spending growth of 3.3% per year, over the outlook. This is based on the government's 2017 Budget, and includes significant new spending across all sectors, including the new drug program, child care spaces, increased funding for hospitals, and the government's so-called 'Fair Hydro Plan' (FHP), the 25% hydro rebate (more on that expense later).

While combining the revenue and expense projections should normally provide all one would require to develop an outlook, there is a twist here in Ontario. The FAO provided two projections, to account for the ongoing battle between the government and the Auditor General (AG) on the application of government accounting standards for two jointly-sponsored pension plans. The FAO felt compelled to present the two different accounting treatments to have people better understand the implications of the different accounting interpretations.

Based on the AG's treatment for the pension assets, the FAO projects significant budget deficits over the entire outlook. "On this basis, it is unlikely that the government will balance the budget without significant fiscal policy adjustments to raise revenue or lower expense." Under the government's accounting, the FAO projects that a balanced budget is within reach in 2017-18 "in part because of the significant one-time revenues that I described earlier." He continued with "Beyond 2017-18, the deficit is projected to deteriorate steadily due to rising expenses and slower revenue growth."

Debt

Again, there are two tracks to take here; one based on the Auditor General and another based on the government's numbers. Under the AG's treatment, the FAO projects Ontario's debt to grow by $76 billion over the next five years, reaching $390 billion. That would put the net debt-to-GDP ratio at 40.3% by 2021-22. Under the government's accounting, the FAO projects Ontario's net debt will increase by $62 billion to $365 billion. This would edge the net debt-to-GDP down to 37.5%. Given his analysis of rising deficits, combined with the government's planned infrastructure investments, the FAO concludes "achieving these debt targets will likely require significant additional fiscal measures under either accounting presentation."

A Deeper Dive

When the FAO presented this outlook, I asked if data from the government's hydro scheme was included. The answer was no, as the FAO's report on hydro had only been released days before. I bring this up as there were significant revelations in that report which will affect Ontario's debt.

The FAO estimates that the proposed FHP, consisting of the provincial HST rebate, electricity cost refinancing, and changes to electricity relief programs, will cost the province $45 billion over 29 years, while providing overall savings to eligible electricity ratepayers of $24 billion. This results in a net cost to Ontarians of $21 billion.

However, the estimated $45 billion cost to the province assumes that the province is able to achieve and maintain a balanced budget over the next 29 years. In the FAO's *Fall 2016 Economic and Fiscal Outlook*, and again in the *Spring 2017 Economic and Fiscal Outlook*, he projects continued budget deficits over the same period. If the province is unable to balance the budget and borrows to fund the hydro scheme, the FAO says the cost to the province could increase to between $69 billion and $93 billion.

The FAO also adds another twist; one which I brought up in the Legislature early last March. When the government launched the FHP, they co-opted Ontario Power Generation into their scheme. They announced that OPG would be managing and financing the proposal. Why, you might ask? Well OPG is certainly large enough to absorb this massive financial hit, but primarily … they are two steps removed from the province … so this liability won't show up on the province's books.

Acknowledging that, the FAO stated "The electricity cost refinancing initiative involves a complicated accounting structure that will increase gross debt by approximately $26 billion by 2027-28, but does not impact the province's net debt due to the creation of a regulatory/investment asset; essentially an obligation for ratepayers to repay the province approximately $26 billion." Due to the nature of the proposed financing transaction, (involving OPG) the FAO recommends that Members of Provincial Parliament obtain assurance from the Auditor General that the province's proposed accounting treatment for the electricity cost refinancing meets public sector accounting standards and will not impact the province's annual surplus/deficit and net debt."

That same day, the Auditor General appeared at the Standing Committee on Justice Policy; the Committee studying the government's hydro scheme. She stated right out of the gate that she wanted to make sure the 25% hydro rebate was "properly recorded in the consolidated financial statements of the province and is transparently reported." She then laid bare that "the government plans to borrow about $26 billion … but it does not want to reflect the overall impact of these borrowings on the consolidated financial statements." She acknowledged, as did the FAO, that the government planned to "record anticipated revenue as an asset to offset borrowings." "As a result, (of attempting to use OPG) there will be no impact on the net debt." She then repeated, three different times, "this is NOT allowed under Canadian public-sector accounting standards."

Conclusion

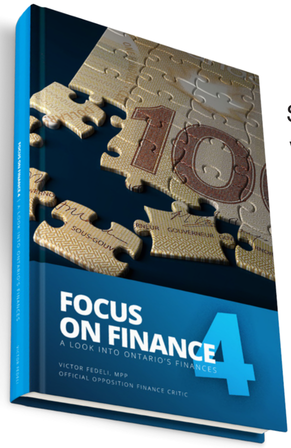
The FAO announced Ontario's debt will reach $390 billion over the next five years, and without significant fiscal measures, expect deficits for the foreseeable future. We also know this debt does not include funding for the hydro scheme, which could reach $93 billion because of borrowing. Despite the government's efforts to keep that additional debt off their books, the AG insists it be reported properly. In addition, the accounting dispute isn't just about numbers in question; it also puts the government's integrity in question. If the Financial Accountability Officer and the Auditor General are acknowledged, then this is the true state of Ontario's finances.

Key Questions

Why does it always take the Auditor General, the Financial Accountability Officer, or the OPP to get to the real numbers in Ontario?

Will the Premier drop the charade with OPG and properly account for her hydro scheme's billions in new debt?

Does the government acknowledge that they are approaching half-a-trillion dollars in debt?



Similar stories of waste, mismanagement, and scandal are disclosed in my new book, ***Focus on Finance 4***.

Please go to **www.fedeli.com** to download your own copy of the book.

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