Fedeli **Focus on Finance**

When balance is an illusion

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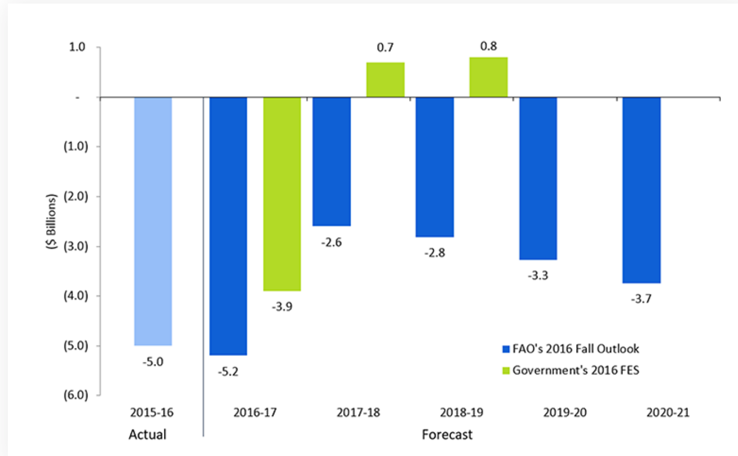
When balance is an illusion



From a financial perspective, the entire month of November was focused on whether the government can balance the provincial budget by 2017/18.

Over the last several years I have revealed many internal, once-confidential government documents outlining how they acknowledge they are not on track to balance. This month, reports from the Financial Accountability Officer (FAO) and the government's own Fall Economic Statement have shown that a balanced budget can only be temporarily achieved through revenue generated from one-time asset sales, the use of contingency funds, revenue from cap-and-trade, and new taxes. The message from all reports is clear: the government's promise to balance the budget by 2017/18 – just in time for the next election – can only be met using artificial solutions.

The FAO's assessment

The Financial Accountability Officer kicked things off with his *Economic and Fiscal Outlook*, which assesses Ontario's medium-term prospects. In his report, the FAO forecasts a budget deficit of $2.6 billion in 2017/18, the same year the government says they will balance. He adds that "Ontario's budget would be expected to remain in deficit over the next five years" and will "steadily deteriorate to $3.7 billion by 2020/21." That would make it thirteen years of deficits in Ontario.

The FAO also revealed that Ontario's net debt, currently $307 billion, is expected to rise by $64 billion and is set to surpass $370 billion in the next five years. Ontario will continue to be the largest sub-national borrower on the planet, yet at the same time have the highest taxes in Canada. With interest payments approaching $12 billion a year, that's more than we spend annually on post-secondary education, community safety, and six other ministries, combined.

The FAO also expected growth to be lower in 2016 and 2017. With his statement that "growth in business investment has been disappointing over the past four years", he revised down his projection compared to the outlook he presented in his spring report. As well, Ontario's net debt-to-GDP ratio will grow to 41% – significantly above the 39.6% peak projected in his last report. The concern here is that the government has pledged to return to the 27% it was at when they took office 13 years ago, yet they have provided no details on how to get there.

He wraps up his November 3rd report with "the outlook for the budget balance has deteriorated" and concludes "Ontario's budget would be expected to remain in deficit over the next five years."

Fall Economic Statement

Only 11 days later, the government released their *Fall Economic Statement* (FES) – a significantly different take on the province's finances. The Minister of Finance claimed "we are on track to balance the budget in 2017/18 and remain balanced in 2018/19." A closer look reveals the revenue tools he uses to artificially balance the budget.

The Fall Economic Statement indicates that contingency reserves have been reduced by $600 million. They are also relying on an additional $800 million through the one-time sale of assets. And they continue to increase administration fees, bringing in a further three-quarters of a billion dollars. For example, vehicle and driver registration fees have increased by $503 million over the last four years. Other licensing fees such as hunting, fishing, camping, etc. have risen by $228 million over that same period.

Despite the Premier's promise that there are no new taxes in the FES Bill 70, the very first page adds new taxes to craft distillers' products. Schedule 1 of Bill 70 amends the Act to introduce a 61.5% tax on spirit sales from local distilleries. During the deputations the head of the Craft Distillers Association shared how he will close down his own craft distillery once this Bill passes. A little later in the Bill, we find $105 million in new taxes from the transfer of land over $400,000.

So far, it seems the FAO had it right when he said "Achieving and maintaining budget balance will likely require additional measures to raise revenue." In his news conference he told the media the sale of one-time assets will bring $5.7-$6.1 billion over 10 years and in addition they will need to raise revenue or lower expenses to balance." It seems they took the 'raise revenue' approach.

Cap-and-trade

Nine days after the FES was released, the FAO released his *Cap-and-Trade* report, which is an assessment of the fiscal impact of cap-and-trade. The FAO stressed that cap-and-trade will likely have an impact on the province's balance sheet. As I said to the Minister during Question Period, quoting directly from the FAO's report, "pick a page … page 1: reduce the deficit now and increase the deficit in future years; page 5: resulting in the cap-and-trade reducing deficits; page 16: the result would be a reduction in the deficit. Speaker, I ask the Minister to pick a page and then tell us, will he come clean and admit that he's using cap-and-trade funds to artificially balance the budget?"

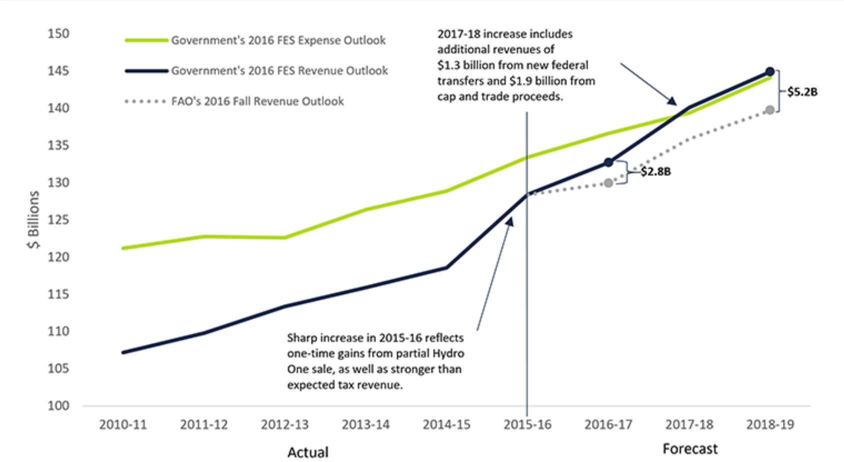
The government will be quick to remind you they promised to create a Greenhouse Gas Reduction Account (GGRA) with cap-and-trade revenue; an account dedicated to funding emissions-reducing projects. But if you read my March *Focus on Finance* issue on cap-and-trade, remember I disclosed the one sentence in the cap-and-trade Bill that allows the government to "reimburse the Crown for expenditures incurred by the Crown" for "active transportation infrastructure, public transit vehicles, and infrastructure, technologies, infrastructure, vehicles, buildings, and structures that reduce greenhouse gas emissions. In other words, the government set it up to allow themselves to pay for projects they have already committed to, and budgeted for, now using revenue they claim to be for new green initiatives.

The FAO was very clear about the government using cap-and-trade revenue to pay down the deficit. Here are the two points he makes right on page one of his report:

"Whatever level of revenue the province achieves from cap-and-trade, if it uses the funds to finance capital projects or programs that are already planned, cap-and-trade expenses would be lower than revenues, resulting in a reduction in the deficit/increase in the surplus."

"If the province does not spend all of the cash raised from cap-and-trade in the same year, it could reduce the deficit in that year and increase the deficit in future years."

This Revenue Outlook graph clearly identifies the government plans to use one-time revenue from the sale of Hydro One as well as revenue from cap-and-trade to artificially balance the budget.



FAO's Commentary

The Financial Accountability Officer ended the month with the publication of yet another document; the *FAO Commentary*. In it he reaffirmed "projected budget deficits of $5.2 billion in 2016/17, $2.6 billion in 2017/18, and a steady deterioration to $3.7 billion by 2020/21." His message is clear: the government's numbers do not reflect reality.

The FAO warns that the plan to balance the budget "continues to rely on optimistic assumptions for revenue growth and program spending restraint. As a result, there is significant risk that the government may not be able to eliminate the deficit in 2017/18, nor maintain a balanced budget going forward."

In this report he gets into a few more financial details as to where his numbers differentiate from the government's. The government projects revenue $2.8 billion higher than the FAO for 2016/17 and $5.2 billion higher by 2018/19. This is primarily due to the government's higher projection of tax revenue. Their forecast for personal income tax is more than $1 billion higher, where the FAO's projection is consistent with estimates from the federal government.

The government's forecast for corporate tax revenue is also significantly higher, based on a more optimistic forecast for growth. The same applies to the government's projections on tax revenue from HST, Gas Tax, Land Transfer Tax, and Health Premiums, based on stronger growth forecasts.

Conclusion

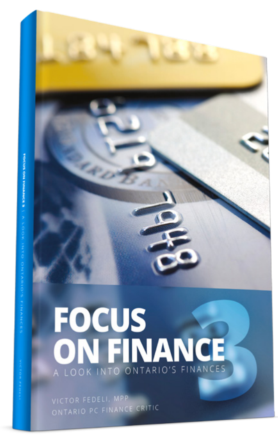
This month I choose to quote the FAO for his conclusion, rather than write mine. He states, "In addition to the government's optimistic tax revenue projection, the FES outlook also assumes $1.3 billion in new federal transfers and $1.9 billion in cap-and-trade proceeds by 2017/18 – assumptions which are incorporated into the FAO's projections. If tax revenue growth disappoints, or these new revenue sources fall short of expectations, the province's fiscal targets would be at risk."

Key Questions

Is the government planning to artificially balance the budget during an election year, before plunging back into deficit?

Will the government admit they're using cap-and-trade funds to artificially balance the budget?

Will the government continue to raise taxes or cut frontline services in order to balance the budget?



Similar stories of waste, mismanagement, and scandal are disclosed in my newest book, **Focus on Finance 3**.

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

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