Fedeli **Focus on Finance**

Ontario's Financial Hole

Volume 4: No. 8 | August, 2017

Ontario

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Ontario's Financial Hole

In what appears to be a repeat of last month's financial summary, this month saw another large and varied group of analysts independently present what they feel is the true state of Ontario's economy, in response to government releases. And again this month, the hydro file played a role. In this issue I will break this all down and present the numbers you need to know.

Deeper in Debt

The month began with what the Toronto Star's QP Briefing called "a blistering Fraser Institute report." Its title, *Wishful Thinking: An Analysis of Ontario's Timeline for Shrinking Its Debt Burden*, suggests there is no realistic plan to get out of their financial hole. The report details how the government's timeline for reducing the province's historically high debt burden relies on optimistic and questionable assumptions and lacks a detailed, credible plan to achieve it.

The government has acknowledged that at 37.5%, the province's debt-to-GDP ratio is too high. (It fell just 1.6% in the last three years.) When the current government took office in 2003 it was 27% – a number it is targeting to return to by 2029/30. Unfortunately, the government has offered no specifics on how it will get back down to that number. "Queen's Park has picked a target date for reducing its debt burden several years from now and is simply hoping, somehow, that the mountain of debt it created will start shrinking on its own," said Ben Eisen, co-author of the report.

The debt ratio reduction will have to nearly triple its current pace to meet the target, and essentially no new debt could be added after 2021. Rather than a pro-active plan to restrain the growth in debt, the government is relying solely on improved economic growth for the next 12 years, and assumes no economic slowdown or recession.

Stephen LeClair, Ontario's Financial Accountability Officer (FAO), backed up the Fraser report charging that the government's plan to lower it net debt-to-GDP ratio is overly optimistic. He says the government will have to get creative if it wants to hit its debt reduction targets, adding it will take some fiscal policy maneuvering. "It's going to be challenging for the government to achieve its debt target without significant additional measures to raise revenue or lower expenses," he told QP Briefing. "They don't say in the budget as to how they will achieve it," added LeClair.

Ontario's Finance Minister rebutted the report in a Letter to the Editor (to which I responded with my own LTE). That prompted Ben Eisen to respond with a media column of his own, entitled *Debt, Part 2*. He highlights how in its recent history "Ontario has suffered from economic stagnation and relative decline compared to the rest of Canada." He also revealed that between 2003 and 2015 "Ontario's inflation-adjusted per-person GDP increased at an average annual rate of just 0.4%; less than half the growth rate in the rest of Canada." In fact, in 2012 "real disposable household income in Ontario slipped below the Canadian average for the first time in recorded history."

Eisen ended his column with sage words for the government. "You can't have it both ways; blaming forces outside government control for periods of economic weakness, while crediting prudent government decisions for good economic news."

Ignoring Reality

In mid-August, the government released its quarterly finances … on time. I make a special note of that very rare occurrence, as you will recall I continually wrote about the fact we went several years without 3rd quarter finances ever being released – a flagrant disregard of the *Fiscal Transparency and Accountability Act*. This prompted the FAO to warn of the government's "broader pattern" of secrecy and their refusal to provide information, making it "difficult to assess the plausibility of the government's financial projections and to evaluate risks that those projections would not be met."

The government report states that they're maintaining balance. Unfortunately, the report completely ignored the concerns raised by the Financial Accountability Officer and the Auditor General (AG). The FAO was clear – not only does he expect a deficit this year, but a steady deterioration of deficits in the coming years, without either tax hikes or cuts to services. In addition, this report continues to thumb its nose at the AG, who contests the government's accounting treatment for jointly-sponsored pension plans. If properly accounted for, the province would be in a deficit position according to the Legislature's independent finance officers.

In addition, there is no accounting for the financing of the government's so-called Fair Hydro Plan. Recall that this is the deal that lowers hydro ratepayers' monthly bills by 25%. It will save ratepayers a total of $24 billion over the next 10 years, but could cost as much as $93 billion to finance, with borrowed money.

The government has ordered Ontario Power Generation to be their financing arm – ostensibly because any borrowing by OPG would not show up on the government's books. This has prompted AG Bonnie Lysyk to claim this is a "dangerous precedent" by keeping the borrowing off the province's books; a move that "does not meet public sector accounting standards." It will be interesting to see this fall, when the AG presents the Public Accounts, to see how she handles the government's statements. Recall that last year they were presented, for the first time in history, without the signature of the AG.

More Reality

As if the "blistering Fraser report" and the rebuking of the quarterly finances wasn't enough 'tough love', the Financial Accountability Officer issued his *Commentary: Optimistic Revenue Projection Underpins Government's Balanced Budget Plan*. Days before, the FAO's release said it all: "The Commentary will highlight the downside risk in the government's forecast and its consequences on their commitment to balance the budget."

In a repeat of what the FAO has been saying to government, month after month, Stephen LeClair stated, "there appears to be a significant downside risk to the government's forecast. As a result, the FAO expects that staying in balance after 2017-18 will require additional fiscal policy measures – that is, new revenues or lower than projected spending." He also stated that if revenues fail to meet the government's "optimistic" targets, that "renewed deficits" are possible.

In a chapter titled "2017 Budget Forecasts Surprisingly Strong Tax Revenue Growth," it states that "after removing the impact of one-time revenue, the budget forecasts revenue growth of 5.5% per year on average from 2016/17 to 2019/20 – significantly above the historical pace of 3.3% since 2004/05." It goes on to say "The budget's forecast for tax revenue growth also seems very strong when compared to the projection for economic growth. Over the past five years, tax revenues increased at the relatively strong average pace of 4.4%, 0.5 percentage points above the average growth in nominal GDP. Over the next four years, the budget is calling for average tax revenue growth of 5.5%, or 1.2 percentage points above the forecast for average nominal GDP growth." It concludes "If the government maintains the spending plans laid out in the 2017 budget, a large shortfall in future tax revenues relative to the budget projection could lead to renewed deficits."

Minimum Wage Hike

Several organizations and businesses presented their research on the effect of increasing minimum wage to $14 on January 1, 2018 and to $15 on January 1, 2019. The reason these groups were compelled to have independent assessments done is the fact that the government did not provide any research, or have a cost-benefit analysis produced.

The Ontario Chamber of Commerce research, conducted by the Canadian Centre for Economic Analysis, concluded there will be "significant, sudden, and sizable uncertainty for Ontario jobs, economy, and communities." The study revealed the measures will put 185,000 jobs at risk in the first two years, impacting Ontario's most vulnerable workers. Data from the economic impact analysis also showed it to be a $23 billion hit to businesses; to increase the cost of everyday consumer goods and services by $1,300 per household; and to add $500 million to the cost of municipalities.

The CEO of Metro Inc. says the grocery industry is facing "significant pressure" over this plan, and could be forced to raise their prices to offset the increased labour costs. Several bank analysts agreed, including TD Securities, commenting that "it is tough to imagine the grocery industry simply accepting lower returns that would flow from a "structural change" of minimum wage increases.

Earlier, groups such as the Canadian Federation of Independent Businesses and the Concerned Manufacturers of Ontario weighed in with their findings, concluding that this "government policy is making it almost impossible to compete globally due to uncompetitive costs placed on us in such a rapid time frame." Restaurants Canada was more specific, with 95% claiming this would hurt the very people it was announced it was helping. They said 98% of their members will raise menu prices; 97% will reduce labour hours; 81% will lay staff off; and 74% will explore labour-saving technology such as self-service touch screens.

The most abrupt comments came from Magna, Ontario's largest auto sector employer, who warned they may leave the province. In a submission to the Committee studying the legislation, Magna says Ontario is at a "tipping point" for business and investment. They added "We find ourselves in the very untenable position of questioning whether we will be able to continue to operate at historic levels in this province." In an interview on BNN, Phillip Cross, Senior Fellow at the Macdonald-Laurier Institute said "It's quite unusual for a large multinational firm like Magna, which has to deal with governments all the time, … to even raise the possibility that they would move."

Conclusion

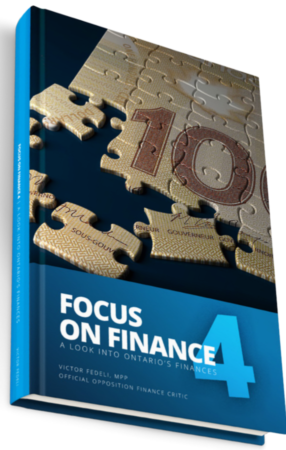
In math or science class, we were taught to prove our solutions. But this government time and again refuses to do this on key claims and decisions that have large implications for Ontario. They refuse to acknowledge or answer the detailed criticism of the Financial Accountability Officer and Auditor General, or put forward an economic analysis to support its policy changes. It's hard to trust claims that can't be backed up by those in government making them.

Key Questions

When will the Finance Minister acknowledge the Financial Accountability Officer's concerns about downside revenue risks and their impact on the deficit?

When will the Finance Minister answer the Auditor General's detailed criticism of his debt reduction claims?

Why won't the government provide an economic analysis to support the minimum wage changes in Bill 148?



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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