Fedeli **Focus on Finance**

Unlikely assumptions; Significantly misstated

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Ontario

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Let me start by thanking the thousands of subscribers who faithfully download *Focus on Finance* every month – and the extra hundred or so friends who I force it on! You have provided great feedback that will make for a better end-product. To those who want fewer words and more graphics – I will do my best. But there's just too much to say – and so little room! Let's get right to it then.

This month began with back-to-back reports from the Legislature's two finance-related officers. You've heard their reports as 'blistering' and 'scathing' far too often, but that's how the media reported both of these, again.

FAO Commentary

The title of the Financial Accountability Office's Commentary, *Ontario's Debt Reduction Commitment Based on Unlikely Assumptions*, says everything you need to know. The FAO projects Ontario's net debt will increase by $76 billion over the next five years, to approximately $392 billion. This will raise the net debt-to-GDP ratio to 40.3%, as opposed to the government's forecast of 36.3%. This is in very strong contrast to the 27% it was at when this government took office, and the 27% target the government hopes to return to by 2029-30.

Their targets are based on achieving balanced budgets over the next 12 years; future capital spending as outlined in the plan; and strong economic growth. The FAO offers that "if any of these relatively optimistic assumptions fall short, the government's 27% debt-to-GDP would not be achieved." It goes on to suggest that "Achievement of the 27% target is based on unlikely assumptions." This is because for the past 30 years, Ontario has rarely achieved successive balanced budgets; in fact, the FAO projects a steady deterioration in the budget deficit over the next five years. The government plan calls for significant reductions in capital spending, yet the FAO says they will likely increase spending. And the government is relying on nominal GDP growing at an average pace of 4%/year; but nominal growth has averaged 3.6% over the past 15 years, and the FAO says that with slower economic growth forecasted, 4% may prove to be too optimistic. Unlikely assumptions.

Auditor General Report

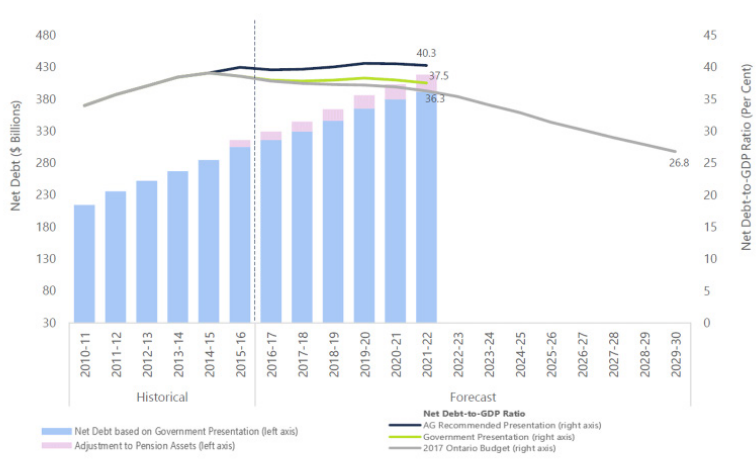
As with the FAO's release, the title of the Auditor General's report, *Ontario Government Understates Annual Deficit and Net Debt*, paints quite a picture. As opposed to signing off on the Consolidated Financial Statements, for the second year in a row, the AG issued a *qualified* audit opinion, saying "the statements significantly understated the 2016/17 deficit, as well as the province's net debt."

The Auditor General must review the province's financial statements annually and give an opinion as to whether they fairly and accurately reflect the state of the province's finances. The AG issues a *qualified* opinion when, based on the audit evidence obtained, the statements are *significantly misstated*.

Rather than table the annual Public Accounts of Ontario in the Legislature, the government released them four days before MPPs returned from their summer break. After their release, AG Bonnie Lysyk stated "I have issued a *qualified* audit opinion because the statements were not prepared following Canadian Public Sector Accounting Standards." She also warned "The Legislature and all Ontarians must be able to rely on the province's consolidated financial statements to fairly report the fiscal results for the year. This year they cannot do so." The AG announced the deficit was understated by $1.44 billion and the net debt understated by $12.429 billion, both for 2016-17.

At issue is the government's accounting of the pension fund surplus (we've written about this often) and "the government inappropriately recording the market account of the Independent Electricity System Operator." Lysyk also warned that the accounting used for the so-called Fair

Achievement of 27 Per Cent Debt-To-GDP Target Based on Unlikely Assumptions



Hydro Plan may lead to a larger understated deficit and debt next year (we first disclosed last March that the government was shifting the costs onto OPG's books). The AG will release a Special Report on this shortly. Significantly misstated.

Minimum Wage Hike

Last *Focus* we saw the Ontario Chamber of Commerce release a report revealing that the proposed 32% increase in minimum wage (by the end of 2018) will put 185,000 jobs at risk. This month, one-after-another, experts weighed-in with their job loss analyses. They all agree on one thing – job losses will be severe – they're just debating how many tens of thousands of people will be affected.

The Legislature's own Financial Accountability Office estimates that Ontario's proposed minimum wage increase will result in a net loss of approximately 50,000 jobs, with job losses concentrated among teens and young adults. They add that "there is evidence to suggest that the job losses could be larger" than their estimate, as the increase is both "larger and more rapid than past experience, providing businesses with a greater incentive to reduce costs more aggressively." They also concluded that "since minimum wage targets low-wage workers, but not necessarily low-income families, raising the minimum wage would be an inefficient policy tool for reducing overall poverty."

The Fraser Institute released their bulletin, *Ontario Enters Uncharted Waters with a $15 Minimum Wage*. They suggest that such a rapid increase in the minimum wage could have harmful unintended consequences, reducing employment opportunities for young and less skilled workers. Their analysis drills deeper into how various regions will be affected when minimum wage passes 45% of the region's average wage – the threshold where negative economic effects grow more severe.

TD Economics published their economic assessment which forecasts "a net reduction in jobs of around 80-90,000 positions by the end of the decade." TD concludes that the "relatively rapid speed of the implementation and its timing within the economic cycle are two factors that will likely accentuate the negative hit to Ontario employment." With respect to the timing, they feel it could coincide with "significantly slower economic growth"; the economy is "likely to endure a cyclical slowdown in both housing activity and household leverage, (and) economic growth will likely slow sharply in the province." As one solution, they suggest "these estimated job impacts could be mitigated by extending the implementation timeline."

The Canadian Federation of Independent Business also issued their research snapshot, *$15 Minimum Wage: Jobs for Canada's Youths at Risk*. Their job-loss number is between 68,100 – 155,900 and "would particularly affect employment opportunities for Ontario's youth, a segment of the population that already suffers from high unemployment."

The Keep Ontario Working coalition released their report, *The Flip Side of "Fair"*, which showcases testimonials from employers outlining how this new government Bill will negatively impact their ability to do business in Ontario. They also released their final economic impact analysis by The Canadian Centre for Economic Analysis. It reveals that if the government were to do nothing other than implement the minimum wage increase over five years instead of the next 15 months, jobs at risk would decrease by 74% in the first two years.

The Economy

The government continues to push their $15 minimum wage plan because according to them, the Ontario economy is doing well, and everyone should share in that. Ontario's Labour Minister announced "The prosperity that we're seeing in the Ontario economy now has to be shared by everybody." That's it in a nutshell; this is the government's central rationale.

To push this point, the Labour Minister stood in the Legislature and announced "It's true that the Ontario economy is doing very well; manufacturing exports are up." Except that isn't accurate. A recent headline, *July Trade Deteriorates*, leads the story indicating Ontario's exports fell 22% this summer. Stats Can just released their data showing manufacturing sales in Ontario suffered their largest decline in eight years. Then the Minister doubled-down with, "We're leading the G7 in economic growth." Ontario's Finance Minister backed him up with "Ontario is number one in North America when it comes to growth." Except neither of those statements are even close to being accurate. Ontario's growth is not number one; it is tied for 28th place – there are 27 U.S. states ahead of us!

If that wasn't enough, perhaps some of this summer's media headlines will complete the picture.

"Exports Languish"
"International merchandise exports fell, while imports edged higher"
"Manufacturing sales slipped in a widespread decline across industries"
"Retail sales cool"
"Ontario ranks 44th (out of 60) in Labour Market Rankings"
"Once powerful Ontario now a fiscal laggard in Canada"
"Canadian incomes jump; Ontario residents hit by manufacturing downturn"
"Ontario: Fiscal leader to fiscal laggard"

Sadly, the facts don't align with the government's narrative, but that doesn't stop them from continuing to read from their talking points.

Conclusion

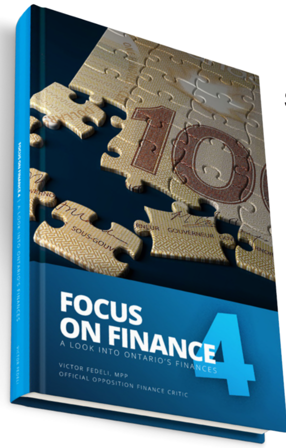
The government continues to make fiscal and economic boasts that are not supported by facts. Ontario businesses and families need accuracy to make solid judgments when it comes to making investment and other vital decisions.

Key Questions

If two independent officers of the Legislature say they can't trust the government's numbers, why should Ontarians?

Why does the government continue to ignore the warnings and analyses of so many experts?

Why is political self-interest being put ahead of the interests of the public, markets, and investors when it comes to proper and accurate reporting on the government's finances?



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.

Please feel free to SHARE this report with as many people as you can!

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