FAO Commentary

TBD, 2017

Ontario’s Debt Reduction Commitment Based on Optimistic Assumptions

The FAO projects that Ontario’s net debt will increase by $76 billion over the next five years to approximately $392 billion in 2021-22, resulting in the net debt-to-GDP ratio rising to 40.3 per cent.[1] In contrast, in the 2017 Budget, the Province projects a small decline in the net debt-GDP ratio to 36.3 per cent by 2021-22.

Commented [JP1]: Not able to verify how this was calculated or what method was used.

In the 2017 Budget, the government also restated its commitment to reduce the net debt-to-GDP ratio to its pre-recession level of 27 per cent. The Province projects that this 27 per cent target will be achieved by 2029-30, based on three key assumptions:

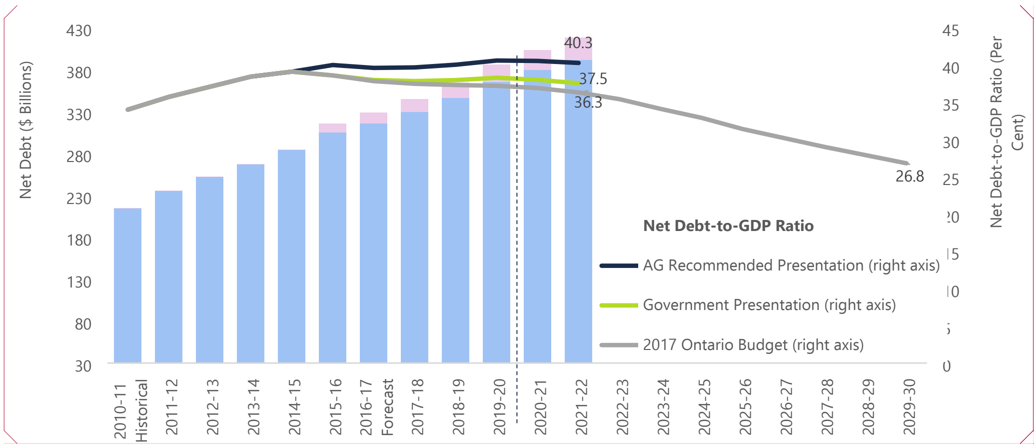
- on-going balanced budgets over the next 12 years;
- future capital spending as laid out in the long-term infrastructure plan; and
- a continuation of strong economic growth.

Commented [JP2]: resulting in GDP growing more quickly than debt

However, if any of these relatively optimistic assumptions fall short of expectations, the government’s 27 per cent debt-to-GDP target would not be achieved.

Commented [JP3]: not achieved by 2029-30 presumably.

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



Commented [JP4]: While inclusion of the AG recommended presentation is fair, some mention of the conclusions of the independent Pension Asset Expert Advisory Panel in February 2017 should be disclosed in this document to give some additional perspective to the reader. The panel concluded that the province reporting of net pension assets was in accordance with PSAB standards. Such inclusion therefore has an impact on net debt and net debt projections. Also, not able to verify the FAO’s 40.3%. Not sure what “Government presentation” means as opposed to the Budget % of 36.3, which is correct.

Commented [HS(5R5]: Including both AG recommended and government presentations of the pension assets would be consistent with how FAO treated the issue in their Spring 2017 Economic and Fiscal Outlook.

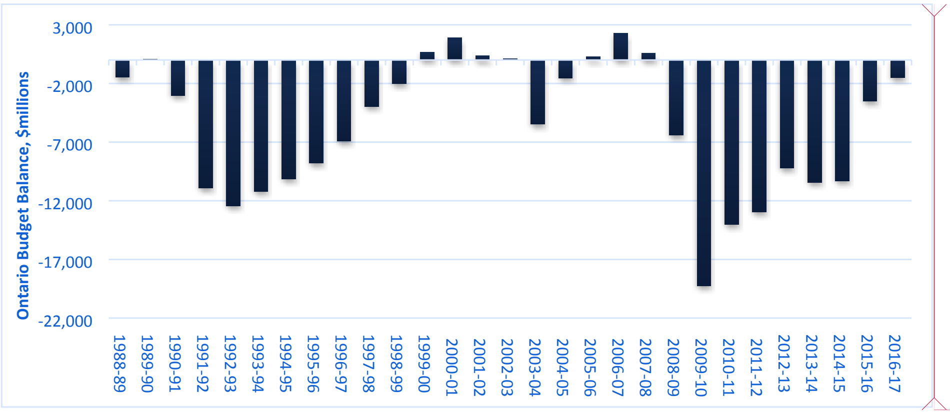
Note: AG recommended presentation based on FAO estimates of the pension adjustment.
Source: Ontario 2017 Budget and FAO

The government’s forecast for a gradual decline in the net debt-to-GDP ratio depends critically on achieving a string of consecutive balanced budgets each year over the next 12 years. Over the past thirty years, Ontario has rarely achieved successive surpluses or balanced budgets. In contrast to the 2017 Budget, the FAO continues to project a steady deterioration in the budget deficit over the next five years, due to moderating revenue growth combined with higher expenses.

Commented [JP6]: Not able to verify this.

[1] Based on the FAO’s application of the Auditor General’s recommended accounting treatment for pension assets - see the FAO’s ‘Economic and Fiscal Outlook, Spring 2017’. By comparison, based on the government’s accounting presentation, the FAO projects Ontario’s net debt will rise by $62 billion to roughly $365 billion by 2021-22 and that the net debt-to-GDP ratio will fall modestly to 37.5 per cent.

Ontario has Rarely Achieved Balanced Budgets in Consecutive Years

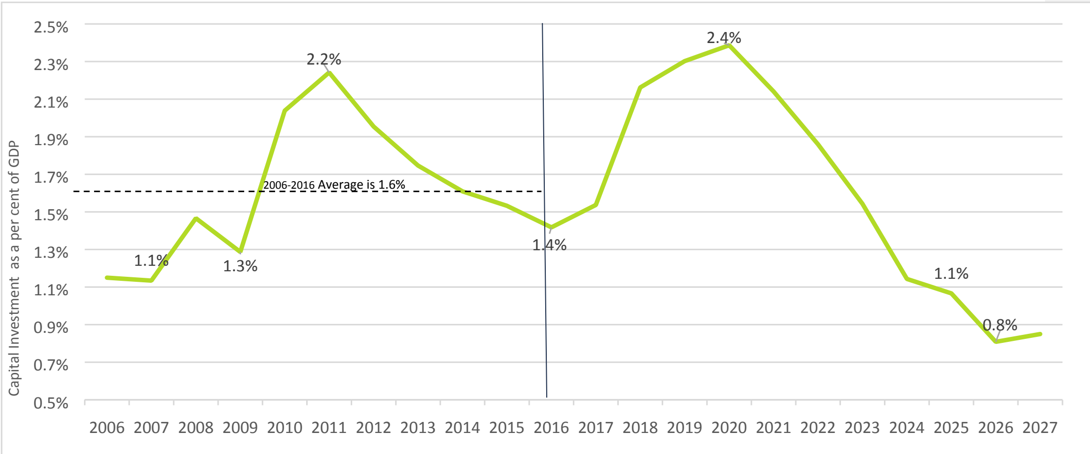


Source: Ontario Budgets 1988-89 to 2017-18

Commented [JP7]: The 2014-15 deficit value on the graph above is 10,314. However, the Net Debt spreadsheet indicates 10,315. (right click then hover over the chart to see)

The government's debt reduction commitment is also linked to the Province's 13-year, $190 billion infrastructure plan which includes significant reductions in capital investment in the 2020s. After peaking in 2019-20 at 2.4 per cent of nominal GDP, the Province is projecting capital spending to fall to just 0.8 per cent of GDP by 2027-28 – half of the historical average of 1.6 per cent.

Investment in Capital Assets as a share of GDP to Decline Sharply in the 2020s



Source: Investment in Capital Assets, 2017 Infrastructure Update, Ministry of Infrastructure, FAO

Since the Province has made substantial investments in public sector assets (such as hospitals) over the last 10 years, some pullback is to be expected.[2] However, given the government's focus on new and large transit and highway projects, it is likely that the Province will need to augment its capital plan and increase spending in the latter part of the next decade. Higher than planned capital spending in the future would add to the Province's net debt, increasing the net debt-to-GDP ratio.[3]

Finally, the government's debt-to-GDP projection relies on nominal GDP growing at an average pace of 4 per cent per year over the long-term.[4] However, nominal GDP growth has averaged just 3.6 per cent per year over the past 15 years, and given Ontario's aging population and slower expected growth in its labour force, 4 per cent annual growth may prove to be too optimistic for the next decade.

Given the risks associated with the government's assumptions, a fiscal plan that focuses only on achieving balanced budgets may not be enough to lower Ontario's net debt-to-GDP ratio to 27 per cent by 2029-30.

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[2] See Infrastructure Ontario's list of major projects, http://www.infrastructureontario.ca/Major-Projects/, August 16, 2017.
[3] The government's capital spending projection may also prove to be too conservative given a number of announced but unfunded initiatives including high-speed rail and subway expansion in Toronto.
[4] Ontario's Long-Term Report on the Economy, Ministry of Finance, 2017