BEHIND THE ISSUES: Ontario 2003

The manager myth

(or how Ernie Eves balanced Ontario's budget one year in a row)

Fiscal management and balancing the budget stand just behind delivering tax cuts for pride of place in the list accomplishments claimed by the Ontario Conservatives. Every budget since the Harris Government's first in 1996 has featured forceful rhetoric on the need to tame the deficit and dramatic-looking graphs showing the deficit coming down and then being eliminated.

Almost without fail, Ernie Eves' campaign speeches call attention to his claim that the Government has balanced the budget five years in a row.

The evidence is mounting, however, that the Tories' manager mystique is more of a manager myth.

The publication on September 22 of a report by the Fraser Institute predicting a deficit this year in Ontario of $4.5 billion is a substantial political setback for Ontario's Conservative Government. The report's author, Mark Mullins, was one of the originators of the Harris Common Sense Revolution. His willingness to attack the Conservatives on these grounds signals that the split between the Harrisites and the more moderate wing of the Conservative Party is nowhere close to being healed.

But this report is by no means the first to question the Ontario Tories' reputation as strong fiscal managers.

In April 2003, the Dominion Bond Rating Service released a study of Ontario's finances forecasting a deficit of nearly $2 billion this year, even without considering the impact on the economy of the SARS outbreak and the Conservatives' election campaign promises.

More significantly, making the same adjustments for each year, the DBRS report concludes that the Harris-Eves administrations in Ontario have balanced the budget only once in eight years in government, in the 2000-1 fiscal year.

A study by the CCPA, using a slightly different analysis, reaches the same conclusion. Using the cash-basis accounting used in Ontario for the entire history of the province prior to the election of the Harris Government in 1995, Ontario's budget has been balanced only once in eight years, in the 1999-2000 fiscal year.[1]

What does all this mean for the election and beyond?

It has become standard practice, when governments change, for the incoming government to order an independent examination of the fiscal situation and then declare that "things are much worse than we had ever imagined" before embarking on a program that departs from its campaign platform.

Here, we already know well in advance of the election that the situation is not as it is being represented. Even former friends of the Government are saying that.

To complicate matters further, two of the three parties have made "no tax increase" pledges and pledged support for the Harris-era legislation that prohibits deficits and requires referenda for any tax increase that was not the subject of debate in an election.

These two factors raise what may well be the most important political question in this election campaign: What will you do if you discover that Ontario's finances are in much worse shape than is being represented by the Government?

The Fraser Institute clearly has its answer. True to its Reaganite roots, it wants to use the Harris Government's duplicity on fiscal matters to kick off another round of Harris-era-like massive cuts to public services.

Of the three parties, the Conservatives are the most vulnerable on the fiscal front. The financing of their platform rests on the 2003-4 Ontario Budget, which in turn depends on the assumption that Ontario can generate $2 billion this year from asset sales.

Neither the Liberal nor the NDP platform depends for their financing on asset sales in 2003-4, and both would generate additional revenue from cancelling some Conservative tax cuts that are counted in the funding base for 2003-4.

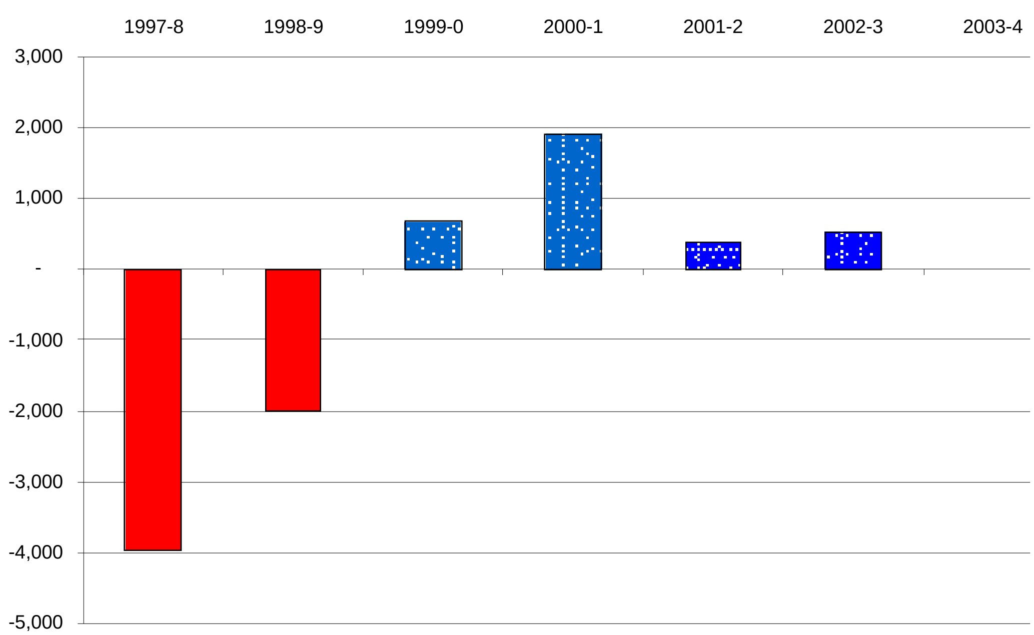
However, the Liberals have painted themselves into a political corner with their endorsement of a Canadian Taxpayers Federation pledge not to increase taxes beyond those set out it their platform, leaving themselves little flexibility. In addition, by including $900 million in asset sales in the second year revenue calculations in their fiscal plan, they have ceded potentially valuable political ground to the Government. They can hardly attack the Government for its failure to specify which assets are to be sold when their platform does exactly the same thing.

The NDP platform, because it already contains general tax increases, would find itself with more flexibility in responding to an as-yet-unspecified fiscal problem.

Regardless of the difficulties the parties will experience, however, the question should be answered. Because barring some unforeseen revenue windfall, the next government's response to the fiscal situation facing the province now will be the hallmark of its term in office, and the electorate deserves to hear how they would deal with it.

Figure 1

Budget balance, as reported, 1997-8 to 2003-4



Comparing the results

The official numbers

Figure 1 shows the budget balance for the years 1997-8 to 2003-4 as presented by the Ontario Government in its official documents.

It shows the budget balance improving steadily from 1997-8 to 2000-1, and remaining positive from 1999-2000 to 2003-4 as claimed.

It is worth noting that in three of the five years of "surplus", budget balance even on the Government's own terms is only achieved through extraordinary asset sales (1999-2000 — sale of Highway 407; and 2003-4 — unspecified asset sales of nearly $2 billion) or through the application of one-time-only Federal Government transfers (2002-3 — one time only CHST transfer of $771 million).

Over the period since 1995, nearly $4.5 billion of the Government's fiscal performance has been attributable to higher-than-normal revenue from asset sales — an amount higher by more than $1 billion than the total surplus run by the Government in its fabled "five consecutive years of balanced budgets". It is literally true that the Government has bought its fiscal record by selling off public assets — the public policy equivalent to selling off the furniture to pay the mortgage.

The DBRS estimates

Figure 2 shows the budget balance for 1997-8 to 2003-4, presented on the basis used by the DBRS.

Using this adjusted accounting approach, the five consecutive years of surplus turn into one year of surplus, and the claimed record of steady improvement in Ontario's fiscal situation turns into four consecutive years of fiscal deterioration.

Figure 2

Budget balance as adjusted by DBRS, 1997-8 to 2003-4

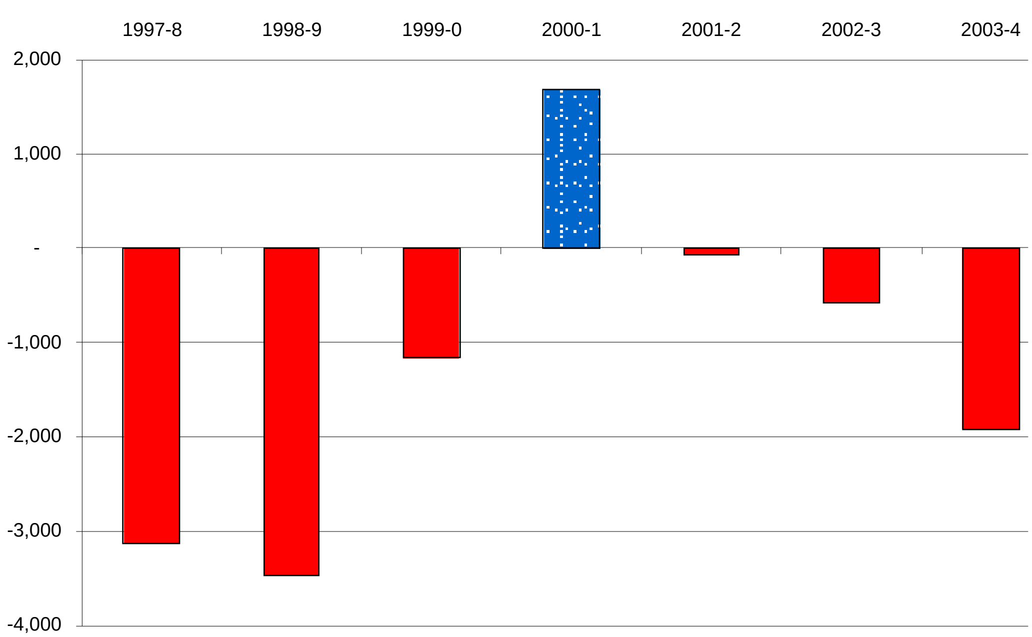
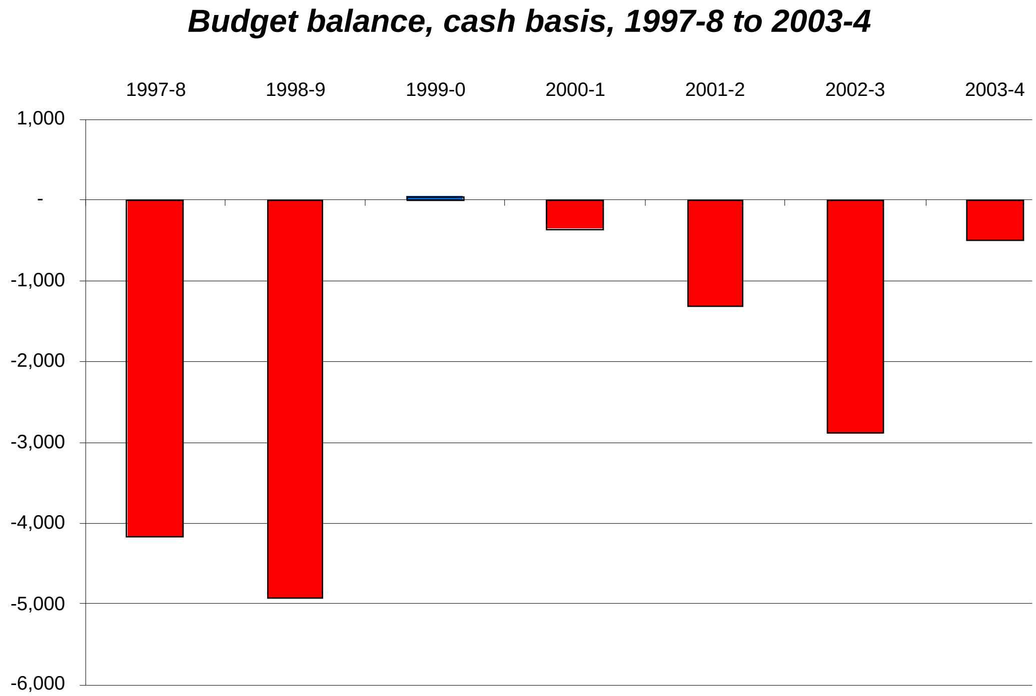


Figure 3



CCPA analysis — cash accounting

Figure 3 shows the budget balance on a cash basis, with the budget in balance only once, one year earlier than in the DBRS analysis.

If asset sales and other non-recurring revenue items are ignored, the budget has not once been balanced in the eight years of the Harris-Eves era. On a cash basis, the closest the Government has come to balancing the budget without resorting to asset sales was in 2000-1, when the deficit on this basis was slightly below $600 million.

If this is just a fight amongst accountants, why should anyone care?

When the Harris Government's adopted accrual accounting in 1996, the move was touted as a way to make the province's financial situation clearer and more transparent to the public and to the financial community.

That was the theory. In practice, the accounting system has been manipulated to present a rosy picture of a successful fight against the deficit, and to disguise the Government's true financial situation.

The DBRS and CCPA are by no means the only critics of the Government's accounting for Ontario's public finances.

As early as the 1999-2000 Auditor's Report, the Provincial Auditor was raising serious questions about the Government's use of accounting tricks.

The report of the Provincial Auditor for 1999-2000 featured an unprecedented attack on the credibility of the Government's financial reporting.

The Auditor forced the Government to change radically the way it was reporting the costs associated with its plans for privatizing Ontario Hydro. He rejected the Government's attempt to keep the true cost of the debt resulting from the restructuring of Hydro off its books and hidden from Ontarians, claiming the costs would be recovered from ratepayers.

The practice of accounting for multi-year expenditures in a single year came under even harsher criticism.

> "Over the last few years, there has been a trend in Ontario to approve and treat as current year's expenditure grants and other transfers that are provided to fund the activities of future periods. …

"Our view is that this practice distorts government financial reporting."
—2000 Annual Report, Provincial Auditor, p.9

The Auditor's review concludes as follows: "I firmly believe the practice of charging multi-year funding to current year's operations must cease. At year-end, funding that relates to future years should be treated as advances, included on the government's statement of financial position as assets, and drawn down and charged as expenditures in the years in which the activities funded actually occur.

"Because accounting standards in this area are open to interpretation, I have to date accepted these types of expenditures. However, my Office has advised the government that significant items related to future years' operations – whether it be by way of transfers to trusts funded by the government, 'unconditional' grants or certain 'restructuring' charges – should in future be charged in the appropriate year. *If such multi-year items are in future recorded as expenditures in one year, on a substance-over-form basis, I will have to reassess whether to then include a reservation in my Auditor's Report on the province's financial statements*."
—2000 Annual Report, Provincial Auditor, p.11 (emphasis added)

The Auditor's conclusion, and his explicit threat to qualify his Report, were unprecedented.

If this is a fight about accounting, it is a fight that matters. When the Auditor questions the Government's accounting practices, the financial markets take notice. Criticism from the DBRS matters, because the agency's ratings affect directly the Province's cost of borrowing from public financial markets.

Endnotes

1 The DBRS modifies the accrual accounting results by accounting for restructuring and capital expenditures, on a cash basis and by discounting non-recurring revenue and expenditure items. The CCPA analysis uses data provided by the Ministry of Finance to covert the accrual accounting balance into a cash balance. Although the two methods are similar, pure cash accounting delays the timing of spending, for accounting purposes, relative to a modified accrual method. This explains why the CCPA analysis has the single year of budget balance one year ahead of the DBRS analysis.

Hugh Mackenzie is co-chair of the Ontario Alternative Budget steering committee. For more information on the Ontario Alternative Budget, visit the CCPA's web site at: http://www.policyalternatives.ca.

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