Briefing Note

Title
Summary of the Newfoundland and Labrador provincial debt

Topic
Newfoundland and Labrador’s (NL) provincial debt continues to rise over $14 billion which jeopardizes the province’s economic stability and threatens the province’s public service.

Background
Governments such as the NL provincial government rely on outside investment to aid in the development and funding of expensive public projects. These investments or “loans” that have yet to be paid back make up the government’s debt. While government debt is not uncommon or a necessarily negative thing, problems arise when that debt begins to rise uncontrollably and the government has trouble paying back what it owes. Currently NL’s government debt has risen to over $14 billion and continues to rise. This is an accumulation of the province’s yearly deficit, which was $1 billion in 2016. Unsustainable spending includes the controversial Muskrat Falls hydroelectric project and the province’s civil service which is the largest in Canada per capita.

Status
NL’s rising debt has already had consequences. In 2016 several bond rating agencies downgraded NL’s credit rating, which could potentially affect the government’s ability to borrow money in the future. Furthermore the government debt is a growing concern for citizens. A 2017 Corporate Research Associates poll showed that on average people rated their concern about the debt as 8.4 on a scale of 1 to 10. While declining provincial revenues are popularly thought to be responsible for NL’s rising debt, a 2016 report by the Fraser Institute notes that between 2005 and 2012 government spending increased by 8.4%, while an increase of only 2.3% would have matched increasing prices. Recognizing this, the NL government announced plans to cut government spending by $300 million in the 2017 budget. These cuts combined with projected revenues are expected to bring the annual deficit down to $778 million in 2017. The provincial government has also attempted several strategies to generate provincial revenue. These include the introduction of unpopular taxes such as the “gas tax,” which is to be reduced throughout 2017. Budget projections predict a return to surplus in 2022-23.

Key Considerations
There are several important facts, situations and costs to be considered.

- **Budget 2016 increases in taxes and fees**
  - The budget introduce a broad array of tax hikes and fee increases.
  - A temporary budget reduction levy is in place, which led to public protest.
  - The Harmonized Sales Tax (HST) was increased to 15%.
  - The gasoline tax was significantly increased, by 16 cents/litre.
  - Public unrest resulted from the closure of libraries and introduction of a book tax.

- **Public Service Pensions**
  - $10 billion of the province’s debt is owed to public service pensions.
• Weak Demographic Statistics
  o The province has the highest unemployment rate in Canada, hovering at 15%.
  o NL had the second lowest birthrate at 1.45 children/women in Canada in 2011.
  o As the population ages more people will require long term care with fewer young people to care for them, necessitating government spending.
  o A smaller population will provide fewer skilled people to drive the economy.

• Paying Interest Rate on debt
  o The second largest expense item in the 2017 budget is the interest rate on the current debt, which is currently increasing.
  o Interest rates are set by bond rating agencies, which have lowered the provincial government’s credit rating. This is a consequence of poor financial management.

• Muskrat Falls
  o Expected to operate in 2020, generating increased revenue for the province.
  o Construction costs have increased from originally predicted $8 billion to $11.4 billion since the project began four years ago.

• Civil Service Size
  o Newfoundland and Labrador had the largest civil service in the country per capita in the 2016 provincial budget.
  o Approximately 300 civil service jobs were cut in February of 2017 resulting in an annual saving of between $20 million and $25 million.

• Declining Commodity Value
  o The 2017 budget assumes a Brent oil price of $56 US per barrel, with overall oil production lower than 2016/7.
  o Based on data from Bloomberg, as of June 2017 the price of Brent oil is $48.42, with spikes in April of $55.98 and in late May of $54.15.

• Citizens and politicians tend to have a short-term focus
  o Research shows that Canadian politicians tend to respond to citizens’ policy priorities by allocating government monies (Soroka & Wlezien 2004).

**Recommendations**
The financial debt of the Government of Newfoundland and Labrador must be addressed. To reduce the annual deficit the government must reduce its spending. However, the reliance on the public sector as an economic engine creates a conundrum: reduce the number of employees and government will shrink its tax base and consumer spending that drives economic growth. It is recommended that spending constraints occur through generating increased efficiencies within government institutions, or by increasing partnerships between the provincial government and private institutions. Furthermore it is recommended that the government not pursue policy options which increase provincial revenues at the expense of its citizens.

**Date**
June 10, 2017

**Prepared By**
Leia Organa, Political Science 4600 student