

The Economic and Fiscal Trajectory of Newfoundland and Labrador:

The prospects for relying on Ottawa and reforms to fiscal arrangements in Canada

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September 15, 2012

Summary of the Talk

Scale of the Challenge

- Future decline in resource revenues
- Aging population
- Healthcare costs

→ Rising public debt, but a role for the federal govt

Policy Options, Esp. to Transfers

- Equalization
- Canada Health Transfer
- Provincial own-source revenues

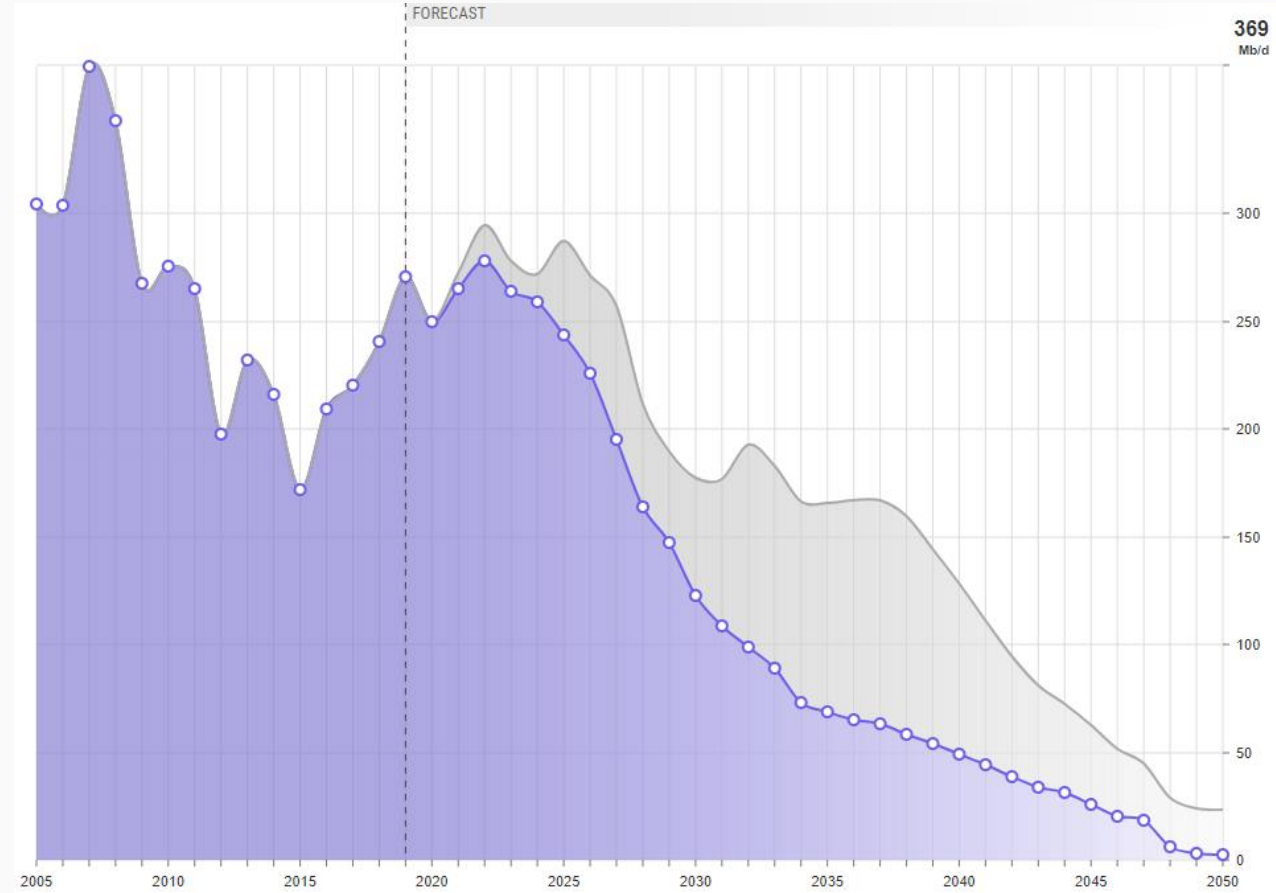
→ Mixed approach required

Potential Declines in NL Oil Production

*Canada Energy Regulator
Energy Future Report 2020*

*Evolving action on climate
and global energy transitions
may accelerate the pace of
oil production declines in
Newfoundland and Labrador*

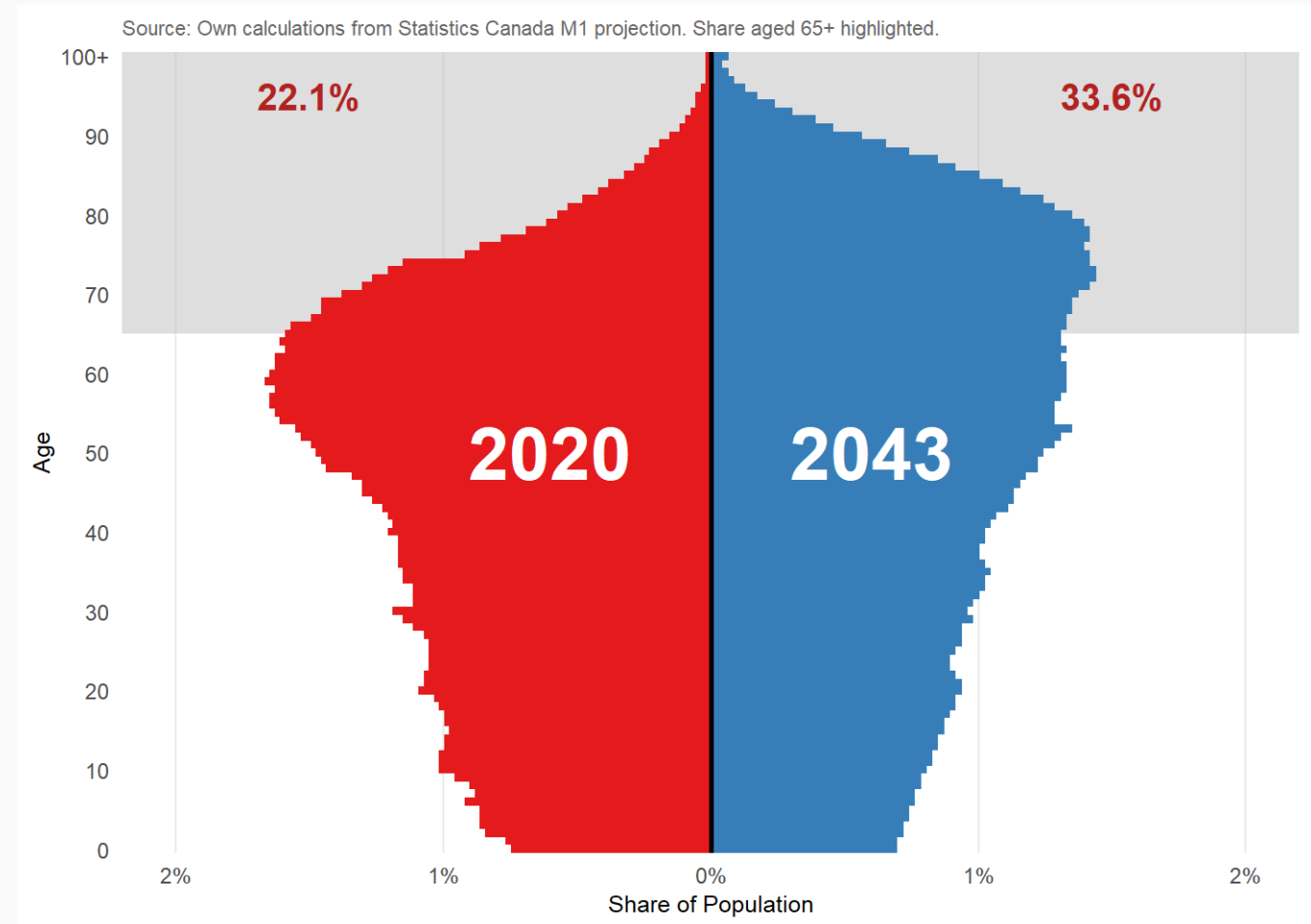
Particularly acute after 2025



NL's Rapidly Aging Population

Share of Newfoundland and Labrador's population over 65 may increase by nearly 12 p.p.

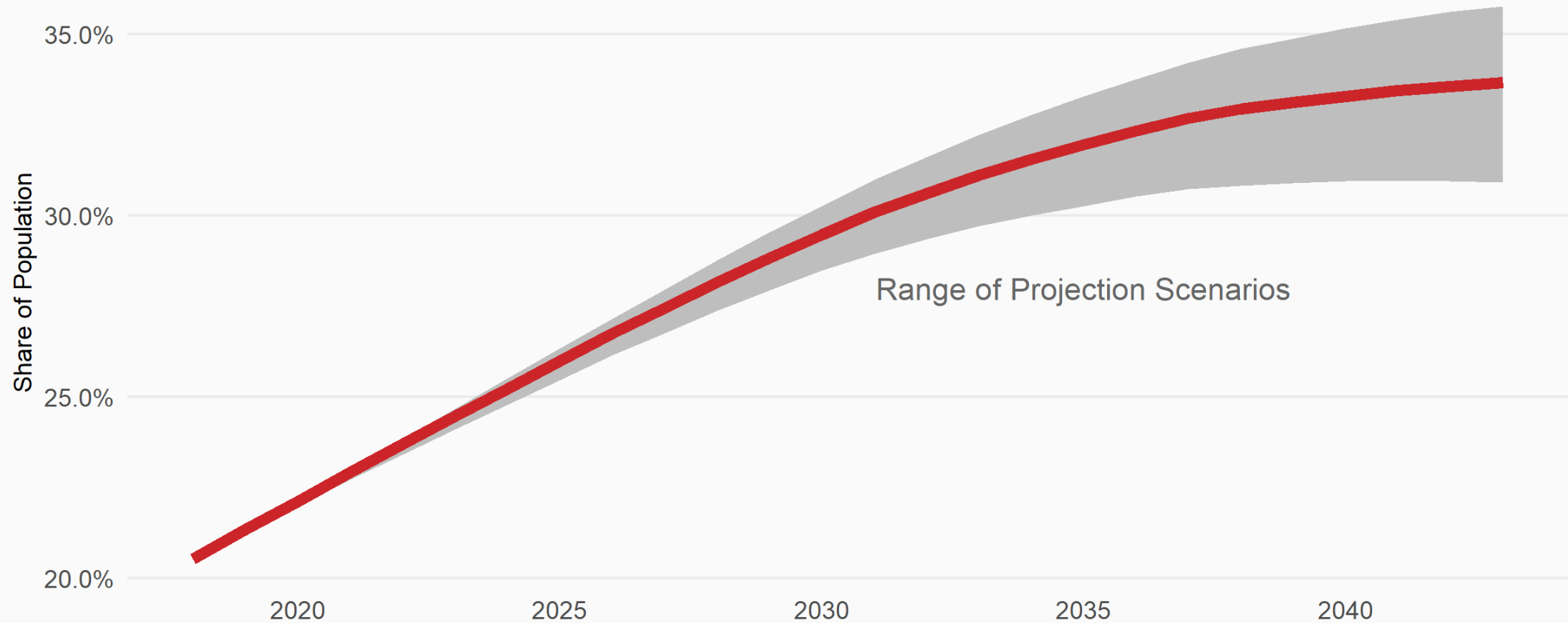
Share over 80 may triple



NL's Rapidly Aging Population

Share of Newfoundland and Labrador's Population Age 65+

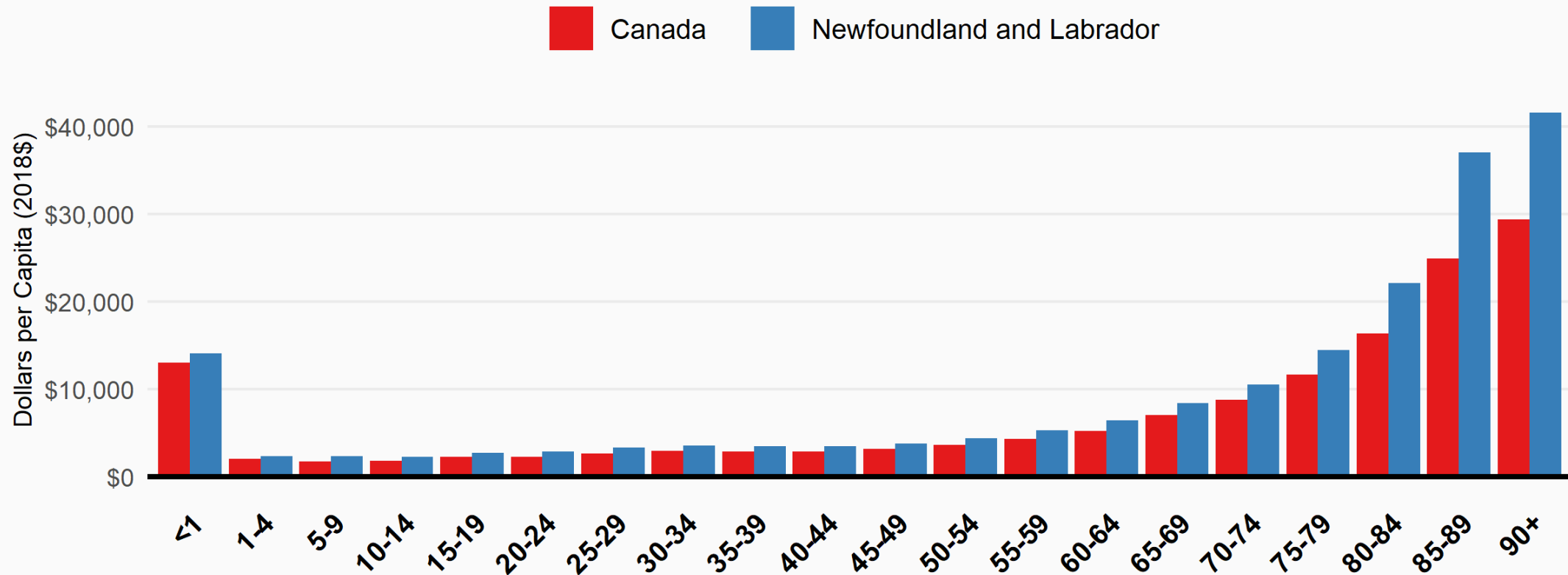
Source: own calculations from Statistics Canada data table 17-10-0057



Population Aging May Increase Health Costs

Per Person Health Spending by Age Group (2018)

Based on provincial/territorial government health expenditures only.

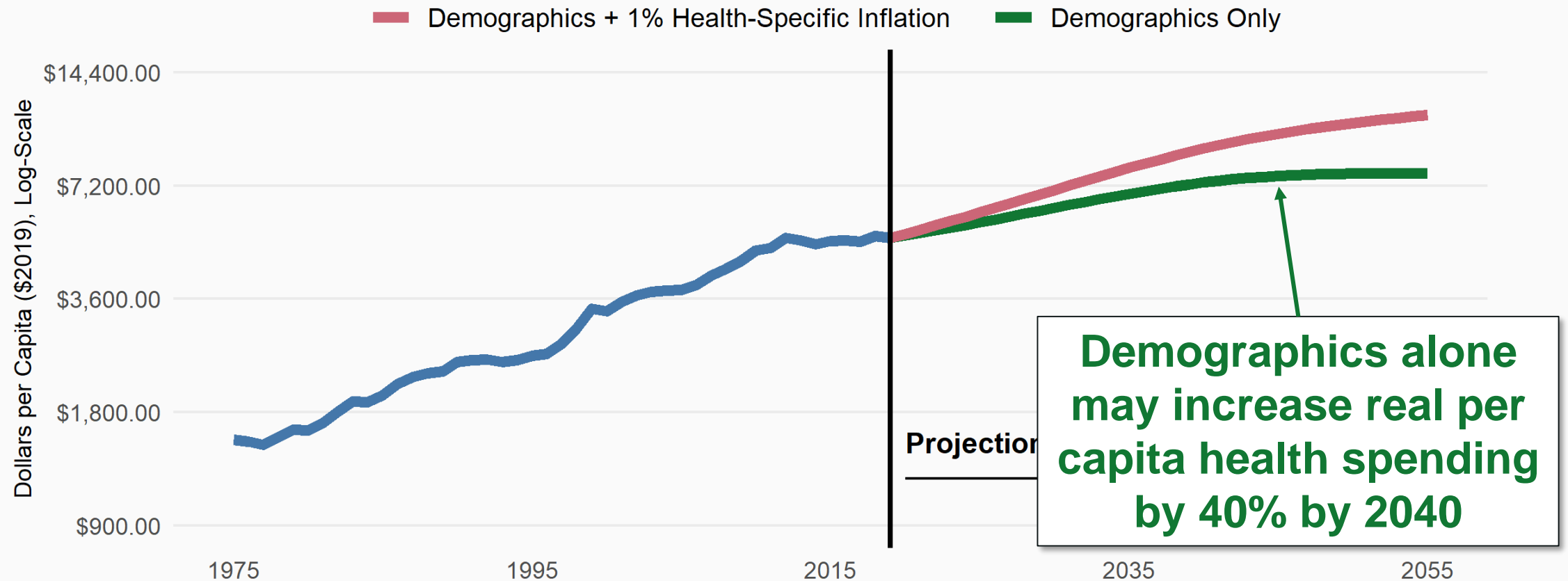


Note: Age/gender specific spending by province from CIHI Open Data Table O.2.
Source: Canadian Institute for Health Information, National Health Expenditure Trends 1975-2018. Graph by @trevortombe.

NL's Rapidly Aging Population

Potential Increases in Newfoundland and Labrador's Healthcare Costs

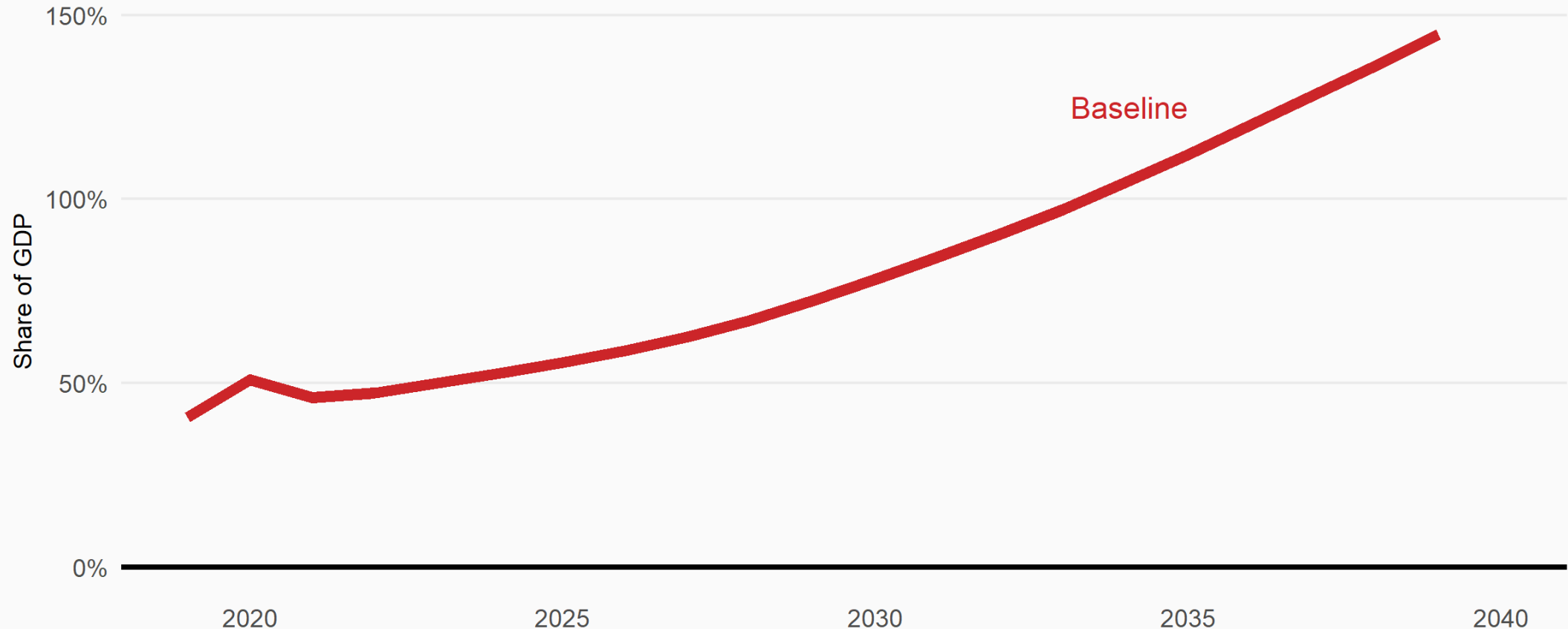
Source: Own calculations from CIHI health spending data and population projections based on provincial projections (Jan 2021) during the period 2019 to 2043 and extrapolated beyond with national StatCan M1 scenario (17-10-0057).



Newfoundland and Labrador's "Fiscal Gap"

A Projection of Newfoundland and Labrador's Net Debt to GDP

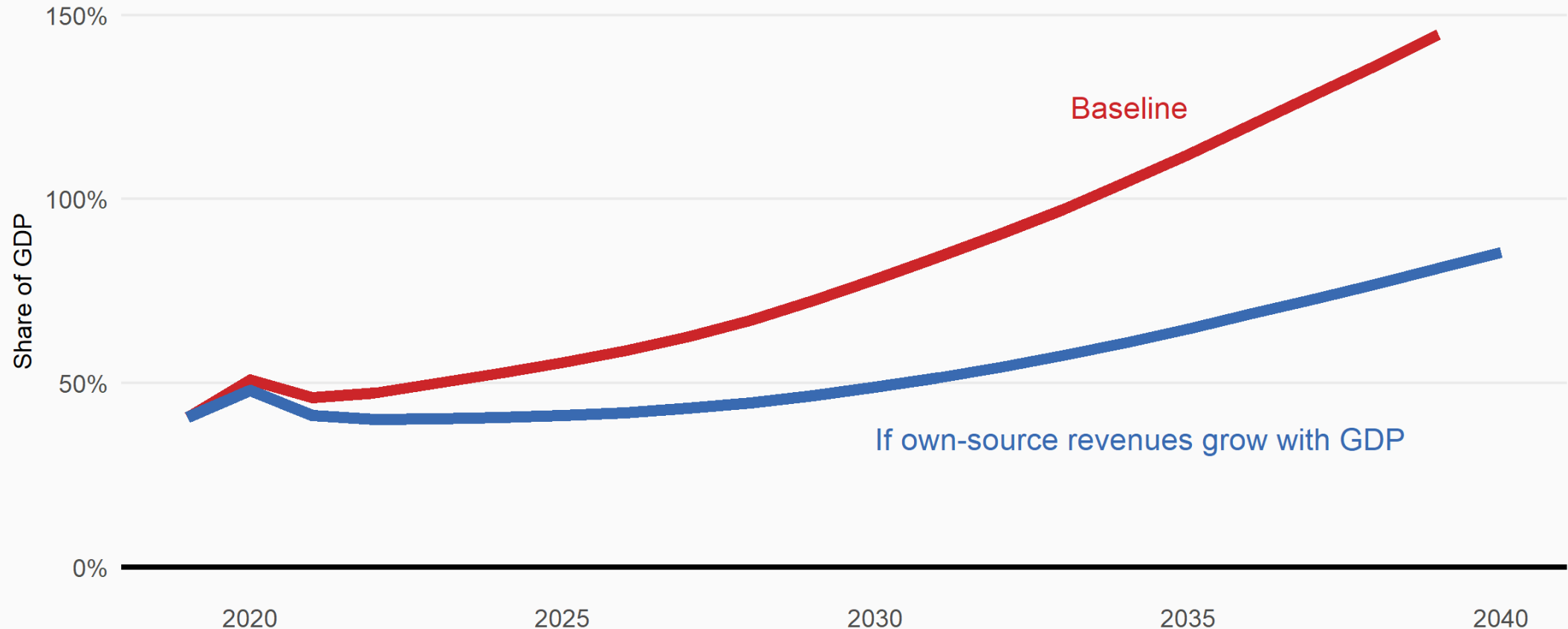
Source: own calculations from Tombe (2020, CTJ), Finances of the Nation, Unpublished Sept 2021 update.



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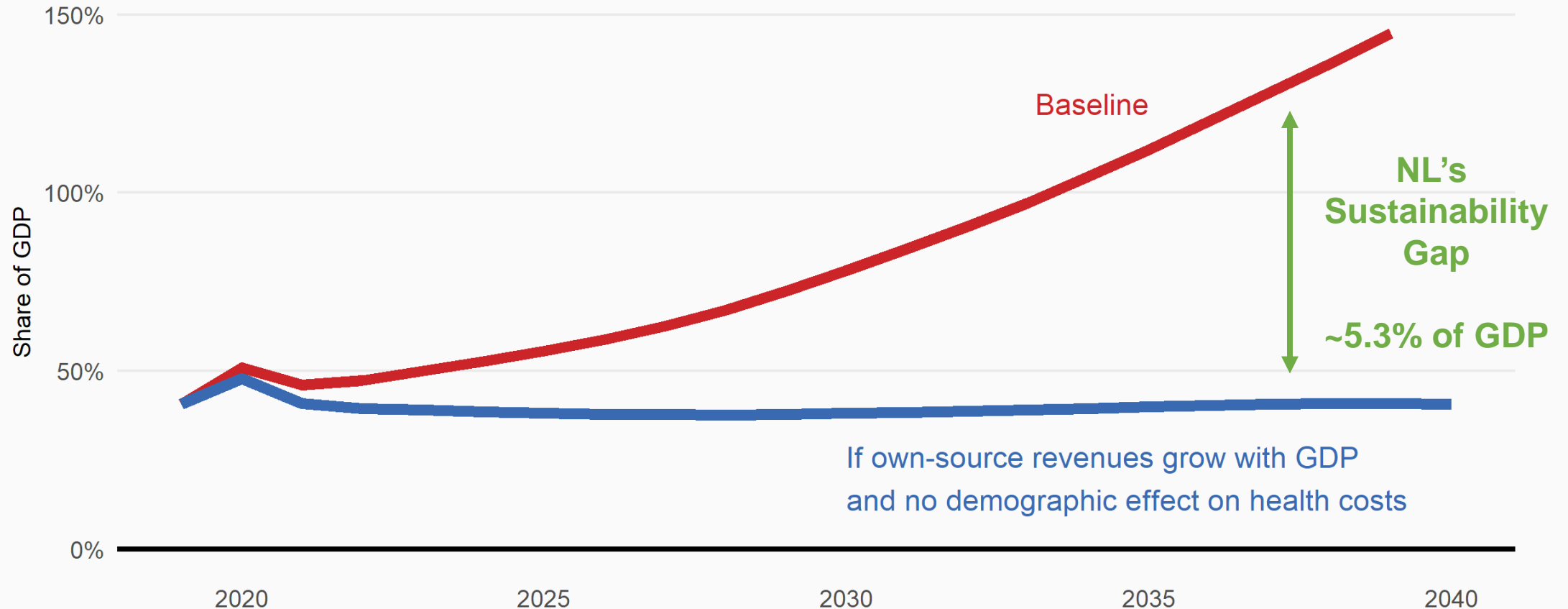
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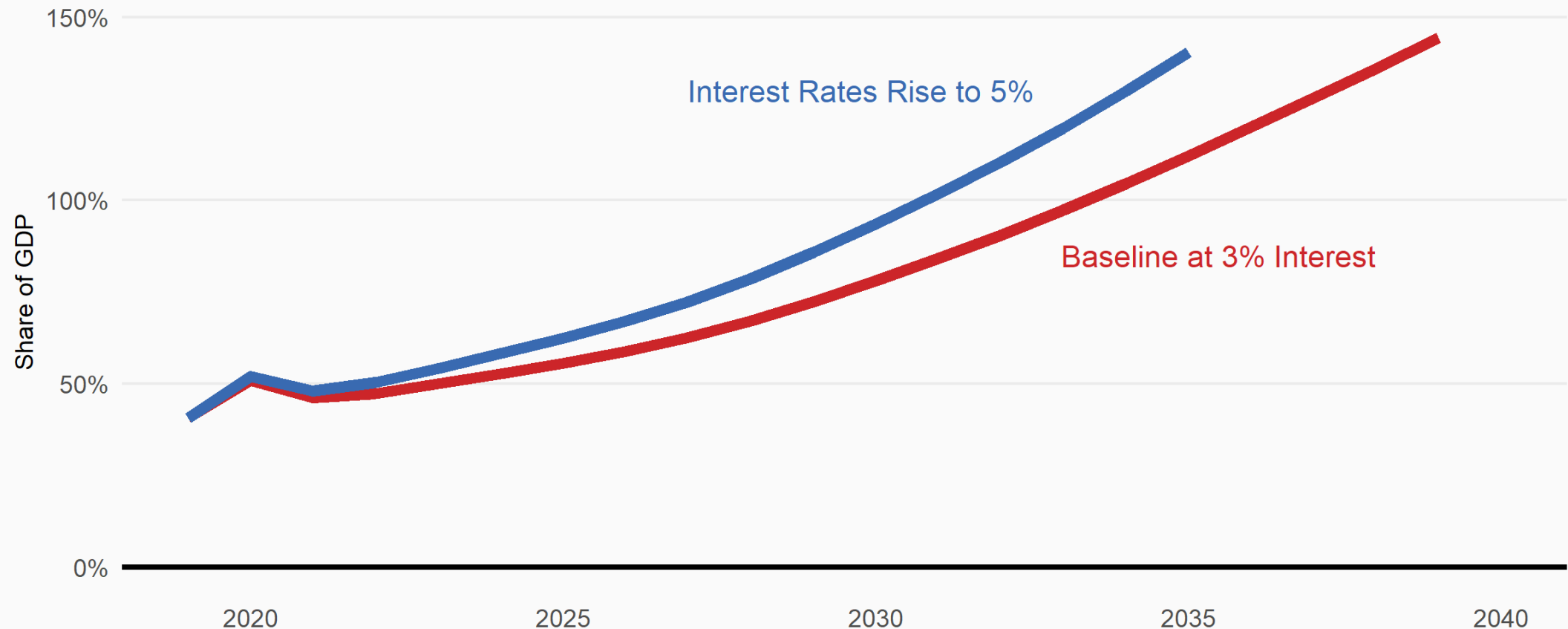
Source: own calculations from Tombe (2020, CTJ), Finances of the Nation, Unpublished Sept 2021 update.



Caveat: Significant Uncertainty in Projections

A Projection of Newfoundland and Labrador's Net Debt to GDP

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Prospects for Federal Transfer Reform to Address the Challenge

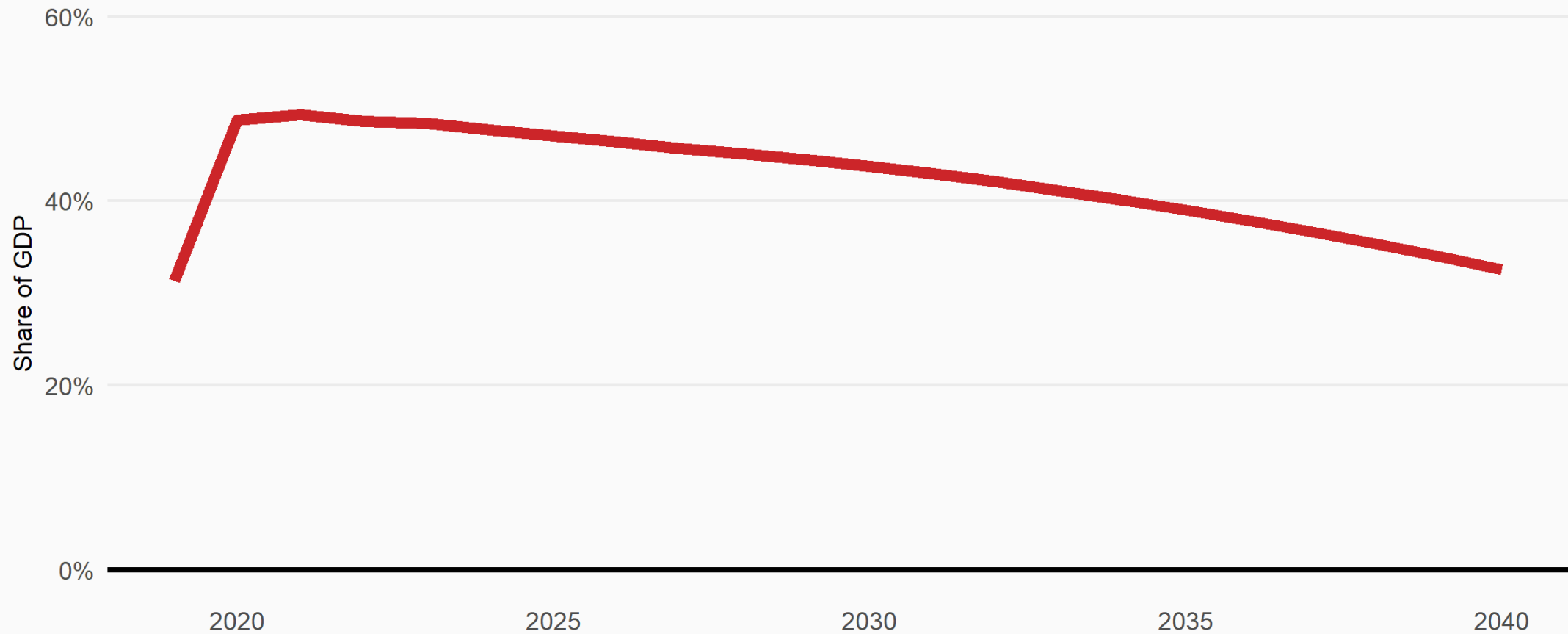
Principles Guiding the Analysis

- Work within current institutional/constitutional structures
- Align fiscal capacity with expenditure responsibilities
- Ease horizontal imbalances
- Limit exposure of federal finances to provincial policies
- Simple and transparent formula-based approaches
- Aim for sustainable debt/GDP trajectories

Moderate Federal “Fiscal Room”

A Projection of Federal Net Debt to GDP

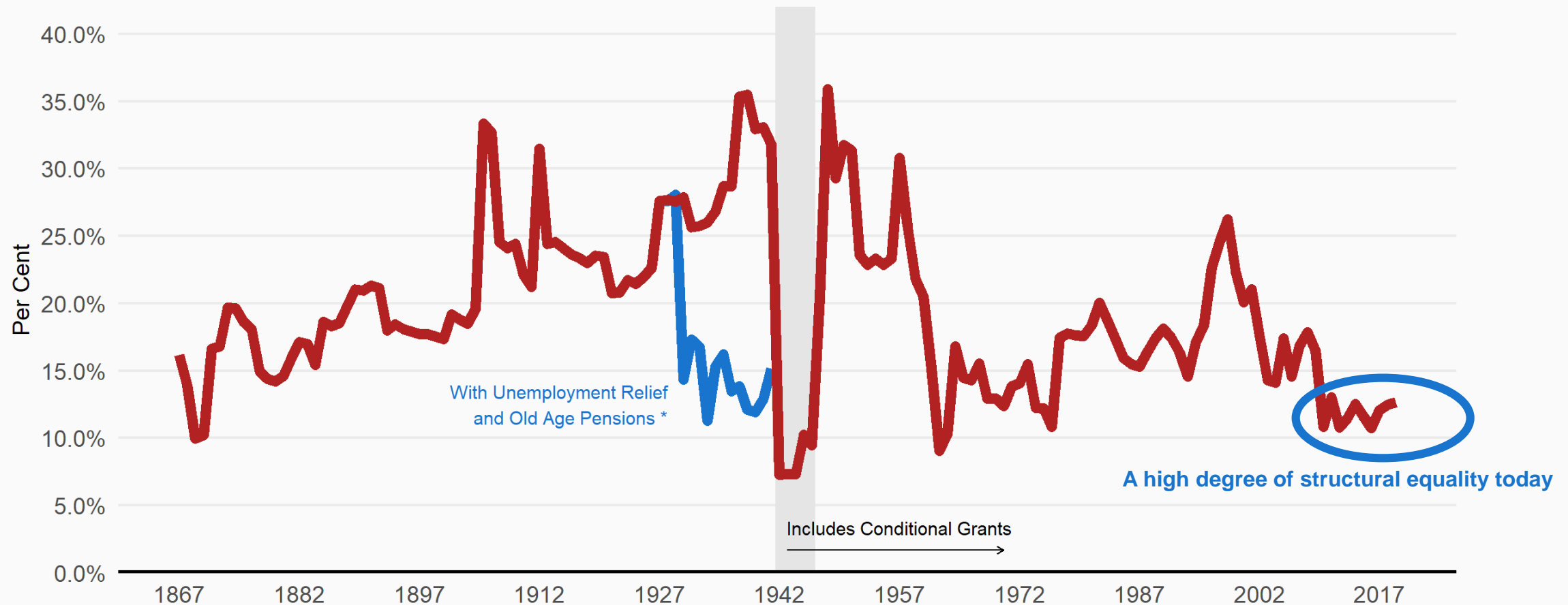
Source: own calculations from Tombe (2020, CTJ), Finances of the Nation, Unpublished Sept 2021 update.



Federal Transfers Currently Very Equal

Inequality in Federal Transfers Across Provinces

Source: own calculations from Tombe (2018, CTJ), Finances of the Nation, Unpublished Sept 2021 update.



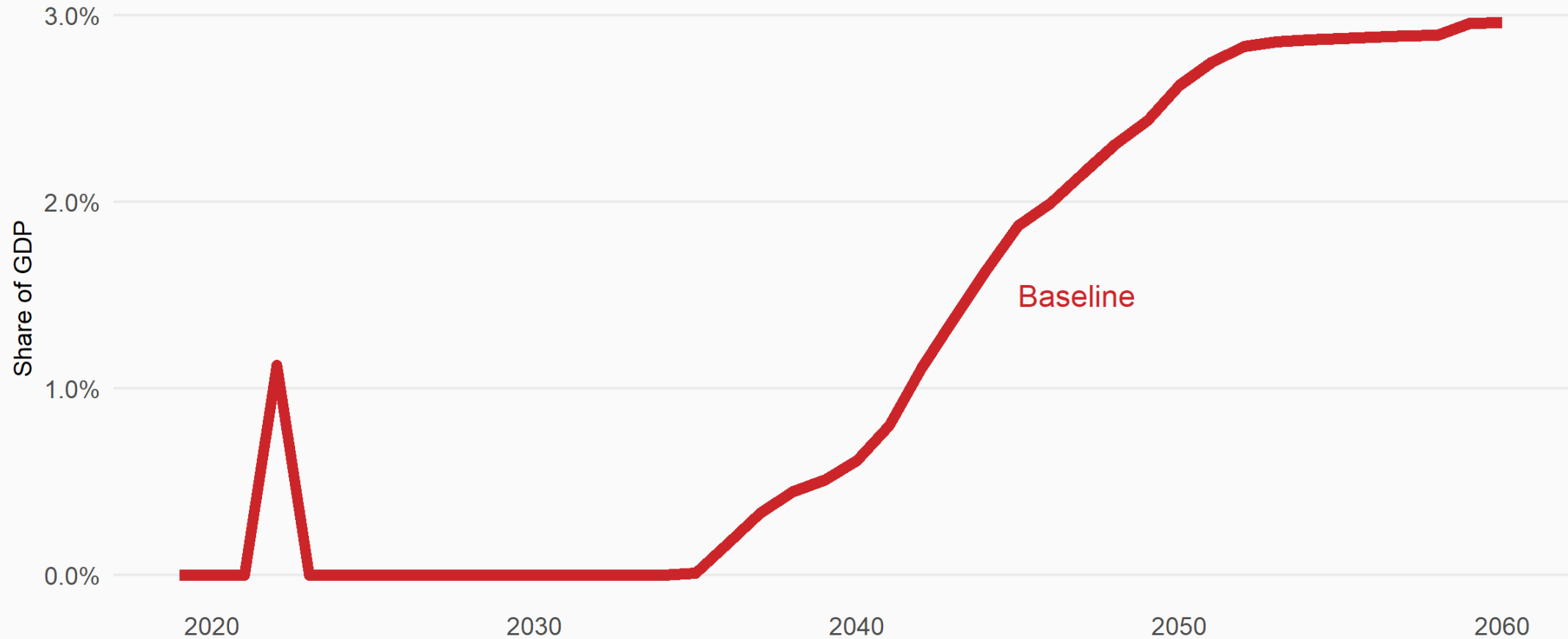
Reforms to Fiscal Federalism in Canada

- Alternative Equalization formula
- Increased CHT growth
- Demographic-based allocation rules
- A new transfer program based on demographics
- Ad-hoc arrangements for specific regions

Equalization to (Eventually) Modestly Help

A Projection of Equalization Payments to Newfoundland and Labrador

Source: own calculations from Tombe (2020, CTJ), Finances of the Nation, Unpublished Sept 2021 update.



Examining Changes to Equalization

- Fiscal capacity cap
- Resource revenue treatment
- Adjustment payments
- Enlarging the program

Illustrating Equalization in 2021/22 (\$ M)

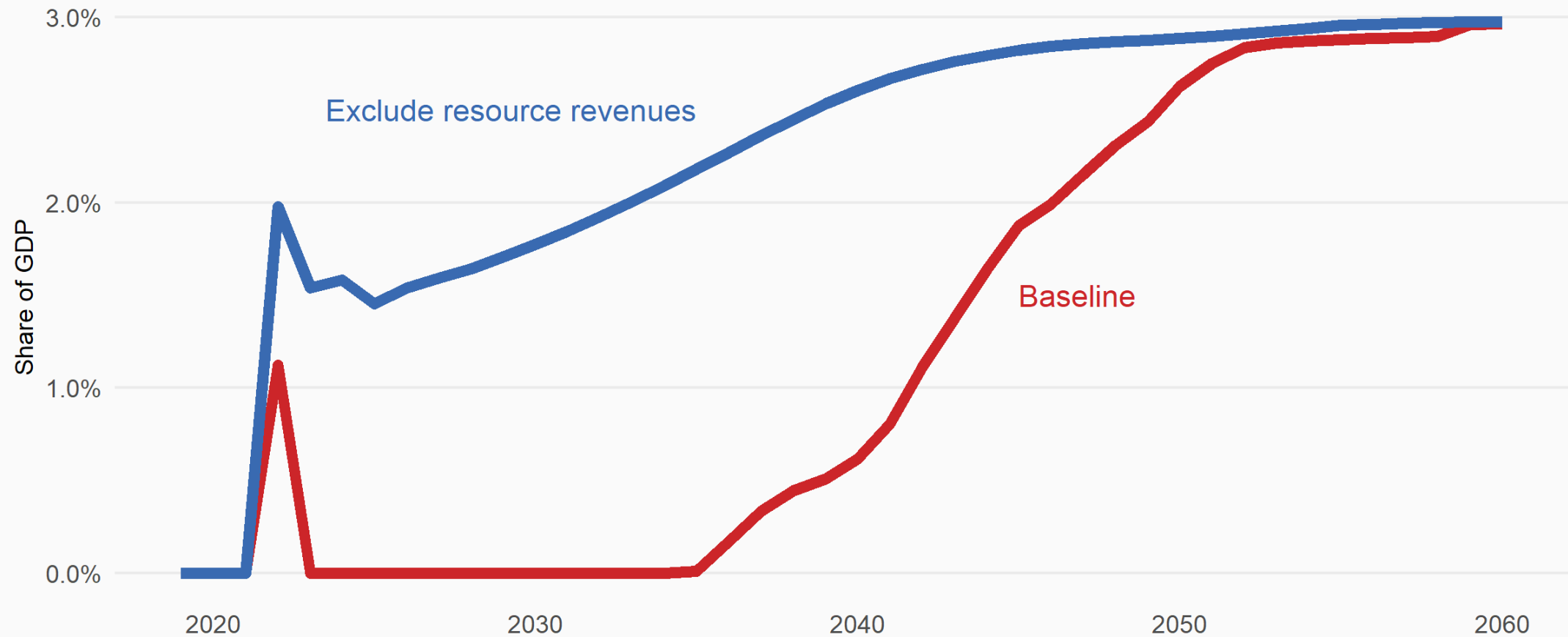
Table 1: Fiscal Capacity and Equalization Payments to Newfoundland and Labrador

	Current Formula	Remove Fiscal Capacity Cap	Exclude Resource Revenues
Non-Resource Fiscal Capacity	\$4,463	\$4,463	\$4,463
Resource Revenue	\$1,139	\$1,139	-
Pre-Cap Equalization	\$563	\$563	\$563
Fiscal Capacity Cap	-\$846	-	-
Adjustment	-	-\$28	-\$8
Equalization Payment	-	\$535	\$556

Removing Resource Revenues

A Projection of Equalization Payments to Newfoundland and Labrador

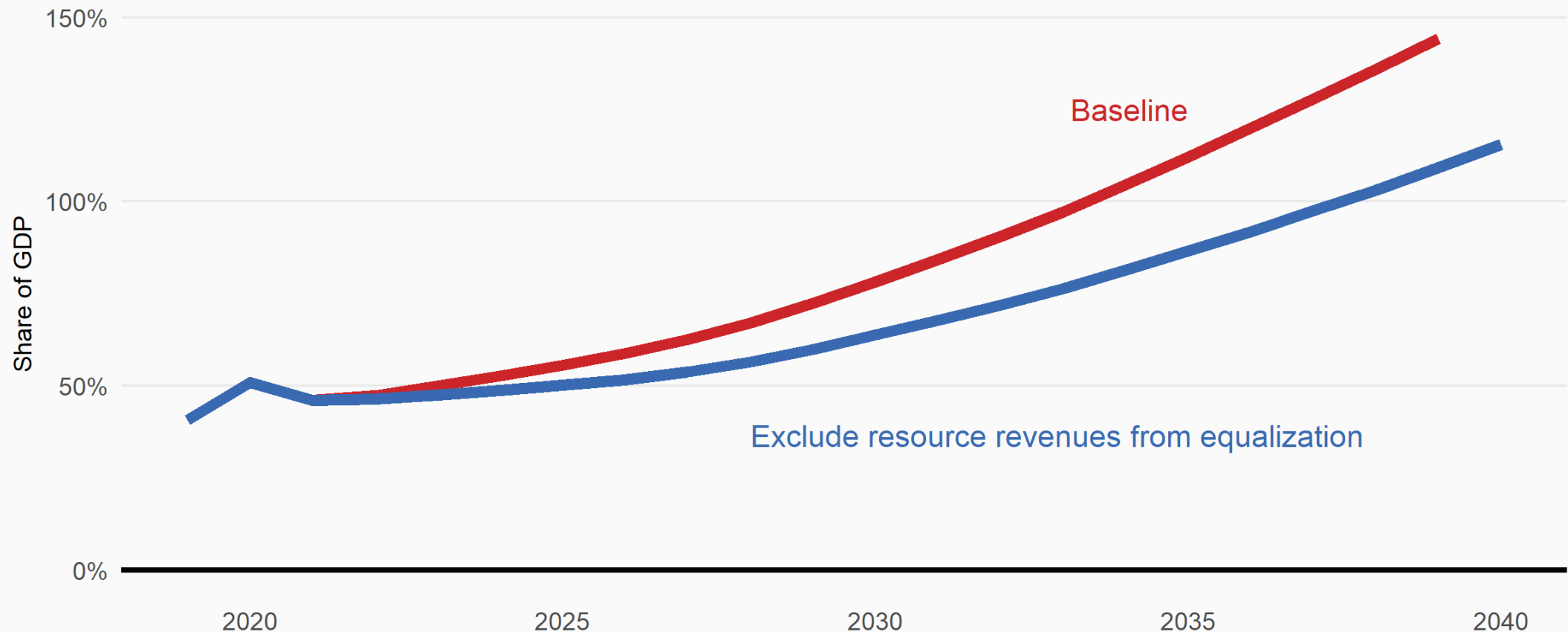
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Fully Excluding Resource Revenues

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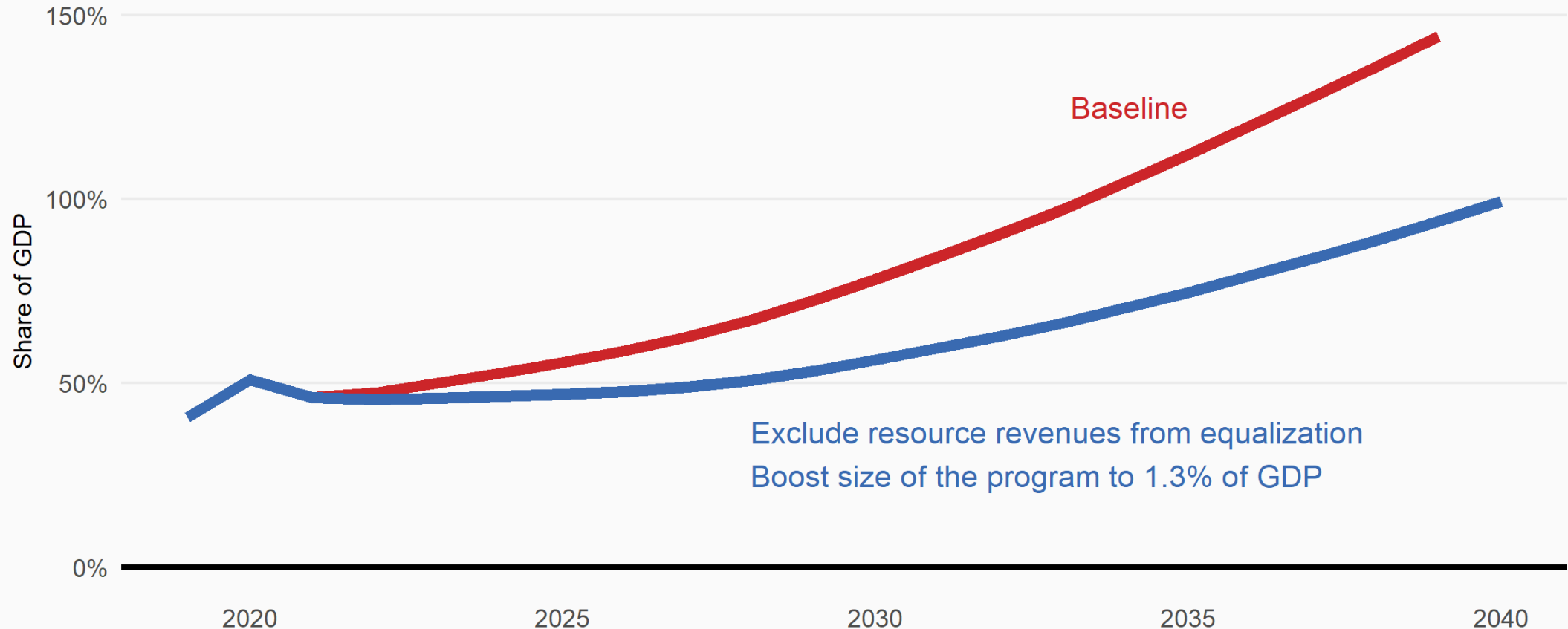
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Enlarging the Size of the Program

A Projection of Newfoundland and Labrador's Net Debt to GDP

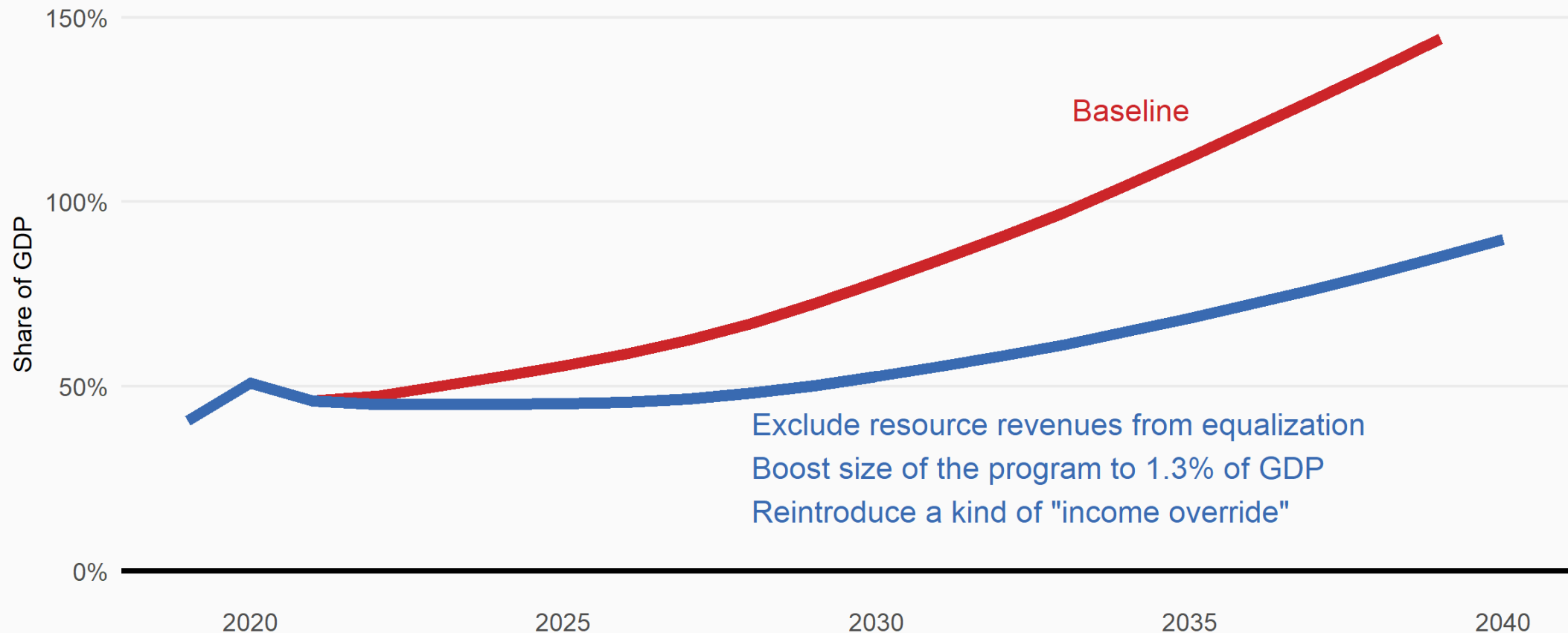
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... and Exclude Richer Provinces (i.e., ON)

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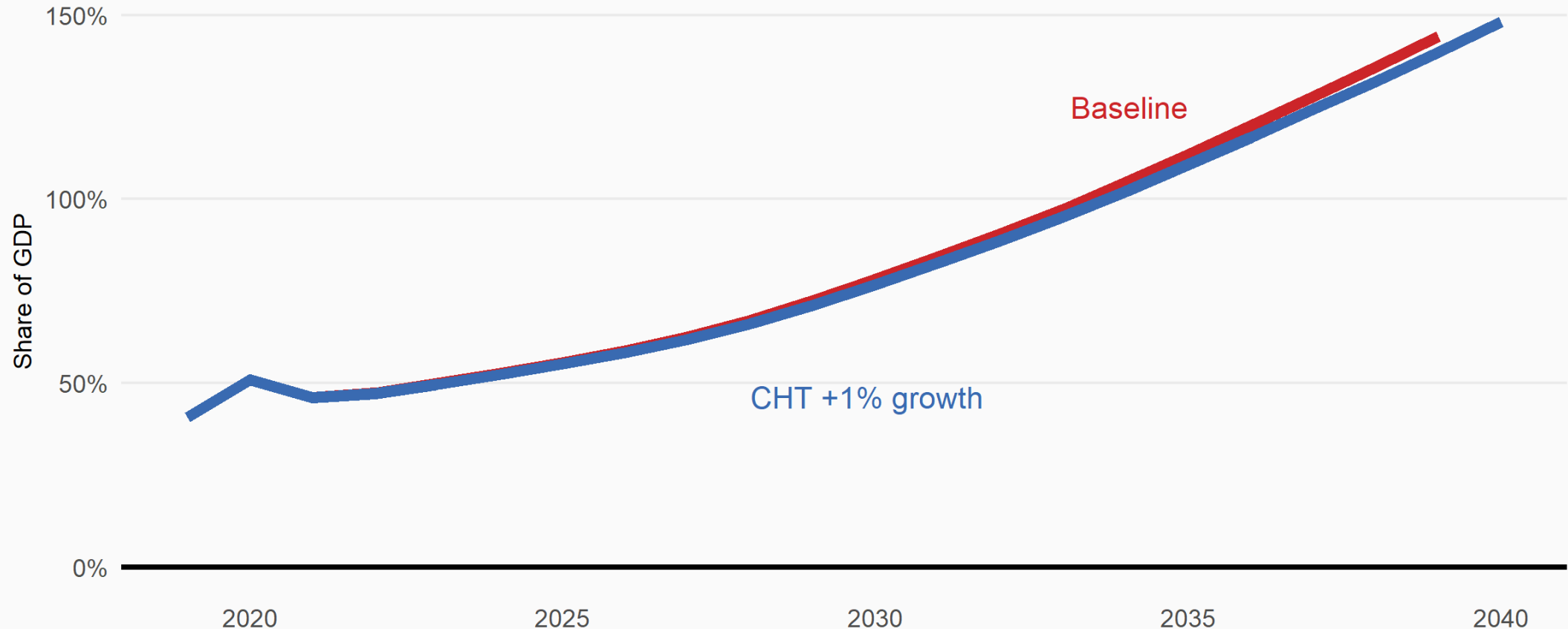
Reforms to the Canada Health Transfer

- Increased annual growth rates
 - +1 p.p. per year
 - +2 p.p. per year
- Allocate based on demographics
 - Share of 65+ population, rather than total population
 - A more complex formula to centralize demographic costs

Baseline Fiscal Projection for NL

A Projection of Newfoundland and Labrador's Net Debt to GDP

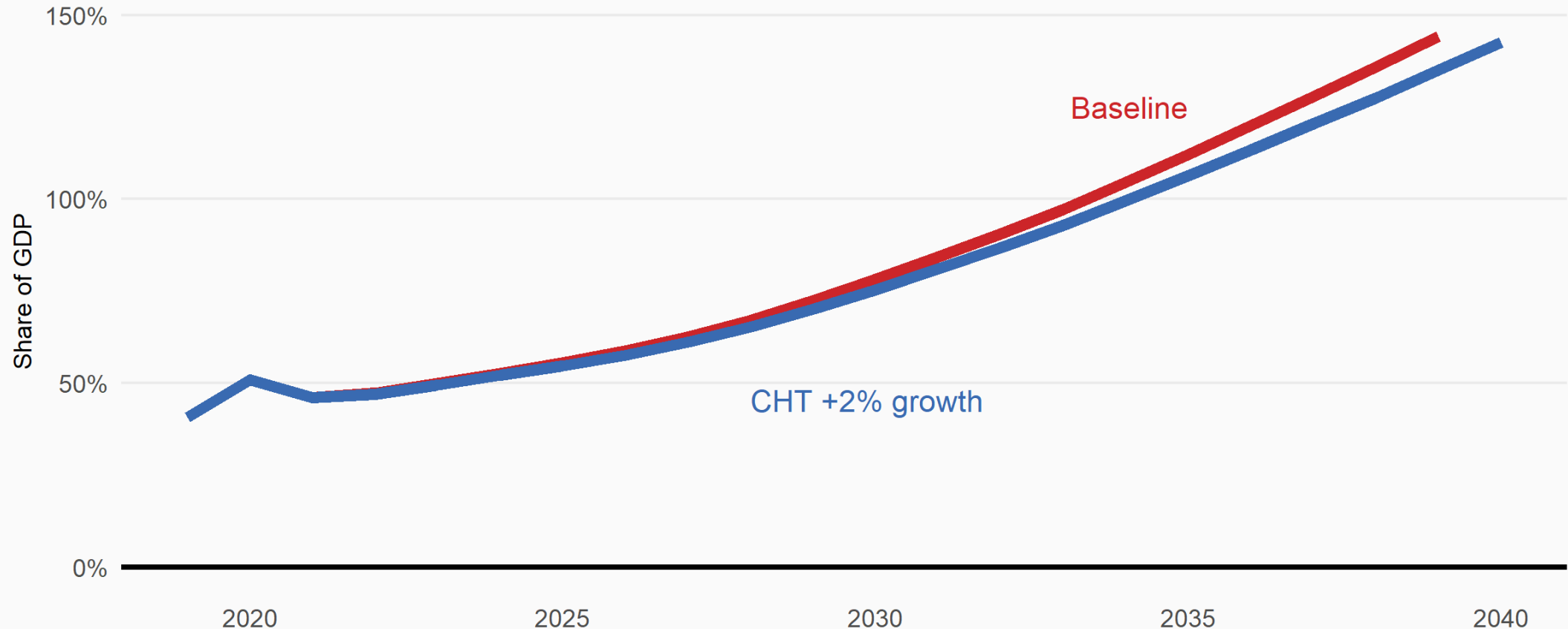
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Baseline Fiscal Projection for NL

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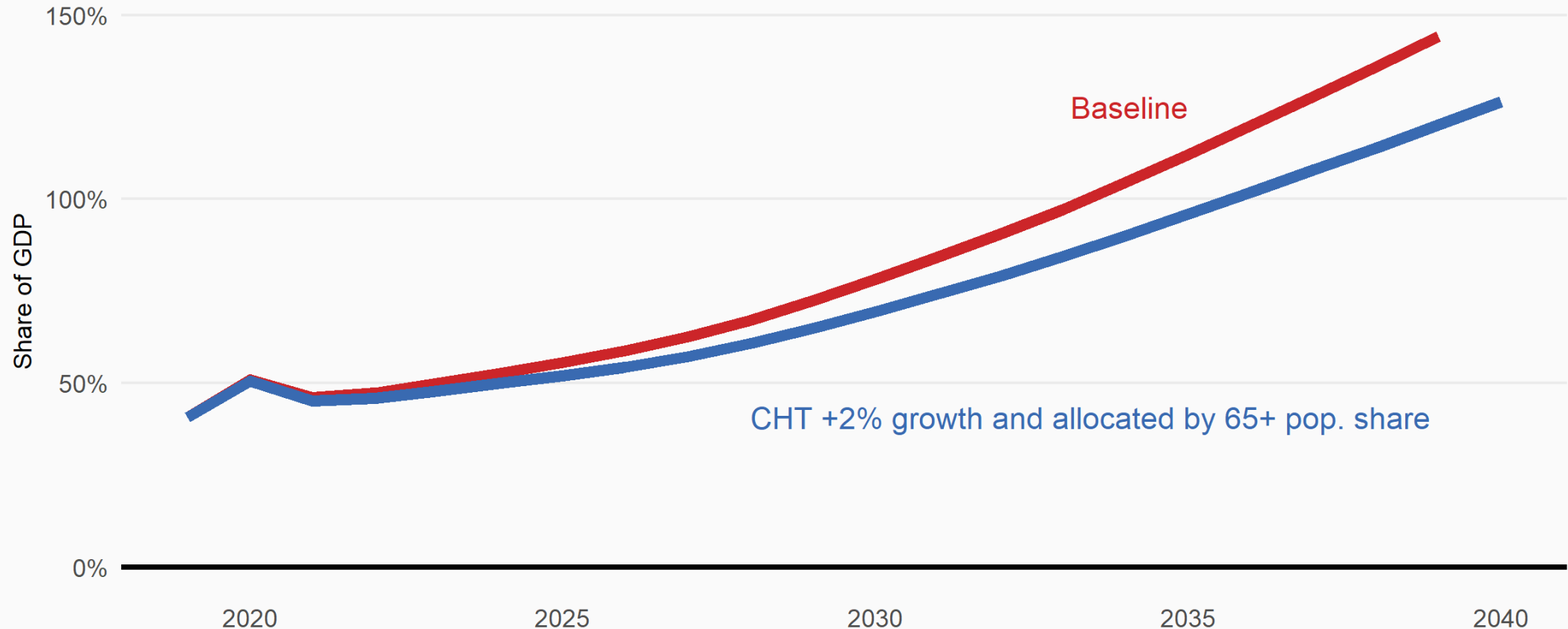
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Baseline Fiscal Projection for NL

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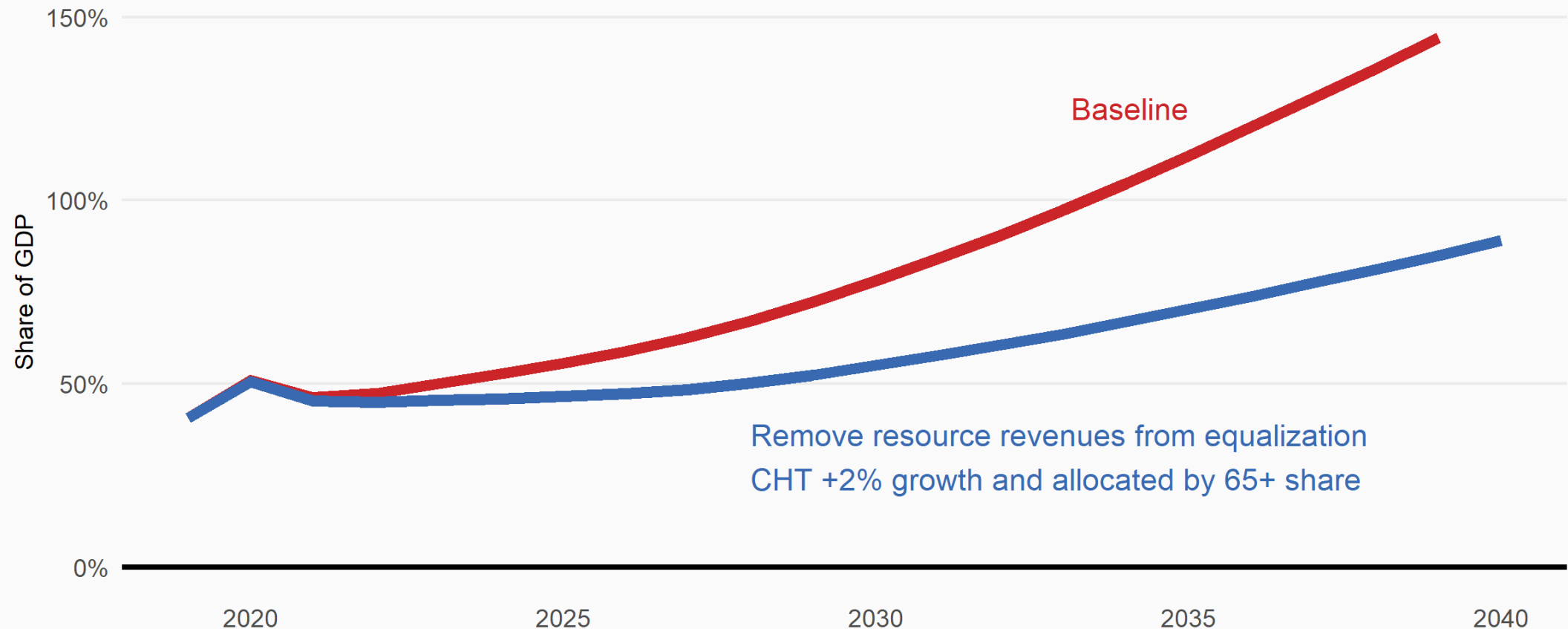
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Baseline Fiscal Projection for NL

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A Canada Demographic Transfer?

- Just as equalization pays only to provinces with below-average per capita fiscal capacity, consider a transfer that pays only to provinces with above-average 65+ residents per capita.

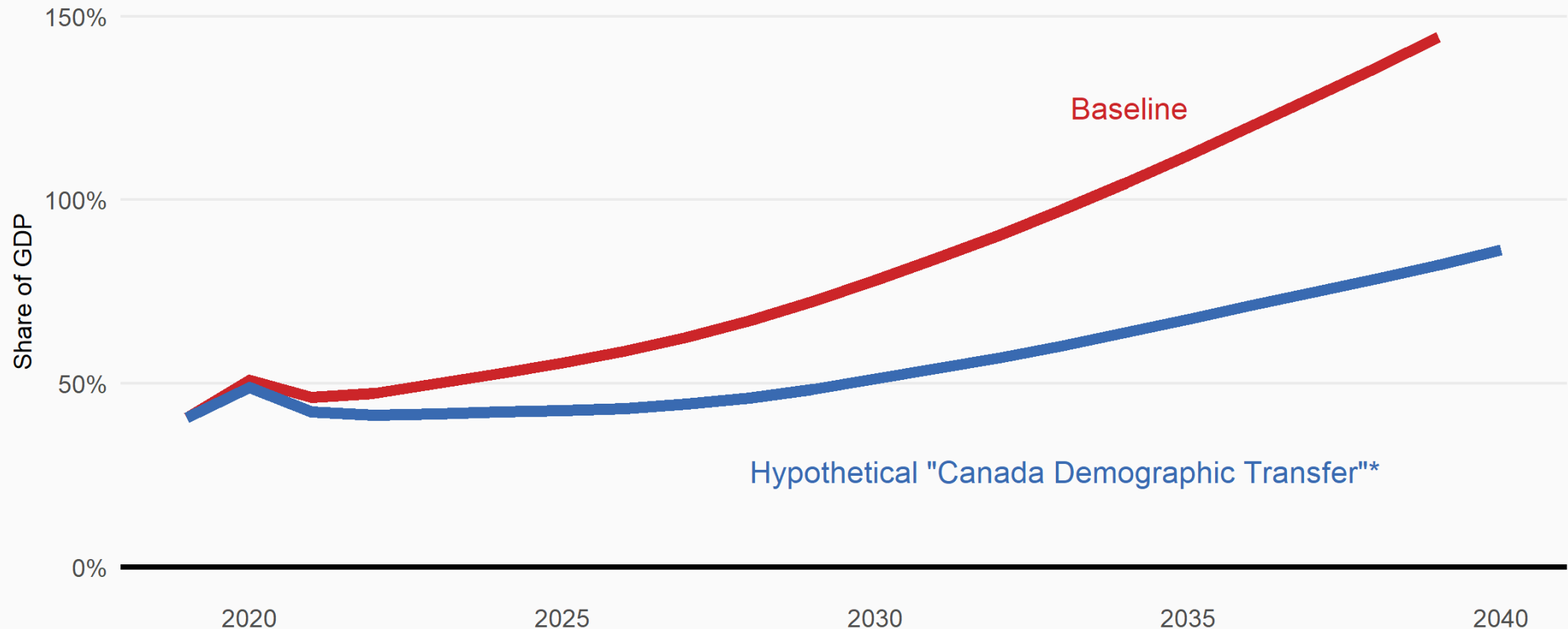
$$* CDT = \$\$ \times (p_i^{65+} - p_i) \text{ but only if } p_i^{65+} > p_i$$

- Exhaust federal room: \$10 billion, indexed to GDP

A Canada Demographic Transfer?

A Projection of Newfoundland and Labrador's Net Debt to GDP

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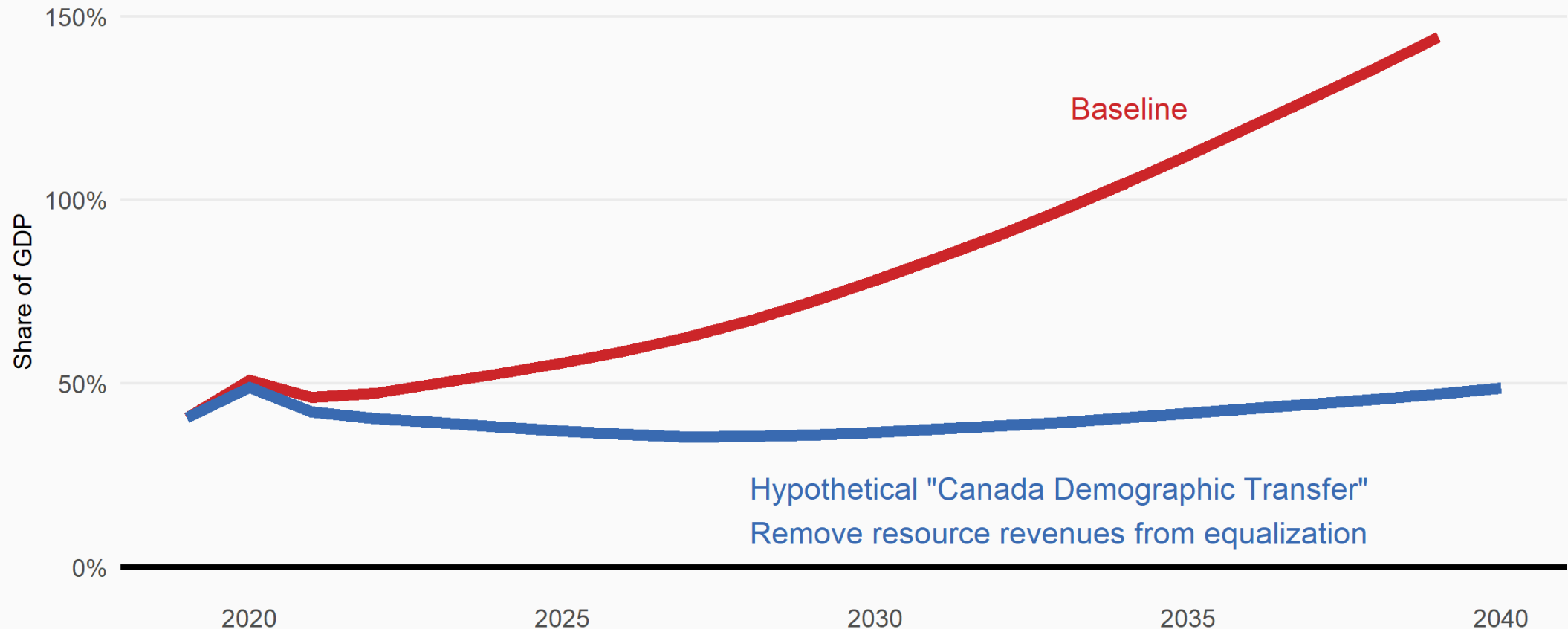


* $CET = \$\$ \times (p_i^{65+} - p_i)$ but only if $p_i^{65+} > p_i$

A Canada Demographic Transfer?

A Projection of Newfoundland and Labrador's Net Debt to GDP

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Atlantic Provinces Adjustment Grants?

Ad-hoc arrangements are occasionally used to address specific challenges facing certain regions

- 1962/63, the \$10.5 million to NL was ~1.8% of GDP
- Today, would be equivalent to ~\$600 million
- Less arbitrary: index Term 29 payments to GDP growth (post-1967). The \$8 million today would be \$275 million.

Prospects for Relying Only on Federal Transfer Reforms

The Effect of Reforms on NL's Fiscal Gap

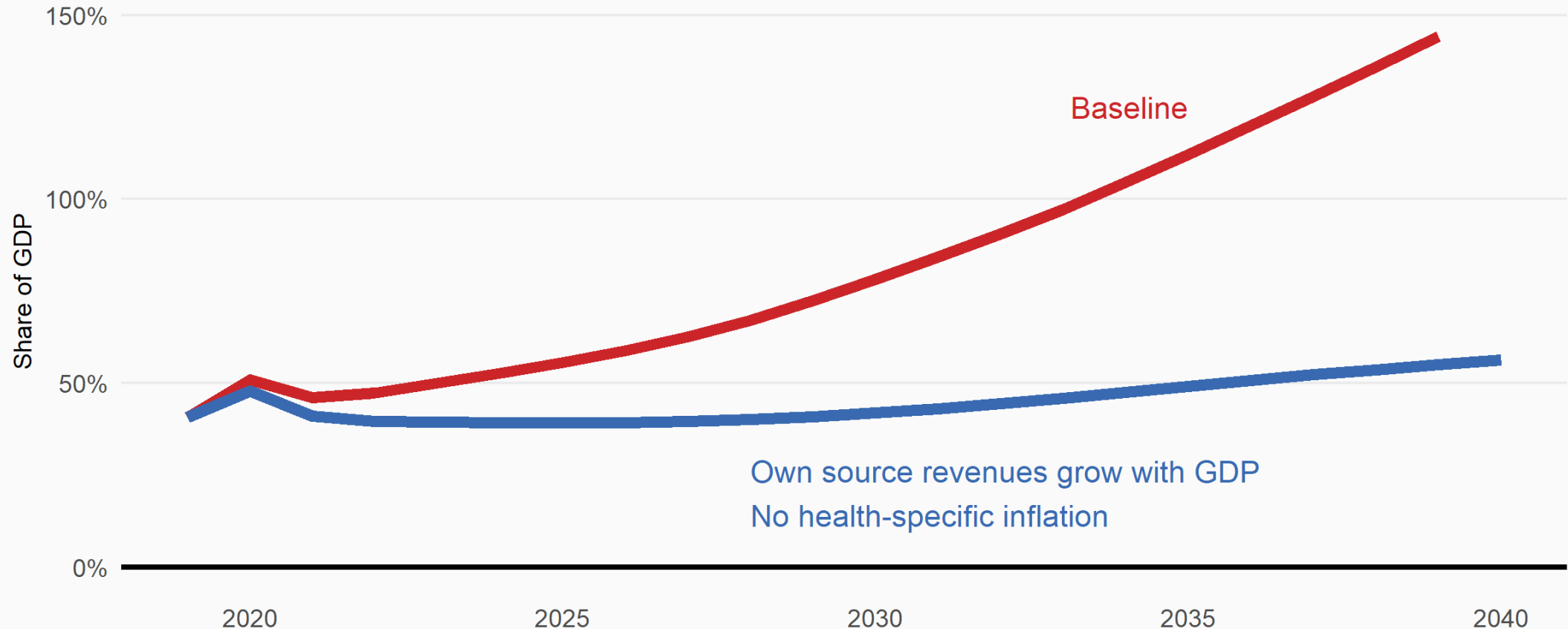
	25 Year	50 Year
Baseline	5.2% of GDP	6.1% of GDP
Remove Resource Revenues from Equalization	-1.6	-1.0
+1 p.p Annual CHT Growth Rate	-0.2	-0.5
+2 p.p Annual CHT Growth Rate	-0.5	-1.1
+2 p.p CHT Growth, Allocated by 65+ Share	-1.3	-2.2
Canada Demographic Transfer **	-3.0	-3.7
Grow Provincial Own-Source Revenue with NGDP	-3.1	-4.1
No Incremental Health Cost Inflation	-1.5	-2.9

** (roughly) the limit of what's feasible in the long-run without federal tax rate changes

Heavy Lifting by Provincial Government

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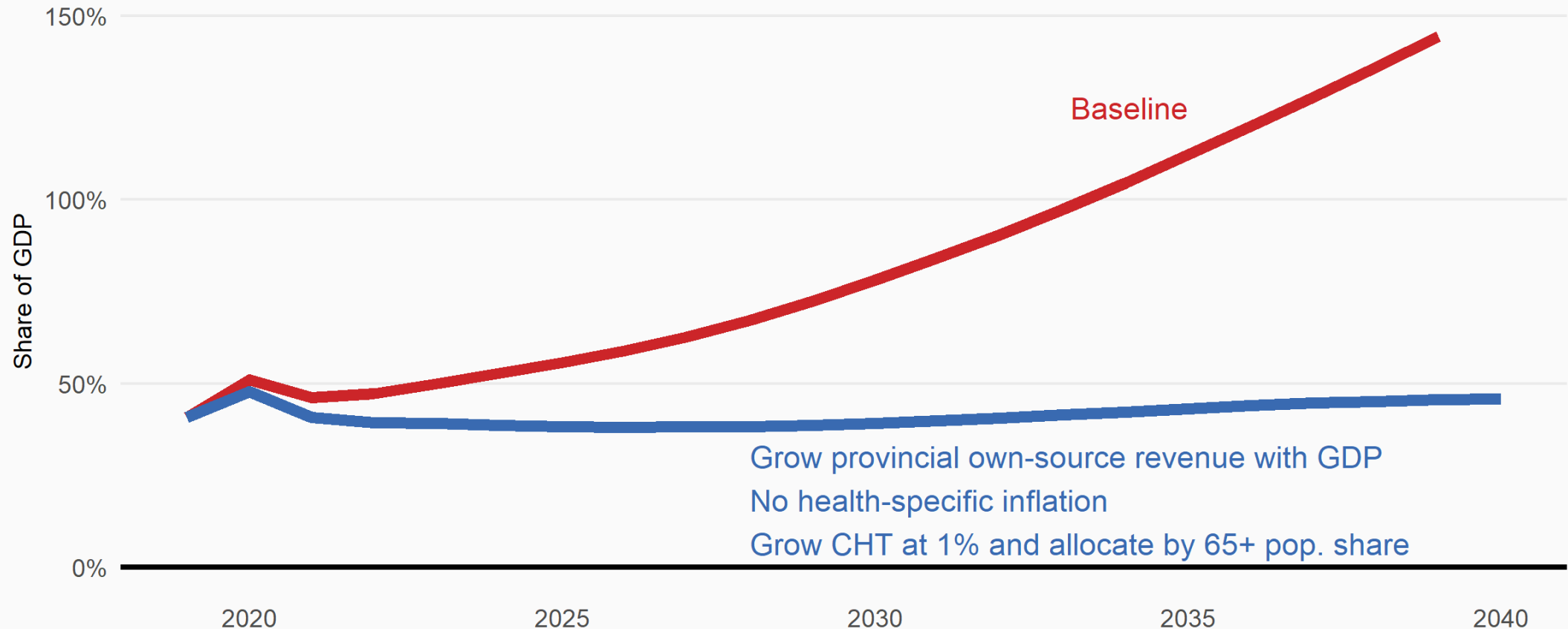
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Transfer Reform + Provincial Action

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Concluding Thoughts

- Neither reasonable reforms to fiscal arrangements nor provincial fiscal choices are individually sufficient
- Opportunity for consensus among provinces?
 - Put **demographics** at centre of transfer reform efforts
 - Equalization changes are tough, but worth exploring
- Combined with provincial focus on modest revenue growth + health spending restraint, this may be sufficient