The Financial Condition of the Province - Economics Department Speaker Series, Memorial University of Newfoundland

January 25, 2019
Office of the Auditor General

- Independent, non-partisan office that reports to and serves the House of Assembly and is an integral component of Government accountability.

- Conducts audits of Government programs and services and provides recommendations designed to improve processes and overall performance in the delivery of public services and management of public funds.

- Independent auditor of the financial statements of the Province (Public Accounts).

- The Public Accounts provide the most complete information about the financial position and operating results of the Province.
Report on the Audit of the Public Accounts


- Included chapter on the Financial Condition of the Province and considered:
  - Financial Position/Results for fiscal 2018
  - Comparative information (10 years)
  - Financial Indicators
  - Economic Outlook (2018 to 2022)
  - Fiscal outlook (2019 to 2023)
  - Risks to fiscal outlook
Indicators of Financial Health

**Sustainability** – whether a government is living within its means

**Vulnerability** – the extent to which a government relies on sources of funding outside its control to pay for existing programs and services

**Flexibility** – whether a government can meet rising commitments by expanding its revenues or increasing its debt
Annual deficits over the last six years of $5.9 billion ($0.9 billion for 2017–18).

Cumulative deficit for years 2019 to 2022 of $2.0 billion; return to small surplus in 2022–23.
Province’s deficit as a percentage of GDP for 2017–18 is 2.8%, the highest in Canada.

Forecast to narrow to 1.6% for 2018–19 but is still expected to be higher than the average of both all other provinces and the Maritimes.
$14.7 billion at March 31, 2018 – highest level in the Province’s history.

Forecast to increase to $16.8 billion by 2022–23.
$27,761 at March 31, 2018 – the highest in the Province’s history and significantly higher than both the average of all other provinces and the Maritimes.

Forecast to increase through to 2021–22 before leveling off in 2022–23.
Fluctuated over the last 10 years – low of 23.4% in 2012 to high of 44.5% at 31 March 2018 – significantly higher than the average of 30.0% of all other provinces.

Forecasted deficits and modest GDP growth beyond 2018–19 could continue to increase the ratio of Net Debt to GDP in the future.
Province has become more reliant on own source revenues.

Own source revenues include oil royalties that are subject to volatile pricing and production swings – factors outside of Government’s control.
Ten year average of 23% of revenues with a peak in 2011–12 of 31.7%. Last five years, average dropped to 17%. For 2017–18, represented 13% of revenues.
Production has fluctuated significantly with overall downward trend since 2007–08.

Production for 2018–19 to 2022–23 forecast to increase each year and reach 112.4 million barrels in 2022–23.
The 2018 Fiscal and Economic Update, for the timeframe October 2018 to March 2019 indicated for:

- Every $1.00 decline in oil price - revenue loss $10.4 million ($1.00 increase - additional $19.9 million).
- Every one-cent increase in the CAD/USD exchange rate - revenue loss of $9.8 million ($19.5 million in additional revenue for every one-cent decrease).
At March 31, 2018, net borrowings and post-retirement benefits totaled $19.6 billion, an increase of $9.8 billion or approximately 100% over the last ten years (does not include the borrowings of Government business enterprises and partnership).
Ten year average of 11.5% with a low of 8.6% for 2009. Over the past five years, averaged 12.9% – an upward and deteriorating trend.

13.7% for 2017–18; estimated to average 13.8% between 2018–19 and 2022–23.
Over 10 year period, expenses have grown steadily from $5.7 billion to $8.2 billion, an increase of $2.5 billion or 44%.

For same period, revenues fluctuated significantly – increase of $139 million or 2% more at end March 2018 vs March 2008.
Significant decline in revenues from oil royalties and Federal transfers and a moderate decline in corporate income taxes.

Declines have been largely offset through increased personal income tax, HST and other taxes and revenues.
On a per capita basis, Newfoundland and Labrador generates more revenue than every other province.

Newfoundland and Labrador also has one of the highest tax burdens on a per capita basis in the country.
Over 10 years, program expenses have grown by $2.2 billion – 45%.

Last five years, growth of 4%, or an average of 0.8% per year, with most increases for social programs and services.

<table>
<thead>
<tr>
<th>Expense by Department or Sector</th>
<th>2012-13</th>
<th>2017-18</th>
<th>5-Year Trend</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Amount</td>
<td>Percent</td>
<td></td>
</tr>
<tr>
<td>Health and Community Services</td>
<td>$2,832</td>
<td>$3,172</td>
<td>$340</td>
</tr>
<tr>
<td>Advanced Education, Skills and Labour</td>
<td>1,144</td>
<td>1,161</td>
<td>17</td>
</tr>
<tr>
<td>Education and Early Childhood Development</td>
<td>758</td>
<td>797</td>
<td>39</td>
</tr>
<tr>
<td>General Government Sector and Legislative Branch</td>
<td>1,123</td>
<td>947</td>
<td>(176)</td>
</tr>
<tr>
<td>Resource Sector - Other</td>
<td>364</td>
<td>314</td>
<td>(50)</td>
</tr>
<tr>
<td>Social Sector - Other</td>
<td>700</td>
<td>802</td>
<td>102</td>
</tr>
<tr>
<td><strong>Total Program Expenses</strong></td>
<td>6,921</td>
<td>7,193</td>
<td>272</td>
</tr>
<tr>
<td>Debt expenses</td>
<td>780</td>
<td>998</td>
<td>218</td>
</tr>
<tr>
<td><strong>Total Expenses</strong></td>
<td>$7,701</td>
<td>$8,191</td>
<td>$490</td>
</tr>
</tbody>
</table>

Source: Public Accounts

Note 1: Unlike revenue, due to structuring of departments, comparative 10-year expenses by department or sector information was not readily available.
Significant portion of expenses related to health care and education.
Health Care Expenditures – Per Capita by Age

Source: National Health Expenditure Database, Canadian Institute for Health Information
NL spends more per capita than every other province by a considerable margin and more than our per capita revenues.

Noted earlier - On a per capita basis, NL generates more revenue than every other province and also has one of the highest tax burdens on a per capita basis in the country.

Suggests that revenue is not the primary issue creating the deficits but the level of spending.
Improvement expected for 2019 with increased capital investment, increased exports and growth in real GDP.

Modest GDP growth expected from 2018 to 2022 based on increases in oil prices and oil production and increases in activities in the mining and aquaculture sectors.

Medium-term outlook beyond 2019 is expected to remain challenging due to declining major project investment and Government fiscal restraint.
Capital Investment expected to decline significantly from 2018 through 2022 as compared to its peak in 2016 – corresponding negative impact on employment and revenue to the treasury.
Employment forecast to drop from 224,100 persons in 2017 to 214,800 persons by 2022 – decrease of 9,300 persons over a five-year period and a decrease of 27,900 from the high of 242,700 in 2013. (Note: Does not include Bay du Nord project which was announced since Budget 2018).

Source: Department of Finance
Deficits for fiscal years 2019 to 2022 with return to small surplus in 2023 through a combination of:

- increased revenue of $769 million – 10.6% or an average of 2.11% per year; and
- decreased program expenses of $400 million – 5.6% or an average of 1.12% per year.
Fiscal Outlook – Key Risks to Revenue Forecast

- Economic forecast – subject to considerable risk and change, provides the basis for predicting taxation and other provincial revenues.

- Corporate tax – expected increase subject to volatility as some of largest remitters are commodity–based.

- Carbon Tax – provision for $20 per tonne commencing 2019 and increasing to $50 per tonne by 2022–23 – assumption now subject to principle of Atlantic parity.

- Oil royalties – expected increase based on an assumption of increasing oil prices and oil production to 2022–23 – factors outside the Province’s control.
Decline in program expenses - decline in program expenses of $400 million (1.12% per year) is less than the expected rate of inflation and would not allow for inflationary or other pressures.
Fiscal Outlook – Key Risks to Expense Forecast

- Muskrat Falls –
  - Any further cost overruns will likely result in additional borrowings and related debt expenses.
  - Mitigation measures implemented by Government to reduce electricity rates during 2020–2023, beyond the amounts included in the Budget 2018 forecast, may impact the Province’s forecasted surplus/deficit.
  - Monitoring Nalcor’s valuation of the Muskrat Falls assets (assess for impairment) on its financial statements.
Fiscal Outlook – Overall Observations

- Province still facing a significant fiscal problem.
- Not living within our means.
- Risks to plan for return to surplus by 2022–23.
- Should risks materialize that significantly impacts forecast, Government would be very challenged to address such a shortfall and remain on target to return to surplus in short term.

Important to:
- Continue efforts to diversify the economy over the medium to longer-term timeframe.
- Continue to prioritize investments and programs to allow for a prudent pace of deficit reduction and timely stabilization of net debt burden.
- Monitor Government’s response to Muskrat Falls.
- Maintain particular emphasis on sustainably reducing the Province’s per capita spending to achieve quality services that we can afford.
Questions?