

February 11 Presentation

Good afternoon.

I am here today to speak on behalf of the Schroeder Policy Group about the only plausible solution to the current situation in Newfoundland and Labrador.

The provincial government has assured rate payers that they will not be called upon to assume the burden of the Muskrat Falls project. However, as of this date, and I include yesterday's confusing announcement in this assessment, no actual legislation or verifiable plan has been put into place to alter this situation

Much of the discussion over the past year has ignored the larger problem of NL's debt, and focused instead on **rate mitigation**.

Rate mitigation in NL won't work, because there are two options for NL and neither works without outside help.

In option **number one**, which was the plan along, the cost of the project is borne by businesses, institutions and consumers, via higher electricity rates.

We all know why this would be impossible, as it would double electricity rates in NL and do enormous damage to the economy, damage we are in no position to absorb.

Or there is option **number 2**— the government NL subsidizes power rates through its tax revenue.

Unfortunately, assuming the burden of rate mitigation from current revenues would increase the debt dependent on tax revenue from \$18 billion to \$26 billion, and increase our debt ration to 76% of GDP. Most provinces have a debt to GDP in the low 30's - half that of NL. There is no way the world's bond raters and financial markets will accept this level of debt while still loaning us money, and the province has zero capacity to raise taxes. NL & Labrador will inevitably drift into insolvency.

So we need another idea.

Realistically saving NL from bankruptcy requires a serious infusion of funds directly from the federal government or a federal entity. The Schroeder Policy Institute calls on the Canadian government to provide the people of NL & Labrador with \$1.4 billion a year, a sum which would approximate the coming burden of the Muskrat Falls project and the accumulated debts associated with this project. There is no other institution in Canada capable of providing fiscal relief at this level.

The Solution for Ottawa in respect to Muskrat Falls and the impending Insolvency of NL is for the federal government to pay the interest portion of NL's \$500 million Muskrat Falls financing - including \$300 million of interest on the \$8 billion in direct Muskrat debt, and \$200 million on interest used to finance the \$4 billion equity interest NL has in Muskrat Falls, until the year 2041.

Then, the federal government pays NL 3 cents a KWH for the 30 billion net KWHs produced by Churchill Falls to the year 2041.

All debt coming due at Muskrat Falls must be reissued past the year 2046.

After Sept 1, 2041 NL will be able to pay interest and principal on the debt. This can be done from profits from the province's 65.8 % interest in Churchill Falls. We estimate that NL will be earning \$1.4 billion per year at that stage, and can repay both principle and interest from this Churchill Falls revenue.

There is no question that these are huge sums. And critics of this policy have suggested that there is no justification for such an infusion, suggesting that having gotten itself into this situation, then NL should somehow slash its budget and raise taxes enough to buy our own way out of it.

While we can certainly do much more here, realistically the 210,000 working people in this province cannot do this on their own, for several critical reasons.

The first reason is **Urgency**. The current fiscal situation in NL is dire.

The province is now vulnerable to the reaction of the Rating Agencies to Muskrat Falls and what is happening in NL.

If Ottawa does not help NL, this means the structural deficit of NL rises above \$1 billion. The deficit to GDP will exceed 5% of GDP, which is unsustainable. The current \$18 billion in debt plus the \$8 billion in Muskrat debt leads to over \$26 billion in debt dependent on tax revenue - is 76 percent of GDP.

The first stage for NL is rating cuts by the rating agencies. Without help from Ottawa NL risks falling out of investment grade, which would be a disaster for financing costs.

The price paid by NL in interest would skyrocket, ultimately added to the \$1 billion in interest costs that the province already pays on debt.

Availability of funds will also suffer with a lower rating . As its credit status deteriorates NL in 2020 must fund a \$1 billion deficit, \$600 million in infrastructure expenditure and \$1 billion in maturing debt, all of which must be somehow refinanced.

The market now assumes that Ottawa will bail out any province before it fails. Proof is shown by the fact that each Canadian province virtually pays the same interest rates , regardless of the credit worthiness of the province.

This comfortable scenario would change immediately if Ottawa lets NL fail , and other Maritime Provinces would experience similar increases in borrowing costs as NL .

By virtue of being the weakest province, NL is the canary in the coal mine, and would be one of the first to fail. And since other Canadian provinces don't have much tax capacity, all provinces would come under pressure. NL is the first province to approach insolvency, but it won't be the last.

The third reason to for federal support is the **Unfairness of Equalization**.

Under the rules for the federal equalization program, NL receives nothing from the \$20 billion fund, as it is considered a have province. These rules are complex in the extreme, but in essence NL's non-renewable resource revenues have deemed it a 'have' province.

This is patently unfair to NL, given the evidence we can see all around us – to quote economist Dr. Jack Mintz, “it is absurd that a province with double-digit unemployment, a shrinking population and GDP, and below average per capita personal income be considered a “have” province. What is worse is that Ottawa has approved the same equalization formula for five more years, when it is clear these trends will not reverse themselves”.

To put this fairness question in another context, the other three maritime provinces receive approximately 35% of their provincial income from the federal government, in the form of equalization and other transfers. NL receives approximately 17% of its income in this manner. Is the economy of Nova Scotia so much worse than NL’s, that it receives these transfers while NL does not? Right now, Quebec, a province so prosperous that it is running a budget surplus, receives \$13 billion from the equalization fund, while NL, teetering on the edge of oblivion, receives not a cent. How is this fair?

In addition, there is a strong **Precedent** for this intervention.

In 1993 the Province of Saskatchewan came within days of defaulting, when it was unable to arrange further loans on its debt of \$15 billion dollars. The Bank of Canada and the federal government became concerned that such a default would weaken the entire Canadian financial system. Although it was kept secret at the time, in a 1997 Globe and Mail article, former premier Roy Romanov revealed that the federal government had made emergency transfers to Saskatchewan, to help it make its debt payments. That province was subsequently able to find the breathing room to right-size its finances, something we desperately need here in NL right now.

Finally, we believe that Ottawa has a **Historic Obligation** to come to NL’s aid.

In the mid-1960s NL was desperately trying to develop the Churchill Falls basin. It was already well known throughout Canada that this resource had tremendous hydro potential. The government of NL knew how valuable this dam could be but lacked an essential piece of the development puzzle – a transmission corridor through the province of Quebec. Jean LaSage, the Premier of Quebec made it clear that any power produced in Labrador would never see a market anywhere unless it was first sold to what was soon to become Hydro Quebec. Smallwood

and the men around him knew the difference and knew without that power corridor that Labrador power would never make the province any money, as did the government of Liberal Lester Pearson.

But the federal government made a very clear choice – the political stability of Quebec and Canada was more important than the financial future of Newfoundland and Labrador. And the outcome of that choice was to ignore the provisions of the BNA Act, and ignore the fairness of Newfoundland's cause. With no other options, Brinco made a deal that sold NL's greatest resource away for a song. As power prices soared in the 1970s, the deal became worse and worse, until it became a national shame that endures even today, two generations later.

The federal government was silent while the people of Newfoundland were fleeced.

It is time for the Government of Canada to right that wrong, to step up and help fix this mess, to finally pay the people of NL what they were due.

What Happens Next – the Nuclear Option

If the federal government does not step up and help, then NL and Labrador must pursue the so-called **Nuclear Option**.

Really, if we have the courage, NL does not have to negotiate electricity rates at all. All it has to do is to not pay interest on the \$8 billion in Muskrat Falls debt when it comes due .

Ottawa has guaranteed the principal and interest on this debt, and if NL doesn't make any interest payments, then Ottawa has 5 days to pay the interest. The province can walk away and force the federal government to make good on the payments of this debt.

This would leave the Government of Canada to refinance that debt on their own terms. This would significantly reduce our own payments and give us a fighting chance to maintain our fiscal stability.

Will this make us popular in Ottawa? No.

But I ask you all, honestly, what difference would it make? Yesterday, in his letter to Premier Ball, announcing measures about which we are not quite entirely sure, the federal finance minister Bill Morneau made his perspective very clear:

“As this proceeds, it is important to remember these are provincial Projects, in provincial jurisdiction, and the Province bears responsibility to ensure they are delivered economically.”

We cannot accept this conclusion. The federal government must come to Newfoundland and Labrador’s assistance.

There is no other entity that can provide the level of support this province needs now.

With a rapidly aging population and a struggling economy, does anyone in this room think we can somehow get out of this mess on our own?

Does anyone think Equinor is going to discover a vast new oilfield off Middle Cove, one that is somehow going to deliver billions to the provincial coffers?

Does anyone believe that oil prices are going to soar again, and that our problems will disappear in a shower of petrol-dollars?

Does anyone think we can cut enough teachers, nurses, hospital beds and wildlife officers to save more than a billion dollars a year?

Does anyone really think our struggling rural communities can survive a doubling of power rates, while austerity and restraint mean they have to gut their already meagre services?

Does anyone think immigrants will be drawn to a province where they will pay ridiculous power rates and wait in endless cues for non-existent public services?

Does anyone think there will be a tree left within 100 kilometres of St. John’s if electricity rates double, and the people of this Island are forced to return to the ways of their ancestors, and burning our forests to keep warm?

Does anyone think our small businesses can somehow absorb huge power increases and tax hikes and still prosper?

And most important of all – with electricity prices soaring and the economy staggering, does anyone in this room think the young people growing up now, the young people who are the hope for our future – do you think they love this place so much that they will spend their lives struggling to stay afloat, limiting their own horizons, crushing their own ambitions, just to spend their careers paying an ill-conceived and terribly managed mega-project? Those of you who are parents – is this what you hope and dream for?

Big problems require big solutions.

And this is why we call for the country we chose to come to our aid. For Canada has a great chance now to help fix this mess, to prove to us once and for all that we made the right choice, that not only did we chose Canada, but that Canada chose us.