



**AUDITOR  
GENERAL**  
of Newfoundland and Labrador

# **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

- ▶ Full Report <https://www.ag.gov.nl.ca/ag/finStatements.htm>
- ▶ 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

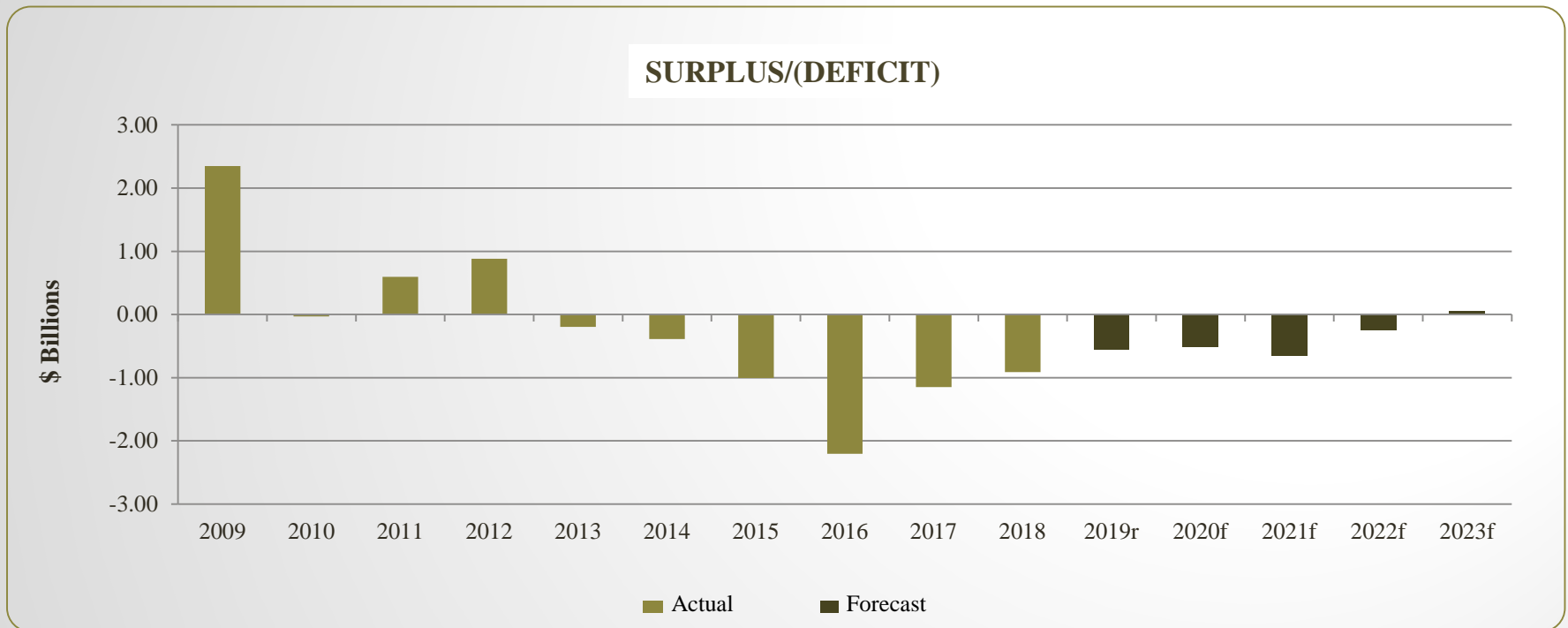
# Indicators of Financial Health

**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

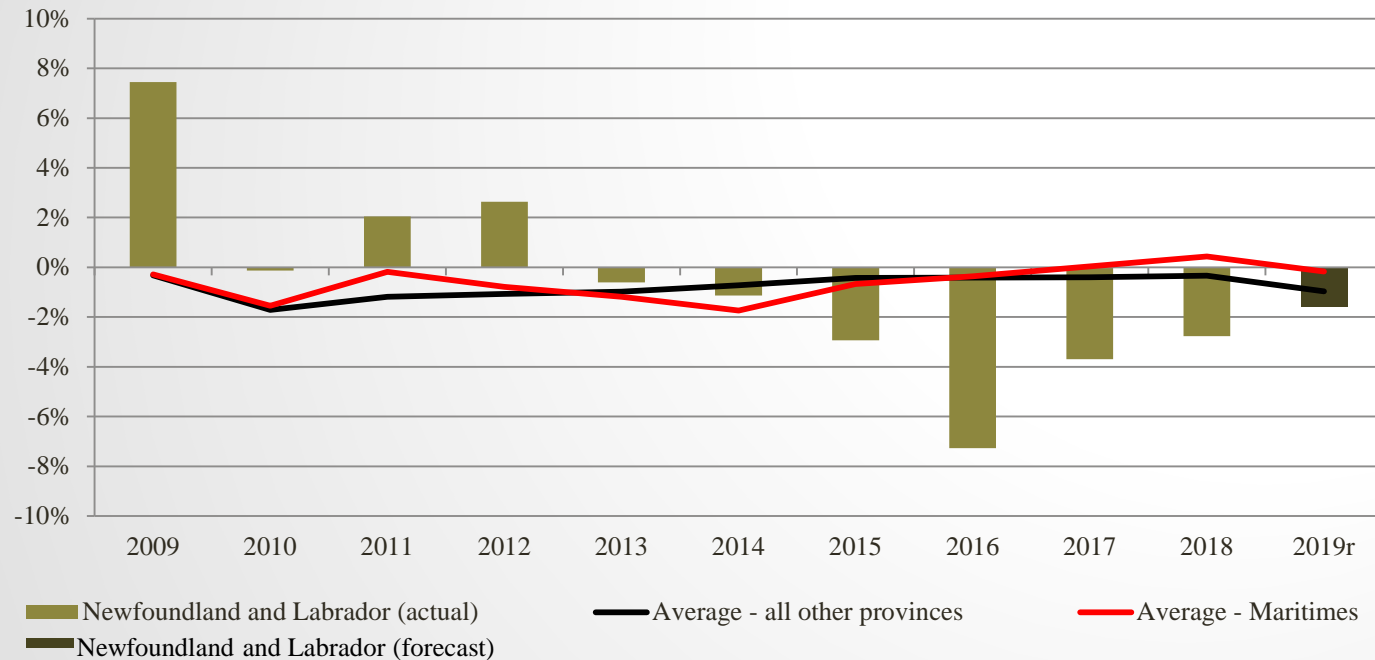
# Sustainability – Annual Surplus/Deficit



Source: Public Accounts (actual); Department of Finance (forecast)

- ▶ 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.

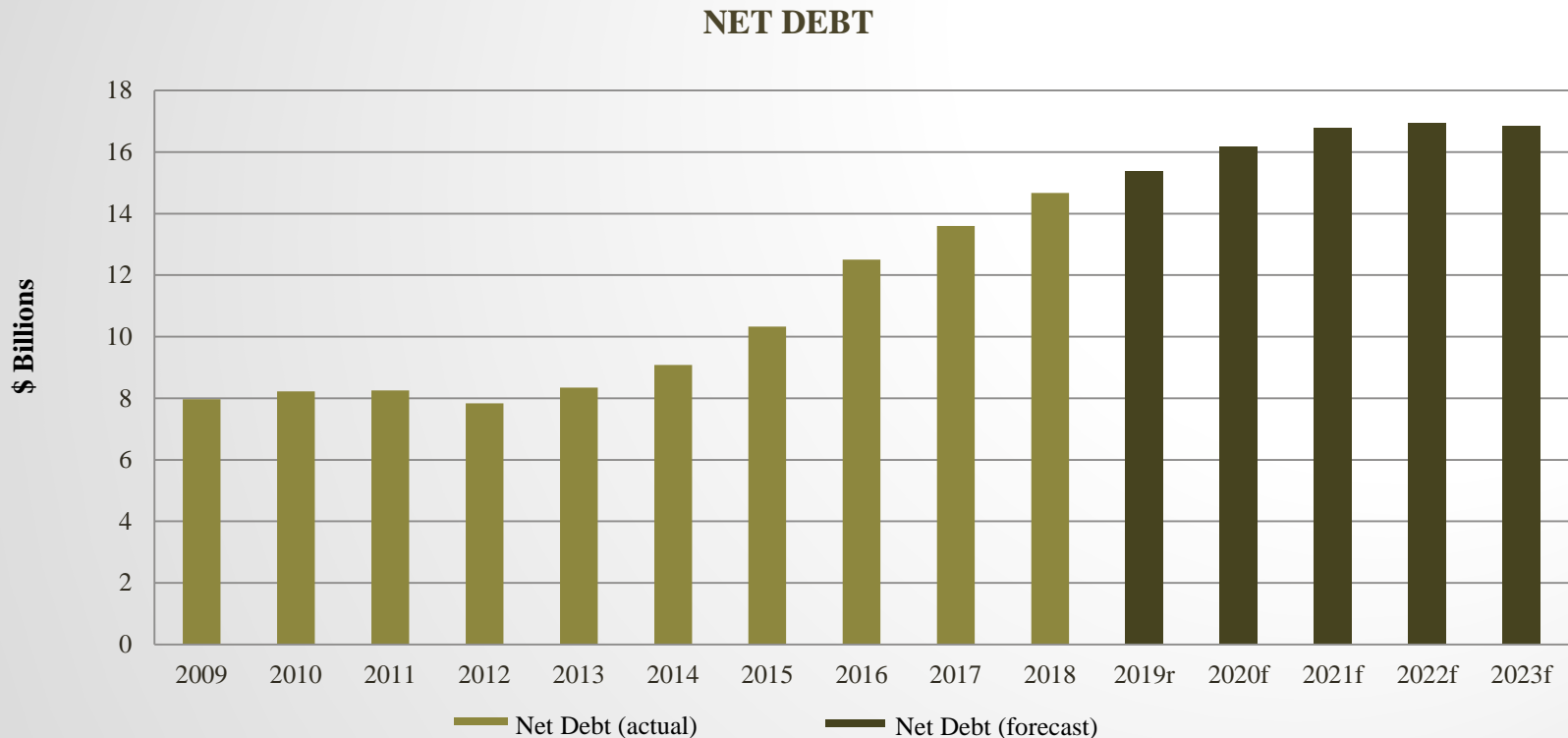
# Sustainability – Deficit as % of GDP



Source: Economic Updates – all provinces; Statistics Canada; Public Accounts – all provinces

- ▶ 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.

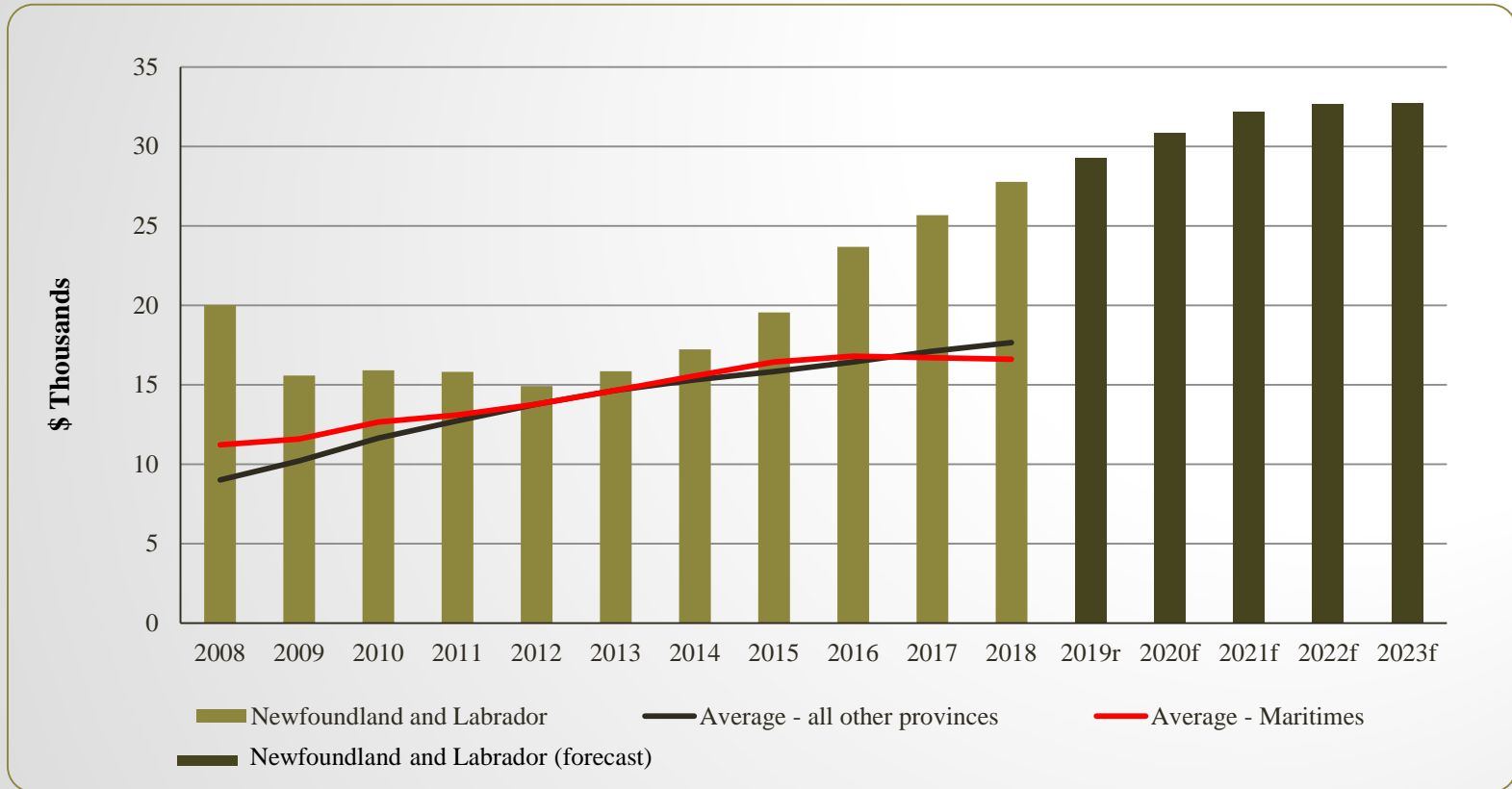
# Sustainability – Net Debt



Source: Public Accounts (actual); Department of Finance (forecast)

- ▶ \$14.7 billion at March 31, 2018 – highest level in the Province's history.
- ▶ Forecast to increase to \$16.8 billion by 2022–23.

# Sustainability – Net Debt per Capita



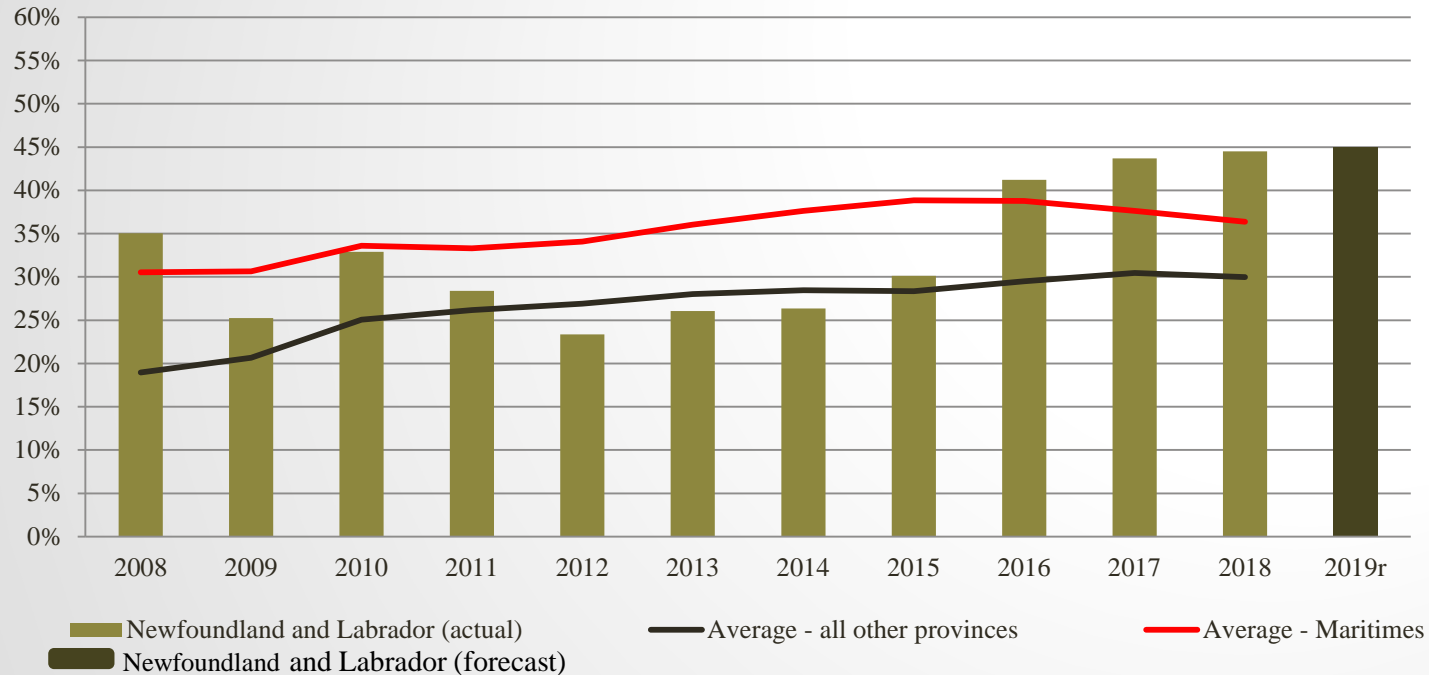
Source: Public Accounts – all provinces; Statistics Canada; Department of Finance (forecast)

- ▶ \$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.



# Sustainability – Net Debt as % of GDP

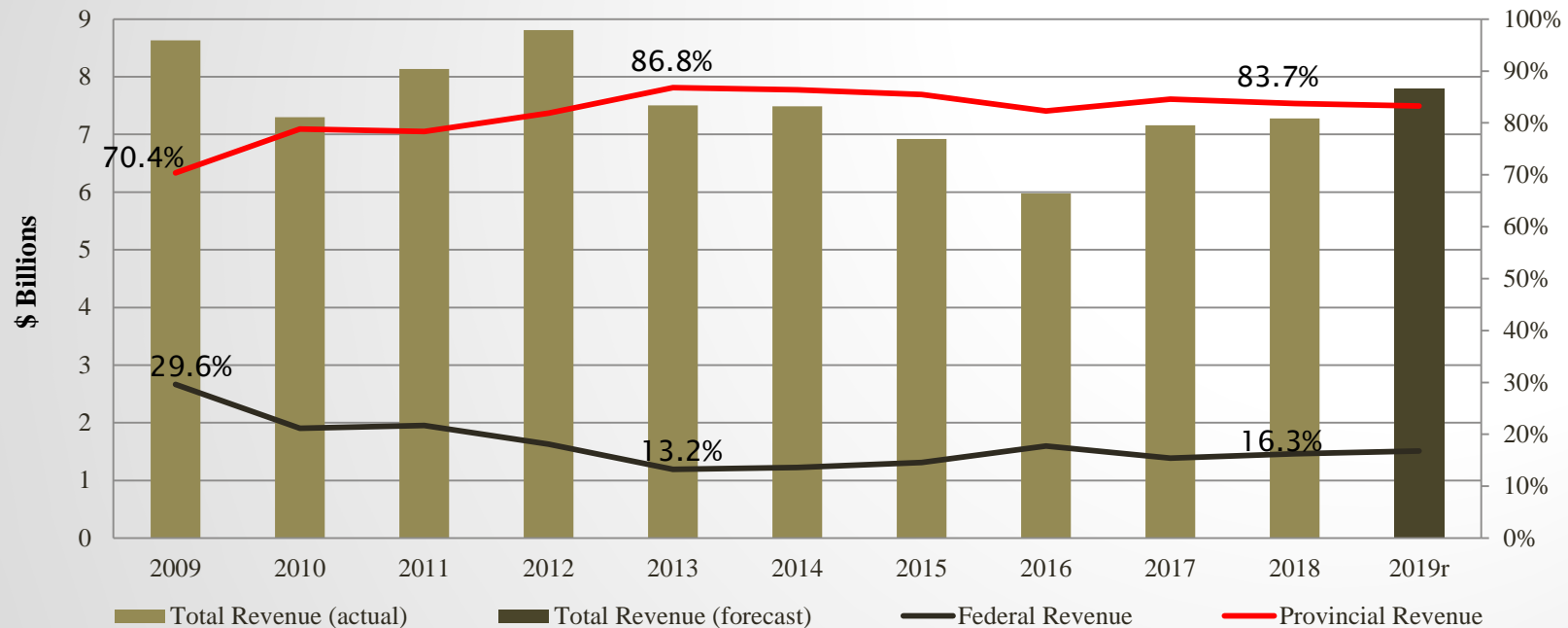
NET DEBT AS A PERCENTAGE OF GDP



Source: Public Accounts – all provinces; Statistics Canada; Economic Updates – all provinces; Department of Finance (forecast)

- ▶ 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.

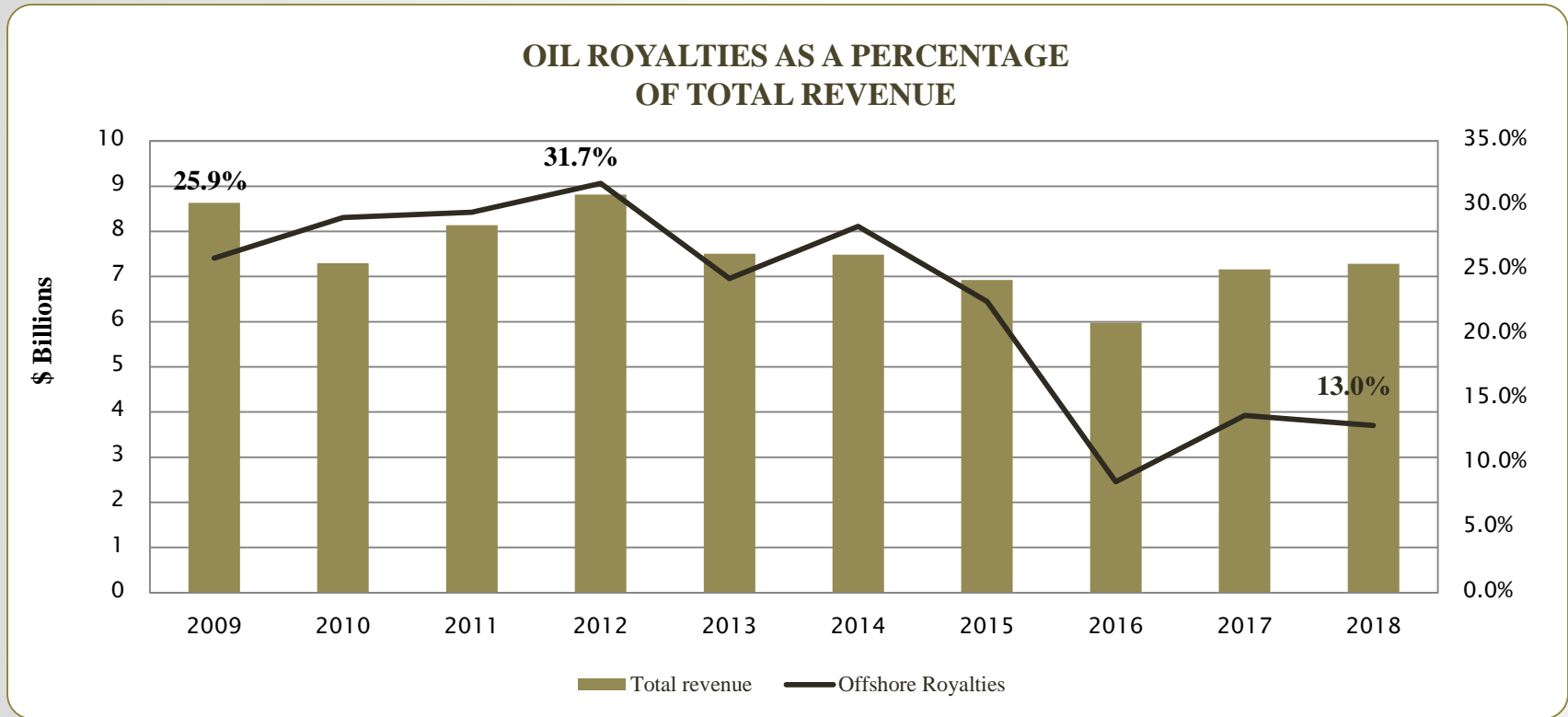
# Vulnerability – Federal Government and Own Source Revenue compared to Total Revenue



Source: Public Accounts (actual); Department of Finance (forecast)

- ▶ 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.

# Vulnerability – Oil royalties as a % of Revenues



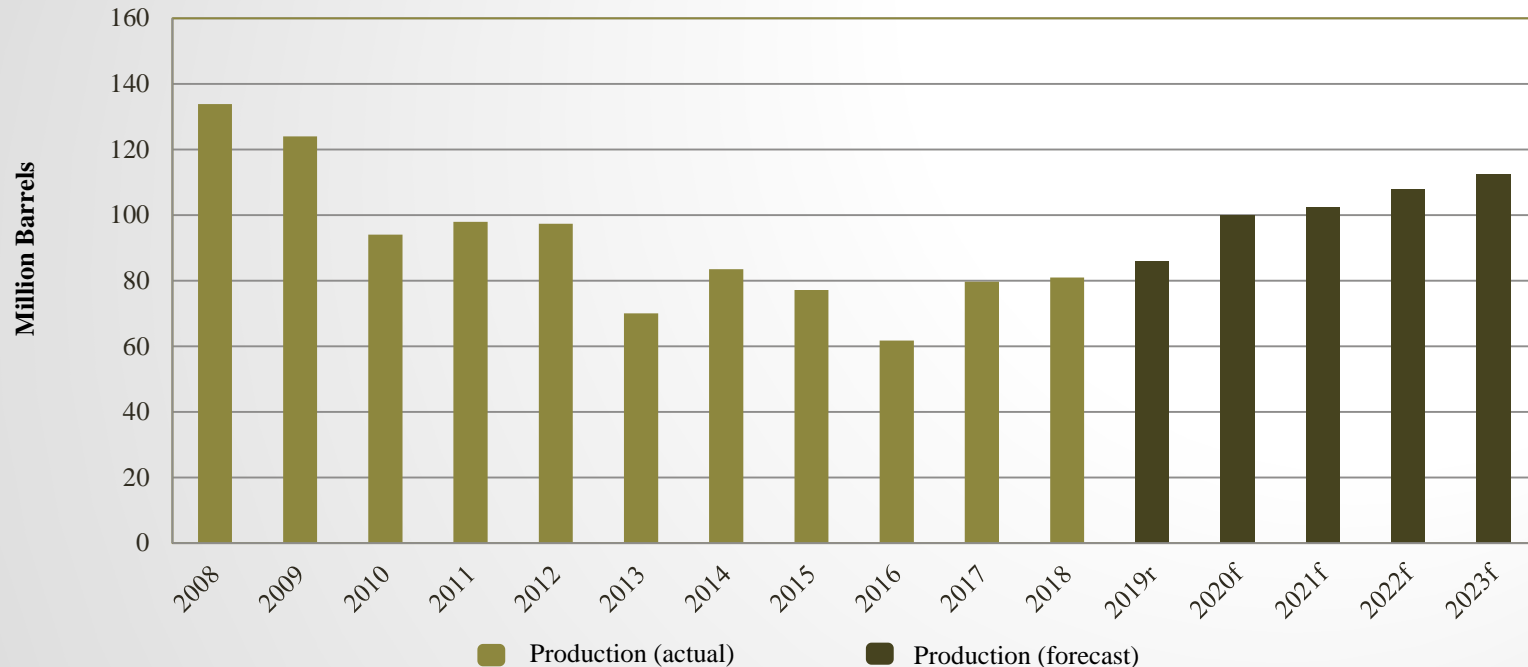
Note: Total revenue includes revenues received under the Atlantic Accord

Source: Public Accounts

- 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.

# Vulnerability – Oil Production

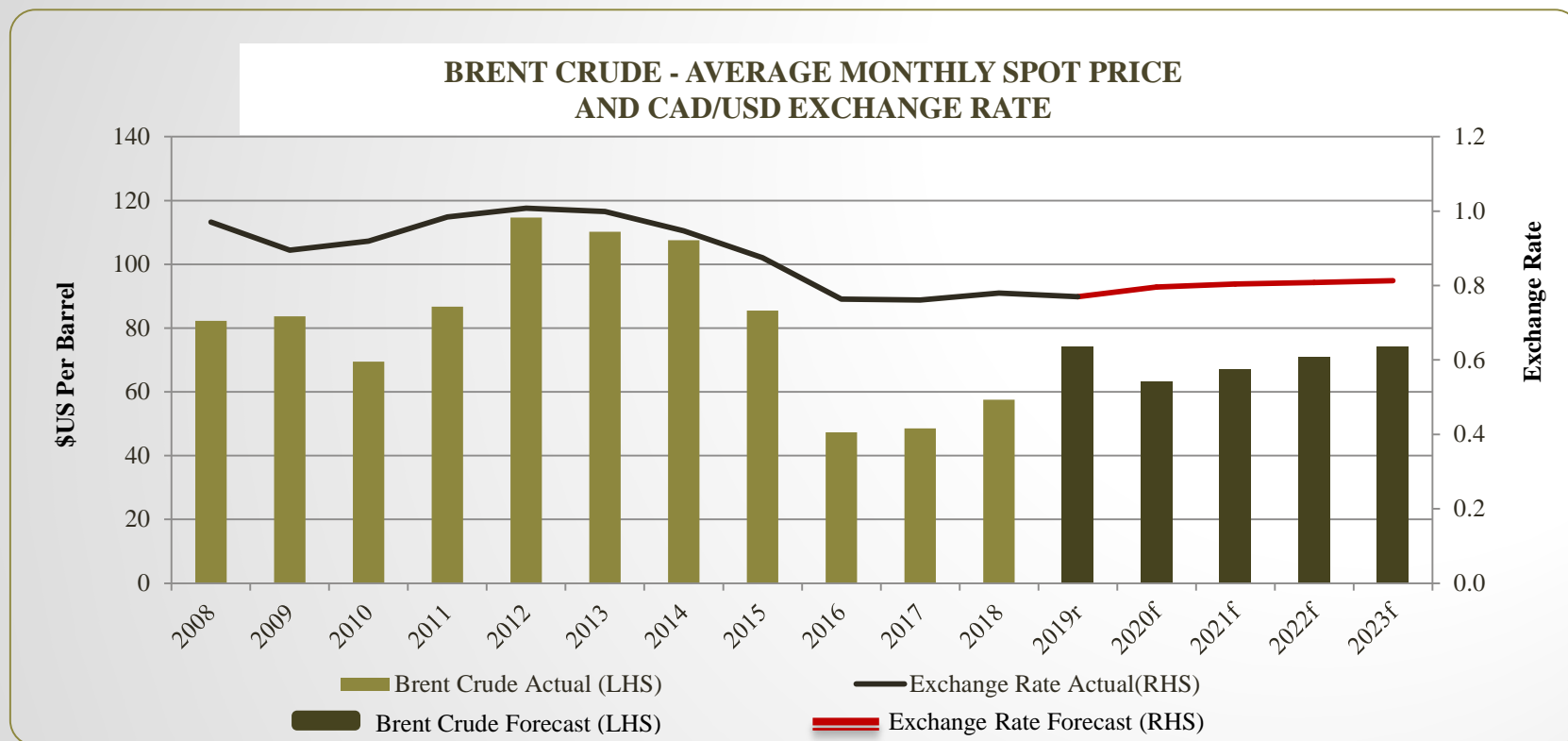
ANNUAL OIL PRODUCTION



Source: Canada-Newfoundland and Labrador Offshore Petroleum Board (Actual)  
Department of Finance (forecasted)

- ▶ 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.

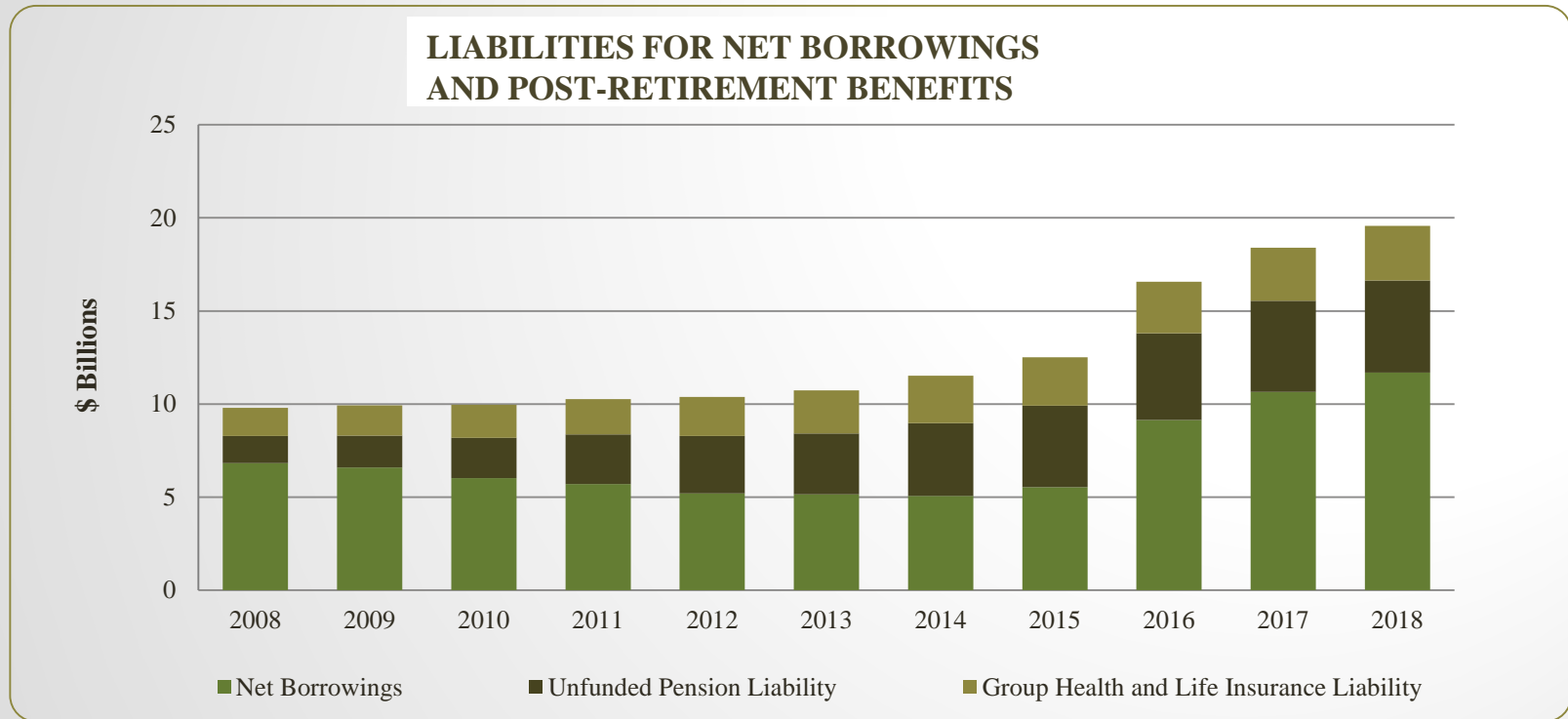
# Vulnerability – Oil Price and Exchange Rate



Source: US Department of Energy – Energy Information Administration (Brent Crude price)  
 Bank of Canada – (Canada-US Exchange Rate)  
 Department of Finance (forecasted information)

- ▶ 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).

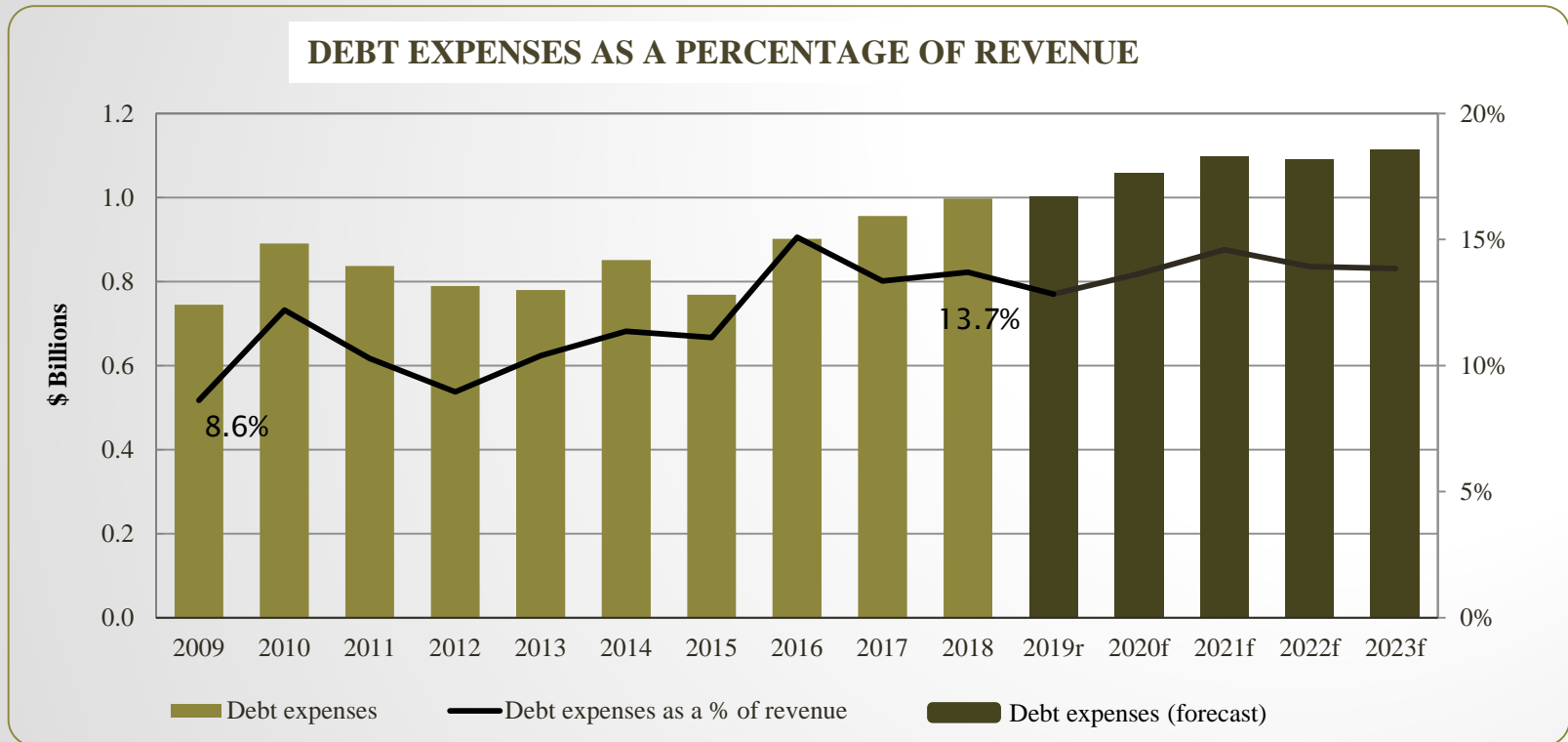
# Flexibility – Net Borrowings and Post-Retirement Benefits



Source: Public Accounts

- 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).

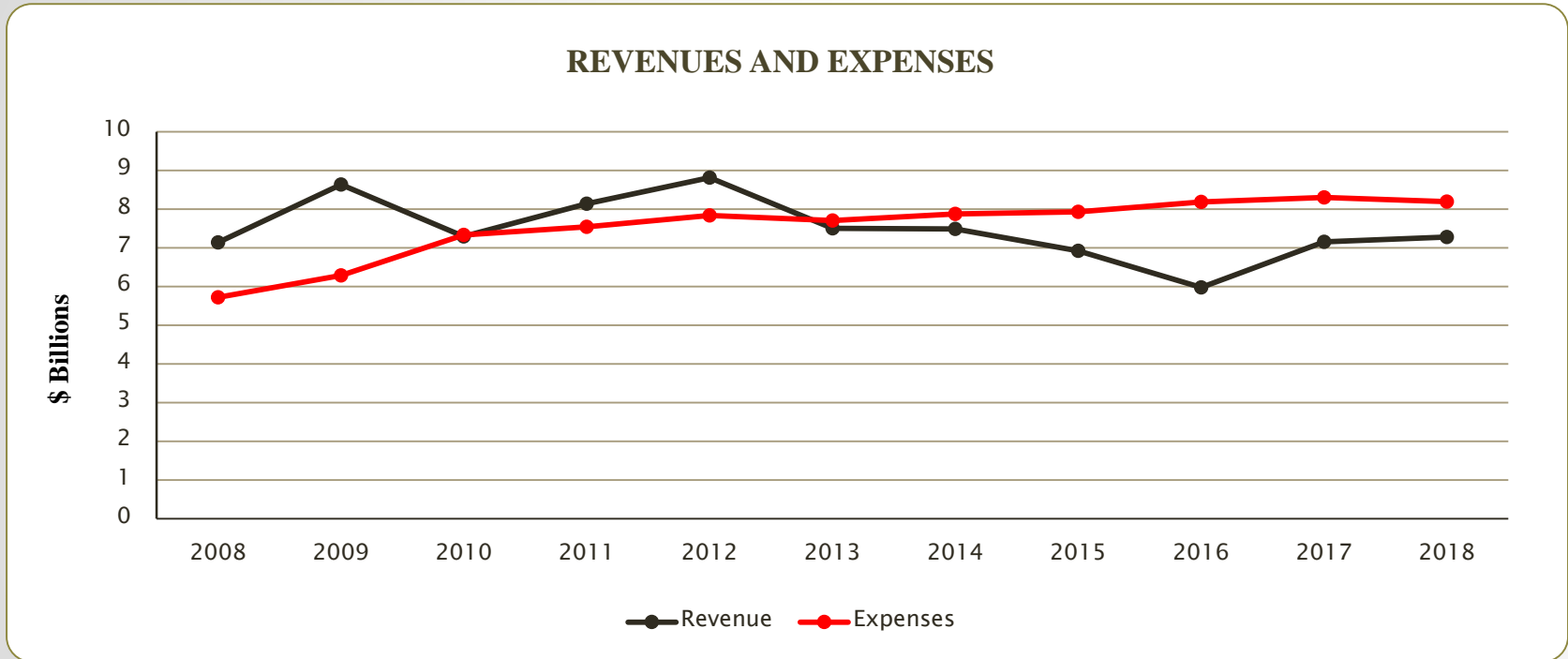
# Flexibility – Debt expenses as % of Revenues



Source: Public Accounts (actual); Department of Finance (forecast)

- ▶ 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.

# Revenues and Expenses



Source: Public Accounts

- ▶ 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.



# Changes in Revenue Categories

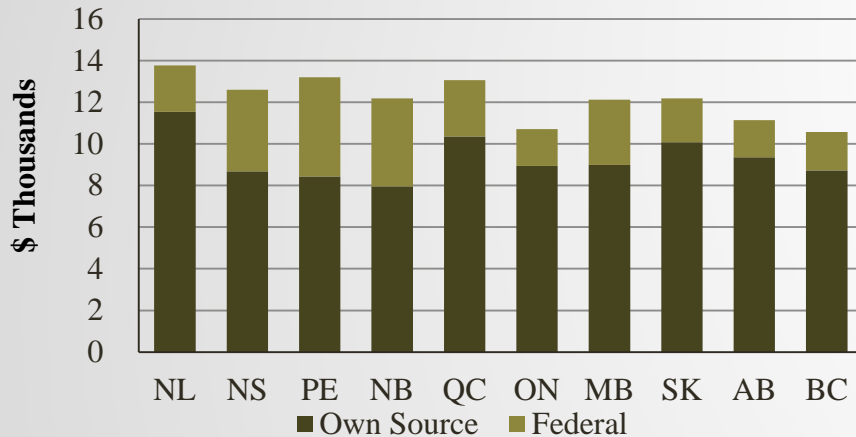
| 10-Year/5-Year Trend of Change in Total Revenue (\$Millions) |                 |                 |                 |                             |            |                              |           |
|--|-----------------|-----------------|-----------------|-----------------------------|------------|------------------------------|-----------|
| Revenue Category   | 2007-08         | 2012-13         | 2017-18         | 5-Year Trend<br>(2013-2018) |            | 10-Year Trend<br>(2008-2018) |           |
|  |                 |                 |                 | Amount                      | %          | Amount                       | %         |
| Oil Royalties  | \$ 1,754        | \$ 1,828        | \$ 944          | \$ (884)                    | -48%       | \$ (810)                     | -46%      |
| Personal Income Tax  | 804             | 1,159           | 1,473           | 314                         | 27%        | 669                          | 83%       |
| Corporate Income Tax   | 484             | 767             | 302             | (465)                       | -61%       | (182)                        | -38%      |
| HST and Other Taxes  | 1,333           | 1,596           | 1,992           | 396                         | 25%        | 659                          | 49%       |
| Other Revenues   | 978             | 1,163           | 1,385           | 222                         | 19%        | 407                          | 42%       |
| Federal Transfers  | 1,788           | 992             | 1,184           | 192                         | 19%        | (604)                        | -34%      |
| <b>Total Revenues</b>  | <b>\$ 7,141</b> | <b>\$ 7,505</b> | <b>\$ 7,280</b> | <b>\$ (225)</b>             | <b>-3%</b> | <b>\$ 139</b>                | <b>2%</b> |

Source: Public Accounts

- ▶ 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.

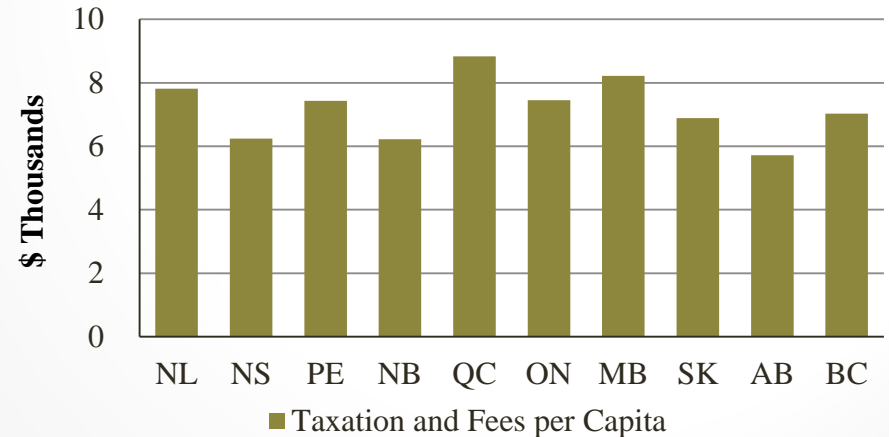
# Per Capita Revenue/Taxes and Fees

**PER CAPITA REVENUE: 2017-18**



Source: Public Accounts – all provinces; Statistics Canada

**PER CAPITA TAXES AND FEES: 2017-18**



Source: Public Accounts – all provinces; Statistics Canada

- ▶ 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.

# Changes in Expense by Department/Sector

| 5-Year Trend of Change in Total Expenses (\$Millions) |                 |                 |               |            |
|---|-----------------|-----------------|---------------|------------|
| Expense by Department or Sector                       | 2012-13         | 2017-18         | 5-Year Trend  |            |
|   |                 |                 | Amount        | %          |
| Health and Community Services                         | \$ 2,832        | \$ 3,172        | \$ 340        | <b>12%</b> |
| Advanced Education, Skills and Labour                 | 1,144           | 1,161           | 17            | 1%         |
| Education and Early Childhood Development             | 758             | 797             | 39            | 5%         |
| General Government Sector and Legislative Branch      | 1,123           | 947             | (176)         | -16%       |
| Resource Sector - Other                               | 364             | 314             | (50)          | -14%       |
| Social Sector - Other                                 | 700             | 802             | 102           | <b>15%</b> |
| <b>Total Program Expenses</b>                         | <b>6,921</b>    | <b>7,193</b>    | <b>272</b>    | <b>4%</b>  |
| Debt expenses   | 780             | 998             | 218           | <b>28%</b> |
| <b>Total Expenses</b>                                 | <b>\$ 7,701</b> | <b>\$ 8,191</b> | <b>\$ 490</b> | <b>6%</b>  |

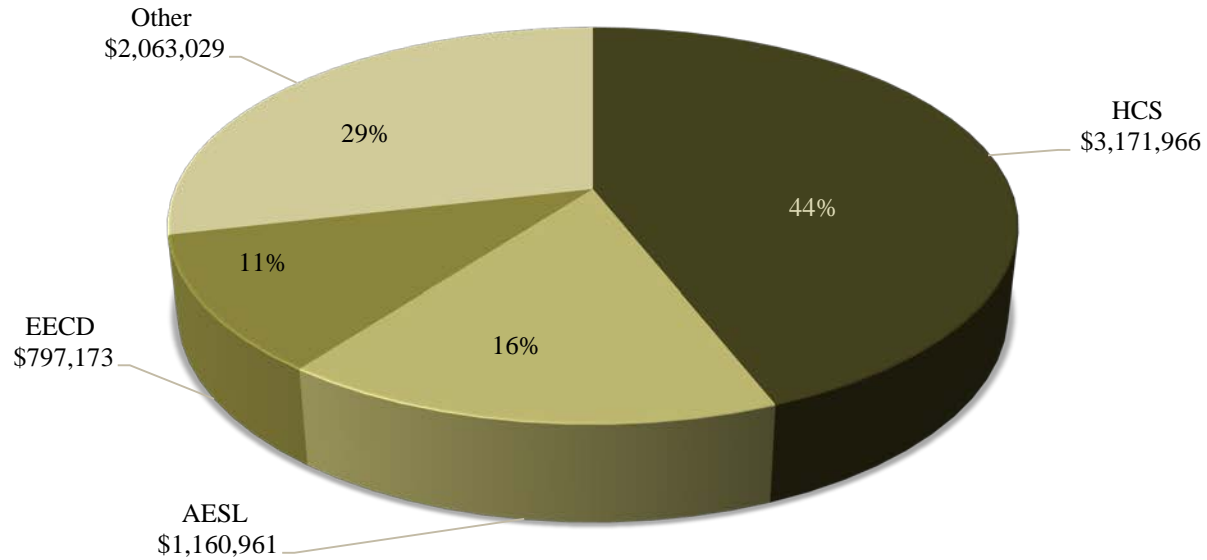
Source: Public Accounts

Note 1: Unlike revenue, due to structuring of departments, comparative 10-year expenses by department or sector information was not readily available.

- ▶ 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.

# Program Expense by Department: 2017-18

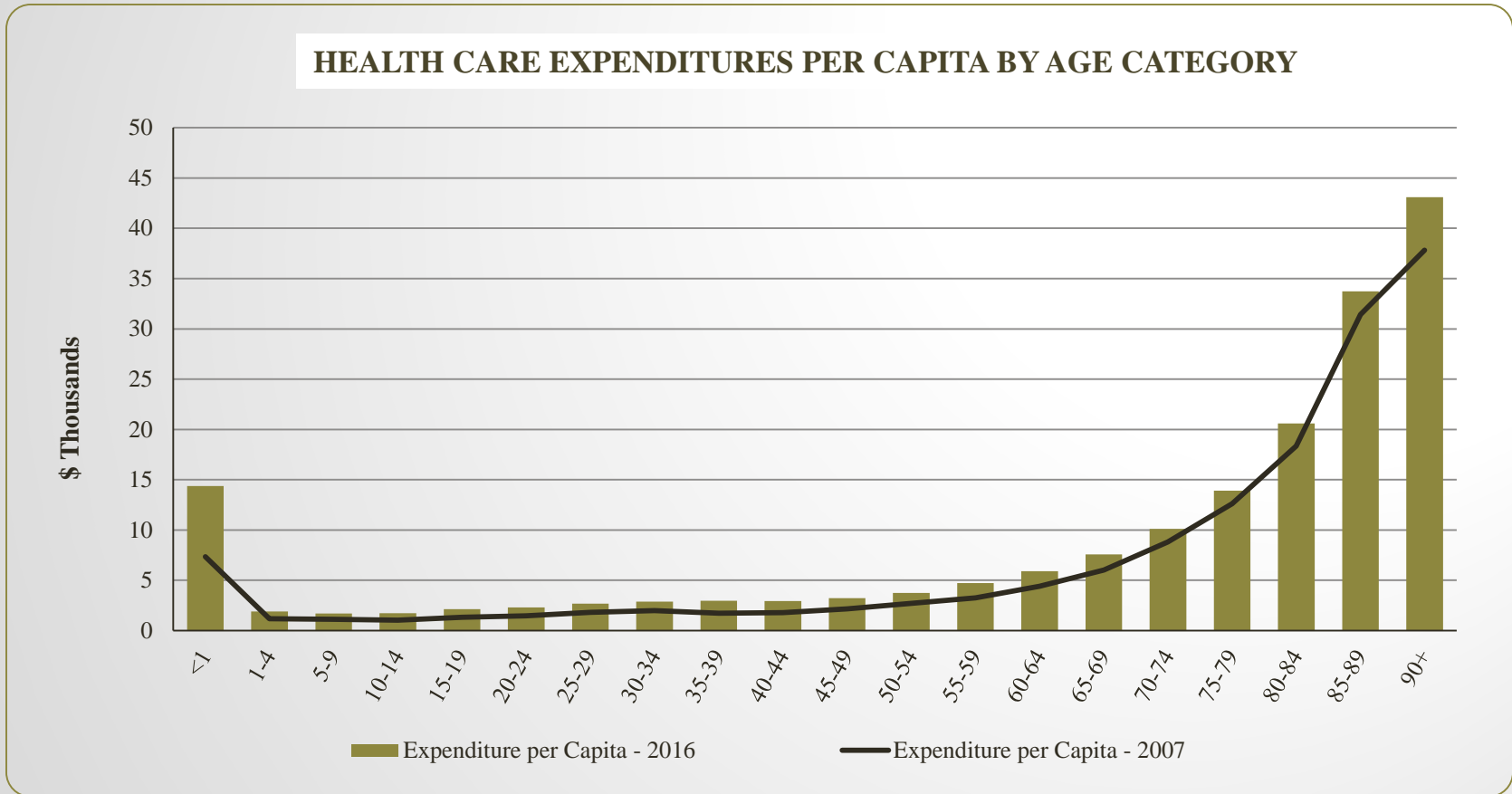
PROGRAM EXPENSES BY DEPARTMENT: 2017-18 (\$000s)



Source: Public Accounts

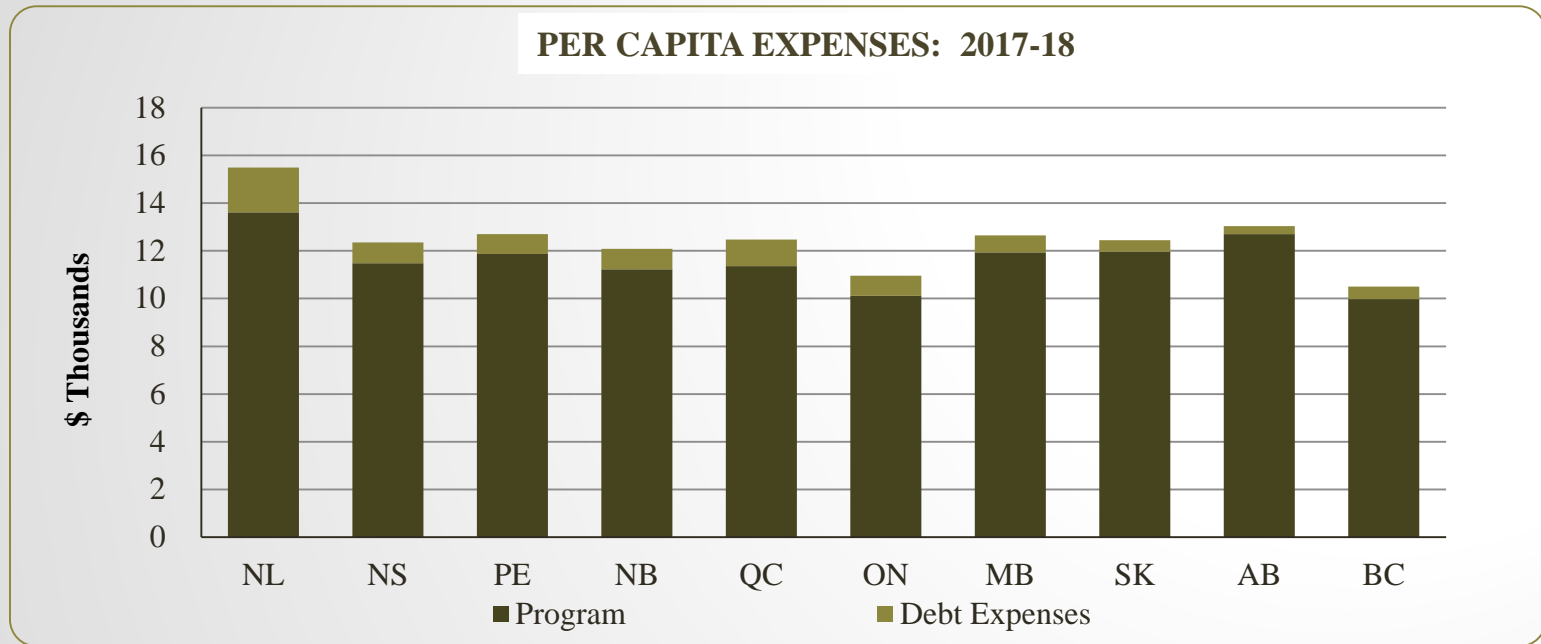
- Significant portion of expenses related to health care and education.

# Health Care Expenditures – Per Capita by Age



Source: National Health Expenditure Database, Canadian Institute for Health Information

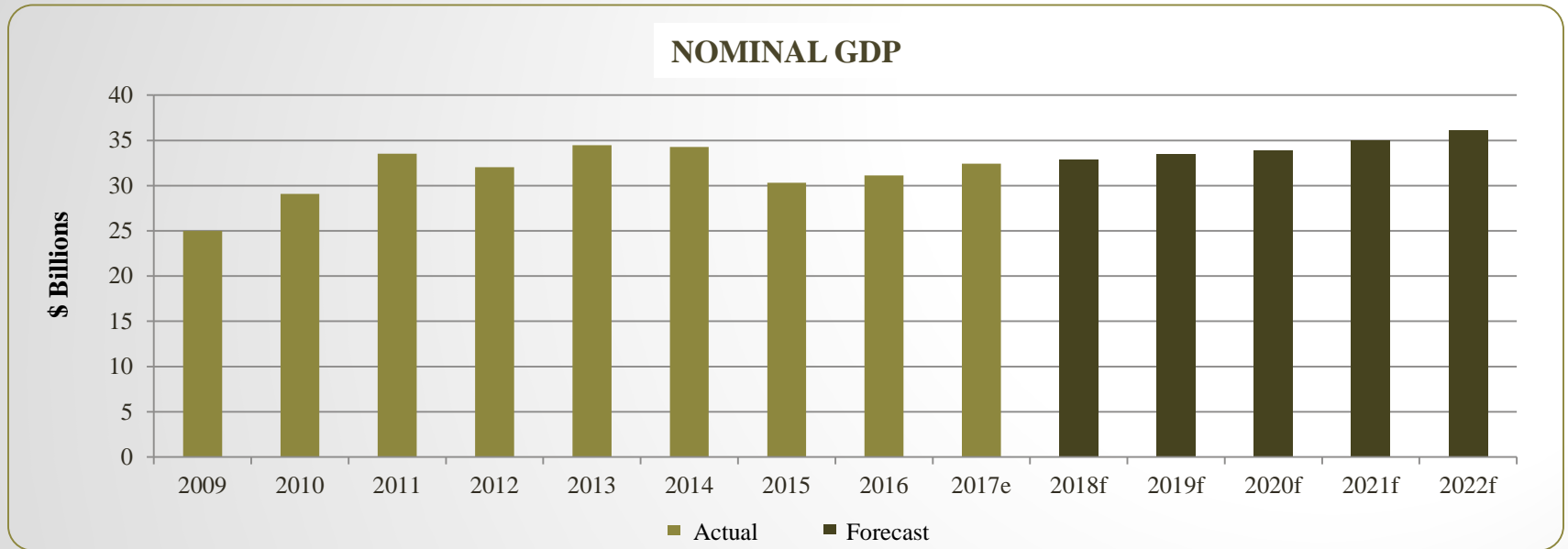
# Per Capita Expenses



Source: Public Accounts – all provinces; Statistics Canada

- ▶ 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.

# Economic Outlook – GDP

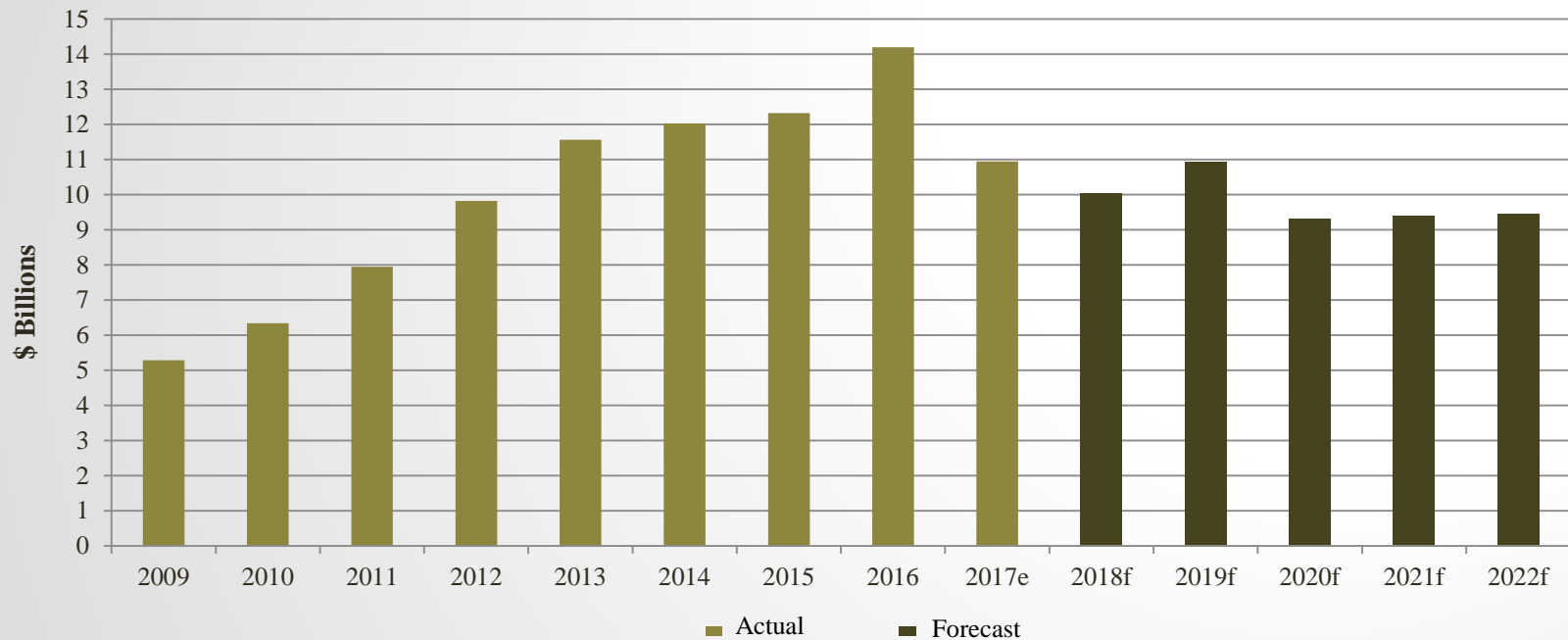


Source: Department of Finance

- ▶ 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.

# Economic Outlook – Capital Investment

CAPITAL INVESTMENT



Source: Department of Finance

- ▶ 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.



# Economic Outlook – Employment

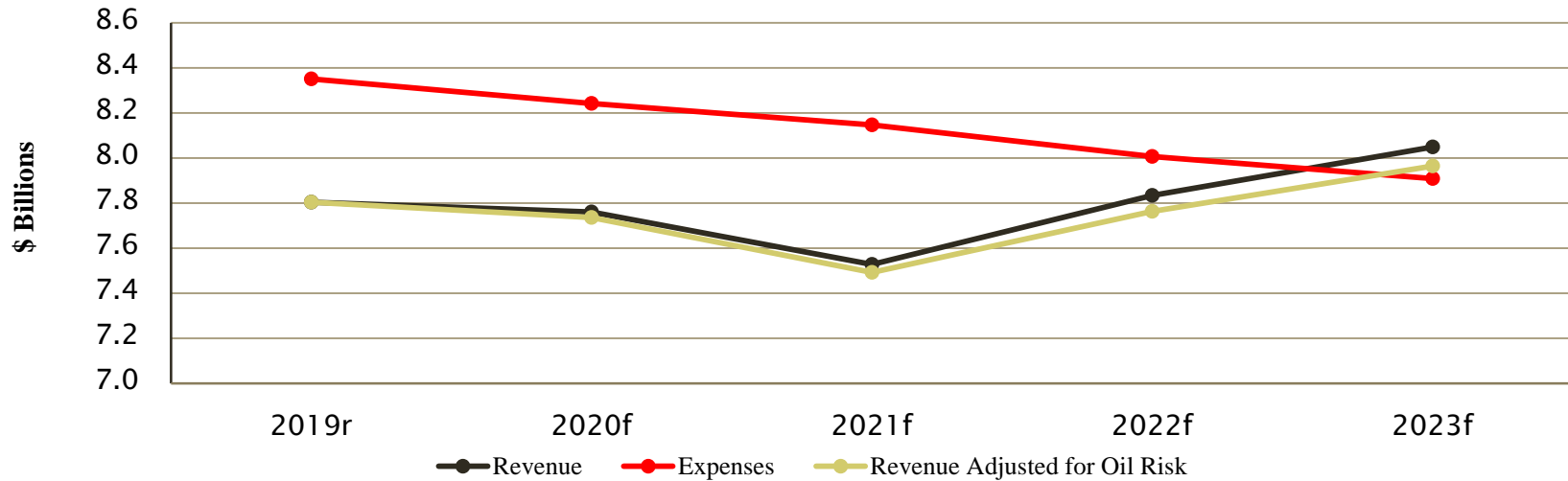


Source: Department of Finance

- ▶ 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).

# Fiscal Outlook – 2019 to 2023

FORECAST REVENUE AND EXPENSE



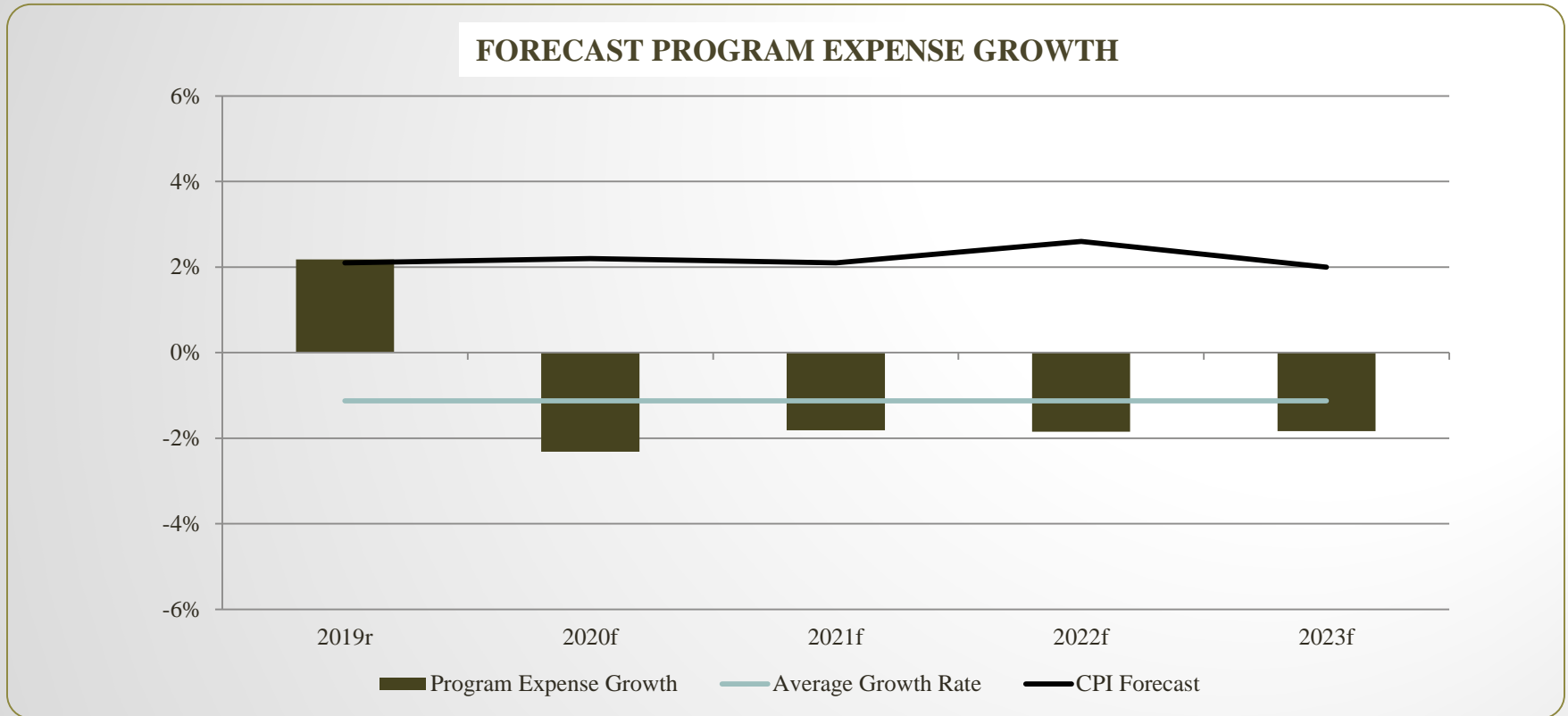
Source: Department of Finance

- ▶ 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.

# Fiscal Outlook – Key Risks to Expense Forecast



Source: Department of Finance

- ▶ 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?