# NL's Fiscal Crisis:

**Harris Centre**

Presentation

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# OPENING REMARKS

- Overview of the Province’s fiscal position
- How this developed
- A basic fiscal framework
- A new tax as part of the framework

# Where We Are

- The provincial government budgetary deficit for 2015/16 is huge: approx. $2 billion.

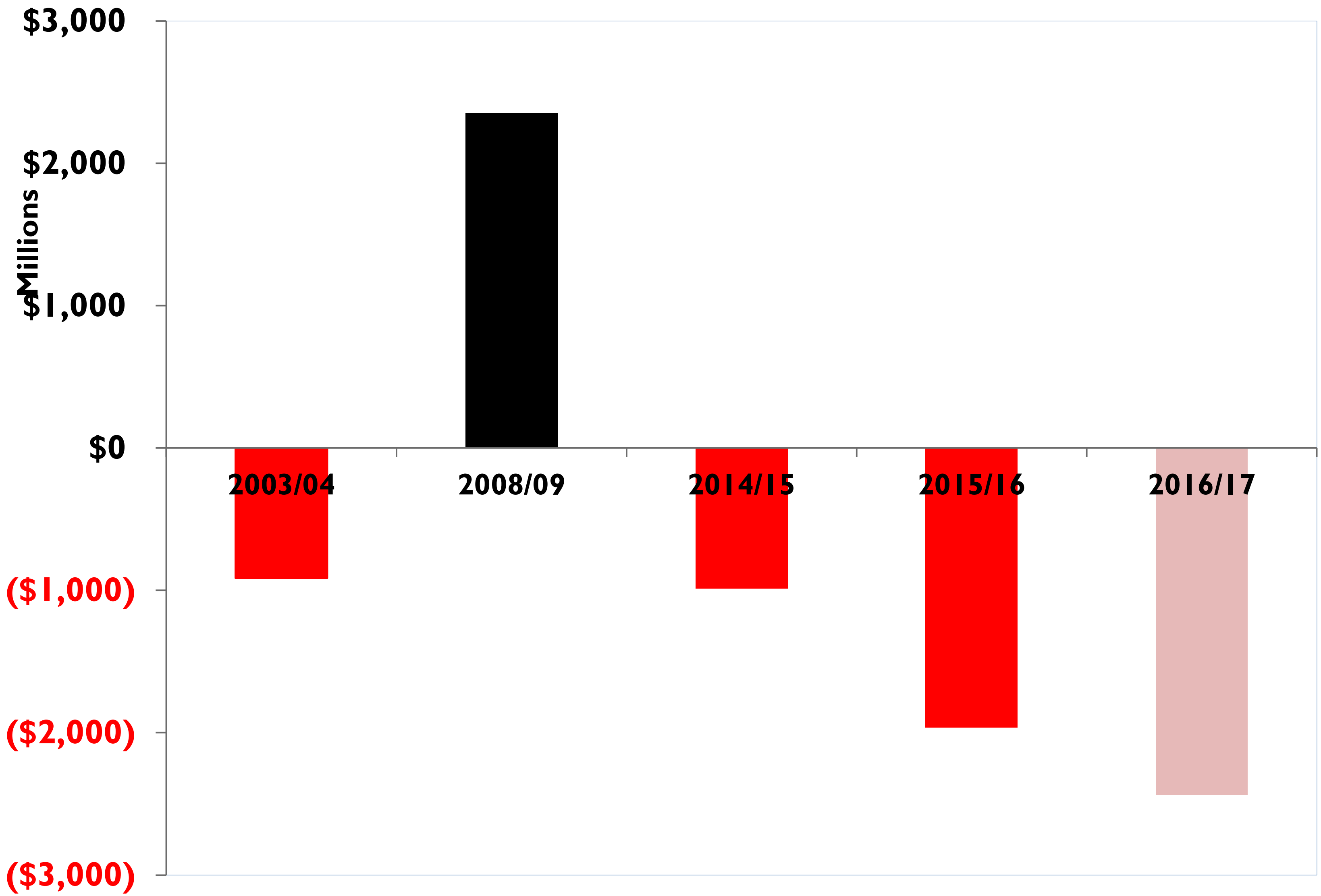
- Without a change in taxation and spending (or luck!), deficits are expected to persist and be large or larger.

- The Auditor General says such deficits not unsustainable (CBC Jan.29, 2016)

# Surpluses and Deficits: Some Records

- 2003/04 a record deficit.
- After 2004, oil-boom and revenue surge
- 2008/09 a record surplus: almost $2.4b
- Decline to deficit by 2012/13
- Then record deficits

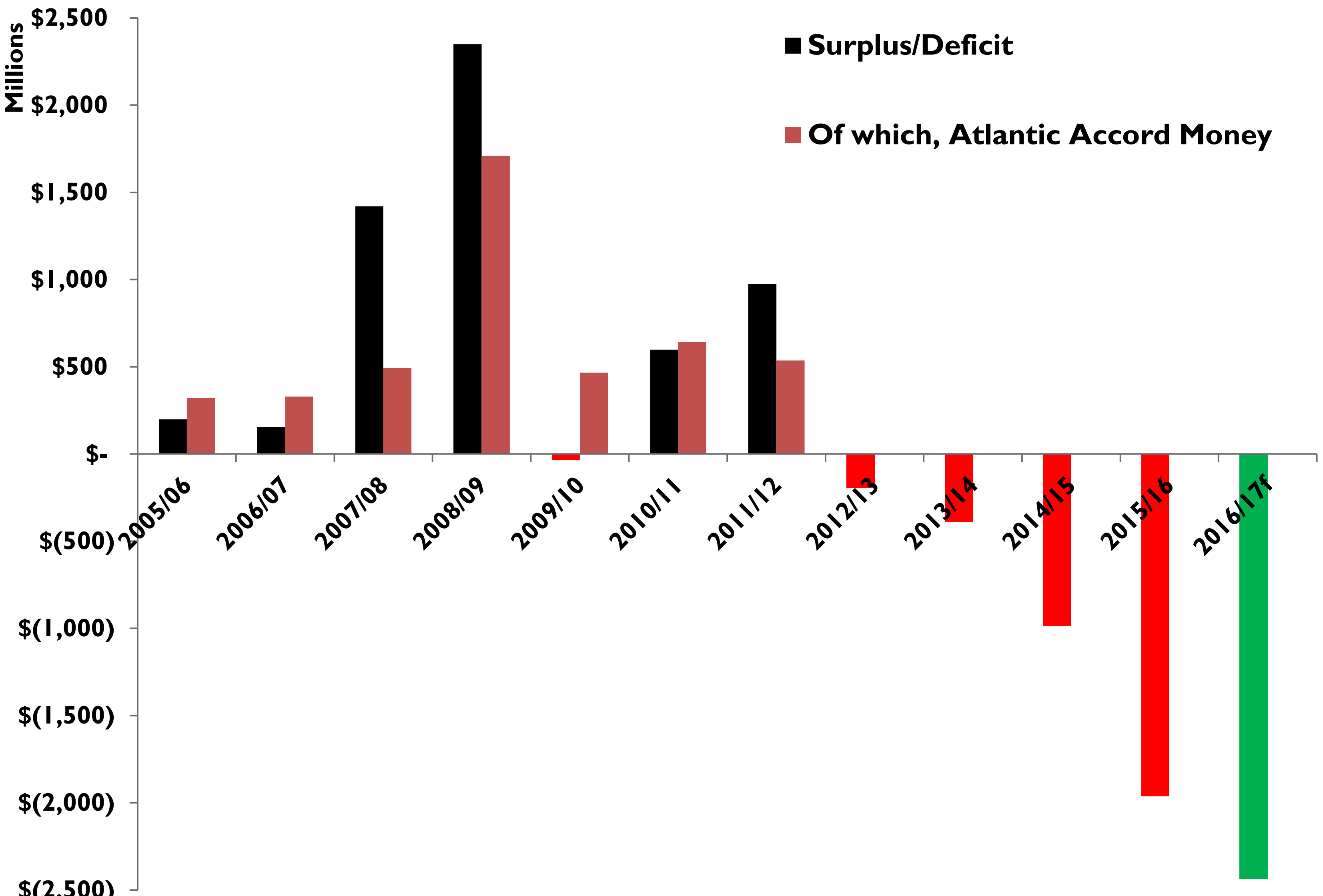
# The Record Surplus and Deficits



# How We Got Here

- **End of Equalization from Ottawa-2007/08**
- **Increased Spending since 2007**
- **Major tax reductions:  2007- 2014**
- **End of Atlantic Accord Money in 2011/12**
- **Oil & commodity prices fell; oil in late 2014**

# Surpluses and Atlantic Accord Money

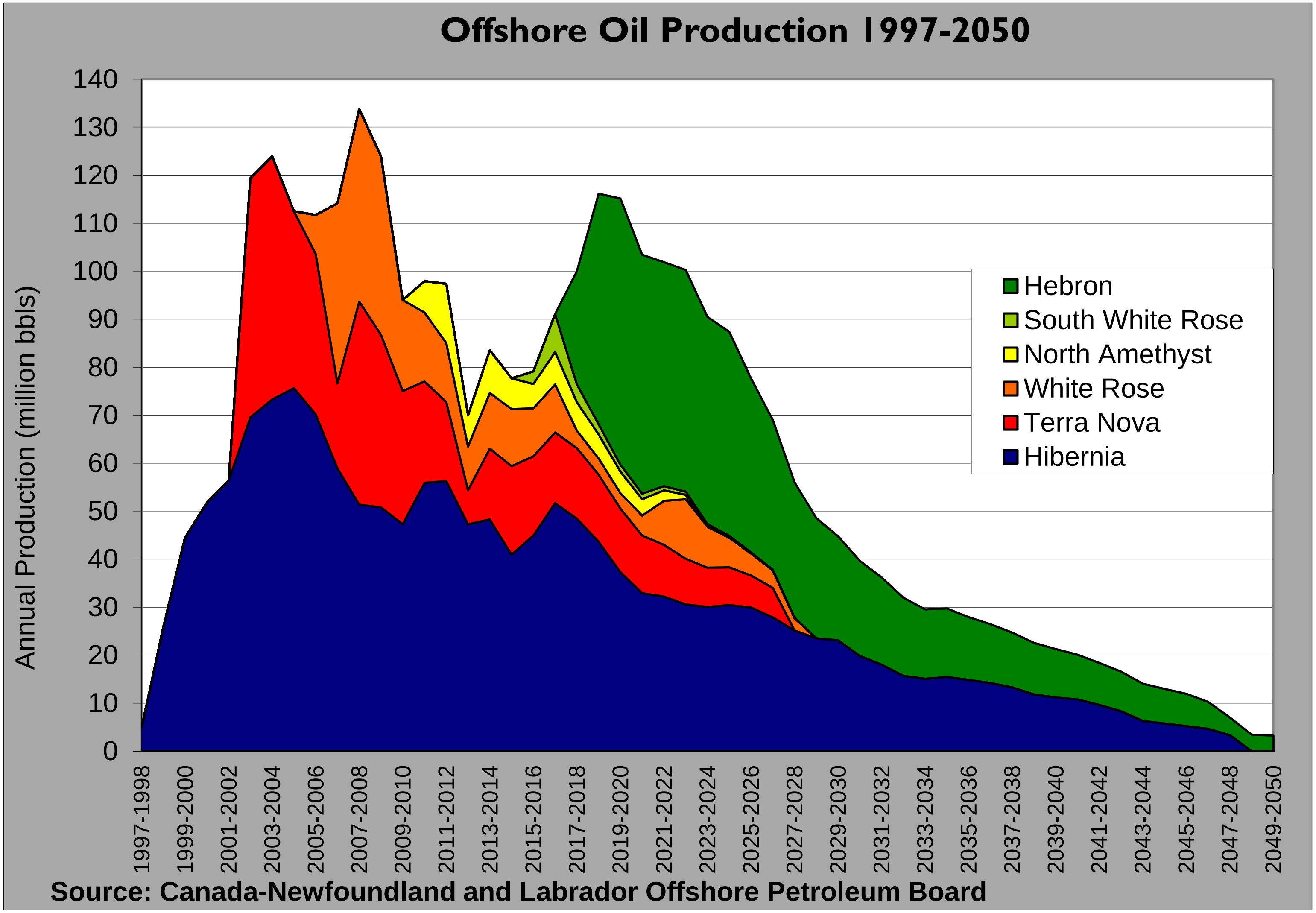


# Borrowing Exceeds the Deficit

| | Deficit | Borrowing |
|---|---|---|
| 2015/16 update | $2.0 billion | $2.4 billion |
| 2016/17 forecast | $2.4 billion | $3.7 billion |
| 2017/18 forecast | $2.0 billion | $3.0 billion |
| 2018/19 forecast | $1.9 billion | $2.5 billion |
| 2019/20 forecast | $1.9 billion | $1.8 billion |
| 2020/21 forecast | $2.0 billion | $2.0 billion |

# Meeting the Fiscal Challenge - I

- Future oil may be substantial…..



# Oil Over-reliance

- But oil cannot be counted on now.
- It's unpredictable….high risk.
- If oil goes back up to $80+, it can go back down.
- Oil is a substantial source of revenue and provides business and employment opportunities but it's not enough alone.
- A new framework is needed for the long-term: e.g., retain revenue in excess of a 5 or 10 year moving average of the oil price.
- NOW. The immediate challenge must be addressed.

# Meeting the Fiscal Challenge - II

## A Basic Framework

1. The Budget Deficit

2. Spending

3. Revenue

# I. The Budget Deficit

- Neither feasible nor desirable to bring it to balance in the next few years – barring a major oil recovery
- It must be substantially reduced. Otherwise,
  - Per capita debt forecast 2016/17: $28,600 (highest)
  - Net Debt as percentage of GDP: 43.5% (2nd highest)
  - Nalcor debt complications:
- A feasible deficit limit should be adopted
  - credit rating, priorities, future equalization
- Revenues and spending be adjusted to do no worse than that limit.

# 2. Spending

**Provincial Program Spending per capita in NL is highest among the provinces:**

**($13,700 in 2015/16, $11,700 in Alta. , $12,300 in SK, and less elsewhere)**

**Immediate actions on spending:**

- **Grants and subsidies – reductions/freezes for public institutions and private sector.**
- **Some programs.**

**Near Medium Term**

- **Review programs.**

# 3. Revenue

Action on revenues can be taken more quickly.

There are relatively few major own-revenue sources.

Revenue increases should be an immediate priority

## A Basic Principle

- Increase revenues from sources with the least collateral damage or, where possible, with some beneficial side effects.
- Minimize Excess Burden – damage in excess of the revenue raised.

# Revenue Sources to Consider

**1.Gasoline/Diesel Tax –Motive Fuel Taxes**

- **16.5 cents/litre ($185 million) at present**
- **Demand for gasoline is quite price-inelastic**
- **An increase of 10-15 cents would return people to previous prices and yield proportionate revenue gain.**
- **A small positive side effect – ghg impact**

# 2. Corporate Income Tax

## Rates:

| | | |
|---|---|---|
| General | 14% | (relatively high) |
| Manuf&Processing | 5% | (the lowest) |
| Small Business | 3% | (low, recently cut) |

## Economics:

- Different rates distort investment, which damages the economy
- Small Business rate (on first $0.5 million) also benefits very high income people.

## Immediate Action

- Eliminate M&P credit
- Raise the Small Business rate back to 4%

## Near Medium Term

- Review Edge & special credits; keep only the most effective

## Medium Term

- Consider reduction in the general rate

# 3. Provincial Employee Pension Premiums

Despite changes in Sept.2014, the unfunded liability for the Public Service Pooled Pension fund is still growing.

The growth in the unfunded liability is included in the deficit.

An increase in employee premiums would reduce the deficit.

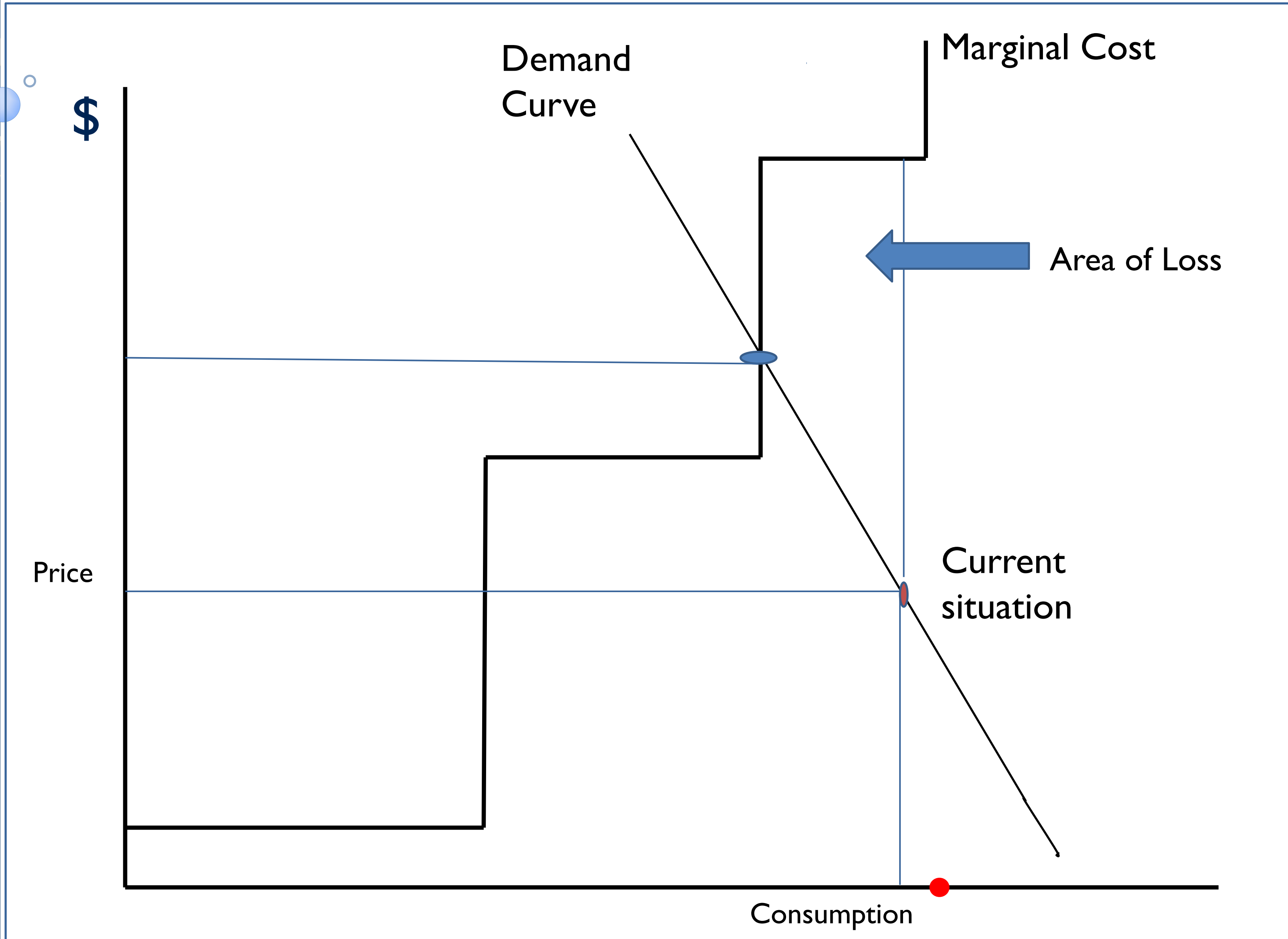
Higher premiums are better than wage roll-backs; employees' retirement benefits are more assured.

No damage to the economy beyond the redistribution.

# 4. An Electricity Tax

- The price of electricity is less than marginal cost of generation.
- Holyrood diesel generation costs 21.4 cents a kilowatt hour.
- That causes losses to the economy.
- Consumers will pay because future rates will recover the extra fuel costs.
- A tax on retail sales of island grid electricity will have beneficial side-effects.

# 4. Electricity Tax -continued



# 4. Electricity Tax - continued

- **Rationale**
  - **It raises revenue:**
  - **Perhaps an earmarked cap for MF**
  - **3 to 4 cents a kwh yields ~ $200-290 million.**

- **Its side-effects are beneficial:**
  - **Reduces fuel costs, which benefits consumers later**
  - **Reduces emissions**
  - **Improves reliability, by reducing demand on Holyrood.**

- **Many Jurisdictions use Electricity Taxes**

  E.g., Ontario Debt Financing Tax,

- **A Temporary Tax?**
  - Once MF is operating the whole pricing regime will change.
  - If MF is not completed then the tax continues until/unless pricing is reformed.

# 5. Personal Income Tax vs HST

- NL PIT Rates are among the lowest
- Income tax is progressive
- Income taxes partially fall on savings

- HST is a more efficient tax than what it replaced, but as an alternate to PIT:
- HST is not progressive
- HST falls entirely on consumption spending

Increased PIT and HST rates are not mutually exclusive but PIT first.

# Conclusions

## Gov't Faces A Severe Challenge

- Inherited a built-in deficit
- Inherited Muskrat Falls and oil investment commitments
- The fall in oil and commodity prices
- No cushion from Equalization (delays in the program)
- Forecasts of status quo deficits are not sustainable.

## Immediate measures are needed

- Spending reduction/program review is needed
- Revenue increases can be enacted quickly, with priority to measures that have beneficial or least negative side-effects
  - Gasoline Tax, CIT, Electricity Tax, PIT
  - HST if needed

# Conclusions - continued

## Near Medium Term

- More spending restraint based on program review and least-damage principle.
- Possibly more revenue-raising measures.

## Long Term

- A new approach to oil-revenue budgeting.

# End of Presentation.

# Questions?