Untangling the Accord

The Atlantic Accord, Equalization, and Offsets

An Independent Assessment

Memorial
University of Newfoundland

The Atlantic Accord Negotiations – Trying to Understand What was Offered and What We Accepted

A Presentation by

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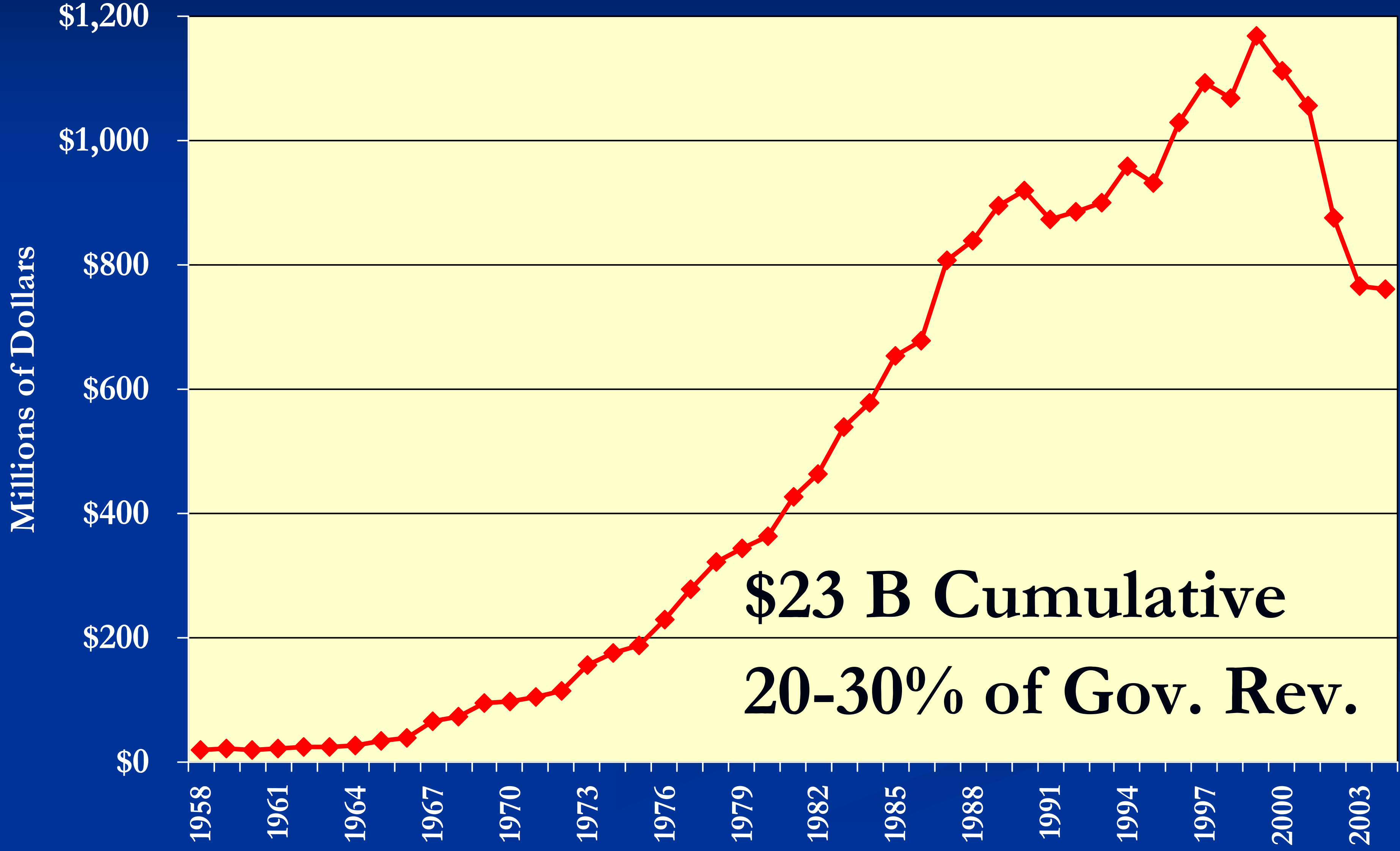
What is Equalization

- Formula-driven, unconditional grant introduced in 1957
- Based on Representative Tax System
- Renewed every 5 years (2004 last renewal)
- Atlantic Accord signed in 1985
- Generic Solution in 1994, retro to 1993
- Bill C24 in 2004 overrides formula (transitional)
- Expert Panel to be named and make recommendations by end of 2005

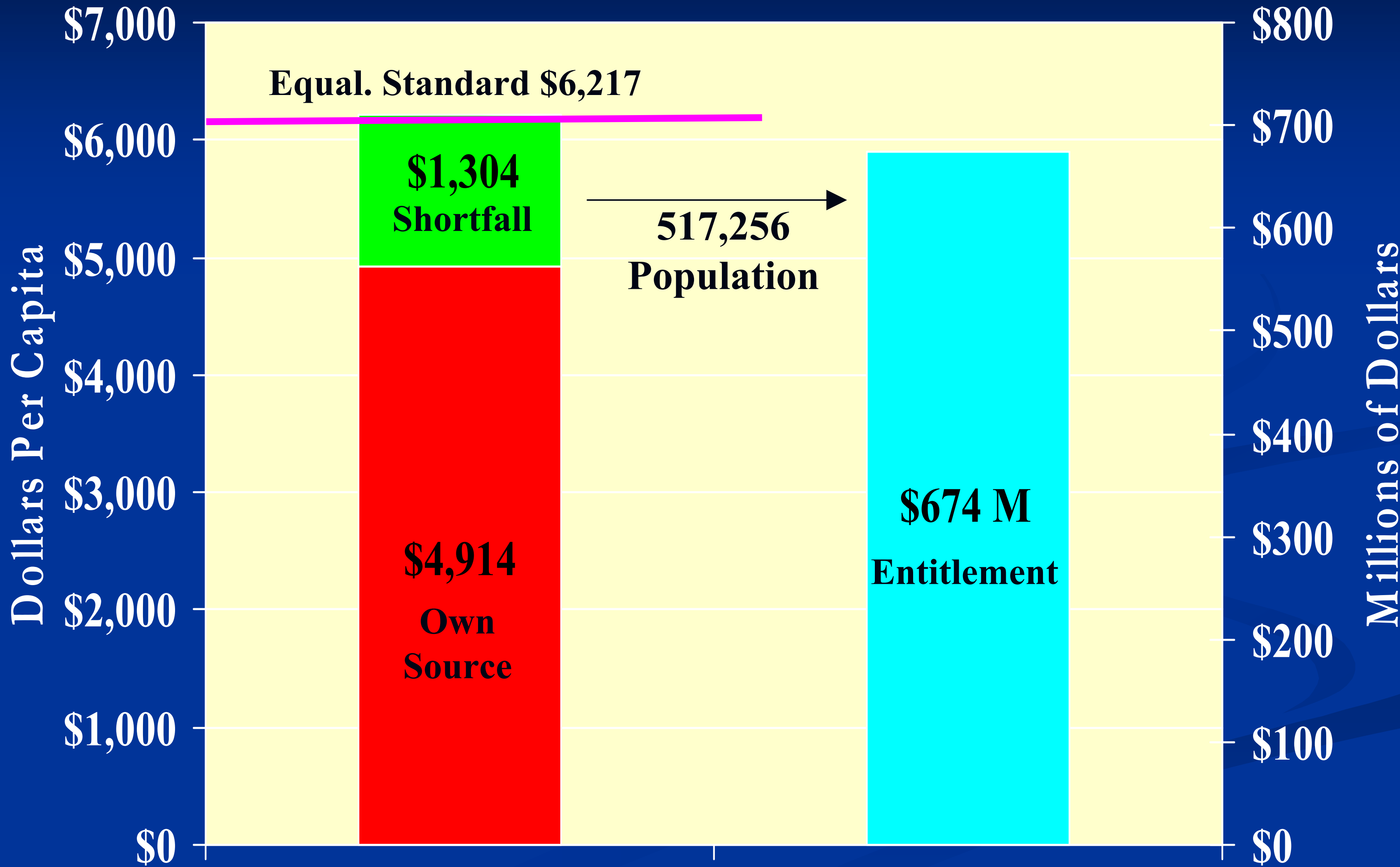
Bill C24 and Expert Panel

- Bill C24 overrides the equalization formula for 2004-05 and 2005-06 by fixing entitlements
- 2004-05 - NL's entitlement set at $761 M
- 2005-06 – NL's entitlement set at $861 M
- No longer equalization and there is zero claw back in these two years
- Transitional – expected two years only
- awaiting report of Panel of Experts

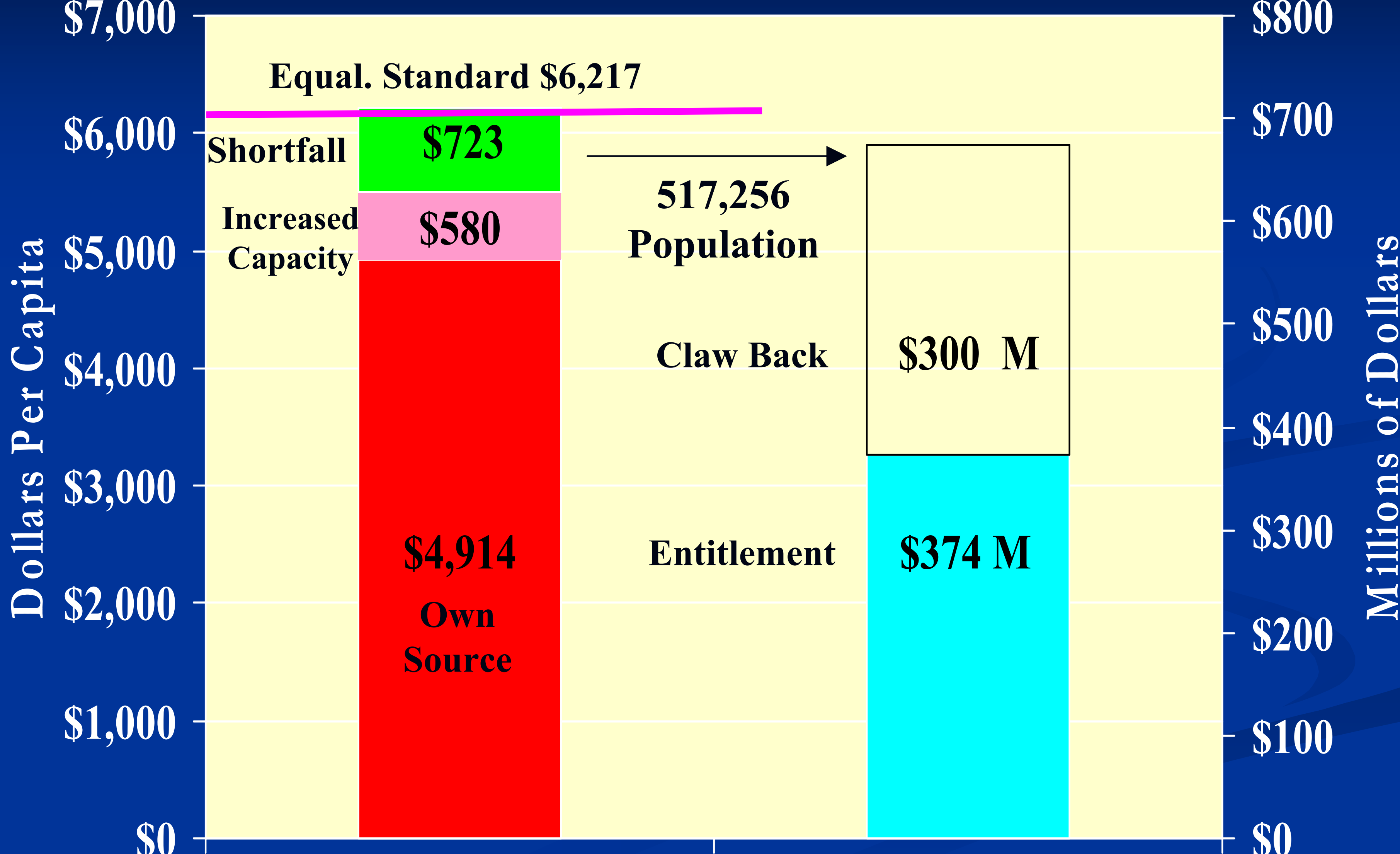
Equalization – What Have We Received?



How Does Equalization work?



What is an Equalization claw back? ($300 Million in Offshore Revenue)



The Atlantic Accord

- Gave the province the right to tax the offshore resources as if they were on provincial land
- provided offset payments to mitigate equalization claw back for 12 years from 1999-00 to 2010-11
- **Part I** – ensures that equalization plus Part I payments do not fall dramatically from between adjacent years (percentage protection determined by relative fiscal capacity)
- **Part II** – ensures province is compensated for percentage of any decrease in equalization entitlements plus Part I payments

Atlantic Accord Offset percentages

	Part I	Part II		Part I	Part II
1999	95%	90%	2005	85-95%	60%
2000	95%	90%	2006	85-95%	50%
2001	95%	90%	2007	85-95%	40%
2002	95%	90%	2008	85-95%	30%
2003	90%	80%	2009	85-95%	20%
2004	85%	70%	2010	85-95%	10%
			2011		0%

Illustration First Payments under Accord

- Entitlements in 2000/01 were **$1,112 M**
- Entitlements in 2001/02 were **$1,055 M**
- Oil Revenue $52 M in 2001/02

- Part I Base = 95% * **$1,112M** = **$1056.4 M**
- Part I Payment = **$1,056.4 M** - **$1,055 M** = **$1.4 M**
- Fall in Part II Base = **$1,112 M** – **1,055 M** - $1.4 M = **$55.6 M**
- Part II Payment = 90%* **$55.6 M** = **$50 M**
- Total Payment = **$1.4 M** (Part I)+**$50 M** (Part II)

  = **$51.4 M**

What is the Generic Solution?

- Applies when an equalization-receiving province has in excess of 70% of the total equalization base in the country.
- Only 70% of the revenues of all provinces for that base are included in calculating equalization.
- This is the often cited 70% claw back for oil and gas.
- In any given year, the provincial government can choose the Generic Solution in lieu of the Atlantic Accord.

What are offshore revenues?

- Offshore revenues are not just royalties include:
  - Royalties
  - Direct Provincial Corporation Income Taxes
  - Sales Taxes
  - Bonuses and rentals
  - Other fees

Offset Payments & Generic Savings
How have we done so far?

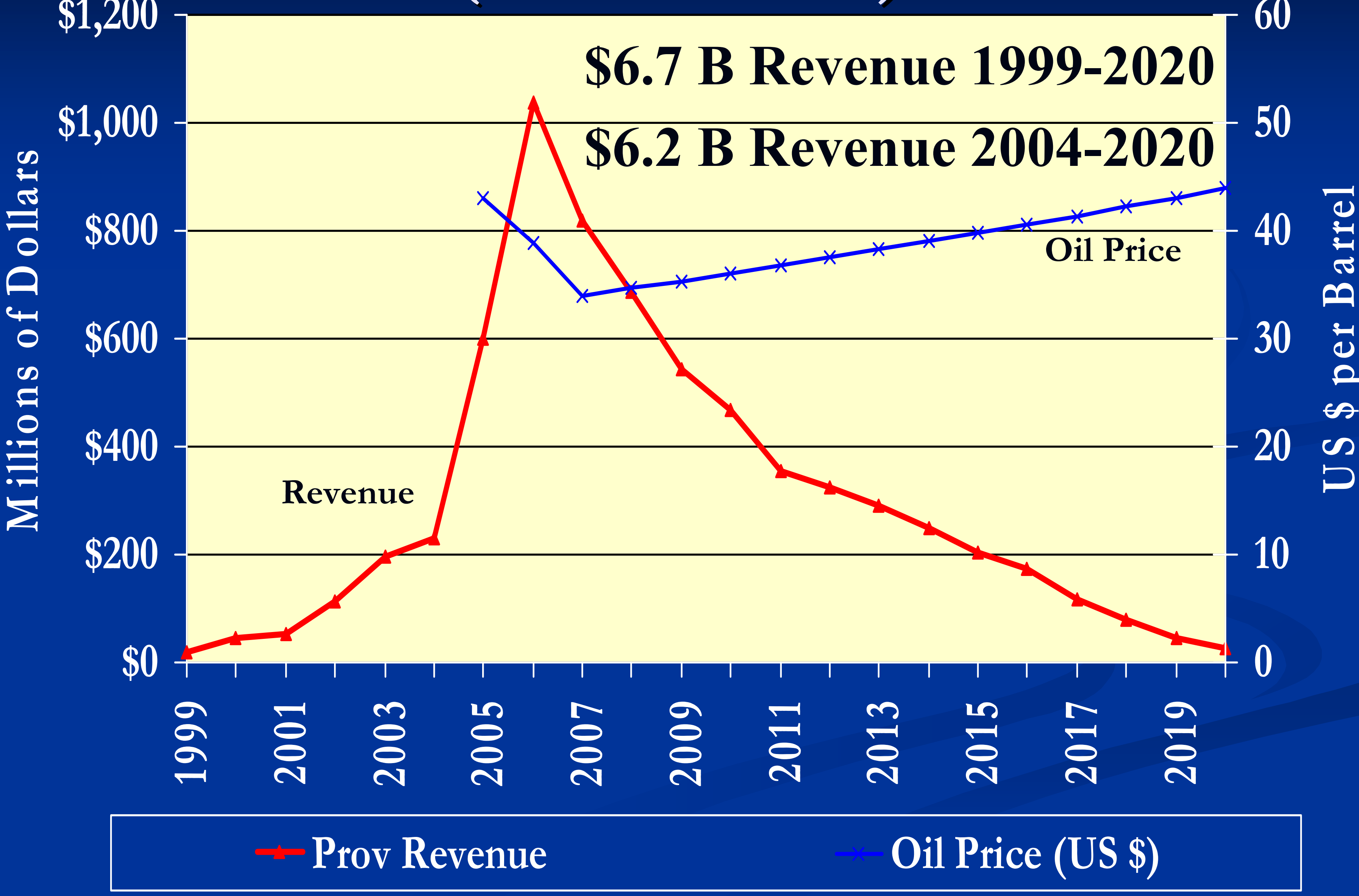
	Oil Revenues	Offset Payments & Savings Under Generic Solution
1999	$20 M	$6 M
2000	$46 M	$14 M
2001	$52 M	$51 M
2002	$115 M	$176 M
2003	$195 M	$218 M
2004	$232 M	$102 M
Sum	$660 M	$567 M

So what is the problem?

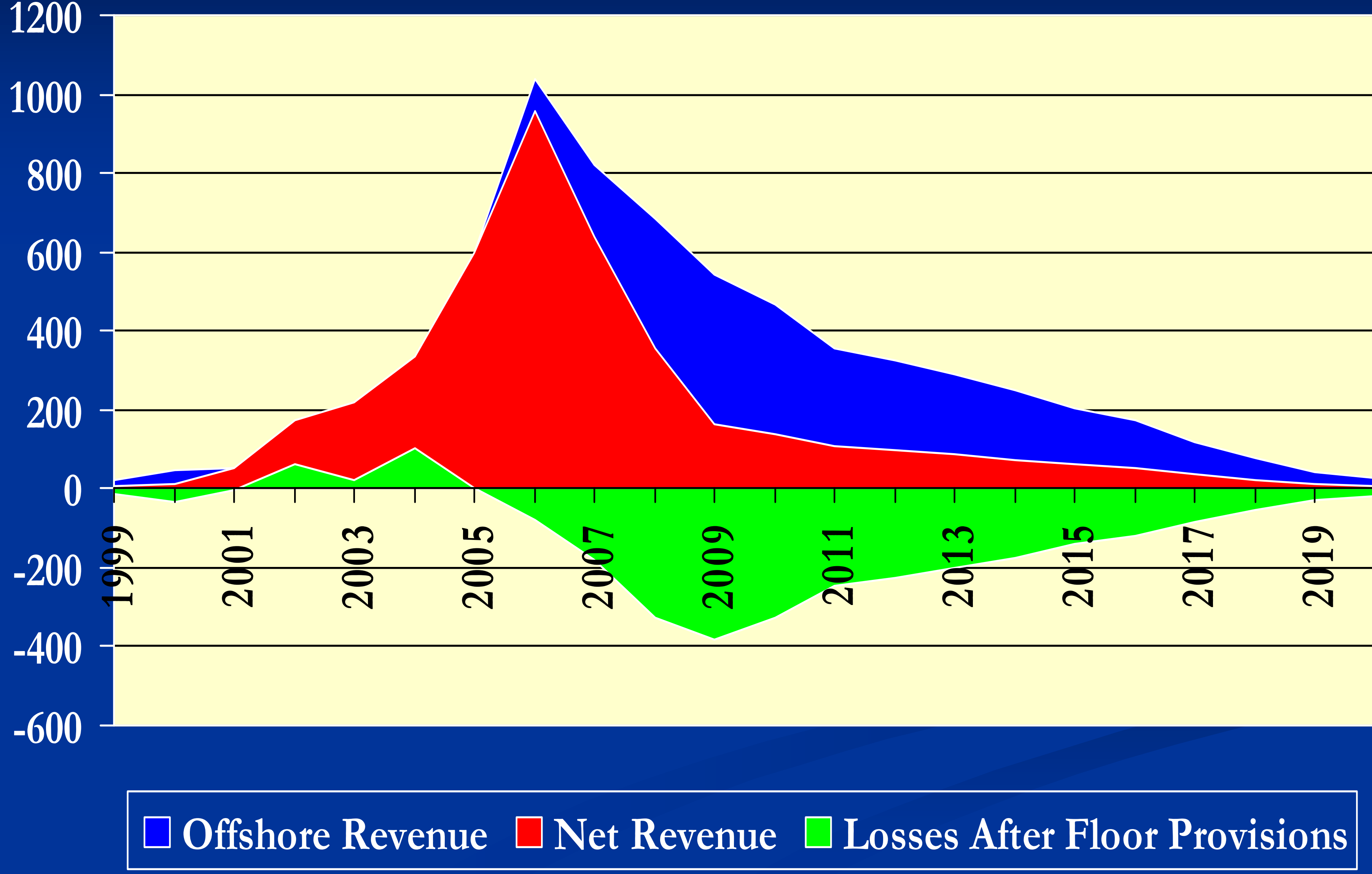
- Received $660 M in revenue
- Lost only $90 M
- Only 14% claw back

- **This is about to get much bigger!**

Provincial Revenue Profiles (No Hebron)



So what is the problem? (No Hebron)



What is the Problem?

	Revenue	Equal. Floor	Bill C24	Accord Generic	Claw back
2004-12	$5.0 B	$0.7 B	$0.8 B	$1.9 B	$1.7 B
2013-20	$1.2 B			$0.4 B	$0.8 B
2004-20	$6.2 B	$0.7 B	$0.8 B	$2.3 B	$2.5 B

What did the province want?

- June 10th – the province **"receive 100% of net direct provincial offshore revenue from these resources after the impact of the equalization program is taken into account"**
- Also, the Atlantic Accord "**be replaced by a new offset provision continuing over the life of the offshore petroleum production…**"

What did the federal government offer in October?

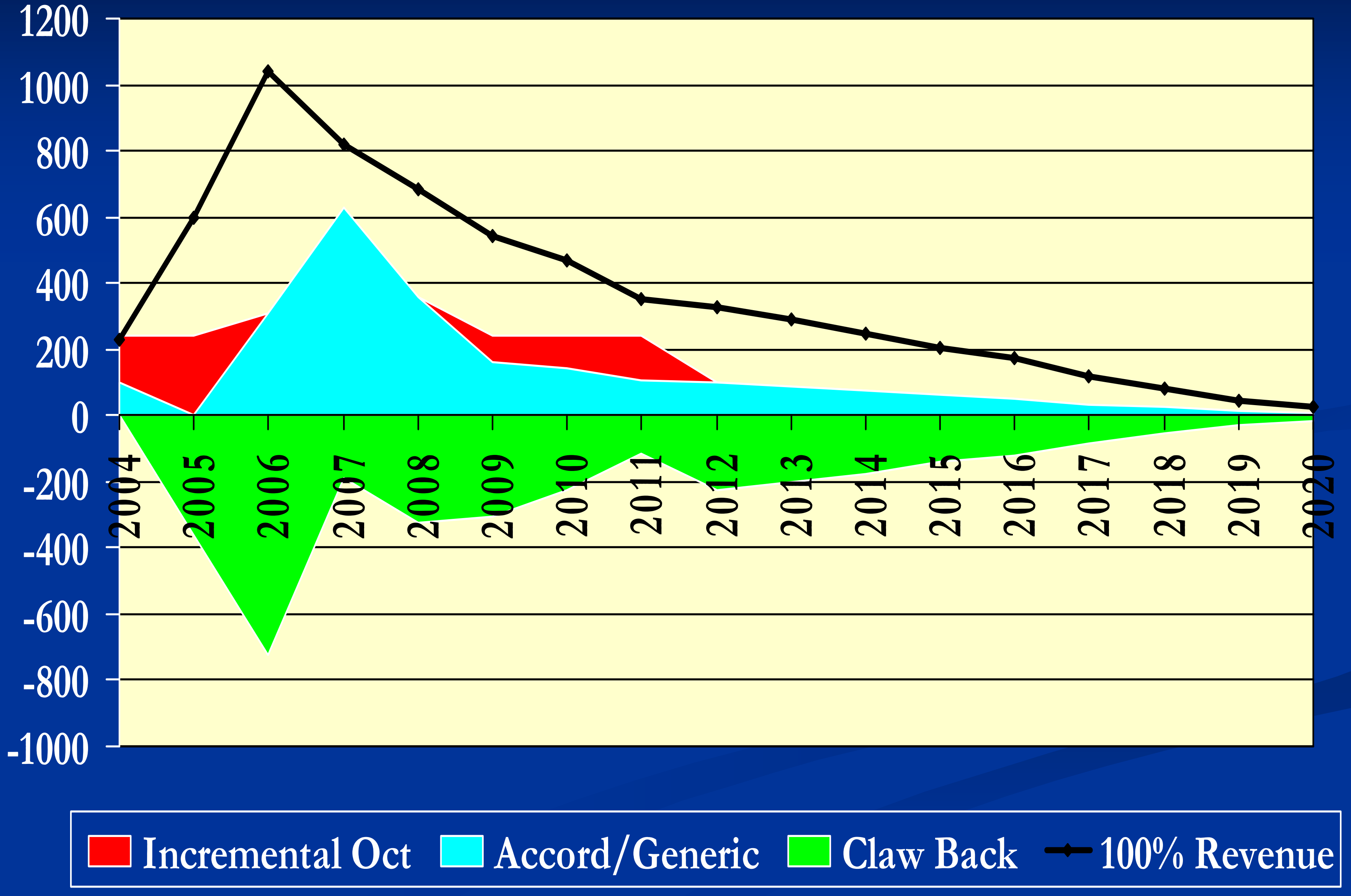
1. Lump-sum payment of $1.4 billion over the period 2004-05 to 2011-12 ($175 M per year for 8 years)

2. Annual payments to ensure that province retains 100% of offshore, subject to condition that fiscal capacity of province not exceed that of Ontario in any year
   - Where fiscal capacity is determined by own-source revenues, equalization and any offset payments

What was the October offer worth at that point in time?

- NL own-source fiscal capacity per capita $4,900,
- Equalization entitlement $675 million
- Standard per capita entitlement $6,220
- Ontario per capita entitlement $6,670
- Extra available to province - $450 per capita
- Province's population 517,256
- Implies so any revenue over $240 M puts NL over Ontario standard)

What was the October Offer Worth? (No Hebron)



What was the October offer worth?

	Revenue	Accord	Increm. October	Offset	Claw back (Adjusted)
2004-11	$4.7 B	$1.8 B	$0.7 B	$2.5 B	$0.7 B
2012-20	$1.5 B	$0.5 B		$0.5 B	$1.0 B
2004-20	$6.2 B	$2.3 B	$0.7 B	$3.0 B	$1.7 B

What did the federal government offer in December Draft Agreement in Principle?

1. additional payments to provide 100% offset against reductions in Equalization payments resulting from offshore revenues (2004 -2011)

2. After 2006, if province no longer qualifies for equalization, then additional offsets disappear (left with the Accord or Generic if relevant)

What did the federal government offer in December Draft Agreement in Principle?

3. A new arrangement may be renegotiated after 2011 for another 8 years (2012-2019)

4. The new arrangement would require that province
    1. maintain balanced budget for each year of the new agreement,
    2. qualify for equalization in that year or previous year,
    3. debt to GDP not fall below a province that is not party to the agreement.

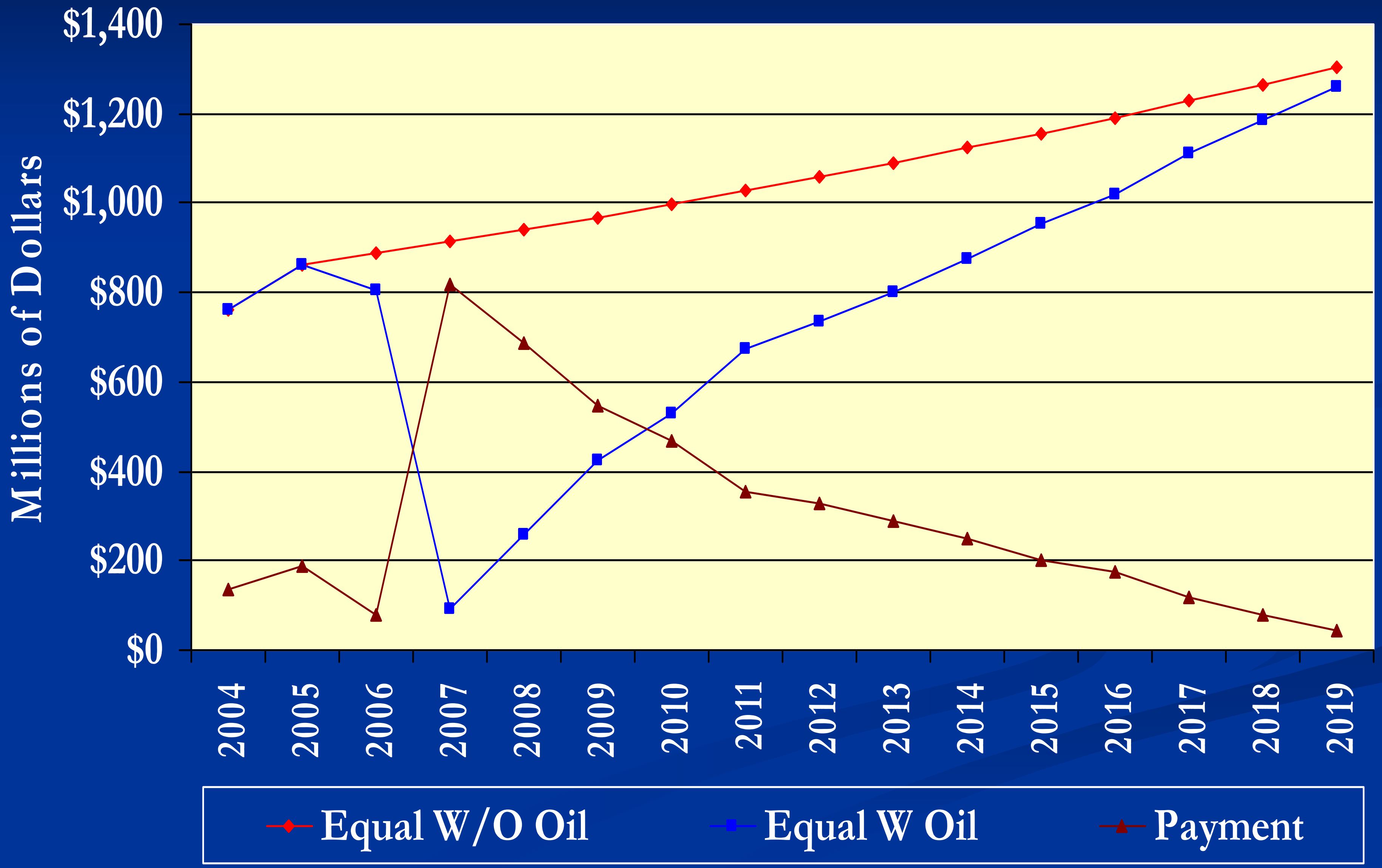
Violating either constraint terminates the agreement.

5. Also, possibly a new 8 year agreement for Hebron

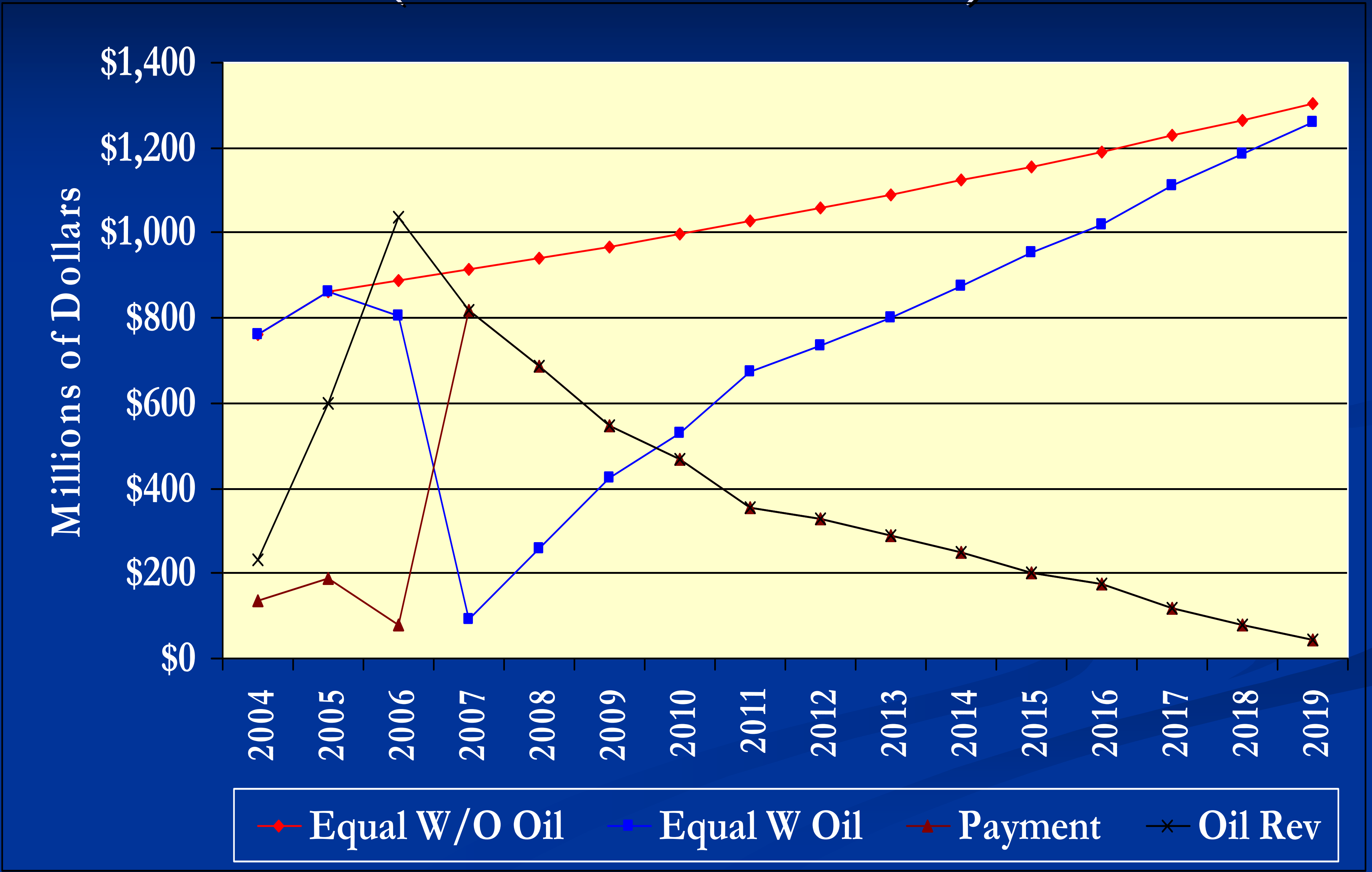
Issues with respect to December Agreement in Principle

- Is it possible that we might not qualify for equalization after 2006 – **Yes, depends on oil prices & other things going on in the province**
- Province must maintain balance budget to extend agreement – **No government can commit itself and future governments to that constraint**
- Debt to GDP stay above other provinces – **that may not be a binding constraint, but it is not so implausible as to dismiss out of hand**
- Not qualify for equalization in 2 consecutive years – **this is not likely to be binding either, but it certainly is possible**
- Expert Panel Recommendations – big **uncertainty**

What was the December Offer Worth?



What was the December Offer Worth? (cont'd) (Oil Revenue Overlaid)



What was the December offer worth?

	Revenue	Accord Generic	Floor Bill C24	Payment	Increm Payment
2004-11	$4.7 B	$1.9 B	$1.4 B	$3.6 B	$1.7 B
2012-20	$1.5 B	$0.4 B		$1.5 B	$1.1 B
2004-20	$6.2 B	$2.3 B	$1.4 B	$5.1 B	$2.8 B

So Why Wasn't this Acceptable?

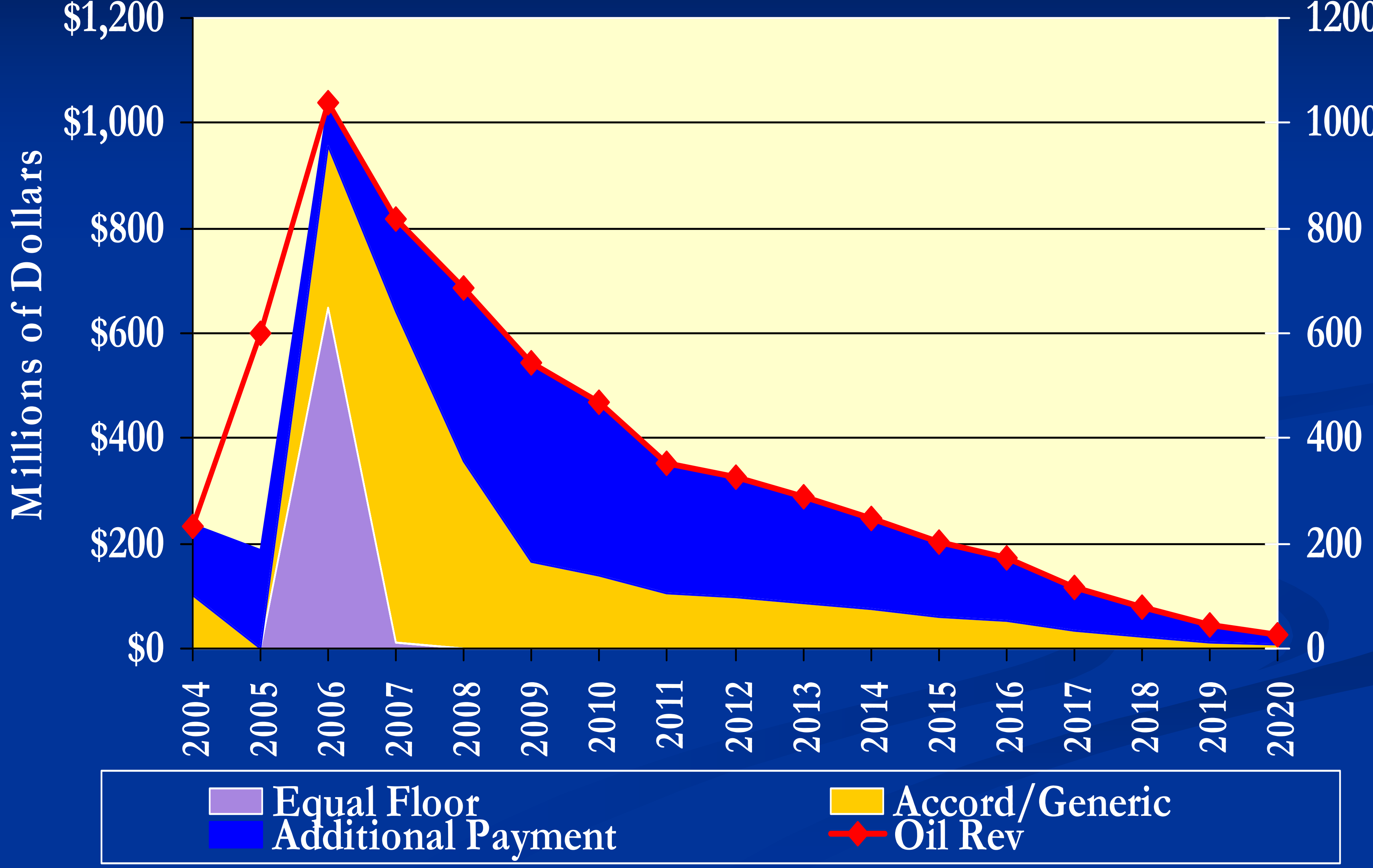
- **Uncertainty**

- Debt to GDP condition could have been violated
- Balanced budget could have been violated
- Might have been off equalization in 2006 or 2007, depending on oil prices, exchange rates and inflation
- Panel might change how equalization is calculated (eg macro formula)
- Generic Solution might be eliminated after the Panel reports

What was in the deal that was accepted in January?

- 100% protection against claw backs so long as receiving equalization (2004-2012)
- Up-front payment of $2 B, as prepayment against future payments (represents minimum that can receive)
- Existing provisions of Atlantic Accord retained
- 8 year extension so long as receiving equalization in 2010-11 or 2011-12 and per capita debt servicing costs does not fall below at least 4 other provinces
- Transition payments in the extension if become have province (2/3 of previous payment in first year and 1/3 in second year)

What was the January Offer Worth?



What was the January Deal Worth?

	Revenue	Equal. Floor	Accord/ Generic	Claw back	Extra Payment
2004-12	$5.1 B	$0.7 B	$1.9 B	$1.7 B	$2.0 B
2013-20	$1.2 B		$0.4 B	$0.8 B	$0.8 B
2004-20	$6.2 B	$0.7 B	$2.3 B	$2.5 B	$2.8 B

What was achieved in January deal?

- Upfront payment worth about $350- 400 M

  - enhanced flexibility

- Guaranteed minimum payment of $2 B

  - protects against price falls & large price increases

- Balance budget and debt to GDP constraints removed and replaced with per capita debt servicing costs

  - increases the probability that extension will be in effect for 8 years

- Two year transition period

  - insurance against falling off a cliff

Summary

	Revenues Retained	Clawed Back
No Deal	$3.8 B	$2.5 B
October	$4.5 B	$1.7 B
December	$6.2 B	$0 B
January	$6.2 B	$0 B

Conclusion

- Each offer was an improvement over the previous one
- The latest deal improved on the December by upfront money and reduced uncertainty.

Thank You

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