

Debtors' Prison II

Shortening the Sentence



by
Roland T. Martin
Aims Fellow
in Public Finance



Research Report

Atlantic Institute for Market Studies

The Atlantic Institute for Market Studies (AIMS) is an independent, non-partisan, social and economic policy think tank based in Halifax. The Institute was founded by a group of Atlantic Canadians to broaden the debate about the realistic options available to build our economy.

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- a) initiating and conducting research identifying current and emerging economic and public policy issues facing Atlantic Canadians and Canadians more generally, including research into the economic and social characteristics and potentials of Atlantic Canada and its four constituent provinces;
- b) investigating and analysing the full range of options for public and private sector responses to the issues identified and to act as a catalyst for informed debate on those options, with a particular focus on strategies for overcoming Atlantic Canada's economic challenges in terms of regional disparities;
- c) communicating the conclusions of its research to a regional and national audience in a clear, non-partisan way;
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Roland T. Martin



About the author

Roland T. Martin is an experienced executive in both the private and government sectors. These experiences include being Comptroller and Deputy Minister of Finance for the Province of Newfoundland and Labrador, President and CEO of a number of organizations, including a Toronto Stock Exchange listed company, and a Professor on the Faculty of Business at Memorial University. He has also been a stockbroker. Mr. Martin has written on public policy issues, and for over 20 years was a director of the fourth largest electrical utility in Canada. He has served as a corporate director of over 30 private and crown corporations.

Roland has an MBA from the University of Western Ontario, a Bachelor of Commerce and Bachelor of Arts (Economics) from Memorial University and the Canadian Securities Course designation.

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The Advisory Committee

Nicola (Nickie) Young, on the Accounting faculty at Saint Mary's University in Halifax, is interested in government financial reporting, having recently stepped down as Chair of the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants, the body responsible for setting financial accounting and reporting standards for government and other public sector organizations.

Robin M. Richardson, Chairman and Chief Investment Officer of AlphaOmega Capital Management Inc., has more than 30 years in senior positions working for large and small businesses, governments, Crown Corporations, public policy research institutes, taxpayer and business associations. Of this, 26 years has been in the financial services industry in banking, trust, insurance, portfolio management, investment and financial advisory firms. He is a former Director (1993 - 1996) of the Fraser Institute's International Centre for the Study of Public Debt.

Research Assistance

Keith Messenger, who was born and raised in Pugwash, Nova Scotia, recently joined AIMS as a policy analyst. He holds a B.A., B.Sc. and M.P.A. from Dalhousie University. His recent work with the Institute includes contributions to *Nova Scotia - On the Financial Brink* and *Getting Back to Basics: A Strategy for Effective Program Review*. Keith lives with his wife, Sandra, in Sackville, Nova Scotia.

Executive Summary

Five years of good fiscal management and budgetary discipline in most of Atlantic Canada has slightly reduced the time the region's people and governments will have to spend in "Debtors' Prison". This progress, however, is precarious. Shocks, in the form of higher interest rates, a fall in the value of the Canadian dollar, or an economic downturn could easily end up stretching out the time of Atlantic Canadians who are imprisoned by the excesses of earlier governments.

"Debtors' Prison" is the term the Atlantic Institute for Market Studies has chosen to describe the trap into which the region's governments have fallen by accumulating far more debt than the economies of the four provinces can reasonably bear. That debt, which now represents a breathtaking record \$27.0-billion, or \$11,400 for every Atlantic Canadian, constrains every action of government. It threatens the viability of every government program. It holds back the economy because such huge debt loads imply the threat of higher taxes sooner or later.

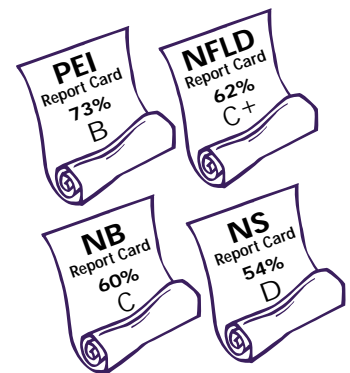
According to Roland T. Martin, the author of *Debtors' Prison: Shortening the Sentence*, relief from the burden can only come from the disciplined pursuit of four guiding principles:

- increasing sustainability, or matching spending and debt levels to available means;
- improving flexibility, or the ability of government to raise new money for needed public purposes;
- reducing vulnerability, or the risk that inability to sustain present debt levels will result in a loss of financial, and even political control; and
- improving financial management practices, such as transparency and forthrightness about provincial finances, and using revenue windfalls wisely.

Martin, the Institute's Fellow in Public Finances, has used these principles as a guide to measuring the progress of each of the region's governments in shortening their sentence in "Debtors' Prison" since the Institute's June 1996 report card on the public debt of the region. Here are his findings:

- Prince Edward Island receives the best Report Card of the four Provinces, remaining in first place. It achieved the highest marks because of its financial results, by demonstrating good management practices, and by improving its sustainability and financial flexibility while not increasing its financial vul-

Provincial Report Cards



nerability. The ranking for the other Provinces has Newfoundland and Labrador moving from third place to second place, New Brunswick slipping to third place and Nova Scotia remaining in fourth place.

- During the past five years, the Atlantic region managed its way through significant Federal cuts in Health and Social Programs. However, if solutions are not found quickly, the relentless spending pressures in the health care sector, and renewed growth in education demands, threatens to return all four Atlantic Canada Provinces to unacceptable deficit positions.
- In spite of the progress made, the crushing size of the Atlantic Provinces' debt, together with the annual debt servicing costs, cannot be sustained without urgent action to both reduce the size of government spending, and improve the efficiency and productivity of existing programs.
- Population is growing very slowly in three provinces and actually declining in Newfoundland, making rapid economic growth the prime focus for the creation of additional financial flexibility in the long term. In the short term, only the Government of Canada has the capacity to implement programs in debt refinancing, taxation reform and new economic oriented infrastructure projects that could provide a significant “kick start” to broaden and strengthen Atlantic Canada's financial position and economy.

The Report Card

Prince Edward Island (Grade: B or 73%), while the best performer of the four provinces over the period, still only manages a middling mark. This is because while its economy has grown strongly, and the province has wisely managed to reduce its unfunded pension liabilities, danger signals are flashing. Spending on health and education is rising, and this threatens the province's ability to reverse its small increase in total accumulated debt in the past two years.

Newfoundland and Labrador (Grade: C+ or 62%) has, over the past decade, become one of the best managed provinces financially in the country. It has significantly reduced unfunded pension liabilities, and managed a crushing reduction in federal transfers while achieving two credit rating increases. The province has the best economic growth rate in Canada. This strong performance continues to be overshadowed by a significant population outflow, which means that fewer taxpayers are left to produce the wealth necessary to service the region's highest per capita debt and highest debt to GDP.

New Brunswick (Grade: C or 60%) has slipped significantly in the ratings this year. It still has the region's best credit rating and a relatively strong financial position overall, but rising spending and NB Power's poor performance have dragged

it down from the top ranking. This fall has been exacerbated by a restated budget for 1998/99 that turned a small surplus into a \$227-million deficit. These factors, together with poor handling of unplanned federal payments and a growing total debt burden, justify the province's third place showing.

Nova Scotia (Grade: D or 54%) remains the region's poorest fiscal performer by a long shot. The debt burden is massive, and the current (restated) deficit of \$497-million is truly alarming. Several key financial indicators have deteriorated significantly, and its financial practices and lack of commitment to balanced budgets has earned it the lowest grade. The only bright spot is a strongly performing economy, which improved its debt to GDP ratio and its revenue position.

The recommendations:

In order to hasten the region's release from financial constraint, Martin recommends that:

- Ottawa offer a stimulative tax cut and undertake a "millennium debt program" to help refinance the region's debt burden and place it on a sustainable footing.
- PEI should strengthen its commitment to balanced budgets and debt reduction, while controlling health care spending and improving revenue by diversifying the economy.
- Newfoundland and Labrador must remain committed to fiscal prudence, including by binding itself through new balanced budget legislation. It must reduce its foreign currency exposure to 20% within three years and it should devote all windfall revenues to reducing its huge debt.
- New Brunswick must restore confidence by implementing recommendations contained in the recent Grant Thornton report, deal with the disquieting state of NB Power, return to tight controls on health and education spending, close the budgetary gap opened by the end of the HST transition payments next year, and tighten its balanced budget legislation.
- Nova Scotia must eliminate its \$500-million operating deficit. An operating surplus is possible within two years if tough decisions are taken on crown corporations such as Sysco and Nova Scotia Resources, and health spending is contained. Confidence in the province's commitment to financial transparency and accountability can only be improved by concerted leadership by the Premier and Minister of Finance. Balanced budget legislation is a must, as is a target for aggressive reduction in foreign currency exposure to 20% within three years.

Section 1

The population growth of Atlantic Canada has been stalled for most of the 1990's, remaining at slightly less than 2.4 million people. Moreover, the population is aging.

Introduction

The fight to rescue Canada from the brink of financial disaster during the past five years has been remarkably successful in most regions. The overall change in public sentiment, from acceptance of deficit spending to insisting on a policy of fiscal prudence, has contributed significantly to the increased resolve by most political leaders to get our financial house in order before it is too late.

However, not all provinces have pulled back far enough from the brink to have financial shelter from any future storm, either by way of an economic downturn or higher interest rates. In the West, British Columbia could become an equalization recipient if the trends continue. And in the East, Nova Scotia's political leaders must first eliminate a significant annual deficit before they can consider reducing the debt.

The Canadian Federation will become even more strained during the initial decade of the 21st Century if a solution isn't found to manage the wide financial disparities that are rapidly developing in the debt loads and taxation systems, as well as the human and physical infrastructures of the country.

For example:

- Newfoundland and Labrador has been one of the best financially managed provinces in Canada for the past 10 years. The hard numbers do not show this result because over 40,000 people have left the province, leaving behind approximately \$625 million in 'stranded' provincial debt while the inter-provincial immigrants take their human capital and earning power elsewhere, mostly to other regions of Canada. The annual revenue loss in transfer payments alone from this exodus is approximately \$92.0 million, or enough to service \$1.15 billion of Newfoundland's direct debt at 8%.
- The population growth of Atlantic Canada has been stalled for most of the 1990's, remaining at slightly less than 2.4 million people. Moreover, the population is aging. Despite a number of tax increases during this period, the total debt burden of these four Provinces increased from \$25.6 billion to \$27.0 billion, or \$11,400 per person. The region has 7.8% of Canada's population, 6.9% of national employment, but only 6.0% of its Gross Domestic Product.
- The biggest financial reason why Atlantic Canadians have not been able to better themselves during this period has been the cutbacks in the cash component of Federal transfers for health and social services. This has improved

the Federal deficit position while at the same time offsetting the financial impact of many prudent financial decisions by the Provinces.

- The gap in taxation loads from the highest taxed province to the lowest has become much wider. Today, Quebec has a 'tax effort' index of 133 compared to Alberta, which is the lowest in Canada at 60, or a ratio of 2.22:1 – versus a similar high/low measurement in 1992-93 of 1.55:1 between Newfoundland and Alberta. Within Atlantic Canada the ratio has also widened, from 1.14:1 in 1992/93 between Newfoundland and New Brunswick, to a more significant gap in 1999/00 of 1.46:1, with Newfoundland still the highest and Nova Scotia now having the lowest taxation effort.

Background

Debtors' Prison: Public Sector Debt and What It Means For You was published in June 1996 by the Atlantic Institute for Market Studies (AIMS). It provided a timely, comprehensive and objective evaluation of the financial management of the four Atlantic Provinces, focused primarily on the debt burden of its 2.4 million citizens.

The 1996 paper concluded that Atlantic Canada could not afford to delay decisive action in dealing with the debt and stated, 'The only way to regain command of our economic health and future is to re-establish our financial self-reliance'. The Report Cards on each of the four provinces clearly demonstrated the failure of our regional politicians to provide sound financial stewardship during the previous two decades. Both Newfoundland and Nova Scotia received failing grades and Prince Edward Island and New Brunswick scraped through with a 'D', the minimum passing grade.

It's Exam Time Again

AIMS has put together a new team of financial evaluators to produce *Debtors' Prison II: Shortening the Sentence*. This report addresses questions such as:

- What is the financial position, primarily defined by the debt obligations of each Atlantic Province, that the region's citizens must manage as we enter the new millennium?
- Can Atlantic Canadians sustain the level of public services they have been consuming?
- How well have Atlantic Canadians been served by their elected governments during the past four years?

*The only way to regain
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reliance*

- What acts of good fiscal governance have been undertaken?
- What decisions should be taken by each Provincial Government, and the Government of Canada, to improve the position of the region, both financially and economically?

Debtors' Prison II provides a detailed assessment of the finances of each Atlantic Province, draws a set of conclusions and makes recommendations. It then issues a 'Financial Management' Report Card to each of the four Atlantic Provincial Governments, covering the 'course period' from 1995/96 to 1999/00.

While it is unfortunate that the total debt burden of the Atlantic region increased during this period, it was encouraging to see an awareness of, and a commitment to, financial prudence improve significantly.

Significant Observations

During the period of 1995/96 to the existing provincial budgets for 1999/00, Canadians have experienced a dramatic 'financial seismic shift' in the awareness shown by most governments of the urgent need for action to avert a financial crisis. This is most evident at the Federal Government level where successive budgets, starting in 1995/96, have aggressively addressed perennial annual deficits and the resulting compounding of the debt load. The outcome has been a very significant improvement in financial performance and growing annual surpluses beginning in 1997/98. Total debt at the Federal level has begun to decrease, and the Government has regained a degree of control and flexibility with respect to both revenue and spending.

While it is unfortunate that the total debt burden of the Atlantic region increased during this period, it was encouraging to see an awareness of, and a commitment to, financial prudence improve significantly. The glaring exception is Nova Scotia, particularly during the two years of a minority Liberal government. This increase occurred at a time when the provinces were grappling with significant cuts in federal transfer payments in health and social services and low growth in provincial revenue sources, providing clear evidence of the dangers of high debt levels and the vulnerability such levels inflict on an economy.

However, the picture is neither uniform nor comforting when each Atlantic Province is examined:

- Prince Edward Island has improved in almost every financial indicator, and has a stable but challenging immediate future.
- Newfoundland and Labrador has the largest debt burden per capita and as a percentage of GDP, highest taxes, and smallest economy, yet it has stabilized its financial position against major obstacles such as a declining population, and a devastated groundfish industry, and received two credit rating increase during this period.

- New Brunswick received a setback to its reputation for fiscal prudence and spending discipline when the new Progressive Conservative government concluded it had to re-state financial reporting for 1998/99 as a result of an independent review of the provincial Auditor General's qualifications of the 1997/98 Public Accounts. While it still has the highest credit rating in the region, it is challenged by rising health costs and the need to eliminate a projected deficit for 1999/00.
- Nova Scotia has the largest regional economy and lowest taxation burden, yet it has the worst financial management record in the region. Its debt load has increased, its deficits have been out of control and its high exposure to foreign exchange borrowing has added volatility and losses to the Province's budget results.

Section 2

What are the Characteristics of the Citizens' Debt?

Before proceeding to a detailed analysis of Atlantic Canada's debt burden and grading the financial management of the four provinces, we will examine the concept of borrowing and its impact on our financial position. We will also explain the principles this report uses to evaluate the provinces' financial situations and their performances over the past five years.

From the late 1960's, governments developed the habit of spending more than they collected, and funding those deficits from numerous increases in tax sources and from what for decades appeared to be a bottomless pool of borrowing capacity.

Why do we Borrow?

Originally, like most private citizens, governments borrowed for capital expenditures: for example, assets that have a long life such as roads, bridges, schools and hospitals. Conceptually it was similar to a house mortgage or car loan – a debt with a repayment schedule and an annual interest expense. Credit was granted if the lenders judged the burden of servicing the debt and repaying the principal to be reasonable, and did not absorb too high a percentage of the annual revenues required for on-going operating and living expenses.

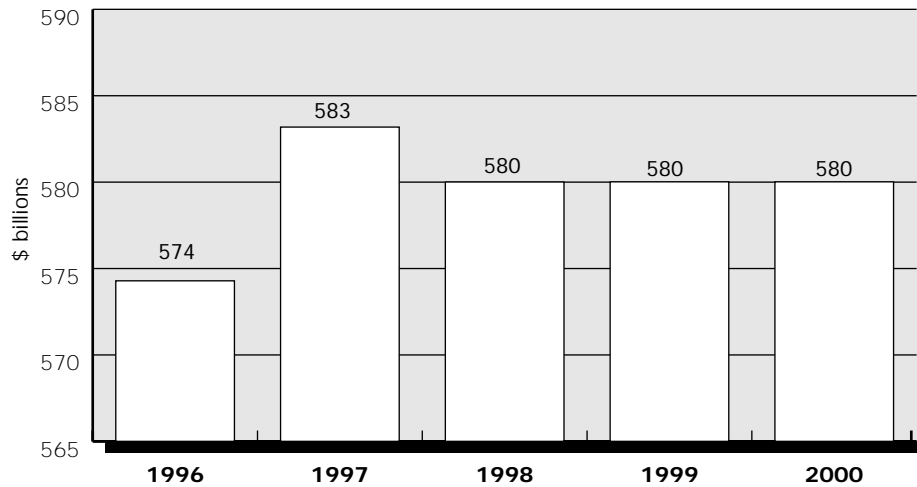
But the similarities end there. From the late 1960's, governments developed the habit of spending more than they collected, and funding those deficits from numerous increases in tax sources and from what for decades appeared to be a bottomless pool of borrowing capacity. Of course, governments universally found additional ways of spending all the money they could collect or borrow. The common sense linkage of borrowing for investments in capital expenditures was ignored, and often the deficits represented borrowings to pay for annual consumption, including for interest payments on previously issued debt!

By the mid-1990's, the insidious cycle of deficits and ever compounding debt levels by the Federal Government and most provinces could no longer be sustained. The average Canadian family of four had Provincial and Federal debt obligations of approximately \$120,000, which at 8.5% resulted in interest payments equivalent to \$850 per month for each family! In other words, the various governments had to annually raise \$10,200 in taxes from each family, just to meet interest payments.

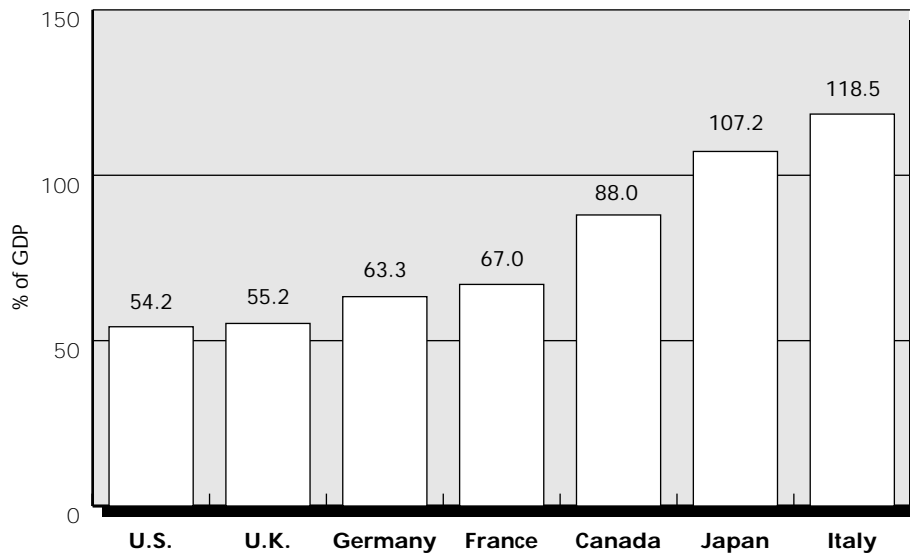
Canadians were, and still are, truly in 'Debtors' Prison.' The total issued debt of the Government of Canada and all Provinces is approximately \$925 billion. If every man, woman and child contributed \$100 per year to debt reduction, (\$400 per average family), it would still take over 256 years to pay off the current accumulated debt! This is on top of the \$10,200 of annual interest payments per family, which fortunately would decline slowly but steadily as the debt was repaid. Based on the direct debt of the Federal Government and the Provinces

(excluding Canada Pension Plan unfunded liabilities and other public sector debt such as utilities, native claims, Crown agencies, etc.) Canada ranks as one of the most indebted nations of the World. The Federal Government's direct debt alone is 63.1% of GDP (see Graphs 1 & 2).

1. Total Debt Burden (Federal Government of Canada)



2. Total Debt to GDP for the G-7, 1999





The Three Principles

Sustainability

Flexibility

Vulnerability

Of course, all Provinces are not equally in debt as some have exercised much better financial management. During this fiscal year, Alberta will have eliminated all of its direct debt, and will have no accumulated provincial debt within 25 years if it continues to implement its current plan. Meanwhile, if Nova Scotia were to eliminate the current year's projected \$500 million deficit immediately, and then each citizen contributed \$100 per year to provincial debt reduction, it would take 119 years to repay the Province's estimated \$11.15 billion accumulated debt!

Is all Debt Bad?

Incurring debt is not necessarily a poor financial decision. If the purpose of borrowing is to make an investment in a public policy area that will return economic and social benefits to its citizens greater than the costs of borrowing, then it is a good decision. Infrastructure investments in health, education and roads are the most obvious.

The challenge for political leaders, and one that they have consistently failed to meet, is to make wise use of the capital they extract from the public through taxation and from lenders. The consequences for most Canadians have been crushing debt loads and high annual interest charges, which displace funds that could be better used for essential government spending, or to reduce taxation levels.

How to Measure Debt Management?

The accumulated debt burdens of the various levels of government throughout Canada are obviously too high. This has resulted in a long term decline in our credit ratings, escalating annual costs to service the debt and excessive taxation levels required to meet spending demands. These trends converged into a financial crisis around 1995/96. Since then, the standards of fiscal responsibility have been improving.

The three principles we will use to evaluate the financial performance of the four Atlantic Provinces are outlined below. They have been adapted from the recommendations on 'financial position' brought forward by the Canadian Institute of Chartered Accountants in a study published in 1997, which are gaining acceptance in many Government Finance Departments. We have added a fourth category of 'Financial Practices' to take into account some of the difficult decision-making situations Provincial Managers have had to cope with in the past four years. The best example of the latter is the major challenge created by the Federal Government's cuts to Health and Social spending beginning in 1996/97.

The three principles are:

Sustainability – a measurement of whether each Provincial Government is likely to be able to maintain current program spending, while at the same time meeting existing debt-service commitments and not exceeding prudent debt levels.

Flexibility – this is a measurement of how much a government could increase the financial resources available to it for the purpose of fulfilling rising spending commitments, either by implementing higher taxes or user fees, or by borrowing further funds.

Vulnerability – this is the degree to which a Province’s self reliance is at risk because it has become dependent on revenue sources other than from its own citizens, such as borrowing in foreign currencies and Federal Government transfer payments.

Once we analyzed the financial performance of the past four years, we applied certain measurement tools to the above three principles to get the components of our quantitative scoring. The most accepted measures of a government’s financial position are as follows:

- Total debt burden as a percentage of Gross Domestic Product (GDP). This is an indication of the size of economic production available to the citizens of a province from which they generate their ability to pay the costs of operating their personal, business and government activities. High percentages of debt to GDP indicate that lenders get too big a share of these resources.
- Per capita debt is the total debt divided by the population in each Province. The size of this number and whether it is growing is an indication of the average debt obligation an individual citizen is responsible to service and repay. Its relevance hits home, when, as stated earlier, the population of a region ceases to grow or even declines, leaving more debt for a smaller earning population to service and more debt for future generations.
- Debt services costs as a percentage of total revenues. This ratio indicates how much of the revenues collected from taxation or Federal Government transfers are committed to paying interest expenses on existing debt. Like individuals, lenders to governments want to measure the fixed obligations a borrower has in order to determine whether or not they are likely to meet all their financial obligations.
- Foreign currency debt to total debt burden. This ratio measures the degree to which a province is exposed to fluctuations in the value of the Canadian dollar compared to other currencies when the annual fixed interest expense and principal repayments must be made in those foreign currencies.

Sources of Data

In preparing this Report we have visited each of the four Provincial Departments of Finance and met Senior Managers, including the Deputy Ministers. We have reviewed and researched the Budgets, Public Accounts, Auditor General Reports and other financial information from governments and other sources, and have

Once we analyzed the financial performance of the past four years, we applied certain measurement tools to the three principles to get the components of our quantitative scoring.



consulted with various public finance experts and writers. This Report uses Credit Rating Agencies as one of its main sources of financial data, in particular the Dominion Bond Rating Service (DBRS) credit rating reports, due to the depth and consistency of its analysis (see references). We have had many discussions with DBRS and other major rating agencies.

We are especially appreciative of having an Advisory Board consisting of very knowledgeable and helpful individuals. We do, however, take full responsibility for the information gathered, its analysis and our conclusions and recommendations.

What has been the Quality of Financial Stewardship in Atlantic Canada?

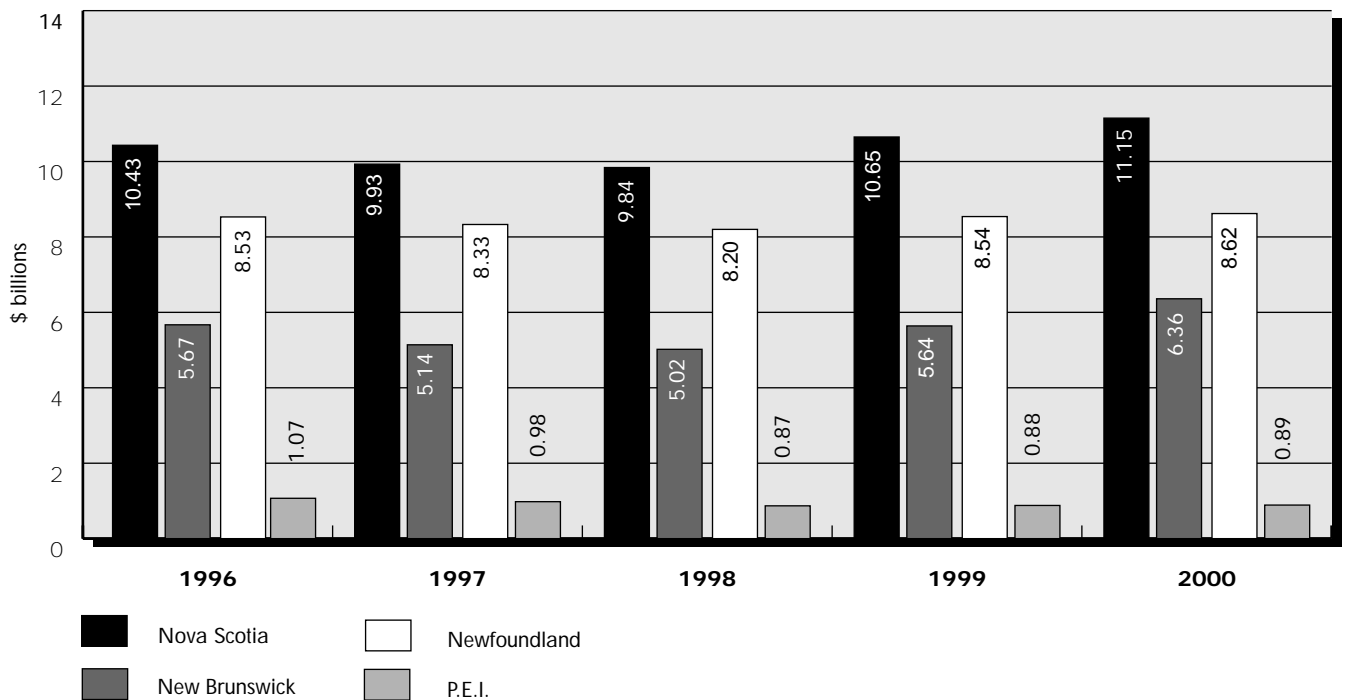
Section 3

Overall Assessment

Since fiscal year 1995/96, the Atlantic region, on average, has been financially well managed. The total debt load has increased from \$25.6 billion to \$27.0 billion, using DBRS figures, adjusted for our conclusions on New Brunswick's and Nova Scotia's projected debt position at March 31, 2000 in light of recent accounting and financial information changes (see Graph 3).

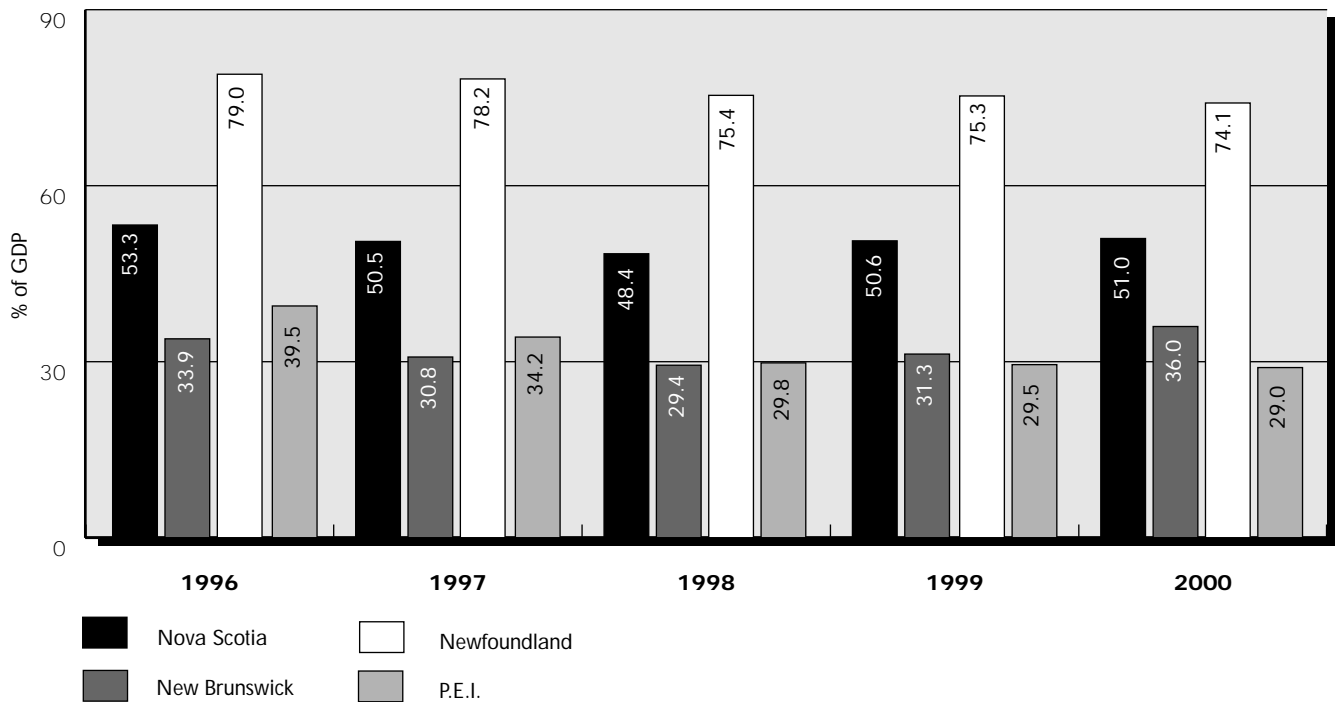
3. Total Debt Burden (Atlantic Provinces)

(as of March 31st)



The key measurement of flexibility, the total debt burden to GDP ratio, has improved in each of the provinces due to the steady growth in their economies. PEI has led the region in this measurement as both its debt position and its economy have improved, while Newfoundland is the next best performer as its economy has been the fastest growing in Canada for two years, and will likely continue to be ranked first for several more years (see Graph 4).

4. Total Debt Burden (% of GDP - Atlantic Provinces) (as of March 31st)



The Provinces have had to overcome several major financial challenges to achieve financial stability during the past five years. Continued spending demands from the provincial health systems has been the biggest internal challenge, while the biggest revenue challenge came from the Federal Government's decision to reduce the cash component of Health and Social Program transfer payments. These reductions, totaling \$1.65 billion, began in 1996/97 and had the following impact on revenues by Province (see table 1).

Table 1: Changes in CHST Funding

\$ Millions	Base 1996	1997	1998	1999	2000	Total Reductions⁽¹⁾
PEI	90	72	59	60	69	100
Newfoundland	434	351	280	272	280	553
New Brunswick	455	397	328	335	324	436
Nova Scotia	626	536	439	441	524	564

⁽¹⁾ To calculate the total cash component reductions in CHST, it is assumed the base year transfers of 1995/1996 would have remained constant during the four-year period.

The other major decline in provincial revenues came from personal income tax (PIT) reductions by Ottawa. Because the provinces' PIT is a percentage of the Federal PIT base, any cut in the rate results in a lowering of PIT revenues to each Province in Canada, with the exception of Quebec which has its own PIT system. The impact for the current year by Province will be approximately \$80.0 million in lost revenues. (see Table 2).

Table 2: Estimated Provincial Personal Income Tax Losses

From Federal Government Tax Reductions For Year 1999/2000

Province	\$ Millions
PEI	4.6
Newfoundland and Labrador	30.0
New Brunswick	23.0
Nova Scotia	20.0

The impact of federal cuts has been offset to a large extent by several positive events. The 'windfall' growth in equalization payments compared to the budgets in 1997/98 and 1998/99, and the prior years' adjustments in equalization, were significant for all four provinces. These resulted primarily from higher than projected growth in the economies of other provinces, particularly Ontario.

These payments increased the volatility of revenues, and were treated differently by each Province. Newfoundland used most of its unbudgeted 'windfalls' to pay off municipal, school board and hospital debt; Prince Edward Island set up reserves for future health and education expenses; while Nova Scotia and New Brunswick simply used the unplanned monies to finance higher than forecast program spending, primarily in health care. The increased equalization revenues of approximately \$822.0 million had the following annual impacts for the period (see Table 3).

Table 3: Increase in Provincial Equalization Revenues

\$ Millions	Base					Total Cumulative Increase ⁽¹⁾
	1996	1997	1998	1999	2000	
PEI	188	187	208	207	230	81
Newfoundland	912	958	995	896	1,012	213
New Brunswick	903	904	1,053	1,026	1,035	406
Nova Scotia	1,163	1,116	1,194	1,183	1,281	122

⁽¹⁾To calculate the total equalization increases, it is assumed the base year payments of 1995/1996 would have remained constant during the four-year period.

Despite the operating improvements and changes in fiscal management attitudes, the single biggest financial issue facing the Atlantic region is the huge stockpile of debt that has been accumulated over the past 25 years, which at \$27.0 billion is 50.2% of the region's \$54.6 billion annual GDP.

There was a substantial improvement in program spending (total spending less debt charges) discipline during the past five years. The four-Province average annual program spending growth rate was 2.3%, while the region's economy was growing at an average of 2.5% per year. Revenues also remained very constant as a percentage of GDP, both the 'own source' revenues of each Province and the Federal transfer revenues.

The results of overall improved financial management show up in year-by-year program surpluses for most provinces, a significant turnaround from perpetual deficits for most of the previous 20 years. The worst exception is Nova Scotia which, even using its original financial reporting prior to the new Government's changes in accounting policies and re-statement of financial results, managed only one surplus, \$27.0 million in 1996/97. New Brunswick has also re-stated its budgetary results for 1998/99, creating a \$227 million deficit after consolidating a \$450 million write-down of NB Power's assets, along with other additional revenue and expenditure changes. It is now also projecting a deficit for 1999/00. Newfoundland achieved operating surpluses in four of the five fiscal periods from 1995/96 to 1999/00 (estimated), while PEI had two surplus years.

Despite the operating improvements and changes in fiscal management attitudes, the single biggest financial issue facing the Atlantic region is the huge stockpile of debt that has been accumulated over the past 25 years, which at \$27.0 billion is 50.2% of the region's \$54.6 billion annual GDP. Without immediate and constant action to reduce spending, the absolute amount of this debt, and its annual servicing costs, will prevent the innovative private and political leadership the region needs if we are to become more competitive on both the national and international economic fronts. While some may argue, with some degree of merit, that growing health program spending requirements or improved education programs are the top public policy priorities, these cannot be achieved without a solution to our financial constraints.

These high debt levels will continue to adversely affect our ability to sustain current programs, limit our flexibility to be innovative and responsive to growing

competition, and will increase our vulnerability to pressures from both economic and financial forces.

Credit Ratings

The credit ratings for each of the four Atlantic Provinces is an appropriate score-card to demonstrate the importance of good financial management. During the past five years the ratings have for the most part been stable. Only Newfoundland has been upgraded, in fact twice, the most recent by Standard & Poor's on November 22, 1999, from a BBB+ to A-. This is a welcome change from the early 1990's when all but New Brunswick had received at least one downgrading. Nova Scotia is currently under 'rating watch with negative trends' by one of the Credit Rating Agencies. The agencies measure all aspects of a Province's financial position; however, the rating is a relative indication of risk with a focus on the borrower's ability to fulfill its long-term debt obligations. The agencies may well consider governments quite capable of servicing debt levels that at the same time severely restrict public services or result in unrealistic tax burdens.

The ratings for each of the Atlantic Provinces from the major credit rating agencies are as follows (see Table 4):

Table 4: 1999 Credit Ratings ⁽¹⁾

Province	Dominion Bond Rating Service	Standard & Poor's	Moody's	Canadian Bond Rating Service
Nova Scotia	BBB (high)	A-	A3	A-
New Brunswick	A	AA-	A1	A+
Newfoundland	BBB	A-	Baa1	BBB
PEI	BBB (high)	N/A	A3	BBB

⁽¹⁾ See Schedule I for an explanation of DBRS' credit rating scales for each category.

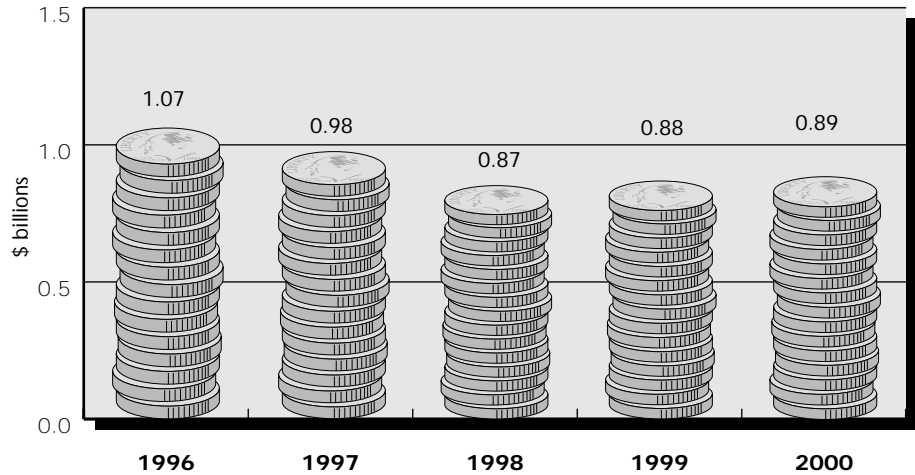
Prince Edward Island Financial Analysis

Prince Edward Island is the smallest Province in Canada, both in terms of population and its economy. It has traditionally been a seasonal economy based on farming, fishing, tourism and the government sector. The completion of the Confederation Bridge in 1997, between New Brunswick and PEI, has had a profound social and economic impact on the Island.

The fiscal performance of the Province over the past five years has been quite good. Tight financial decision-making, coupled with the fact that PEI has no foreign debt exposure, has allowed the government to reduce its total debt burden, defined as tax supported debt plus unfunded pension liabilities. Total debt bur-

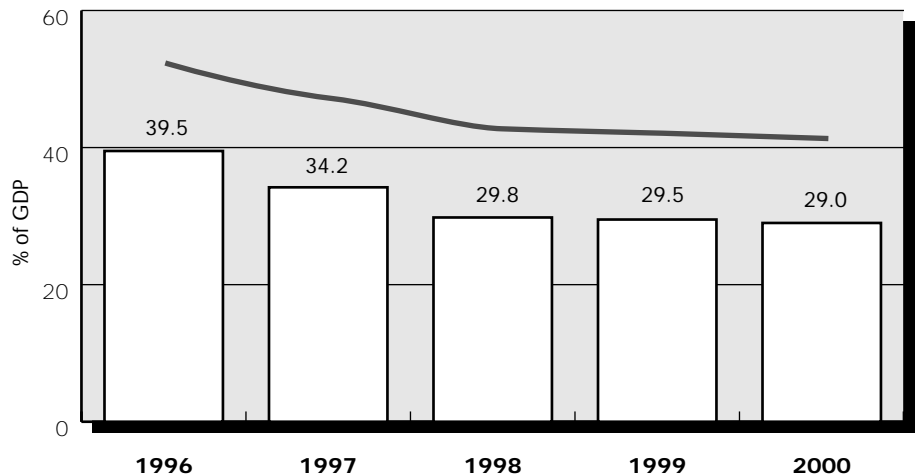
den decreased from \$1.07 billion in 1995/96 to \$889 million in 1998/99, and is forecast to increase slightly to \$897 million in 1999/00 (see Graph 5).

5. Total Debt Burden (PEI)
(as of March 31st)



It has also had a dramatic positive impact on the important sustainability measurement of total debt burden to GDP which has decreased from 39.5% in 1995/96 to an expected 29% in 1999/00, one of the best performances in Canada (see Graph 6).

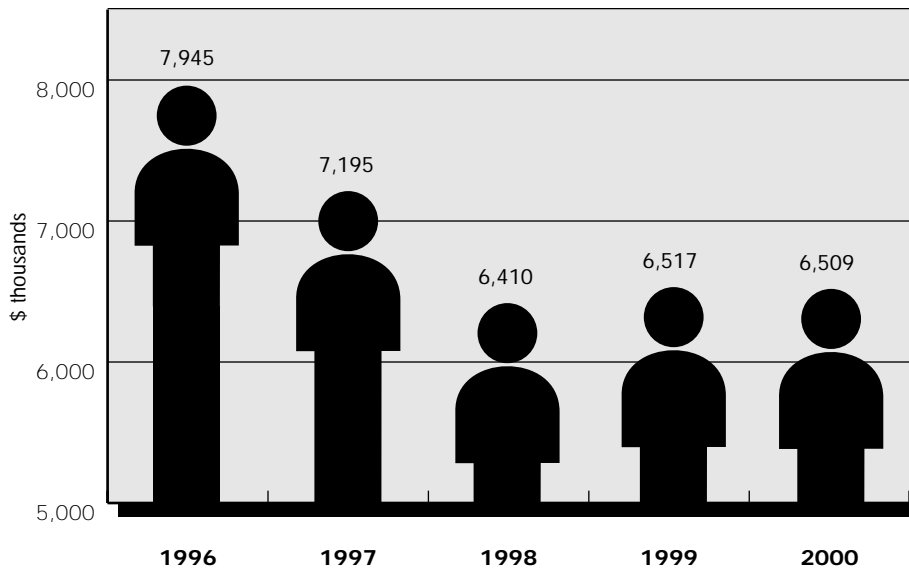
6. Total Debt Burden (% of GDP - PEI)
(as of March 31st)



Over the past five years, the Province has kept program expenditure growth at or below revenue growth. This has resulted in a stable financial environment, surpluses in two of those years, and a declining debt per capita, from \$7045 in 1995/96 to \$6509 projected for 1999/00 (see Graph 7).

7. Total Debt Burden (per capita - PEI)

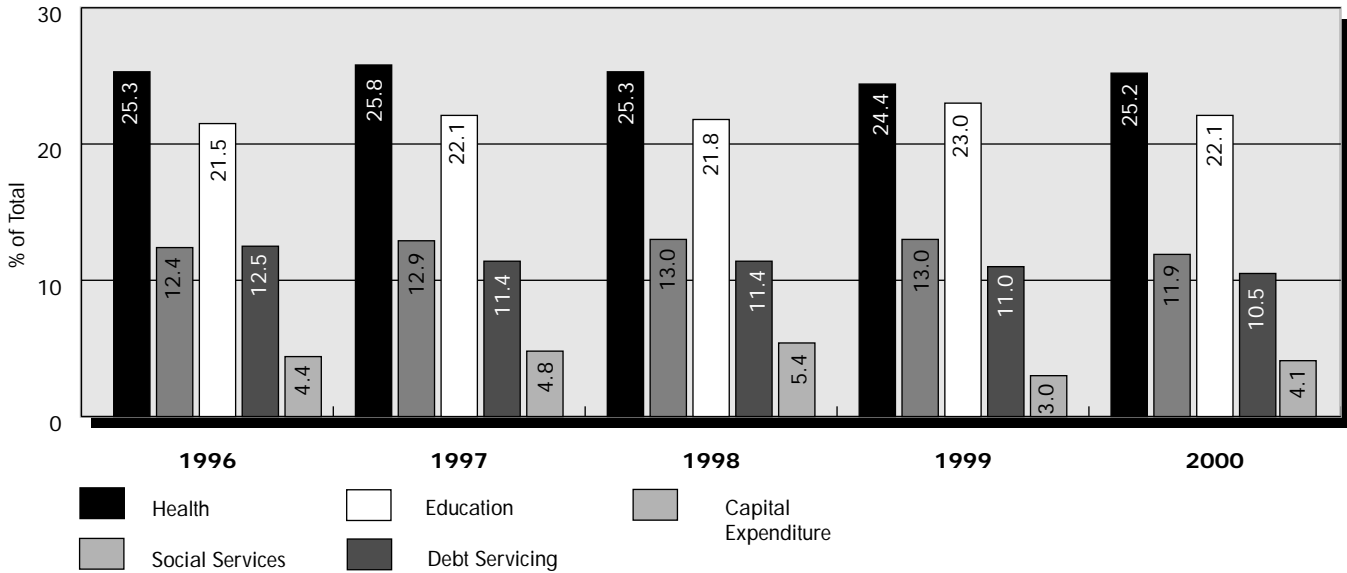
(as of March 31st)



The Province's unfunded pensions have also improved substantially over the past four years, from a deficit of \$294 million in 1996 to less than \$25 million for the current fiscal year.

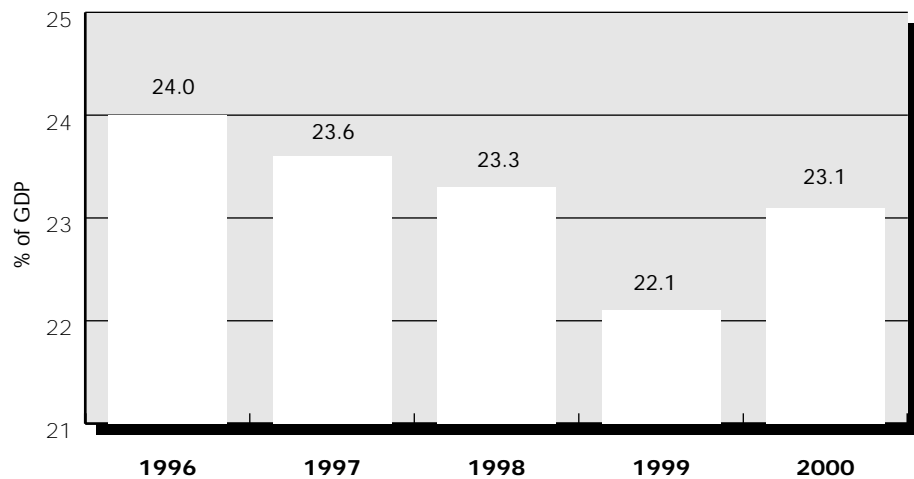
The spending strategy of Prince Edward Island over the past five years has been one of fiscal prudence. Health spending as a whole has remained at or below 26% of the Province's total yearly expenditures, the lowest in the region. Education spending has risen slightly to just over 22%, and the average increase in spending for the period was only 1.85% (see Graph 8).

8. How Your Money is Spent (PEI) (as of March 31st)



Overall, the Province's program spending, in essence all annual operating expenditures except debt service charges, as a percentage of GDP has declined from 24% in 1996 to 22.1% in 1999. This level is expected to rise to 23.1% by March 31, 2000 (see Graph 9).

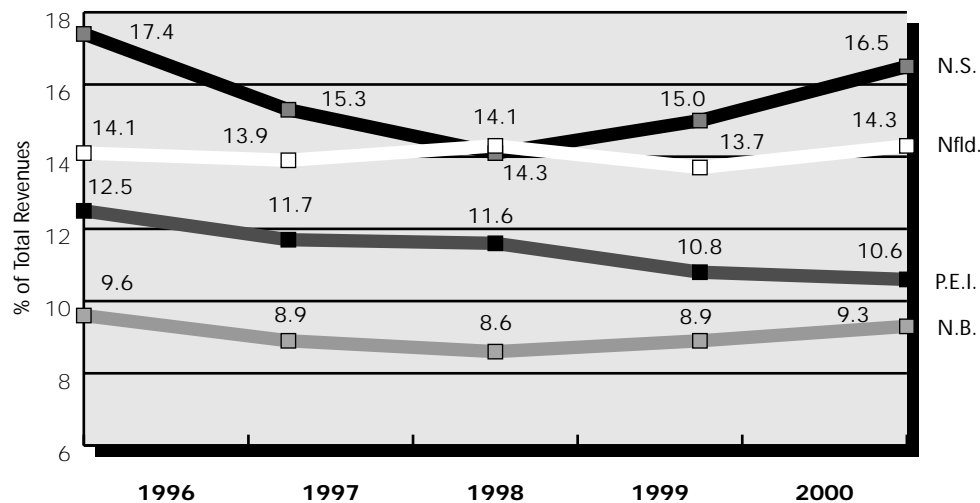
9. Program Spending/GDP (PEI) (as of March 31st)



The most significant improvement in PEI's financial performance has been the debt servicing ratio. This refers to debt service charges defined as a percentage of total revenues, and indicates how much of the citizens' annual payments to government are required just to service the existing debt load. In PEI, this ratio has declined each year for the past five years from 12.5% to 10.65% (see Graph 10).

10. Debt Service Changes (Atlantic Provinces)

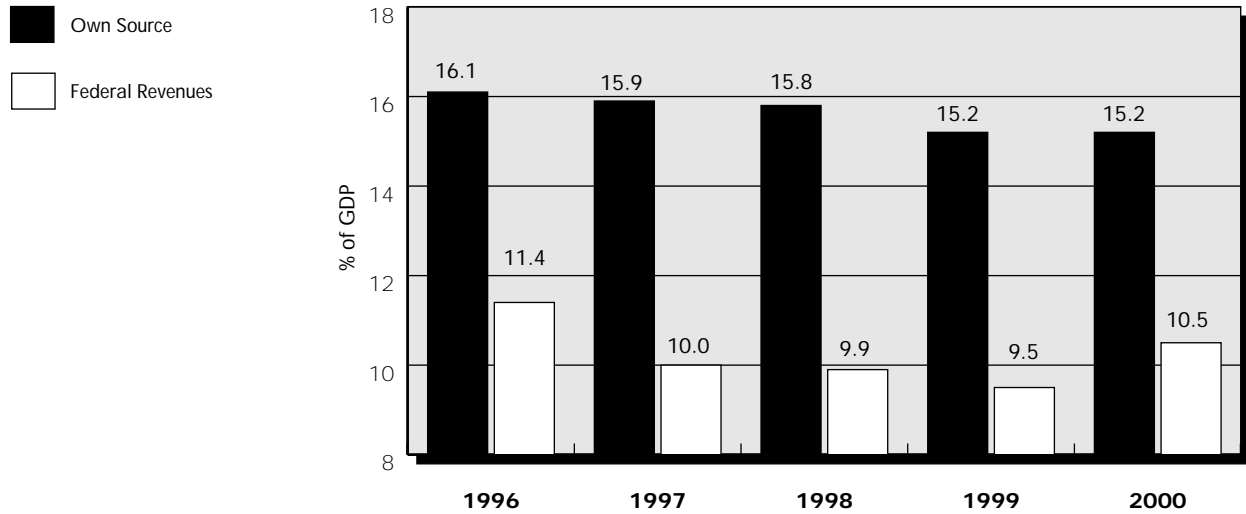
(as of March 31st)



As can be seen from this all-provinces debt services graph, the differences in percentages among the four Atlantic Provinces is very wide, from a low of 9.3% of total revenues in New Brunswick to a high of 16.5% in Nova Scotia. This dramatically demonstrates the recurring annual costs created by past excesses of government deficit spending.

Over the past five years, the Province's own revenues grew a total of 6.3%, and as a percentage of GDP have decreased. In 1996, it stood at 16.1% but has declined to 15.2% of GDP for 1999 and 2000. Meanwhile, Federal revenues to GDP have also declined, standing at 11.4% in 1996 and declining to 9.5% in 1999. For the current fiscal year, this level is expected to rise to 10.5% of GDP due to increased equalization and CHST payments (see Graph 11). The Province's dependency on Federal revenues is 40.8% of its total revenues.

11. Own Source and Federal Revenues/GDP (PEI) (as of March 31st)



Examples of Good Government Practices

The political leaders and professional public sector managers in PEI have delivered excellent results in a number of areas over the past five years. These can be summarized as follows:

- Disciplined control over expenditures. Budgeting is taken seriously, reporting is quarterly, and actions taken where needed. The results show this has been successful.
- The Government set a 'positive' economic environment and began to lower taxes in 1998/99 (PIT and Retail Sales Tax), having increased a number of taxes to fight the deficits of 1996/97 and 1997/98.
- The total debt burden has been reduced significantly over the five-year period.
- The Province has 'managed' its financial situation very well in the face of material cuts in Health and Social programs by the Federal Government.
- The Province has invested well in its public infrastructure of hospitals, schools and roads, embraced the building of the Confederation Bridge, promoted growth and diversification of the manufacturing sector, and created a new Department of Technology to help grow the IT sector of its economy.

Conclusion

As a whole, Prince Edward Island has executed a disciplined financial strategy. Bolstered by the new Confederation Bridge, it has begun the process of diversifying its economy, both seasonally and sectorally. The Government has a proven commitment to fiscal prudence, and appears headed in the direction of lowering the tax burden on individuals and businesses. The low and declining debt load, and almost balanced public sector pension funds, will provide the Province with a reasonable degree of sustainability and flexibility for its financial management. With no foreign debt exposure and little interest rate risk in its existing outstanding debt, combined with a slight declining dependency on Federal transfers, PEI has relatively moderate vulnerability.

The challenges for PEI come from growing pressures in the health and education spending areas, and the fact that it does not have a record of consistent annual surpluses. Its economy has under-performed the Atlantic region recently, and has weak fundamentals due to its seasonal nature. It remains highly dependent on government spending. Therefore, the comfort margin should be of concern as an economic downturn or a loosening of spending controls could push the Province back into financial deficits.

The Province must have continued strong and energetic political leadership and good financial management.

The challenges for PEI come from growing pressures in the health and education spending areas, and the fact that it does not have a record of consistent annual surpluses.

Newfoundland and Labrador Financial Analysis

Newfoundland has had to manage the most difficult structural financial problems in Canada over the past 25 years. Its public sector infrastructure and economy were far below Canadian standards when it joined Confederation in 1949 and this has been a significant drag on its performance ever since. The Province remains the poorest partner – it has the highest debt burden per capita and as a percentage of GDP, high unemployment and lowest income levels.

Notwithstanding these major obstacles, Newfoundland has been one of the best managed Provinces financially in Canada during the past ten years, and the period from 1995/96 to 1999/00 in particular. It has managed its scarce resources very well in economically turbulent times. The catastrophic decline of the cod fishery and other groundfish species, together with the out-migration of approximately 40,000 people, or 6.9% of the 1993/94 population, have had a significant impact on the financial and economic position of the Province.

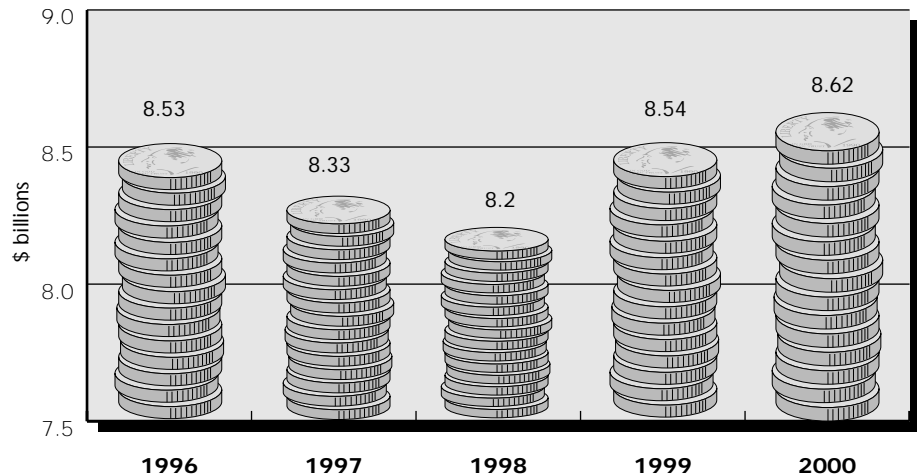
Fortunately these have been partially offset by the start of offshore petroleum production on the Hibernia field, with the Terra Nova field and others to follow in what will be the foundation of one of North America's great energy industries for the next 40-60 years. Other seafood species such as crab and shrimp have replaced groundfish catches and at higher export values. They have not, however, restored the numbers of people previously employed. There are other growth situations in the economy which have combined to deliver the fastest growing GDP in the nation. But it must be noted that large dollar volumes of petroleum exports do not have the same 'economic impact' in the short term as land based economic growth, either in jobs or revenue flows to the provincial treasury.

The fiscal results during the past four years can be described as steady. The Government has maintained its commitment to financial prudence and has a track record of four budgetary surpluses in the past five years, with a small deficit budgeted for the current period of 1999/00. It has grappled with substantial volatility in both Federal transfer payments and some of its own source revenues, such as retail sales taxes and personal income taxes.

The total debt burden in Newfoundland has increased slightly over the past five years. From a 1995/96 level of \$8.53 billion, the total debt burden decreased to a five-year low of \$8.2 billion in 1998. Unfortunately, the fiscal years 1998/99 and 1999/00 have witnessed increases and the March 31, 2000 total debt burden is forecast to be \$8.62 billion. This increase is attributed to the rise in unfunded pension liabilities and an increase in unrealized losses on existing foreign currency debt (see Graph 12).

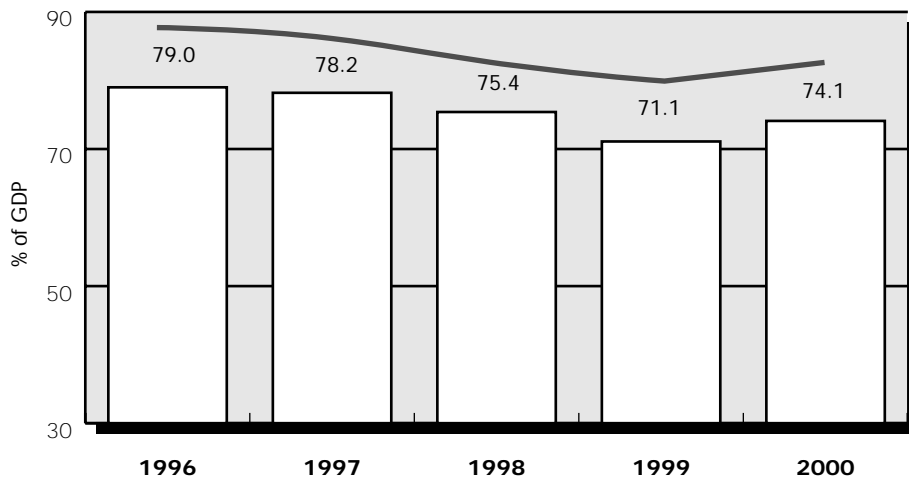
12. Total Debt Burden (Newfoundland)

(as of March 31st)



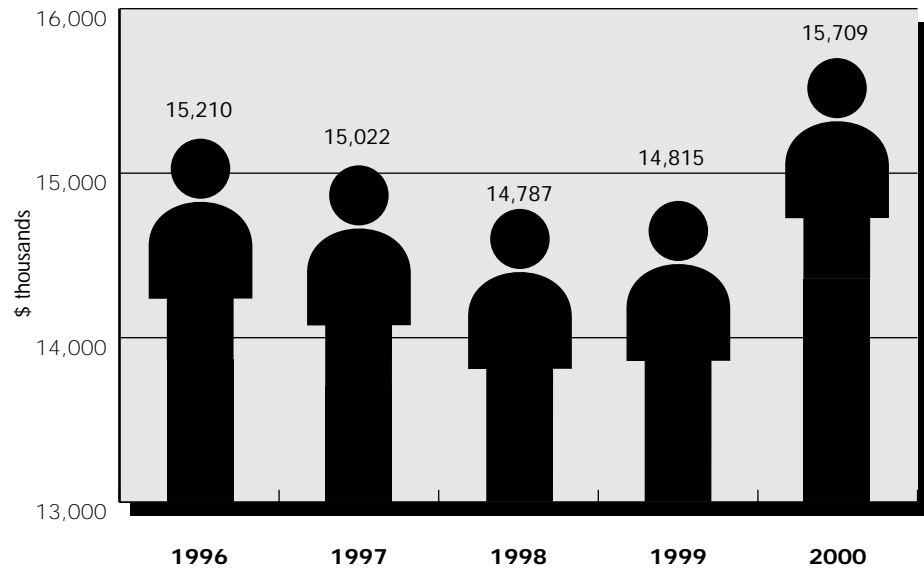
Newfoundland continues to have, by far, the highest total debt to GDP percentage in the Atlantic Region. While this ratio has decreased from 79.0% in 1995/96 to a projected 74.1% for 1999/00, it forcefully demonstrates the impact unfunded pension liabilities have on the total debt load, because without these pension obligations, Newfoundland direct debt would be approximately 48% of GDP (see Graph 13).

13. Total Debt Burden (% of GDP - Newfoundland) (as of March 31st)



The per capita debt of Newfoundland is by far the highest in the Atlantic Provinces. This debt indicator also decreased from 1995/96 levels of \$15,210 to \$14,787 per person, before rebounding to a five-year high of \$15,709 on March 31, 1999. The per capita increase is due to a declining population, a factor over which the government has little control, and the increase in the absolute amount of debt outstanding. The provincial debt which was left stranded when approximately 40,000 people left Newfoundland from 1992/93 to the current year represents approximately \$625 million of the debt, or \$1,163 per capita, that must continue to be serviced by the remaining population. There may be some offsets because of lower program spending from a smaller population (see Graph 14).

14. Total Debt Burden (per capita - Newfoundland) (as of March 31st)



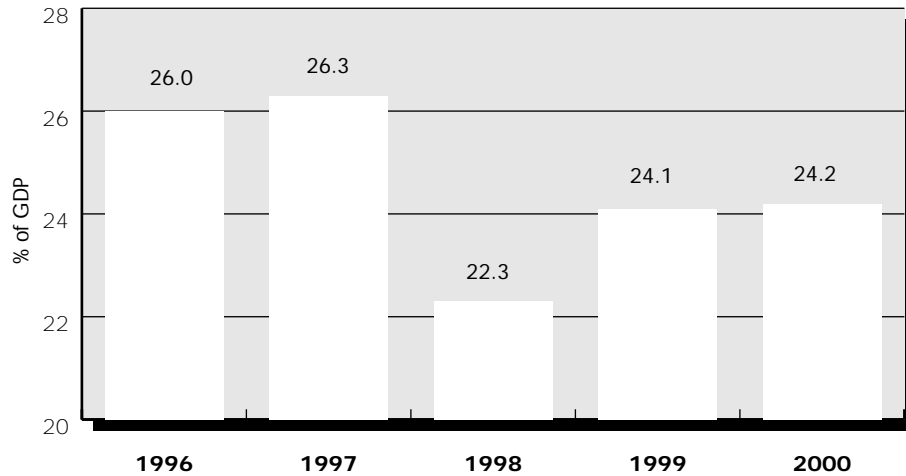
Newfoundland is also the only Atlantic Province to see its unfunded pension liabilities rise over the past five years. The 1995/96 amount was \$2.85 billion and has increased to a projected level of \$3.13 billion for 1999/00. This is a major financial risk for future generations of Newfoundlanders and governments. The Province has begun a program of 'extra' funding for these pension obligations, adding approximately \$205 million in each of 1997/98 and 1998/99, and will inject at least \$103 million per year thereafter. This results in provincial borrowings which add to the net direct debt, while at the same time decreasing the indirect debt of pension obligations. At December, 1997 the Public Service Pension Plan was approximately 50% funded, and the Teachers Pension Plan was only 17.2% funded, a decline from 17.8% in December 1992.

The foreign currency debt exposure of Newfoundland has been improved over the past five years. The 1995/96 percentage of foreign debt to total debt was 51%, and has been reduced to 39% for the current fiscal year. This significantly reduces the risk of currency fluctuations having an annual impact on the amount of interest expense paid, or on the principal amount of debt being repaid. The exposure at 39% is still too high and a plan to reduce this to at least 20% within three years would be a more prudent financial policy.

The trends regarding Newfoundland's program spending during the past five years can be characterized as well disciplined. Total program spending increased less than one percent (0.76%) and has decreased from 26% of GDP in 1996 to

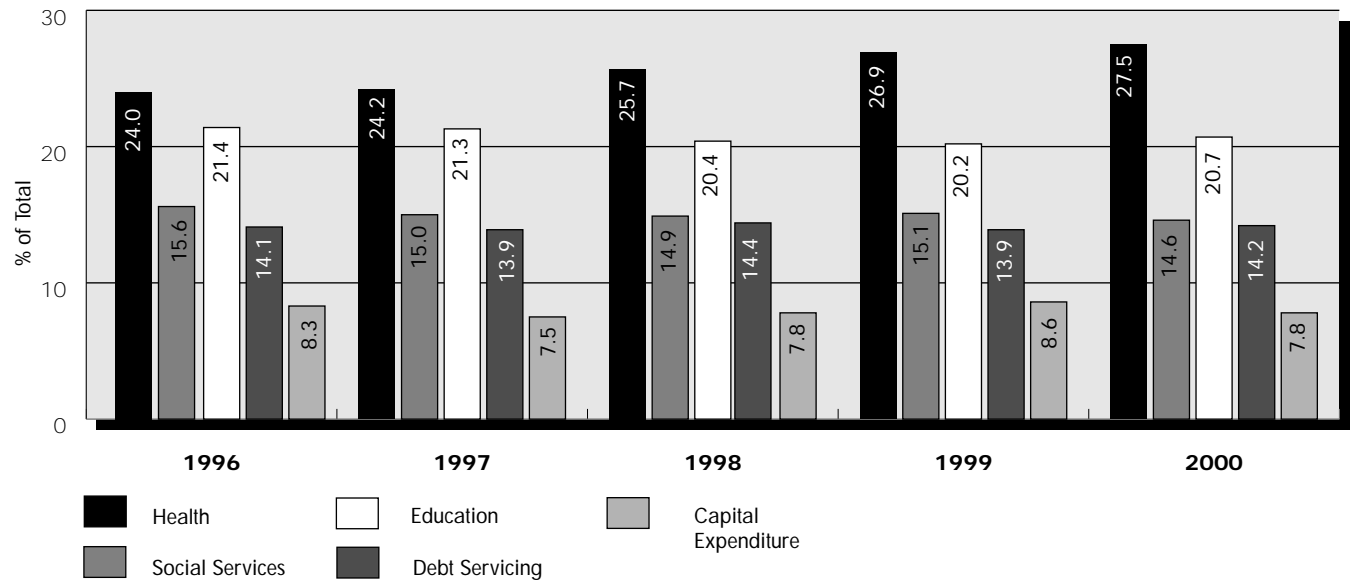
24.2% in the current fiscal year, which is a slight increase from a low of 22.2% in 1997/98 (see Graph 15).

15. Program Spending/GDP (Newfoundland) (as of March 31st)



Social services, education, debt servicing and capital expenditure have not varied much over this period; however, health spending has risen each year from a level of 24% in 1995/96 to 27.5% of total spending budgeted for 1999/00 (see Graph 16).

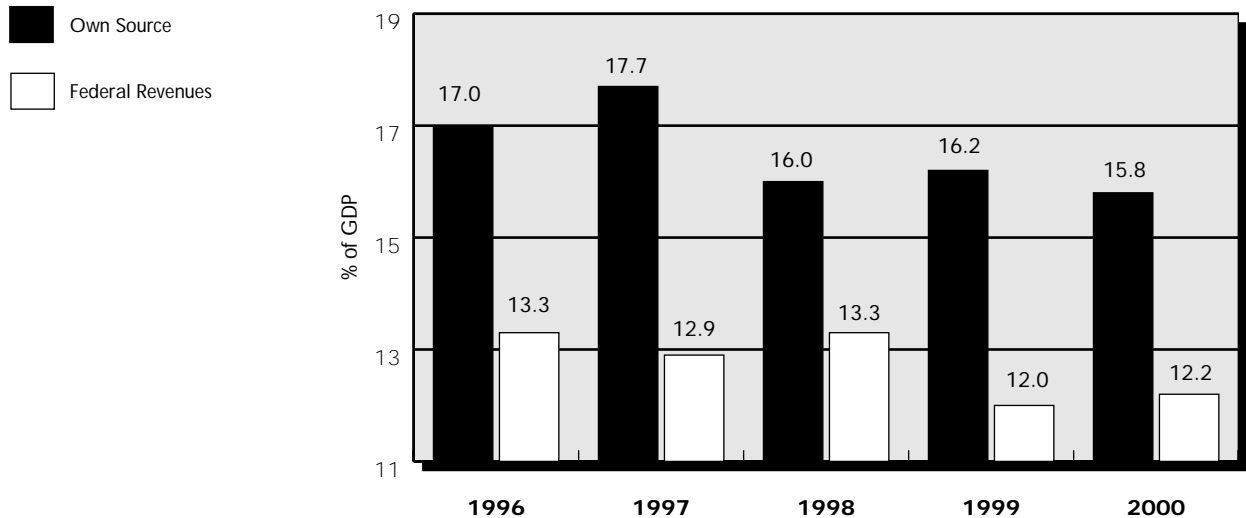
16. How Your Money is Spent (Newfoundland) (as of March 31st)



Pressures for increased operating and construction spending on health programs pose the biggest risk to Newfoundland's ability to manage its very high debt load, without having to increase revenue sources or cut other programs. Notwithstanding the improvements in financial management during the past five years, the Province still has unconsolidated health spending activity outside its budgetary process. This could become a threat to its commitment to fiscal prudence and balanced budgets.

Newfoundland's own source revenues to GDP have decreased over the past five years from 17% in 1996 to 15.8% for 1999/00, a good sign that Government is taking less of the economy's production of goods and services. At the same time, federal revenues to GDP have decreased from 13.3% in 1996 to 12.2% for 1999/00, as the Federal Government has reduced its spending to get its debt-burdened house in order (see Graph 17). Total revenues actually decreased by 0.3% during the period.

17. Combined Own Source & Federal Revenues/GDP (Newfoundland) (as of March 31st)



Examples of Good Government Financial Practices

Some of the sound financial management practices accomplished by the political leaders and public service managers in Newfoundland during the past five years include:

- Reducing the number of crown corporations and agencies by selling Marystown Shipyard and Newfoundland Farm Products, thereby eliminating annual losses and the risk of future debt increases.

- Applying most of the ‘windfall’ equalization payments from prior years’ adjustments and revised 1998 and 1999 entitlements to pay down accumulated debts of hospital boards, school boards and those municipalities that were prepared to restructure their financial affairs.
- Changing its accounting to consolidate Government operating and capital programs such as construction into the budget process. There is still considerable work to be done for Newfoundland to have fully consolidated financial reporting in accordance with Generally Accepted Accounting Principles (GAPP) for public sector accounting. Its budget documentation is the best in the Atlantic region.
- The Province has not borrowed in foreign currencies since 1994, and has reduced its percentage of foreign debt exposure from 51% in 1995/96 to 39% at March 31, 1999.
- The Province has achieved surpluses in most years, despite substantial cuts in Federal Health and Social Programs that totaled \$553 million in the four-year period to 1999/00 (see Table 1).
- There have been no tax increases during this five-year period, placing the priority of financial management on spending controls in the public sector. On November 17, 1999, the Government announced proposed PIT decreases beginning in the taxation year 2000 that would reduce the provincial PIT in three stages from 69% of the Federal tax, to 49% by 2002. The reductions are partially offset by increases in the provincial surtax on incomes above a certain level.

The existing mountain of public sector debt, and its vulnerability to economic down-turns or reduced Federal transfers, places Newfoundland in a constant state of financial ‘high-wire’ balancing.

Conclusion

The existing mountain of public sector debt, and its vulnerability to economic down-turns or reduced Federal transfers, places Newfoundland in a constant state of financial ‘high-wire’ balancing. The Province depends on Ottawa for 43.4% of its total revenues.

Recent political leaders, specifically the two Liberal premiers during this period, and its public service managers, have demonstrated strong fiscal prudence. They have achieved a number of positive outcomes and have improved the Province’s financial creditworthiness, all within a difficult economic, social and financial environment. However, the challenge remains to service and eventually pay down its large accumulated debt, so that the Province can gain flexibility and freedom for its citizens and businesses to expand all sectors of its economy.



New Brunswick began this period with the third best credit rating in Canada, a rating it has maintained.

New Brunswick Financial Analysis

After a decade of developing a reputation as one of Canada's most fiscally prudent provinces, New Brunswick's recent accounting changes and re-stated numbers have caused a setback to this record. The main impetus for the financial reporting changes originated with the Auditor General's qualifications to the 1997/98 Public Accounts. The new Government engaged the accounting firm of Grant Thornton to review the financial health of the Province, including the Auditor General's comments on NB Power and HST transition funds treatment. Grant Thornton's report and the Government's response were made public on November 18, 1999.

The Province's government had been proud to state its philosophy of 'living within its means and paying as it goes'. When Federal transfer revenues were materially cut in 1996/97, the Government showed its resolve to stay the course by tightly controlling all expenditures, lowering taxes and reducing total debt, while still achieving 'reported' surpluses in four of the past five years.

This picture has been re-framed by the implementation of the Grant Thornton report, resulting in a re-stated deficit of \$227 million in 1998/99, and a projected deficit of \$96.3 million in 1999/00. Prior to these changes for 1998/99, the Province had over-achieved its original budgeted \$19.6 million surplus and was projecting a surplus of approximately \$153 million. The main accounting changes and their financial impact can be summarized as follows:

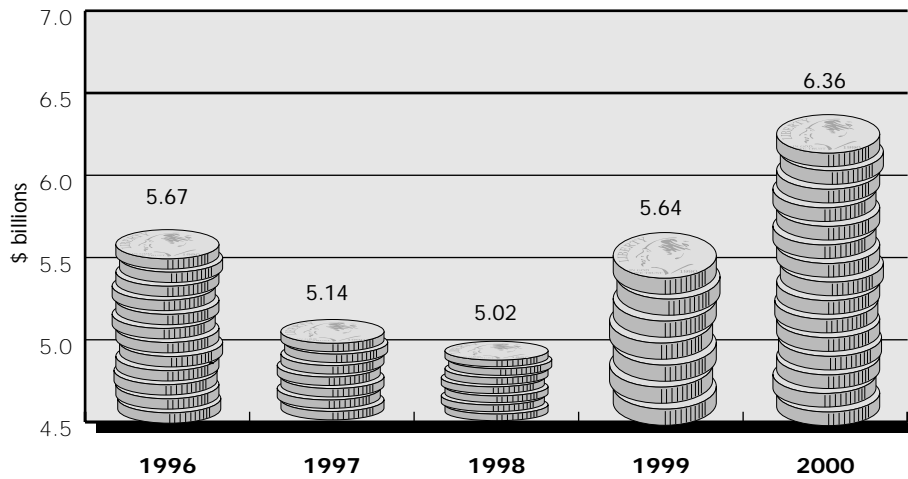
1. A write-down of \$450 million for the impairment of NB Power's Point Lepreau plant is recorded in the 1998/99 Public Accounts.
2. HST transitional revenues are recast and \$253 million is recognized in 1998/99 instead of \$89 million, an increase of \$164 million.
3. Various increases for loan reserves, low interest rate valuations and consolidating hospital corporation deficits resulted in a total increase in budgetary expenditures in 1998/99 of \$94 million.
4. The change from a budgeted surplus of \$12.5 million to a deficit of \$96.3 million in 1999/00 can be mostly attributed to the re-statement of HST revenue, from a budgeted \$181.0 million to a revised \$66 million, plus some higher than planned spending.

New Brunswick began this period with the third best credit rating in Canada, a rating it has maintained. The total debt burden decreased from \$5.7 billion in 1995/96 to a low of \$5.0 billion in 1997/98, mostly due to favorable changes in the value of outstanding foreign currency debt, and the pre-payment by the Government of Canada of \$354 million in HST harmonization funds. In the past

two years, and adjusting DBRS's latest credit rating report for the impact of the Grant Thornton report, as well as the toll highway and hospital debt described more fully below, total debt burden has increased to \$6.36 billion (see Graph 18).

18. Total Debt Burden (New Brunswick)

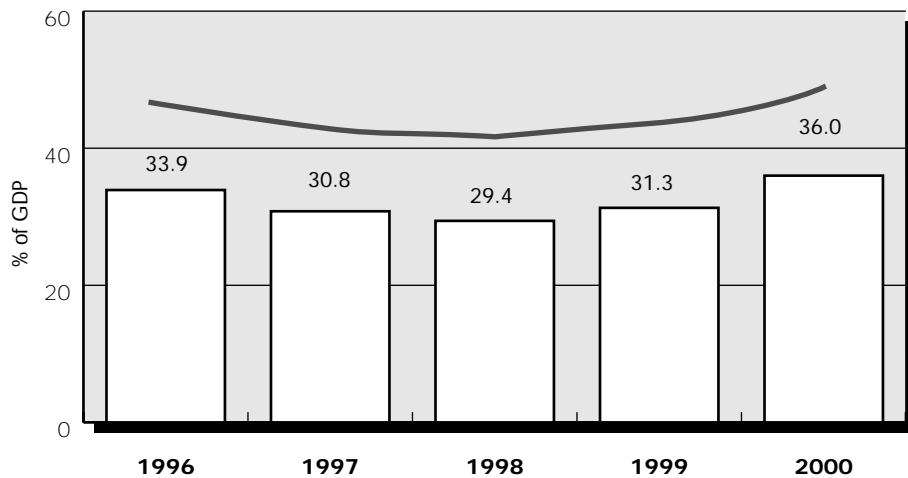
(as of March 31st)



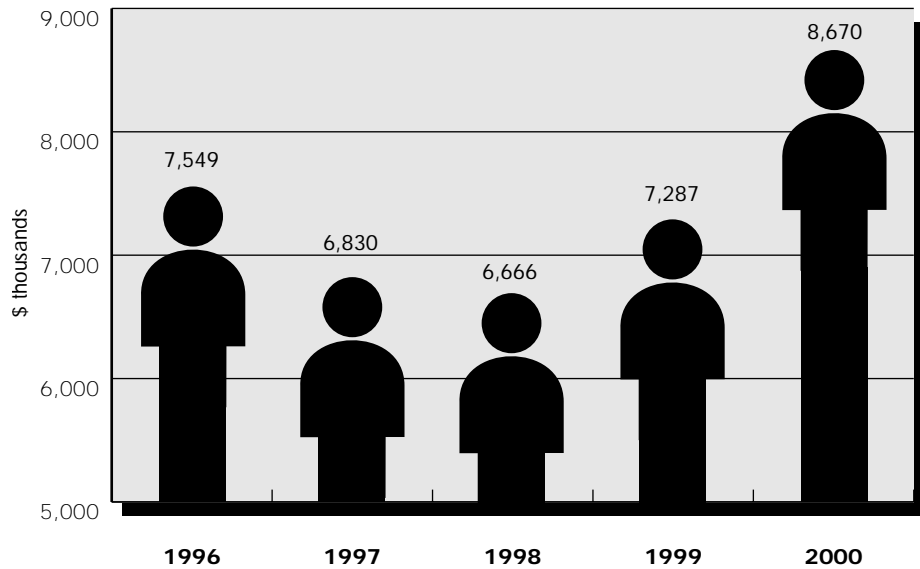
The Province has incurred an increase in its total debt to GDP from 33.9% in 1995/96 to 36.0% in 1999/00, and its per capita debt has increased from \$7549 to \$8670, having reached a low of \$6666 in 1997/98 (see Graphs 19 & 20).

19. Total Debt Burden (% of GDP - New Brunswick)

(as of March 31st)



20. Total Debt Burden (per capita - New Brunswick) (as of March 31st)



The Province has had 'balanced budget legislation' since 1996/97, and by its definition will have achieved its targets for the four-year period ending 1999/00. This Act states that the targets cannot be retroactively affected by subsequent accounting policy changes. Furthermore, in the 1997/98 Budget the Government announced its intention to introduce a 'debt reduction plan and legislation' complete with specific debt reduction targets over a 25-year period. This debt reduction legislation has not been implemented.

New Brunswick's past leadership in fiscal matters has resulted in the Province being disciplined in most areas and achieving a strong financial position overall. However, as described above, there have been inconsistencies that with hindsight should have been applied in the year the expenditure or revenue actually occurred. Some background on these items is necessary:

1. NB Power recognized a \$450 million impairment of its Point Lepreau nuclear plant in its March 31, 1998 financial statements, but did not have a net write down on its balance sheet because it created an offsetting deferred asset, stating an 'assumption' of finding future new revenue sources as the reason. At least \$450 million should have been added at that time to New Brunswick's total debt burden for impaired generative assets, since the Province reduced its publicly stated debt by the amount of NB Power's equity when it adopted full equity accounting earlier in the 1990's.

Since NB Power has net equity less than \$450 million, and has had net operating losses in recent years, this may create a serious financial situation for the Corporation and the Province.

2. The new toll highway between Moncton and Fredericton will cost approximately \$750 million when it is completed in 2003. The Province has created a wholly owned crown corporation and there is an absolute assignment of the sublease payments, which the Province has agreed to pay through appropriation by the New Brunswick Legislature to the issuer of the Highway Bonds raised to build the toll highway. These payments from the Province will be \$58 million annually for 26 years, starting in November, 2003.

One of the major credit rating agencies has already added the current amount of the Highway Bonds debt to New Brunswick's debt statement. This Report adds \$622 million to the Province's debt, the projected amount outstanding on March 31, 2000.

3. The Province's Hospital Boards had accumulated debt of approximately \$70 million at March 31, 1998 that is not accounted for on the Province's debt statement. It is understood that hospital operating deficits are now fully accounted for by the recent adjustment of \$28 million recommended by Grant Thornton. As health care costs continue to increase, and the Province has a stated policy of full consolidation and transparency, it would seem logical to add the \$70 million of Hospital Board debt directly to the total debt burden.

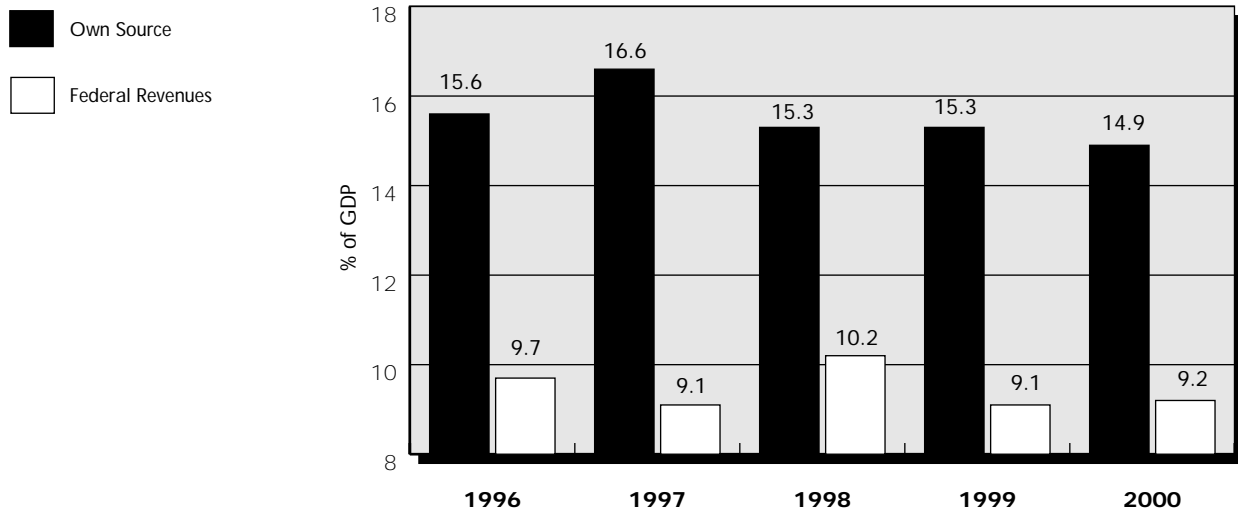
The increase in total net burden from the above items and the implementation of Grant Thornton's recommendations is approximately \$960 million (see Graphs 18 & 19).

There is one other significant area where the timing of recording transactions causes difficulty in assessing New Brunswick's financial performance in any given year compared to other fiscal periods, which is as follows.

In fiscal 1997/98, substantial prior years' adjustments, totaling \$289 million, were recorded in the Province's books and added to its net debt. These were not disclosed in the 1998/99 Budget, but rather in the 1999/00 Budget, likely owing to the fact the 1998/99 Budget was delivered on December 4, 1997, months before audited Public Accounts for the year ended March 31, 1998 were finalized. These adjustments were due to accounting policy changes and were for retirement allowance entitlements (\$195.2 million), summer pay for teachers (\$47.3 million), vacation pay entitlements (\$16.3 million), and Workers' Compensation Benefits (\$31.0 million). These items also resulted in retroactive downward adjustments of the 1997/98 surplus totaling \$12.5 million.

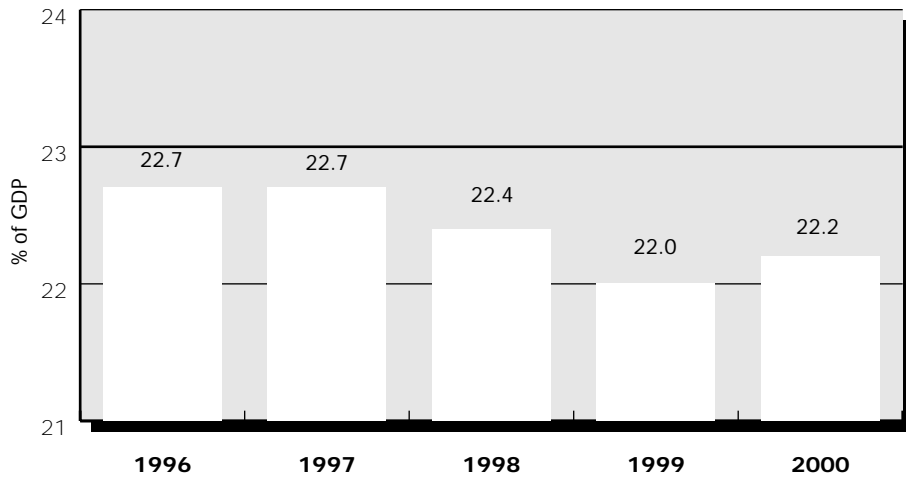
New Brunswick's economy has grown at an average of 2.1% over the past four years, slightly less than the Canadian average. Own source revenues for the Province are decreasing annually with the current level of 14.9% of GDP at a five-year low, down from a high of 16.6% in 1996/97. Federal revenue to GDP ratios for the past five years have been as high as 10.2% of GDP in 1997/98 and as low as 9.1% in 1996/97 and 1999/00. Total revenues for the period grew 2.9% while the economy was growing 8.5% (see Graph 21).

21. Combined Own Source & Federal Revenues/GDP (New Brunswick) (as of March 31st)

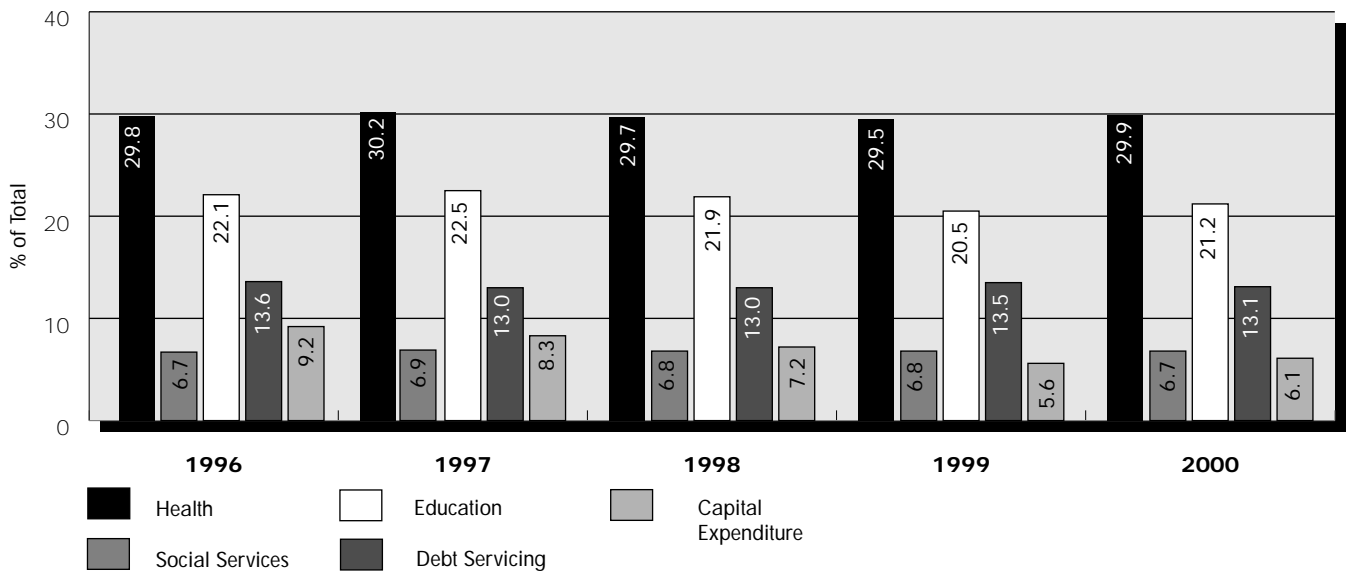


The program spending to GDP for the Province decreased from 22.7% of GDP in 1995/96 to 22% in 1998/99, and is expected to climb to 22.2% for 1999/00. The recent rise in federal revenues and program spending to GDP may be indicative of a move away from the tight fiscal management that produced operating surpluses during each of the past four years. Total spending grew 5.8% during this period, twice the growth rate of revenues. The largest increased expenditures are health care, education, new school construction and improvement to rural roads. These total \$171 million in 1999/00 and result in a 4% increase in the total expenditure budget compared to 1998/99 (see Graphs 22 & 23).

22. Program Sending/GDP (New Brunswick) (as of March 31st)



23. How Your Money is Spent (New Brunswick) (as of March 31st)





New Brunswick has one of the lowest debt services as a percentage of revenues, and lowered this from 9.6% in 1995/96 to 9.3% in 1999/00.

Examples of Good Financial Management Practices

Some of the good financial decisions or outcomes of note in New Brunswick during the past five years include:

- New Brunswick has one of the lowest debt services as a percentage of revenues, and lowered this from 9.6% in 1995/96 to 9.3% in 1999/00.
- The foreign currency exposure as a percentage of total debt has been reduced to 23%, the second best in Atlantic Canada.
- The Province has shown leadership in expenditure control in most areas for over a decade; however, increases in health and education have returned the Government to projected operating deficits.
- New Brunswick has maintained one of the lowest total debt positions in Canada, and also one of the lowest overall 'taxation loads' with respect to both businesses and individuals.
- In light of Federal transfer cuts in Health and Social programs totaling almost \$440 million over four years, financial management has been quite good. The Province has the lowest dependency on Federal transfers at 38.1% of total spending.
- The Province's history of accounting transparency, and its consolidation of most Government crown agencies and boards, had made it a leader in the Atlantic region. As a result of the Grant Thornton report, additional steps to full disclosure have now been taken. In addition, the budget documentation could be improved to provide simpler and better communication to the population at large.
- Achieving close to a fully funded position, due to extra funding by the Province and high investment returns on the portfolios of the Province's pension plans, is a credit to its financial managers. This substantially reduces the Province's vulnerability, while improving both its ability to sustain future programs and its flexibility to address tax reductions and/or other spending decisions.

Conclusion

Over the past decade, New Brunswick has been one of Canada's most fiscally responsible provinces. Despite a relatively undiversified economy and increasing spending pressures on its health care system, its political leaders had achieved consistent operating budgets and a stable level of debt, prior to the recent adjustments. They had also managed to survive a difficult period of Federal cuts.

However, several concerns are growing. The problems with both NB Power's asset valuations and its competitive position will directly impact the Province's financial position if long term solutions are not found. Also, 'windfall' equalization payments totaling approximately \$170 million in the past three years have all been spent on budget over-runs in various departments, while at the same time the Government changed direction on its debt reduction goals.

New Brunswick needs to return to strong political leadership of its finances if it is to remain economically competitive and be in a position to eliminate the current projected deficit and resume the reduction of taxation levels.

Nova Scotia Financial Analysis

Compared to the other three Atlantic Canada provinces, Nova Scotia's financial performance has deteriorated significantly since 1995/96. This continues a trend of relatively poorer financial leadership and management that has existed for over twenty years.

The recent decision by the new government to adopt fully consolidated financial statement reporting, consistent with GAAP, is a profound change in financial attitude. The next step is to develop a financial management standard of accountability within all departments and agencies toward the stewardship of public monies they are entrusted to manage.

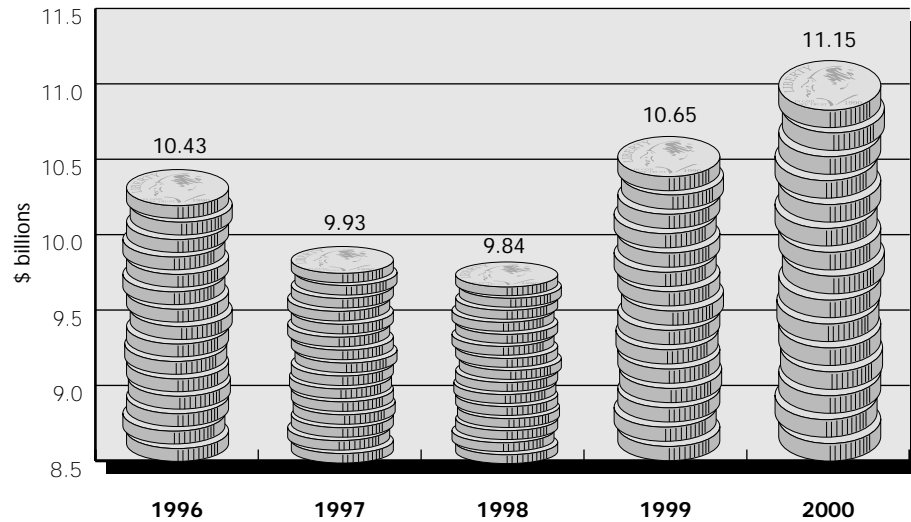
The irony of Nova Scotia's recent 'openness' is that the credit rating agencies who rate the Province's bond issues have, for the most part, been reporting their own sets of numbers for years, simply by adjusting the annual deficits and total debt burden to give what they have felt to be the more appropriate financial picture. While even the rating agencies have some differences in their treatment of some items, they have consistently reported Nova Scotia's debt to be higher than the numbers put forward to the public.

For example, DBRS showed Nova Scotia's total debt burden in 1995/96 at \$10.385 billion. This number declined to \$9.466 billion in 1997/98, mostly due to favorable swings in the value of outstanding foreign currency borrowings. With the recent accounting changes and the revised projection of a \$497 million deficit for 1999/00, the Province's current revised total debt burden, using DBRS's format, will be approximately \$11.15 billion. The Provincial budget in November, 1999 reported total debt of \$10.1 billion, approximately \$1 billion lower, mostly due to not including guaranteed and contingent debt (see Graph 24).

Compared to the other three Atlantic Canada provinces, Nova Scotia's financial performance has deteriorated significantly since 1995/96. Accumulated deficits for this period total \$1.974 billion.

24. Total Debt Burden (Nova Scotia)

(as of March 31st)



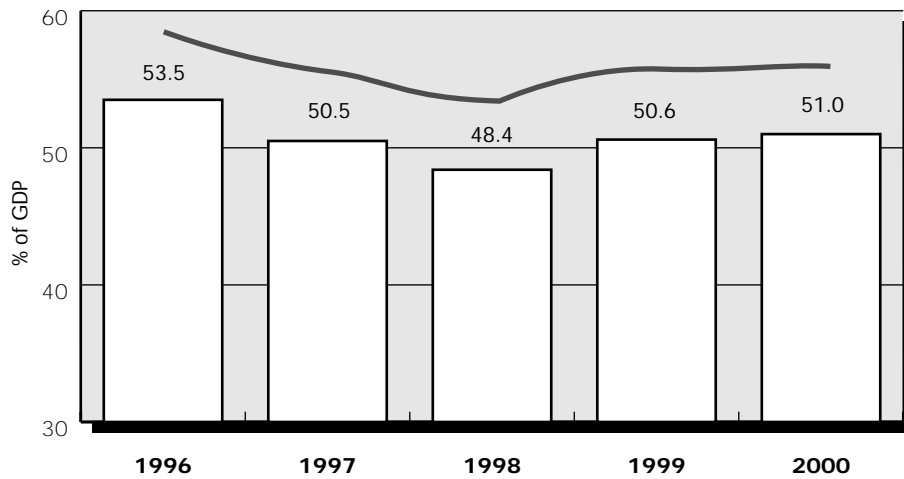
The move to GAAP and fully consolidated financial statements is a very positive decision, and will assist both the political leaders and the public sector managers to be held accountable in a more understandable way by the people of Nova Scotia. However, in our opinion there are still several financial areas to be considered for inclusion in reporting its total debt burden: the guaranteed and contingent debt; the under-funded long term disability program of public sector employees which stood at \$45 million in 1992; and the off-balance sheet lease debt of the P3 schools which will eventually total over \$300 million.

The increase in total debt during the past five years is the highest in the Atlantic region. The major reasons are a significant reversal in the value of the Canadian dollar, turning the earlier debt reduction into a net increase; the accumulated losses of Sydney Steel Corporation and Nova Scotia Resources Limited; the extensive budget overruns in Health spending (financed initially through off-budget debt); and a recent reversal in the progress toward fully funded public sector pension plans. The total accumulated re-stated deficits of Nova Scotia for the period from 1995/96 to 1999/00 are \$1.974 billion!

Due to the consistent growth in its economy, Nova Scotia's debt to GDP has improved slightly from 53.5% in 1995/96 to 51.0% projected for 1999/00, but it is still the second highest in the region behind Newfoundland. The per capita debt also increased during the four-year period, from \$11,185 to \$11,900, also the second highest in the Atlantic region (see Graph 25 & 26).

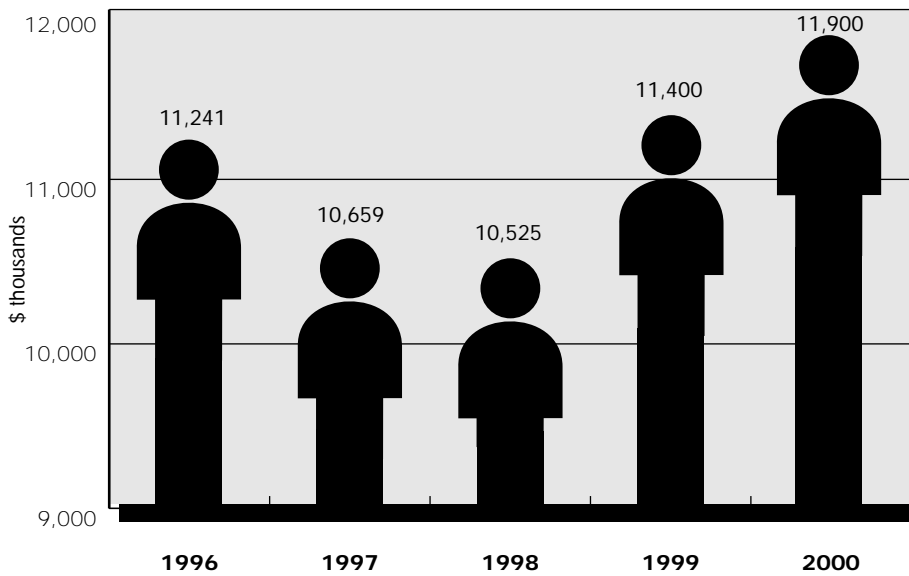
25. Total Debt Burden (% of GDP - Nova Scotia)

(as of March 31st)



26. Total Debt Burden (per capita - Nova Scotia)

(as of March 31st)



The Province now has the lowest credit rating in Canada from Standard & Poor's, tied with Newfoundland, and the second lowest from the other rating agencies. It has been placed on 'credit watch' by one agency.

The Nova Scotia economy is projected to continue its solid growth over the next couple of years.

The most significant result of the increasing debt position of Nova Scotia and its unwillingness to eliminate deficit budgeting, is a dangerous decrease in its financial flexibility and its ability to sustain existing programs. The gross annual debt service charges in 1999/00 will be approximately \$1.0 billion in 1999/00, excluding lease commitments. This is 22.5% of gross provincial revenues. The more conventional measurement is to net out interest paid by the Province on the debt held in its sinking funds, amounting to almost \$218 million this year. Using the net debt services charges of \$799.6 million, the percentage is still the region's highest at 16.5%.

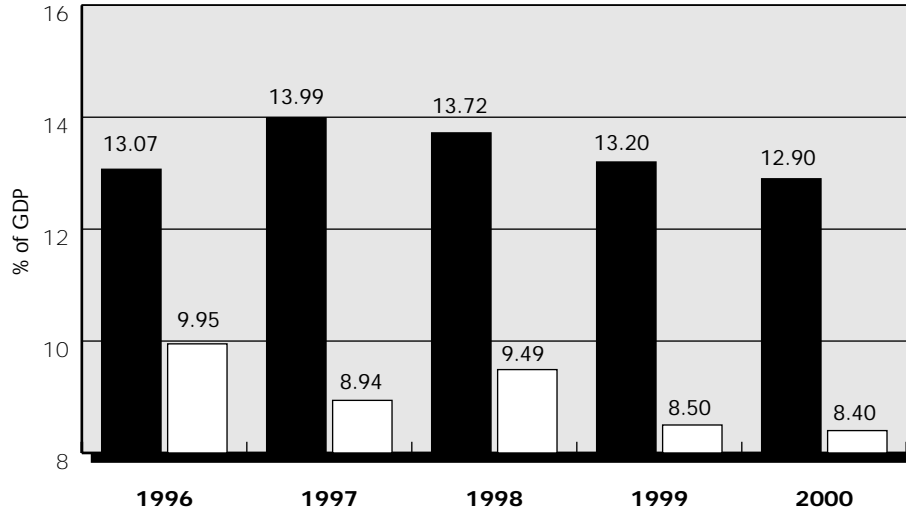
Nova Scotia's urgent challenge is its huge current operating deficit and massive outstanding debt burden. It must take action immediately:

- It must quickly stop the compounding of annual interest costs by eliminating deficits.
- If Nova Scotia's per capita debt were equivalent to that of New Brunswick, its annual debt service charges would be approximately \$255 million lower. This amount likely represents more than Nova Scotia's current structural deficit problem.
- If we eliminate the losses of Sysco and Nova Scotia Resources, and there are no further non-recurring expenditures and accounting changes (such as those recently recorded for pensions, school board debt, foreign exchange and hospital board debt for equipment and Y2K solutions) then the Province's deficit could be eliminated in the short term.

This would be a profound accomplishment and place Nova Scotia on the path to financial recovery. It would also create the real possibility of personal tax reductions over the next 3-4 years.

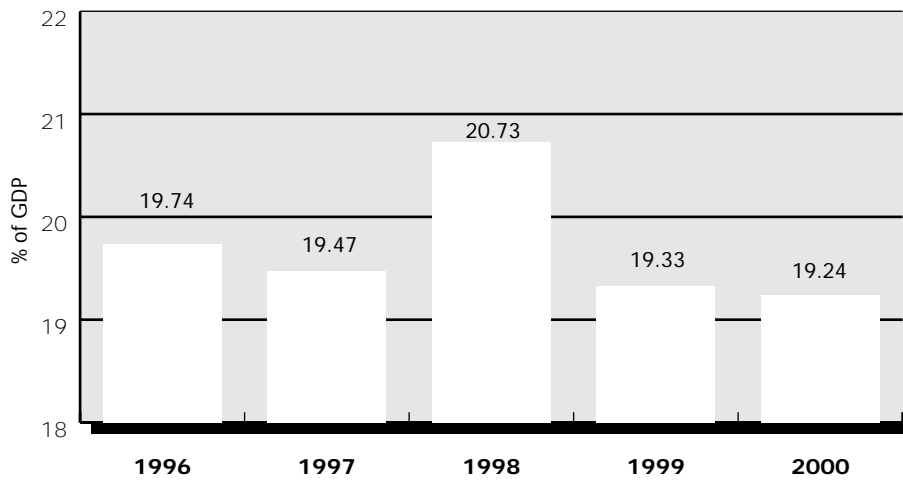
The Nova Scotia economy is projected to continue its solid growth over the next couple of years. In the past five years, GDP growth has totaled 11.5%, an average of 2.9%. Total revenues increased 8.3% during this period, the highest growth rate in the region. Own source revenue growth to GDP and Federal revenue growth to GDP are shown in Graph 27.

27. Combined Own Source & Federal Revenues/GDP (Nova Scotia)
 (as of March 31st)



As Graph 28 indicates, program spending increased 8.74%, or an average of 2.19% per year, and decreased from 19.74% of GDP in 1995/96 to 19.24% in 1999/00. Total government spending increased 6.0% over the five years, almost one half the rate of GDP growth.

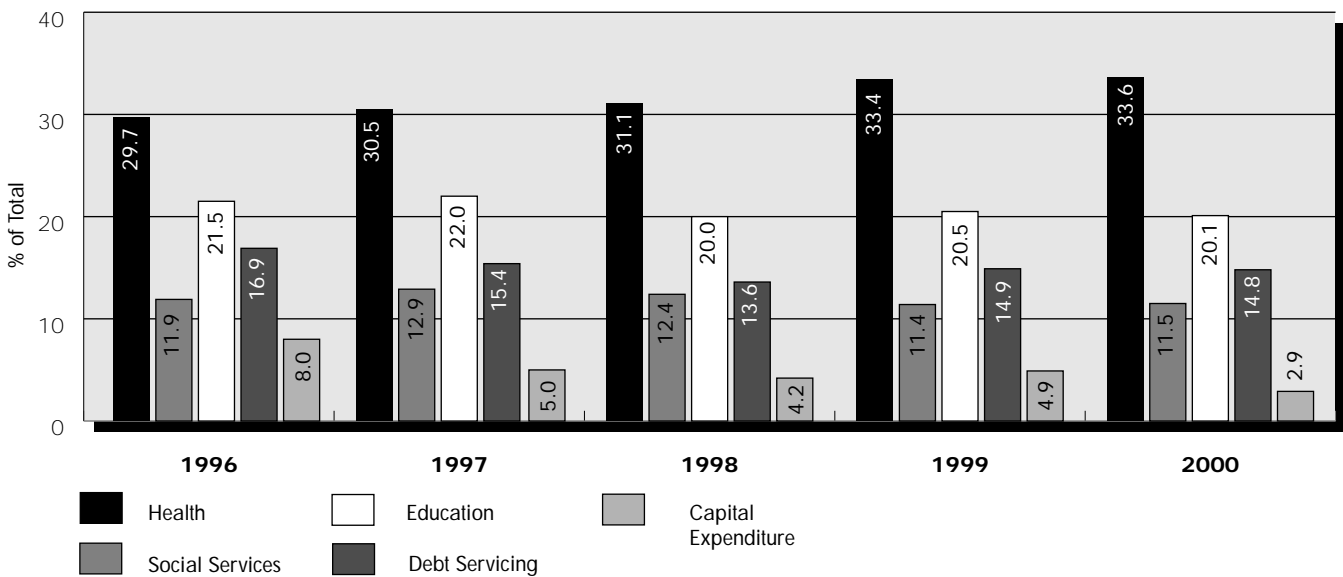
28. Program Spending/GDP (Nova Scotia)
 (as of March 31st)



These graphs indicate that while the government is not taking a higher percentage of revenues from GDP, nor spending a higher percentage, its own revenues are growing faster than GDP. This leads to the conclusion that the Province's financial problems of deficits and volatility in its total debt burden are caused primarily by foreign currency fluctuations, losses in crown agencies and off sheet accounting practices, such as hospital board deficit financings, that are only now going through the Government's books.

Graph 29 (below) indicates that Nova Scotia is spending almost 33.6% of total expenditures on health care, the highest percentage in the Atlantic region. This is projected to be \$1.770 billion in 1999/00. Both total spending and the percentage have increased substantially in the past five years, with the growth in spending averaging 8.80% annually.

29. How Your Money is Spent (Nova Scotia) (as of March 31st)



It should also be noted that calculations of totals and averages partly mask significant changes within Nova Scotia's Federal revenue sources. For example, during this five-year period, Nova Scotia has received at least \$564 million less in Health and Social payments than the level existing in 1995/96. Excluding HST transitional payments that end in 2000, the Province's revenues in 1999/00 are basically the same as in 1995/96.

Examples of Good Financial Management Practices

While the overall financial performance of Nova Scotia has been poor, there have been a number of areas where its finances and management practices have improved during the past five years. The starting point for some of these was the majority Liberal Government elected in 1993. The people of Nova Scotia would be experiencing a much better financial future, especially in the short term, had these practices been continued. It should also be noted that some of the recent bad news is due to accounting changes, whereas the underlying financial situation had existed for some time.

During the past five years there have been positive results in a number of areas:

- The percentage of foreign currency exposure has declined from a peak of 72% to a current level of around 49%, not including Nova Scotia Resources Limited whose \$620 million of debt is denominated in US dollars. Scheduled maturities of direct provincial foreign issues will reduce this to 40% by March 31, 2004. This is still a high risk area that requires more aggressive action.
- The Province has established a Provincial Debt Retirement Fund (PDRF) for those bond issues that do not have mandatory sinking funds. This prudent move means an annual reduction in the debt through regular principal contributions and the interest earnings on these PDRF sinking funds.
- There has been a continued improvement in funding the public sector pension plans. Despite some volatility in the performance of the portfolios, the total liabilities for all pension plans are in excess of 85% funded.
- With the exception of health care spending, there has been good discipline exercised in most other government programs.
- The commitment to move to GAAP and fully consolidated financial statements is a very positive decision.
- If the commitments by the new Government to resolve the financial drain of Sysco and Nova Scotia resources in the short term, and to bring better financial management to all areas of government are implemented, this will result in major progress in the financial affairs of the Province.
- While not originated in this four-year period, the privatization of Nova Scotia Power, which was completed in 1995/96, removed almost \$2.0 billion in guaranteed debt from the Province's public sector debt.

The people of Nova Scotia would be experiencing a better future if the financial practices of 1993-96 were continued.



Conclusion

The economic performance of Nova Scotia during the past two years has been solid, and the near term outlook is quite good. However, its biggest challenge is the management of the government sector, and specifically its finances. Conquering the deficit is of the utmost priority. It will threaten all other plans and actions of the Government and its citizens if it is not successfully addressed. The Government is transferring a profoundly heavy debt burden and high levels of government spending to the children and grandchildren of Nova Scotia. This comes at a time when demographics are adding a higher percentage of people to the retirement sector.

The earnings base of Nova Scotians is just not large enough, or growing fast enough, to afford the current costs of government. In addition, the Province depends on Ottawa for 40.3% of its spending, a ratio that is declining. Therefore, a tough, realistic and courageous financial plan is required. The first step was taken by the Minister of Finance when he fully disclosed the financial condition of the Province. This is not enough. Eliminating the deficit and beginning the process of reducing its debt burden is urgently required.

Handing Out the Report Cards

Section 4

The overall financial performance of the Atlantic Provinces during the four-year period from 1995/96 to 1999/00 has improved, and this is reflected in the grades compared to those in the June, 1996 edition of Debtors' Prison. There has been an overall increase in commitment to prudent fiscal practices and a recognition that annual deficits cannot be sustained. The public has become much more aware of the dangers of continual deficits, excessive debt burdens and suffocating tax rates. The citizens have indicated they want a solution, and governments are beginning to respond.

The improvement in financial reporting is evident in the budgets, Public Accounts and the reports of the various Auditor Generals during the past four years. While there is much work left to be done on getting all governments to adopt uniform accounting and financial reporting, there is no turning back from the progress that has already been achieved.

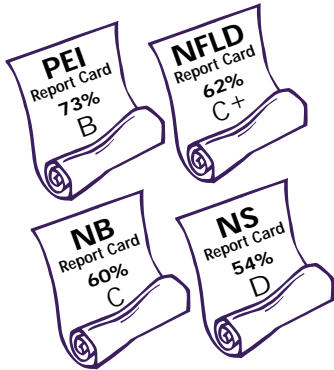
The financial performance of the four provinces has varied greatly; however, significant improvements have been made on financial indicators in all four provinces. The expenditure programs have been stable in every province, and tax levels have either been reduced or at least kept at existing levels. When the benefits to the consumer of the HST program, and the personal income tax reductions by the Federal Government on both its revenues and the provinces' revenues are considered, taxation loads have been reduced in all four Atlantic Provinces.

Grading Categories

The Report Cards have been graded on four categories of financial performance:

1. **Sustainability** – has the Province improved the probability that it can continue its current programs without increasing its debt load?
2. **Flexibility** – has the Province improved its ability to withstand economic downturns or interest rate increases, and does it have any taxation room to avoid cutting essential programs should such events occur?
3. **Vulnerability** – has the Province reduced the risk that its financial destiny could be seriously affected by foreign borrowers, or additional cuts in Federal transfer payments?
4. **Financial Practices** – has the Province improved the quality of its financial decision making, handled difficult situations such as Federal cuts effectively, used its 'windfall' revenues wisely, and improved its accounting standards and financial reporting?

Provincial Report Cards



The Rankings and Final Report Cards

The smallest Province, Prince Edward Island, has the best Report Card for the evaluation period of 1995/96 to 1999/00, scoring 73% for a 'B' grade; Newfoundland is second with 62% for a 'C+' grade; New Brunswick third with 60% and a 'C' grade; and Nova Scotia is fourth with 54% for a 'D' grade. The evaluation took into account the opening financial position of each province and the current absolute numbers such as total debt, per capita debt and debt service charges percentage. However, the highest weighting factors for all components were the financial actions and trends of the past four years, and the degree of improvement and quality of decision making and financial reporting each Province has achieved. The Report Card summaries are as follows:

Table 5: Atlantic Provinces Financial Management Report Card 1999

		P.E.I.	NFLD.	N.B.	N.S.
Sustainability					
15%	Debt/GDP	11	8	6	9
10%	Per Capita Debt	9	5	4	6
25%		20	13	10	15
Flexibility					
15%	Debt Charges %	10	9	11	7
10%	Own Source Revenue/Total Spending	6	5	7	6
25%		16	14	18	13
Vulnerability					
12%	Foreign Currency Exposure	15	9	10	7
10%	Federal Transfer Payments/Total Revenue	4	6	6	6
22%		19	15	16	13
Financial Practices					
7%	Commitment to Balanced Budgets	3	6	5	1
7%	Management of Federal Cuts	5	6	3	4
7%	Accounting and Disclosure Quality	5	5	4	4
7%	Funding of Pension Liabilities	5	3	4	4
28%		18	20	16	13
100%		73%	62%	60%	54%
Letter Grade		B	C+	C	D

Comments on Performance

Prince Edward Island achieved improvements in all areas of its financial management over the five-year period. It also had the highest cumulative GDP growth in the Atlantic Region of 14.1%. The Province receives a high mark for accounting standards and fully consolidated financial reporting. During the period it began implementing the financing of the unfunded liabilities of its various pension plans. These extra annual payments and the high investment performance of its pension portfolios have produced an almost fully funded position at March 31, 1999.

PEI's performance has been good in most areas; however, its increased spending in health and education has prevented a consistent balanced budget performance. This poses future risks to its ability to return the Province to a state of debt reduction versus the small increases in total debt burden of the past two years.

Newfoundland and Labrador is the second best financial performer in the region over the past five years. While it has the highest per capita debt and highest debt to GDP, its commitment to balanced budget and prudent financial management has been rewarded by two credit rating increases. It managed a very difficult economic climate and crushing cuts to health and social spending, without using the 'windfalls' in Federal equalization payments to fuel more spending or incur deficits. It is being challenged by the pressures on health spending and the overhang of its debt, a situation compounded by the decline in its population. The economy has grown more quickly than the Canadian average and promises to deliver real incremental petroleum revenues to the Government's treasury in the near term.

Newfoundland has avoided surprises, and communicated its financial practices and information in a consistent and timely manner. It has a tough financial road ahead, and must continue its firm and disciplined management of its scarce resources. It has been bold in announcing lower PIT rate as the first step in reducing the heavy taxation loads on individuals.

New Brunswick has slipped in its performance as the region's top financial manager. It still has the region's best credit rating and a relatively strong overall financial position, but the pressures from spending programs and NB Power have resulted in a decline in its evaluation compared to the other provinces, and a re-stated deficit for 1998/99 of \$227 million versus a reported surplus. The Province has not dealt with some of its financial issues in a timely manner, and consequently its reputation for disclosure and clarity has suffered. The increase in total debt burden and per capita debt, together with incurring a deficit as a result of accounting changes and re-stated financial information, contributed to its grade being the third lowest.

New Brunswick still has a low annual debt service cost and a reasonable taxation load. Now that the one-time accounting adjustments and recognition of debt are behind it, the focus should return to disciplined spending, elimination of the deficit and debt reduction.

Nova Scotia has also seen its relative financial performance decline in the Atlantic region. The major changes to accounting policies and financial statements by the new Minister of Finance make it very difficult to evaluate performance and year-to-year comparability. As stated earlier in the Report, many of the Province's debt obligations were already contained in various credit rating agency reports, therefore the increase in total debt burden is lower than if one uses the Department of Finance's new numbers. Nevertheless, the debt burden of Nova Scotia is massive, and the current annual deficit of \$497 million is alarming.

Nova Scotia stays at the bottom of the grades as several key financial indicators deteriorated, and confidence in its financial practices and commitment to balanced budgets received failing marks. The bright spot was the performance of its economy, which resulted in lower total debt to GDP and rising tax revenues, which explains the improved mark compared to *Debtors' Prison I*.

Conclusions and Recommendations on Atlantic Canada's Financial Position

Section 5

Government of Canada's Role

The financial position of each of the four Atlantic Canada Provinces is overwhelmingly influenced by two variables: the large debt burden created by two decades of deficit budgets; and the continued high dependency on Federal Government transfer payments because the region's own source revenues fall far short of covering its spending programs. If the region is to achieve national economic and personal income standards, it must grow its economy much faster and rely less on governments.

The region's financial challenges are solvable within a generation. This requires a strategy based on a growing and profitable private sector. The role of government needs clear definitions for which, once determined, political leaders and public sector managers would be held accountable. One of the keys to measuring accountability is open and timely reporting of financial information, using standards such as GAPP applied uniformly by all Provinces.

The Government of Canada has an immediate and significantly expanded role as a partner in Atlantic Canada's 'economic catch-up'. Improvements to Ottawa's financial position have partially been at the expense of all the other provinces, and some say, disproportionately by Atlantic Canada. While the Federal Government has major challenges to reduce its own staggering \$580 billion of direct debt, it does have an AAA credit rating and growing annual cash surpluses. It could 'jump start' the economic renewal in Atlantic Canada by taking at least three constructive actions in the short term:

1. Significant reductions in the Federal tax rates of individuals and corporations to make the region competitive, and motivate both parties to invest more in consumption, education and new equipment or services.
2. Develop a national infrastructure program with priority to transportation systems, education facilities, technology, and research and development.
3. Undertake an innovative 'debt re-financing program' by issuing very low interest rate bonds with long maturity terms, such as 30-40 years, to the four Atlantic Provinces to improve their immediate cash flow and operating



deficits, and prepay where possible existing high risk and volatile provincial foreign currency borrowings.

This Federal Government 'millennium debt program' would contribute to correcting certain injustices and oversights of the past several decades, such as: Newfoundland's 'stranded' \$625 million of debt because 40,000 people are now living and contributing to the economies of other provinces; and Nova Scotia, which has shouldered extra costs of being the regional center for certain health and education programs. For example, re-financing Newfoundland's 'stranded' debt at 5% below current borrowing rates would free up debt service charges and sinking fund payments of approximately \$40 million per year, enough flexibility to enable it to reduce its PIT rate another 7%.

It would be vital for the Federal Government to set terms and conditions on access to the 'millennium debt program' to ensure it was used to grow the economy – terms such as achieving annual operating surpluses, gradual lowering of tax rates, and commitments to debt reduction.

Recommended Actions by the Atlantic Provinces

Prince Edward Island needs to:

- Confirm its commitment to balanced operating budgets and earn a reputation for consistently achieving surpluses. This requires new legislation that would establish the principles of balanced budgets, complete with consequences for both political leaders and public sectors managers should targets not be met. These consequences would be penalties for shortfalls, and incentives for meeting or over-achieving.
- Control its main financial risk of health care spending, and increase its revenues by further diversifying PEI's economy.
- Direct any 'windfalls' in revenues toward reducing the total debt burden.

Newfoundland and Labrador has to:

- Remain firmly committed to fiscal prudence, a policy that has served it well in recent years.
- Introduce balanced budget legislation similar to that recommended for PEI.
- Expand its financial accounting standards to a fully consolidated policy, and consolidate all operating and capital spending through its budgetary process.

- Report sinking fund earnings in gross revenues so that a better appreciation of total financial performance can be shown.
- Set a target of 20% for its foreign currency exposure within a three year time-frame.
- Stick to its funding of the huge pension liabilities.
- Direct all 'windfall' revenues to reducing its immense debt.
- Approach the Federal Government with an innovative debt transfer and restructuring proposal to relieve the financial burden of at least the \$625 million 'stranded' debt due to population decline, based on using the increased financial flexibility to reduce tax rates and provide incentives for faster private sector growth.

New Brunswick must:

- Restore confidence in its financial reporting and budgetary results to previous high levels by implementing all of the recommendations of the independent review by Grant Thornton.
- Deal with the asset quality and operating deficits of NB Power as a top priority.
- Return to tight financial controls on spending in the health care and education sectors.
- Initiate urgent actions to address the budgetary gap that has developed as a result of the termination of HST transition payments in 2000/01.
- Implement a revised balanced budget legislation as detailed above, with a high emphasis on accountability.
- Move quickly to full compliance with GAAP standards.
- Take steps toward reducing debt levels with any 'windfall' revenues.

Nova Scotia's top financial priorities are:

- Urgent elimination of its \$497 million operating deficit. Until this is achieved, the immense debt load will continue to rise and so will the annual interest costs to service this debt.
- Realizing an operating surplus within two years if one-time costs such as Y2K, accounting changes and large losses in crown corporations such as Sysco and Nova Scotia Resources, and investments by Nova Scotia Business Development Corporation, are eliminated; and the immediate containment of health care costs is achieved.
- Restoring confidence in Nova Scotia's financial information as a priority until GAAP standards are fully implemented. This will require the leadership of the Premier and Minister of Finance, with participation by all government members and public sector managers, if an environment of accurate and open financial reporting is to be embraced.
- Introduce balanced budget legislation as detailed above.
- Setting a target to reduce foreign currency exposure to 20%, including Nova Scotia Resources, within three years.
- The application of all 'windfall' revenues to reducing the debt.

In conclusion, financial inflexibility due to high debt levels, fragile budgetary positions and growing spending pressures in the health and education sectors are challenging the long term competitive position of all four Atlantic Provinces. Governments must achieve consistent operating surpluses so that debt burdens and tax levels can be lowered, thereby stimulating their economies to become more productive and competitive. To achieve this, Government spending programs need to be prioritized and higher efficiencies achieved from existing funding levels.

The citizens of Atlantic Canada need to embrace and encourage less, but better government; and to expand our determination to be completely self-reliant during the next twenty years. It is an achievable goal if governments and the people of each province in Atlantic Canada work together.

Glossary

Total Debt Burden: the sum of tax supported debt (direct, contingent and guaranteed debt) and unfunded pension liabilities.

Federal Transfers: Funding provided by the Federal government to the provinces and territories. The Federal government provides most of its transfers by way of three major programs: the Canada Health and Social Transfer, Equalization and Territorial Formula Financing.

Canadian Health and Social Transfer: Federal transfers provided to each province in support of provincial health care, post-secondary education, social assistance and social services.

Equalization: Federal transfer program that allows all provinces, regardless of their ability to raise revenue, to provide roughly comparable levels of services at roughly comparable levels of taxation.

Taxation Load: includes personal income, sales, tobacco, gasoline, property and payroll taxes.

Foreign Debt Exposure: percentage of total debt burden which is denominated in foreign currency.

Gross Domestic Product (GDP): The market value of all the final goods and services produced in an economy over a specified period of time.

Unfunded Pension Liabilities: amount that a pension plan's total future obligations exceed its assets.

Program Spending: total government expenditures minus debt service charges.

Deficit (surplus): The amount left over after all government expenditures have been deducted from total government revenues. If the difference is negative, it is a deficit. If the difference is positive, it is a surplus.

Debt Service Charges (Debt Servicing): interest and amortization/administration costs associated with maintenance of the public debt.

HST Transition Program: funding provided by the Federal government in order to offset the projected fiscal impacts of moving from the GST tax structure to the HST for the fiscal years 1997/98 to 1999/00.

Net Direct Debt: the direct liabilities of the Province less realizable assets and unamortized foreign exchange translation gains/losses and discounts on outstanding debenture issues.

Per Capita Debt: total debt burden of a province divided by the population of that province.

Own Source Revenues: provincial revenues derived from personal and corporate income taxes, corporate capital taxes, retail sales tax, tobacco taxes, motor fuel taxes, insurance premium taxes, and earnings of Crown agencies, and other miscellaneous provincial user fees and revenues.

GAAP: Generally Accepted Accounting Principles as communicated by the Canadian Institute of Chartered Accountants.

Credit Rating Agency (Credit Rating): agencies which provide investors with an independent and forward looking assessment (credit rating) of the credit quality of the debt issuer.

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Schedule 1: DBRS Rating Scales

Long Term Debt Rating Scale

DBRS long-term debt ratings provide a relative indication of risk. They reflect the relative capacity of a borrower to fulfill its long-term debt obligations in a timely manner. DBRS ratings do not take factors such as pricing or market risk into consideration and, therefore, comprise only part of an investor's investment decision-making process. Every DBRS rating is based on quantitative and qualitative considerations. All DBRS rating categories (except AAA) use "high", "middle", or "low" as subset grades to designate the relative standing of the credit within a particular rating category.

The rating categories include:

AAA

Bonds are of the highest credit quality. The degree of protection afforded principal and interest is of the highest order and overall liquidity is unquestioned. Revenues and cash flows are relatively stable, and expenditures are under control. The political environment is stable, and the financial system is fundamentally sound. Monetary and fiscal policy are on a sustainable track, and the government is able to respond to event shocks such as volatility in interest rates, exchange rates or international capital flows. The economic base is diverse and overall economic performance remains relatively strong. There are few qualifying factors present, which would detract from the performance of the entity.

AA

Bonds are of superior credit quality, and protection of interest and principal is considered high. Expenditures remain under reasonable control, and are growing at a level consistent with revenues. They may differ from "AAA" in only a small degree.

A

Bonds are of satisfactory credit quality. Protection of interest and principal is reasonable, but the degree of strength is less than "AA" rated entities. Overall financial performance remains good and local economic growth remains reasonable although the economic base may be somewhat smaller or somewhat less diverse. Overall financial flexibility remains very good.

BBB

Bonds are of adequate credit quality. Protection of interest and principal is considered adequate. Although financial performance remains reasonable, the revenue and economic base may be smaller, less diverse or somewhat susceptible to the adverse effects of business cycle changes. Other adversities, which reduce the strength of these bonds relative to higher rated securities, may be present.

**BB**

Bonds are defined as mildly speculative. The degree of protection afforded interest and principal is lower. The size of the entity and the scope of the entity's revenue base may be relatively small while the expenditure pattern may be high and growing. The economic base may be somewhat concentrated in relatively few industries and economic growth may be sluggish.

B

Bonds are speculative. Uncertainty exists as to the ability of the entity to pay interest and principal on a continuing basis in the future. A high level of expenditures combined with an inadequate revenue base has contributed to consistent operating deficits. The economic base is narrow with a significant concentration in only a few industries and local economic growth may be weak.

CCC

Bonds are highly speculative and are in danger of default of interest and principal. There exists limited financial flexibility, as the revenue base is small with very little additional tax capacity and unable to support the high level of expenditures.

CC

Bonds are either in default of either interest or principal, or default is imminent.

C

Bonds are of the lowest rating provided to long-term debt. Bonds rated C are reserved for a second tier of default or junior claims on an entity, where the senior claims are rated CC.

AIMS Library

Books

Taking Ownership: Property Rights and Fishery Management on the Atlantic Coast, edited by Brian Lee Crowley

Looking the Gift Horse in the Mouth: The Impact of Federal Transfers on Atlantic Canada (photocopies only), by Fred McMahon

Charter Schools in Atlantic Canada: An Idea Whose Time Has Come, by Joe Freedman, MD with assistance by Fred McMahon

Research Reports

Population Change in Atlantic Canada: Looking at the Past, Thinking about the Future, by Frank T. Denton, Christine H. Feaver & Byron G. Spencer

Debtor's Prison: Public Sector Debt and What It Means for You, by Tom Riley (photocopies only)

Nova Scotia - On the Financial Brink: Immediate Action Is Required. A Brief to Hon. Neil LeBlanc, Minister of Finance, Province of Nova Scotia, by Brian Lee Crowley, Roland T. Martin and Keith D. Messenger

Commentary Series

Let's Debate the Facts: Did Government Policy Lead to Wage Distortion in Atlantic Canada and its Economic Consequences? by Fred McMahon

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Speakers Series

Turning Pain into Gain: What Atlantic Canadians Can Learn from the New Zealand Experience
A composite transcript of three talks by Sir Roger Douglas (cassette also available)

The Coming Revolution in Local Government:
Conference Binder
Binder and the book, *Revolution at the Roots*

Proceedings of Rising Tide: Rights-based Fishing on the Atlantic Coast, the November 1996 AIMS fisheries conference in St. John's, Newfoundland

Choosing Better Schools. Conference Binder including video and booklet (*The Charter School Idea: Breaking Educational Gridlock*), and *Charter Schools in Atlantic Canada*, by Joe Freedman (with Fred McMahon), the May 1997 AIMS charter schools conference in Fredericton, New Brunswick

Proceedings of Everybody's Business: Market Solutions for Rural Development in Atlantic Canada, the June 1998 RSTP/AIMS conference on Rural Development in Sackville, New Brunswick

Proceedings of The Road to Growth: Mapping a Route to Economic Development and Business Success, the May 1999 AIMS conference on Economic Development in Halifax, Nova Scotia