COULD DO BETTER 2:
Grading Atlantic Canada's 2005/06 Provincial Finances

DAVID MURRELL
BRUCE WINCHESTER

May 2006

Atlantic Institute for Market Studies

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Executive Summary

This study grades the Atlantic provinces' fiscal year 2005/06 finances. In determining a single overall grade for each province, we first construct three separate subgrades. The first measures the *fiscal health* of each province just before the tabling of the fiscal year 2005/06 budget in spring 2005. The second subgrade is a measure of the *fiscal accuracy*, or transparency, of the 2004/05 budget. The purpose of this grade is twofold: to assess how the province has adhered to its 2004/05 budget forecast according to the revised data in the 2005/06 budget, and to assess how the province's budget data deviate from the more comprehensive statistics published by the Dominion Bond Rating Service. The third subgrade, which we call the *budget impact* grade, assesses the 2005/06 budget itself. We then average the three subgrades to derive an overall grade for each of the four Atlantic provinces, with a C+ representing an average grade across all ten provinces.

At the end of the exercise, we determined that, as a region, Atlantic Canada rates a C, which is a modest improvement on the C– we awarded last year but still slightly below the ten-province average. Newfoundland and Labrador improved from a very low D– last year to D+/C– this year, Prince Edward Island improved from D+ to C, while Nova Scotia improved from C/C+ to C+. Only New Brunswick's aggregate grade slipped slightly, from B- last year to C+ this year.

In terms of the fiscal health of the four provinces, we assess the budgetary positions of Newfoundland and Labrador, PEI, and New Brunswick at the start of fiscal year 2005/06 as weak, mainly due to the large amount of provincial government spending relative to their small populations. Newfoundland and Labrador's poor budget position is further compounded by its chronically high debt load. Nova Scotia, in contrast, runs a more efficient government, although it, too, has a relatively high debt load.

As for the fiscal accuracy of their 2004/05 budgets, New Brunswick, Nova Scotia, and PEI all score reasonably well, despite the small size of their budgetmaking staff, relative to other provincial governments. Collectively, the four provinces earn an average grade of C+, with New Brunswick leading the way with a B–. Newfoundland and Labrador stills fares poorly, however, registering a D+.

In grading the 2005/06 budgets, we note that all four provinces have benefited from increased federal health transfers, while Nova Scotia and Newfoundland and Labrador have benefited from agreements signed with Ottawa concerning royalties from offshore oil and gas. In general, however, although both New Brunswick and Nova Scotia reduced corporate taxes slightly and Newfoundland and Labrador promised to limit spending increases, none of the four spring 2005 budgets broke important new fiscal ground. Collectively, the four 2005/06 budgets earn a somewhat below average grade of C.

In summary, the four Atlantic provincial governments, with additional health funding and a steady flow of equalization payments, could start limiting spending, reducing debt loads, and lowering business taxes in order to attract capital and stimulate the region's lagging growth. Yet, they continue to construct their budgets as though they were blissfully unaware of the steady westward movement of economic activity in Canada.

INTRODUCTION

This study is the second of an ongoing project at the Atlantic Institute for Market Studies (AIMS) to grade the spring budgets of the four Atlantic provincial governments. We grade the budgets on the premise that careful, well-planned budgetmaking, incorporating lower tax regimes and a prudent balance of revenues and expenditures, is a key component of the region's economic growth.

Our grading philosophy remains the same as that used in AIMS' first report card on the fiscal health of the Atlantic provinces (Murrell 2005). Since that study contains a detailed explanation of the grading scheme (pp. 7–11), we present only a brief summary of our approach here.

To begin, we grade each Atlantic province's budget relative to the average of all ten provinces. However, we cannot simply grade each province's spring 2005 budget on its own merits, for three reasons. First, a budget is merely a statement of how government intends to spend and collect revenue — nothing more. To place these intentions in context, therefore, we must measure the state of a province's public finances before the budget is tabled and compare that state with the national average. For example, a province that cuts government spending might do so not out of a sense of frugality or fiscal conservatism but because it is attempting to deal with a high deficit and debt load. Alternatively, a province might introduce an unnecessary new revenue measure, as the Ontario Liberal government of Dalton McGinty did with its health tax at a time when that province need not have raised taxes at all. Thus, the context in which the province undertakes a spending cut must be taken into account. Accordingly, we assign a *fiscal health grade*, which is a measure of the state of the province's fiscal finances for fiscal year 2004/05, prior to the tabling of the spring 2005 budget; this component is worth 40 percent of the total grade.

Another complication is that, although a province might promise a spending cut in its budget, it might not deliver on that promise during the fiscal year. Alternatively, the province might forecast a balanced budget but end up with a deficit at the end of the fiscal year. Accordingly, to assess the government's fiscal accountability, we assign a *fiscal accuracy grade*, which we determine in two ways. First, we gauge the believability of the province's budget data using comparable statistics from the Dominion Bond Rating Service (DBRS), which we believe provide the best, most complete picture of a provincial government's fiscal status. We do this for per capita deficits and surpluses, as well as for per capita total spending. Second, we measure the forecasting error of the numbers in the fiscal year 2004/05 budget as determined by the revised data for 2004/05 contained in the 2005/06 budget. The fiscal accuracy grade is also worth 40 percent of the total grade.

Finally, we assign a *budget impact grade* for the fiscal year 2005/06 budget, based on the extent to which, in our judgment, it promotes the province's economic growth. We determine that grade

Table 1: ***Definitions of the Fiscal Indicators Used to Compile the Three Grades***

Indicator	Definition
Indicator 1	2004/05 per capita debt interest paid
Indicator 2	2004/05 per capita deficit (or surplus)
Indicator 3	2004/05 per capita ordinary expenditures less debt interest
Indicator 4	Number of provincial employees per 1000 population in 2004
Indicator 5	Negative of the absolute value of the 2004/05 per capita deficit error (DBRS vs. budget documents)
Indicator 6	Negative of the absolute value of the 2004/05 per capita spending error (DBRS vs. budget documents)
Indicator 7	2004/05 deficit estimate error (2004/05 vs. 2005/06 estimates)
Indicator 8	2004/05 expenditure estimate error (2004/05 vs. 2005/06 estimates)
Indicator 9	Change in per capita deficit (or surplus) from 2004/05 to 2005/06 (from budget documents)
Indicator 10	Change in per capita debt interest from 2004/05 to 2005/06 (from budget documents)
Indicator 11	Change in per capita dollar expenditures from 2004/05 to 2005/06 (from budget documents)
Indicator 12	Qualitative estimate of tax rate and tax base changes

according to whether the budget holds spending growth to a modest rate, reduces a deficit or maintains a surplus, and keeps provincial tax rates down. In particular, we look for a provincial government to cut business corporate and capital tax rates first, then personal income tax rates. This component is worth 20 percent of the final grade.

Each of the three subgrades is determined by four indicators — 12 in all (see Table 1). Indicators 1 to 11 are calculated using a statistical measure known as a "z-score," which permits data from all ten provinces to be graded relatively. Indicator 12 is a subjective estimate of tax changes offered in each province's budget (see Table 2).

Finally, because of the availability of revised and more up-to-date statistics from the DBRS, we were obliged to re-estimate the grades we assigned in last year's report card on provincial finances. We present these revised grades in Appendix Table A-4. Of note is that the fiscal year 2004/05 grades for Newfoundland and Labrador and for Prince Edward Island have been revised slightly downward and the grade for New Brunswick slightly upward. The grade for Atlantic Canada as a whole has been revised slightly downward, from C to C-. Accordingly, when discussing changes in grades from 2004/05 to 2005/06, we use the revised marks for 2004/05 as our point of reference.

Table 2: ***Announced Tax Changes by Province, fiscal year 2005/06 Budget***

	Business Taxes	Personal Income Taxes	Sales and Excise Taxes	Other Taxes and User Fees	Indicator 12 Grade	Reason for Grade
Newfoundland and Labrador			Tobacco taxes increased by $2 per carton		C–	Net increase in taxes levied at a time when the province gains much in federal transfers
Prince Edward Island	Small business corporate tax rate reduced to 6.5%		Gas taxes cut in favour of wholesale manufacturing and processing tax, net result is tax increase from 7% to 11%		C	Cut in business taxes offset by rise in gas and diesel taxes
Nova Scotia	Large corporate capital tax rate reduced to 0.275%				B–	Slightly higher than average mark for modest reduction in business taxes
New Brunswick	Small business capital tax rate reduced to 1.5%				B–	Slightly higher than average mark for modest reduction in corporate tax rate
Quebec	Capital taxes for large and financial corporations reduced; small business corporate rate reduced to 8.5%				B	Good effort at reducing business taxes
Ontario					C	No tax changes means slightly below average mark
Manitoba	Corporate tax rate reduced by 0.5 percentage point	Middle personal income tax bracket reduced to 13.5%			A	Very good effort at reducing broad-based taxes
Saskatchewan					C	No tax changes
Alberta					C	No tax changes
British Columbia		Low-income tax credit introduced			C+	Tax reductions only for poor individuals rates average mark

THE RECENT ECONOMIC BACKGROUND

Over the past three years, real economic growth in Atlantic Canada has slowed markedly, after registering strong increases in 2001 and 2002, a time when the region's oil and natural gas supplies were coming on-stream and resource prices were high. In 2003, however, the Newfoundland and Labrador economy slowed noticeably, and in 2004 actually declined. Also in 2004, weak external markets constrained Nova Scotia's exports of natural gas and fish, while the increasing value of the Canadian dollar relative to its US counterpart reduced pulp and paper production in New Brunswick. The high Canadian dollar also increased the costs of travel for visitors from the United States, with harmful effects on tourism in all four provinces. These unsettling conditions persisted during 2005. Atlantic Canada's economy grew by only about 1 percent in 2004 and by slightly more than 2 percent in 2005 — noticeably lower than the 3.2 percent and 2.9 percent rates for Canada as a whole during those years.

Atlantic Canada's economy is forecast to rebound in 2006, however, buoyed by several megaprojects. In Newfoundland and Labrador, nickel production at Voisey's Bay is expected to increase to capacity output, while high oil prices (at least at the beginning of the year) are expected to fuel spin-off secondary spending in government and housing. In New Brunswick, construction of the Irving Oil-Repsol liquefied natural gas terminal is expected to get under way, as is a major refurbishment of the Point Lepreau nuclear power plant. Largely as a result of these projects, the economies of the two provinces are forecast to post real gains in gross domestic product (GDP) of 5 percent and 3 percent, respectively. Although economic growth in Nova Scotia and Prince Edward Island, in contrast, is expected to lag behind the other two provinces, Atlantic Canada's GDP is expected to grow by about 3.3 percent in 2006, compared with 2.5 percent for Canada as a whole (see Table 3).

Trends in Provincial Government Revenues

The relatively strong growth of Atlantic Canada's economy in 2002 translated into comparatively strong growth in own-source provincial government revenues in fiscal years 2002/03 and 2003/04 relative to that of Canada as a whole (see Table 4). The slowdown in economic growth in 2004 and 2005, however, is reflected in a concomitant slowdown in own-source revenue growth in fiscal years 2004/05 and projected for 2005/06 to rates below those forecast for Canada as a whole.

As Table 4 indicates, federal transfers to the Atlantic provinces have followed an erratic pattern. The region's robust economic growth in 2002 meant that equalization payments fell in fiscal year 2002/03, but the slowdown in economic growth in 2003 and 2004 led to a corresponding increase in

Table 3: ***Estimated and Forecast Growth in Real GDP , Atlantic Provinces and Canada, 2001–06***

Real GDP	Newfoundland and Labrador	Prince Edward Island	Nova Scotia	New Brunswick	Atlantic Provinces	Canada
			(year-over-year percentage change)			
2001	1.5	(0.4)	3.4	1.6	2.2	1.6
2002	18.0	6.2	3.9	3.8	7.0	3.2
2003	6.1	1.8	1.3	2.2	2.7	2.3
2004	(0.9)	1.6	1.3	2.5	1.1	3.2
2005	2.0	2.5	2.0	2.5	2.2	2.9
2006	5.2	1.8	2.5	3.0	3.3	2.5

Sources: *Statistics Canada Daily*; economic foreacsts from BMO Nesbitt Burns.

Table 4: ***Growth Rates in Components of Provincial Government Revenue, Atlantic Provinces and Canada, fiscal years 2002/03 to 2005/06***

Component	Newfoundland and Labrador	Prince Edward Island	Nova Scotia	New Brunswick	Atlantic Provinces	Canada
			(year-over-year percentage change)			
Own-source revenue						
2002/03	5.8	7.4	4.9	4.2	5.0	1.4
2003/04	4.7	0.2	5.4	4.0	4.5	3.8
2004/05	3.4	3.9	5.0	1.6	3.5	7.9
2005/06	1.6	5.0	3.3	5.0	3.5	n/a
Transfers						
2002/03	5.9	(16.1)	(7.7)	(5.3)	(3.7)	5.3
2003/04	(3.2)	12.1	4.4	0.8	1.4	12.4
2004/05	10.3	12.8	15.9	19.8	15.3	15.9
2005/06	4.9	0.8	5.2	0.3	2.1	n/a
Total revenue						
2002/03	5.8	(2.0)	0.7	0.8	1.8	2.0
2003/04	1.3	4.2	5.1	2.9	3.4	5.2
2004/05	6.3	7.2	8.3	7.6	7.5	9.3
2005/06	2.9	3.1	4.4	3.0	3.4	n/a

Source: Internal data obtained from the Dominion Bond Rating Service..

equalization payments in 2003/04 and 2004/05. Furthermore, in February 2005, both Nova Scotia and Newfoundland and Labrador signed agreements with the federal government guaranteeing the two provinces 100 percent of offshore oil and gas royalties. In addition, all four provinces received sharply increased federal health care transfers, as did all the other provinces. The growth of federal transfers to Atlantic Canada is expected to level off in 2005/06 at about 2 percent above the high levels of the previous year.

The rapid rise in federal transfers in fiscal year 2004/05 also caused total provincial government revenues in Atlantic Canada to rise by a significant 7.5 percent that year, but this rate was still below the ten-province average. It must be remembered, however, that Atlantic Canada has experienced zero population growth for the past several years, so that per capita provincial government revenues in the region have grown by about the same rate as that for the nation as a whole. In fiscal year 2005/06, total provincial government revenues are forecast to rise by a more modest 3.4 percent.

Trends in Provincial Government Expenditures

The increases in provincial government revenues in Atlantic Canada in fiscal years 2003/04 and 2004/05 allowed the provinces to accelerate their expenditures by 4.8 percent and 4.6 percent, respectively, in those two fiscal years (see Table 5). Reflecting the region's aging population, health spending, in particular, grew by a substantial 8.6 percent and 7.3 percent, respectively, with Nova Scotia and New Brunswick leading the way. However, spending in non-health areas (shown as "residual" in Table 5) also increased, perhaps suggesting a lack of concern by provincial governments to restrain spending in areas of lower priority.

It is interesting to note that, although the four provinces were disinclined to restrain spending in most areas, they appear to have restrained themselves when it comes to servicing their debt, as Table 5 shows. Indeed, in fiscal years 2002/03 through 2004/05, interest payments on government debt actually declined in Newfoundland and Labrador and in PEI. In 2005/06, however, higher interest rates are projected to oblige the provinces to increase their debt-service payments once more.

Summary

Atlantic Canada's provincial government expenditures grew at about the national rate in fiscal year 2002/03 and above the national rate in 2003/04. Considering the region's lack of population growth, however, the increase in spending in per capita terms illustrates that the four provinces were not particularly frugal with their spending, in contrast to Canada as a whole. It was this loose spending that was largely responsible for the low marks we accorded the 2003/04 provincial budgets.

In 2004/05, spending continued to grow at a robust 4.6 percent, although this rate was lower than that of the ten-province average of 6.3 percent. Nevertheless, spending growth rates of 4.8 percent and 4.6 percent for Atlantic Canada are neither affordable nor sustainable. Given that the region missed an opportunity to restrain spending in any major way, the collective grade for its public finances remains marginally below the national average. Having said that, we should note that both Newfoundland and Labrador and PEI did restrain per capita spending, which is reflected in a noticeable improvement in their respective marks.

Table 5: ***Growth Rates in Components of Provincial Government Expenditures, Atlantic Provinces and Canada, fiscal years 2002/03 to 2005/06***

Component	Newfoundland and Labrador	Prince Edward Island	Nova Scotia	New Brunswick	Atlantic Provinces	Canada
			(year-over-year percentage change)			
Health						
2002/03	3.1	11.8	3.9	4.0	4.2	5.9
2003/04	8.4	4.7	8.5	9.7	8.6	7.7
2004/05	2.2	3.6	10.8	7.8	7.3	8.7
2005/06	6.9	3.3	7.2	6.1	6.6	n/a
Interest						
2002/03	(3.9)	(0.8)	(3.0)	6.2	(0.0)	(4.7)
2003/04	(2.7)	(3.4)	2.3	(0.1)	0.2	(1.0)
2004/05	(5.2)	(1.8)	1.8	0.7	(0.1)	1.1
2005/06	0.7	1.3	(0.2)	2.3	0.8	n/a
Residual						
2002/03	2.4	(5.1)	7.9	1.2	3.2	3.2
2003/04	5.9	12.3	2.2	2.7	4.1	2.6
2004/05	3.0	(2.3)	6.9	4.8	4.4	6.0
2005/06	(0.3)	8.1	4.7	2.1	2.6	n/a/
Total						
2002/03	1.7	(0.2)	4.4	2.7	2.9	3.0
2003/04	5.5	8.4	4.3	4.2	4.8	3.8
2004/05	1.7	(0.5)	7.3	5.0	4.6	6.3
2005/06	2.8	5.5	5.0	3.3	3.9	n/a/

Sources: Statistics Canada; various provincial budgets.

PRESENTING THE GRADES

In our grading of the fiscal year 2005/06 spring budgets of the four Atlantic provinces, we assign the region a collective C, which is a modest improvement over the revised C– earned for the 2004/05 budgets. Given our relative grading scheme, shown in Table 6, this grade is slightly below average. For its fiscal health grade, the region earns a C–, with difficulties apparent for PEI, New Brunswick, and especially Newfoundland and Labrador (see Table 7). For its fiscal accuracy grade, we give Atlantic Canada a fairly respectable C+, which is right at the national average. New Brunswick earns a mark somewhat above average, as it did last year, while Newfoundland and Labrador again fares poorly. Finally, the region as a whole gets a C for its budget impact grade, with only New Brunswick having tabled a 2004/05 budget that was as good as the national average. What is striking about this last subgrade is that, despite having signed agreements with Ottawa to keep off-shore energy revenues, neither Nova Scotia nor Newfoundland and Labrador tabled budgets that took advantage of the extra money that would come from these agreements.

As for overall grades, Nova Scotia and New Brunswick lead the way with an "average" C+, while PEI rates a C and Newfoundland and Labrador trails with a mediocre C–/D+.

We note that, although Nova Scotia and Newfoundland and Labrador earned higher fiscal health grades than they did last year, both provinces still face high debt loads and excessive government spending, and are making only meagre progress in addressing these problems. New Brunswick's fairly decent grade for fiscal accuracy is largely due to the credible and serious efforts it makes to

Table 6: ***The Grading Scheme***

Grade	Z-Score Interval	Grade Interpretation
A+	1.11 and above	outstanding
A	0.91 to 1.1	excellent
A–	0.71 to 0.9	excellent to very good
B+	0.51 to 0.7	very good
B	0.31 to 0.5	good
B–	0.11 to 0.3	slightly above average
C+	–0.1 to 0.1	average
C	–0.11 to –0.3	slightly below average
C–	–0.31 to –0.5	mediocre
D+	–0.51 to –0.7	mediocre to poor
D	–0.71 to –0.9	poor
D–	–0.91 to –1.1	very poor
F	–1.11 and below	failure

Table 7: ***Grades for Provincial Government Finances and Budgets***

	Fiscal Health	Fiscal Accuracy	Budget Impact	Overall Grade
Atlantic Canada	C–	C+	C	C
Newfoundland	D+	D+	C	D+/C–
Prince Edward Island	C–	C+	C–	C
Nova Scotia	C+	C+	C–	C+
New Brunswick	C–	B–	C+	C+
Quebec	C–	C–/C	C+/B–	C
Ontario	B+	B–	C+	B–/B
Manitoba	B–	C+	C–	C+
Saskatchewan	C+	B–	B–	C+
Alberta	A	C–/C	C+	B–
British Columbia	B–	B–/B	B–	B–

confirm the accuracy of its budget numbers. Nova Scotia, even with its Offshore Offset Agreement with the federal government and a reasonably good mark for fiscal accuracy, brought in a budget for fiscal year 2005/06 that was not as good as we had expected. Finally, Newfoundland and Labrador's mediocre budget despite the Atlantic Accord with Ottawa suggests that the province has yet to put its fiscal house in order.

Let us now discuss the results for of the four provinces in turn.

Newfoundland and Labrador

Overall Grade: D+/C–

Newfoundland and Labrador's overall grade of D+/C- represents a noteworthy improvement to the revised D– it received last year. The province has undergone severe fiscal difficulties in recent years, but its strenuous negotiations with the federal government and eventual signing of the Atlantic Accord were factors very much in its favour.

Nevertheless, the province still faces a troubling fiscal picture, partly stemming from its refusal to reduce its deficit spending. One way to tackle that problem would be to transfer the proceeds from the Atlantic Accord directly to debt retirement, as Nova Scotia has done with its offshore revenues. In other words, Newfoundland and Labrador should treat the additional revenues from its oil royalties as an asset, and use the money to retire its debt through immediate deficit reduction.

Fiscal Health Grade: D+

In his 2005 budget speech, Finance Minister Loyola Sullivan referred to “a staggering mountain of debt and financial obligations that exceeded the province's fiscal means….Our province was facing billion-dollar deficits that, within a decade, would have nearly doubled the province’s debt” (Newfoundland and Labrador 2005, 1). According to our calculations, in fiscal year 2004/05, each resident of the province paid $873 in interest on the provincial debt, a figure substantially higher than the $540 per capita national average.

Newfoundland and Labrador’s provincial government remains quite large, employing 66 workers per 1000 population, compared with the ten-province average of 56 per 1000 population. Total ordinary spending per capita is $7272, compared with the national average of $6708. Together, these higher-than-average indicators keep the province’s fiscal health grade at a low D+ (see Appendix Table A-1). However, the province did manage to bring down its stubbornly high deficit, which, in fiscal years 2002/03 and 2003/04, was $1213 and $1765, respectively, per capita. Such red-ink numbers were by far the worst in the country. In 2004/05, however, the province actually managed to record a budgetary surplus of $92 per capita. Though still lower than the national average surplus of $291 per capita, this number is a welcome turnaround and a positive development for the province.

Fiscal Accuracy Grade: D+

As it did with the 2003/04 budget, Newfoundland and Labrador had difficulty reconciling its 2004/05 budget numbers with the published DBRS statistics that are generally accepted in financial circles. The province underestimated its reported deficit by more than $2000 per person, as well as ordinary expenditures by almost $200 per capita (Indicators 5 and 6, respectively). The province improved its deficit forecasting, however (Indicator 7), and predicted its 2004/05 ordinary expenditures quite accurately, but despite these reasonably good budget predictions, we give the province an overall fiscal accuracy grade of D+ (see Appendix Table A-2).

Budget Impact Grade: C

With the signing of the Atlantic Accord with the federal government, Newfoundland and Labrador gets to keep 100 percent of the royalties earned from offshore oil while maintaining current levels of equalization payments. Given this unexpected bonanza, one would have thought the provincial government might have constructed a budget more oriented toward economic growth. Yet, the province’s finance minister still plans for ongoing deficits into fiscal year 2006/07, with a rising net debt projection. In his 2005 budget speech, he called for the province to “reduce the deficit progressively over time...for long-term fiscal sustainability” (Newfoundland and Labrador 2005, 4), as if the mere idea represents a sound plan.

As it stands, the province’s 2005/06 budget projects a total deficit of slightly under $400 million and a per capita net debt of $25,000 by 2007/08. We feel that these targets are simply not good enough.

Indeed, the projected $946 increase in the per capita deficit in 2005/06 is the worst of any province but Ontario. Moreover, the province refused to lower any taxes, but instead raised tobacco taxes. The 2005/06 budget does forecast a slight reduction in debt interest — though this is dubious, given its forecast of another deficit — and the government plans to limit expenditure increases in this fiscal year. Yet, in our view, the province ought to have used the increased cash flow from the Atlantic Accord to engage in more aggressive belt-tightening on the deficit front.

Prince Edward Island

Overall Grade: C

Last year, Prince Edward Island posted a revised overall grade of D+. This year, we award the province a clearly improved C. The province's fiscal health grade is a mediocre C–, but its keeping of reasonably accurate books earns it a C+ for fiscal accuracy. For its spring 2005/06 budget, however, we assign a relatively mediocre C–. To summarize, PEI continues to face difficult fiscal circumstances, and its 2005/06 budget fails to make the tough choices needed to address these problems.

Fiscal Health Grade: C–

In his 2005 budget speech, PEI Provincial Treasurer Mitch Murphy emphasized the difficulties of "spiralling costs" and reduced federal transfers (Prince Edward Island 2005, 2). Yet it is the provincial government itself that is responsible for keeping service delivery costs low, while federal transfers actually totalled $434.6 million, up sharply from the province's original forecast of $391.6 million.

The provincial treasurer stated that the four priorities guiding his budgetmaking were "health, education, jobs and communities" (ibid., 1). Notable by its absence from this list, however, is fiscal responsibility, despite the troubled fiscal picture the province faces. True, the provincial government did set tough fiscal goals in its 2004/05 budget, but it failed to follow through on those promises, which led us to revise the province's overall 2004/05 grade downward to a mediocre D+ from the C-/C we originally assigned.

PEI's continuing fiscal difficulties are borne out by the $636 each of the province's residents paid out in interest payments to service the province's debt in 2004/05, which was higher than the ten-province average. The province also recorded a deficit of $145 per Islander, the third-worst per capita budget balance in the country. And the province continues to maintain an inefficient, overly large government for such a small jurisdiction, with each Islander paying $7141 for everyday provincial government services, an amount $430 higher than the ten-province average. The ratio of 66 provincial government employees for every 1000 residents is also higher than the national average. The combined effect of these indicators earns the province a below-avergae C- for its fiscal health grade.

Fiscal Accuracy Grade: C+

Despite the small size of PEI's Provincial Treasury, its staff manages to publish data that are more accurate and transparent than those of much larger counterparts in other provinces. Compared with the published statistics from the DBRS, the province's 2004/05 deficit and spending estimates were almost spot on — indeed, they were the most accurate estimates in the country. For this reason, PEI earns grades of B+/A– and A- for Indicators 5 and 6 (see Appendix Table A-2). At the same time, however, the province did have difficulty predicting its 2005/06 budget numbers. It underestimated the size of both its 2004/05 budget deficit (Indicator 7) and total ordinary spending per capita in 2004/05 (Indicator 8). taken together, however, these four statistical benchmarks earn the province a C+ for fiscal accuracy, which is a reasonably good grade for a province with few staff to calculate the budget numbers.

Budget Impact Grade: C–

For fiscal year 2004/05, PEI constructed a tough, no-nonsense budget. But its 2005/06 budget reflects the provincial treasurer's omission of fiscal prudence as a worthy priority. The province is satisfied with increasing its deficit by $22 per capita, and predicts an increase in per capita interest payments on the debt for 2005/06 at a time when interest payments are declining for the ten provincial governments as a whole. Equally worrisome, PEI plans to increase total ordinary spending by $488 per capita, which is above the national average increase. Finally, in its 2005/06 budget, the provincial government has undertaken a considerable change in the manner in which it collects gasoline and diesel taxes, the net effect of which is difficult to predict. On the positive side, the government did reduce its small business tax rate to 6.5 percent.

Nova Scotia

Overall Grade: C+

Nova Scotia's overall grade of C+ for fiscal year 2005/06 represents a slight improvement over the C/C+ it earned last year. The fairly good state of the province's finances before the spring 2005 budget was tabled merits an average mark of C+ for fiscal health, and the province managed to improve its fiscal accuracy grade from a C last year to a C+ this year. However, since the 2005/06 budget was tabled before the Offshore Offset Agreement between Nova Scotia and the federal government was struck on August 15, 2005, our grade for that budget does not take into account the province's subsequent announcement that it would use the extra offshore royalties to start retiring its debt. Nevertheless, we still believe that the province plans to increase its total spending in 2005/06 at too high a rate.

After the Offshore Offset Agreement was signed, Minister of Finance Peter Christie stated that “the $830 million Offshore Offset cash payment will be used to retire outstanding debt in 2005-06” (Christie 2005, 2). We commend the Nova Scotia government for its use of the energy royalties in this way.

Fiscal Health Grade: C+

The relatively good state of Nova Scotia’s finances before the tabling of the 2005/06 budget earns the province a C+ for fiscal health. It does well in those indicators (3 and 4) that measure the relative size of government — its spending per capita of $6157 is lower than the national average, as is its employment of 52 government workers per 1000 population.

Nova Scotia is still having difficulties with its deficit and debt, however, recording a budget deficit of $52 per capita in fiscal year 2004/05, even as the ten-province average was a net budget surplus. Its worst problem, however, is its debt-service obligations, which in 2004/05 amounted to $961 per capita — higher than all other provinces except Quebec. Nova Scotia has promised in its 2005/06 budget to reduce its deficit; if it can follow through, it will improve its current average grade for fiscal health.

Fiscal Accuracy Grade: C+

Nova Scotia improved the transparency and accuracy of its budget numbers this year, compared with the published data from the DBRS. However, its underestimate of total ordinary spending in fiscal year 2004/05 by some $770 per capita erred more than the ten-province average. The province did better in estimating its deficit. All the provinces tended to understate their budget deficits (or overstate their surpluses), and here Nova Scotia was no exception. But the province understated its 2004/05 deficit by “only” $362 per person — modestly better than the national average.

Nevertheless, we remain puzzled by how the Nova Scotia government presents its budget balance figures. In his 2005 budget speech, Finance Minister Peter G. Christie stated, “Let me take moment to point out that Nova Scotia is one of only two provinces in the country in recent years to have tabled four balanced budgets in a row” (Nova Scotia 2005, 2). Yet the DBRS reports that the province registered per capita budget deficit figures of $76, $116, and $62 in fiscal years 2002/03, 2003/04, and 2004/05, respectively.

Nova Scotia does reasonably well in forecasting its two key budget indicators. The province overestimated its 2004/05 budget deficit by $508 per capita, a good result that leads to a B–/B for Indicator 7. It also did no worse than the national average in targeting its 2004/05 spending estimate.

Budget Impact Grade: C–

Again, because Nova Scotia's 2005/06 budget was tabled well before the Offshore Offset Agreement was signed with Ottawa, our assigned grade does not take in account the extra revenues the agreement will generate. We note, however, that the additional federal cash flow would allow the province to end its deficits quickly, record surpluses, bring down its debt interest obligations, and start reducing taxes. But these possible moves lie in the future. Looking at the spring 2005 budget, the province failed to undertake a strong programme to restore fiscal order.

For one thing, the 2005/06 budget promised more spending, with Finance Minister Christie bravely announcing increases in a number of key areas, including "Investing in Education and Healthier Kids" (Nova Scotia 2005, 11), "More Money for Post-Secondary Students" (p. 17), and "Better Health Care, Better Health Decisions" (p. 20), whereby health spending increased by 9.3 percent. In all, Nova Scotia increased ordinary spending by $497 per capita — equal to that of New Brunswick and exceeded only by that of spendthrift Alberta. As well, Nova Scotia's past debt obligations mean that the province must increase its interest payments on its debt by $20 per capita, the second-highest increase in the country.

On the positive side of the ledger, the province did promise to reduce its deficit and to register a budget surplus for fiscal year 2005/06. It also announced a reduction in the large corporation capital tax to 0.275 percent. But, laudable as these goals are, with the signing of the Offshore Offset Agreement, we expect the province to do more.

New Brunswick

Overall Grade: C+

New Brunswick's overall grade of C+ for fiscal year 2005/06 ties it with Nova Scotia and is equal to the ten-province average. It is, however, a slight decline from the revised grade of B– that we assigned for 2004/05.

The province's fiscal health grade slips from a C a year ago to a C–, but its fiscal accuracy earns it a reasonably good B–, the same mark as last year. Its budget impact grade of C+ is the highest of any of the Atlantic provinces, but still only average for the ten provinces as a whole.

Fiscal Health Grade: C-

Going into its spring 2005 budget, New Brunswick could be best summarized has having too large a government but a reasonably sound fiscal balance position. This strange mix thus earns the province a C– for its fiscal health grade.

The province posted a budget surplus of $71 per capita in fiscal year 2004/05, a noticeable improvement over deficits of $145 and $137 per capita in the previous two fiscal years. As well, New Brunswick's $490 per capita interest payment on the provincial debt is the best in Atlantic Canada and the fourth-lowest of the ten provinces. But the amount of per capita spending — $7060 in 2004/05, about $900 more per capita than Nova Scotia — remains a worry.

Fiscal Accuracy Grade: B–

As we stressed in last year's report card, New Brunswick's Finance Department publishes clear, carefully constructed budget estimates. This year, the province earns an A– for the accuracy of the deficit numbers (Indicators 5 and 6) in its 2004/05 budget, compared with the published statistics from the DBRS — the highest grades of any of the ten provinces. New Brunswick did less well with Indicators 7 and 8, so its grade fell on that basis. And the province underestimated total ordinary spending by $212 per capita, only slightly better than the national average.

Budget Impact Grade: C+

In his 2005 budget speech, New Brunswick Finance Minister Jeannot Volpé outlined five major objectives, including increased spending on health and education, reduced taxes, and a balanced budget (New Brunswick 2005, 5–6), which are reflected in the four indicators that make up the budget impact grade.

To highlight the negative side first, the province receives a low mark for its rather large increase in total spending, which we estimate to be about $497 per person. That amount is equal to the increase by energy-rich Nova Scotia and second only to that of Alberta among the ten provinces.

On the positive side of the ledger, New Brunswick has forecast another small budget surplus, which keeps the province right at the ten-province average for this key indicator. Concurrent with that forecast, the province also projects a small decrease in per capita interest payments on the debt. Finally, New Brunswick announced a reduction in small business tax rate to a very low 1.5 percent.

To summarize, despite the positive goals stated in New Brunswick's 2005/06 budget, the province's high spending intentions limit its budget impact grade to an average C+.

SUMMARY AND CONCLUSIONS

As last year's report card emphasized, annual provincial budgets aim at two separate but conflicting objectives. The budgets announce changes in spending on provincially delivered services that affect each resident, but such services must be paid for either with taxes or through borrowing. High taxes, especially on corporations and highly mobile entrepreneurs, deter business formation, while high rates of borrowing lead to high debt interest obligations; moreover, debt interest payments typically leave the province for other, wealthier financial jurisdictions. Thus, Atlantic Canada's provincial governments face the conundrum of wanting to deliver needed services while also developing their economies through lower taxes and lower deficits.

The signing of agreements with Ottawa on offshore energy royalties gave both Nova Scotia and Newfoundland and Labrador an opportunity to lower either taxes or deficits — ideally, both at the same time. With the agreements, both provinces get to keep their large equalization payments despite increasing royalties on offshore energy production. Yet Newfoundland and Labrador failed to undertake any daring changes in its fiscal year 2005/06 budget, although it did promise to limit aggregate provincial spending to a modest increase. For its part, Nova Scotia may be on the way to fiscal recovery in the wake of the Offshore Offset Agreement and the provisions announced in its 2005/06 budget. To its credit, the province did take the noteworthy step of reducing its large corporation capital tax rate, and it has stated that generating a surplus is a major fiscal goal. But both energy-rich Nova Scotia and Newfoundland and Labrador still face persistent per capita debt loads that threaten to impede their economic development.

In contrast, energy-poor New Brunswick and Prince Edward Island have no lucrative agreements to sign with Ottawa. Both provinces continue to maintain fairly large governments relative to their small populations, which hurts their overall fiscal grades. On the positive side, however, both provinces undertake reasonably reliable budgetmaking, which earns them good fiscal accuracy grades that boost their overall marks. Nevertheless, we urge both provinces to keep to their 2005/06 budget promises, and to restrain spending and watch for possible deficits during the coming fiscal year.

Finally, we want to stress the slight improvement that has occurred from our revised fiscal year 2004/05 marks to those for 2005/06. Although New Brunswick slipped a bit from B- to C+, the other three provinces increased their marks: Nova Scotia from C/C+ to C+, Prince Edward Island from D+ to C, and Newfoundland and Labrador from D– to D+/C–. These improvements, however modest, bode well for the future, if the provinces can hold their course.

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Appendix Tables

Table A-1: ***Scores for Indicator Components of Fiscal Health Grade***

	Indicator 1	Indicator 2	Indicator 3	Indicator 4	Grade I
Atlantic Canada	C–	C–/C	C	C–	C–
Newfoundland and Labrador	D	C	D	D+/C–	D+
Prince Edward Island	C/C+	D+	D+	D+/C–	C–
Nova Scotia	F/D–	C–	A–	B	C+
New Brunswick	B	C–	C–	F/D–	C–
Quebec	F	D–/D	A–	B	C–
Ontario	C/C+	D–	A+	A+	B+
Manitoba	A/A+	B–	B	D	B–
Saskatchewan	C	A–	B–/B	F	C+
Alberta	A+	A+	F	A+	A
British Columbia	A–	C–	D	B+	B–

Table A-2: ***Scores for Indicator Components of Fiscal Accuracy Grade***

	Indicator 5	Indicator 6	Indicator 7	Indicator 8	Grade II
Atlantic Canada	C	C–	C	B	C+
Newfoundland and Labrador	F	F	A–	A+	D+
Prince Edward Island	B+/A–	A–	D–	D+	C+
Nova Scotia	B–	C–	B–/B	C+	C+
New Brunswick	A–	A–	D/D+	C+	B–
Quebec	B	B	D	C–	C–/C
Ontario	B/B+	A	F/D–	A	B–
Manitoba	B	B+/A–	C	C	C+
Saskatchewan	C/C+	B–	A–	C	B–
Alberta	F	C	A+	F	C–/C
British Columbia	B	B	C+	B–	B–/B

Table A-3: ***Scores for Indicator Components of Budget Impact Grade***

	Indicator 9	Indicator 10	Indicator 11	Indicator 12	Grade III
Atlantic Canada	C–	D+/C–	C+	C+	C
Newfoundland and Labrador	F	C+	A	C–	C
Prince Edward Island	C	D	C	C	C–
Nova Scotia	C+	F/D–	C–	B–	C-
New Brunswick	C/C+	C+	C–	B–	C+
Quebec	C–	C–	A+	B	C+/B–
Ontario	F	A	A–	C	C+
Manitoba	C+	F	C	A	C–
Saskatchewan	C–	A	C+/B–	C	B–
Alberta	A+	B+/A–	F	C	C+
British Columbia	B+	B	C	C+	B-

Table A-4: ***Change to Total Grades, fiscal years 2004/05 to 2005/06***

	Total Grade 2004/05	Revised Total Grade, 2004/05	Total Grade 2005/06	Direction of Change
Atlantic Canada	C	C–	C	slight increase
Newfoundland and Labrador	C–	D–	D+/C-	increase
Prince Edward Island	C–/C	D+	C	increase
Nova Scotia	C/C+	C/C+	C+	slight increase
New Brunswick	C+	B–	C+	slight decrease
Quebec	C	C+/B–	C	decrease
Ontario	C–/C	C–	B–/B	increase
Manitoba	B–/B	B–	C+	slight decrease
Saskatchewan	C+/B–	C+	C+	no change
Alberta	A–	A	B–	decrease
British Columbia	B–	B–	B–	no change

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