



2019 Pre-budget Consultation

Presentation to the Minister of Finance and President of
the Treasury Board; Honourable Tom Osborne

Association of Chartered Professional Accountants of Newfoundland and Labrador

Presentation to the Minister of Finance and President of the Treasury Board; Honourable Tom Osborne

Disclaimer: The suggestions contained within this document are a collection of the general themes received from a call for feedback from the CPA membership with respect to the provincial government budget process and are not necessarily the specific views of the Association. Any suggestions contained within should be subject to the appropriate internal research, governance and financial assessment processes, generally accepted within the provincial government.

The Association of Chartered Professional Accountants of Newfoundland and Labrador, representing our 1,875 business leaders and trusted advisors; working in business, education, government, and public practice; is pleased to present to Government this pre-budget submission for the 2019–2020 consultation process.

Preamble

The accumulated deficit has climbed by over \$5 billion in the past five years, over double what it was in 2014. The years prior to 2013 saw either a stable or decreasing accumulated deficit, largely due to oil royalties and taxes on higher personal and corporate incomes. Since the collapse in oil prices the province has not seen a return to surplus and expenses have continued to rise for each of the past five years and the majority of any improvement to revenue has stemmed from an improvement in oil prices.

There needs to be an immediate effort to control and reduce public sector expenditures to restore balanced budgets, inclusive of government agencies, crown corporations and departments. This will require political will and courage, considerable management commitment and skill, inclusion and cooperation of public sector unions and employees, and active participation of the general public/taxpayers. Consideration must be given to the services Government should be providing and what should be outside the governments domain as well as how to deliver those services on a cost recovery basis.

Innovation in Public Service Delivery

The province does not have a revenue problem, we have an expenditure problem. Further echoing the Auditor General, emphasis should be placed on “sustainably reducing those

expenditures” rather than giving line departments percentage targets to hit. To accomplish the goal of reducing expenditures, innovation is required.

Health Care

Health care accounts for 39% of the province’s expenditures. It is strongly recommended that the Government focus on health care reform, with the goal of identifying and implementing both financial and process improvements, ultimately delivering a better client service at a lower cost.

We recommend that government evaluate the following as potential opportunities with respect to health care:

1. Alignment of the four regional health authorities under a shared vision and set of objectives is instrumental in achieving the desired healthcare outcomes. Focus of the regional alignment should:
 - Allow for a single strategic direction for long-term planning of infrastructure and service delivery.
 - Facilitate development and implementation of consistent policies, procedures and service delivery models province-wide.
 - Allow for a single strategic direction for mission critical Information Technology and Information Management investments.
 - Increase purchasing power for supplies and contracted services.
2. A working group or executive committee from each of the health authorities should be charged with the responsibility to develop a long-term infrastructure and service delivery plan for health care throughout Newfoundland and Labrador.
3. Newfoundland and Labrador has among the highest incidence of obesity and chronic diseases linked to unhealthy eating and sedentary lifestyles. We commend the Government, the Health Authorities and the Department of Education on its initiatives in promoting a healthier population. We suggest further investment in the areas of health education and to encourage more active living. Treating chronic diseases with costly medications and medical procedures should not be a substitute for tangible investment and real effort to reverse negative population health trends.

Digital Government

With respect to innovation in public service delivery, we are encouraged by the government’s work in implementing a digital government approach to find innovative ways to reduce cost in public service delivery. We encourage the province to establish a special secretariat jointly under the Department of Finance and the Office of the Chief Information Officer tasked with a three-year mandate to find efficiency in operation.

Alternative Service Delivery

It is becoming increasingly difficult to maintain the same expectation of services, especially in rural areas of the province. Government should challenge departments, agencies and crown corporations to identify innovative ways to deliver a reasonable level of service across all areas of the province. Alternative service delivery could manifest in the forms of telemedicine, mobilized units and virtual offerings. For example, an alternate service delivery option may be to have a motor vehicle registration on wheels going to many communities rather than have bricks and mortar in each location, the same model could be applied to many services. Another option may be to utilize existing infrastructure to provide a service to an area on a set schedule, to continue with the motor vehicle registration example, the department could setup in schools throughout the region on a set schedule when the school is otherwise not utilized, like during professional development days.

Cross-Departmental, Cost Recovery Review

There are numerous services that the Province provides to individuals that are a direct benefit to those individuals and not a general good to the public as a whole. Services that benefit individuals versus the general public should have reasonable and rational levels of cost recovery. It is recommended that the province consider mandating ministers to conduct a cost-recovery review of services provided across departments, agencies and crown corporations.

For example, the Provincial Government estimated there are 348 kms of local roads that the Province provides snow clearing services at a cost of \$3.1 million in 2014/2015. These are roads that would be connected to a Provincial highway or other Government owned road. If these roads were in a municipality they would be the responsibility for the town to maintain and clear the snow. The Department of Municipal Affairs and Environment (MAE) estimates that 10% of the population of the province reside in areas that have no property taxation.

The Independent Tax Review Committee, established by the Department of Finance, noted the following in its report of November 30, 2018; “For equity and fairness reasons, the province should consider implementing a provincial property tax, one similar to provincial property taxes in other provinces. The goal is to have property owners pay at least a minimum property tax on all properties in the province.” To recover the costs of snow clearing, for example, Department of MAE should consider a base property tax rate for the 10% of the population to recover costs arising from Transportation and Works.

Another example where cost recovery could be considered is related to an increase in tuition fees at Memorial university and a corresponding reduction in government grants. Typically, low cost is associated with low quality, however Memorial continues to enhance its rankings amongst Canadian universities, winning national and international recognition in Business, Engineering, Medicine and Ocean Technology yet tuition fees remain significantly below national and regional averages. While the goal of “affordable education” is commendable,

consideration should be given to whether tuition should be increased to be marginally below average tuition at Atlantic universities. Elsewhere in this submission, we have highlighted an opportunity related to a future tax benefit related to these tuition costs, to support those that will continue to drive the Newfoundland and Labrador economy in the future.

Salaries and Benefits

Salary and Benefit costs have been a significant target of the government and that is to be expected given salaries and benefits account for 45% of the province's expenses. The reduction in the provincial government's workforce is inevitable. However, the loss of jobs will have a significant impact on the provincial economy. Alternatives that should be considered as the workforce reductions are implemented are allowing reduced work weeks, job sharing, reduction in overall benefits; etc.

It is important that the impact of workforce reductions on service levels be carefully assessed. Rather than cutting specific percentages from department budgets, an evaluation of the services being provided and related costs should be conducted. Services should be eliminated where the expense to provide the service outweighs the benefits. For functions that are outside of typical provincial government roles, consideration should be given to whether a public private partnership would serve the community better and more efficiently.

We offer the following observations and recommendations with respect to salaries and benefits throughout government:

1. We acknowledge that the province is continuing to negotiate the elimination of severance in its prior form and suggest this trend should continue, however the province will need to carefully consider the impact that will have on its cash flow constraints at this critical time.
2. Based on current pension calculations (i.e. best five years' salary) management level employees can achieve a large increase in pension benefits when they experience significant late-career salary increases from promotions, reclassifications or benchmark adjustments. We recommend that this issue be examined in detail and that amendments be implemented where necessary to ensure that management employees contribute an appropriate share of pension contributions.
3. We recommend a comprehensive review of the benefits provided in collective agreements and employment policies to ensure that benefits reflect the differing workplace circumstances and conditions throughout the public service. Benefit packages tailored to suit specific jobs and working conditions will reduce negative impacts on productivity and cost.

Strategic Growth in the Future Tax Base

Newfoundland and Labrador's population is roughly the same today as it was in 1970 and down 50,000 since the 1990's, every other province has seen nearly 20% growth or better. Over the same period, Newfoundland and Labrador has seen the smallest growth in the working age population and amongst the highest of its population who are retired.

At the time of confederation, Newfoundland and Labrador was demographically Canada's youngest province. With the decline of one of the primary economic drivers, the fishery, the diaspora began and the trend reversed dramatically. According to the 2018 Fiscal Sustainability Report, by 2042 the province is projected to lead the country in the senior dependency ratio (65%) and population decline (-0.9% annually). The province is supporting a higher level of per capita debt and a higher level of health care expense as the population ages, on a shrinking tax base. We need to invest now in ways to grow tomorrow's tax base.

As the government reduces its workforce, we feel it is critical that appropriate incentives be provided for the business community to thrive and grow. Incentives should be streamlined and targeted toward specific outcomes that are critical to the province in the short and long term, like investment in resource-based industries, growth in tourism and increased employment in the private sector. Our members have indicated that they and their clients are not fully aware of what programs are available to them. Current incentives programs should be re-evaluated to ensure they are accessible to those intended to benefit from them and that they are meeting their intended results.

To grow the tax base, we must grow the provincial population of working age individuals. This can only be accomplished through economic diversification and expanded employment opportunities, while attracting new entrants to the population in the form of immigration and expatriation while also retaining our home-grown talent.

Immigration

The Association recognizes that with the provinces aging population and low birth rates any growth in the future tax base will require significant employment opportunities to attract working age members to the population, but this will not be able to be solely accomplished through opportunity, to meet the demands of that opportunity the government will require a carefully designed and implemented immigration strategy. Through a strong immigration strategy, the province will create more opportunities and grow the economy.

The attractiveness of our university has played a significant role in attracting immigrants to the province, but more will need to be done to help establish Newfoundland and Labrador as a home for those newcomers and to create opportunities for that segment of our population to grow and prosper within the province.

The addition of the International Entrepreneur and the International Graduate Entrepreneur streams under the Provincial Nomination Program (PNP) will allow the province to retain talent arising from the post-secondary system as well as attracting international business success. The Government should research what has been done in other areas of the country to implement a successful immigration strategy. Prince Edward Island has been very active in this space and has had some success in growing this segment of their population, and recently Moncton has demonstrated it has made great progress in this area adding 4,500 new immigrants in the last four years and a 77% retention rate. Like all new strategies, there will likely be areas for improvement in their strategy as well, but we believe there is a great deal that this province could learn from the work they have done.

Talent Retention

As a province, we need to do a better job of retaining talent who are attracted to the province for post-secondary education. Attracting students to the university or other post-secondary education through low tuition, is a commendable approach, however, we continue to lose a significant portion of those students post graduation to other areas of the country. Another approach would be to increase tuition fees, but provide a portion of the education in the form of a forgivable loan contingent on staying in the province and earning income for a set period, or create a tax incentive that would offset increased tuition for those who choose to stay. This could be administered through CRA and be based on income earned in Newfoundland and Labrador, ultimately ensuring that a lower cost of post secondary is aligned to those that help grow our economy in the future.

As it relates to our immigrant population, the government will need a strategic focus on this segment of the population to help create a sense of community for our newcomers, helping them become well established and ensure their success and connectiveness to Newfoundland and Labrador. To this end, it is also important to educate the public about why immigration is important and how it boosts the economy.

Expatriation

From a population growth perspective, the most reliable long-term growth strategy would be to attract those who were here and left, back to the province. We have been successful in doing this for those entering their retirement years, demonstrating their strong desire to be here, the challenge generally is access to stable employment. To accomplish this growth, government will need to build an environment that encourages business growth in the province, minimize 'red tape' and provide business incentives for entrepreneurs to start and grow their businesses in Newfoundland and Labrador.

Economic Diversification

Private sector investment will typically support the development of natural resources where global markets exist for products and services. Governments may use incentives to encourage global enterprises to choose a local development from a global portfolio of development prospects. Governments may use permits and regulations to leverage investment in value-added processing of these resources for global markets. We believe that our abundant natural resources will continue to be the economic engine of the province and encourage government to continue investing to support the development of our natural resources.

We also believe that opportunities exist to diversify the economy to create employment opportunities and additional revenues to government. We acknowledge improvements in capacity in areas like aquaculture and agriculture to enable diversification, but it is critical that government executes on a plan to ensure the capacity is utilized in a timely and effective manner to yield the intended results.

Education and workforce development is the key to any sustainable diversification of our economy. In recent years, government has made substantial strategic investment in workforce development to fill near-term labour market gaps but this has largely been focused on supporting construction-phase activities in major natural resource projects.

We believe that the recommended strategic investment in Science, Technology, Engineering and Math (STEM) education will also contribute to the development of an entrepreneurial culture in the province and the development of knowledge-based industries in the province.

The government must support and encourage the operations and activities of incubators that aid in the development of knowledge-based businesses in the province. Past support in this area has resulted in many organizations commencing commercial operations for global markets while remaining based here in Newfoundland and Labrador. Some of these companies have attracted significant venture capital funding, a key milestone in the development and growth of a sustainable knowledge-based business. We encourage government to extend support for business incubators outside of the knowledge economy and into other sectors in the province. The model of incubating companies has been successfully applied to the agricultural sector and will have applications in other areas such as tourism, culinary, aquaculture, mining, etc. Existing incubators in our province, Genesis and the O'Brien Farm Foundation for example, are demonstrating a proven model for economic development and new company creation.

Another challenge the province faces with economic diversification, is growth in rural areas of the province. The current connectivity divide poses a challenge, similar to the necessity to maintain the appropriate means of transportation systems, it is necessary to maintain and create the digital infrastructure to assist in regional economic development. Connectivity of cellular and internet services is necessary for new business growth. We encourage the

government to continue to fund the Cell Phone Pilot for 2019 and advocate that the federal government consider a cost share model like broadband. In addition to economic diversification, a well-established digital infrastructure will enable alternative means of service delivery in more geographically dispersed segments of the population.

Budgeting Assumptions

The government has been presented a return to surplus in 2022-23 in its budgets since it took office. There are a significant number of assumptions built into the revenue forecast and while the assumptions worked out in governments favour in 2016-17, revenue was slightly below expectations in 2017-18. Similarly, expenses were below forecast in 2016-17, but above expectations in 2017-18, resulting in a lower deficit than expected in 2016-17, but a greater deficit than anticipated for 2017-18. The most recent economic update presented a positive variance with respect to revenue and a balanced forecast for expenses, indicating an improvement in overall deficit for the 2018-19 fiscal year. While it is positive to see that the plan is being followed, we continue to have concern regarding the pace at which the deficit is being managed and significant concern with the level of risk that exists within the budget assumptions.

One assumption built into the revenue model is an increase in production volumes each year for the next five years. Starting in 2020 production volumes are forecast in excess of 100m barrels per year, a level the province has not seen since 2009. Given the challenges we have seen in the current year related to production volumes, and looking at the current oil production projects, specifically the West White Rose where first oil is expected in 2022 and Bay du Nord first oil not expected until 2025, it is unclear whether this increase in production volumes is achievable.

The budget assumptions the government has used related to exchange rate appear to be conservative, showing a steady but minimal increase in the exchange rate for the next five years, which of course has a negative impact on the provinces revenue from oil. Economic forecasts would suggest the Canadian dollar will see a continual decline in the next five years. We support the conservative view government has taken on the exchange rate and feel that is the safest approach.

It is much more difficult to budget for oil price, with significant fluctuations in recent years and within the year, it will be challenging to set a price. The one suggestion in this regard would be to base any future budgets on the low end of all economic forecasts related to oil price to minimize volatility risk.

The provincial budget like all budgets carry with it several assumptions. Expenditures should be linked to income that is generally well known and has a low risk of volatility. Income from volatile sources should be budgeted very conservatively to improve the chance of a favourable variance within our overall financial picture.

Tax Fairness for All

We believe that Government should continue to review the revenue measures implemented as part of Budget 2016 in order to find other possible means to reduce the burden on low and middle income earners while having a minimal impact on overall provincial revenue. While we appreciate the need for revenue, the revenue generated using the levy would be better accommodated through the normal income tax process and rates, rather than through a special levy and would ensure that taxes are generated from those who can afford to pay while also ensuring our continued competitiveness with the other Atlantic provinces.

With respect to taxes imposed on businesses and industry, we believe Government should carefully review the system of incentives that it offers businesses. In order to reduce the provinces dependence on oil & gas revenues, economic diversification is required, and properly designed tax incentives may go a long way in order to spur investment in new and existing industries (i.e. technology based industries, manufacturing & processing, etc.). Many other provinces have a wide range of specialized tax incentives that they use to encourage investment, so Newfoundland & Labrador needs to make sure its tax system remains competitive within Canada and the world.

For example, in order to incentivize capital expenditure and investment in the province by businesses the provincial government may want to consider implementing a provincial Investment Tax Credit on certain types of capital expenditures. This would be similar to the Atlantic Investment Tax Credit that exists at the Federal level which is a non-refundable tax credit that is available on qualifying expenditures. Other Atlantic provinces, including Prince Edward Island and Nova Scotia have implemented similar programs. Encouraging significant capital investment within the province should help spur job creation, economic development and future provincial tax revenues. If there are specific areas where the provincial government would like to target investment, they could limit access to this Investment Tax Credit to specific types of capital investment – or only make the incentive available to any capital expenditure exceeding certain dollar thresholds.

We support the tax review committee's recommendation that government needs to study the impact of local taxes and fees to determine the total tax burden in our province and over the next 4-7 years, the payroll tax (HAPSET) exemption threshold should be increased from \$1.2 million to \$2.5 million.

Overall, we recommend that rates of personal income tax, corporate income tax and HST remain competitive with other Atlantic provinces.

Finally, with respect to tax fairness to all, careful consideration will need to be given with respect to how the costs associated with the Muskrat Falls project will be covered. Government has been on the record indicating that the costs will not fall to the rate payer or the tax payer. As a professional organization, we have been challenged in determining how this is possible.

Unless the costs will be fully covered by revenue we would not otherwise have had, then it would appear it will have to come at the expense of reduced profits by a crown corporation, tax burden or rate increases, either on the provincial tax/rate payer or the Canadian. We encourage government and all parties to outline its mitigation plan, in advance of the general election to give the people of the province a clear view of how the impact on the public will be mitigated.

Conclusion

In conclusion, we recognize that the reduction of the provincial debt is a very challenging process, however we feel this should be the number one priority for government as a return to surplus is instrumental to the stability and growth of the province for generations to come.

We appreciate any opportunity to be involved in the solution as the government works through strategic changes to achieve a brighter future for the province, thank you!

*Association of Chartered Professional Accountants of Newfoundland and Labrador
March 11, 2019*