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FISCAL LESSONS FOR ATLANTIC CANADA FROM SASKATCHEWAN

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Executive Summary

COVID-19 and the related economic recession have thrown governments across Canada into varying degrees of fiscal peril. In Newfoundland & Labrador, the challenges of rapidly increasing debt and large deficits have created perhaps the largest fiscal challenge in the country. The Maritime Provinces are in somewhat better shape, but still face challenging deficits and rising debt.

While COVID-19 has added to these challenges, it did not create them. The Atlantic Provinces have long had economic and fiscal challenges. Fortunately, governments in Canada have overcome these types of fiscal challenges before. Even Newfoundland & Labrador's severe fiscal challenges aren't unprecedented. Lessons from previous deficit reduction efforts in Canada can be useful for the Atlantic Provinces as they chart their respective fiscal paths to financial stability.

Atlantic Canada's fiscal precariousness has a number of underlying sources. First, a long-term tendency to run budget deficits more often than surpluses has resulted in perpetually rising debt-to-GDP ratios, a situation that is unsustainable. Second, the Maritime Provinces in particular are heavily reliant on the federal government, with over a third of their program spending coming from federal programs such as equalization. All four Atlantic Provinces are vulnerable to changes in federal programs, changes over which they may have little control. Finally, the Atlantic Provinces have high rates on personal, corporate, and sales taxes, which leaves little room to raise taxes in an effort to tackle budget deficits.

At the time of writing, Newfoundland & Labrador is facing a budget deficit exceeding $1.8 billion, with Nova Scotia at $585 million, New Brunswick at $245 million, and Prince Edward Island at $112 million. As a result, net debt will rise in all four provinces. In particular, Newfoundland & Labrador will add $2 billion to its net debt this year, which is already the highest per-person in Canada.

Several Canadian governments found themselves in similar difficulties during the 1990s. While the fiscal turnaround of the Chrétien government during the 1990s is well documented, similar lessons were applied at the provincial level. Saskatchewan provides a strong comparison case for Atlantic Canada in general, and Newfoundland & Labrador specifically, due to its size and the relatively similar nature of its economy. Saskatchewan's budget deficits peaked at over six percent of GDP causing the province to have difficulty selling provincial bonds, a challenge similar to that which Newfoundland & Labrador currently faces.

Prudent fiscal choices in the years that followed this fiscal crisis allowed Saskatchewan to go from the brink of insolvency to relative fiscal health in a few short years. A detailed program review focused on the role of government and the elimination of programs that were unaffordable or inefficient. Fifty-two hospitals were closed, education spending was cut by 19 percent, and 500 government positions were eliminated.

While difficult, the result of these reforms was a reduction in program spending from a peak of $9,098 per person to $6,963 per person in less than five years. The ultimate result was a remarkable turnaround from a deficit of $1.53 billion to a surplus of $184 million in just three years.

Having brought spending under control, the province was able to later reduce taxes on personal income, corporations, and investment. As a result of the spending reforms first, and tax reforms later, the province was able to come full circle from its fiscal peril over the course of about a decade. There is perhaps no better evidence of this than the debt-to-GDP ratio, which peaked at 37.2 percent in 1992-93, was lowered to 30.7 percent in just five years, and continued to decline thereafter as government largely spent within its means and enjoyed strong economic growth.

Saskatchewan's remarkably fast fiscal turnaround—and the lasting nature of that turnaround—provides a template for current fiscal challenges in the Maritimes, especially Newfoundland & Labrador. While no two situations are entirely alike, the case of Saskatchewan's spending and tax reforms does provide Canada's Atlantic Provinces with a hopeful path out of their daunting fiscal situation.

Introduction

The Atlantic Provinces have long had fiscal and economic challenges. While the COVID-induced recession has added to these challenges, it did not create them. The general fiscal trend in Atlantic Canada over the past 30 years has been one of regular deficits leading to increasing levels of public debt.

More recently, prior to the pandemic, the Maritime Provinces appeared to be making modest progress on their long-term fiscal challenges. For example, Nova Scotia and Prince Edward Island had each posted five consecutive years of balanced or near-balanced budgets, while New Brunswick had reversed nearly a decade of deficit spending by posting three consecutive budget surpluses. As a result, each of those provinces enjoyed a declining debt-to-GDP ratio during that time.

However, Newfoundland & Labrador is a different story. That province has posted multiple years of large deficits and rising debt, leaving the province with arguably the most challenging fiscal circumstance in Canada. Newfoundland & Labrador's challenges are in some ways similar to those in the Maritime Provinces. For instance, all have long-term persistent deficits and relatively large government debt loads. But Newfoundland & Labrador's challenges are more acute and more subject to the whims of commodity prices. In some respects, its challenges are a hybrid of those facing the Maritimes (slow growth and an aging population) and Alberta, where resource price fluctuations have added considerably to the province's fiscal difficulties (Abdelrahman, 2020).

For Newfoundland & Labrador, these fiscal realities have been confirmed by the recent release of the report of the Premier's Economic Recovery Team (also known as the Greene report), which articulated the pressing need to bring annual deficits and escalating spending under control as soon as possible (Greene, 2021). Combined with recent warnings from the auditor general about the province's "considerable (fiscal) risks" (CBC, 2021), there appears to be a growing sense of urgency in that province to resolve its fiscal problems.

Regardless of more recent fiscal ebbs and flows, however, the long-term fiscal policy trend in Atlantic Canada has involved regular deficits and rising debt, and as a result is likely not sustainable. According to the most recent report from the Parliamentary Budget Officer, Newfoundland & Labrador, Prince Edward Island, and New Brunswick all have unsustainable finances over the long term. Nova Scotia is considered sustainable, but only by a slim margin (PBO, 2020). Persistent deficit spending combined with population aging make the fiscal road ahead difficult across the region. COVID and the resulting recession only serve to make the situation more challenging.

Fortunately, governments in Canada have overcome these types of fiscal challenges before. Even Newfoundland & Labrador's severe fiscal challenges aren't unprecedented. This is not the first time a province has faced a budget deficit in excess of 5 percent of the economy. One of the key purposes of this paper is to identify lessons from previous deficit reduction efforts in Canada.

Atlantic Canada's future prosperity will depend, in part, on specific policy choices. Luck and outside factors will play a part, but good policy choices from governments can provide a stable fiscal framework that can lead to sustained economic and fiscal improvements. Waiting and hoping for fiscal results to improve while making no changes to the underlying policies would be a dangerous choice.

Our analysis of fiscal turnarounds will focus mainly on Saskatchewan, for three reasons. First, though it is a bit larger, the province is not dissimilar to the Atlantic Provinces in terms of its relatively small population size spread out among a few medium-sized cities with many rural residents. Second, Saskatchewan provides a vivid example of a province getting into, and out of, fiscal trouble through sustained policy choices. Third, Saskatchewan provides a good comparator for Newfoundland & Labrador in particular, given that both economies have major resource sectors.

In addition to Saskatchewan, we will look briefly at some other Canadian examples of fiscal turnarounds to glean lessons that can be applied to Atlantic Canada's current situation. However, before turning to an examination of those lessons, we will begin by examining Atlantic Canada's fiscal situation, both before and during the current recession.

Atlantic Canada's Fiscal Situation

The fiscal situation of the four Atlantic Canadian provinces is generally more precarious than the rest of Canada. While COVID and the resulting recession has exacerbated the fiscal challenges facing all governments, the Atlantic provinces remain more fiscally precarious than most provinces. This section will focus on three broad areas[1] in which the Atlantic Provinces' finances are vulnerable and are likely to remain so. This discussion builds a case for implementing policies aimed at improving the provinces' fiscal positions in the aftermath of COVID.

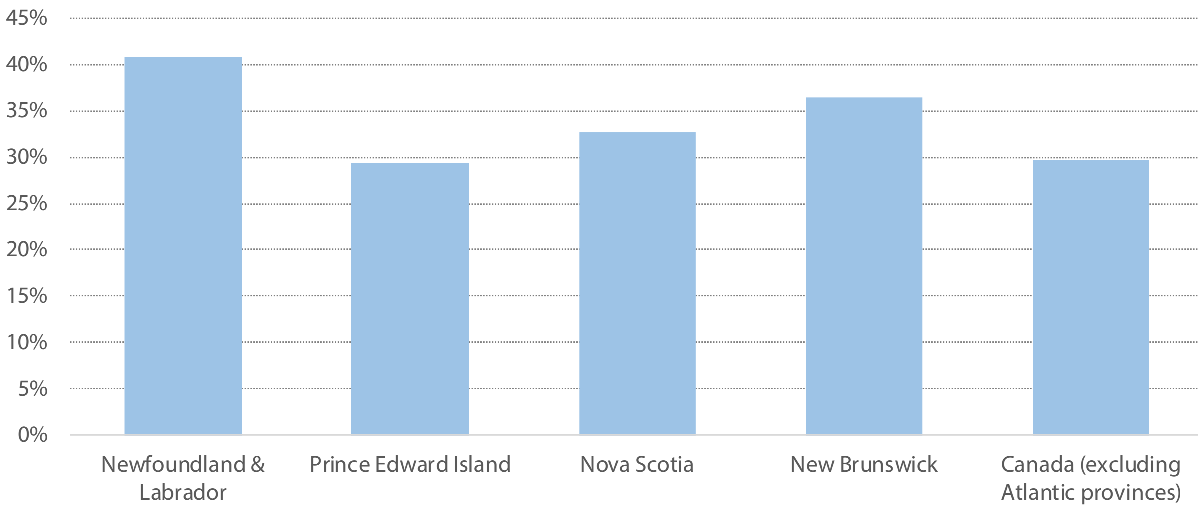
Debt and deficit

Atlantic Canadian provinces have run deficits regularly over the past several decades. For example, in the last 30 years across all four provinces (120 budget years), Atlantic Canadian governments have run deficits 66 percent of the time (RBC, 2021). Prince Edward Island leads the way, by posting deficits 77 percent of the time (23 of the last 30 years), followed by 73 percent in Newfoundland & Labrador, and 57 percent in both New Brunswick and Nova Scotia.

Partly as a result of these frequent deficits, the government debt burden in the region has been rising. One important measure of the debt burden is the debt-to-GDP ratio, which measures a government's debt as a percentage of annual gross domestic product. As Figure 1 shows, the Atlantic Canadian provinces with the exception of Prince Edward Island had debt-to-GDP ratios higher than the average for the rest of the Canadian provinces (henceforth referred to as ROC) in 2019/20. Newfoundland & Labrador had the highest debt-to-GDP ratio in the region (and indeed the country) at 40.8 percent – roughly 11 percentage points higher than the average of the Canadian provinces outside of Atlantic Canada. New Brunswick had the next highest debt-to-GDP ratio in the region at 36.4 percent, while the Nova Scotia ratio was at 32.7 percent. PEI is the one bright spot

[1] This section is intended to provide an overview of the fiscal risks facing the Atlantic Provinces. For a more detailed discussion, interested readers could consult Eisen, Whalen, and Palacios (2021).

Figure 1: Debt-to-GDP Ratio, 2019-20



Sources: Department of Finance, 2020; Provincial Public Accounts; Statistics Canada, 2020d; calculations by authors.

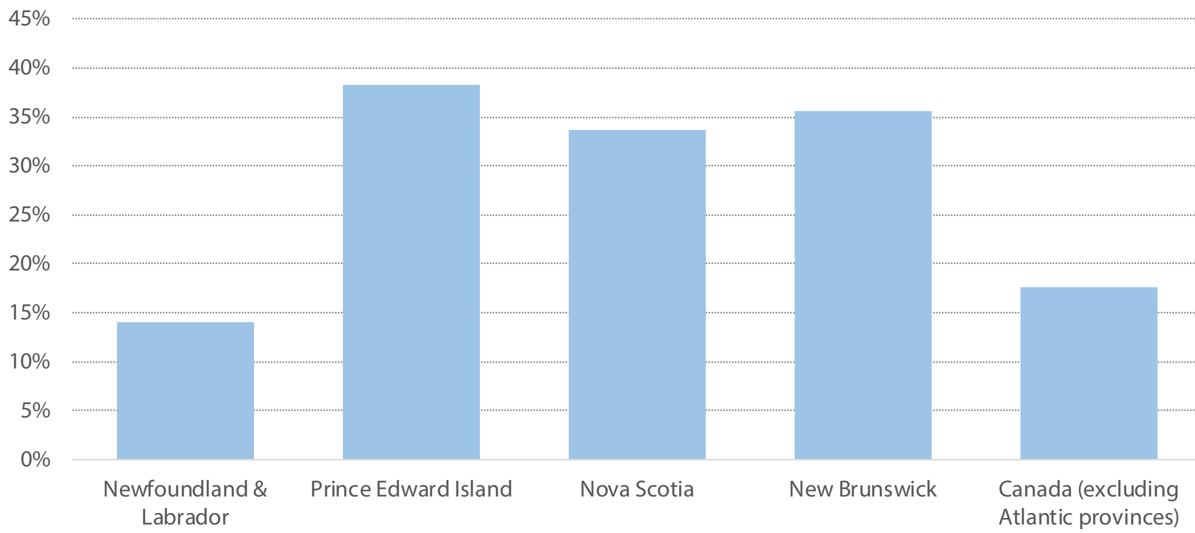
in the region on this metric, coming in with a debt-to-GDP ratio of 29.3 percent, just slightly lower than the average of non-Atlantic Provinces.

The debt-to-GDP ratio for provinces in the region has also been rising over time. Since 1990-91, the ratio has risen from 38.1 to 40.8 percent in Newfoundland & Labrador, 26.8 to 32.7 percent in Nova Scotia, and 23.4 to 36.4 percent in New Brunswick. Prince Edward Island, which fares relatively well compared to other Atlantic Provinces in current debt to GDP, has experienced the largest increase over time, from 10.0 to 29.3 percent.

This overall deterioration in fiscal condition raises concerns about the region's sustainability. The debt-to-GDP ratio is considered perhaps the most important measure of fiscal sustainability, and a province's debt-to-GDP ratio that rises indefinitely over time is considered unsustainable (PBO, 2020; Tombe, 2020). By this measure, the Newfoundland & Labrador, Prince Edward Island, and New Brunswick debt-to-GDP ratios are all currently considered unsustainable.

One of the key contributing factors to this fiscal unsustainability in the region is population dynamics. Atlantic Canada's population is projected to age faster and grow slower than the rest of Canada (PBO, 2020). This is compounded by the fact that the region already has the largest share of seniors among its population of all provinces (Eisen, Whalen, and Palacios 2021). The implication for the fiscal discussion here is that older

Figure 2: Federal Transfers as a Share of Provincial Spending, 2018-19



Sources: Department of Finance, 2020; Provincial Public Accounts; calculations by authors.

populations put significant pressure on health care budgets, thus adding to the region's challenging fiscal outlook.

Federal transfers

Another area of fiscal vulnerability is the region's relatively high reliance on federal transfers.

More than one-third of program spending in the Maritime Provinces was paid for by federal transfers in 2018/19,[2] with PEI being the most (38.2 percent) and Nova Scotia being the least (33.6 percent) reliant on these transfers. The three Maritime provinces all received transfers that were nearly twice as generous as the ROC in 2018/19. This means that any change to Canada's fiscal arrangements resulting in smaller transfers would add significant fiscal pressure to the Maritime Provinces.

Newfoundland & Labrador, which had been the top recipient of federal transfers in 2008/09, received the lowest percentage of revenue from federal transfers of any Atlantic province (14.1 percent) and less

[2] Elsewhere in this study we use 2019/20 data as the most recent year available. For this discussion on federal transfers, we have chosen to use 2018/19 data because Newfoundland & Labrador received a large, one-time spike in transfers in 2019/20 from a lump-sum payment relating to the Atlantic Accord. As a result, the 2018/19 data is more representative of the overall trend than is 2019/20.

Table 1: Provincial Statutory Marginal Tax Rates[1] at Various Income Levels, 2021

	Marginal tax rate (%) at $50,000	Marginal tax rate (%) at $75,000	Marginal tax rate (%) at $150,000	Marginal tax rate (%) at $300,000
British Columbia	7.70	7.70	14.70	20.50
Alberta	10.00	10.00	12.00	14.00
Saskatchewan	12.50	12.50	14.50	14.50
Manitoba	12.75	17.40	17.40	17.40
Ontario	9.15	9.15	18.97	20.53
Quebec (2)	16.62	16.62	21.46	20.31
New Brunswick	14.82	14.82	17.84	20.30
Nova Scotia	14.95	16.67	21.00	21.00
Prince Edward Island	13.80	16.70	18.37	18.37
Newfoundland & Labrador	14.50	14.50	17.30	18.30

Notes:

(1) Personal income tax rates include surtaxes where applicable.

(2) For comparability, the Quebec tax rates are adjusted downwards due to the federal abatement. The federal abatement results in Quebecers paying less in federal taxes than other provinces. A direct comparison between statutory provincial rates, without adjusting for the abatement, can be misleading in terms of judging the differences in tax rates paid in Quebec versus other provinces.

Sources: CRA, 2021; Revenu Quebec, 2021; calculations by authors.

than ROC in 2018/19. This is due in large part to the province becoming a "have" province, and it therefore no longer qualifies for the Equalization Program. On this metric, Newfoundland & Labrador is less exposed to the risk of changes in federal transfers than the Maritime Provinces. However, the province does still receive federal transfers equal to 14.1 percent of total spending. Given the province's other fiscal difficulties, any change to transfers will still present significant challenges.

Extensive research has noted the long-term net inflow of federal transfers into Atlantic Canada. One recent estimate, which included all federal transfer programs, showed that the federal government spent $82,953 per person in net transfers to Atlantic Canada between 2007 and 2018 (McMahon, 2021). Other research has demonstrated how certain aspects of these transfers may be changing in a way that will reduce Atlantic

Canada's net inflow of federal cash. For example, converging fiscal capacity among the provinces could cause changes in the equalization program that would reduce payments to the three Maritime provinces (Eisen and Palacios, 2020). In general, future changes to federal transfers are a key fiscal risk facing the Atlantic Provinces.

Taxes

Deficit elimination could come either from increasing revenue or decreasing expenditures relative to current expectations. Raising taxes to bring in more government revenue might seem like an intuitive option. However, the Atlantic provinces as a group have among the highest marginal tax rates[3] in the country.

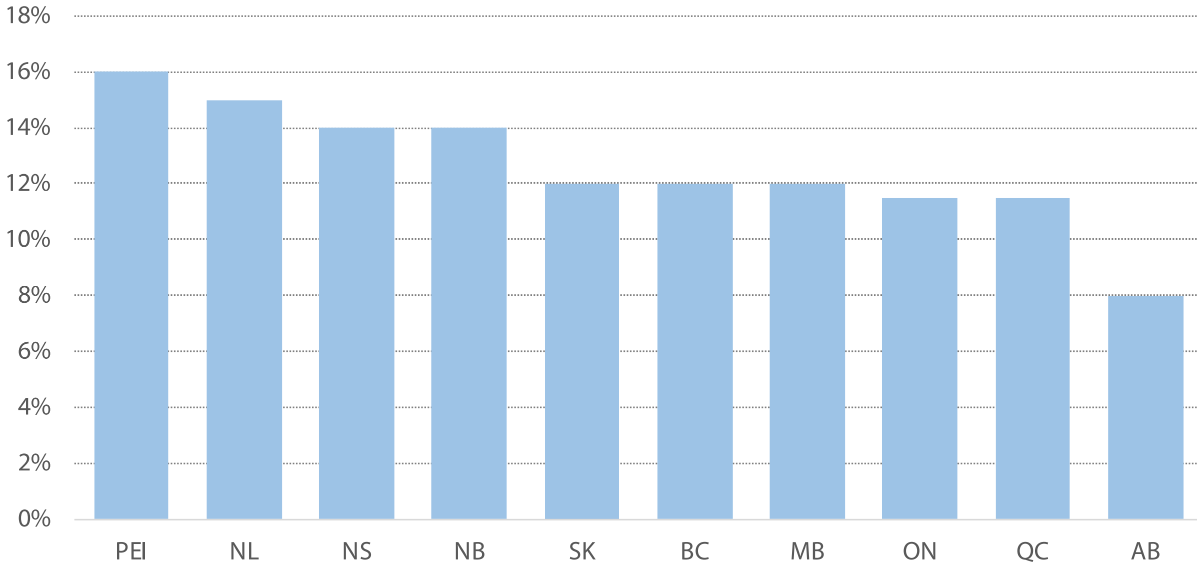
To illustrate the existing tax burden in Atlantic Canada, table 1 shows marginal tax rates at various income levels. Nova Scotia in particular fares poorly; it has the highest marginal tax rate among all provinces at the $150,000 and $300,000 income levels, the second highest at $50,000, and third highest at $75,000. New Brunswick had the second highest marginal tax rate at the $300,000 income level, while PEI and Newfoundland were fifth and sixth at that level. High marginal income tax rates create a disincentive for professionals, other highly skilled workers, business owners, and entrepreneurs to move to (or stay in) Atlantic Canada.

The region faces similar challenges when it comes to the general corporate income tax rate. As figure 5 shows, the Atlantic provinces have the four highest general corporate income tax rates in the country, ranging from 14 percent in New Brunswick to 16 percent in PEI and Nova Scotia. In fact, the general corporate income tax rate in Nova Scotia is twice as high as in Alberta, and the lowest tax province in the region, New Brunswick, still has a corporate income tax rate two full percentage points higher than the highest in the rest of the country. This is a major disincentive for investment in the region.[4] Moreover, attempting to generate more revenue by increasing the general corporate income tax rate in any

[3] Marginal income tax rates refer to the rate of taxes charged on the next dollar of income earned.

[4] While the general corporate income tax rate gives us an idea of the tax burden facing corporations, marginal effective tax rates (METR) are what ultimately matter to investors. Due to a number of complexities in the tax code, such as the Atlantic Investment Tax Credit, some industries in fact face very low rates of taxation in Atlantic Canada. However, for the sake of simplicity and in order to generalize, we have focused here on the general corporate income tax rate. See Bazel and Mintz (2020) for a discussion of METRs in the provinces.

Figure 3: Provincial General Corporate Income Tax Rate, 2021



Sources: CRA, 2021b.

of the Atlantic provinces would likely backfire. Ferede and Dahlby (2019) have estimated that increasing corporate income tax rates would actually reduce corporate tax revenue in each of the Atlantic provinces.

In addition to having little room to increase personal or corporate income taxes, the Atlantic provinces already have high sales tax rates. Each of the Atlantic provinces has a harmonized sales tax rate of 15 percent, which is marginally higher than the rate in Quebec, two percentage points higher than Ontario, and seven percentage points higher than Alberta (which only has a sales tax at the federal level). So while well designed sales taxes tend to be less economically damaging than many other categories of taxation, and are therefore where rate increases are often recommended in budget balancing efforts, the rates are already comparatively high.

Even if governments in Atlantic Canada were to increase tax rates, it isn't necessarily the case that they would increase revenues (Ferede and Dahlby, 2016). Moreover, even if provincial governments didn't already have high tax rates, research suggests that fiscal consolidations that rely on tax increases are more economically harmful than those undertaken primarily by reducing spending (Alesina et al., 2014). Simply raising tax rates does not appear to be a viable option to improve the fiscal standing of the provinces.

COVID's impact on Atlantic Canada's public finances

By some measures, the COVID-induced recession has closed the fiscal gap between Atlantic Canada and the rest of the country. For example, as noted above, "fiscal capacity" has converged, while the Atlantic Provinces are in the middle of the pack in current budget deficits when compared to their provincial peers. However, while the relative position of the region has improved during the current recession, the absolute position has undoubtedly worsened.

At the time of writing, Newfoundland & Labrador faces a budget deficit exceeding $1.8 billion, with Nova Scotia at $585 million, New Brunswick at $245 million, and Prince Edward Island at $112 million (RBC, 2021). As a result, net debt will rise in all four provinces. In particular, Newfoundland & Labrador will add $2 billion to its net debt this year, which is already the highest per-person net debt in Canada (RBC, 2021).

The result is added pressure to what was already a difficult fiscal position. Debt servicing costs are a key aspect of this challenge. One method of measuring debt servicing costs is debt as a share of own-source revenue in each province. By this measure, Newfoundland & Labrador ranks first, New Brunswick second, Nova Scotia third, and Prince Edward Island fifth in the country (Eisen, Whalen, and Palacios, 2021). Any rise in interest rates will cause significant additional budget pressure to the challenges above, particularly given the added debt loads taken on during the pandemic.

Lessons from Other Provinces

Taken together, these three broad factors (debt and deficits, federal transfers, and a high tax burden) combined with the impact of COVID demonstrate that the Atlantic Provinces are in a difficult fiscal position now and will continue to be so in the years ahead. However, these challenges are not unprecedented.

Several Canadian governments found themselves in similar difficulties during the 1990s.[5] Perhaps the most prominent example is the federal government in 1993. Faced with massive deficits and mounting interest costs, the Chrétien government was forced to undertake a large fiscal consolidation. After its first largely status quo budget, the government initiated a program review that intended to rationalize public spending. Indeed, this led to the landmark 1995 budget which succeeded in balancing the budget over a two-year period largely through program spending reductions, putting the federal government on solid footing for the next two decades. Other examples include the Klein and Harris governments in Alberta and Ontario during the 1990s. Each tackled similar fiscal challenges largely by reducing program expenditures, leading to balanced budgets in short order. Arguably the most relevant example for Atlantic Canada is from the Romanow years in Saskatchewan.

Saskatchewan found itself in a comparable position in the early 1990s, and like Newfoundland & Labrador today, ran into challenges raising money via bond auctions as investors lost confidence in its ability to service the provincial debt. Saskatchewan's experience successfully pulling back from the brink of a major fiscal crisis while at the same time creating a pro-growth tax environment could prove instructive for Atlantic Canadian provinces generally.

The degree to which the provinces will face future fiscal peril will be influenced by the decisions they make in the intervening time. With all four Atlantic Provinces facing past and present budget deficits and public debt challenges, we will now take a closer look at some Canadian success stories in dealing with such challenges.

5 See Clemens et al. (2017) for a detailed discussion of budgetary reforms during the 1990s.

Saskatchewan's Path from the Brink of Insolvency to Prosperity

The government of Saskatchewan experienced serious fiscal challenges in the early 1990s, much like Newfoundland & Labrador is facing today. As we shall see below, prudent fiscal choices it made during that period enabled Saskatchewan to go from the brink of insolvency to relative fiscal health in a few short years. The lessons of Saskatchewan's reforms during the 1990s and 2000s are relevant to all of Atlantic Canada.

The Romanow/Calvert era

When Roy Romanow's NDP government came to power in 1991, it inherited a province on the verge of insolvency. The provincial government had run uninterrupted deficits since the early 1980s. Despite modest economic growth during that period, provincial government revenue simply wasn't keeping up with spending growth. In the 1991/92 fiscal year, the deficit amounted to nearly 30 percent of total program spending. This is among the factors that led the cost of debt interest to jump from 1.6 percent of revenues in 1981/82 to 23 percent by 1993/94. Finance Minister Janice MacKinnon later described the unsustainability of the path the province was on; the government at the time was concerned that it might be unable to sell its bonds, and that federal officials might take control of provincial finances. She remarked that "the desperate scramble to avoid such a scenario began the day we were sworn in to government" (MacKinnon, 2003)

Like current day Newfoundland & Labrador, there was a real risk of default, particularly given that interest rates were far higher then than they are today. To take one example of the cost of borrowing, in Saskatchewan in 1993, borrowing costs represented 10.56 percent of net debt. That number is just 4.96 percent today, implying that the cost of servicing each dollar of debt in Saskatchewan is about half of what it was back then (Department of Finance, 2018). Furthermore, the Atlantic Provinces already pay interest rates that are higher than those that other provinces pay on their debt, partly because their credit ratings are worse, which only exacerbates additional interest-rate risk (Eisen, Whalen, and Palacios 2021).

Saskatchewan's fiscal difficulties were such that Premier Romanow later admitted that the province was flirting with bankruptcy. In fact, the situation was so dire that the Bank of Canada agreed to facilitate emergency borrowing on fears that the hard-pressed province might be shut out of international capital markets (Roberts, 1997). This story bears a concerning parallel to present-day Newfoundland & Labrador, where the bank of Canada stepped in on two occasions in early 2020 to facilitate additional borrowing that private capital markets alone would not finance (Bank of Canada, 2020).

In short, Saskatchewan's government faced an unusually difficult fiscal situation and needed to make dramatic reforms to keep the province solvent while also creating a more competitive economic environment. This was the backdrop for the 1992 budget, which not only began the process of reforming Saskatchewan's finances, but created a template for other reform-minded governments throughout the country.[6]

Reforms

Despite Saskatchewan's perilous financial situation going into the 1992 budget, the government was able to turn around its public finances within a few short years. By 1996, for example, the province posted a $573 million surplus, which stands in stark contrast to its $1.53 billion deficit in 1992. Additionally, the provincial government was able to implement lower rates on key tax categories that helped set the table for future prosperity by rapidly balancing the budget and making room for tax relief. We will discuss both the spending and tax reforms from this era below.

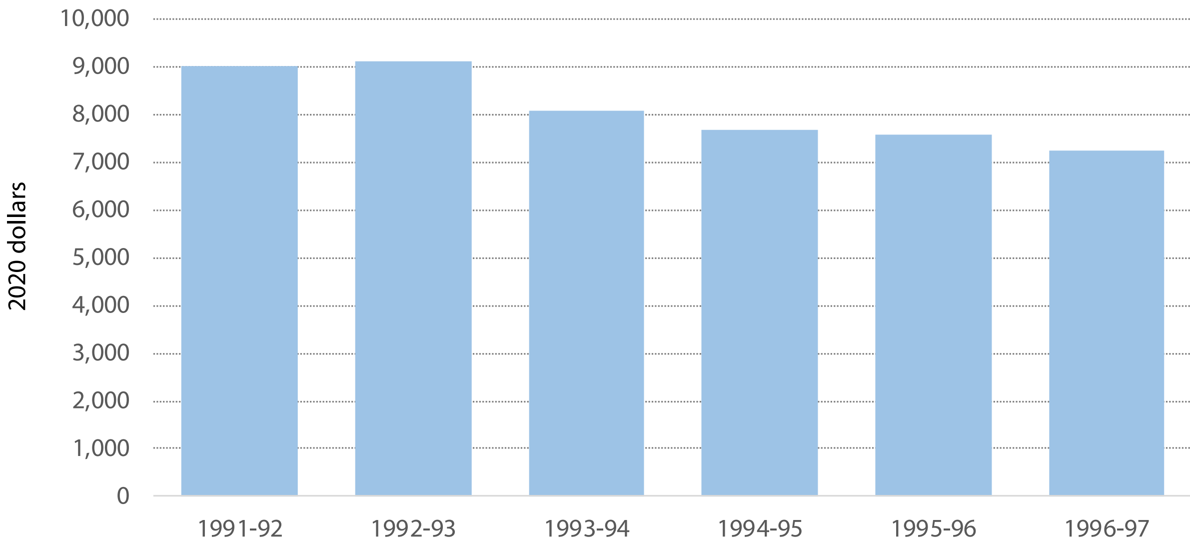
First, a look at spending reforms.[7] In 1992, while dealing with a large deficit, the province realized that the level of provincial spending was part of the problem. Saskatchewan's Finance Minister Ed Tchorzewski emphasized that spending would have to be cut, saying, "we can no longer pay for all of the services that government provides" (Clemen, et al., 2017).

Tchorzewski's successor, Janice MacKinnon, explains the province's approach to spending reform in her book. Detailing a process that was later applied by Finance Minister Paul Martin at the federal level, MacKinnon recalled that her government undertook a comprehensive program review, ultimately focusing on the role of government. All government spending was evaluated according to whether programs were determined to be in the public interest, whether government needed to be involved

[6] See Clemens et al (2017).

[7] This section relies heavily on Crowley, Clemens, and Veldhuis (2010).

Figure 4: Real Per Capita Program Spending in Saskachewan, 1992-1997



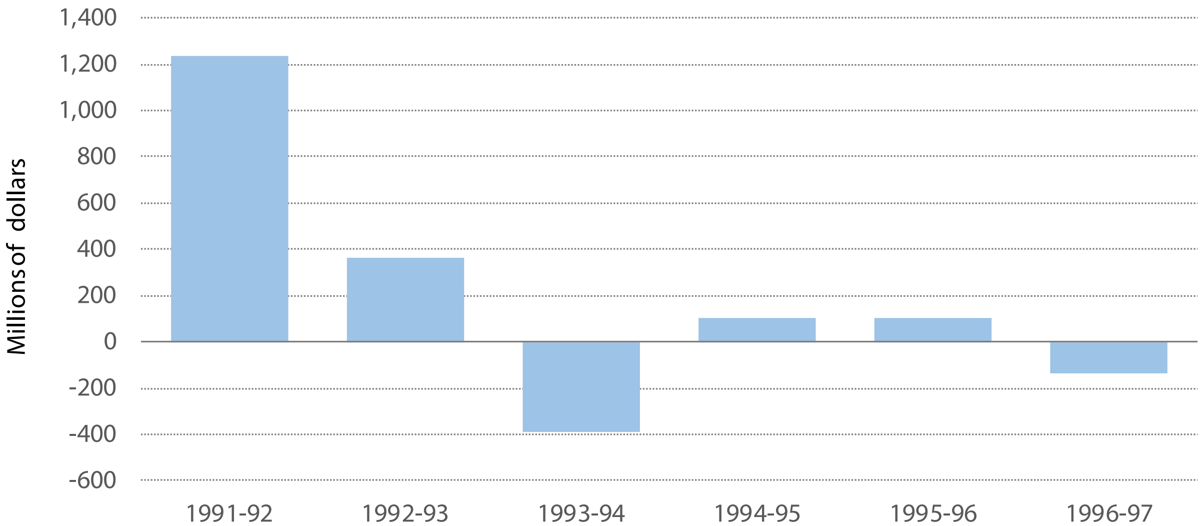
Sources: Department of Finance, 2020; Statistics Canada, 2020b and 2020c; calculations by authors.

or whether the private or voluntary sector would perform the task better, whether programs were ultimately affordable, and whether they could be made more efficient (MacKinnon, 2003).

In 1992, at the time of Tchorzewski's first budget and just before the fiscal crisis, real per-capita program spending in the province had reached $9,098 per person (in 2020 dollars). Figure 4 details the change in program spending that followed. The figure shows real per-capita program spending declining in five consecutive years to $6,963 in 1996-97. This is a key element of what enabled the province's remarkable fiscal turnaround in the years following the 1992 budget, as the program spending cuts enabled government to bring its finances quickly back to balance.

MacKinnon's explanation of how the government cut spending to tackle its deficit reveals other interesting specifics, applicable to any government with such a problem. Cuts began at the top, with the size of cabinet reduced, ministers' salaries cut, and communications budgets reduced. While mostly symbolic, MacKinnon explained that these cuts were necessary so that average people could see that politicians were sharing in the sacrifice. Other reforms included streamlined service delivery, cuts to administrative costs, and crucial reforms in health care, where 52 hospitals were closed in the name of more efficient service delivery. Education spending was also cut by 19 percent over a four-year period (MacKinnon, 2003).

Figure 5: Yearly Change in Fiscal Balance in Saskatchewan, 1992-97



Sources: Department of Finance, 2020; calculations by authors.

The comprehensive review of programs and services resulted in more than 20 programs being eliminated along with 500 government positions (Clemens et al., 2002). The result was a cut of 7.1 percent of overall program expenses over the course of the government's first two budgets. All in all, program spending was reduced significantly in three consecutive years (1992-94), which was a major contributing factor in the province's remarkable turnaround from deficit to surplus.

This program review and the resulting spending cuts drove per-person government spending down substantially, year over year, as detailed in figure 4. The results that followed in the province's fiscal balance were remarkable. Starting in 1992-93, province's fiscal situation improved substantially over four consecutive years, by between $389 million and $739 million each year. This improvement ultimately resulted a three-year turnaround from a deficit of $1.53 billion to a surplus of $184 million.

Looking more closely at taxation,[8] Saskatchewan initially raised several of its tax rates in an effort to help balance the budget. However, the province later took a longer view and carried out important steps to en-

[8] While tax reforms undoubtedly contributed to Saskatchewan's turnaround, this section is not intended to be a comprehensive discussion of Saskatchewan's policy changes. Furthermore, research suggests that additional reforms in more recent years could have improved the province's progress even further. For a longer discussion of both topics, interested readers can consult Clemens et al. (2002) or Veldhuis et al. (2009).

sure tax competitiveness. This process began in earnest with the formation of the Saskatchewan Personal Income Tax Review Committee[9] chaired by Jack Vicq (which became known as the "Vicq Committee"). The result was that beginning in 2000, Saskatchewan implemented a series of personal, business, and capital tax changes that made it more competitive (Rushton, 2000).

Following the Vicq Committee's report on personal income taxes, the government began implementing changes to both personal income tax rates and the structure of Saskatchewan's tax system. Beginning in 2001, the province moved to a tax bracket system and gradually reduced personal income taxes in the years that followed. For example, in the first year of the three-bracket system, 2001, the top personal rate was 16 percent and applied to income over $60,000 (Ort and Perry, 2000). By 2003, the top personal rate was 15 percent, while the middle rate and lowest rate had also been reduced by half of a percentage point each. The effect of the reduction was in fact even more significant, because the upper rate was now applying only over a threshold of $100,000 (as opposed to $60,000), while the middle rate applied to income between $35,001 and $100,000 (Ort and Perry, 2003).

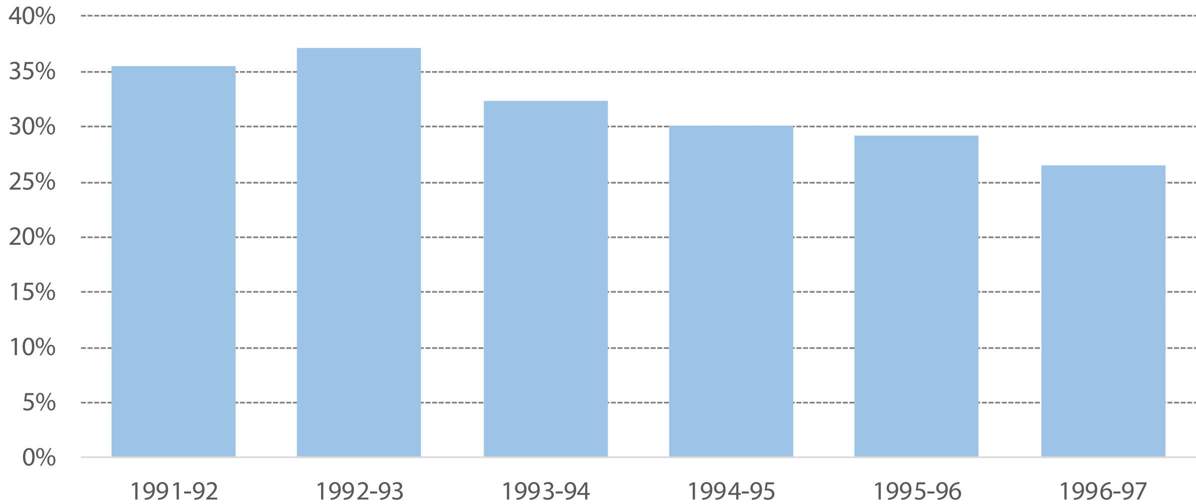
These changes preceded business tax reform. Despite its fiscal progress and personal tax reforms, Saskatchewan remained uncompetitive on business taxes as of 2002 (Clemens et al., 2002). However, beginning with the 2003-04 budget, the province made progress in this area as well. The 03-04 budget included a reduction in the small business rate as well as important reforms on capital taxes.

In 2005, a second Vicq Committee reported on business taxes. This committee's findings led to crucial reforms to business taxes, which were implemented in the 2006 budget and included the elimination of the corporate capital tax and reductions to corporate income taxes. Over the course of three budgets from 2006-08, Saskatchewan's corporate income tax rate was reduced from 17.0 percent (the highest in the country), to 12.0 percent (the fourth lowest) (Veldhuis, 2009).

The NDP Calvert government of the day also eliminated two different income surtaxes, making the province more tax competitive overall. Tax competitiveness has an effect on a province's ability to attract and retain people and investment, and ~~is~~ has been an important part of Saskatchewan's success over the past three decades. The overall picture in that province in the early to mid 2000s was one of increasing tax competitiveness.

[9] Vicq also chaired the Saskatchewan Business Tax Review Committee, which released its findings in 2005.

Figure 6: Saskatchewan's Debt-to-GDP Ratio, 1992-1997



Sources: Department of Finance, 2020; Statistics Canada, 2020d; calculations by authors.

By the time the corporate tax reforms took hold in the mid to late 2000s, Saskatchewan's fiscal reforms, personal income tax reforms, and corporate income tax reforms had brought the province nearly full circle over the course of about a decade. There is perhaps no better evidence of this than the dramatic change in the province's debt-to-GDP ratio, as detailed in figure 6. As the figure shows, the province's debt-to-GDP ratio went from a high of 37.2 percent in 1992-93 at the beginning of the reform period down to 26.5 percent in just five years, leaving it in a much stronger and more sustainable fiscal situation.[10]

The above is not to suggest that Saskatchewan's financial position was then perfect, or that more couldn't have been done. However, it does provide an example for the Atlantic Provinces, particularly Newfoundland & Labrador, of how much positive improvement can occur in a relatively short period of time as a result of sound policy decisions.

Of course, sound policy does not guarantee short term results. Saskatchewan did benefit from a recovery in commodity prices and the resulting boom of the mid to late 1990s. But good policy is generally a necessary, if not sufficient, requirement for good fiscal outcomes.

[10] The province's debt-to-GDP ratio continued to decline for many years thereafter as well, further evidence of the lasting effects of this fiscal turnaround.

Discussion

No two provincial financial situations are entirely alike. There are key differences between the fiscal and economic circumstances facing Saskatchewan in the 1990s and Atlantic Canada today. But there are some general principles that governments in the region can learn from Saskatchewan.

First, when possible, fiscal challenges are best dealt with swiftly. Unfortunately, at the moment Atlantic Canada and the world are beset by public health and economic challenges brought on by Covid-19. This, coming on top of their existing fiscal and economic challenges, will no doubt make it much more difficult to restore the region's economic and fiscal health. But when the pandemic has passed, moving decisively towards balanced budgets and more competitive tax rates would promote economic growth that could help the region gradually catch up with the rest of Canada.

While many governments across Canada have attempted gradual returns to budgetary balance, that course of action hasn't proven to be the most effective. The recent fiscal histories of Ontario and Alberta provide instructive examples. But, as we saw above, the Romanow government's decisive efforts to tackle its budgetary problems were successful. Throughout Canada's history short paths to budgetary balance have had a great deal of support; that support is not limited to just Roy Romanow and Saskatchewan. The Chrétien Liberal government, the Harris government in Ontario, and the Klein government in Alberta all managed to restore budgetary balance over two- to three-year periods and they all did so by adopting concerted plans reflective of the Saskatchewan experience (Clemens et al., 2017).

Second, while the Romanow government did increase taxes during its fiscal crisis, it relied primarily on spending cuts to balance the budget. This is crucial because, as work by Harvard economist Alberto Alesina and his co-authors have found over the years, fiscal consolidations that rely primarily on spending cuts tend to be more successful and impose fewer economic costs than those that rely primarily on tax increases (Alesina et al., 2014). Moreover, after the quick return to budgetary balance Saskatchewan's government was able to reduce corporate and personal income tax rates, which helped set the table for ongoing prosperity.

Third, by delegating tax reform decisions to an independent committee, sound tax policy reform recommendations were relatively insulated from political pressure. The Vicq Committee recommendations were not diluted through pressure from interest groups and were largely adopted by the government. Atlantic Canadian governments seeking to improve their tax competitiveness could task an independent committee, similar to the Vicq Committee, with a broad mandate to provide advice on tax reform. The committee's recommendations would be all the more valuable given the likelihood that there will be pressure in the years ahead to raise tax rates rather than reduce them.

Conclusion

Atlantic Canada's long-term fiscal challenges have been exacerbated by the Covid-19-induced recession. Coming out of the recession, provincial governments in the region will need to take corrective action to deal not only with the recession's financial fallout, but with those long-term fiscal challenges. Elevated debt levels paired with elevated tax levels have put these provincial governments in a precarious position, as witnessed by Newfoundland & Labrador's recent debt problems. Addressing both public debt and uncompetitive tax rates should be key priorities in the region coming out of the recession. As we have shown, governments in Atlantic Canada have much to learn on both of those fronts from reforms in Saskatchewan.

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