Government Tables Ninth Consecutive Balanced Budget

Fiscal Stabilization Fund Plays Key Role in Balancing Budget

Shrinking revenues as a result of lower corporate taxes, declining oil and gas prices, and drought conditions led to the province drawing $411 million from the Fiscal Stabilization Fund (FSF) in order to balance the budget last year. A preliminary estimate placed the province’s GDP growth for 2001 at -1.9 per cent, the lowest of the provinces.

Provincial revenues fell 11.8 per cent last year compared to the year prior. The decline is explained by larger than expected revenues in fiscal 2001 due to a one-time dividend received from Saskatchewan’s Lottery and Gaming Authority of $700 million and the difficult economic conditions present in the province last year. Corporate income tax revenues were down 50 per cent, due to a significant delay in corporate tax assessments and reduced economic activity. Consumer spending slowed and farm receipts were down as the drought produced a harvest 22 per cent lower than the ten-year average. Sagging oil and gas prices held down non-renewable resource revenues as well.

Added to the challenge of lower revenues was an increase in total expenses of 7.6 per cent, largely due to an accounting change in the farm income support program. The change pushed program expenses up over 9 per cent last year. A lower than expected interest rate environment resulted in interest expenses falling more than 6 per cent, a welcomed relief. In the end, more than half of the fiscal stabilization fund was required to balance the books in 2001-02.

The province established the Fiscal Stabilization Fund in 2000-01 as a source of funds to be used by the government to smooth over years when expenses exceed revenues. The fund was established with a $775 million commitment in 2000-01 and after using $411 million in 2001-02 and an expected $225 million this year, only $139 million will remain.

The government is budgeting another surplus in 2002-03, with the help of an additional $225 million from the FSF. Still, on January 1, 2002, the personal income tax rates were reduced again, in keeping with announcements in previous budgets. Even with the current fiscal challenges, the
government moved forward on the tax reductions, choosing instead to increase ‘sin taxes’ such as tobacco and liquor consumption taxes, mirrored in other provinces recently.

The province is calling for revenues to increase by 2.3 per cent next year. Own source revenues are targeted to rise by 1.5 per cent under modest economic growth, given the assumptions of an average harvest and conservative oil and gas prices. Federal transfers are expected to rise 5.2 per cent as Equalization payments and Canada Health and Social Transfers increase.

Total program expenses are estimated to fall by 1.1 per cent next year even though health care costs are rising nearly 6 per cent. Health care costs now account for more than 41 per cent of all program expenses, up 5 percentage points in the past six years. Many other departments saw their budgets reduced this year and the Premier’s office announced ahead of the budget, a reduction in the size of cabinet and government, saving the province about $40 million over the next two years. Debt servicing costs will rise close to 2 per cent, the result of an increased debt-load and a slightly higher interest rate environment.

The 2002-03 budget included a change in tax policy that will be beneficial for businesses located in the province. The Corporation Capital Tax threshold was increased by 50 per cent from $10 million to $15 million. The threshold increase will reduce the number of companies required to pay the tax which is good news for business, as capital taxes are often referred to as ‘job killers’. Offsetting this positive news is the fact that once past the threshold, corporations pay the second highest corporate capital tax rate in the country, a situation that will need to be addressed along with general corporate taxation issues, once the province has navigated through the current fiscal challenges and returns to operating in the black without the aid of the FSF.

The ratio of tax-supported debt-to-GDP for the province has trended down over the past seven years. In 1995, the debt-to-GDP ratio was more than 40 per cent and total tax supported debt stood near $11 billion. Since then, the ratio has been cut to less than 25 per cent, and the debt reduced by close to $3 billion. It is expected that total tax-supported debt will rise slightly for the second consecutive year, but the debt-to-GDP ratio will continue to hover around the 25 per cent level. The province has one of the lower debt-to-GDP ratios of all the provinces, bettered only by Alberta, B.C. and Quebec.

Each of the major bond rating services confirmed or maintained the province’s debt ratings over the past year. Standard & Poors lists the province at A+ for their long-term debt. Similarly, Moody’s continues to show Saskatchewan as an A1 credit for their long-term debt and DBRS confirmed the rating of the province’s long-term obligations at A in August of 2001. This marks a clear improvement from the BBB+ rating assigned to the province in 1996. The credit rating for the province now ranks in the middle of the pack compared to other provinces. Saskatchewan ranked near the bottom of that list only five years ago.

The most recent issue of Saskatchewan government debt was a $400 million issue in January 2002. Saskatchewan bonds also trade in the secondary markets. A typical bond with 10 years to maturity currently trades around 30 basis points above Canada bonds, which ranks Saskatchewan bonds in the top half compared to other provinces.

**Capital Markets Activity in the Province**

There is a limited underwriting market for companies with head offices located in Saskatchewan. Over the
past two years, just over $20 million of equity has been raised in the province through the public markets. Most of the capital formation activity has been directed at junior resource companies, particularly mining and oil and gas firms. Along a similar vein, merger and acquisition transactions in the province totaled $237 million for 2001, dominated by one Potash Corp. of Saskatchewan acquisition. This amount is three times higher than 2000 where $72 million of M&A activity took place, again with an acquisition by the Potash Corp. of Saskatchewan accounting for the majority of the value.

The securities industry has an active presence in the province. While there are no member firms with a head office located in Saskatchewan, there are 49 branch offices operated in the province by IDA members in addition to over 100 subbranches. In total, over 400 registrants operate in the province, a number that has increased in each of the past two years.

Policy Issues in the Province

Financial Services Regulatory Reorganization

The Saskatchewan Department of Justice released in November a proposal to establish a single regulatory body to regulate financial services in the province. The proposal is called “Reorganizing the Financial Services Regulators in Saskatchewan: The Saskatchewan Financial Services Commission”. The proposal contemplates a single Commission, which would coordinate the Saskatchewan Securities Commission; the Financial Institutions Section of the Consumer Protection Branch; The Pension Benefits Branch; and the self-regulatory organizations that are involved in various aspects of financial services regulation.

The proposal suggests that the benefits of a single Commission would include giving consumers and the financial industry a single point of access to the financial market regulator and provide a stronger voice for Saskatchewan in discussions of national financial market policies. It would also improve decision making and responsiveness with respect to regulatory initiatives in new areas of regulation or that cross sectors, and provide the financial market regulator with a pool of resources that has a variety of knowledge, experience, and expertise. Consolidation would also raise the public profile of the FIS and the PBB and improve recruitment, employee development, and retention.

The Investment Dealers Association is encouraged by the proposal, but has two concerns:

(1) Fair fees, without cross-subsidization

The securities industry, through various securities commission fees and charges, contributes revenues to the provincial government that far exceed the present costs of regulation. This excess financial burden imposed on the securities industry raises a concern about fair treatment among regulated financial institutions. The merger of the various financial services regulators such as securities and insurance will make it difficult to properly segregate regulatory costs. This creates the risk that market participants regulated by the Saskatchewan Securities Commission will subsidize the operations of the merged regulator.

(2) Regulatory Harmonization

The merged regulatory entity in Saskatchewan will presumably strive to develop similar rules for securities and insurance registrants, a key rationale for the merger. However, it has become clear that several other provincial jurisdictions do not intend to follow the Saskatchewan model of merging securities and insurance regulators. The concern is that the melded Saskatchewan approach may differ from that of other securities Commissions.

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The Investment Dealers Association of Canada is the national self-regulatory organization (SRO) and representative of the securities industry. The Association’s role is to foster fair, efficient and competitive capital markets by encouraging participation in the savings and investment process and by ensuring the integrity of the marketplace.