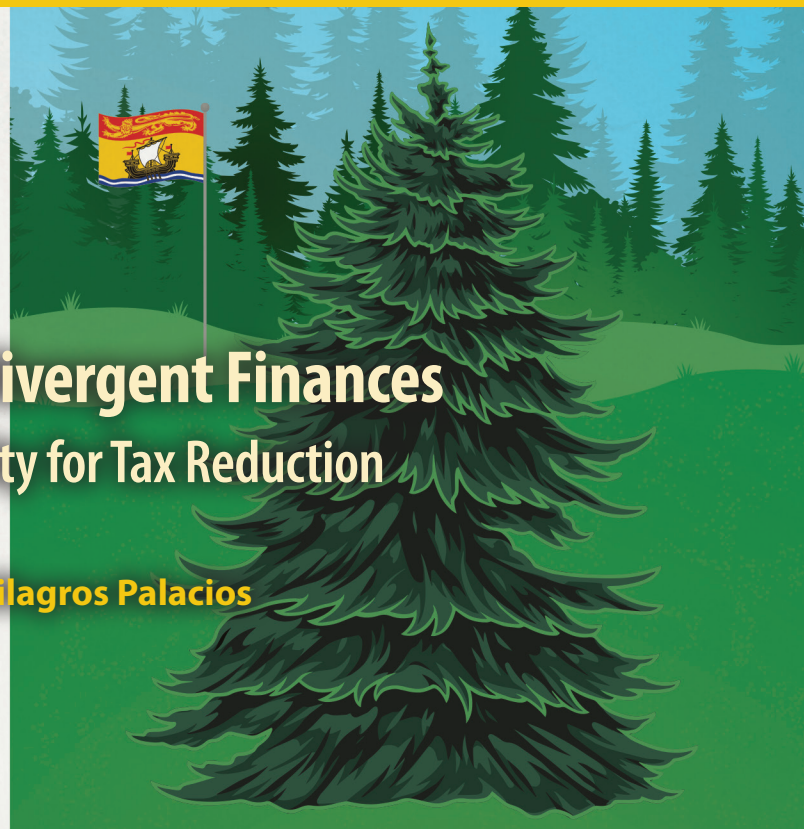




New Brunswick's Divergent Finances A Possible Opportunity for Tax Reduction

Ben Eisen and Milagros Palacios



Executive Summary

- In recent years New Brunswick has begun to make substantial progress addressing its fiscal challenges. Specifically, it has exercised greater restraint with respect to its spending growth than the other two Maritime provinces.
- This restraint has contributed to positive fiscal outcomes for the province including budget surpluses and a declining debt-to-GDP ratio.
- The province began making significant fiscal progress in 2017/18 when it started running balanced budgets, a decision that it has maintained in subsequent years.
- These surpluses have contributed to a reduction in the province's net debt-to-GDP ratio; it declined from 38.9 percent in 2017/18 to 25.1 percent in 2022/23. As recently as 2015/16, New Brunswick was the second most indebted province in Canada. In 2022/23, New Brunswick had the fourth lowest debt-to-GDP ratio (pending the finalization of annual statistics), behind only Alberta, British Columbia, and Saskatchewan.
- This bulletin shows that if government revenue continues to grow on its current trajectory, the province will see a substantial operating surplus developing over time that could generate the fiscal room needed for substantial tax cuts.
- Under this scenario, the government would have the option of introducing transformative tax policy changes. For instance, the province could reduce income taxes by \$3,604 per income tax filer while maintaining the current fiscal balance.

Introduction

For many years Canada's Maritime region has faced fiscal difficulties which have led economists and policy analysts to identify future public finance challenges (Eisen, Whalen, and Palacios, 2021). The fiscal challenges facing New Brunswick have received particularly close attention. In 2014, economist Richard Saillant published *Over the Cliff? Acting Now to Avoid New Brunswick's Bankruptcy*, which discussed the origins of the province's fiscal challenges and offered policy prescriptions (Saillant, 2014). Also that year, the Atlantic Institute for Market Studies published *New Brunswick's Debt and Deficit: A Historical Look*, which traced the evolution of the province's fiscal position over time (Murrell and Fantauzzo, 2014).

In recent years New Brunswick has begun to make substantial progress in addressing its fiscal challenges. Specifically, it has exercised greater restraint with respect to its spending growth than the other two Maritime provinces, while experiencing revenue growth comparable to those two. This restraint has contributed to positive fiscal outcomes for New Brunswick including budget surpluses and a declining debt-to-GDP ratio.

This bulletin reviews these recent developments while paying particular attention to the trajectory of provincial government expenditures and revenues relative to the other Maritime provinces. (We focus on the Maritime provinces rather than the broader Atlantic Canada region because the energy-intensive, sectoral economy of Newfoundland & Labrador makes it a less useful comparator province.) Further, we examine the implications of the recent trends in New Brunswick on the future of the province's public finances and economy if those trends persist. Specifically, we consider the extent of the fiscal room that the province could create over the next decade if

it continues following its recent revenue and expenditure trends; that fiscal room could potentially be used for growth-enhancing tax relief.

The bulletin begins with a brief overview of New Brunswick's finances in the middle of the 2010s. The subsequent section examines recent developments, with a particular emphasis on the changes that have taken place since 2018/19. It compares spending and revenue growth in New Brunswick to the other two Maritime provinces, as well as fiscal outcomes in the three jurisdictions. The next section considers the implications for the province's fiscal trajectory in the years ahead if the trends documented in the preceding section continue. It puts a particular emphasis on the various policy options that would be possible from the fiscal room created by continued fiscal restraint. A final section provides a brief discussion and conclusion.

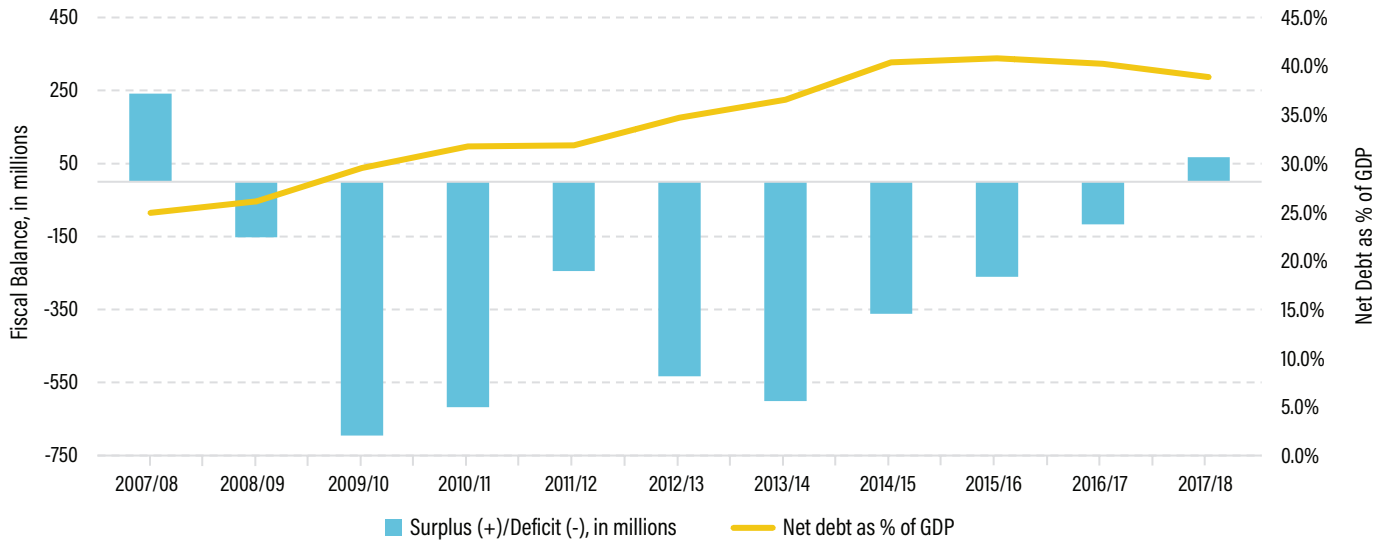
New Brunswick's dim fiscal prospects in the early-to mid-2010s

For some decades, the Maritime provinces have been particularly highly indebted. However, during and immediately following the 2008/09 global financial crisis and recession, the severity of New Brunswick's fiscal position became sharply apparent.

The province's public finances were amongst the hardest hit in Canada during and in the immediate wake of the 2008/09 recession. In Fiscal Year 2009/10, New Brunswick's operating deficit was 2.4 percent of GDP, the second in Canada behind only Ontario. The province ran another large deficit of 2.0 percent of GDP the following year, again the second largest in Canada (RBC, 2023).

In subsequent years, the province did not see a strong revenue rebound but despite that failed to reduce spending, which caused persistent deficits

Figure 1: Fiscal Balance and Net Debt as a Share of GDP, New Brunswick, 2007/08 to 2017/18



Sources:

Canada, Department of Finance (2022). Fiscal Reference Tables October 2022. <https://www.canada.ca/en/departement-finance/services/publications/fiscal-reference-tables/2022.html>

New Brunswick, Department of Finance and Treasury Board (2023). Budget 2023-2024. <https://www2.gnb.ca/content/gnb/en/corporate/promo/budget.html>

New Brunswick, Department of Finance and Treasury Board (2000-2022). Public Accounts. https://www2.gnb.ca/content/gnb/en/departments/finance/comptroller/content/public_accounts.html

Statistics Canada. Table 36-10-0221-01 Gross domestic product, income-based, provincial and territorial, annual (x 1,000,000). <https://www150.statcan.gc.ca/t1/t-bl/en/tv.action?pid=3610022101>

Calculations by authors.

and a quick run-up in provincial debt. Figure 1 illustrates these developments, showing that the province ran nine consecutive deficits during this period and quickly accumulated debt.

In 2015/16, the province's net debt peaked at 40.8 percent of GDP before beginning to decline, but only modestly, in the years immediately following. This net debt peak was an increase of more than 10 percentage points from its pre-recession levels and made New Brunswick the second most indebted province relative to the size of its economy, behind only Quebec (RBC, 2023).

During this period, credit rating agencies began to express increased concern about the province's fiscal position—and they started to take action. In 2009, Moody's downgraded the province's credit rating and warned that the province's "long-term

financial capacity to service its debt is conditioned by an economic base that underperforms the national average on a number of growth, income, and wealth metrics" (Moody's Investor Services, 2009a). In June 2012, Standard and Poor's also downgraded the province's credit rating on the basis of projections that the provincial debt load would climb to approximately 40 percent of GDP in the middle of the decade which, as we have seen, proved correct (Standard and Poor's, 2012).

A review of provincial debt ratings conducted in 2014 by various rating agencies collectively concluded that New Brunswick's credit ratings were amongst the lowest in Canada—and the trend remained negative (Murrell and Fantauzzo, 2014). Another comprehensive review of the province's fiscal situation and bleak outlook for the future

entitled *Over the Cliff? Acting Now to Avoid New Brunswick's Bankruptcy* also generated significant public interest (Saillant, 2014).

Quasi-governmental bodies were also increasingly recognizing the severity of New Brunswick's fiscal challenges. In its annual report for 2013, the New Brunswick's Auditor General wrote that "the increase in net debt represents a very disturbing trend" (Auditor General of New Brunswick, 2013: 11).

The late 2010s and early 2020s saw New Brunswick's fiscal outcomes improve

Throughout the early 2010s New Brunswick's revenue growth was weak, which meant that the process of deficit reduction was slow and debt accumulated rapidly. This ran counter to the rapid improvement that jurisdictions often enjoy in the period immediately following a steep recession. Due largely to the cessation in provincial spending growth, which will be discussed in greater detail in the next section, New Brunswick's fiscal footing started to improve slowly as the decade went on. The province was eventually able to eliminate its deficit and slow its accumulation of debt.

The deterioration of New Brunswick's finances in the 2010s was largely the result of government policy choices. A recent analysis by University of Calgary economist Ron Kneebone examined whether external economic developments or government choices were the prime sources of debt accumulation. He observed that between 2008/09 and 2015/16, a period of "fiscal recklessness" added 8.6 percentage points to the debt ratio in just 8 years. The ratings agency warnings and public finance problems were therefore largely a result of government policy rather than

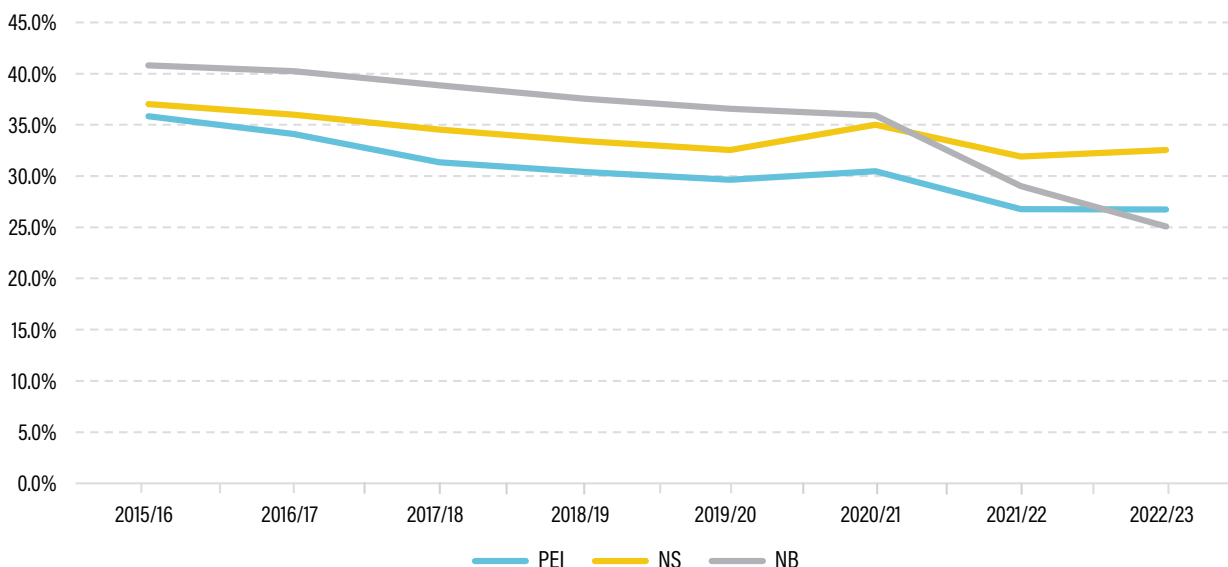
economic conditions outside the government's control (Kneebone, 2019).

In the final years of the 2010s, however, the government changed course and began to address its high public debt. Starting in 2017/18, the province began to run balanced budgets, and is forecasted to deliver its 7th consecutive surplus this year. In fiscal years 2020 and 2021, these surpluses were more than 1 percent of provincial GDP (RBC, 2023). These surpluses contributed to a rapid decrease in the province's debt burden both relative to the size of the economy and in nominal terms. This turnaround was markedly different than the fiscal outcomes in the other Maritime jurisdictions. New Brunswick was the only province to keep its books balanced throughout the pandemic, and had the largest surplus of the three in 2021/22.

From 2017/18 to 2022/23, New Brunswick's net debt dropped from \$13.9 billion to \$11.6 billion, which caused the province's debt-to-GDP ratio to decline from 38.9 percent in 2017/18 to 25.1 percent in 2022/23. As noted above, as recently as 2015/16, New Brunswick was the second most indebted province in Canada. In 2022/23, New Brunswick had the fourth lowest debt-to-GDP ratio (pending the finalization of annual statistics), behind only Alberta, British Columbia, and Saskatchewan (RBC, 2023).

A comparison with the other two Maritime provinces is striking. In 2017/18, New Brunswick had the highest debt-to-GDP ratio in the region, 4.3 percentage points higher than Nova Scotia. In 2022/23, New Brunswick is estimated to have had the lowest debt-to-GDP ratio in the Maritime region, 1.7 percentage points lower than next-best Prince Edward Island, and now 7.5 percentage points lower than Nova Scotia. This is a 11.8 percentage point relative change compared to Nova

Figure 2: Net Debt as a Share of GDP, 2015/16 to 2022/23



Sources:

Canada, Department of Finance (2022). Fiscal Reference Tables October 2022. <https://www.canada.ca/en/departement-finance/services/publications/fiscal-reference-tables/2022.html>

New Brunswick, Department of Finance and Treasury Board (2023). Budget 2023-2024. <https://www2.gnb.ca/content/gnb/en/corporate/promo/budget.html>

New Brunswick, Department of Finance and Treasury Board (2000-2022). Public Accounts. https://www2.gnb.ca/content/gnb/en/departments/finance/comptroller/content/public_accounts.html

Statistics Canada. Table 36-10-0221-01 Gross domestic product, income-based, provincial and territorial, annual (x 1,000,000). <https://www150.statcan.gc.ca/t1/tbl/en/tv.action?pid=3610022101>

Scotia over the course of just 5 years. Figure 2 illustrates these developments.

These data show that New Brunswick has gone from being the weakest fiscal performer in the region to the strongest.

The role of spending restraint in New Brunswick's fiscal turnaround

We have seen that New Brunswick has experienced a remarkable fiscal turnaround in recent years, running a string of surpluses and a large reduction in its debt-to-GDP ratio. The other two Maritime Provinces have not seen comparable improvements in this key indicator of fiscal health and sustainability. Since 2017/18, where New Brunswick's debt-to-GDP ratio has declined by 13.8 percentage points, Nova Scotia's has declined by 2 percentage

points, and PEI's by 4.6 percentage points over the same period. Figure 3 illustrates these results graphically.

This section examines the reason for the divergent outcomes in the Maritime provinces.

We can begin by ruling out differential rates of revenue growth as the key driver of the outcomes presented in figure 3. Figure 4 compares real per capita revenue growth in the Maritime provinces since 2010/11. It shows that real per capita revenue grew in New Brunswick by 16.2 percent during this time compared to 15.2 percent in PEI and 10 percent in Nova Scotia.

Annualizing these figures provides needed context. The annualized revenue growth rate since 2010 has been similar in the three jurisdictions at 1.3 percent in New Brunswick, 1.2 percent in PEI,

Figure 3: Percentage Point Change in Net Debt as % of GDP, 2017/18 to 2022/23

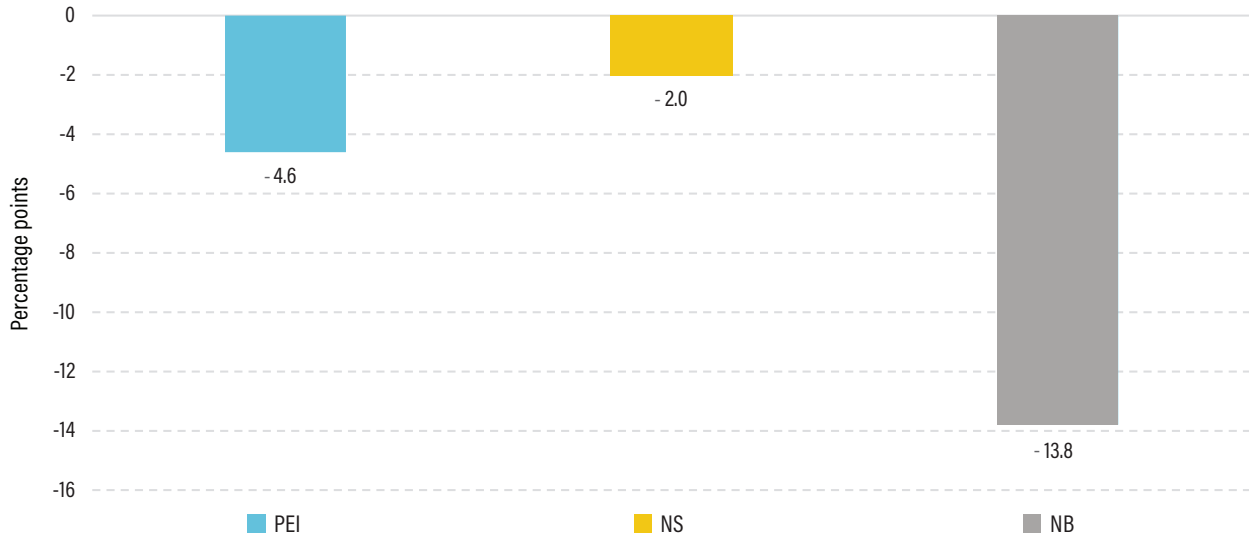
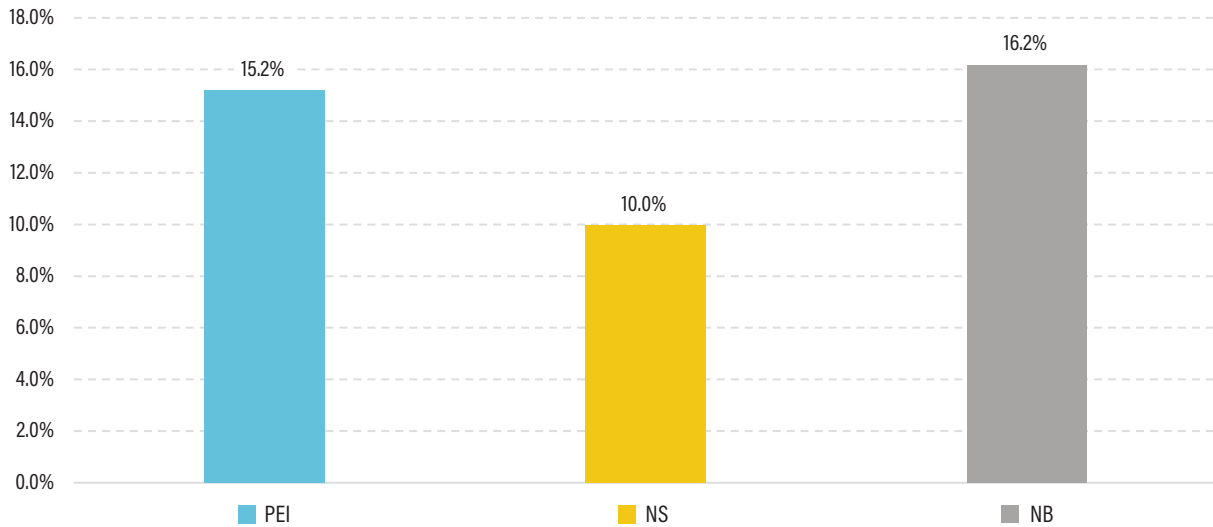


Figure 4: Real Per Capita Revenue Growth from 2010/11 to 2022/23



Sources: Figure 3 and Figure 4

Canada, Department of Finance (2022). Fiscal Reference Tables October 2022. <https://www.canada.ca/en/department-finance/services/publications/fiscal-reference-tables/2022.html>

New Brunswick, Department of Finance and Treasury Board (2023). Budget 2023-2024. <https://www2.gnb.ca/content/gnb/en/corporate/promo/budget.html>

New Brunswick, Department of Finance and Treasury Board (2000-2022). Public Accounts. https://www2.gnb.ca/content/gnb/en/departments/finance/comptroller/content/public_accounts.html

Nova Scotia (2023). Budget 2023-2024. <https://novascotia.ca/budget/>

Nova Scotia (2000-2022). Public Accounts. <https://beta.novascotia.ca/public-accounts>

Prince Edward Island, Department of Finance (2022). 2022-2023 Fiscal Update. <https://www.princeedwardisland.ca/en/information/finance/fiscal-and-economic-updates>

Prince Edward Island, Department of Finance (2000-2022). Public Accounts. <https://www.princeedwardisland.ca/en/information/finance/public-accounts> and <https://www.princeedwardisland.ca/en/topic/previous-years-public-accounts>

Statistics Canada. Table 18-10-0005-01 Consumer Price Index, annual average, not seasonally adjusted. <https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1810000501>

Calculations by authors.

and 0.8 percent in Nova Scotia. New Brunswick has therefore had the fastest rate of real per capita revenue growth, but the difference with the two other Maritime provinces has been small, particularly in comparison to the difference in the rate of spending growth among the three provinces to which we will now turn.

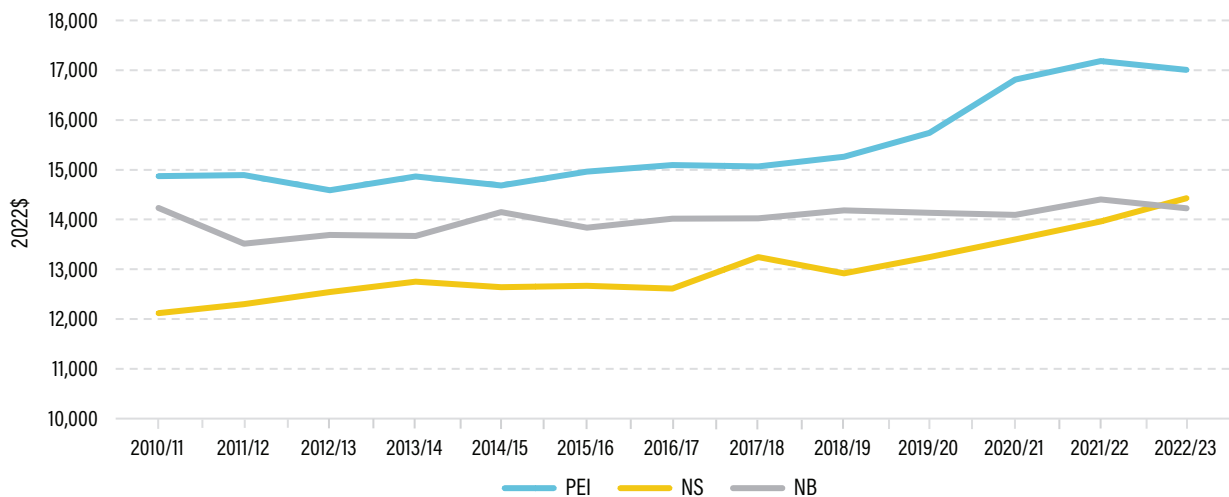
Figure 5 shows that real per capita spending was essentially flat in all three Maritime provinces in the start and middle of the 2010s, but increased dramatically in Nova Scotia and PEI in the later years of the decade along with per-capita revenues. The crucial difference between New Brunswick and the other two provinces is that the former did not increase real per capita spending when revenues rose; it

maintained the same restrained approach it had developed in previous years.

Following the 2008/09 recession, spending growth slowed down in all three provinces. Figure 6 shows that from 2010/11 to 2022/23, aggregate real per capita total spending in New Brunswick declined by 0.1 percent. This compares to an increase of 19.1 percent in Nova Scotia and a rise of 14.3 percent in PEI. The divergence relative to the change in revenue is stark.

Again, annualizing these figures provides context. New Brunswick's rate of average real per capita spending growth from 2010/11 to 2022/23 is 0.0 percent, compared to 1.1 percent for PEI and 1.5 percent for Nova Scotia.

Figure 5: Real per Capita Total Spending, 2010/11 to 2022/23 (in 2022\$)



Sources:

Canada, Department of Finance (2022). Fiscal Reference Tables October 2022. <https://www.canada.ca/en/departement-finance/services/publications/fiscal-reference-tables/2022.html>

New Brunswick, Department of Finance and Treasury Board (2023). Budget 2023-2024. <https://www2.gnb.ca/content/gnb/en/corporate/promo/budget.html>

New Brunswick, Department of Finance and Treasury Board (2000-2022). Public Accounts. https://www2.gnb.ca/content/gnb/en/departments/finance/comptroller/content/public_accounts.html

Nova Scotia (2023). Budget 2023-2024. <https://novascotia.ca/budget/>

Nova Scotia (2000-2022). Public Accounts. <https://beta.novascotia.ca/public-accounts>

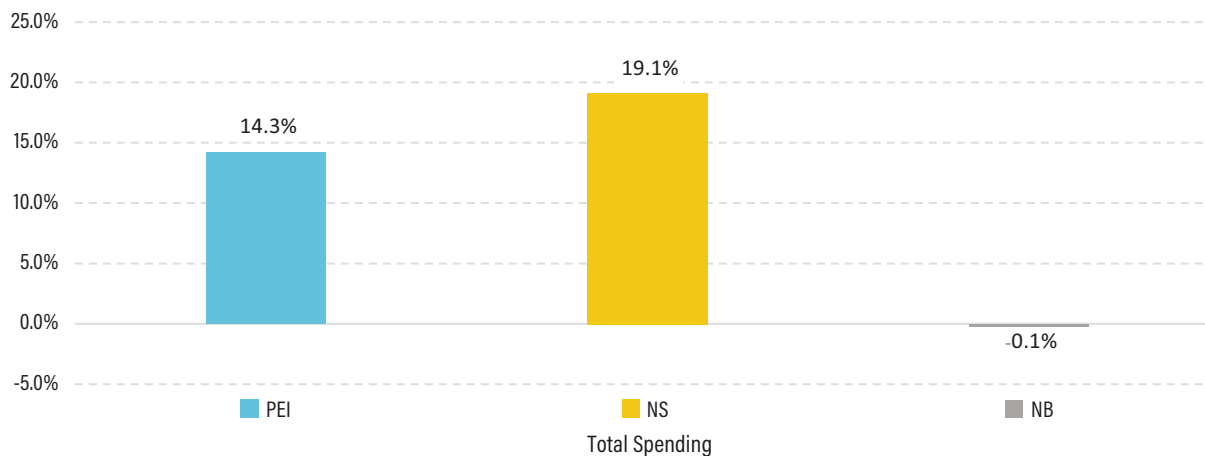
Prince Edward Island, Department of Finance (2022). 2022-2023 Fiscal Update. <https://www.princeedwardisland.ca/en/information/finance/fiscal-and-economic-updates>

Prince Edward Island, Department of Finance (2000-2022). Public Accounts. <https://www.princeedwardisland.ca/en/information/finance/public-accounts> and <https://www.princeedwardisland.ca/en/topic/previous-years-public-accounts>

Statistics Canada. Table 18-10-0005-01 Consumer Price Index, annual average, not seasonally adjusted. <https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1810000501>

Calculations by authors.

Figure 6: Aggregate Real Per Capita Spending Growth, 2010/11 to 2022/23



Sources:

Canada, Department of Finance (2022). Fiscal Reference Tables October 2022. <https://www.canada.ca/en/departement-finance/services/publications/fiscal-reference-tables/2022.html>

New Brunswick, Department of Finance and Treasury Board (2023). Budget 2023-2024. <https://www2.gnb.ca/content/gnb/en/corporate/promo/budget.html>

New Brunswick, Department of Finance and Treasury Board (2000-2022). Public Accounts. https://www2.gnb.ca/content/gnb/en/departments/finance/comptroller/content/public_accounts.html

Nova Scotia (2023). Budget 2023-2024. <https://novascotia.ca/budget/>

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Prince Edward Island, Department of Finance (2000-2022). Public Accounts. <https://www.princeedwardisland.ca/en/information/finance/public-accounts> and <https://www.princeedwardisland.ca/en/topic/previous-years-public-accounts>

Statistics Canada. Table 18-10-0005-01 Consumer Price Index, annual average, not seasonally adjusted. <https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1810000501>

Calculations by authors.

As a result of these developments New Brunswick has become the lowest spender in the region. A comparison to Nova Scotia is illustrative. In 2017/18, real per capita total spending in New Brunswick was 5.8 percent higher than in Nova Scotia; in 2022/23, Nova Scotia's spending was 1.4 percent higher than New Brunswick's.

Future opportunities from continued restraint

The previous sections have shown that in recent years the improvement in New Brunswick's fiscal position has been remarkable. They have also shown that by restraining spending, even during times of revenue growth, New Brunswick's fiscal position has

improved far more than that of its Maritime neighbours.

In this section, we briefly discuss the policy options that could become available to New Brunswick if its government is able to maintain its fiscal restraint and discipline and if revenue growth persists at a similar rate as in recent years. Specifically, we discuss in broad terms the scale of tax reductions that the province could achieve if its current spending and revenue projections persist.

Limitations

The discussion is not meant to be prescriptive. There are many good options aside from tax relief open to the province from a steadily improving fiscal

balance, including debt reduction and investment in well-chosen growth-promoting capital projects. Further, we do not provide a roadmap for the type of tax reductions that may be most beneficial, focusing on the scale of the available options rather than considering the various efficiency, equity, and other considerations that must enter into any discussion of tax reform.

Finally, we do not discuss the feasibility of keeping per-capita spending essentially flat for the next decade, nor do we discuss the likelihood of revenue growth persisting at the same levels as it has since 2010 for the next decade. The province faces many fiscal headwinds that could reduce revenue growth. For example, the province remains highly dependent on federal grants to support its budget. The province's finances rely precariously on a rapid growth in those federal grants. A change in federal policy that reduced the rate of growth for federal transfers could badly derail the province's fiscal plan. The province could improve the consistency of its revenue stream and make itself less reliant on federal grants by growing its real per capita GDP, which would generate increased own-source revenues.

In addition, New Brunswick has potential liabilities that could add to provincial government debt, depending on future developments, including New Brunswick Power's \$5 billion in debt. Further, demographic realities will put the province's health care budget under pressure in future years. Clearly,

New Brunswick still has a long way to go before it can consider itself on a secure fiscal footing and can reduce its reliance on Ottawa to ensure a fiscally sustainable future.

Given the risks associated with a reduction in the growth rate of federal grants, the possibility that new liabilities will emerge, and that an aging population will lead to cost pressures for the health care system, New Brunswick's long term revenue outlook is difficult to predict. Our projection here does not attempt to forecast that outlook, but instead show the fiscal room that the province could create for itself if the province remains on the same spending and revenue trajectories from recent years.

Of course, any change in spending and revenue trends would change the options available to the government. Our purpose here is illustrative, to help demonstrate that spending restraint coupled with revenue growth can create opportunities for policy change and tax reform.

Possible tax reduction options from future spending restraint

As discussed, since 2010, New Brunswick's real per capita total spending has increased at an average annual rate of 0 percent. In the meantime, the province's real per capita revenue has grown by 1.3 percent annually. Table 1 shows how New Brunswick's revenue and expenditure outlooks would evolve between now and 2032/33 if these trends continue.

Table 1: Projection for 2022/23 to 2032/33 Based on the Trend for New Brunswick's Revenues and Spending Since 2010

YEARS PROJECTED	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30	2030/31	2031/32	2032/33
Revenues per capita, in 2022\$ (Assuming Revenue Growth Rate from 2010-2022)	15,287	15,479	15,673	15,871	16,070	16,272	16,477	16,684	16,894	17,106	17,321
Total Spending per capita, in 2022\$ (Assuming Spending Growth Rate 2010-22)	14,224	14,224	14,223	14,222	14,221	14,221	14,220	14,219	14,219	14,218	14,217

Under this scenario, at the end of 2032/33, real per person revenue in New Brunswick would be \$17,321 and per person expenditures would be \$14,217.

To further our thought experiment, consider the type of tax relief that would be possible today if this gap between revenue and expenditures currently existed. (Because the calculations are expressed in real per capita numbers, we can calculate the possible tax reductions using this year's fiscal numbers without making adjustments for the future.) Under this scenario, in real per capita terms, revenues would exceed expenditures by \$3,104, which would amount to a total of \$2.5 billion. These savings would be sufficient to reduce revenue by 17.9 percent without effecting the fiscal balance.

One option that this would allow is transformative tax change. For instance, in 2021/22, New Brunswick collected less than \$2.2 billion in sales tax (Finances of the Nation, 2023). As such, the province could in this scenario eliminate its sales tax.

But there would be other, more pro-growth tax reform options, such as income tax reform and reduction. It is beyond the scope of this paper to model income tax reform options, however, we note that there were 610,400 income tax filers in New Brunswick in 2021. This means that, on average, if all the savings described above were devoted to income tax relief, the average income tax bill for New Brunswickers could be reduced by \$3,604 per tax filer. Either of these options, or one of many others, or a combination of them, or smaller versions of some combination, could create a substantial tax advantage for New Brunswick.

Given the threats to the province's fiscal stability discussed above, the provincial government would be well-advised to consider tax reductions that could help stimulate growth and thus increase own-source revenue from most sources of provincial taxation. The models presented here are static, presenting only the mechanical effect of tax relief on revenues, without accounting for dynamic effects related to economic growth. The provincial government could partially offset the fiscal cost of tax relief by choosing pro-growth options.

For example, research from Ergete Ferede and Bev Dahlby of the University of Calgary has shown that for most provincial tax mixes the marginal cost of public funds¹ is generally highest from corporate income taxes (CIT). As such, CIT reductions with comparable mechanical effects to sales tax reductions² would almost certainly produce smaller actual revenue losses. Similarly, recent research from Michael Smart and James Uguccioni suggests that for governments in high tax provinces the aggregate revenue losses from reductions to marginal income tax rates are likely small due to base shrinking behavioural effects such as reduced economic activity (Smart and Uguccioni, 2019). Given the risks to future provincial revenue and liabilities discussed above, tax rate reductions designed to minimize revenue losses by increasing the size of various tax bases may help alleviate concerns about the province's ability to finance tax reductions in the face of significant fiscal risks.

To reiterate, this bulletin makes no claims about the likelihood, feasibility, or desirability of

1 In the simplest terms, the marginal cost of public funds as it is used here refers to the negative effect of tax increases on the broader economy.

2 The mechanical effect of a tax increase is simply the amount of money a tax increase would generate if there were no effect at all on economic activity or tax planning strategies. When particularly economically damaging taxes are raised, the mechanical effect and the actual amount of revenue raised can be significantly different from one another.

maintaining current levels of spending growth. Critics of the government's current approach frequently argue that the provincial government is underinvesting in various priorities. For instance, a recent auditor general's report asserted that the province needed to spend an additional \$1 billion to add long term care capacity (Auditor General of New Brunswick, 2022).

Rather than presenting a policy prescription, the purpose of this bulletin is to help illustrate the fact that over time, spending restraint combined with revenue growth can create conditions that may make substantial pro-growth tax reform and relief a viable policy option for New Brunswick. The province's revenue and expenditure trajectories since 2010 could, if maintained, create such opportunities. This is in contrast to the other Maritime provinces which have not shown similar restraint.

Conclusion

In the early and mid-2010s, New Brunswick was amongst the most fiscally imperiled provinces

in Canada. Since then, much has changed. Now although it faces many long-term challenges, New Brunswick has in some important respects gone from being the region's laggard to its fiscal leader.

This bulletin has documented the recent turnaround in New Brunswick's finances. Further, it has shown that spending restraint rather than stellar revenue growth is the reason for superior fiscal outcomes in recent years compared to the other Maritime provinces. Finally, it has discussed the scale of the opportunities for tax relief that could be available if the province maintains its recent spending and revenue patterns.

New Brunswick still faces many long-term fiscal risks, but in recent years it has substantially improved its capacity to face those risks. With continued restraint and revenue growth, we have shown that the province may be able to create the fiscal room in the years ahead to substantially reduce the tax burden on the province's residents.

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New Brunswick's Divergent Finances: A Possible Opportunity for Tax Reduction

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