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Canadian Subnationals — Framework Report

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>
> Douglas Offerman, Senior Director

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Strong Institutional Framework

Fitch Ratings views the institutional framework of subnational entities in Canada (AA+/Stable) as "strongly predictable". Provinces, territories and local governments operate within Canada's stable legal, regulatory and political structure.

Financial management at the provincial level is characterized by objective economic and revenue forecasting, detailed budgeting, long-term planning and transparent accounting. Liquidity and debt management are likewise sophisticated.

Decentralized Federalism

Provinces operate within a highly decentralized federal structure that accommodates regional and linguistic diversity across the country's vast expanse. Few functions are exclusively reserved for the federal government.

Functions under provincial jurisdiction involve the federal government, with collaboration and consensus resulting in uniform approaches to key policy areas, although divergent solutions are common. Local governments are established by provinces, typically under tight fiscal oversight.

Established System of Transfers

Vertical transfers are well established and stable, augmenting provincially-generated revenues. An equalization transfer targets those provinces with lower fiscal capacity to support relatively similar service levels nationally. Formula-based transfers to all provinces and territories for health care and social services offset the burden of these key spending categories, although health spending is rising far faster than associated transfers.

Expansive Fiscal and Borrowing Powers

The Constitution of Canada bestows responsibility for most public services on the provinces, and provides them with unlimited revenue and borrowing powers to support spending responsibility. Some services, notably education and health care, are funded provincially, and partially offset by federal monies but delivered by local entities.

Revenue bases are diverse but economically sensitive, especially in those provinces with higher reliance on natural resource revenues. During recessions, sustaining public services and stimulating the economy leads to deficit spending and higher borrowing.

Significant Debt at Provincial Level

Provinces' unlimited power to borrow is one reason Canada's share of subnational to general government debt is far higher than most global peers. Borrowing supports routine cashflow, capital and deficit financing of provinces, and many government enterprises and most local entities.

Market access is essential, including rolling maturing debt. Larger borrowers maintain sizable internal balances, external CP or lines of credit, and federal authorities actively support a stable market for subnational borrowing. Absent market- or federally-imposed borrowing limits, provinces periodically impose their own policy targets to control spending, with varying degrees of success.

Canadian Subnational Framework

The second-largest country in the world, by geographic size, is Canada. The nation encompasses 40% of North America's landmass and spans six time zones. Canada is composed of 10 provinces and three territories in the upper subnational tier, followed by varying local government entities including regions, districts and municipalities in the lower tier. This report focuses primarily on provinces and, to a lesser degree, on territories and local entities.

Canada's federal structure dates back to the Constitution Act of 1867, originally enacted as the British North America Act, under which Nova Scotia, New Brunswick, Quebec and Ontario created a confederation. New provinces were gradually carved from territories farther west, spanning North America by the early 20th century. The 10th province, Newfoundland and Labrador, joined in 1949.

The provinces differ considerably in size, population and economic profile. Prince Edward Island (PEI) measures only 5,660 square kilometers (sq km), while Quebec covers more than 1.5 million sq km. PEI's population totaled just under 160,000 in 2020 compared with over 14.7 million in Ontario.

Decentralized Federalism

The distinguishing characteristic of Canada's federal structure is its exceptional decentralization. The Constitution Act of 1867 distributed responsibility for specific functions to the federal government, to provinces, or to both.

Similar to other federal systems, division of powers and responsibilities continues to evolve with The Constitution Acts of 1930 and 1982, judicial rulings and institutional practices. Constitutional change requires approval in both the federal House of Commons and Senate, and provincial approval by two-thirds of provincial legislatures, or seven provinces, representing at least 50% of the population.

The powers and responsibilities of provinces limit the ability of the federal government to unilaterally impose changes, notably on matters falling exclusively to provinces. With broad powers devolved to the provinces, negotiation and consensus among the provinces and federal government is necessary to address a range of policy concerns. Numerous institutional structures reflect consensus among provinces or accommodations for individual provinces' specific needs, resulting in asymmetric federal-provincial solutions to multiple key services or policy matters.

For example, pensions are a constitutionally shared responsibility. Provinces manage the national system of pensions, the Canada Pension Plan (CPP), which is administered by the federal government. Quebec operates a parallel pension system, the Quebec Pension Plan (QPP).

Policing is provided by both locally administered forces and separate provincial police forces in Quebec, Ontario, and Newfoundland and Labrador, while other provinces have contractual arrangements with the federal Royal Canadian Mounted Police, or Gendarmerie Royale du Canada, to provide policing, subject to local control.

Canada's decentralized structure has been motivated by multiple factors through its history, including the challenge of developing and delivering public services effectively across its vast geographic expanse and the need to accommodate different linguistic and religious communities.

Canada periodically faces strong regional political challenges, most notably Quebec's status within Canada but also numerous, narrower questions, such as control of resource wealth and status of Aboriginal communities.

The sovereignty movement in Quebec created uncertainty in the past, with narrowly-failing voter referenda in 1980 and 1995 on separation from Canada. A variety of constitutional questions remain unresolved and controversies continue to arise around language in both English- and French-speaking Canada.

However, another referendum on Quebec's status appears unlikely at the moment. Political disaffection in western Canada, especially surrounding control and the future of natural resources, recently intensified, although this has not yet led to a broader separatist movement.

Political Environment

The federal and provincial governments have parallel Westminster-style parliamentary systems combining legislative and executive functions. There are relatively minor institutional differences between levels. The federal House of Commons is bicameral, while each province's legislative assembly is unicameral. Both federal and provincial governments maintain similar administrative structures.

Each province determines its own election cycle. Some have fixed election periods for legislatures, while in others, election dates are subject to the government's discretion within a set period. The political party winning the most seats tends to form the government.

The prime minister at the national level or premier at the provincial level leads the governing party and names cabinet ministers that are parliamentarians to head ministries or policy portfolios. Should a budget or appropriation bill be voted down in the legislature, this is considered a vote of no confidence in the government, which leads to a new government being formed or a dissolution of parliament and fresh elections.

Political parties are separate at the national and provincial levels, with major parties at both levels falling along the left—right spectrum. At the federal level this currently consists of the centrist Liberal Party (LP), the center-left New Democratic Party (NDP), and center-right Conservative Party of Canada (CP), among others. Each province likewise has two or three main parties, and often several smaller parties, that may or may not share overlapping policy goals with the corresponding federal party.

Ontario's Legislative Assembly has three main parties similar to their federal counterparts. By contrast, in British Columbia, the main parties consist of the center-right British Columbia LP and the center-left NDP of British Columbia.

Among parties in Alberta's legislative assembly are the ruling center-right United Conservative Party and center-left Alberta NDP. Saskatchewan also has two main parties, the ruling center-right Saskatchewan Party and the center-left Saskatchewan NDP.

Questions related to Quebec's status in Canada also influence party representation in both the federal House of Commons and Quebec's National Assembly, although to a lesser degree than in the past.

At the federal level the Bloc Quebecois is currently one of the largest parties, behind the federal LP and CP. At the provincial level, Quebec has multiple political parties, including the ruling center-right Coalition Avenir Quebec (CAQ), the centrist Parti Liberal du Quebec (PLQ) and the separatist Parti Quebecois (PQ).

Local Governments

Provinces have exclusive power to establish local tiers of government under Canada's constitution. Similar local structures are present across Canada, including cities, counties and regional districts, with governance by locally-elected officials or boards.

Provinces determine their revenue mix, typically property taxes, development, other fees and provincial transfers, and service responsibilities, such as schools, health care, police and fire, public transport, roads and bridges, parks, water/wastewater and other utilities. Schools and health care are particularly prominent and are consolidated in provincial financial statements. Provincial transfers typically are restricted for use, unlike most federal transfers to provinces.

Provincial oversight of local government finances is strong. Local governments may not budget for deficits, must report to their respective provincial governments and have limited borrowing power. Larger cities often have special charters granting expanded revenue collection, service responsibility and debt issuance powers.

Debt issuance practices vary, with some municipalities receiving loans from provincial resources and others authorized to borrow directly, subject to specific restrictions.

Territories

Three territories, the Northwest Territories, Nunavut and Yukon, cover Canada's northern reaches. Although they constitute 40% of the nation's landmass, the combined population is about 127,000. The institutional status and fiscal power of the territories is fundamentally distinct from provinces, with federal statute authorizing their powers and responsibilities rather than the Constitution.

Changes to territorial powers require a change by the federal Parliament. The territories exercise an increasing degree of self-government, given devolution of powers in recent years to territorial legislatures. The territories manage their own budgets, set tax rates, including rates on natural resources, and deliver routine services.

However, federal control remains extensive. For example, borrowing by the territories is subject to federal approval with the total outstanding capped by the federal government.

The territories have a considerably higher dependence on federal support through territorial formula financing (TFF) transfers. The TFF transfer is intended to support the territories' ability to provide services to residents comparable with those provided by the provinces, although it recognizes the significantly higher cost of doing so across the vast geographies.

The territories also receive the routine Canada Health Transfer (CHT) and Canada Social Transfer (CST) payments provided to provinces. Federal transfers constituted 82% of reported revenue for the Northwest Territories, 89% for Nunavut and 85% for Yukon as of fiscal 2020.

Canada: Public Spending Breakdown

(As of Fiscal 2018-19)	(CAD Mil.)	(% of GDP)
General Government Expense	937,780	45.4
Federal Government Expense	350,429	17.0
Provincial and Territorial Expense	511,782	24.8
Local Government Expense	193,709	9.4

Source: Fitch Ratings, Department of Finance Fiscal Reference Tables, Statistics Canada.

Budget and Accounting Framework

Budgeting and accounting are detailed and transparent. All provinces and the federal government are on a FYE of March 31. Typically, the budget process commences with pre-budget consultations late in the prior FY, with a final budget tabled near the FYE. This budget is voted on, generally with few changes, although implementing legislation may follow.

As with the federal government, most provinces rely on private sector surveys to provide an objective comparative benchmark for their own economic forecast. Budgets typically include detailed, multi-year economic, revenue and spending targets, sensitivity analyses for key economic variables, and detailed spending, capital and debt information. Quarterly or mid-year budget updates are released thereafter to reset forecasts based on interim performance.

Canadian provincial accounting shifted to IFRS more than a decade ago and municipalities rely on Canadian Public Sector Accounting Board principles. Public accounts are audited and consistent with budget presentation. These include five primary statements: financial position (balance sheet), operations (income statement), change in net debt, change in accumulated deficit and cash flow.

Reporting is on a consolidated basis, with full consolidation for some entities, notably school boards and hospital districts, reporting to a minister or to the legislature, and equity consolidation for others, such as most government enterprises.

Oversight of government spending and performance, including at the provincial and government enterprise levels, is vested in independent provincial auditors-general appointed by respective legislative assemblies, which have the authority to hire and manage staff. Municipal financial statements are audited by independent private sector accountants.

Revenue Framework

Canada's constitution provides similar revenue powers at the federal and provincial level. The federal government may raise revenues by any mode or system of taxation, while the provinces may tax for provincial purposes. The federal government and provinces levy generally similar types of taxes including personal income tax (PIT), corporate income tax (CIT) and consumption taxes, such as value added, sales or excise.

PIT rates vary, with the federal government and provinces levying varying progressive rate structures. Payroll taxes are levied by the federal government for social insurance, such as unemployment and retirement security, and by several provinces for specific needs, notably health care.

Provinces' Revenue Breakdown: FY 2019–20

(% as of FYE March 31)	Operating Revenue	Total Revenue
Taxation	60.7	—
Governmental Enterprise Net Revenue	3.5	—
Resource Revenue	2.5	—
Miscellaneous	13.1	—
Federal Transfers	20.2	—
Operating Revenue	**100.0**	**98.9**
Financial Revenue	**—**	**1.1**
Capital Revenue	**—**	**0.0**

Source: Fitch Ratings, Provincial Public Accounts.

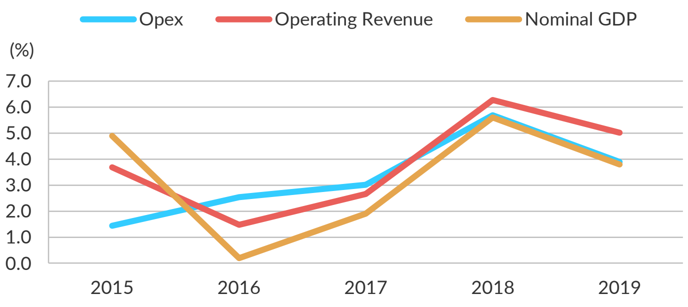
Under bilateral agreements between the federal Canada Revenue Agency (CRA) and individual provinces, the CRA collects specific provincial taxes, simultaneously with federal taxes, and remits the provincial component. The PIT for nine of 10 provinces is collected by the CRA and only Quebec collects its own. Marginal rates differ among the provinces but definitions of taxable income are aligned. The CIT in eight of 10 provinces is collected by the CRA, with only Quebec and Alberta collecting their own.

In five provinces, the CRA collects a harmonized sales tax (HST), a unified value-added consumption tax consisting of the federal goods and services tax (GST) and provincial component. Alberta collects no sales tax, while Quebec collects both the federal GST and its own provincial sales tax (PST) and remits the federal component.

The provinces' ownership of public lands, timber and natural resources, recognized in The Constitution Act of 1982, is the basis for various natural resource levies, including royalties, land sales and leases. The provinces retain ownership of oil and gas, minerals and hydropower potential within their boundaries, while the federal government retains ownership of certain offshore and territorial resources.

Although provincial power to levy taxes is vested in legislative assemblies, several provinces authorized voters to change taxes through voter referenda. Ontario and British Columbia implemented an HST in 2009 but a 2011 voter initiative in British Columbia overturned the change, re-imposing the earlier GST/PST structure. Under a 1995 law, Manitoba voters are required under certain circumstances to confirm rate increases for income, sales or payroll taxes.

Real Total Expenditure and Revenue Growth



Source: Fitch Ratings, Department of Finance Canada Fiscal Reference Tables.

Governmental Enterprises

Governmental enterprises, known as Crown Corporations in many provinces, are publicly-owned commercial entities outside of direct federal or provincial administration. These enterprises report to a ministry and have boards named by the government.

Generally, the largest enterprises are electric generation and distribution utilities, such as Hydro-Quebec (AA–/Stable), BC Hydro, Ontario Power Generation, and Nalcor Energy in Newfoundland and Labrador. Provinces operate other entities, including telecoms, liquor, lottery and casino enterprises, and in some cases insurance or credit union enterprises.

Most enterprises are consolidated on a modified equity basis, with equity reported on the statement of financial position and net surpluses or deficits on the statement of operations. Debt is likewise reported, although typically as self-supported debt. Major enterprises in most years provide routine, although variable, revenues to provinces. Enterprises' operating losses can affect provinces, as was the case for several years in British Columbia when its automobile insurance enterprise, Insurance Corporation of British Columbia, generated five years of deficits, peaking at more than CAD1.3 billion in FY 2017–18.

Canada's System of Transfers

Vertical transfers from the federal government to provinces are fundamental to Canada's fiscal structure and are a stable component of provincial revenue structures over time. The prominence of transfers varies considerably. Transfers ranged from about 16% of consolidated revenues in wealthier provinces with higher fiscal capacity, such as British Columbia, to 37% in Newfoundland and Labrador in FY 2019–20.

The major federal transfers to provinces are equalization and program-specific transfers for health care (CHT) and social services (CST). Smaller transfer programs are also present. These include a longstanding fiscal stabilization transfer program to partially offset provincial revenue volatility and a childcare transfer gradually being implemented across many provinces. There are numerous narrow or time-limited programs, such as for disaster assistance, cleaning up abandoned oil wells, or for specific capital needs. There is no ongoing system for federal capital transfers.

Equalization transfers in various forms have been present since 1957, with the current program formalized in The Constitution Act of 1982. The goal is to ensure all provincial governments "have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation", despite the wide divergence in economic and revenue resources across Canada. The separate TFF performs the same role for the three territories but is not constitutional.

Revenue Composition by Province: FY 2019–20

(% as of FYE March 31)	Own-Source Revenues	Federal Transfers
British Columbia	83.7	16.3
Alberta	80.4	19.6
Saskatchewan	82.6	17.4
Manitoba	72.5	27.5
Ontario	83.7	16.3
Quebec	78.4	21.6
New Brunswick	63.2	36.8
Nova Scotia	67.8	32.2
Prince Edward Island	61.3	38.7
Newfoundland and Labrador	62.6	37.4

Source: Fitch Ratings, Provincial Public Accounts.

The current equalization formula compares a province's per capita tax capacity to the average across all 10 provinces. The provinces below the average receive equalization, with the federal pool of available funds rising based on a three-year moving average of GDP. Currently, as of FY 2020–21, five of the 10 provinces receive equalization.

The formula incorporates part of the revenue effects of natural resources, and, thus, a resource-rich province, such as Newfoundland and Labrador, is currently ineligible, despite relatively low fiscal capacity once natural resource revenues are excluded.

The formula is not explicitly intended to address economic cyclicality but a decline in fiscal capacity may trigger equalization payments. The economically diverse, wealthy province of Ontario became eligible for small equalization payments for a decade following the Global Financial Crisis (GFC) of 2007–09, while the oil price shock beginning in 2014 did not trigger equalization payments to energy-producing provinces. The separate fiscal stabilization program, while intended to offset cyclical weakness, had limited effects given a per capita cap.

Several transfers support provincial spending on a per capita basis across all provinces and territories. The primary programs are CHT and CST. Both are delivered as block transfers, rather than cost-sharing transfers conditioned on provinces matching federal spending requirements. Across all provinces in FY 2019–20, CHT equaled CAD40.4 billion and CST equaled CAD13.7 billion.

In aggregate, CHT covers about 22% of provincial health care spending. Under federal policy, since 2018, amounts available for CHT rise annually by the greater of nominal GDP, or 3%, exposing provinces to long-term cost pressures due to rapid health care inflation and aging demographics. CST rises 3% annually.

Provinces together, or individually, actively lobby for favorable changes in transfers but ultimately the federal government has discretion over how transfers are structured. Still, changes to transfers historically are not sudden but instead are signaled ahead of time. Recently, provincial premiers collaborated to demand CHT be increased to an average of 35% of provincial health care spending, with a higher escalator to maintain this contribution level over time.

Discretionary Federal Support

Numerous legal avenues exist to provide ad hoc support to provinces, beyond major transfers and routine assistance, such as disaster response. The Bank of Canada (BOC) Act authorizes the bank to make short-term loans to provinces. The maximum amount is 25% of estimated revenue in the current FY, with repayment required no later than one quarter after the start of the following FY. Separately, in early pandemic-related market disruption, the BOC opened two temporary programs supporting provincial debt markets. See the *Debt and Liquidity Framework* section.

Similarly, the Federal-Provincial Fiscal Arrangements Act, which governs federal transfers and certain tax collection agreements, allows advances of tax collections to provinces and permits borrowing for cyclical revenue losses under the fiscal stabilization transfer mechanism, detailed earlier. These budget loan programs have not been not widely used, if at all.

The federal government's incentive to ensure stable economic and fiscal performance at the provincial level results in a wide range of other ad hoc support. For example, successive agreements with Nova Scotia allowed it to benefit from offshore oil drilling without negatively affecting equalization transfers. Revenues from offshore natural resources are subject to federal, rather than provincial, taxes under Canada's Constitution.

Similarly, a 2019 bilateral agreement between the federal government and Newfoundland and Labrador is providing the latter with CAD3.3 billion in revenue from offshore oil drilling over 38 years.

More recently, a federal guarantee of CAD7.9 billion on Nalcor Energy's Lower Churchill Project reportedly allowed it to waive CAD844 million in debt payments, mainly due in December 2020, which could have required a provincial equity infusion.

Expenditure Framework

Provinces' broad spending missions derive from Canada's constitutional division of powers. Provinces are responsible for schools, health care, property and civil rights, transportation, civil law, labor relations, liquor sales and municipal governments.

Federal responsibilities are confined to defense, foreign affairs, trade and commerce, although the federal government operates a Canadian-wide unemployment system. Agriculture and immigration are among a handful of functions shared at the federal and provincial level. Direct program spending falls into broadly similar program spending categories from one province to another, with health care comprising the largest component, followed by education.

Health care is typically delivered by regional health districts, except in Saskatchewan and PEI, and funded by a combination of provincial resources and CHT. Similarly, primary and secondary education is delivered by local school boards and funded by a mix of provincial transfers and property taxes.

LRG's Expenditure Breakdown: FY 2019–20

(%)	Opex	Total Expenditure
Health	43.0	–
Education and Training	27.3	–
General Government	6.4	–
Transportation	4.3	–
Other	30.4	–
Opex	**100.0**	**87.3**
Financial Charges	**–**	**6.2**
Capex	**–**	**6.5**

LRG – Local and regional governments. Note: Opex by category as reported.
Source: Fitch Ratings, Provincial Public Accounts.

At the provincial level, spending by object is dominated by salary and benefits, including employee pensions, and provincial grants or transfers to local governments. Labor contracts are an important lever in provincial expenditure management, with periodic contract negotiations providing a key mechanism for addressing service needs or controlling expenses. Debt service is funded by provincial operating receipts but represents only 6.4% of expenditures in FY 2019–20.

Debt and Liquidity Framework

The Canadian constitution's provision for the "borrowing of money on the sole credit of the provinces" is the basis for the provinces' powers over debt and liquidity, and one reason Canada's share of sub-sovereign/general government debt is far higher than global peers.

Provinces carry out expansive, centralized treasury operations, which include overseeing operating and capital spending, collecting taxes and fees, monitoring federal transfers and intergovernmental flows, and managing liquidity and debt portfolios. Government enterprises, school boards, regional health authorities and local governments are typically overseen by a relevant ministry.

The debt burden of provinces varies and is influenced by capital spending needs, accumulated deficits and differing economic resource bases. The preferred measure of public sector debt is net debt, a comprehensive calculation combining all liabilities, such as accounts payable, leases, direct borrowing, etc., and nets financial assets.

Net Debt by Province: FY 2019–20

(CAD Bil. as of FYE March 31)	Liabilities	Financial Assets	Net Debt	Net Debt (% GDP)
British Columbia	93.6	48.2	45.4	15.0
Alberta	116.5	76.4	40.1	11.4
Saskatchewan	24.4	12.1	12.3	14.8
Manitoba	36.8	11.5	25.2	34.2
Ontario	447.4	94.1	353.3	39.6
Quebec	259.3	88.0	170.6	39.9
New Brunswick	10.8	24.7	13.9	36.4
Nova Scotia	20.3	5.0	15.2	32.7
Prince Edward Island	3.6	1.4	2.2	29.3
Newfoundland and Labrador	26.1	11.7	14.4	40.7

Note: Data not adjusted by Fitch.
Source: Fitch Ratings, Provincial Public Accounts.

Provincial direct debt is senior and unsecured, payable from general resources rather than specific revenues and on a parity basis with other spending. There is no formal distinction in borrowing to support liquidity, bridge deficits or fund capital. Guarantees, capital leases and public-private partnerships are relatively small components of debt but are reported in financial statements.

Subnational issuance is concentrated at the provincial level. Most borrowing is for provincial purposes, including liquidity, capital and operating needs. Some provinces also issue directly on behalf of public enterprises and local governments, while others authorize borrowing by enterprises or certain cities. Government enterprise debt is usually self-supporting through enterprise revenues, chiefly utilities fees. Some contingent obligations include financial risks, such as for insurance lines, workers compensation, automobile and crop insurance, or bank deposits.

Local governments cannot plan for deficits and cannot borrow to cover a deficit. Local borrowing is primarily for capital purposes, and is often undertaken through provincial conduit financing authorities, regional entities or, less frequently, under their own name.

Ontario finances some local infrastructure needs through Infrastructure Ontario, with the debt carried on the province's balance sheet. Ontario locals borrowing independently, chiefly the largest cities, are subject to a debt service limit of 25% of revenue funds, except for Toronto, which may set its own debt limit.

In British Columbia, the Inspector of Municipalities must approve local borrowing. Although the City of Vancouver borrows on its own, most locals rely on provincial grants for capital, or finance capital following multiple layers of approvals through the Municipal Finance Authority of British Columbia (MFABC). Debt issued by MFABC is not carried on the province's balance sheet. In contrast to provinces, borrowing by territories is subject to federal approval, with explicit caps on outstanding debt that must be periodically adjusted.

Liquidity and Market Access

Provincial debt issuance is sophisticated, with the most active provinces borrowing in a variety of instruments, including treasury bills, medium term notes and debentures. Borrowing by the largest provinces is often concentrated in benchmark maturities to enhance liquidity. Borrowing for short-term needs is routine. Larger borrowers maintain CP programs in domestic and U.S. markets and credit lines with Canadian banks.

Most borrowing is issued with bullet rather than serial maturities. Maturities are typically long, with the average extending to a decade or longer. Strategies for managing future bullet maturities include setting aside sinking funds or directly repurchasing outstanding bonds prior to final maturity. The vast majority of borrowing is fixed rate and issued in domestic markets but provinces readily issue in foreign currencies and at variable rates, hedging foreign currency and interest rate risks.

Market access for routine liquidity and to refinance maturing debt is essential, particularly given bullet maturities. Several recent periods of market volatility, including during the GFC, the Eurozone crisis and at the start of the coronavirus pandemic, highlighted the risk of temporary interruptions in market access.

The largest provincial borrowers, Ontario, Quebec and Alberta, responded to market volatility by establishing internal liquid pools intended to provide sufficient liquidity in the event of market disruption. Ontario has CAD23 billion in liquidity, Quebec has CAD13 billion and Alberta holds CAD11 billion as of FY 2020–21.

Ontario and Quebec size their pools based on near-term scheduled maturities. Some provinces have access to other assets, such as Alberta's Heritage Fund and Quebec's Generations Fund, that, while less immediately available, could provide additional flexibility in extreme circumstances.

Federal Role in Provincial Debt Markets

There is no explicit guarantee of provincial debt by the federal government. However, the federal government and the BOC have a clear incentive to support stability in the huge market for provincial debt, along with numerous mechanisms to prevent a fiscal crisis in a single province from triggering a wider crisis in the debt market for Canadian provincial and municipal bonds.

Recent examples of federal support of provinces were on an ad hoc basis, such as the early 1990s, when Saskatchewan faced loss of market access, and several episodes in recent decades in Newfoundland and Labrador.

At the start of the pandemic, in late March 2020, converging pressures from rising debt, plunging oil prices, public health shutdowns and market uncertainty left Newfoundland and Labrador at risk of being shut out of debt markets. Just four days after the then-premier notified the prime minister of the province's dire situation, the BOC announced the first of several temporary programs to support liquidity in provincial debt markets.

The Provincial Money Market Purchase program provided for the direct purchase of up to 40% of a province's short-term debt issuance. Temporary programs have ended but had the desired effect of narrowing spreads between provincial and federal paper and improving the liquidity of provincial debt markets.

Debt Limitations

The federal government has no power to limit provincial borrowing. Provincial debt limits are periodically self-imposed by policy or statutory targets, often in response to public concern about rising debt balances and the budget burden of interest. While policy anchors help set public expectations for lower debt and establish political accountability, policy is subject to change, particularly when an economic shock triggers a deficit.

Debt limits often establish a goal of lowering the growth rate of debt to a level below GDP growth. For example, in its budget for FY 2021–22 Ontario is targeting a net debt/GDP ratio cap of 50.5% through its medium-term outlook ending in FY 2023–24. Alberta established a 30% net debt/GDP policy cap among several fiscal anchors as it addresses the pandemic.

Since its 1996 Balanced Budget Act and the 2006 Act to Reduce the Debt and Establish the Generations Fund, Quebec maintained formal policy targets for annual deficits and long-term debt reduction. The latter includes a statutory future target to lower gross debt/GDP to 45% in 2026. Despite periodic setbacks, most recently as a result of the pandemic, the statute generally served as a useful policy anchor across multiple governments and helped the province lower its debt burden over time.

Provinces also harness natural resource revenues to lower debt. Saskatchewan prudently took advantage of oil and mining revenue windfalls two decades ago to rapidly lower its then-outstanding debt balance. Quebec established a separate investment pool for debt reduction, the Generations Fund, to which it deposits hydropower and other receipts. Other provinces considered similar mechanisms.

Retirement Obligations

All provinces operate employee pension and other retirement benefit programs distinct from, and supplemental to, Canada's broader systems of support for retirees, including the federally-funded Old Age Security program and joint federal/provincial CPP/QPP systems.

Funding of provincially-sponsored, or jointly-sponsored, pensions is usually solid, with actuarial liabilities based on reasonable discount rates and relatively solid levels of prefunding, in most cases. Provinces report net assets and pension expenses in public accounts. Plans are contributory, requiring both employer and employee contributions.

The provinces' constitutional power over civil and property rights means pensions are generally regulated at the provincial level, although many plans are jointly governed by boards combining employees and employers. Benefits, once accrued, are generally not subject to being reduced. However, future benefit accrual and indexation of benefits are subject to adjustment. Some plans have gone farther, instituting greater risk-sharing with employees or establishing target benefit plans for younger workers. Reforms to pensions included reducing or eliminating indexing, reducing benefit accruals for new workers or existing workers from the reform date, or requiring longer service to achieve the same benefit levels.

Some major plans were closed to new workers, replaced either with reduced benefit tiers or defined contribution structures, reducing long-term risks associated with pensions. For example, most of Alberta's pension liabilities are for several plans closed in 1992, while Saskatchewan likewise carries liabilities for plans closed in 1977.

Summary of Provincial Financial Performance

The period before the pandemic reflected accelerating economic and revenue growth as Alberta and other provinces with large natural resource sectors slowly recovered from the energy sector recession of 2014–15.

Operating balances and net debt kept pace with this trend. Provincial borrowing rose steadily in aggregate, with deficits in Alberta, Ontario and elsewhere initially pushing net debt higher, offset by declines in some provinces, notably Quebec. The pace of economic growth accelerated over the period, gradually outpacing the rise in debt.

Provinces Financial Performance by FY

(CAD Bil. as of FYE March 31)	2015	2016	2017	2018	2019	2020i
Total Revenue	377.9	385.7	400.0	422.9	442.0	449.1
Program Expenditure	359.9	369.0	380.2	401,8	417.4	434.3
Debt Charges	28.5	29.1	28.8	29.3	30.1	29.4
Operating Balance	(10.4)	(12.3)	(9.2)	(8.0)	(5.1)	(14.7)
Net Debt	572.0	600.4	620.7	643.2	664.2	692.7
Net Debt/GDP (%)	29.7	31.0	31.7	31.9	32.2	33.0

i – Interim. Note: Table excludes adjustments made by some provinces.
Source: Canada Department of Finance, Fiscal Reference Tables.

Canadian Provinces and Territories

PEI – Prince Edward Island.
Source: Fitch Ratings, mapchart.net.

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