Provincial Borrowing in Nova Scotia

By W. F. LOUGHEED and W. C. MACKENZIE

AT various times in the financial history of the Province, and particularly during periods of economic disturbance the Government has deemed it expedient to spend more money than is available from ordinary revenue collections. In order to acquire the supplementary funds the Province, like the private individual or business organizations, applies to the banks and investment houses for loans. However, unlike the private concerns who usually borrow in the anticipation of future monetary gain, the government borrows in order to maintain or expand public services.

It is not always realized that the Federal and Provincial governments have been assuming a social responsibility far exceeding the notions of governmental functions held even a generation ago. Under the Canadian constitution it happens that the functions which are expanding, namely social and welfare expenditures are those which lie within the Provincial jurisdiction and the municipal governments. However the conception of "social" and "public" services has undergone such changes that, as a result, the local units, with few exceptions are in no position to provide them from either a financial or an administrative point of view.

As a result of the many increased demands the Province has found it necessary to engage in what seems to be an ever widening program of public works. At the present, this program embraces the construction of public buildings, institutions and highways. Some of these "improvements" may be regarded as of a relatively permanent nature, but even a paved highway may last only two or three years if it is subjected to very heavy traffic. It is, however, significant to consider for purposes of expenditure policy that there is a difference in degree if not in kind in the various disbursements made during the fiscal year.

Governmental expenditures are often classified as *ordinary recurring* and *capital* —*ordinary recurring* being those which are expected each year in the normal discharge of business; *capital*, those which may be considered apart from the regular expenditures. Based on this classification, it is considered a sound business principle to finance *ordinary recurring* expenditures from current revenues (e.g. taxes, fines, fees, etc.) while on the other hand *capital* or *periodic* expenditures may be financed by borrowing. Furthermore, these non-recurring expenditures often require the utilization of equipment and resources beyond the immediate command of the government. The scope as well as the urgency of such a program therefore necessitates the spending of larger sums than are currently available and hence a borrowing policy may be justified.

Emergency financing also falls within the category of *capital* expenditures. In order to alleviate the distress resulting from such emergencies as severe temporary unemployment, storms and fires, funds may be raised by borrowing, either through short or long term loans whichever may be deemed fiscally expedient.

The classification of expenditures is, at best, relatively arbitrary. If such classifications are not utilized with great care in the formulation of fiscal policy, it may result in expenditures falling first into one class and then into another without any change in the technique of financing them. Should a government find that what it has been calling a *capital*

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expenditure, has in reality become an *annual recurring* expenditure, then prudence suggests that the tax structure be revised to finance this expenditure out of current revenues.

The life expectancy of a municipality or province is considered (on this continent) to be greater than that of private individuals and even corporations. Also, large governmental units have, in the main, the power to draw upon wider resources than are available to most firms. Thus there is a great possibility of prudent governmental organizations maintaining a good credit standing. Moreover, it is of vital importance to the people of the Province that this standing should be preserved since governmental action is often the determining factor in the maintenance of social security. Finally, good credit relations enable the government to raise funds at relatively low interest rates thereby saving the taxpayers additional costs.

Many examples of the credit standing of the Province may be cited. Consider, for instance, the $4,500,000 bond issue of 1936. The Province was required to pay 3 1-4% (nominal) annual interest for the use of the money for a twenty year period. The interest on this debt amounts to approximately $138,000 each year. Had the Province a less favourable credit standing and as a result been forced to pay 4% as in Alberta, then the taxpayers would have been forced to pay approximately $185,000 rather than $138,-000. The rates of interest at which the Province has been able to borrow are seen in summary form in Table I, page000.

By virtue of section 92, subsection 3, of *The British North America Act*, the Province may (among other things) "borrow money on the sole credit of the Province." The utilization of this borrowing power is, in the final analysis, subject to control by the Legislature. Briefly, there are two ways in which the Province is granted the privilege of borrowing. The first and most important is the Legislative sanction provided—(a) in an annual act "To Provide for Defraying Certain Charges and Expenses of the Public Service of the Province", and (b) by special acts passed to authorize the raising of a loan for a specific purpose. In the former case certain items regularly are chargeable to *capital account*, and funds to meet these charges are raised by borrowing. Authority is given by the Legislature as follows:

> "The Governor-in-Council is authorized to raise by way of loan on the credit of the Province—the several sums of money for the Public Service that are chargeable to capital and granted by this Act."

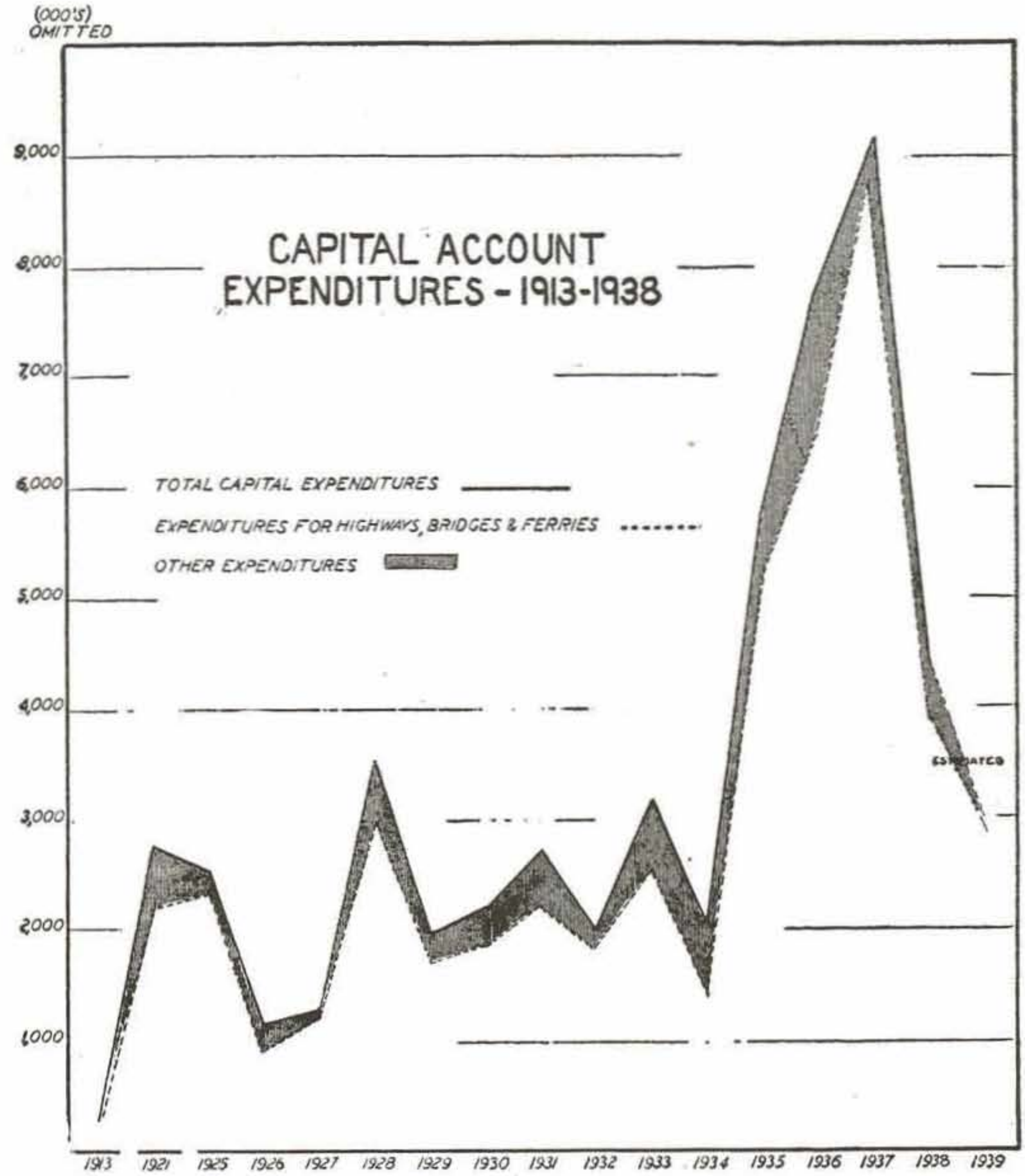
The second method of granting the Province the right to borrow is through Orders-in-Council. Due to miscalculations in estimated revenues, emergencies, or unanticipated demands, it may be determined that funds are necessary in order to discharge certain obligations. In such cases the minister of the department or departments involved makes a recommendation to the Executive Council which report is carefully examined. Should the recommendations be approved the Provincial Treasurer is authorized by the Governor-in-Council to provide the funds deemed necessary.

When private individuals borrow money from banks or investment houses usually some security is pledged, collateral deposited, or other similar procedures are followed. In the case of the Province, however, public property is not pledged as security for the repayment of the loan. Instead, the Province pledges its ability to collect revenues by virtue of its taxing powers. Although the possibilities of governmental borrowing in theory may seem limitless, the economic resources of the Province, in the final analysis, govern the scope and extent of Provincial indebtedness.

When authority is given by the Legislature to borrow money, it is usually obtained by the issue and sale of Nova Scotia debentures or Nova Scotia stock. (The terms "stock" and "debentures" to all intents and purposes may be considered as synonomous.) The amount deemed necessary having been decided upon, the first act of the Treasurer's Department is to call for tenders or bids from the various investment groups or syndicates (e.g. groups headed by

CHART II

Trend in Expenditures Charged to Capital Accounts 1913-1937



the Royal Securities, the Bank of Nova Scotia or the Bank of Montreal.) These groups offer certain amounts; either par value, less than par or more than par, depending upon market conditions. The bid considered most satisfactory to the Province is accepted. Bonds are printed and signed by the Treasurer and delivered to the investment house for further distribution. The investment house deposits in an accredited banking institution the sum agreed upon to the credit of the Province.

Borrowing has been resorted to by the Province for various purposes for many years. In the early part of the twentieth century debts were incurred largely for development and expansion. Increased demands on the government, as mentioned above, accompanied by relatively little change in the tax structure, have resulted in an extension of the policy of borrowing. In the past ten or twelve years, as it will have been seen from chart I (see cover), the debt burden has been more than doubled. In the main, borrowing has been resorted to for the following purposes, namely: construction and maintenance of highways (including bridges and ferries) unemployment relief[1] (beginning in 1932) —the erection and equipment of public buildings and the refunding of loans previously contracted for these purposes.

Chart II above presents in graphic form the various expenditures that have

(1) Under "Nova Scotia Unemployment Act 1931", N. S. Statutes, Acts of 1932, Chapter 7, the provincial government was authorized to purchase debentures of cities, towns and municipalities issued to finance unemployment relief in the local units. This virtually amounts to provincial borrowing to aid "the local units."

been charged to capital. The funds to meet these expenditures have been derived from borrowing. The major expenditures have been made either for highways, bridges and ferries (including docks) *or* for the refunding of bonds sold for these purposes *or* for a combination of the two above purposes.

At the end of November, 1937, the total of approximately $95,219,246 remained pledged against the credit (i.e. the economic future) of Nova Scotia[1]. In its entire history the Province has never repudiated an issue. The debt is now over eight times the revenues annually collected.

Although the credit rating of this Province is higher than in some Canadian provinces, some examination of the cost to the taxpayer of maintaining this record should be made. Table I indicates in summary form some of the costs of borrowing since 1924. It will be noted that, on an average, for every hundred dollars borrowed, one hundred and two dollars must be paid back to the creditors. Each and every year interest to the amount of nearly three dollars and seventy-five cents is paid for every hundred dollars borrowed by the Province. For the use of a dollar for a twenty-year period the taxpayers are paying approximately seventy-five cents. Also, and of more direct significance, the annual cost to the taxpayer of maintaining this debt burden is approximately three and one-quarter million dollars. Moreover, in order to give not only a complete picture of the debt burden but also an indication of the cost of borrowing to the public, a comparison of the "effective" and nominal rates of interest (graphically presented in Chart III below) is of some significance.

TABLE I

Some Significant Costs of Provincial Borrowing 1924-1937

Date Issued	Term	Amount Borrowed	Discount	Amount Received	Rate of Interest	Amount of Annual Interest
1924	20	$ 2,530,000	$ 29,854	$ 2,500,146	5	$ 126,500
1927	25	12,370,000	319,418	12,050,582	4½	556,650
1928	25	500,000	32,400	467,600	4½	22,500
1928	20	2,000,000	96,592	1,903,408	4½	90,000
1928	25	500,000	24,906	475,094	4½	22,500
1928	20	3,000,000	144,888	2,855,112	4½	135,000
1928	30	500,000	26,750	473,250	4½	22,500
1929	30	2,560,000	35,200	2,524,800	5	128,000
1929	30	2,028,000	27,885	2,000,115	5	101,400
1929	30	1,500,000	15,000	1,485,000	5	75,000
1930	30	5,054,000	54,280	4,999,720	5	252,700
1930	30	4,043,000	43,422	3,999,578	5	202,150
1930	30	4,404,000	104,331	4,299,669	4½	198,180
1931	30	2,115,000	15,291	2,099,709	4½	95,175
1933	10	2,800,000	114,800	2,685,200	4½	126,000
1933	12	2,000,000	62,400	1,937,600	4½	90,000
1934	5	5,050,000	49,995	5,000,005	3½	176,750
1934	5	3,534,000	24,031	3,509,969	3	106,020
1935	10	2,000,000	41,964	1,958,036	3	60,000
1935	15	1,796,500	55,659	1,740,841	3	53,895
1935	5	3,012,000	11,747	3,000,253	2½	75,300
1935	12	4,140,000	140,346	3,999,654	3	124,200
1936	20	4,579,000	78,896	4,500,104	3¼	160,265
1936	20	2,103,000	103,320	1,999,680	3	63,090
1937	15	5,111,000	110,909	5,000,091	3	153,330
1937	4	1,528,000	27,351	1,500,649	2½	38,200
1937	9	2,549,000	48,176	2,500,824	3½	89,215
Totals..	..	$83,306,500	$1,839,811	$81,466,689	...	$3,344,520

(1) Province of Nova Scotia, *Public Accounts*, 1937, P. XXXIV.

Some people argue that in this Province, and in some municipalities, many "capital" expenditures have become *annual* or *recurring* expenditures. This school of thought says that the effects of borrowing to finance such expenditures should be distinguished from the effects of borrowing to finance periodic *capital* expenditures. If loans are floated year after year to finance continuing expenditures, (even of a capital nature), the indebtedness mounts rapidly. Such a policy if persisted in gradually results n a growth of annual debt and service charges which in time may come to dominate the whole budget. This fact should be clearly recognized and a quota of the annually recurring *capital* expenditures should be financed by taxation. Of course, for those capital projects that recur only periodically, a complete "pay as you go" program is not economically feasible. But, with a long range planning of capital improvements financed by a combined policy of taxation and borrowing—taxes should, so far as economically possible, be levied to finance the annual recurring capital expenditures, with resort to borrowing to cover the *periodic capital* expenditures. Increases in tax levies, however, often give rise to undesirable political repercussions from which proposed bond issues are relatively free. Yet, a policy of cash financing properly presented to the voters should be met with considerable interest.

On the other hand many experts regard the above proposals as practically impossible. Since a budget is merely an estimate of expenditures and anticipated revenues, there can be little possibility of achieving a balance under present conditions. Furthermore, it is pointed out that expenditure needs do not coincide with revenues and more often are in inverse proportion. Moreover, in contracting a debt for annual or periodic *capital* expenditures, resources are required that otherwise might remain idle. This school of thought does not regard debt as an evil in itself; it argues that the evil lies in the improper management of debt. According to this view it is considered wise policy to borrow during depressions and to pay off the debts during prosperous periods by expanding the tax rates or adding new levies. Any fiscal policy that increases economic productivity and welfare to a greater degree than if expenditures, either public or private, were not made, presents a major justification for increasing the debt according to this view.

CHART III

Trends in Interest Rates on Provincial Loans 1925-1937.