

Minister of Finance



Ministre des Finances

Ottawa, Canada K1A 0G5

OCT 10 2007

The Honourable Michael G. Baker, M.L.A.
Minister of Finance
Government of Nova Scotia
7th Floor – Provincial Building
1723 Hollis Street
P.O. Box 187
Halifax, NS B3J 2N3

Dear Minister:

I am writing to conclude our discussions on the application of the 2007 Budget to Nova Scotia. The Government of Canada's 2007 Budget restored fiscal balance in Canada by introducing a renewed and strengthened Equalization program. This new system treats all provinces fairly and equitably.

Canada's New Government fully met its commitment to respect Nova Scotia's Offshore Accord by offering Nova Scotia the choice of adopting the O'Brien formula or continuing to operate under the existing Equalization formula and receive the same benefits as before. These are complex issues and it is important that our respective governments share a common understanding of the precise implications for Nova Scotia of the Budget measures.

Since the release of Budget 2007, you have raised questions regarding specific aspects of the transition to a new, principles-based Equalization program. We have had open and positive discussions of your concerns that while the O'Brien regime would be good for Nova Scotia in 2007-08, obliging the Province to choose immediately could mean losing out on anticipated benefits from the Accord in the future. You have made your case clearly and the Government of Canada has listened and acted to provide greater comfort to the Province on these issues. For example, following these early discussions, we immediately provided enhanced flexibility for 2007-08, allowing Nova Scotia to benefit from the new Equalization system for 2007-08, while postponing a decision to permanently opt into that system for a year. This additional flexibility provided Nova Scotia with an additional \$95 million in 2007-08.

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We have continued to have positive discussions since then to address your additional concerns related to the precise commitments set out in the 2005 Accord, and the challenges of deciding which formula is most beneficial to Nova Scotia over the life of the Accord.

As I have said on a number of occasions, I have been willing to explore with you any measures that would help ensure a smooth transition to the new principles-based system. I am pleased that we have reached agreement on an important element of this transition. By providing a cumulative-best-of guarantee, effective 2008-09, the Province can be confident that if it wishes to opt into the new Equalization formula Nova Scotia will do at least as well, on a cumulative basis, as it would have under the formula in place at the time the 2005 Accords were negotiated. Nova Scotians are guaranteed full protection, for the life-time of the 2005 Accord, of the benefits negotiated by the Province at the time the agreement was signed. The ultimate value of these benefits will depend upon a range of uncertain factors, including offshore energy prices and production levels, and the economic performance of your province relative to other provinces.

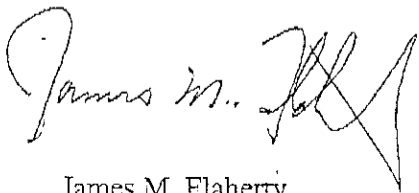
Your Government also recently requested that the status quo equalization formula to be used for the purpose of this guarantee should be the formula which had been agreed to at the time that the Accord was signed. We agree. The Government of Canada will make the technical changes necessary to ensure that this status quo formula is available to you. With these steps, we can now agree that Nova Scotia's benefits under the 2005 Accord are fully protected, and that all provinces will benefit from Budget 2007's commitment to restore fiscal balance in Canada.

There is a second issue, that of the Crown Share, that has eluded resolution between the Governments of Canada and Nova Scotia for over twenty years. We have agreed that it is the time to quickly move towards resolution of the outstanding questions concerning Crown Share. Successive federal governments have always intended to meet their obligations regarding Crown Share Adjustment Payments (CSAP) to Nova Scotia consistent with the terms of the 1988 *Canada-Nova Scotia Offshore Petroleum Resources Accord Implementation Act (1988 Act)*. At issue, however, has been an inability to come to an agreement with Nova Scotia on the formula and assumptions to be set in regulations in order to calculate the value of benefits to accrue to Nova Scotia.

In order to make progress on what is a unique issue for Nova Scotia, the Government proposes the appointment of a joint, independent three-member panel to make recommendations concerning the calculation of the value of federal CSAP obligations, with a view to facilitate the development of an approach agreeable to both governments. We propose that each Government appoint one member who will jointly select a third member, as Chair. The panel will be asked to report its recommendations to both Governments by March 15, 2008.

The measures set out in this letter not only pave the way for the positive implementation in Nova Scotia of important Budget 2007 actions, they underline the capacity of our respective governments to work together. I am pleased that our discussions and good faith efforts have resulted in such a favourable outcome for both parties.

Yours sincerely,

A handwritten signature in black ink, appearing to read "James M. Flaherty". The signature is stylized and cursive, with a large initial "J" and a long, sweeping tail.

James M. Flaherty