

Solutions to Newfoundland and Labrador's Fiscal Reality

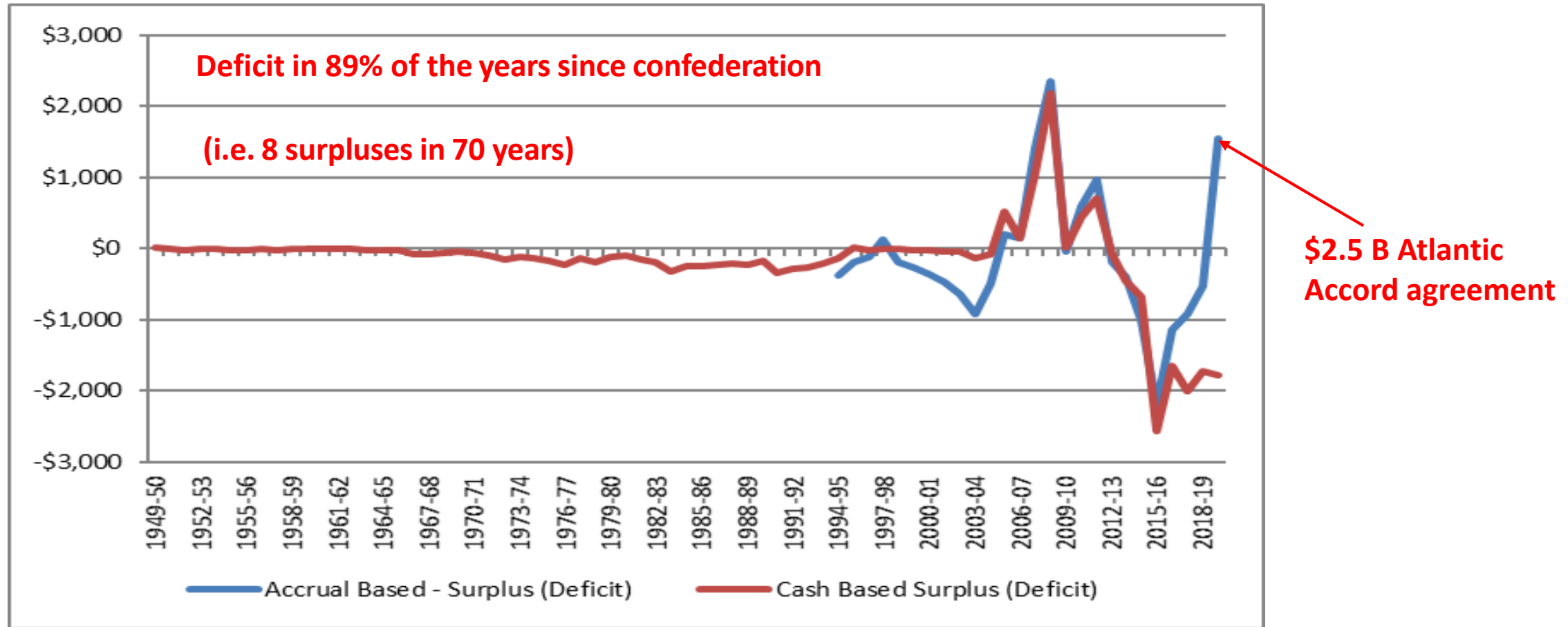
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Part 1: The Reality

Over NL's Last 70 Years Deficits Are The Rule Rather Than The Exception But



Source: between 1949-50 and 2004-05, the cash-based data were taken from Public Accounts of Newfoundland and Labrador, Vol III, various years, for 2005-06 and beyond, the cash-based data, was taken from The Report on the Program and Expenditures of the Consolidated Revenue Fund, and accrual-based data was taken from Public Accounts of Newfoundland and Labrador, Vol I, various years.

The Last 15 Years Are Exceptional

Seven Years of Abundance

- 2005-06 to 2011-12 (\$5.1 B in accumulated surpluses)
 - Rising Oil Prices
 - Rising Oil Production
 - Rising Oil-related revenues
 - Rising Gov't Expenditures
 - Expanding public sector
 - Rising public sector wages and other benefits (health, pensions)

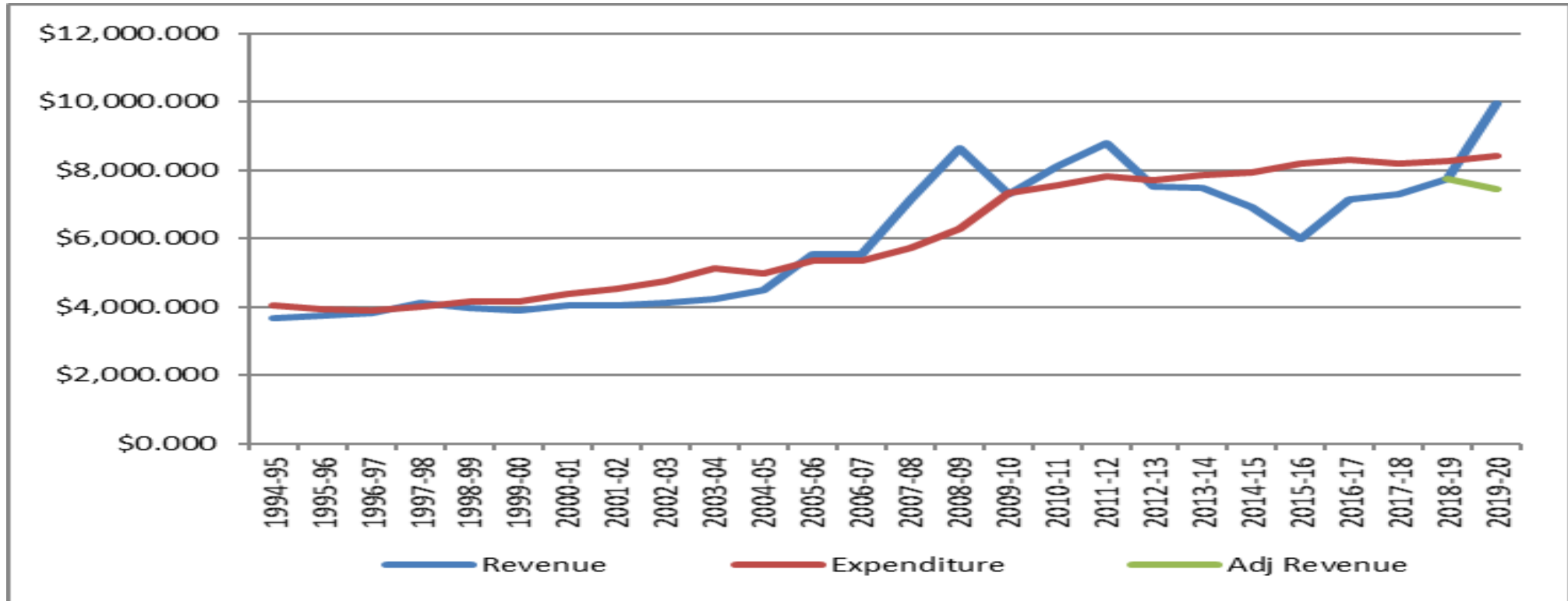
Seven Years of Famine

- 2012-13 to 2018-19 (-\$9.2 B in accumulated deficits)
 - Falling Oil Prices
 - Falling Oil Production
 - Falling Oil-related Revenues
 - Slowly Rising Provincial Government Public Sector Employment
 - Rising Deficits and Debts

One Year of Atlantic Accord Adjustment (\$2.5 B) and an Agreement on Mitigation

- 2019-20 (initially resulted in \$1.92 B surplus, but later revised to \$1.56 B in the update)
 - It is important to recognize that there are simply political agreements

Provincial Government Revenues and Expenditures, NL, 1994-95 to 2019-20



Sources: Public Accounts (2006-2018), GNL Estimates 2019 (2019-20) and Fiscal Update 2019-20

The accrual based revenue from the 2019 Atlantic Accord transfer tend to distort the true picture for 2020. The "adjusted revenue" (the green line) might be better to use in this current discussion.

Part 2: The Reasons Why

Inevitable Deficits !

- On the Revenue Side:
 - Our economy is basically a “**staples economy**” as defined in the 1920’s by Canadian Scholars (Macintosh (Queen’s) and Innis (Toronto)).
 - NL is highly dependent on the export of **primary products (fish, iron ore, oil, nickel, and pulp and paper)**.
 - These staples have major fluctuations, both in terms of prices and production, which, in turn, have economic, social and political implications for the province.
 - NL witnessed major declines in commodity prices, most recently around the 2014-15 period.
 - These prices are not only determined by supply and demand forces, but by international political factors so no local control and difficult to predict with precision.
 - In other words, **price fluctuations are inevitable** and the timing and magnitude hard to predict.
 - **Lesson to be learned:** The short term is not the long term. **Save part of new-found resource incomes in years of abundance for the inevitable lean years or, at least, pay down your debt obligations so that you are in a better position to deal with the inevitable decline in commodity prices.**

Public Expenditure Hysteresis

- **Hysteresis** in the field of **economics** refers to a stimulus on the economy that persists into the future, even after the factors that led to that stimulus having been removed.
- In particular, as resource rents increased and led to large fiscal surpluses, there was an incentive to increase expenditure.
- Specifically, hysteresis indicates that even though resource revenues fell, one should not have been surprised that provincial public expenditures kept rising.
- In other words, even though fiscal circumstances have changed dramatically, history determines the present and expenditure continues along the same path as was generate during the stimulus period

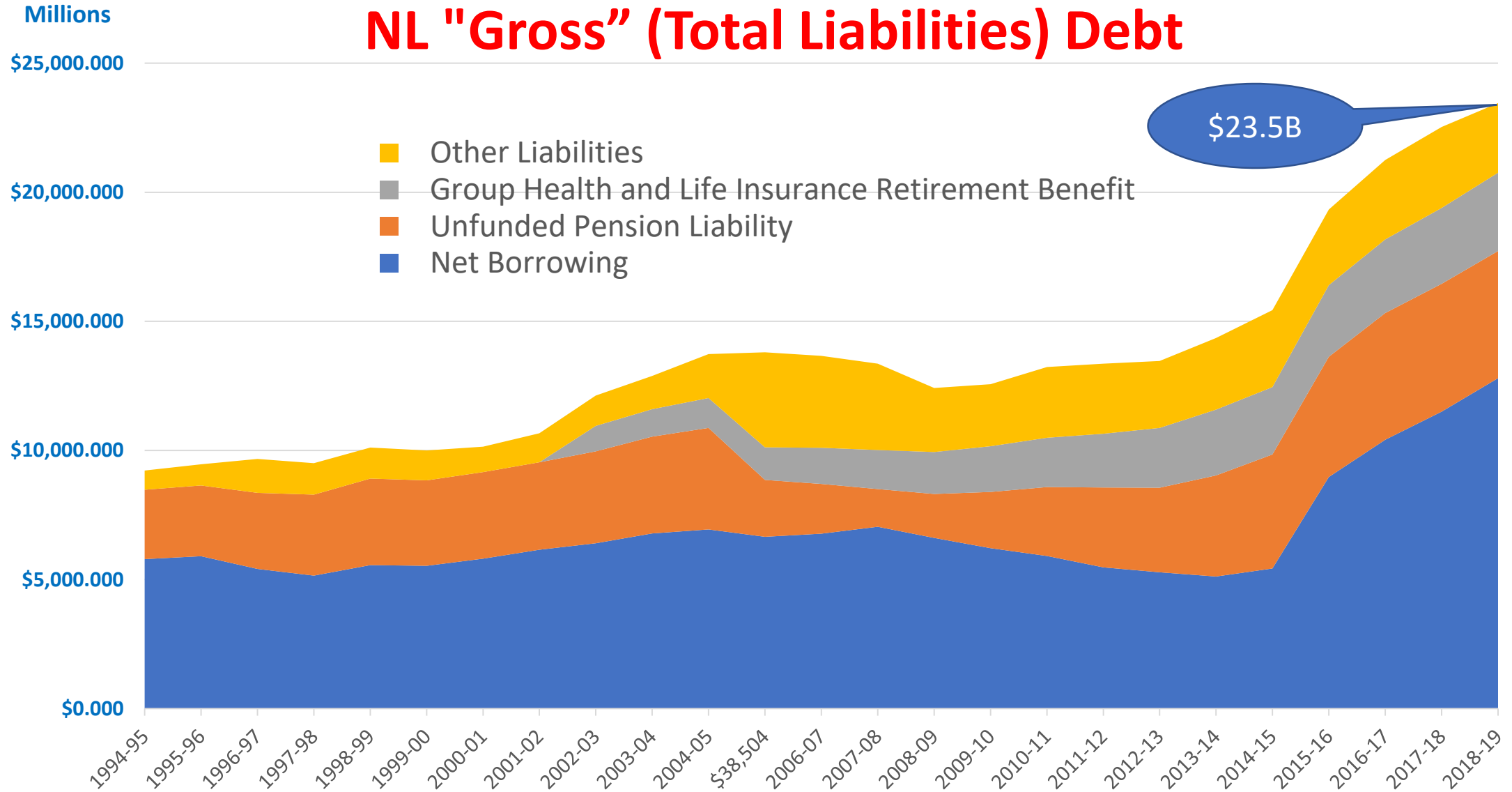
Downward Expenditure Rigidity

- Public expenditures are subject to a “ratchet effect” – i.e., upward flexible but downward rigid.
- Public acclimatization to the new service levels in health care, education and transportation services, supported by the “bricks and mortar” infrastructure and well-paying permanent, year-round **jobs** explains public resistance to any reduction in services and also to any adjustments to new fiscal circumstances.
- These factors are especially important outside the St. John’s urban core, where new economic opportunities are often limited.
- Most MHAs cannot support expenditure reductions and expect to be re-elected. This is especially true when they live in a world where there are 2 degrees of separation between the politicians and their constituents.
- As well, caucus matters to the Minister of Finance and to the Premier. This effect is magnified in a minority government.
- Furthermore, the elected executive of the strong public sector unions have a duty, not just a responsibility, to protect the “interests” of their constituents.
- The aging population and community attachment make **it very difficult** to reduce services.

Part 3: The Result

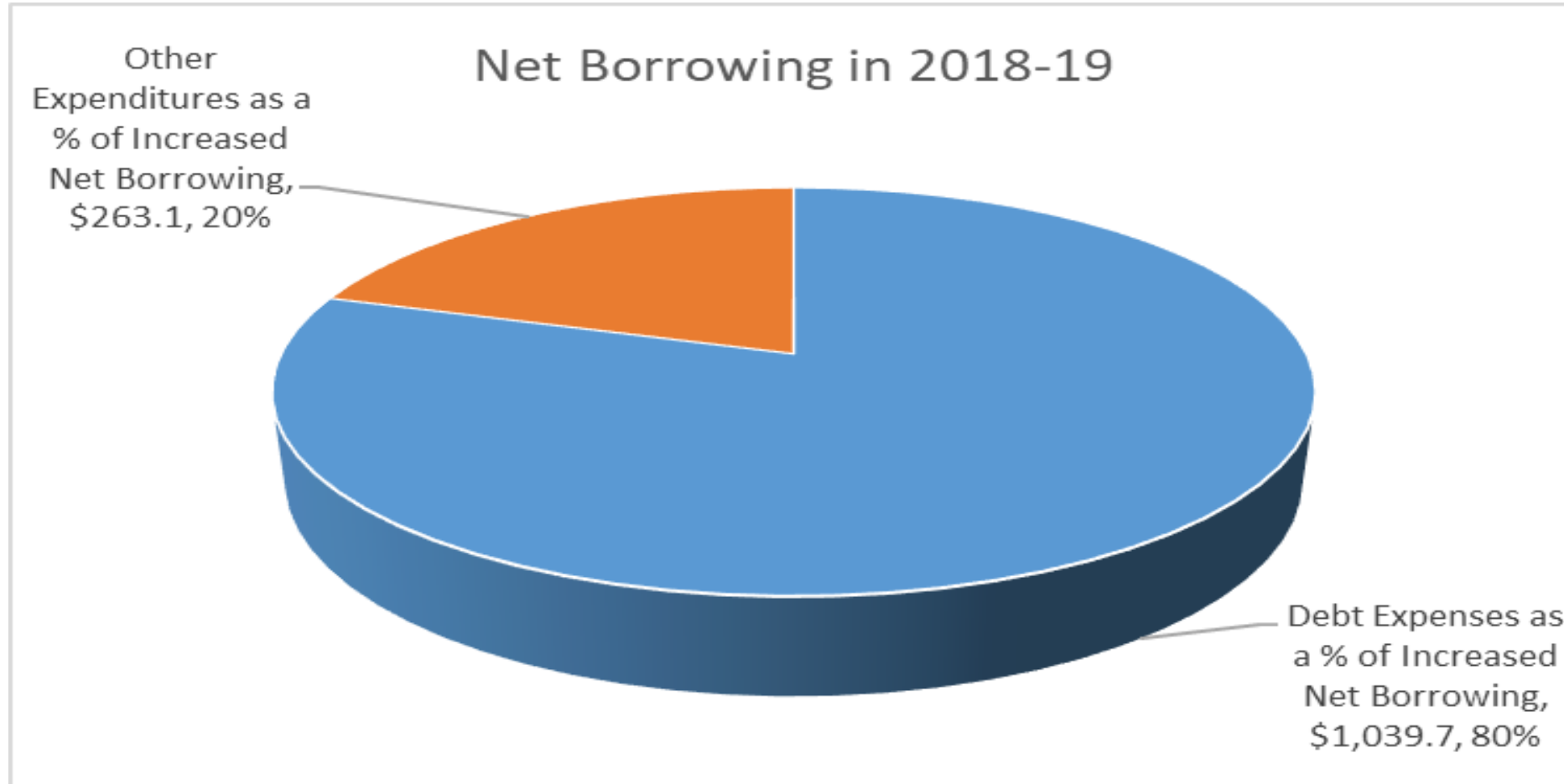
Our Legacy

NL "Gross" (Total Liabilities) Debt



Source: Public Accounts of Newfoundland and Labrador

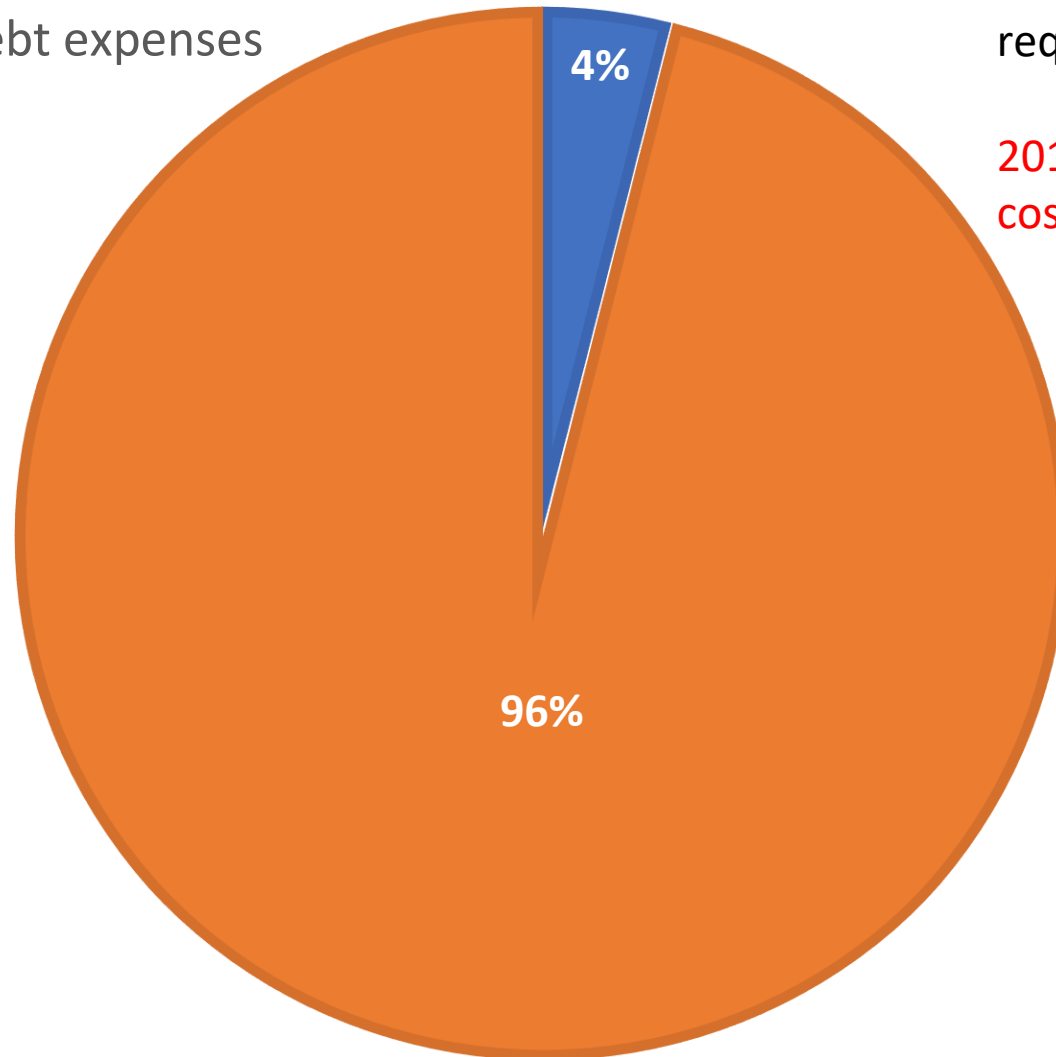
Borrowing as a Percent of Additional Net Debt



Are we really borrowing from our Master Card to pay the interest on our Visa card?

USING OUR OIL ROYALTIES TO FULLY FUND DEBT EXPENSES

- other expenditures
- debt expenses



In actuality, about ½ of debt expenses (42%) relate to unfunded pension funds and health insurance liabilities that will require funding at some future date.

2018-19 Royalties \$1.083 B and debt costs \$1.040 B

Source: Province of Newfoundland and Labrador Public Accounts, Consolidated Summary Financial Statements for the Year Ended March 31, 2019, Schedules 11 & 13

We Have A Problem !

At Best, A Non-Sustainable Equilibrium

- We must move to a new lower steady-state equilibrium.
- This movement to this new equilibrium involves slower growth in the economy reduced GDP/capita, and lower household consumption.
- That is, a lower standard of living (in a material sense)
- We should expect increased out-migration as well.
- Although, the rapid adaptation of new technologies could result in public sector productivity gains, which could lessen the pain.

Part 4: Possible Solutions

Exogenous Solutions (Outside Help)

- ❖ Rising Oil Prices and Increased Production: Given concern over climate change, technological change (electrification) and international political tensions, this is neither likely to be a long-term nor a medium-term solution. However, we can hope!
- ❖ Relying on Ottawa: NL from the “welfare state”, to the “state being on welfare” (e.g., 1982 – FPI collapse, 1992 – cod moratorium).
 - ❖ Substantial help has already been given (enhanced “Atlantic Accord”), but **substantial** help to a “have” province, such as Newfoundland and Labrador creates a political problem for the federal government .
 - ❖ We should expect some help from the federal government (e.g., mitigation measures).

Endogenous Solutions:

❖ Rational Gradualist Approach (Expenditure Side):

- ✓ Set **5-year plan per capita** expenditure targets in each sector which are generally in line with national levels for user age-groups.
- ✓ Set social progress **outcome** targets which are in-line with achievements of top two provinces: To excel aim for the top!
- ✓ Have strategic management plans submitted to tri-party House of Assembly committees by small (i.e., 6 member) “commissions.”
 - ✓ 3 commissioners should from elsewhere (at least 1 from a non-Atlantic Province and 1 from another country) so we can learn from elsewhere
 - ✓ There is the potential for leap-frog technological, including organizational developments that would produce large public sector productivity gains. That is, adapt best practices from elsewhere

❖ Rational Gradualist Approach (Expenditure cont'd):

- ✓ Commissions would be Finance, Health, Education, Natural Resources, Community Sustainability and Human Resources tasked with improving efficiency, modernizing and prioritizing service delivery.
- ✓ Consider the possibility of adjustment grants for individuals such as the poor and potentially those in non-sustainable communities.
- ✓ Continue with public sector attrition under guidance from Human Resource Commission.

Endogenous Solutions (cont'd):

❖ Rational Gradualist Approach (Revenue):

- ✓ NOTE: It may be that Newfoundlanders and Labradorians want and are willing to pay for a social structure that is different from elsewhere in Canada. This may include one with smaller communities.
 - ✓ In this case, raise the HST by 5% after a referendum on the matter. In other words, if we want to be different, then need a different revenue structure that pays for that difference.
- ✓ Review rents from resources, including the fisheries where “slipper-skippers” receive rents that propel them into the top 1%. NL is a resource-rich province, but the incomes from most of these resources are low or negative.
- ✓ Review property taxes so that all property owners pay a tax. This is similar to NB property owners where property owners pay a higher rate of tax on second properties, such as inherited land without a primary residence, cabins etc.
- ✓ Work with other provinces to simplify and modernize our income tax system to move to a family-based system for all and not just seniors.
- ✓ Ottawa should play a major role in financing elder-care and in ensuring pan-Canadian delivery.

Endogenous Solutions (cont'd):

❖ New Rational Economic Approach:

- ✓ Focus on “**Outcomes**” and the **outputs** that produced them, rather than narrowly on **inputs** such as jobs and buildings.
 - ✓ Inputs are a means to an end, not the end.
 - ✓ Re-examine current ways of delivering services, considering the latest and possible near-future technology to produce better outcomes.
 - ✓ Use scientific evidence, not storytelling anecdotes. **See Pat Parfrey’s Medical model for consideration.**
- ✓ The focus should be on the **well-being** of people in communities.
- ✓ Over 20 years ago (1998), the Tobin government had a vision that introduced a social accounting system (Community Accounts) and a social audit (Joyce Hancock’s idea) of measuring and reporting RESULTS.

Possible Solutions (Part 3):

➤ No Solution is also possible:

❖ That is, we could Crash

- ✓ Effective Control given to outsiders, similar to Commission of Government in 1934.
 - ✓ A crash is a real possibility given apparent public indifference and understandable reluctance to change. Inertia is a strong force.
 - ✓ The greatest burden of a crash will fall on the young, particularly those with illiquid property assets.
 - ✓ Especially those in that group that are forced to move since property values may collapse.
 - ✓ Businesses which are reliant on provincial household markets may suffer heavy losses, especially outside the urban core.
 - ✓ The least affected should be seniors.

The Real Tragedy

- Is that policy-makers and public sector analysts did not recognize the inevitable cyclical price patterns of staples products.
- For at least the last 20 years, economists (including Herb Emery) have advocated an optimal fiscal policy of saving in years of abundance for famine. This advice has been met mostly with indifference and sometimes with resentment.
- Attempting to maintain provincial expenditure levels is understandable, but savings are necessary to make this strategy successful. Not doing so will lead to an economic crash without a savior.
- This is a “stabilization” strategy arising from prudent fiscal management, rather than a bailout from big brother in Ottawa.

Long Term Outcomes

- Adjustment impacts will be similar to resettlement in outport communities. Core age individuals who are resettled lose the most, but the very youngest and the eldest may be winners.
- The rapidly aging population with low fertility rates will imply labour shortages after the adjustment period.
- Given the small population with its vast resources and sense of community, in the long-run, individuals should face good economic opportunities with high levels of well-being.

Thanks.

Some controversial solutions offered to encourage thoughts and discussion.