

Addressing Nova Scotia's Fiscal Challenge

*An Executive Summary prepared by the
Nova Scotia Economic Advisory Panel*

for

Premier Darrell Dexter

Province of Nova Scotia

November 2009

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Written by members of the Nova Scotia Economic Advisory Panel:
Elizabeth Beale, Tim O'Neill, Lars Osberg, Donald J. Savoie

Summary

It is now customary for newly elected governments to ask for an independent review of the books. Nova Scotia's newly elected NDP government was no exception and, within days of coming to office, it asked Deloitte to undertake a review and analysis of the province of Nova Scotia's current and future financial position. The government also decided to establish a panel of economic advisors with a mandate to provide advice on establishing "priorities with respect to the fiscal challenge identified by the external audit, to address the current economic recession taking realistic account of the province's fiscal condition, and to provide strategic objectives and options to dealing with the federal government and for dealing with other Atlantic governments." The panel decided to focus on the first two issues, convinced that they were the more important ones and knowing that answers to them would invariably shape the government's response to the issues of dealing with other governments.

Modern means of communication enabled panel members to share information, exchange views and data, and remain in constant communication with one another throughout the exercise. Different viewpoints were presented by all four members, but we share some common beliefs. For one thing, all four panel members see a positive role for government in society. For another, we are all firmly of the view that progressive government cannot be built on a mountain of debt.

As the reader will see, Nova Scotia is confronting important fiscal challenges. The panel offers no easy solution because none exists. While we see potential for economic growth in the province, we are concerned with a significant drop in projected revenues from offshore royalties and uncertainties around federal government transfer payments, particularly for health care, beyond the current cost-shared agreement that will shortly expire. As is well known, the recent recession has played havoc with government budgets throughout the western world; here too, Nova Scotia is no exception. It is against this backdrop that the panel undertook a review of the province's fiscal condition.

In carrying out the review, the panel was able to draw on a number of resources for data and support. We want to express our gratitude to provincial government officials, notably those in the Department of Finance and the Treasury Board for their willingness to share information and to answer numerous questions. In all our meetings and in dealing with all our requests for information, they demonstrated a high level of professionalism. We also benefited from the work of Wade Locke at Memorial University and Mike McCracken of Infrometrica. Locke prepared a paper on future

revenue flows from equalization and from offshore energy, and McCracken reviewed the forecasting methods employed by the provincial finance department.

We also benefited greatly from Nova Scotians who made the effort to write to us or attend two focus sessions held in Halifax and Antigonish. The sessions proved extremely valuable to the panel, and they generated a number of ideas.

What We Heard

Individuals and organizations wrote to us to voice their opinions, and a number of Nova Scotians took the time to attend two focus sessions. We were fortunate in that we were able to hear from a cross-section of Nova Scotians, including the labour movement, the business community, volunteer groups, and representatives from the health and education sectors. We appreciated their contributions and we listened very carefully to what they had to say. They will see their input in the pages that follow.

The consultations were structured around the following four questions:

- Question 1: In your opinion, how important is it for the government of Nova Scotia to eliminate this deficit? If you agree that it should be eliminated, how quickly should this be done? If you think that it is not desirable to eliminate the deficit, how large a deficit is acceptable and for what period of time?
- Question 2: What measures are likely to be most effective in improving the fiscal position of the province? At what point should these measures be introduced?
- Question 3: What steps should the province take to introduce new programs or revamp existing programs in areas such as social assistance, education, health, tax reductions, and economic development?
- Question 4: A faster-growing economy in Nova Scotia could broaden the province's revenue base, thus improving its fiscal position. What immediate steps could the province take to improve its long-term economic prospects?

To be sure, many Nova Scotians are concerned about recent developments in the global economy and the state of the province's fiscal situation. They wrote or presented briefs to the panel or came to the two focus sessions armed with both ideas and a degree of optimism. It is not possible here to report in any detail what we heard from all the participants at the two gatherings and from those who wrote to us. However, we decided to present a summary, in point form, of the key points that were made:

- ▶ Some participants called on the government to articulate a vision and to promote “transformational change”—incremental change, one insisted, will not do.
- ▶ A number of participants focused their contributions on the high cost of delivering health care and education with the suggestion that measures should be introduced to limit growth in spending in these two sectors.

- ▶ Many stressed the need for greater accountability from those spending public funds. One participant insisted that “tax increases without accountability is unacceptable.”
- ▶ One participant cautioned the government against generating economic projections to 2012–13 because “we don’t know what the world economy will do.”
- ▶ Another suggested that the government should increase taxes on “things that contribute to poor health”; another urged increasing taxes “on very affluent people”; and still another suggested that the province “could occupy the 2 per cent HST that the federal government gave up.”
- ▶ There appeared to be consensus among the participants that the government should deal with the deficit problem over a three- to four-year period rather than to address it over the next 12 months or so. Indeed, no one recommended dealing with the deficit problem over the next 12 months.
- ▶ There is also consensus on the need to consult Nova Scotians widely in any effort to deal with the deficit and debt problem. A labour representative put it succinctly with the observation that the “government needs a plan that the public has brought into; otherwise, it will be thrown off course every time there is a protest against a proposed change.”
- ▶ There was, however, no consensus on how to address the deficit and debt problem. Some looked to tax increases, while others insisted that tax increases should be avoided, making the case that Nova Scotia needs to have competitive tax rates to prosper. A good number of the participants pointed to spending cuts provided they were carried out in an orderly fashion after consulting Nova Scotians.
- ▶ Some participants argued that the government should review how it delivers public services, insisting that important savings could be realized.
- ▶ Many participants stressed the importance of economic growth to deal with several public policy challenges, including the province’s deficit and debt problem.
- ▶ There was no shortage of ideas on how to promote economic growth, with most insisting that the government must play an active role. Some suggested measures to reduce the cost of doing business; others warned against a continuing depopulation of rural Nova Scotia; and still others stressed the importance of all facets of human resources development. Some urged the promotion of local markets, investing in the green economy, attracting new Canadians, placing new emphasis on Nova Scotia as a great place to live, and promoting greater coordination among the various federal and provincial economic development agencies.

What We Did

With limited time and limited resources, panel members decided to pursue in some detail four related issues and to divide up the work. Lars Osberg wrote a background paper on an issue of considerable importance to the current government: Delivering on “Making Life More Affordable for Nova Scotia Families”—an Economic Perspective. Tim O’Neill wrote on Assessing the Fiscal Challenges Facing the New Government;

Elizabeth Beale on Shaping a Path for Growth and Prosperity in Nova Scotia; and Donald J. Savoie on Reviewing the Expenditure Budget: Lessons Learned. All four papers are available on the government of Nova Scotia website.

Lars Osberg reminds the reader that the recently elected government pledged during the campaign to “make life more affordable” for Nova Scotia families. He maintains that pursuing an agenda of “affordability” need not be very costly and acknowledges that delivering a budget in the middle of a recession is no small challenge. Osberg reminds us that governments do much more than tax and spend, and he looked to “low-budget/off-budget” ways to promote affordability, help families meet family needs, and provide for tangible improvements in family well-being. He does not see much merit in selective sales tax exemptions, which he describes as economically inefficient as well as “very expensive and quickly forgotten.”

Osberg instead points to improved coordination of public service delivery, better regulation, and enhanced program delivery. As an example, he notes that well-functioning public transit is “a public service that saves private costs.” He maintains that “building public transit is sometimes an expensive and slow process, but it has long-run structural benefits and is particularly important for rural Nova Scotia.”

He argues that better coordination of services and “smarter” regulation are also important ways in which government can make life more affordable for Nova Scotia families, and he points to the need of young families for better integration of before-school and after-school child care. Osberg attaches a great deal of importance to *how* government delivers benefits to families and argues that policy innovation can enhance efficiency. He suggests, for example, that a review of labour standards legislation to provide for “unpaid family leave days to improve the security of family life” might provide significant benefits to employees, at little real cost to their employers.

Tim O’Neill explores in some detail the fiscal challenges confronting the government. He concludes that Nova Scotia is dealing with a structural deficit in the making, which he describes as a mismatch of the medium-term revenue and expenditure paths. He makes the case that even with a return to typical GDP growth levels for Nova Scotia, the province’s deficit will continue to grow if no changes to current taxes are made and recent expenditure growth trends continue.

O’Neill outlines a number of options for the government to consider in dealing with its fiscal challenges. He concludes that the government should not attempt to eliminate the deficit by 2010–11, but that it should put in place measures to balance the books over the economic cycle. He considers possible tax cuts, tax increases, and spending cuts. He recommends that the government should look to both new tax measures and selected

spending cuts as the way forward. More to the point, O'Neill maintains that "the only way to achieve fiscal balance by 2012–13 is either to cut spending significantly at some point over the next three years or to keep spending flat for a protracted period *and* combine that with material tax initiatives." He insists that doing nothing about the fiscal difficulties confronting the province "is not an option for the government."

Donald J. Savoie draws on the experiences of other governments to draw out lessons learned on how to review expenditure budgets. Governments will very often look to spending cuts as the way to deal with their fiscal challenges. Indeed, the federal and all provincial governments have launched program review exercises in recent years, and most, if not all, are planning new ones in the coming months. Few of the past exercises, however, have been able to live up to expectations.

The successful ones hold important lessons learned. Perhaps the single most important one is that citizens have to be part of the expenditure review process. They need to know that a problem exists before they are prepared to hear options. This calls for governments to lay out the facts on public finance as they are—no need for media spin specialists or costly communication strategies.

Savoie suggests that if expenditure reduction is the objective, the premier and Finance minister have to speak as one. The process to generate spending cuts should not allow for any end runs for ministers or others to appeal directly to the premier. To have any lasting impact, the process should go beyond across-the-board cuts, temporary hiring, or salary freezes and have a three- or four-year planning and implementation horizon. The process should involve relevant actors outside of government in the key sectors and also promote transparency in all things.

Elizabeth Beale provides a brief overview of the economic development challenges confronting Nova Scotia and outlines a number of suggestions for the way ahead. She calls for greater emphasis on growth and improving productivity, human resources development, and an improvement in the effectiveness of post-secondary education. Beale calls for improving the province's business climate and recommends a review of province's regulatory environment, improved infrastructure, and a sustained effort to improve coordination among the various economic development agencies.

Beale attaches a great deal of importance to workplace training and literacy as means of strengthening the Nova Scotia economy. She also calls on the government to redirect its investments to new technology and skills development and for the development of new partnership arrangements between the different orders of government and with the business community and labour.

What We Recommend

The panel is of the view that Nova Scotia is on an unsustainable fiscal path and that difficult decisions are needed to change course. One can make the case that annual deficits can constitute good public policy and this fiscal year is an excellent case in point. Structural deficits, however, are never good public policy, and we believe that Nova Scotia is looking at one in the making. In addition, Nova Scotia's current debt level, at \$13 billion and growing, sends wrong messages, and the cost of servicing it—currently more than 10 per cent of total provincial government spending—crowds out government activities from sectors that it should be more active in, from education to social welfare to economic development.

The panel is also concerned about Ottawa's future funding for health care and equalization payments. The federal government has its own fiscal challenges, and if history is to be a guide (see circa 1995–97), one can easily speculate that federal transfer payments will be reduced in the years ahead. In addition, we know that offshore petroleum royalties will drop off significantly in the coming years.

What to do? The panel views the province's fiscal challenge not simply as a problem but also as an opportunity for the provincial government to reposition the province's public policy and program structure. Public institutions and government-funded institutions, organizations, and programs must be subjected to rigorous reviews from time to time, if only to ensure that they are efficiently run and meet current socio-economic circumstances and requirements. History reveals that there is a natural tendency on the part of many in public-sector activities to leave well enough alone and avoid fundamental policy and program reviews.

The panel accepts the recommendation of Tim O'Neill, one of its members, that “doing nothing is not an option for the government.” We also agree that achieving fiscal balance by 2012–13 will require spending cuts and some tax initiatives.

Simply pointing to political will as the necessary ingredient to launch such reviews can never tell the whole story. Political will does not grow in a vacuum. As we already noted, citizens need to appreciate that a problem exists before they will consider options to solve it. On this point, we can do no better than once again quote a labour representative at one of the two focus sessions when he observed that the “government needs a plan that the public has brought into; otherwise it will be thrown off course every time there is a protest against a proposed change.” In brief, any expenditure review exercise must be prepared in full consultation with Nova Scotians to have any chance of success. More to the point, it cannot be produced by a handful of politicians and senior public servants in a government boardroom in Halifax.

It is important to recognize that if federal transfers are reduced and if provincial tax rates are unchanged, the total revenue of the province of Nova Scotia will shrink over time as a percentage of provincial GDP. Hence, balancing the budget over the economic cycle means a diminishing role for the public sector in Nova Scotia unless the provincial government increases own-source tax revenue to offset the withdrawal of federal funds. It is also important to recognize that each Nova Scotia family is likely to be affected somewhat differently by the individual cuts to public services and the specific tax increases that will be necessary to reduce or eliminate the deficit over time. The fairness of the deficit reduction process as a whole depends on how these service cuts and tax increases add up in over-all impact on the distribution of income.

It is beyond the scope of the panel's mandate to put forward detailed proposals for specific tax increases or spending cuts, or to propose the sale of certain government assets. The following are the panel's recommendations for a broad approach to the fiscal management and economic development challenges facing Nova Scotia:

1. The government of Nova Scotia is looking at a substantial structural deficit, which means, even with a return to normal GDP growth, both year-over-year deficits and the long-term accumulated provincial debt will continue to grow if no action is taken. It is the panel's view that the government of Nova Scotia should pursue both tax increases and spending cuts and promote an economic growth agenda to deal with the province's deteriorating fiscal position.
2. The government should not attempt to eliminate the deficit by 2010–11, but adopt a more gradual fiscal strategy to avoid slowing the economic recovery and destabilizing needed public services. The panel recommends that the government aim to erase the deficit by fiscal year 2012–13 and urges the government to implement tax increases, introduce significant spending restraint measures, and focus more on economic growth to achieve this goal.
3. Among possible tax measures, the government should explore taking up the 2 per cent HST points that the federal government recently vacated, with appropriate protection for low-income families and individuals. The government should also consider an increase in personal income taxes.
4. The panel supports the province's decision to rescind the balanced budget legislation and urges that it not replace it with another rigid fiscal rule.
5. A comprehensive consultation process should be put in place to enable Nova Scotians to understand the nature and scope of the problem.
6. To guide the government in addressing economic and policy challenges, the government should explore the option of establishing a Premier's Council on the Economy comprising leaders and key spokespersons for the business, labour, and voluntary sectors. The Council could be modelled on successful examples from the past in Ontario, Québec, and, more recently, Manitoba.

7. The government should explore “low-budget/off-budget” measures to deliver on its commitments to promote affordability in meeting family needs.
8. The government should review its public service delivery mechanism to promote better coordination and review labour standards to provide for unpaid family leave days.
9. The premier should launch a program review exercise that involves consultations with Nova Scotians. The review must be led with firm hands by the minister of Finance, with the premier’s full support.
10. The program review exercise, to have any significant and lasting impact, should go beyond across-the-board cuts, temporary hiring, or salary freezes.
11. In launching a program review exercise, the government should establish a three- or four-year planning and implementation horizon. The purpose of a significant review exercise is to change the shape of the government’s expenditure budget. This requires senior government officials to take the long view and to redesign their programs and operations.
12. The government should define a process to consult relevant actors in the key sectors of health care and education in search of more effective and efficient spending. These two departments have large expenditure budgets, and past attempts to reorient them have met with modest success. If the goal is to reorient the two sectors in any meaningful fashion, it is vitally important to involve representatives of the health care and education communities. That said, to have any chance of success, the rules of the consultation process have to be laid out at the very outset: given the province’s fiscal situation, it should be made clear that the goal is to promote greater efficiency in the spending of public money in both sectors.
13. One measure to promote transparency would be to produce economic and fiscal forecasts every six months and ensure wide distribution with a view to encourage public discussion.
14. The government should encourage transparency in all things if it wishes to launch a meaningful program review exercise. A lack of transparency is quickly revealed and is all too often interpreted as masking a hidden agenda or special treatment for someone, some departments, or some communities.
15. A program review exercise should be guided by a series of questions for *all* departments to answer. The questions should, among other things, centre on affordability, impact on economic growth, fairness, and whether programs or policy goals can be achieved through other means.
16. The government should promote a stronger business climate in the province through strategic infrastructure investments, improvements in the regulatory environment, and more effective coordination of its economic development agencies.
17. The government should overhaul the province’s economic development agenda by focussing on human resources development, including literacy, and on high-growth sectors and firms.

18. The government should focus its future economic development on strengthening the province's productivity performance and on developing a highly skilled and adaptable labour force.
19. Nova Scotia shares a public policy challenge with the other three Atlantic provinces: a serious vulnerability to changes in federal transfer payments. It is easy for one to speculate that there are rough waters ahead, given Ottawa's own deficit problem. The four Atlantic provinces have a much better chance of securing a proper hearing in Ottawa if they are able to develop a common strategy and speak with one voice on the future of federal transfer payments, particularly for health care.