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10 YEARS OF RAISING DEBATE AND PROPOSING POLICY ALTERNATIVES

The Sky is Falling. The Sky is Falling. Or is it?

The NDP Government's Independent Review of Finances an Exercise to Kill Expectations.

Larry Haiven

At the Nova Scotia NDP government's first cabinet meeting on June 22, Premier Darrell Dexter announced that the government would commission an independent review of the province's finances[1]. The new government budgeted $100,000 for the review which would start on July 6, produce an interim report in August and make its final report in October.

Why would the government, which has the resources of its own Department of Finance as well as the province's Auditor General at its disposal, order such a costly review? What will the government gain that it would be missing from those other two sources? Why did the NDP government decide to launch its first major public foray into economic policy with a technical report by mainstream accounting firm Deloitte Touche?

Liberal leader Stephen McNeil questioned the spending of funds during a time of economic hardship and wondered why the Finance Department could not provide the same information for free. Tory spokesperson Cecil Clarke wondered why the finance department or the Auditor General could not provide this service and suggested that the new government was embarking merely on a political exercise[2]. He was implying that the government's aim was not primarily to clarify the province's finances but rather to advance its own political agenda and make the former Tory government look bad.

Premier Dexter gave a less than convincing answer "Having the opportunity of having more than one perspective I think better informs your decision-making[3]."

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Saskatchewan 1991: Another Independent Review

To glean some reason for the government's actions, it instructive to look back not that many years ago to another newly-elected NDP government.

The NDP led by Roy Romanow swept into office in Saskatchewan in October 1991, at the height of a severe recession, defeating a highly unpopular Progressive Conservative government under Grant Devine[4]. Within a month the new government had commissioned Don Gass, a Saskatoon chartered accountant, to convene the "Saskatchewan Financial Management Review Commission" and deliver a report on the province's finances. It is has become clear in the intervening years that the purpose of the report, delivered three months later, was to portray the province's finances in the direst possible light.

Why would the government want to paint such a picture of their own financial state? In a book published in 2003, about her time in the NDP cabinet (she was also later Saskatchewan's Finance Minister,) Janice MacKinnon championed the government's motivation behind the commissioning of the report. Soon after the 1991 election, she reported, "looming on the horizon…was the NDP convention, where the party faithful who had worked so hard to get us elected would be passing resolutions telling us to spend millions of dollars rebuilding the New Jerusalem after Saskatchewan people had endured nine years in Devine's wilderness."

According to MacKinnon, it was necessary "to curb the New Democrats' appetite for new spending." So the first target of the campaign was the NDP's own membership.

The second target was the general public. Portraying the province's financial situation in the starkest terms would be "the opening volley in a campaign to prepare the public for a very tough 1992 budget." As for the Gass Commission, it was necessary to arrange "…the appointment of an independent body to report on the magnitude of the fiscal crisis so that there would be support for the solution…..". Added MacKinnon, "It reflected the need to establish credibility with a cynical electorate[5]."

Among those whose expectations needed especially to be tamed were the public sector unions, particularly the Saskatchewan Government Employees Union (SGEU), the Canadian Union of Public Employees and the Service Employees International Union, who represented direct government workers and those in the broader public sectors like education and health care. Wrote MacKinnon, "The [SGEU], for example, depicted the fiscal crisis as nothing more than a bogeyman that was being used by their employer, the government, to get the employees to accept a wage freeze[6]."

Consensus Building For Drastic Measures

But the question was never whether the province was running large deficits, or had accumulated a large debt, or needed to develop a serious plan for handling the two problems. There was already considerable consensus on that, even on the left.

The real question was first, how big the problem was and second, how drastic the solution needed to be. The Gass Commission delivered: it said that the problem was big, almost insurmountable, and the solution had to be drastic. And these conclusions were instrumental in delivering a strong consensus for whatever bitter medicine the government decided to administer.

The Commission reported a provincial budget deficit three times the estimate made by the previous government. and a debt (the accumulated deficits) twice as high. The commission concluded that the province was in an "extremely serious financial situation," that the province's ability to raise revenues to remedy the situation was negligible, that the public sector infrastructure was insupportable and that there was no alternative but to reduce the province's overall level of expenditures[7].

The way the Report was commissioned was a piece of political genius. It was ostensibly to be a mere accounting of the province's books, But the goal and the result were almost purely political.. The new government's own warnings prior to February 1992 had had some impact but many saw these as political posturing. However when a seemingly "independent" report declared financial armaggedon, it would be no exaggeration to say, widespread panic ensued. It was as if the entire discourse on the province's finances had been plunged into political liquid nitrogen. When Premier Roy Romanow announced that Saskatchewanians would have to tighten their collective belts, there was little opposition. The business community and right-wing interest groups applauded. When the opposition parties and public sector unions raised questions, they were ridiculed. The consensus gave the government a unique opportunity to initiate almost without objection a series of harsh measures for which it would otherwise have elicited widespread criticism, if not condemnation.

The government eliminated hundreds of civil service positions. It cut payments in health, education and to municipalities, including children's dental care and the provincially-subsidized drug plan . It closed 52 of the province's 132 hospitals[8]. Government departments and public sector organizations shrank their budgets. Government operating spending dropped dramatically for the next several years[9]. For example, health care spending as a proportion of Gross Domestic Product (GDP) shrunk from almost 11% in 1992 to just over 8% in 1996 and even declined in current dollars in that period[10]. Education spending dropped by over 10% in real terms between 1991 and 1994[11].

Public sector employers, including the government, arrived at bargaining tables demanding their unions accept compensation cuts or freezes (which inflation rendered into cuts.) Public sector unions, sensing a lack of member resolve (which the Gass Report had helped to generate) responded weakly to these demands.

The Romanow government also used the crisis to break a long-standing axiom that taxes could not be raised outside of wartime. It introduced a suite of temporary hikes, including a personal income surtax, higher taxes on large corporations, increased fuel and tobacco taxes and an increased provincial sales tax.[12]

The "crisis" did not last long. A mere three and a half years later the financial near-death experience had transformed into a miracle. "Bankrupt" in 1992, by 1995 the province was the first in Canada at the time to have balanced its budget. The effect of spending cuts and tax rises would soon combine with an improving economy to produce a landslide of surpluses.

While many of the cuts were never fully restored, the government found a use for the run of almost-embarrassing surpluses. In 1999, the government carefully chose another commission to review and make recommendations on the province's personal income taxes. Chaired by an accounting professor and two accountants working for major financial firms, the committee did what was expected and recommended deep cuts, indeed the largest personal income tax reductions in the province's history and the third-lowest marginal personal tax rate in Canada[13]. Again, Saskatchewan was among the first jurisdictions in the country to do this. A similarly-loaded committee recommended deep corporate tax cuts a few years later.

Thus, over a decade, the NDP government was able to do what nominally more right-wing governments could only dream of doing. Indeed it was able to do this precisely because it was the NDP. From the time of Tommy Douglas, Saskatchewan had been a leader in Canada in social innovation. It was here that the Medicare system and public hospitals were first developed and incubated before they were adopted nationally. It was here that public automobile insurance, homemakers' pensions, a children's dental program, a world-beating education system and an impressive array of crown corporations were spawned, uniting the co-operative ethos of its citizens with a growing bounty of resources.

But after 1991, the Saskatchewan NDP went in the other direction. A decade later it had succeeded in shrinking the size of government by close to ten percent[14]. When the NDP was finally defeated by the neoconservative Saskatchewan party in 2007 most of the heavy lifting was done. In other words, through a series of measures, especially tax and royalty cuts, the NDP precipitously decreased government revenues as a proportion of the province's GDP. This meant that the government had less capacity, as a proportion of the province's total wealth, to deliver programs and services like health care, education, social services, roads, parks and all the other amenities of a modern state. Moreover this was done over a period, not of provincial economic difficulty, but of growing prosperity, wherein the province emerged from "have-not" to "have" status.

Was the province's crisis as severe as the Saskatchewan NDP government and its Financial Management Review Commission said it was? And was the remedy more brutal than it needed to be? Of course, the two questions are linked. If the crisis was less severe than reported, then the remedy was more brutal than necessary. But there is not a linear connection between the two. There is a point below which the report would not necessarily have brought about the panic it induced, the consensus it generated and the solution it justified. Above that threshold, all bets were off.

The fact that the government was able to go from touted economic catastrophe to celebrated economic miracle so quickly should make us suspicious about how calamitous the situation was in the first place.

Economist's Critique Of Gass

In fact, a closer critical look at the Gass Report suggests that its methodology was seriously flawed. Soon after the Report's release, the National Union of Public and General Employees and its provincial affiliate commissioned University of Prince Edward Island economist James Sentance to critique the Report. The resulting analysis reveals how differently an economist and an accountant can view the same situation.

Sentance concluded that the Gass Report had vastly inflated the severity of the crisis. Using his own reckoning of the province's finances, he concluded:

"Overall, the Province's current finances demonstrate no alarming tendencies, no evidence that debt financing will soon push expenditures to the point where infrastructure would have to be cut further to match available revenues[15]"

For the public finance novice, a deficit is an annual figure and occurs when the government pays out (expenditure) more than what it takes in (revenue). If the government has higher revenue than expenditure in any year then it generates a surplus. Debt is the sum of the deficits that it has not paid off. Interest costs on the debt are part of the government's annual expenditures. The greater these "public debt charges," the less money the government has in any year to pay for other important things. While governments cannot go bankrupt like citizens or businesses, a high ratio of debt to the province's annual income (GDP) will cause the interest rates to rise as lenders see the government's ability to pay as more risky. It may also make it harder for the government to borrow new money for needed projects and infrastructure.

The Gass Report abandoned existing methods of calculating government debt and deficits, said Sentance. Gass included as expenditures things that hadn't been counted before, either in Saskatchewan or elsewhere, and discounted the province's ability to raise revenues to match those expenditures. Sentance warned that "this has raised the perception that the fiscal position of the province has been altered radically for the worse, when what has really happened is that they have radically altered what is being measured."

An example was counting the province's unfunded pension liabilities as a current expenditure. If the government owes money to the pension fund, it will have to pay it at some point. But owing it at some point is not the same as owing it now. Counting now what we need to pay to the pension plan to cover employees' retirement in, say, fifteen years is neither necessary nor wise.[16]

Inflating the deficit and debt in this way, Sentance claimed, "have only limited applicability to the current cash flow of the Province, and perhaps less if any to the more pressing question of what direction Government finances are moving in. Pension fund liabilities do not reflect curent cash flows or borrowing obligations, and stated as they are in the Gass report, just make the numbers look considerably more intimidating than the reality… It is important to note… that the deficit has not suddenly gone up, just because of accounting changes."

Sentance also pointed out that governments count liabilities (what they owe) but, unlike businesses, they do not count assets (what they own, like buildings and machines and and public infrastructure.) Even if governments have debts they see as onerous, or run into a cash-flow problem, they can reduce their debts or come up with more money by selling assets. Businesses do it all the time. The CBC did this recently to deal with a shortfall in revenues and the refusal of federal government to bail them out — they sold off some of their buildings. These are drastic measures, to be sure, but to assume that they cannot be done is irresponsible.

Sentance also faulted the Gass Commission for ignoring that the economy was in recession. Recessions incur abnormal pressures on government finances. Tax and other provincial revenues are drastically down because businesses and people are making less money. Transfer payments from the Federal Government are also down because the rest of the country is also suffering from the recession. At the same time, government spending on social assistance and social programs to help people out is up. This inevitably makes the deficit situation worse.

But recessions do end. When they do, revenues go back up even if tax rates remain the same, while those "rescue" expenses go down. As the economy improves, the government might even be able to raise some taxes if it wanted to reduce the deficit even faster. But if you take a snapshot of revenues and expenditures at the lowest point of a recession and use that to predict the future, that future will appear very bleak. Sentance faulted Gass for not drilling down below the recession to look at the province's underlying economic structure. He also criticized the Commission for taking as a bedrock assumption that taxes could *never* be raised, even temporarily. That assumption made the situation appear even worse.

Applying drastic measures to an economy during a recession can actually make the recession last longer, Sentance warned. Recessions involve a radical drop in people's ability and willingness to purchase goods and services. If the government cuts services and income supports, it makes the situation worse.

Another danger in overstating the province's economic problems is the reaction of the bond-rating agencies. These organizations assess a government's capacity to pay the interest on its loans. If the province's economy appears worse, raters will downgrade their assessment and lenders may charge more interest. Anything that makes the government's situation look worse can influence the bond-raters to drop their ratings, thereby potentially costing the government more money than it would otherwise have paid.

As it happened, the underlying economy of Saskatchewan was strong, stronger than both the government and its Commission were willing to accept or admit at the time. The recession ended and Saskatchewan did turn its deficits into surpluses and reduced its debt. Had the government resorted to less drastic measures, the same result would have happened, only somewhat slower. Instead of balancing its budget in three and a half years, it might have taken four and a half years or even five. But had it opted for less drastic measures, it would not have been able to cut so many programs, to generate such strong surpluses year after year and to cut taxes so sharply. In short, it would not have been able to shrink the role of government in the economy so radically.

Conclusions

What can the actions of another NDP government fifteen years ago possibly tell us about Nova Scotia's new government? The details of an independent review of finances are not as important as its impact. The purpose of the Saskatchewan's review was to make the financial situation appear as grave as possible and give the government political room to lower expectations, especially among the NDP's membership and traditional constituency including the unions. And no doubt the purpose of the review here is to give the NDP in Nova Scotia political room, which it desperately needs.

During its several years as "government-in-waiting" the NDP made promises and took policy positions that would make it very difficult to maneuver as government-for-real. That's not to say that the NDP made many promises. It was very careful not to commit itself to policy but rather preferred to quietly wait for the Conservatives to defeat themselves while the Liberals floundered.

However, the NDP did box itself in. It has long promised balanced budgets. This became unsustainable as the recession hit. Even the ruling Tories were forced to engage in deficit spending. Their government tried to hide it with a last-minute re-direction of offshore accord revenues, which had earlier been pledged to debt-reduction. There was nothing economically wrong with this move. Governments can and must change priorities in this way, especially as circumstances change. The problem was that it contravened a law the Tories had brought in to cut government's economic flexibility. It was enough to provoke mock outrage by the opposition and trigger an election. Once elected as the government, the NDP could hardly pull the same stunt. At least not without a good excuse.

In these days, even the most die-hard conservative politicians, such as Stephen Harper, have succumbed to the necessity of a counter-cyclical stimulus package and new deficits. But the NDP kept on insisting throughout the election campaign that it would balance the budget. No government could avoid a deficit, maintain current levels of public spending and keep taxes where they are. Yet the NDP claimed it could do all three. Now it is looking for a way out of this dilemma. What better way than to call for an independent review of finances, declare a fiscal emergency of unexpected magnitude, and announce that, sorry folks, all bets are off. If that is the case, their previous actions show that the NDP in Nova Scotia may be poised to go the same route as the NDP in Saskatchewan did in the early 1990s, namely, choose spending cuts over other options.

As for taxes, Darrell Dexter and the NDP under his leadership have long been against any kind of tax increase, even to reduce a deficit incurred from fighting a recession. Indeed, in 2003 they supported the Hamm Tories when that government brought in a tax cut. Having achieved a razor-thin surplus the previous year, Hamm moved to fulfill one of his election promises. So desperate was he to cut taxes immediately that he mailed a $155 cheque to every taxpayer in the province. The political rewards he anticipated did not follow. The Halifax Chamber of Commerce denounced the tax cut and called for the surplus to be directed to debt-repayment. The Liberal Party opposed the tax cut as well, saying it was irresponsible to squander a precarious surplus. The Canadian Centre for Policy Alternatives showed how the tax cut would favour the wealthy, men and those living in the Halifax Regional Municipality at the expense of the poor, the regions and women[17]. Only the NDP supported the tax cut and lashed out at its critics.

Support for the tax cut revealed deeper problems in the Nova Scotia NDP and Darrell Dexter. As this author wrote at the time:

"In supporting the Tory tax cut, the Party leadership exhibited ignorance of rudiments of the Nova Scotia economy. The Party leadership has effectively talked itself into a corner full of right-wing tax slashers, public sector shrinkers and privatizers and has disillusioned those who think the NDP should be different than the old-line parties with their slick opportunism and reckless mudslinging[18]."

A serious look at Nova Scotia's finances would have shown the NDP that tax cuts were not only bad politics but bad economics as well in an economy as precarious as ours. The Alternative Provincial Budget produced by the Canadian Centre for Policy Alternatives has shown for several years that Nova Scotia has the smallest government sector in Canada. Our government's "own source revenues" (the revenues we raise exclusive of federal transfers) are smaller as a proportion of GDP (our collective wealth) than any other Atlantic province. Our per-capita and per-GDP spending on programs is the lowest in the country. Far from having an expenditure problem, as right wing critics insist, Nova Scotia has a revenue problem[19]. Tax cuts would shrink the government even farther, seriously harming our economic capacities.

The current NDP government must find a way to wiggle out of its self-imposed problem, and it may try to do so by generating a sufficient sense of "financial crisis" for their supporters and the public more broadly to excuse budget deficits, tax hikes, and/or (possibly) public sector spending cuts. The problem with relying on the Finance Department to do this work is that it was at least partly responsible for the budgetary predictions of the former government. The government of the day cannot expect that the Finance Department would change its own long-accepted accounting methods just to make the financial situation look worse. And despite attempts by both the Finance Minister Graham Steele and his deputy Vicki Harnish to publicly make up after a bitter fight last March, tempers are no doubt still frayed on both sides. The mandarins at Finance could not be trusted to deliver the kind of report the new government wanted.

As for the Auditor General, he is even more independent than the Department of Finance. Accountable directly to the legislature rather than to the government, he is even more unpredictable than the Department.

Will the Deloitte Touche report be as apocalyptic as the Gass Report in Saskatchewan? Much depends on the instructions given by the government. The authors may find it difficult to find as much profligacy by the MacDonald government as Gass found in the Saskatchewan Devine regime. But Deloitte Touche need not find sources of as-yet-undiscovered budgetary shortfalls as huge as did Gass. An altered assumption here, a recalculation there, and it should not be too difficult to show that Nova Scotia's finances are worse than hitherto acknowledged. After all, the point of the Gass Report was not so much *how* Saskatchewan's finances were worse but *that* they were worse, to change the discourse by generating a pervasive sense of financial urgency that can excuse extraordinary measures by a government that, they say, would act differently in "ordinary" circumstances.

With all the talk of doom and gloom, it's too easy to forget that Nova Scotia is 63 percent richer (in GDP per capita) than we were twenty-five years ago[20]. Dig just a little deeper than the current financial problems, and we find that the province's people actually have a stronger capacity to accomplish great things individually and through our government than we did a quarter century ago.

As they discuss their report on the province's finances, the NDP government will no doubt refer to Tommy Douglas in Saskatchewan. They may remind people, as have countless Conservative and Liberal politicians, that Douglas insisted on balancing his province's books as one of his first priorities. But Tommy Douglas was not just about balancing budgets. To make a fetish out of this one fact disgraces the man's name. Tommy Douglas had social imagination; he had great ideas of what he was going to accomplish, like medicare, public automobile insurance, rural electrification, children's dental care and many more. He announced these things publicly and lifted people's spirits in the promise of what they could do collectively. He and his immediate successors took on the vested business and professional interests and rallied people to demand better. In recent years, NDP governments across Canada have been all about dampening people's spirits, especially the party grassroots. The NDP promise has become a promise of better management of crisis. Will the Deloitte Touche report be just another weapon in that arsenal?

Rather than kicking off its first major discussion of public policy with a closed technical exercise by an accounting firm that will deaden our spirits, the NDP government should have opened up the discussion with a democratic forum that drew its inspiration from the NDP's greatest strength — its connection to the grass roots, that balanced economic realities with the real needs and aspirations of the people of this province.

Notes

1 Smith, Amy. 2009. "A peek into province's books: Dexter announces independent review of finances to start on July 6." *Chronicle-Herald*. A1

2 Ibid.

3 Ibid.

4 Several cabinet members of the Devine government were later convicted of fraud relating to expense accounts, including Deputy Premier Eric Berntsen. Devine himself was not part of this group.

5 All quotations above from MacKinnon, Janice. 2003. *Minding the Public Purse: The Fiscal Crisis, Political Trade-offs, and Canada's Future*. Montreal, McGill-Queen's University Press. 99–100.

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10 Hickey, Daniel. 2005. *Health Spending in Saskatchewan: Recent Trends, Future Options*. The Saskatchewan Institute of Public Policy.

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12 De Clercy Cristine. 2005. "Leadership and Uncertainty in Fiscal Restructuring: Ralph Klein and Roy Romanow." Canadian Journal of Political Science, 38(1):175–202.

13 Saskatchewan Hansard. 2005. Comments of Harry van Mulligan, Minister of Finance. Nov. 24

14 In 1991 Saskatchewan government revenues were 28.28% of the province's Gross Domestic Product. By 2001, they were 25.55%. (Sources: Statistics Canada: CANSIM Tables 379–0025 and 385–0002.

15 Sentance, James. 1992. "Critique of the Gass Commission Report." typescript

16 An example of this kind of accounting problem is happening in the current economic downturn. If I have $10,000 invested in the market and its value has declined to $5,000, do I "write off" $5,000 as an expense right now? Or do I wait to see if my investment regains its value? If I expense it now, my financial situation will look worse.

17 Jacobs, John. 2003. "Who Really Benefits from Nova Scotia's Income Tax Cut (Part 1): The Distribution of the Nova Scotia Tax Cut by Income." Canadian Centre for Policy Alternatives – Nova Scotia. July 1; and Jacobs, John. 2003. "Who Really Benefits from Nova Scotia's Income Tax Cut (Part 2): The Distribution of the Nova Scotia Tax Cut by Gender and County." Canadian Centre for Policy Alternatives – Nova Scotia. July 1.

18 Haiven, Larry, Judy Haiven and Max Haiven. 2003. "Supporting The Tory Tax Cut – A Betrayal By The Provincial NDP Leadership." typescript

19 Canadian Centre for Policy Alternatives – Nova Scotia. 2003. "Nova Scotia Alternative Provincial Budget 2002–2003."

20 Dufour, Mathieu and Larry Haiven. 2008. "Hard Working Province – Is It Enough?: Rising profits and falling labour shares in Nova Scotia." Canadian Centre for Policy Alternatives – Nova Scotia. November.

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