

Budget Season

Bill Black
New Start Nova Scotia
Revised 27 September 2012

Originally published in New Start Nova Scotia
www.newstartns.com
January 2012

FINDING A WAY FORWARD

September 27, 2012

The resurrection of the deal with Stern on September 22 came as a considerable surprise. It will be even more surprising if it lasts for more than ten years without Stern asking for another handout.

There are two principal differences from the deal that collapsed the previous day. First, the \$40 million that was to be a repayable loan will now be “earned” as long as the mill makes the expected electricity purchases from NSPI.

Secondly, a different arrangement is proposed to take advantage of the mill’s most valuable asset—its past tax losses. These can be used to reduce tax on future income by pooling Stern’s other properties in Canada with the mill. Nova Scotia will share in this bounty. If all goes well it is estimated to be worth \$52 million to the province over the next ten years and \$110 million to Stern, with lesser amounts possible in subsequent years. This is in addition to the



subsidies of \$124.5 million that the company will receive from the province. For this, Stern will pay \$33 million.

So Stern, which appears to have little of its own money at risk, will benefit to the tune of about \$200 million over the first ten years, an average of \$20 million per year. Unless the market conditions for the mill improve a great deal over that decade, more subsidies will be demanded.

A breathing space has been purchased at very considerable expense. Government should use it to facilitate development of new industries with good future prospects, first and foremost in Cape Breton.

The best economic opportunities going forward will be those that take advantage of natural assets, with capable proponents who are willing to risk substantial amounts of their own capital:

- 1) The proposed Melford terminal is being advanced, albeit slowly, by a credible group that has spent a lot of their own

money without so far requesting any financial support. Their recent decision to finalize land purchases in Guysbrough County is further evidence of their serious interest. Government should be willing to help with infrastructure, for example with the rail connection, and by accelerating regulatory processes. In sharp contrast, the Sydney harbour dredging project has consumed \$38 million of taxpayer money without any evidence of serious private sector participation.

- 2) Likewise the Cabot Links resort is being led by one of North America's most successful golf course developers. Again, a lot of private money is being invested. Cape Breton has the possibility of becoming a major golf destination. Government should be willing to help with infrastructure but should not subsidize operations.
- 3) Extractive industries are fuelling all of the best performing provincial economies. Government should actively promote itself as open for business for mining as well as oil and gas exploration,

including appropriately regulated fracking. One of the best investments by government in recent memory was the Play Fairway data gathering on offshore oil and gas prospects, which led to Shell's recent spending commitment of almost \$1 billion, with further possibilities to come. Perhaps a similar onshore survey could be done for both minerals and hydrocarbons, starting in Cape Breton .

- 4) Corporations making major capital commitments have choices about where to do business. Government should seek to minimize taxation, keep electricity rates low, and avoid labour legislation that distresses major private sector employers. If the environment was more attractive the Michelin announcement might not have been cancelled.

None of this will produce quick results, which is why it should have started a year or more ago. The lessons from the Newpage mill should extend to every aspect of government activity and every part of the province. Government must focus its efforts on industries with good future prospects.

CORRECTION REQUIRED

August 30, 2012

Alert reader David Wallbridge has spotted a flaw in my column of Aug. 23. In that article I had said that the province's "net debt" increased by 26 per cent. That was a mistake. The number that increased by 26 per cent is the "net financial market debt."

No doubt many professional accountants noticed the same error but failed to show his initiative in pointing it out. Perhaps that was because they recognized that the wrong label was attached to the right number.

For taxpayers, the net financial market debt is the number that matters. It represents the total amount for which lenders will expect repayment with interest.

Why is it different than the net debt? Because net debt does not count money that was borrowed to build things like roads and schools. But the lenders who provided that money have the same expectation for repayment. Governments of all political stripe are thus rather enthusiastic about such projects, since they can get the political benefit now while paying little for it before the next election.

So as of March 31, 2012, the principal amount that Nova Scotian taxpayers will be paying back to lenders in future years will be 26 per cent higher than it was on March 31, 2009, not 7.5 per cent as Wallbridge's Aug. 26 letter to the editor would have it.

Fortunately, today's low interest rate environment means that interest rate costs have gone up only four per cent, so far. This has, as asserted in the Aug. 23 article, meant a saving for government of about \$180 million in the coming fiscal year.

But at some point rates will start to go up again. When they do the government of the day will complain bitterly that interest costs are going up for reasons beyond their control.

Counting only some of their debt is one of the things that has led to financial crises in the European periphery (unaffectionately known as Club Med) and several American states and municipalities.

I will pay more attention in future articles to correctly label important information. As a taxpayer who has been saddled with 26 per cent more government debt over the last three years, Wallbridge (and others) may want to pay more attention to the information that matters.

BALANCING ACT

August 23, 2012

When asked recently about the prospects for balancing the budget in 2012-2013 Finance Minister MacDonald sounded less than confident that she would succeed.

It is fashionable for Finance Ministers to worry aloud (e.g. Flaherty) or moan (e.g. Steele, MacDonald) about the fragile state of the economy. In fact, Canada has done rather well since early 2009, especially in comparison with other advanced economies.

Unfortunately, Nova Scotia has not shared equally in the recovery. For example, in 2011 while Canada as a whole grew 2.6%, our economy grew only 0.3%, ranking 9th overall. The leading provinces benefited from resource developments where Nova Scotia may have less opportunity than say Newfoundland, Saskatchewan, or Alberta. But with the notable exception of aquaculture, where the government has provided stalwart support, there has been little encouragement for the resource industries that are making other provinces thrive.

Rather than seeking a suitably rigorous regulatory regime for onshore oil and gas exploration, Nova Scotia has joined governments in Quebec and a handful of other jurisdictions in declaring a moratorium on fracking. Meanwhile communities from Pennsylvania to North Dakota to Western Canada have been prospering because of this technology.

The government has pursued a variety of handouts which have mostly performed badly: \$5.5 million for Scanwood just weeks before it went bankrupt, \$60 million for DSME Trenton which at present amounts to about \$1 million per job, \$15 million to dredge Sydney Harbour for no jobs at all, and well intentioned but poorly managed efforts to prop up the pulp and paper plants.

Other government initiatives have been unhelpful. The first contract arbitration legislation sends an employer-unfriendly signal to potential investors. Targets for renewable electricity generation that are not needed to meet greenhouse gas goals contribute to uncompetitive power rates. Government seems to be unable to connect the dots between these policy initiatives and their impact on jobs.

Although it bears partial responsibility for weak jobs growth there are some issues over which government has little control.

The challenges facing the pulp and paper industry extend far beyond Nova Scotia's borders.

The price of natural gas has been plummeting, reducing the level of royalties from existing wells and discouraging ongoing production, let alone further exploration. This will mean a further loss of \$100 million in revenue in the next fiscal year. While the prospect of Shell finding offshore oil is exciting (and kudos to the current and previous governments for enabling the exploration) it will be a decade or more before exploratory success could translate to government revenue.

On the other hand governments across Canada are enjoying a prolonged period of exceptionally low interest rates. Although our net financial market debt has grown 26% since 2009 our interest costs have grown less than 4%. Had rates remained the same our borrowing costs would have gone up by about \$180 million. This favourable environment is likely to continue as more and more of our debt is renewed at low rates.

In future years, the benefit from low rates will be as big as or bigger than the loss of revenue from offshore gas. The relatively poor job performance is in part a self-inflicted wound.

Whether or not the balanced budget promise is fulfilled is thus primarily a function of the choices over which government has full control.

This column has looked at the external economic environment and related government actions. Next will be an examination of government's spending choices.

BUDGET REVIEWS

April 5, 2012

Minister Steele's budget landed on carefully prepared terrain. Like his federal counterpart, he

had issued a series of dire warnings, making the final product seem comparatively mild. In fact, all of the bad news was old news while the new information was mostly positive.

The previous provincial and current federal governments deserve much of the credit. Income from federal sources will increase by \$220 million. Equalization is up sharply because of the success of other provinces which have been exploiting their natural resources and was further enhanced by a special arrangement negotiated by the MacDonald government. Federal health transfers are going up far more rapidly than provincial spending. The same is true for social transfers.

Debt servicing costs are well below previous expectation because of historically low interest rates. The province has done well to lock these in by increasing the proportion of its debt financed by long term bonds.

Cuts to schools and universities persist, and health care spending is severely restrained, although not cut as previously forecast.

The prospect of deficit elimination and gradual phase out of the HST increase are both welcome, even if substantially aided by events over which the current government had no influence.

But in two areas this budget is an admission of failure.

Previous budgets had forecast a reduction through attrition of 1,000 civil service positions. In fact there are more civil servants today than when the government took power. There appears to have been no plan to achieve this reduction, which would save perhaps \$100 million per year.

Secondly a large and growing pension adjustment is forecast. This is the additional amount taxpayers are providing for civil servant and

teacher pension funds, even after the recent \$536 million bailout. Over the next four years the budget forecasts a further \$420 million of expense to taxpayers with no corresponding employee contribution. Meanwhile the Ontario and Federal governments are moving to a 50/50 cost sharing arrangement. And the former says that benefits will have to be reduced if current funding is insufficient.

Astonishingly the Minister's self-congratulatory speech and hundreds of pages of supplementary information included barely a word about this enormous problem. The one brief mention is a move toward joint sponsorship of the civil servant plan which could actually make things worse if it takes away the Minister's right to make unilateral changes as he did two years ago.

Fulfilling the promise to reduce staffing and taking the volatility out of pension costs could free up perhaps \$200 million per year for health care and education, while maintaining the path to balance and HST reduction.

Surely these should be the priorities.

BUDGET PREVIEW

April 3, 2012

As we await the 2012 Nova Scotia budget we have the recent efforts by Ontario and the Federal Government to consider. Each provides some lessons.

For the past ten years Ontario has had the worst financial management in the country. The McGuinty government has until recently shown no interest in balancing the books. But after the last election they commissioned a report by Don Drummond on how to get back to balance. Almost all of Drummond's well considered recommendations were ignored in the subsequent budget which was full of rosy assumptions and short on details. The one clearly evident direction was a hard freeze on civil

servant compensation and a commitment to cap the cost of public sector pensions. In particular this otherwise weak-kneed government has said that it will insist, by legislation if necessary, that public sector employees share equally in the cost of their pensions.

The federal government's effort has earned better reviews. Rather than vague references to hiring freezes it has specified for each department the cost savings that are to be achieved and provided a sensible period over which to achieve them. A reduction of 19,000 public sector positions will be effected over three years

It forecasts a less onerous approach to civil servant compensation than Ontario, but has a far more credible track record in sticking to its plan.

Where the two are well aligned is on pensions. The federal government also says that both elected representatives and civil servants will be asked to pay fully 50% of the cost of the benefits and has raised the retirement age to 65 for future hires.

So where should we pay particular attention when Minister Steele presents his budget on Tuesday?

- 1) Previous budgets have called for reductions of 1,000 civil service positions, to be achieved entirely by attrition and retirements. This hardly ever works unless government specifies which departments are to experience the decrease. A comparison of current numbers to last year's will be instructive.
- 2) Government has called for 3% reductions in funding for district health authorities but has not dealt with the fact that there are too many of them. Reducing the number of DHA's , and outsourcing functions not related to

health care such as cafeteria and laundry, represents the best way to realize savings in health care costs while minimizing the impact on patient care. Will government step up to the plate?

- 3) The current government has made some enormous investments in economic development, most recently \$300 million in grants and forgivable loans for Irving. The history is not good: \$4.5 million wasted on Scanwood, \$60 million for DSME where a small workforce is doing maintenance while they wait for orders to show up, tens of \$millions for Bowater and Newpage with no indication that they will succeed.

We should all be enthusiastic about the ships project. But unlike the government, the Irvings know a thing or two about negotiating deals. Was Halifax's proposal so weak that we had to offer \$250 million more in subsidies than Vancouver ? One has to wonder how well government has served us on this one. A much more disciplined process is needed.

(4) Most importantly, the cost of public sector pensions has to be brought under control. Both MLA's and public sector workers, including teachers, must be required to pay fully 50% of the cost of benefits. Where necessary the benefits must be amended to make this happen. To quote from the Ontario budget:

“We do not think it is fair to ask a single mother who earns \$14 an hour and who has no pension plan, to pay even more of her hard-earned tax dollars into the pension funds of others.

We want to work with our broader public-sector partners to limit taxpayer exposure when a pension fund is in deficit ...

By reducing future benefits, rather than asking taxpayers to contribute even more.”

The Dexter government has shown considerable mettle in its commitment to balancing the books. Health care and university funding have been cut. Schools are being closed. To get to the finish line without further damaging public services the government has to deal with public sector staffing and pension costs.

BUDGET SEASON

Original Post

This is the time of year when governments start making choices about what should be in the next budget. These choices reflect the entire scope of Government. The Minister of Finance has solicited taxpayer input and in this vein the following comments on decisions so far, together with recommendations for the next budget, are respectfully submitted.

- 1) After a slow start the Government has engaged in serious efforts to rationalize spending. The fast ferry to Yarmouth soaked up over \$20 million in subsidies in the four years before government pulled the plug. Perhaps a different ferry can be justified but “The Cat” was never a good idea. And the American tourist market to which it was supposedly catering to is drying up everywhere.
- 2) The tough choices on health show a great deal of political courage. But many opportunities to save money without hurting care, such as reducing the number of regional health authorities, can only be made by the Minister of Health and Wellness. She needs to make them. If health care suffers in Nova Scotia it will be ridiculous to blame the Federal Government, which is increasing funding by 6% per year while the province is making cuts.

- 3) University funding has been cut by another 3% while tuition increases are capped at 3%. This is tough but necessary. Anyone who believes that there is no room for improved productivity in the system should read one of the faculty collective bargaining agreements, available on the university websites.
 - 4) The Government has stated that the number of civil servants will go down by 1,000. In fact the number has gone up by 200 as of the last budget. It is time to get serious and that means identifying the departments where the reductions are to occur. Obviously hoping that attrition will do the job has not been made to work.
 - 5) Kudos to the Government for staying far away from the proposed Stadium. The 300 pages of reports produced at considerable expense to the HRM taxpayer do not make a cogent or compelling case.
 - 6) On the other hand some of the choices about “Economic Development” spending have been ill-judged. As the expensive dredging of Sydney Harbour nears completion there is absolutely no prospect for a container operator. The Industrial Expansion Fund, rightly criticized by the Auditor general for poor management, continues to make unwise choices. The \$4.5 million loan to Scanwood that went almost immediately into default is only the most recent example. Let an arm’s length body that understands business issues (such as NSBI) make clear headed evaluations of these choices before they reach cabinet.
 - 7) Labour market policy that creates cost uncertainty for employers makes the province unattractive as a place to invest. Reverse the recent legislation on first contract arbitration. Review other employer-unfriendly legislation. This will make it less expensive to attract new jobs and retain existing ones.
 - 8) The province’s commitment to greenhouse gas reduction is appropriate. The requirement that 40% of electricity be generated by renewable sources is not. It can add to our already expensive power costs, hurting households and energy intensive employers such as paper mills and manufacturing. Eliminating this unnecessary requirement will make it less expensive to attract new jobs and retain existing ones.
 - 9) By far the best chance for jobs in rural Nova Scotia is in resource industries, particularly oil and gas, mining and aquaculture. Create a policy context that encourages each within a framework of environmentally responsible regulations.
- Even if the Government gets all of the above right the province will be in serious difficulty if it does not satisfactorily address the two biggest issues:
- 10) Our population is aging rapidly which will increase health care costs and reduce tax revenues as people progress into retirement. On present form there will be 100,000 fewer working-age Nova Scotians twenty years from now. To improve our demographics we must dramatically increase our immigrant numbers to at least 10,000 per year. Both the Government and the private sector must be energetically engaged.
 - 11) Frequent supplementary funding of public sector pensions have exacted a huge cost to taxpayers, approaching \$1

billion dollars so far. The teachers plan deficit was still \$1.2 billion as of the last valuation. With poor market performance in 2011 and record low interest rates we can anticipate a further deterioration when the next valuation reports are released in the spring. Government must move these plans to a basis where benefits are made to fit what the contributions will buy. They should start with the MLA pension plan.

We are currently a high tax province which discourages investment and interprovincial immigration. But tax cuts should not be considered until the books are balanced.



Atlantic Institute for Market Studies

**2000 Barrington St., Ste. 1302 Cogswell Tower,
Halifax NS B3J 3K1
phone: (902) 429-1143 fax: (902) 425-1393
E-Mail: aims@aims.ca <http://www.aims.ca>**