

Share the pain, Mr. Premier

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Commentary

The following was planned as a submission to the public meeting on the budget in Fredericton, Jan. 20. It has been rescheduled to Feb. 3.



Photo: Kâté Braydon/Telegraph-Journal archive
Transmission towers crowd the landscape.

Thank you for the opportunity to comment on the province's fiscal situation and on approaches which might be suitable for addressing the deficit problem. Mike and myself were, at one time, economists working for N.B. Finance. Brian was also Secretary to the Lotteries Commission, Senior Policy advisor for Liquor and Gaming and responsible for First Nations negotiations with the Department of Finance. Mike eventually became the Chief Economist at NB Power, responsible for strategic planning.

We are motivated to speak tonight, by a hope that the upcoming budget will be seen as an opportunity to initiate action that will secure - well into the future - the economic and social wellbeing of all New Brunswick citizens. As the minister has no doubt experienced already, there are many interpretations of how that future might be secured.

Government action should strive for least damage. It should be fair in its application. It should spread the pain among all economic stakeholders, and it should strive to further reduce poverty. The budget should also promote economic equality - not contribute to what has lately become growing income disparity throughout North America.

The province needs to be creative in its approach. It needs to engage all of us to the point where we truly take ownership over our own futures and accept the compromises that are necessary. We hope that the Department will strive for even more effective engagement processes in future. Budget making should not be left to the elites - the well-heeled, special stakeholders and bureaucratic insiders. We think that this budget is an opportunity to start to do better. Same old, same old is no longer good enough.

N.B.'s economic outlook

The province clearly cannot continue to rack up \$800 million-plus annual deficits if it ever hopes to provide a reasonable level of future benefits for its citizens. How and when action should be taken is crucial.

Our analysis of the data is encouraging, in that it suggests that the operational deficit may not be structural but mainly cyclical, resulting from the current economic cycle and not - contrary to popular lore - runaway government spending.

Our analysis shows that the budgetary deficit worsened sharply over the last three years, coinciding with three years of low or no growth in the provincial economy. This provides evidence that the budgetary deficit may have a strong cyclical component. It is therefore inadvisable to take a "slash-and-burn" approach towards reducing the budget deficit. It would be much more productive to spread the deficit reduction actions over a period of years, on both the expenditure and revenue side.

Government must avoid the temptation to overreact. It is also important that the all too common government practice of low-balling estimates to frighten the public, be abandoned. Good data makes good decisions. Timing of corrective action should also follow the economic cycle, not the political cycle.

Making all the tough budgetary decisions in the first two years of a new government, in the belief that the public will forget by election time, is lousy financial policy. In summary, balancing the budget should realistically reflect the economic cycle and be prudent in its execution. The deficit does not have to be eliminated this year.

Our analysis does not deal with the capital budget, but we would like to mention one important principle of public finance. It is reasonable to spread the cost of a public asset over the cost of its useful lifetime through borrowing. This is particularly attractive during a period when cost of capital is very low. Skimping on maintenance, for example, produces a very short-term gain at a much larger long-term expense.

Tools for balancing the budget

The Premier has yet to demonstrate a capability for turning base metal into gold. The solution, therefore, still means reducing expenditures and/or enhancing revenue. The deficit situation provides an opportunity for better government and an opportunity for the government to reflect on how to better and more cost effectively serve the citizens of New Brunswick. It provides an opportunity to focus on our core business.

Across-the-board program cuts or wage freezes do not produce more efficient and effective operation. Think of it as the "Saint John River ferry effect." People want better, not less. It may be too late to do a program and administrative overhaul this year, but it should be scheduled for next year. Drastic program cuts in the ensuing year could do more damage than good, in terms of the fragility of the recovery.

New Brunswick has a very capable public service (representing roughly 55 per cent of expenditures are in health care and education). Innovative polices, such as furloughs or Kurzarbeit (reduced work weeks), might be more effective in maintaining a skilled public service while reducing costs in the short term.

It instills confidence on the part of the public service, in that their income, albeit reduced, would be maintained while they wait for better times to come. Above all, innovative policies can help to reduce poverty by not sideswiping those on the low end of the income scale. As surveys by the provincial government show, some 15 per cent of the children in New Brunswick are living in poverty.

Kurzarbeit refers to a short-term, recession-related program adopted by several European countries.

Under the program, companies agree to avoid any layoffs but reduce the working hours of all or most of their employees. Kurzarbeit has won praise from both conservative and liberal economists. Indeed, various Kurzarbeit bills have been proposed in the U.S. Senate.

We also think that the province should resist the clamour for moving to defined contribution pensions and raising the age of eligibility. Serious thought needs to be given to the potential for economic harm of such action in the long term. In the short term, more creative approaches to retirement and using retired personnel could motivate voluntary retirements while providing low-cost expertise and experience.

Make power pay

We believe that some opportunities exist on the revenue side, which would have a low negative impact on N.B. citizens. N.B. bears the cost of maintaining a sophisticated road transport corridor, servicing neighbouring provinces - two of whom feel comfortable in levying their own tolls. A general toll for main highway use may be unattractive to the government, but a distance weight charge for commercial traffic would be effective in better directing the costs of highway maintenance to where they occur, while contributing to improving the province's finances.

The province also provides an electrical highway for out of province power corporations. The province should look at opportunities to take advantage of its strategic location as an electricity transmission corridor.

Quebec is endowed with hydro generation resources. They recently imposed a royalty of 0.326 cents/kWh on hydro generation as a deficit reduction measure. New Brunswick is not similarly endowed with hydro generation capacity, but we are a strategically located electricity transmission corridor. A royalty of 0.326 cents/kWh on transmission could result in \$65 million in additional provincial revenue - with little or no negative consequences for the province.

Similarly, the province should rethink the electricity deregulation strategy, in place since 2004. The expected competitive electricity market has not developed, and is not foreseen in future. In the meantime, New Brunswickers are spending \$13 million a year to support the New Brunswick System Operator, a facility set up just in case electricity competition should come. Not only does the province of New Brunswick spend dearly, at \$13 million a year, to support this facility, but the open-access regime as currently implemented by the New Brunswick System Operator costs NB Power \$150 million in electricity export benefits. The \$150 million could have been used to reduce both NB Power's debt and the provincial deficit. Before electricity deregulation, buy-sell arrangements between NB Power and neighbouring utilities had generated net profits of some \$150 million to NB Power. Although such buy-sell arrangements are sanctioned by the U.S. Federal Energy Regulatory Commission, an agency with the authority to regulate interstate commerce in electricity, the open access as currently implemented in New Brunswick has failed to incorporate measures to capture such historical buy/sell benefits.

While we should promote electricity competition in a sensible manner, we should not throw our competitive advantage away. Our competitive advantage is our transmission corridor.

Belatedly, the government in New Brunswick has begun to view electricity transmission as an economic development tool in its own right. In his speech titled New Brunswick's Competitive Edge: Tax Cuts and the Road to Growth delivered to the Economic Club of Canada on March 31, 2009, former Premier Shawn Graham alluded to the economic development role of New Brunswick as an electricity transmission corridor.

In his speech, Mr. Graham said: "...We don't begrudge our sister provinces in the region, particularly Nova Scotia and Newfoundland and Labrador, for having taken full advantage of their resources and

their geographic location. My message today is very simple. In New Brunswick, we are going to leverage every advantage we have to the absolute fullest. And since our geography is so advantageous to us, and we are next door to a large lucrative U.S. market with great export potential, we are not going to give it up for another jurisdiction to simply run wires through our province.

"Our government will fight in the best interest of New Brunswick to ensure we can take full advantage of what is rightfully ours. We will ensure that New Brunswick gets the maximum economic benefits that it can, from the resources and geographic advantages that it has..."

We therefore urge the Minister of Finance to take measures to monetize the value of New Brunswick's transmission corridor.

Selling other Crown corporations has been suggested but it might be just as effective to explore how corporations such as NB Liquor and The Atlantic Lottery Corporation (ALC) might return even more to the province through improved efficiencies and new business concepts. Quebec has, for example, offered co-operative buying for wine. The ALC might consider outsourcing some of its in-house operations or expanding its co-operation with other lottery corporations.

Fine-tune taxes

Tax increases may be unavoidable, but they need to avoid creating even greater income disparity. Growing income disparity may not only inhibit economic prosperity, but also lead to higher social costs down the road.

It is fashionable in some circles to call for increases in consumption taxes such as HST but they tend, as the Premier notes, to be regressive. They hit middle- and lower-income groups worst, while giving free ridership to commercial interests and by extension may cause collateral damage to small businesses.

Taxes reflecting ability to pay might be a preferable for the long term when considering any increases.

Reversing income tax cuts from the 2010-11 Budget should not be off the table. Personal and corporate income tax cuts, made in that budget, were estimated at \$145 million in the first year alone - rising to \$380 million in 2012-13. They would appear to have not served their purpose in promoting economic development but to have contributed to the deficit.

In summary: the province needs to take a creative approach. More effective engagement is needed to exploit the resource that is the New Brunswick public. We need to address our financial problems, but we have time to do it in a thoughtful, smart and fair way.

Brian Steeves is an economist who has worked for the provincial Department of Finance. Michael Wong has worked as chief economist of NB Power.