Repairing the Nets

Nova Scotia
Alternative Provincial Budget
Fiscal Plan 2005-06

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Canadian Centre for Policy Alternatives – Nova Scotia

Box 8355, Halifax, N.S. B3K 5M1

Tel: (902) 477-1252, Fax: (902)484-6344

Email: ccpans@policyalternatives.ca

Web: www.policyalternatives.ca

We are presenting an Alternative Budget:

- Because important choices are being made about Nova Scotia's future and different choices could be made. We support a process in which the people of Nova Scotia debate and have significant input into public policy decisions. We want to ensure that the interests of the majority and those with less influence in our society are served;

- Because government today is a "top down" affair. We advocate a consensus approach to budget making among progressive organizations and individuals, and a process for building links between various communities;

- Because a more democratic process and a fairer outcome will not happen unless the citizens of Nova Scotia have access to better information on the choices and consequences of budget decisions;

The Nova Scotia Alternative Budget for 2005-2006 has been prepared by the Nova Scotia office of the Canadian Centre for Policy Alternatives (CCPA-NS).

Acknowledgements

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Contents

List of Figures and Tables

Summary

After years of dealing with deficits the government of Nova Scotia is starting to post surpluses. Revenue is rising and the federal government is increasing transfers. Debt servicing costs will decrease once funds from the offshore accord are applied against the provincial debt.

Moderate, but steady, economic growth has resulted in an increase in own-source revenue. Over the past five years the economy and own-source revenues each grew by about 35%. The reversal in the last budget of the income tax cuts has been crucial to improving the provincial financial performance. Had the tax cuts remained in place the province would have $150 million less to put towards programs and services. The province's most recent fiscal update is projecting a surplus of $2.7 million (or $72 million according to the Auditor General). Which programs would have been cut or curtailed to pay for the tax cuts?

Overall Nova Scotia has increased its reliance on regressive taxation – taxation that hits poorer citizens harder than wealthy citizens. The share of revenue derived from gambling has tripled, from around 1% of own-source revenue in 1990-91 to 3.8% in 2003-04. Revenue from fees for government services has increased from 4% to 7.6% of own-source revenue over this time period.

Recently-signed federal provincial health transfer and equalization agreements will provide a long overdue boost to the provincial government's capacity to finance social and economic development. Over the past decade federal transfers have not kept pace with economic growth and the costs of providing services. Between 1995 and 2004 inflation alone increased by 19% but total transfers only increased by 9%.

The size of the provincial debt remains a major fiscal challenge facing Nova Scotia, but progress is being made on this front. The level of debt relative to the size of the economy continues to decrease. Debt servicing costs are absorbing a decreasing portion of the province's total expenditures.

However, Nova Scotia still needs to address its biggest challenge. Nova Scotian provincial and local governments invest less than all other provinces in public services, social programs and infrastructure—almost $1,500 (16.8%) less per person than the average of the other provinces in 2003-04. For 8 of the past 10 years local and provincial governments in Nova Scotia have invested the least per capita.

The Hamm government's focus on curtailing government spending made a bad situation worse. The consequences are not hard to find: increasing demand for food bank services, roads in poor repair, lack of funds for affordable housing and women's shelters, a decline in real income assistance rates, high levels of child and family poverty, and under-funded schools and universities.

Program expenditure as a percent of economic activity has also decreased, from 29% of GDP in 1993 to 24% in 2003. In other words the ability of governments to support and regulate the economy has not kept pace with economic growth. This undermines governments' capacity, to for example, establish and enforce environmental and health and safety standards.

When governments relinquish their capacity to promote the public interest through social programs, regulation and public enterprises, citizens lose the capacity to influence events through the ballot box. As more decisions are left in the hands of for-profit private interests, economic power increasingly drives those decisions. Ultimately the result is a less democratic society.

Real wages have been decreasing in Nova Scotia. Too many of the jobs being created are occurring in low-wage sectors such as accommodation and food services and in administrative services such as call centres. The trend towards a low-wage economy can be reversed but the province needs to invest in education and economic infrastructure, such as transportation, that support value-added, manufacturing and knowledge-based industries.

Nova Scotians have an opportunity to strike out on a new path and mend the social safety nets. The books are balanced and revenues are set to increase. It is time for the provincial government to move to a more pragmatic approach that balances fiscal prudence with the promotion of the public good.

The Alternative Provincial Budget (APB) provides a fiscal plan that manages the provincial debt and invests in social and economic development. All surpluses in the APB fiscal plan are allocated to addressing the social and infrastructure deficit that has accumulated.

Repairing the Nets

The news appears to be good regarding the state of the province's finances. After years of dealing with deficits the Nova Scotia government is starting to post surpluses. Revenue is increasing steadily and the federal government is increasing transfers. The offshore accord will also improve the provincial government's bottom line.

The 1990s were very costly for Nova Scotians. Balancing the financial books of the federal and provincial governments resulted in a rising social deficit. We are still paying the price for a decade of cutting and under-funding programs. These cuts have left the social safety net with gaping holes and have undermined the well-being of many in our communities. The lack of investment in infrastructure and economic development is partly to blame for the economy being increasingly reliant upon low wages.

The improved fiscal situation provides an opportunity for the provincial government to address citizens' concerns. Will the Hamm government use this opportunity or continue the current approach of under-funding programs? Will the Hamm government recognize that long-term implications of public sector under-investment include a less vibrant economy and increased poverty?

The 2005 Nova Scotia Alternative Provincial Budget Fiscal Plan assesses the province's fiscal situation. It examines the reasons for the improved fiscal situation and the price that continues to be paid. It assesses the sustainability of the current government's fiscal management strategy and presents a fiscal plan that prudently manages the province's public finances while investing in sustainable social and economic development.

Revenue

Moderate but steady economic growth has resulted in an increase in own-source revenue. Over the past five years the economy and own-source revenues both grew by about 35%. But total provincial revenues only increased by 22% over the same period. For the most part this is because federal transfers only increased by 3% during the same period.

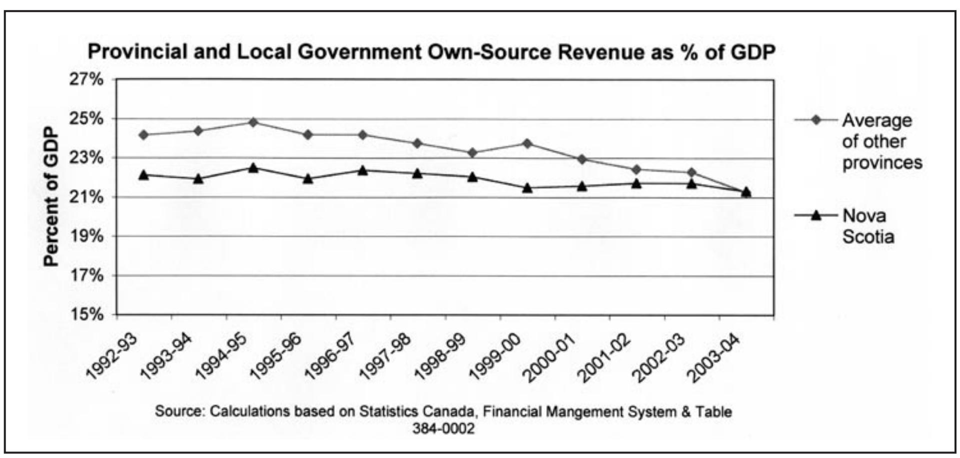
Own-Source

The last provincial budget's reversal of the income tax cuts has been crucial to improving provincial financial performance. Had the tax cuts remained in place the province would have $150 million less to put towards programs and services, or about $700 million less over 5 years. The province's most recent fiscal update is projecting a surplus of $2.7 million (or $72 million according to the Auditor General[1]) – one is left to wonder what programs would have been cut or curtailed to pay for the tax cuts.

The 2004-05 Budget actually contributed to a more progressive income tax system in Nova Scotia. The changes to the bottom tax bracket provide a small break for low and moderate income taxpayers. An additional tax bracket was added for those earning more than $93,000. The changes have contributed to a slight shift in personal income taxation from those least able to afford taxation to Nova Scotians most able to pay for programs and services.

Overall the Nova Scotia economy is not over-taxed. For much of the past decade the province has generated less in own-source revenue as a percentage of the economy than other provinces (see Figure 1). This helps to explain why, during the 1990s, Nova Scotia was under-funding programs and services (see Expenses section below) and was still not able to balance the books.

FIGURE 1



Progressive versus regressive taxation

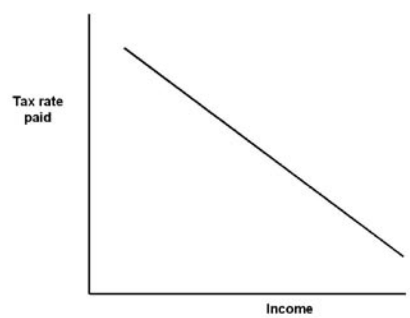
Governments raise revenue by taxing economic activity and wealth accumulation: there are taxes on income (personal and corporate), wealth (e.g., property, capital) and consumption (e.g., sales, tobacco, gambling).

Adam Smith, the father of modern economics (and incorrectly lauded as an opponent of government) had this to say about taxes:

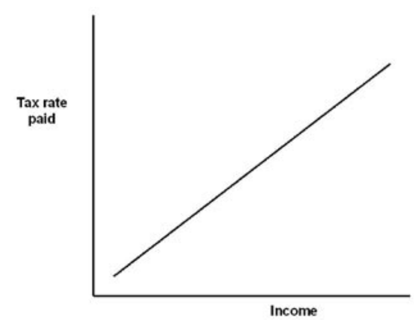
> "The subjects of every state ought to contribute toward the support of the government, as nearly as possible, in proportion to their respective abilities; that is in proportion to the revenue which they respectively enjoy under the protection of the state...a goal of taxation should be to remedy inequality of riches as much as possible, by relieving the poor and burdening the rich."[2]

Since Smith's day, a key concept in fair revenue generation has been "progressivity" i.e., those who are able to pay more should pay more than those who are less able to pay — as the benefits one receives from economic activity rise, the percentage of those benefits paid in taxes should rise.

REGRESSIVE TAX



PROGRESSIVE TAX



Personal income tax is a good example of a progressive tax. Generally, the more a person makes in income, the higher a proportion of their income they pay in taxes. But it is misleading to look at income tax in isolation from other taxes we pay. Most of the other taxes we pay (for example the HST and property taxes) are regressive. Homeowners pay the same amount of tax on a home assessed at, say, $150,000 whether they are earning $30,000 or $150,000 a year. In fact, the only truly progressive tax is the income tax.

Indeed, when we combine all taxes at all governmental levels and calculate their effect, we do not have a progressive tax system at all! Is that what we want for Canada?

Table 1: Own-Source Revenue: Gambling Profits and User Fees
(% OF TOTAL OWN-SOURCE REVENUE)

	1988-89	1990-91	1995-96	2000-01	2002-03	2003-04
Gambling Revenue	1.3%	1.0%	3.7%	3.9%	4.0%	3.8%
User fees	4.4%	4.2%	6.1%	7.6%	7.6%	7.6%

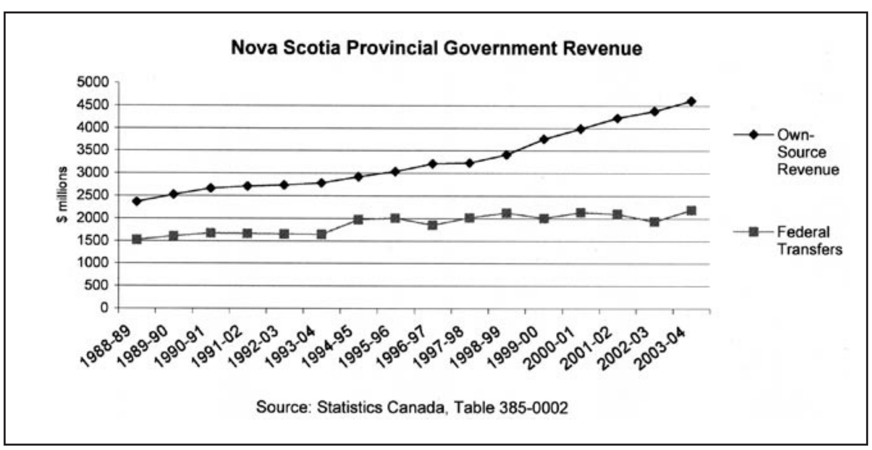
Source: Statistics Canada, Table 385-0002

But personal income tax is only one of the taxes we pay. There are sales taxes, property taxes, corporate taxes and other kinds. Most of those other taxes are quite regressive. While personal income taxation has become slightly more progressive, overall Nova Scotia has increased its reliance on regressive taxation – taxation that is not based on the ability of citizens to pay. For example, the share of revenue derived from gambling has tripled, from around 1% of own-source revenue in 1990-91 to 3.8% in 2003-04. Fees for government services have increased from 4% to 7.6% of own-source revenues over this same time period.

Many Nova Scotians are aware of the social costs of gambling addition. Although gambling is a very profitable activity for private and public providers, it is a losing proposition for the gamblers. Because people on low incomes spend much more as a proportion of their income on gambling than people with high incomes, it therefore collects a much higher proportion of income from the poor than the wealthy. Gambling is therefore a very regressive tax.

The increased user fees are part of a policy approach of "cost recovery" preferred by the Hamm government. According to a Department of Finance bulletin "[t]he philosophy behind cost recovery measures for social programs is that the people who most directly benefit from a service should contribute more to the cost of providing that service than those who do not use it."[3] Fees have been increased for services such as ambulances use, pharmacare, home support services and driver testing. Whether you earn $20,000 or $90,000 a year you generally pay the same fee. User fees, therefore, extract the highest price, as a proportion of scare after-tax dollars, from low-income Nova Scotians.

FIGURE 2



Federal Transfers

Federal transfers to Nova Scotia decreased in real (inflation adjusted) terms over the past decade. Between 1995 and 2004 prices increased by 19% while federal transfers only increased by 9%. General purpose transfers (equalization payments) kept pace with inflation but specific transfers such as support for health care and education have declined as a result of the cuts implemented by the federal government during the mid 1990s. The stagnation of federal transfers provides an insight into the financial turmoil faced by provinces during the late 1990s. Between 1995-96 and 2003-04 transfers to Nova Scotia decreased as a proportion of total revenue from 39.8% of total provincial revenue to 32.1% (Table 2). Transfers decreased as a proportion of GDP from 10% to 7.5%. This has curtailed the provincial government's ability to sustain social programs and other investments in economic growth.

Table 2: Federal Cash Transfers to Nova Scotia ($ millions)

	1988-89	1990-91	1995-96	2000-01	2003-04
Federal Cash Transfers	1512	1660	2000	2127	2178
Percent of Total Revenue	39.1%	38.4%	39.8%	34.9%	32.1%
Percent of GDP	9.9%	9.8%	10.4%	8.6%	7.5%

Source: Statistics Canada, Tables 385-0002 and 384-0002

The low level of federal transfers resulted in the provincial government decreasing funding to programs Canadians have prioritized. For example, while health care costs have increased by more than 50% since 1995, transfers have only increased by 9%. While all provincial governments faced these challenges, Nova Scotia's financial predicament was particularly difficult because for much of the 1990s it failed to generate revenue from the economy at the same rate as other provinces (see Figure 1).

The funding increases contained in recent federal provincial equalization and Canada Health and Social Transfer agreements will boost Nova Scotia's ability to provide essential services such as health care, and to manage its finances (Table 3). In 2004-05 alone these agreements are predicted to provide the provincial government with $163 million more in revenues than forecast in the last provincial budget.

Table 3: Increased Federal Transfers ($ millions)

	2003-04	2004-05	2005-06
Canada Health and Social Transfers	656		
Canada Health Transfer		474	617
Canada Social Transfer		259	261
Health Reform Transfer	30	44	
Wait Time Reductions		18	18
Total Health and Social Transfers	686	795	896
Equalization	1130	1313	1344
Total Federal Transfers	**1816**	**2108**	**2240**

Source: Department of Finance, Canada, "Federal Transfers to Nova Scotia," March 2005.

What kinds of transfers does Nova Scotia get from the federal government?

They come in two main forms. First, the Canada Health Transfer (CHT) and Canada Social Transfer (CST) are provided to *all provinces*, paid on a per capita basis, to help the provinces pay for health, education and welfare expenses. According to a deal reached last year with the provinces, the federal government, now reaping huge surpluses, will be increasing these payments.

Second, equalization payments are a federal transfer in fulfillment of Article 36(b) of the Constitution Act of 1982, which specifies:

> "the Parliament and the government of Canada are committed to the principle of making equalization payments to ensure that provincial governments have... sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation."

All provinces, except Ontario, have at one time or another received equalization payments (Alberta received equalization from 1957 to 1965.) In 2005-06, Nova Scotia will receive $1,344 million. Since 1990, the Atlantic provinces, Quebec and Manitoba have received payments every year while both BC and Saskatchewan have only sometimes received equalization payments. The equalization entitlement of BC in 2005-06 is estimated at $590 million. The objective of equalization is to enable all provinces to provide comparable services at comparable levels of taxation. Many countries around the world have a federal system of government – with the notable exception of the US. They all find that some type of equalization program is necessary if a common level of services is to be delivered fairly, in a decentralized federation.

Equalization in Canada is based on a complicated formula which compares the ability of provincial governments to raise revenues from their economy (their fiscal capacity). The fiscal capacity of a province is a measure of its ability to raise revenues from each of 33 revenue sources – including ***personal income tax***, ***corporate income tax***, sales taxes, property tax, and other sources – assuming that province has ***average tax rates***. The fiscal capacity of any province is compared to a five-province average to determine whether it is eligible for equalization payments. This average does not include Alberta, which (due to royalties from oil and natural gas) has a far higher ability to raise tax revenues than any other province. Because of this, equalization payments depend disproportionately on the performance of the Ontario economy.

It is important to remember that equalization payments come from the federal government. Equalization is a national program, in support of a national objective, and it is therefore financed by ***all*** taxpayers in ***all*** regions. Transfers do ***not*** come directly from any of the wealthier or "have" provinces. For example, the government of Alberta does not transfer a penny of its own revenues to the poorer provinces.

Expenses

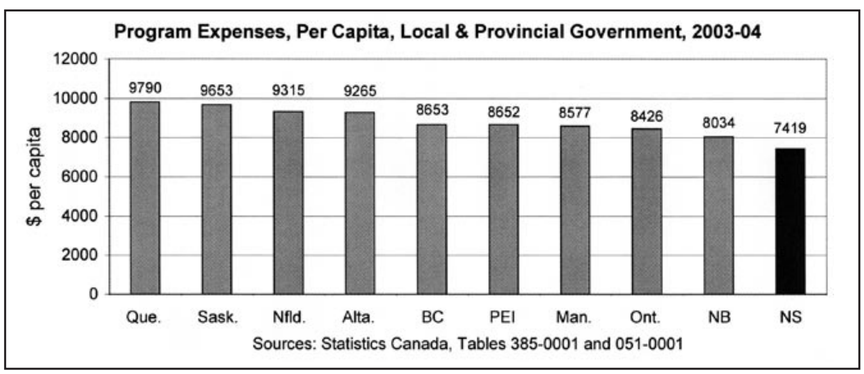
Nova Scotians are still dealing with the impacts of the fiscal policies of the 1990s. The federal government decision in the 1990s to fast track deficit elimination has had long lasting consequences for national programs and for the ability of provincial governments to maintain the social safety net.

Canadians lost affordable housing programs and federal support for social assistance. Programs like health care were left to stagnate due to under-funding. During the 1990s, while unemployment rates were stuck at historically high levels, unemployment supports and income assistance became harder to access and benefits decreased.

To varying degrees all provinces passed on the cuts to municipalities and to their citizens, but Nova Scotians were particularly hard hit. Cuts to federal transfers pressured the provincial government to decrease already low levels of government expenditure. This has left households and the provincial economy in a vulnerable position.

The Hamm government has promoted the notion that Nova Scotia's financial problems are a result of government over spending. The provincial government, they claim, was living beyond its means by providing citizens with Cadillac services. In fact, Nova Scotia has the lowest per capita level of program spending of all provinces.

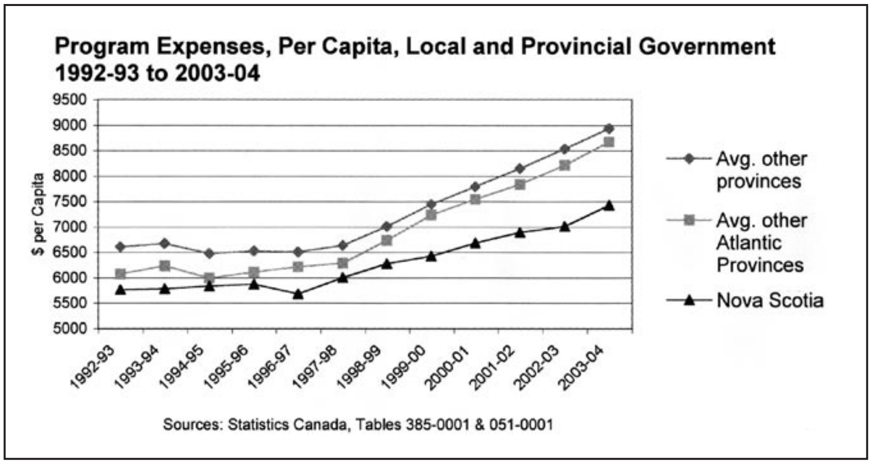
FIGURE 3



Local (municipal) governments operate under the authority of the provincial government. Because of differences between which level of government – local or provincial – provides services varies between provinces, we need to look at combined expenditures if we are to get a true inter-provincial comparison of program expenditures. During the fiscal year 2003-04 local and provincial governments in Nova Scotia spent less than all other provinces on public services for their citizens (Figure 3) – $1,500 (16.8%) less per person than the average of the other provinces. Local and provincial governments in Nova Scotia would need to invest over $1 billion more annually just to reach the average per capita level of expenditure of the other Atlantic provinces. Even when we include debt servicing costs in the calculation, per capita local and provincial government expenses in Nova Scotia were lower than all other provinces in 2003-04.

This lack of investment in social and economic development follows the trend established during the 1990s (Figure 4). For 8 of the past 10 years local and provincial governments in Nova Scotia have invested the least in their citizens, well below the average of other provinces.

FIGURE 4



The Hamm government's focus on curtailing government spending has made a bad situation worse. The consequences of this continued under-funding are easy to identify. We all have stories about the state of disrepair of roads and the time spent waiting for services. Demand for food bank services is increasing. The demand for affordable housing and women's programs and services are not being adequately met. Income assistance benefits continue to decline, in real (adjusted for inflation) terms for single people, people with disabilities, single parents and small families.[4] The prevalence of household and child poverty in Nova Scotia continues to be high.[5]

"Campaign for Fairness" and the social assistance clawback

The Hamm government's "Campaign for Fairness" on revenues from offshore oil and gas has been successful – the federal government now recognizes that it was punitively unfair to cut equalization payments to Nova Scotia by 70 cents for every dollar earned from the offshore.

But, to be consistent there is another "campaign for fairness" that the provincial government should be waging.

Why does the Hamm government continue to cut the benefits of social assistance recipients by 70 cents for every dollar in earned income? At a time when it has also stressed the importance of maintaining "low taxes" and "work incentives", why do the poorest Nova Scotians get less from each additional dollar of earnings than anyone else in the province?

Social assistance support levels in Nova Scotia are not generous. A single employable person in 2003, when all transfers and tax credits were added together, received only 31% of the poverty line. A couple and two children on social assistance had a net income of just over half (57%) of the poverty line. The 70% clawback of any earnings means that their benefits would be completely cut off while they were still well below the poverty line.

In Nova Scotia, people with taxable income over $115,000 now pay, for each additional dollar earned, 29 cents in federal tax and 17.5 cents in provincial tax. By contrast, the province of Nova Scotia cuts 70 cents in benefits from each additional dollar, when a social assistance recipient with an income of $10,000 tries to get ahead.

Why does the rhetoric of "lower taxes" and "incentives" only apply to people with high income? Why do the least well off Nova Scotians get to keep the lowest fraction of an additional dollar of earnings?

There are often added expenses including the costs of going to work, and pressures of child care and commuting. Still, many social assistance recipients want nothing more than to get off the system, and continue to work as much as they can. Surely it's time to recognize that the clawback they face should at least be no higher than for the most affluent Nova Scotians – i.e., 46.5% of earnings.

Research released by Statistics Canada in 2004 confirms that Nova Scotia government investments in P-12 education lags behind. Nova Scotia placed last among all provinces in terms of total education expenditure per student (Figure 5). Average provincial tuition fees in Nova Scotia are the highest in the country (Figure 6).

FIGURE 5

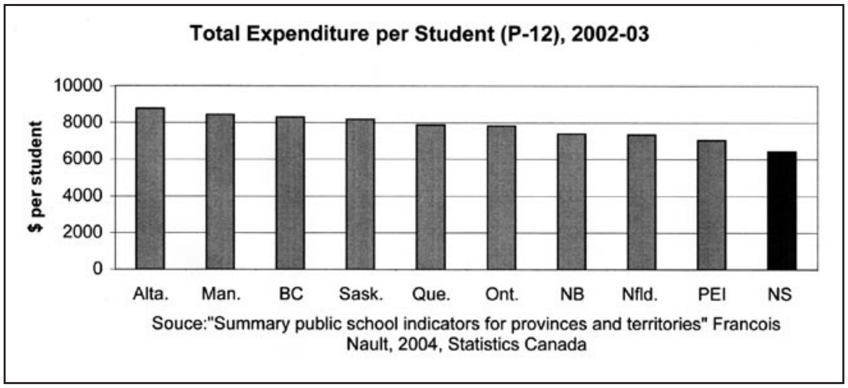
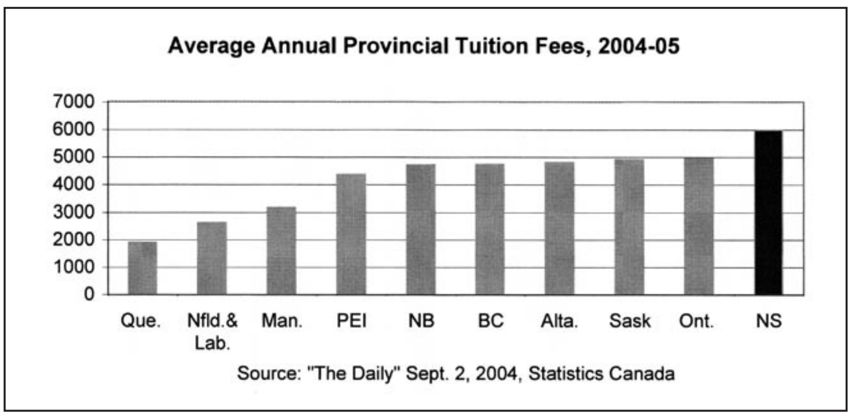


FIGURE 6



Considering removing the HST on home heating oil?

It's been a cold winter in Nova Scotia and home heating oil has surged in price – what should our government do to help?

A few years ago, a typical family home burning approximately 3,000 litres a year of fuel oil might have paid 40 cents a litre, which implies a heating bill of $1200. When oil costs rise to 70 cents per litre, the heating bill rises to $2100. On top of their $900 increase in fuel costs, this family would pay more tax — as its share of the HST, the government of Nova Scotia would collect 8% on the additional $900 in fuel costs, i.e., an additional $72. For many families, some assistance with the bills would be greatly appreciated, but what's the best way to accomplish this objective?

If the sales tax on heating oil is abolished, the biggest winners will be the people who buy the most heating oil. The larger their house, the higher their thermostat setting and the more inefficient their furnace, the bigger their benefit will be. Indeed, the biggest winners of all will be the owners of apartment buildings. While the big landlords of Nova Scotia pocket major savings, tenants whose heat is included in their rent will get no benefit at all. And tax savings for energy users will mean cuts in program expenditures on health, education and other services.

In addition, a selective sales tax exemption is costly to administer. There is no difference between the oil that heats houses and the oil that heats shopping malls and office buildings. Hence, bureaucrats will have to be hired to make sure that tax is paid on the oil that does not heat houses – and that tax free oil is not trucked out of the province. The environment will also be a loser. Higher prices do encourage people to turn down the thermostat and improve the insulation. Oil is a non-renewable resource, and the less we burn, the less greenhouse gases we contribute to global warming.

Abolishing the sales tax on home heating oil is not the most effective way of providing supports to those hardest hit by high heating oil costs. When and if the province's finances recover to the extent that cuts in taxes are warranted, the fairest and most efficient way – by far – is to increase the HST tax credit. Why? Because it goes only to low-income households.

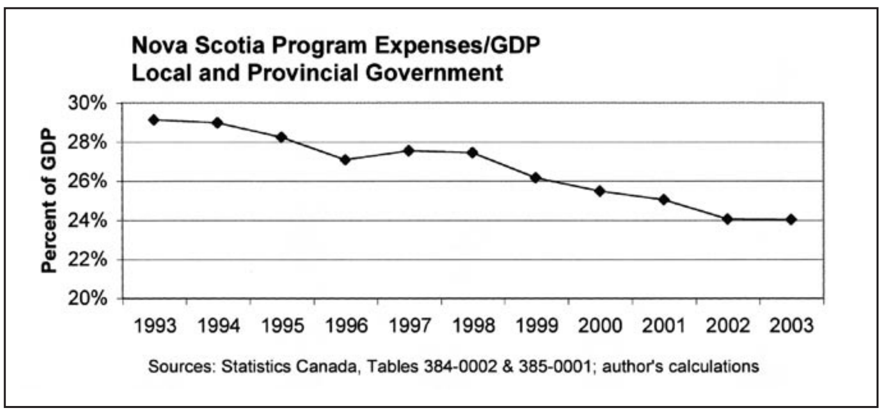
Program Expenditures and Economic Growth

Another measure of the decreased commitment of governments in Nova Scotia is the decline in investments in public goods relative to the provincial economy. Program expenditure as a percent of economic activity decreased from 29% of GDP in 1993 to 24% in 2003 (Figure 7).

This trend has long-term implications for the Nova Scotian economy and the development of our communities. The ability of governments to support and regulate the economy has not kept pace with economic growth. Infrastructure, such as highways and garbage and sewage disposal facilities are deteriorating due to age and increased use in an expanding economy. Recent studies confirm that public infrastructure investments decrease business costs and increase overall productivity.[6]

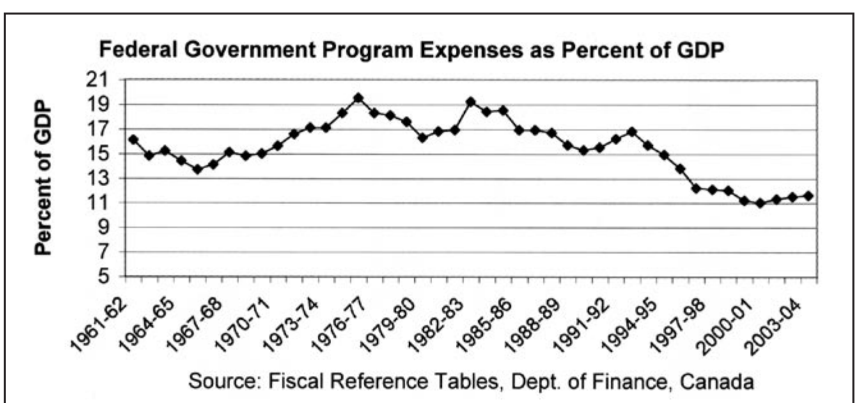
The decreasing level of public investment curtails the capacity of governments to service and regulate the economy. Not keeping pace with economic growth undermines governments' capacity to, for example, establish and enforce environmental and health and safety standards. It undermines the ability of the provincial government to promote the transition to a more environmentally sustainable economy.

FIGURE 7



Federal program expenditures relative to GDP have also decreased over the past decade (see Figure 8), to the lowest level in 40 years.

FIGURE 8



Gross Domestic Product (GDP) – A misleading concept

The concept of Gross Domestic Product (or GDP) is helpful to economists, governments, in fact anybody analyzing modern economies. But it is also a very misleading concept.

Simply speaking, GDP is a measure, in currency (dollars, Yen, Pounds etc.), of the total amount of goods and services produced in a geographic area (e.g., country, province, trading bloc), usually in a year. Or to put it differently, it is the total amount of income earned by individuals and firms.

GDP then becomes a measure of the wealthiness of a place. Thus Canadian provinces with large GDPs are considered "richer" than those with small GDPs. A better measure of "well-offness" is average GDP or GDP per capita, which is derived by dividing the GDP of a place by its population. Ontario's GDP is greater than Alberta's. But because Alberta has considerably fewer people, its GDP per capita is higher than Ontario's. That's an indication that the average Albertan is better off. But it is misleading because income is by no means distributed equally.

As a concept it also excludes much of the valuable and essential activity that human beings do. The only things that count toward GDP are those where money changes hands, even if the world is a worse place for it. For example, if an oil tanker spills oil all over a pristine wilderness, all financial transactions resulting from it count toward GDP The depletion of the environment, however, isn't subtracted. Military expenditures and wars are also great contributors to GDP.

Here are some of the very valuable things that DON'T count toward GDP:

- all the time we (mainly women) spend bringing up our kids and helping bring up other people's kids
- all the volunteer time we (mainly women) spend maintaining households by cleaning, shopping, decorating, gardening, fixing (except that the products we buy count as GDP)
- all the volunteer time we spend in the community coaching soccer teams, serving on the PTA, taking seniors on trips count for nothing.

In recent years, several groups have been promoting a new way of measuring human and economic activity that would add up things of value to us and subtract things that are harmful to us. Some governments, like that of Canada, have expressed some interest in these mechanisms and Statistics Canada has a pilot project to investigate it.

One such mechanism is the "Genuine Progress Index," (GPI) pioneered by, among others, a Nova Scotia organization called "GPIAtlantic." You can learn more about this organization and its critique of GDP at its web site **www.gpiatlantic.org**.

Local governments deliver many federal and provincial government programs to support communities and economic development. Infrastructure investments by local governments in Nova Scotia have fallen behind the investments made in all other provinces (Table 4). These investments include roads, sewage treatment and other major capital costs that keep our communities functioning. Between 1988 and 2003 – a fifteen year period – there was no increase in Nova Scotia local government infrastructure investment. Nova Scotia is the only province where these investments did not increase. In real (adjusted for inflation) terms, investments in infrastructure by local governments in Nova Scotia decreased by 47%.

Table 4: Local General Government Infrastructure Investment 1988 and 2003 ($ millions)

	1988	2003	Percent Change
Yukon	7	31	319%
British Columbia	581	1,472	153%
Alberta	623	1,264	103%
Newfoundland and Labrador	82	156	90%
Saskatchewan	178	315	77%
Ontario	2,842	4,981	75%
Northwest Territories and Nunavut	18	29	56%
Prince Edward Island	13	19	41%
Quebec	1,555	1,919	23%
New Brunswick	92	105	14%
Manitoba	237	242	2%
Nova Scotia	**141**	**141**	**0%**

Source: Public Sector Statistics: Supplement, 2004, Statistics Canada[7]

Total economic activity continues to increase but a decreasing proportion of this activity promotes the public interest. Rather than make the public sector more effective, governments are turning an increasing proportion of the activities that affect our communities and livelihoods over to private corporate interests.

When governments relinquish their capacity to promote the public interest through social programs, regulations and public enterprises, citizens lose the capacity to influence events through the ballot box. As more decisions are left in the hands of for-profit private interests, economic power increasingly drives those decisions. Ultimately the result is a less democratic society.

Developing a Low-Wage Economy

The government of Nova Scotia has to get over its aversion to investing in public goods. The curtailment of such investments is already having a negative impact on the province's economic prospects.

The provincial government has been touting its job creation record, but too many of these jobs pay low wages. Wages in Nova Scotia have been decreasing in real (inflation adjusted) terms.[8] According to a Report Card by the Atlantic Provinces Economic Council (APEC) "Atlantic employment has grown by 19% in low-wage industries but advanced only 7% in high-wage industries."[9] The region, according to the report, has "outperformed Canadian job growth in low-wage sectors."

In Nova Scotia the number of jobs in administrative services, such as call centres and other business services, which pay 75% of the regional all-industry average, "have doubled over the past decade."[10] The APEC Report Card goes on to note that in all 4 Atlantic provinces, the accommodation and food services sector, "where earnings are less than half of the all-industry average – accounted for a rising share of total employment between 1991 and 2002."

The trend towards a low-wage economy can be reversed. The province needs to invest in education and economic infrastructure that support value-added, manufacturing and knowledge-based industries. The record to date is not good in a province that invests too little in education. High tuition fees are an obstacle for Nova Scotians looking to a post secondary education to increase their opportunities. The combination of the highest tuition fees and a low-wage economy ensures that students are forced to leave the province if they are to repay their student loans.

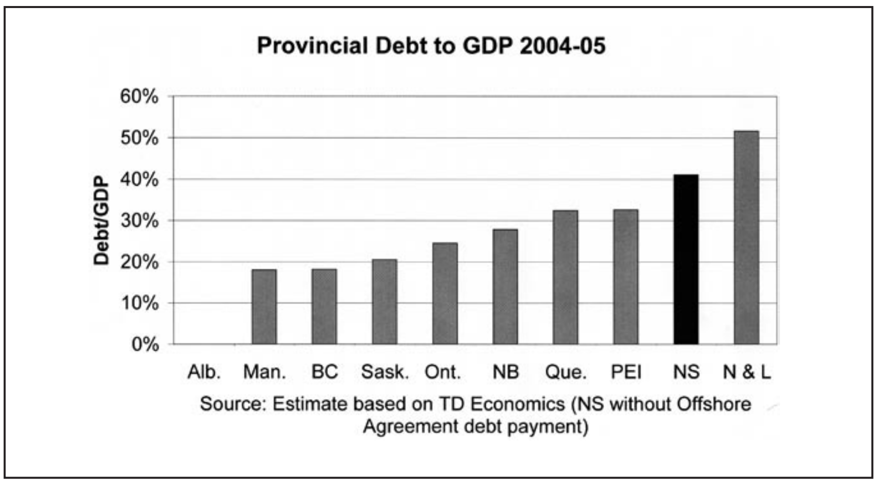
Nova Scotians have an opportunity to strike out on a new path. The books are balanced and revenues are set to increase. It is time for the Hamm government to move on to a more pragmatic approach that balances fiscal prudence with the promotion of the public good.

The Provincial Debt

The major fiscal challenge facing Nova Scotia continues to be the debt management. But debts and deficits in themselves are not inherently a sign of fiscal mismanagement. The crucial indicator is the ability of the province to carry the provincial debt. Nova Scotia's debt is high and managing it is key to the fiscal health of the province. The province's finances are still recovering from the slow economic growth and high interest rates of the early 1990s. Slower growth results in decreased revenue and higher deficits. Between 1991-92 and 1993-94 the provincial debt increased by 72%, but steady economic growth over the past 7 years has stabilized the provincial debt.

The level of debt relative to the size of the economy (debt to GDP) is the best indicator of a government's capacity to manage its debt load. As the provincial GDP increases so does the province's capacity to raise own-source revenue and its ability to finance the debt. That said, Nova Scotia has the second highest proportion of debt to GDP among all provinces.

FIGURE 9



Is there an optimal level of debt?

What is the optimal level of the debt? In thinking about their own family finances, most people would find a policy of zero debt to be unreasonable, since it would rule out car loans and home mortgages – spending on assets which yield benefits well into the future. As well, they realize that it is the level of *debt relative to income* that is the key issue, since a car loan of $30,000 would be a crushing burden to someone on a $10,000 income but is quite manageable for someone making $100,000.

Although the province of Nova Scotia measures its public debts in billions, while its citizens typically measure their private debts in thousands, the same basic principles apply. In both cases acquiring debt to purchase long-term assets can make sense, and it is the debt to GDP ratio that determines whether that debt is manageable. Of course, when either households or governments acquire debts, they have to be paid for, sooner or later – but should we pay the debt down sooner or should we pay later?

What is the optimal level of the debt/GDP ratio? Paying down the current provincial debt represents a decision that today's taxpayers should pay a bit more now in debt servicing – which means that future taxpayers will have to pay a bit less. In debt management policy, there is an unavoidable trade-off to be made between the interests of today's taxpayers and those of tomorrow's taxpayers. If the debt-financed capital assets yield benefits for future citizens, future generations should absorb at least part of the cost. As well, if the economy is growing, future generations will have a higher combined income from which to pay debt servicing costs. Nevertheless, some balance between the interests of current and future citizens must be struck – what should it be?

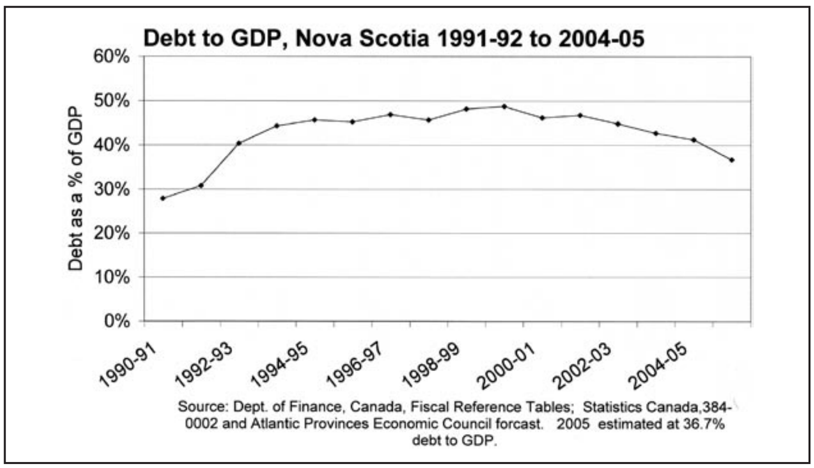
There is no consensus among economists on this issue. In an informal poll of economists at a recent conference[11]on Canada's debt, participants were asked to specify their own estimate of the optimal long-run debt/GDP ratio for combined federal and provincial debt. None of the 20 respondents was willing to suggest an optimal ratio less than 20 per cent or greater than 50 per cent. However, the two most frequently specified ranges (by 30 per cent of respondents in each case) were right at the edges of this band—20 to 25 per cent and 46 to 50 per cent. Although the average response was almost exactly in the middle (35.7 per cent), that average clearly masks a significant divergence of opinion.

Economists would all agree that a continuing rise in the debt / GDP ratio is not sustainable. However, once the debt ratio has been stabilized they – like citizens in general – have a range of values about the optimal level. Some would argue for a rapid pay-down, while others would emphasize the pressing needs of the present. Fundamentally, finding the balance is the legitimate domain of the political process.

Ahead of Target

While the provincial debt to GDP ratio remains high relative to other provinces, it has been decreasing faster than anticipated. Private forecasters have estimated a ratio in the range of 40% of GDP for 2004-05, below the provincial government's forecast of 42.8%.[12] The pending offshore agreements between Ottawa and Nova Scotia and Newfoundland and Labrador will add an one time payment of $830 million to Nova Scotia's coffers immediately. The Hamm government has committed to applying the funds to the provincial debt, decreasing the debt by roughly 6.5%. The provincial government has estimated that applying the $830 million to the debt will decrease debt servicing costs by about $50 million per year. Our calculations, based on an examination of the time to maturity and the interest payable on debentures of the Province of Nova Scotia, suggest that the debt servicing costs will decrease by at least $35 million in 2005-06 and by $75 million from 2006-07 onwards. According to TD Bank estimates the debt-to-GDP ratio will decrease in 2005-06 to 35.2% – more than 5 percentage points below the government's target of 41.7% for the same period.[13] Figure 10 uses an estimate 36.7% of GDP for 2005-06.

FIGURE 10



What to Do With the Surplus?

The provincial government has a new dilemma – what to do with the surplus. There are three main options: invest in public programs, services and infrastructure; provide a tax cut; and/or pay down the debt. However, there is one basic problem – one cannot spend the same dollar twice, so a dollar in tax cuts will necessarily mean less money available to invest in public services or to allocate to reducing the debt.

Nova Scotians have been living with minimal levels of public services for far too long. It is time for the provincial government to shift from short-changing Nova Scotians to developing a fiscal plan that provides real sustainable funding for programs comparable to those in the rest of Canada. The Hamm government needs to focus on strategies that work rather than ideological experiments that jeopardize the well-being of individuals and communities. The Hamm government's reversal of the tax cut provides an indication of the government's ability to take a prudent, pragmatic approach to managing public finances.

Income Tax Cuts?

With the increasing surpluses the government may be tempted to again embark on a tax cut agenda. This would be a big mistake.

Income tax cuts primarily benefit well-off taxpayers. The 10% tax cut implemented and then reversed in 2004 would have cost the province $147 million in its first year alone. Rather than being able to invest this money in supporting Nova Scotians most in need and supporting economic development, the funds would go to those least in need. More than $80 million (56%) of the tax benefits would have gone to taxpayers earning more than $50,000 per year. Only $23 million (16%) would have gone to the majority of tax payers, those earning less than $30,000 per year.

Table 5: Nova Scotia 2004 Income Tax Cuts – Distribution by Income Group[14]

Income Group	Number of tax Returns	Total 2004 tax cut ($millions)	Average tax cut ($)	Percentage Of taxpayers	Percentage of total tax cut
Tax filers with $0 taxable income	244,640	$0	$0	0	0
$1- $30,000	223,050	$23,219	$104	51%	16%
$30,000-$50,000	128,780	$41,993	$326	30%	29%
$50,000 +	82,220	$81,789	$995	19%	56%

Who pays the price for income tax cuts – Nova Scotians most in need such as the sick, students and-low income households. However we all pay part of the price through the deterioration of public services that occurs as money is diverted from government expenditure to fund tax cuts. Economic development suffers because of under-funding of the fundamental supports needed for economic activity such as a healthy, well-educated workforce and a modern infrastructure in areas such as transportation. Income tax cuts provide a windfall for the wealthy that Nova Scotia cannot afford.

Nova Scotians are already trying to cope with the lowest level of government investment in citizens of any Canadian province. Income tax cuts mean that the level of public services and social programs in Nova Scotia will fall even further behind. For example the 10% income tax cut would have drained more than $700 million over 5 years from the provincial government's coffers.

A recent review of the United States' experience with tax cuts that were intended to foster economic development shows that the cuts in fact undermined economic development. The study finds "little grounds to support tax cuts and incentives—especially when they occur at the expense of public investment—as the best means to expand employment and spur growth…. Research, in fact, substantiates that public investment plays a positive role in helping lower costs for firms."[15]

Income tax cuts also undermine governments' ability to weather slower economic growth. As the economy slows revenues already decreased by the tax cuts decrease even further, thereby increasing deficits and the provincial debt and/or resulting in funding cuts to programs. Ontario is currently paying the price in the form of multi billion dollar deficits for the tax cuts implemented by the Harris government of the 1990s.

The reality is that most Nova Scotians are not clamouring for income tax cuts. The failed 10% tax cut experiment proved to be a learning experience for taxpayers and we hope for the provincial government.

Pay Down the Debt?

Nova Scotia is set to generate budget surpluses for the foreseeable future. Is it better to invest the surplus in education, poverty reduction and transport or should the surplus be allocated to debt repayment?

A payment of, for example, $50 million on a debt of $12.3 billion would reduce annual interest payments from $895 million to $891million, a reduction of about $4 million or 0.4%. Given the need to address Nova Scotia's social and infrastructure debt after years of under-funding, a far better investment in terms of return and need would be to allocate funds to programs, services and infrastructure.

The Offshore Agreement

Nova Scotia is set to receive $830 million as a prepayment of the renegotiation of the offshore oil and gas agreement. Given that this is a one time payment, the Hamm government's intention to apply the entire amount to debt reduction strikes a reasonable balance between fiscal prudence and current program spending. Reducing the debt will provide an additional $50 to $70 million, due to lower debt servicing costs, for program spending.

Managing the Debt

Allowing the debt to GDP ratio to fall over time will decrease the proportion of total expenses going to debt servicing. Debt servicing costs account for a decreasing proportion of the province's total expenses. In 2001-02 the net debt servicing costs comprised about 17.5% of total expenses. In 2004-05 the proportion of total expenses is estimated to drop to 14.6%.

Table 6: Debt Management Option -- No Allocation of Surplus to Debt Repayment ($millions)

	2004-05	2005-06	2006-07	2007-08	2008-09
Debt Servicing Costs	896	856	846	846	846
Total Expenses	6,156	6,390	6,667	6,970	7,288
Debt Service Costs % of Total Expenses	14.6%	13.4%	12.7%	12.1%	11.6%
Debt	12,400	11,570	11,570	11,570	11,570
GDP	30,068	31,632	33,277	35,007	36,828
Debt to GDP	41.2%	36.6%	34.8%	33.1%	31.4%
Assumptions: Expenses keep pace with nominal GDP growth (2004-05: 4.9%; 2005-06 on 5.2%); Offshore Agreement $830 million applied to debt in 2005-06					

Sources: Forecast Update, Nova Scotia Finance; GDP growth based on Atlantic Provinces Economic Council and TD Economics and Statistics Canada, table 384-0002

The example shown in the scenario in Table 6 shows that over the next 4 years, *if no additional payments are made on the debt* beyond the one-time payment from the Offshore Agreement in 2005-06, and expenses increase by the rate of GDP growth, the proportion of total expenses going to debt servicing decreases from 14.6% to 11.8%. In other words, debt servicing would decrease from about 15 cents to 12 cents of every dollar spent. The example assumes moderate economic growth. If the economy and expenses were to grow faster, the proportional decrease would occur faster.

The debt management approach taken in the APB focuses on stabilizing the debt. This will decrease the size of the debt relative to the size of the economy. Stabilizing the debt will improve the credit rating for the provincial government and decrease the proportion of expenditures going to debt servicing. It will also enable to the province to make long overdue social and economic investments.

The APB Fiscal Plan for 2005-06:
Investing in Nova Scotians

The ultimate responsibility of any government is the social and economic well-being of all citizens. Nova Scotia needs to reverse the trends of increasing poverty, inequality, ill health, environmental degradation, and marginalization of many communities within the province. We need to invest in programs and services that support social and economic development to address the years of under-funding. The province needs to do this in a fiscally responsible manner.

The APB fiscal plan is guided by two main objectives:

- Investment in programs to bring per person expenditure to a level comparable with at least the Atlantic provinces.
- A decreasing debt-to-GDP ratio.

The fiscal plan develops two new funds:

- **The Social and Infrastructure Investment Fund** to eliminate the social debt that has accumulated in the province. All surpluses generated will be allocated to the fund (see Table 7). Funds will be invested in existing programs and in developing new programs that support social and economic development and protect the environment. The federal government is a crucial partner in the financing of the fund. New program initiatives will be developed through community-based public consultations and environmental impact assessments.

- **The "Hummer Tax" Fund (Gasoline Environmental Fund)** This tax fund encompasses a two-pronged approach: increased registration fees for passenger vehicles with an average fuel consumption rate of more then 8 litres per 100 kilometres; and an increase in the automotive fuel tax. These measures will encourage decreased fuel consumption and generate funds that will be dedicated to supporting public transportation initiatives and innovations in automotive fuel conservation.

    A. The "Hummer tax" is focused on new vehicles with high fuel consumption. The tax would increase registration costs for new passenger vehicles at $50 for each additional litre of fuel consumption over the base of 8 litres per 100km, based on Natural Resources Canada, Fuel Consumption Guide.[16] For example, a vehicle that consumes 12 litres per 100 km would pay an additional $200 (4 x $50) per year in registration costs, while a new Honda Civic would have no tax increase.

B. The provincial fuel tax would increase by 2 cents per litre. This would encourage fuel conservation by motorists and raise additional revenues to be allocated to the fund.

These 2 approaches would raise approximately $35 million in 2005-06.

For 2005-2006 the Alternative Provincial Budget (see Table 7):

- Covers program cost increases due to inflation;
- Allocates $246 million to the Social and Infrastructure Investment Fund;
- Maintains a balanced budget;
- Reduces the province's debt to GDP ratio.

Table 7: Nova Scotia Alternative Budget Fiscal Plan 2005-06 to 2008-09 ($ millions)

Revenue	2004-05	2005-06	2006-07	2007-08	2008-09
Provincial Sources	3,654	3,833	4,030	4,338	4,561
Total Federal Transfers	2,169	2,240	2,333	2,427	2,526
Total Revenue	**5,883**	**6,073**	**6,364**	**6,765**	**7,088**
Expenses					
Net Program Expenses	5,260	5,360	5,741	6,072	6,505
Program & Infrastructure Investment Fund		246	189	280	191
Net Debt Servicing Costs	896	856	826	826	826
Total Expenses	**6,156**	**6,462**	**6,766**	**7,188**	**7,532**
Annual Program Expense Increase		**6.6%**	**6.0%**	**7.1%**	**5.4%**
Net Income for Government Business Enterprises	346	389	402	423	444
Surplus	73	-	-	-	-
Transportation environmental fund, (dedicated tax)		35	37	39	41
Debt	12,400	11,570	11,570	11,570	11,570
GDP	30,068	31,542	33,166	34,874	36,670
Debt/GDP	**41.2%**	**36.7%**	**34.9%**	**33.2%**	**31.6%**
Net debt servicing costs/ total expenses	**14.6%**	**13.2%**	**12.2%**	**11.5%**	**11.0%**

The APB Fiscal Plan is based on on the following sources: NS Public Accounts, 2004; NS Forecast Update, Dec. 20, 2004, Atlantic Provinces Economic Council & TD Bank forecasts and Statistics Canada Table 384-0002. Assumptions: Real GDP growth: 2004-05 4.9%; 2005-06 forward 5.2%; Offshore Agreement $830 million applied to debt 2005-06

Economic Growth Forecast

The APB forecasts a moderate rate of growth (2.5% to 2.7% annual real growth) and inflation is forecast at 2.4% per year, over the next four years It also ensures that there is sufficient revenue capacity to limit the impact of decreased revenue that would accompany an economic slowdown.

Revenue

In 2005-2006 the APB places an immediate freeze on user fees – no new fees and no increase in the cost of existing fees. No individual or corporate tax cuts are contained in the fiscal plan. The first priority in tax reform will be to cut the province's increasing dependence on gaming revenues, in particular video lottery terminals (VLTs). The phasing out of VLTs would decrease provincial revenue. The loss of revenue would decrease the surplus and thereby decrease funds available for investment in public services or the revenue would have to be re-couped through other tax measures.

Any decrease would be covered through decreased allocations to the Social and Infrastructure Investment Fund and/or through increases to individual and corporate income taxes.

The fiscal plan assumes that new federal transfers will increase according to recent federal provincial equalization and social and health agreements.

Sable gas project royalties

Initial royalty projections anticipated that the royalty regime from the Sable gas project would move into a higher tier in 2007-2008. Recent downward revisions of the projected gas reserves could delay the timing of this increase and the amount of the increased royalties. The increases could add between $100 and $200 million annually to provincial revenue. The APB fiscal plan does not include these increases, but when the increases occur, half of the funds would be allocated to the Social and Infrastructure Investment Fund and the remainder divided between paying down the debt and implementing progressive tax reform. These tax reforms could include decreasing reliance on gambling revenue, user fees and the rate of sales tax.

Expenses

The APB ensures sufficient funds to departments to cover increased costs due to inflation (approximately 2.4% increase annually). Expenditure is increased annually by the previous year's program expenses, including the funds allocated to Program and Infrastructure Fund. All new funding initiatives announced by the federal government will be allocated directly as additional funding to programs and services, and not used to replace existing provincial funding to those programs or to fund tax cuts.

In 2005-06 $246 million is allocated a Social and Infrastructure Investment Fund that specifically targets the social debt by investing in the revitalization of programs and services and the provincial infrastructure. Program expenses are forecast to increase by approximately 10% in 2006-07 and following years. This will go some way in bringing the provincial government's investment in the province closer to the level of the other provinces.

Debt

The APB debt management strategy ensures that the province's debt to GDP ratio decreases each year. The fiscal plan assumes that the one time cash payment of $830 million resulting from the Offshore Agreement is allocated to paying down the provincial debt. By 2008-09 the debt to GDP ratio is forecast to decrease to 31.6%

Surpluses

All surpluses are allocated to the Social and Infrastructure Investment Fund. Any additional surpluses beyond those anticipated in the fiscal plan would be allocated as follows:

- half the surplus allocated to the Social and Infrastructure Investment Fund
- remainder allocated to tax reform and debt payments.

The Alternative Budget Fiscal plan presents a responsible, practical fiscal strategy that revitalizes public services, promotes sustainable economic development and manages the debt.

Endnotes

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