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Prosperity for All

An Alternative Economic Path for Newfoundland and Labrador

Diana Gibson and Greg Flanagan

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Summary

Newfoundlanders and Labradorians have a proud tradition of caring and sharing in good economic times or bad. This report will illustrate that these are still good economic times and that sharing the wealth continues to be important, not just from a social justice perspective, but for the health of the economy as a whole.

Newfoundland and Labrador (NL) has achieved considerable success in creating a vibrant economy with increasing prosperity in the past decade. Despite recent deficit projections, the province is in a very strong fiscal position. Revenue has grown more than program spending and there has been a net increase in tangible capital infrastructure. Net debt has fallen from almost 70 per cent of Gross Domestic Product (GDP) in the 1990s to a low of less than 25 per cent — quite a remarkable turnaround.

With dramatic and steady growth in GDP, the province weathered the recession better than elsewhere in Canada. We attribute much of this to the province's strong public sector as a stabilizing force during tough economic times. There has also been continued strong growth in the private sector, where investment has been at record levels. Residential construction also continues to rise, reaching over $2 billion in 2013 without faltering.

Given the province's strong fiscal position, we recommend that the government not make a significant change in direction at this point. This report shows that austerity measures would 'rock the boat'. The report illustrates that spending growth is under control and at the level needed for such an expensive jurisdiction, that there are revenue options that should be ex-

plored and that the job and economic impacts of austerity would negatively reverberate across the entirety of the province's economy.

Historically the NL government has tended to be quite conservative in its budget estimates. Surpluses were underestimated and deficits over estimated by a large margin for every year between 2006 and 2012. According to this record, the deficit estimates for 2013 may be significantly overstated and should be treated skeptically if they are used to justify social spending cuts. Additionally, there are a number of specific drivers that are temporary in nature. Short-term, temporary fluctuations should not drive social sector cuts that will have long-term and damaging impacts.

Spending Is Under Control

Provincial expenditures have fallen as a share of the economy, from 30 percent of GDP in the 1980s to 20 percent in 2012. When compared to other provinces, NL is middle of the pack, even when capital spending is included.

NL spending should be higher than other provinces as it is a much more expensive place to deliver services and programs for reasons that include:

- Low-density, highly rural populations;
- Difficult geography;
- Aging population and changing demographics;
- Higher than average growth in cost of living;
- Infrastructure and human capital investments needed to support the resource economy and to diversify the economy; and
- Higher unemployment and poverty rates.

NL must be careful to not emulate Alberta, a province that now has the richest rich and the poorest poor in the nation and has the highest number of working families using food banks in the nation. Alberta is also paying the price for poor planning; spending a 30 per cent premium on capital for waiting too long to build needed infrastructure and using over 60,000 temporary foreign workers due to lack of appropriate pacing of development and poor human resource planning.

Given the low number of direct jobs in oil and gas, the majority of Newfoundlanders and Labradorians will see the high cost of the resource economy without enjoying the direct benefits. Unemployment in NL remains high, the median income is still low, and poverty and homelessness persist. Many will continue to be hit hard by the rising cost of living and erosion of housing affordability. NL will need to continue to focus on social programs and a progressive tax structure as critical mechanisms of both redistributing income and managing costs for the average citizen.

Look to Revenue Options

Tax revenues as a percentage of GDP are the second lowest in the nation. If NL moved to the Canadian average, it would have created approximately $600 million more in revenues in 2012 alone. Moving up to the higher end of the spectrum would mean over $1 billion in increased revenues.

NL also has the second lowest tax rates on high earners. Other jurisdictions are reinstating progressive income tax rates and surtaxes: Ontario is increasing the rate for top incomes by 2 per cent, BC also by 2 per cent, and Quebec by 1.75 per cent. This reflects a much larger trend, with top marginal rates rising around the world. NL, on the other hand, has gone in the other direction. Tax cuts have disproportionately benefited higher earners. One option for increasing NL's revenues would be to expand the progressive tax system to be more in line with other provinces and create a new tax bracket for high-income earners, by adding a new higher marginal rate on high incomes.

Another area of foregone revenues is high corporate profits. The share of the economy going to corporate profits in NL is more than twice the Canadian average. The resource extraction sector in NL is mostly foreign owned, meaning those profits are not just leaving the province but leaving the country. Given that the oil and gas extraction industry has the lowest number of jobs per dollar invested, it is also not giving much back in the form of employment. The recent budget crunch shows that the province can ill afford to give away such revenues.

Other jurisdictions like Norway and Australia have implemented special taxes to capture windfall profits, especially in the resource sector. A change in price can mean a huge shift in profits that was not anticipated by normal tax and royalty structures. NL should explore the options for an extraordinary profits tax across large corporations to capture a higher share of these windfalls.

Employment and Economic Impacts of Austerity

Public sector spending and employment has benefits far beyond the direct services those employees deliver: it creates jobs and economic activity across the public and private sectors. The people employed directly by government spending will spend most, if not all, of their income locally on goods and services. That spending creates more jobs in the private sector and those employees in turn spend most, if not all, of their income on local goods and services, again creating more jobs and economic growth. Thus, local private sector businesses, many of them small businesses, benefit from government spending. Conversely, private sector businesses will be impacted and jobs lost when public sector jobs are cut.

Given that government spending creates almost 20 times as many jobs as oil and gas extraction, these impacts should not be underestimated. This does not include the added benefit of the positive impact that quality public services have in terms of quality of life, reduced long-term health costs, and social services costs.

There are those who would argue that leaving money in the hands of the corporations and the wealthy creates more jobs and economic growth because they spend and reinvest it. The multiplier data in this report and international studies do not bear that out. The wealthy are more likely to spend funds on out-of-province luxuries, while corporations are investing relatively few of their revenues on productive investment. Thus, more jobs are created if the province taxes that income/profits and spends it directly on programs, services, or infrastructure. This is particularly the case in NL, where the foreign ownership profile guarantees that a high proportion of those profits will leak out of the provincial and national economies all together.

Conclusion

NL is in a strong fiscal position, but this report illustrates that social spending and program cuts would result in significant waves across the economy. In addition, this report clearly illustrates that NL is an expensive place in which to deliver social services and that the social and physical infrastructure needed to support a resource economy, while not cheap, is a necessary investment in the future health of the province — socially and economically.

A critical concern for Newfoundlanders and Labradorians, after sharing the poverty for so long, is how to share the prosperity. Social spending will continue to be an important mechanism for sharing the province's prosperity and mitigating the worst costs of the resource economy for the average citizen.

Introduction

NEWFOUNDLAND AND LABRADOR has achieved considerable success in creating a vibrant economy with increasing prosperity. The evidence for this is seen in many fiscal measures: the rise in GDP and personal incomes per capita; the fall in the provincial debt — both absolute and more spectacularly as a percentage of GDP; the rise in employment and fall in unemployment; the increase in tangible capital infrastructure; the positive climate for private investment; and in the rise in residential construction.

The province also faces challenges as an economy that is increasingly resource-driven. Volatile commodity prices mean relying on resource revenues is risky. At the same time, NL has a very recent history of being a less wealthy province and thus a legacy of underinvestment in social and physical infrastructure. There are additional challenges associated with the province's geography and demographic makeup.

An important concern for Newfoundlanders and Labradorians, after sharing the poverty for so long, is how to share the prosperity. As this report illustrates, the province's median income is still quite low compared to other provinces and the resource economy is not a big employer. In this context, social spending is an important mechanism for sharing the prosperity. Instead of austerity, the NL budget should be looking at social means to expand the economy, such as affordable child care, and programs that address poverty and homelessness.

These challenges are all manifest in the 2013 budget debate. Not unlike other resource-dependent economies in Canada, such as Alberta, NL is facing deficit budgets despite record levels of private capital investment coming into the province. There are pressures on the provincial government to cut spending in reaction to rising deficit projections. However, this report shows that public spending cuts cause waves across the economy, impacting negatively on jobs and economic growth. Also, it is important to maintain stability in public services. Decreasing levels of service because of decreasing short-run revenues incurs disruptions that have much greater impacts on costs in the long run. Current revenue shortfalls should not drive decisions on service levels in the public service and to Newfoundlanders and Labradorians.

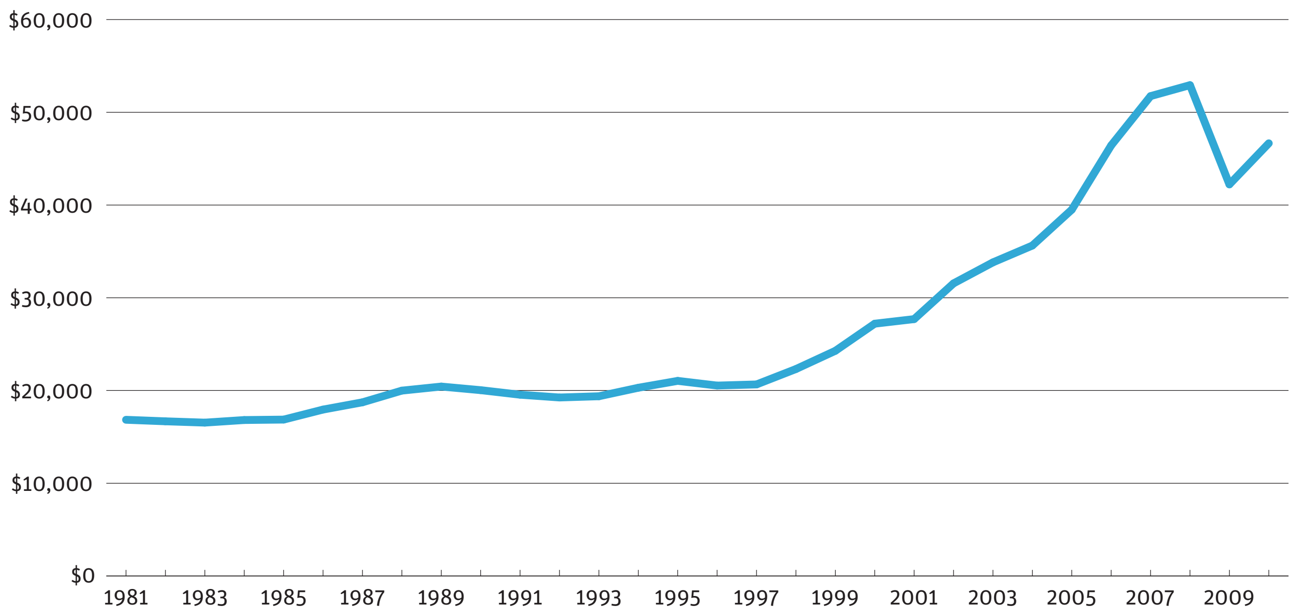
This report examines the overall economy, drivers of the level of debt, the long-term revenue and expenditure picture, and policy options for the province. First, the report begins with a brief overview of the economy. It then examines both expenditure and revenue trends in a historical and comparative context and takes into consideration the unique mix of challenges faced by the province at this juncture. Finally, the report lays out options for further improving the province's fiscal position. We look at the job and economic implications of both public spending cuts and alternatives to cuts. The report begins with a review of overall finances and then turns to a review of expenditure levels, revenue options and examines the employment and economic implications of austerity measures.

We show in this analysis why the NL government should not rock the boat and should, instead, continue the direction it has pursued over the past decade. The province is at a crossroads. In one direction lies the continued strong public sector that has stabilized the economy, supported strong growth in GDP, a falling unemployment rate, shared prosperity that was based on good growth in public revenues, budget surpluses in excess of estimates, and a falling public debt. Down the other road lies austerity, which will mean less stability, higher unemployment, lower economic growth, increasing inequality and a more resource-dependent economy. Lessons from Alberta are used to illustrate why Newfoundland and Labrador should take the high road.

Background on Newfoundland and Labrador's Economy

The province of Newfoundland and Labrador is in a very strong fiscal position, with exceptional growth in its economy over the past decade. *Figure 1* illustrates the growth in real GDP per capita.[1] This measure of individual wellbeing was relatively constant at $20,000 over the 1980s and 1990s.

FIGURE 1 Newfoundland & Labrador Real ($2002) Gross Domestic Product (GDP) Per Capita



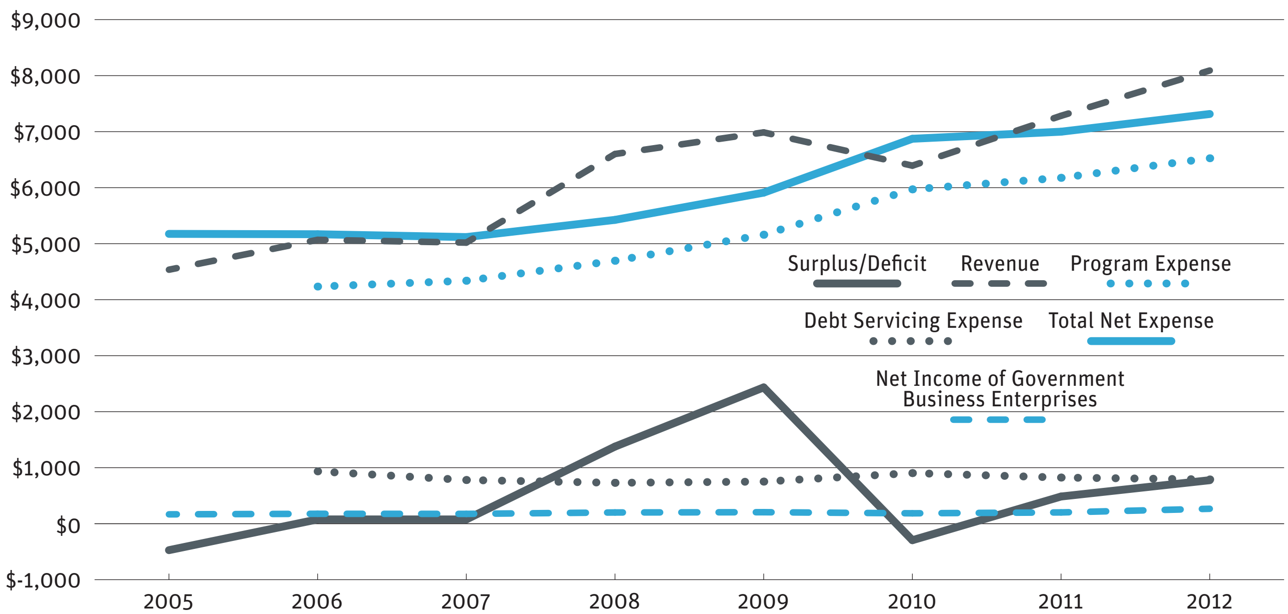
Source Statistics Canada, Table 384-0001 Gross domestic product (GDP), income-based, provincial economic accounts, annual ($1,000,000), Table 051-0001 Estimates of population, by age group and sex for July 11, Annual, Table 326-0021 Consumer Price Index (CPI), 2009 basket, annual (2002=100)

Then in the late-1990s GDP income took off, rising two-and-a-half times, to $50,000. Despite a small setback in 2008, this growth is expected to continue into the near future. The government appears to have managed the provincial public sector well. Especially during the recession of 2008/2009 and given the fiscal turmoil in Canada and abroad, NL has weathered the storm particularly well. We attribute this at least in part to a strong public sector, which has had a desirable countercyclical balancing effect on NL's economy.

Fiscal Situation: The Big Picture

The exceptional growth in the economy over the past decade is illustrated in *Figure 1*. The fiscal situation in NL is illustrated in *Figure 2*, with data taken from the consolidated statement of operation — net expense basis. For the past seven years, revenue has grown more than program spending and there have been surpluses for four of the past five years. Debt service costs have been stable and government enterprise income has been growing slightly.

FIGURE 2 Newfoundland and Labrador Budget Revenue and Expenses, Actuals ($ Millions)



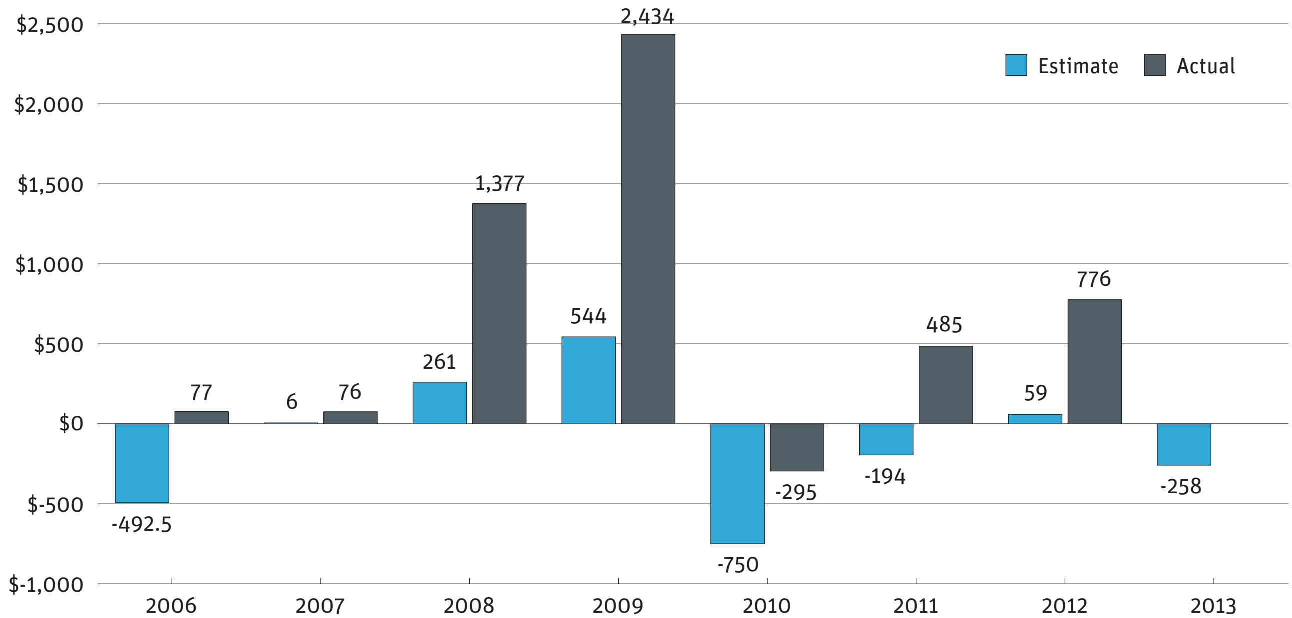
Source Newfoundland and Labrador Consolidated Statement of Operations — gross expense basis, 2005–12.

Debt

Each year the NL government includes in its budget estimates for the surplus/deficit and the "realized" or actual result for the previous fiscal year. *Figure 2* shows the realized (or actual) budget numbers. The government tends to be conservative in its budget estimates, underestimating revenues and surplus. *Figure 3* illustrates the degree to which these estimates have been too pessimistic. Underestimating revenues and overestimating expenditures, to a degree, is appropriate for fiscal prudence. However, the pattern of estimates in *Figure 3* indicates that the government's deficit estimates for 2013 may again be overstated. Those estimates should be treated skeptically if they are used to justify cuts to public services spending, as these cuts may be more due to ideological propensities than to the fiscal situation.

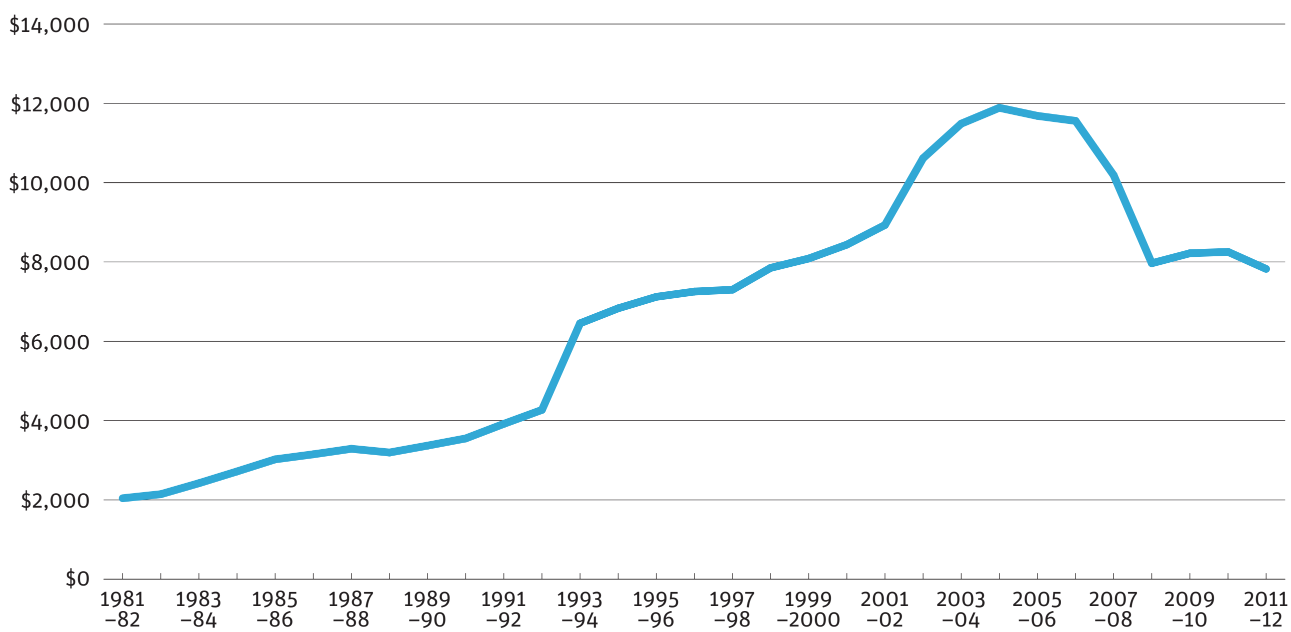
The province's net debt is shown in *Figure 4*. Debt grew until 2006, much of it accumulated as the economy developed at a considerable pace and needed greater infrastructure to support new industries (e.g. oil) and adjusted old industries (e.g. fisheries). After 2006, the absolute debt decreased as revenues substantially exceeded expenditures.

FIGURE 3 Newfoundland and Labrador Budget Surplus and Deficit Estimates and Actuals ($ Millions)



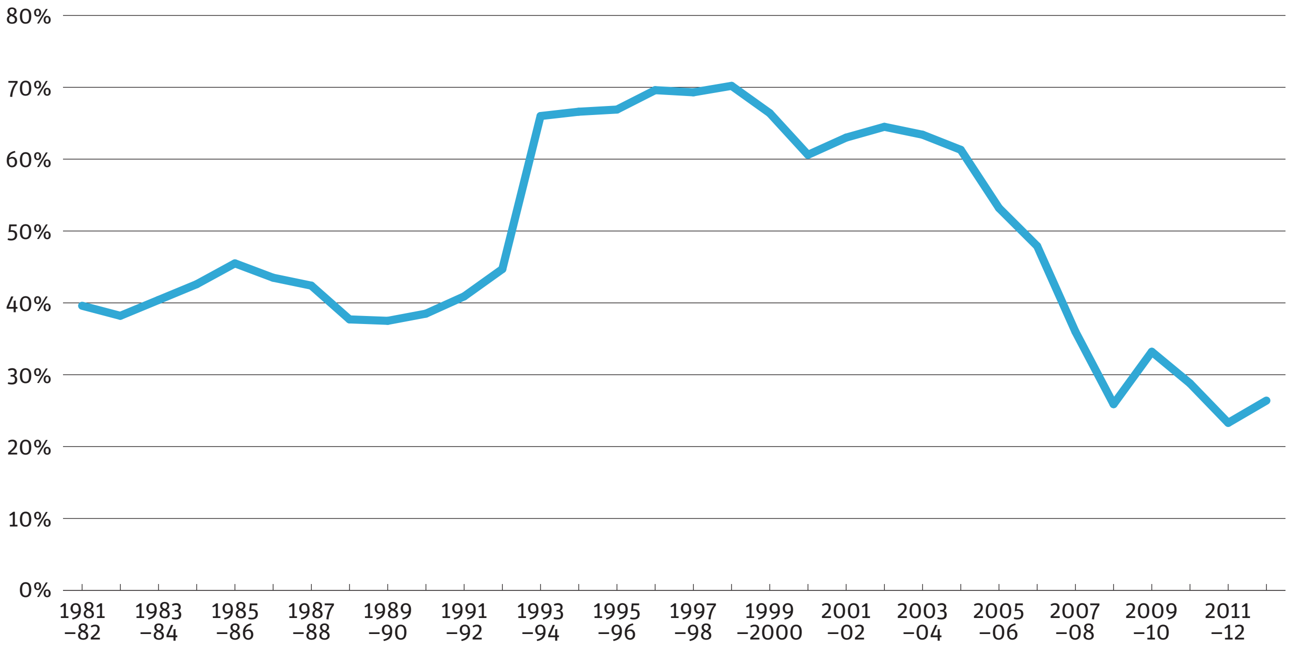
Source Newfoundland and Labrador Consolidated statement of operations—gross expense basis 2005–12
Note Estimates for the 2013 deficit have already been revised upwards to $725.8 million in the province's Fall Update.

FIGURE 4 Newfoundand and Labrador Government Net Debt ($ Millions)



Note The tables are based on the public accounts of provincial and federal governments. Due to differences in accounting and reporting practices, figures are not strictly comparable between provinces. Moreover, a province's accounting and reporting practices may have changed over time, limiting the extent to which historical comparisons can be made. RBC Economic Research , January 21, 2013

FIGURE 5 Newfoundand and Labrador Government Debt as a Percentage of GDP



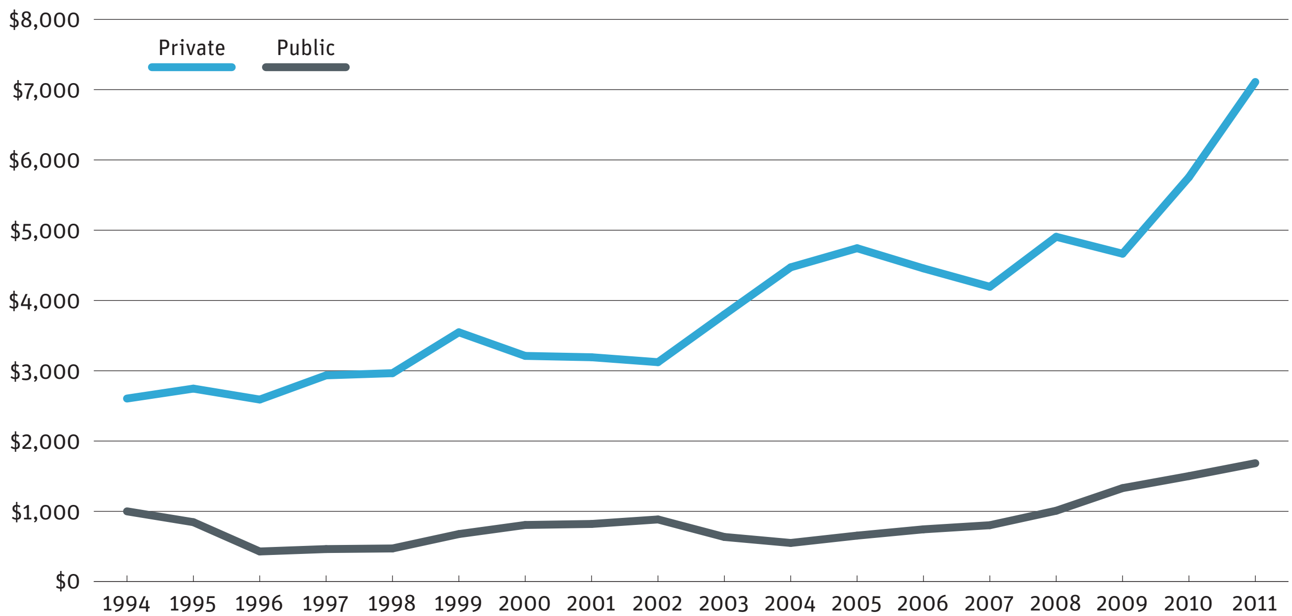
Note The tables are based on the public accounts of provincial and federal governments. Due to differences in accounting and reporting practices, figures are not strictly comparable between provinces. Moreover, a province's accounting and reporting practices may have changed over time, limiting the extent to which historical comparisons can be made. RBC Economic Research , January 21, 2013

A better way to illustrate the positive direction the provincial debt has taken is illustrated in *Figure 5*, where the net debt is measured as a percentage of GDP. The debt of NL was about 40 per cent of GDP during the 1980s, then increased to almost 70 per cent in the 1990s. During the 2000s, the debt ratio fell to a current low of less than 25 per cent— quite a remarkable turnaround. The success to the economy in bringing down the province's debt burden again attests to maintaining a *steady as you* go policy.

Private Sector Indicators

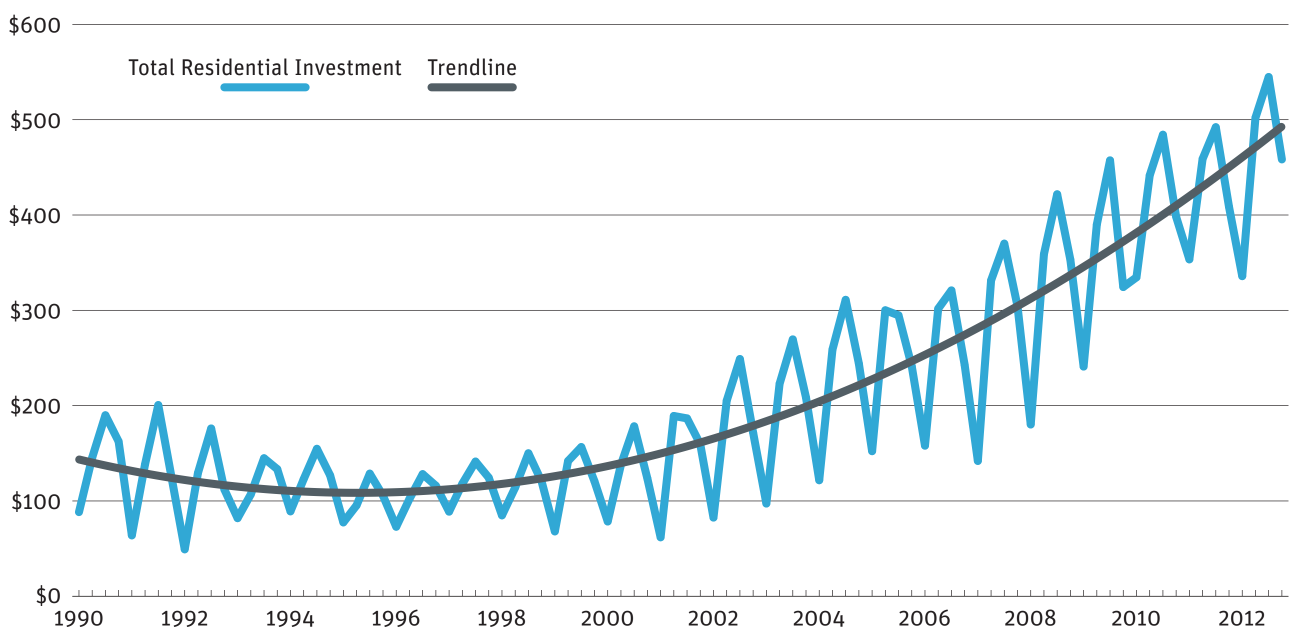
The private sector in NL is strong and optimistic about the future, as indicated by the investments in the province. *Figure 6* indicates the recent surge in private capital and repair expenditures (public expenditure is also shown for comparison). And although expenditures dipped during the recent recession, private expenditures are over double what they were in 2000.

FIGURE 6 Newfoundland & Labrador Capital and Repair Expenditures Actual, Preliminary Actual and Intentions ($ Millions)



Source Statistics Canada. Table 032-0002—Public and private investment, summary by province and territory, annual (dollars)

FIGURE 7 Newfoundland & Labrador Total Residential Investment (Per Quarter, $ Millions)



Source Statistics Canada. Table 032-0002—Public and private investment, summary by province and territory, annual (dollars)

Residential construction is often an indicator of the health of the overall economy. NL, after a very 'flat' residential investment of ~$100,000,000 per quarter over the previous decades, continues to have considerable growth in residential construction. *Figure 7* shows residential construction rising to over $2 billion a year, illustrating that NL's economy is strong by this standard.

Expenditures

THIS SECTION CONSIDERS public expenditures in Newfoundland and Labrador, how they compare to other jurisdictions, and how NL's characteristics inform the need for, and costs of, public services in the province.

NL Expenditures Compared to Other Jurisdictions

Much of the debate around public sector spending in NL has focused on spending per capita compared to other Canadian provinces. This limited measure tells us very little about the appropriateness of public spending. It does not consider affordability, nor does it take into consideration the history or specifics of particular jurisdictional circumstances. Gross Domestic Product (GDP) is the standard measure of income potential used around the world to consider and compare public accounting.

NL business representatives have called for public sector job cuts on the basis of comparing NL to other North American jurisdictions on a spending per capita basis.[2] However, North America is a poor basis for comparison, given that it is quite a low spender compared to other OECD and especially EU countries. Spending as a percentage of GDP is much higher in European countries than in Canada. According to Treasury Board of Canada statistics, Canada's total expenditures average 39.7 per cent of GDP.[3] In contrast, for the EU, in 2011 expenditures were 49.1 per cent of GDP, while the Nordic countries were even higher: 51.3 per cent for Sweden, 57.9 per cent in Denmark, and 50.1 per cent for the Netherlands.[4] In this context, NL is not a big spender. Certainly with inequality levels and the economic malaise evident in the U.S., comparators from the EU are far more in line with the values of NL.

Spending Affordability

NL expenditures as a share of GDP have been falling. *Figure 8* indicates that NL's program expenditures were approximately 30 per cent of provincial GDP through the 1980s and into the late-1990s. Program expenditures then fell continuously to a low of 17 per cent in 2007–08. Expenditures are now approximately 20 per cent of GDP (2012).[5]

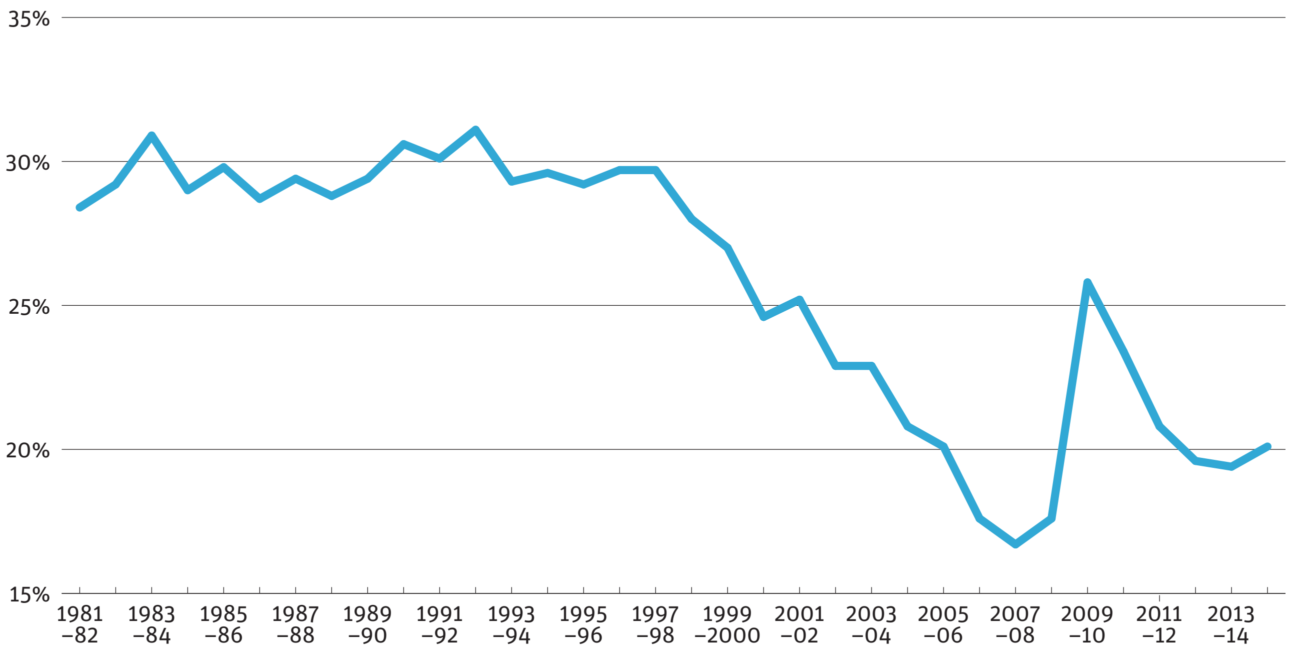
Even when we make a Canadian comparison, NL is not a big spender on public services. Although provincial program spending is relatively high on a constant dollar, per capita basis compared to other provinces, it is not high when considered on a spending-to-GDP basis. Looking at total spending-to-GDP, NL is middle of the pack — and that includes capital spending.

Figure 9 compares NL's situation with other Canadian provinces, showing each province's total public program expenditures as a percentage of its GDP. NL is lower than the other Atlantic Provinces, as well as Manitoba. It is higher than Alberta, BC, Ontario, and Quebec. However, NL faces some very different and more costly circumstances than these highly urbanized provinces.

The province's Minister of Finance has said the current level of expenditure is not sustainable, a clear indication the government intends to curtail spending. This is strongly suggested by the Minister's statement: "The focus of this year's consultations is to seek feedback from the public and stakeholders on effective ways *to reduce spending* and areas that should take priority in Budget 2013" (emphasis added).[6] It is understandable that NL citizens might ask why this should be the case.[7]

The focus on the deficit is misguided. NL can learn from Alberta and not repeat the same mistakes. The large cut to public services spending in Alberta in the mid-1990s was just such an overreaction. Alberta has been paying dearly for almost two decades for this, recently running large deficits while still attempting to redress the damage to health care, education and social services caused by these extreme measures.[8]

FIGURE 8 Newfoundand and Labrador Government Program Expenses as a Percentage of GDP



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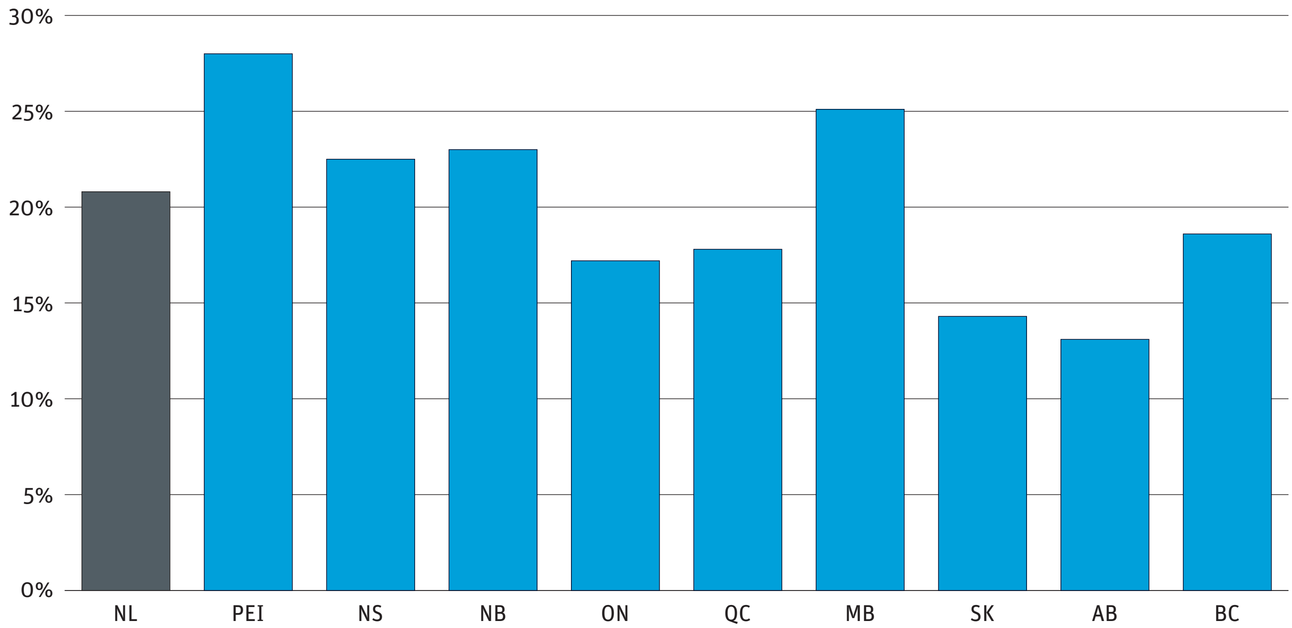
Newfoundland Is More Expensive

Inter-provincial comparators are complicated by differences in history, geography, demographics and density, and many other factors that do not figure into rough per capita spending data. On all of these criteria, NL is not directly comparable to other provinces. The following factors, among others, make it more expensive to deliver public services in NL.

Low-Density, Highly Rural Population

In NL, the number of persons living outside a census metropolitan area (CMA) and a census agglomeration (CA) was 265,772, or 51.7 per cent of the population. This is significantly higher than other Canadian provinces and more in line with the territories. For comparison, the percentage of the provincial population in CMAs and CAs in 2011 was 11.3 per cent in Ontario, 19.4 per cent in Alberta, 39.1 per cent in Saskatchewan, and 53 per cent in the NWT. [9]

FIGURE 9 Provincial Government Program Expenses as a Per Cent of GDP 2011/12



Difficult Geography

Not only is NL less urban, but it is also has very difficult geography. The recent ferry debate is a good example of that. A significant portion of the province's rural population is located in remote regions that are difficult to access.

Aging Population and Changing Demographics

The population of NL is recently on the rebound. NL did lose population between the mid-1990s to the mid-2000s. More significantly, NL lost its young, as they left for greater economic opportunities in the rest of Canada and abroad. Although the population is now growing, it is characterized by an aging demographic. Population data is shown in *Figure 10*. The scale on the right illustrates the median age rising from 21 in 1971 to 44 in 2012. As the average age of the population rises, there is generally an increased pressure on social services and, particularly, on health care costs.

FIGURE 10 Newfoundland and Labrador, Total Population and Median Age

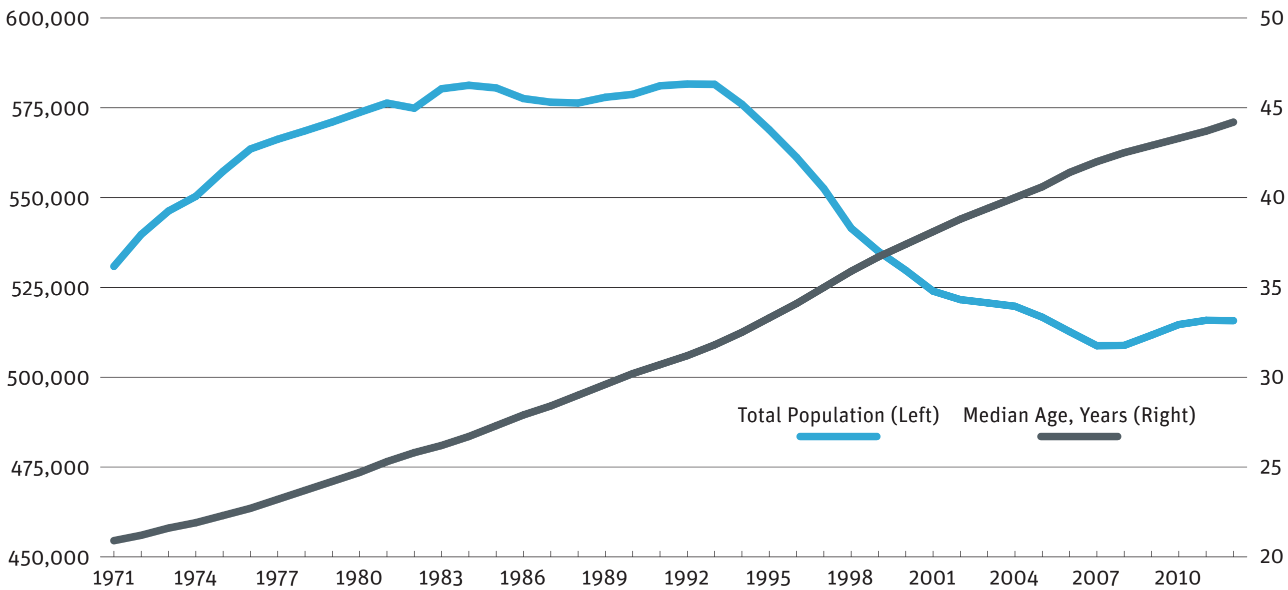


TABLE 1 Inflation: Consumer Price Index Comparisons

CPI All Items	2008	2009	2010	2011	2012
NL	2.9	0.3	2.4	3.4	2.1
Canada	2.3	0.3	1.8	2.9	1.5

Higher Than Average Growth in Cost of Living

As is common in resource boom economies, the cost of living is growing faster, on average, in NL than in other provinces (see *Table 1*). This is an indicator that spending needs to be higher in NL than in those provinces, as a dollar buys less goods and services in than it does in non-resource boom provinces.

Infrastructure and Human Capital to Support the Resource Economy and Diversify the Economy

A resource boom demands social infrastructure such as education, training, and health care. It places demands on housing, mental health, public health services, and other social infrastructure due to an increase in population. It also demands that physical infrastructure such as roads and ports be built, expanded or maintained. Thus, both to attract and keep investment in resource extraction, the government must spend resources to support the increased industrial development. That is not cheap. This part of public spending is so important that we discuss budget issues around infrastructure capital and investment at greater length in the next section.

Higher Unemployment and Poverty Rates

At the close of 2012, NL had the highest unemployment rate of all provinces. At 12.5 per cent, unemployment was far above the national average of 7.5 per cent. This is largely attributed to the large numbers of Newfoundlanders and Labradorians employed in seasonal industries. The only provinces that even come close are Nova Scotia, PEI and New Brunswick. For comparison, unemployment in Alberta and Saskatchewan is currently 4.6 and 4.7 per cent. According to *Canada Without Poverty*, NL also lags the national average on 8 out of 11 indicators of poverty.[10]

Given these drivers, it costs more per capita to deliver the same services in Newfoundland and Labrador than it does in other provinces. NL should be spending more per capita than provinces with less expensive demographic, population, and inflation profiles or it will have to deliver fewer services to it citizens.

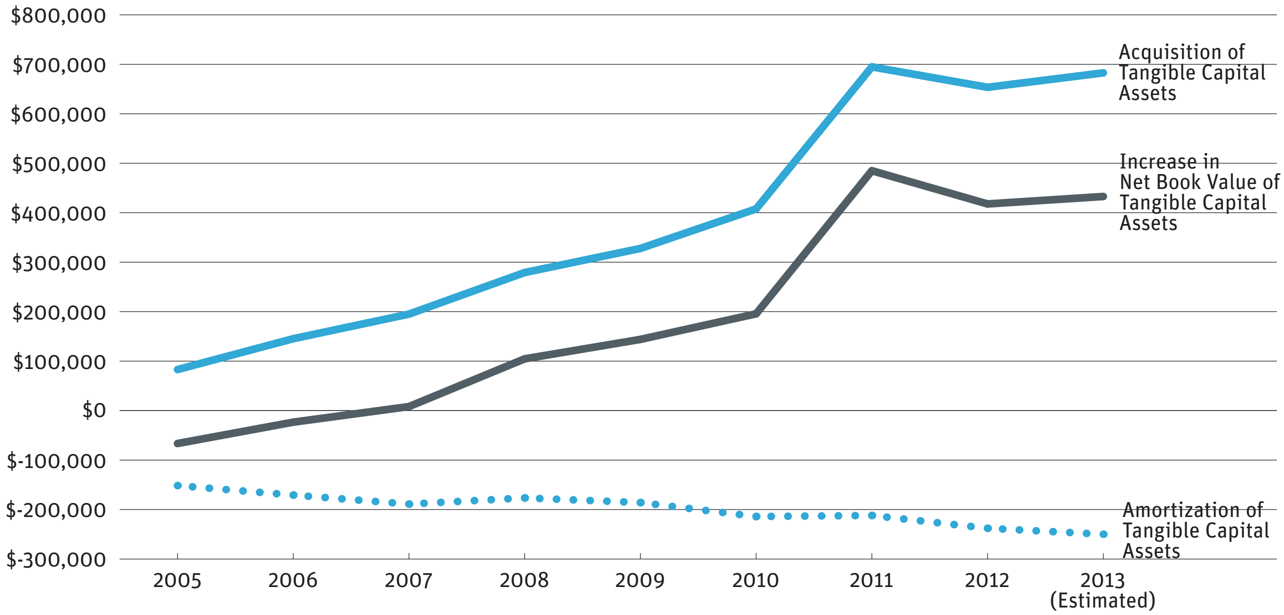
Infrastructure Spending

There are two distinct ways the government is building capital in NL. One is money transferred to Nalcor for energy development in the form of equity purchases. These are addressed as investments in the next section. The other is regular capital spending for schools, roads and other public infrastructure.

In terms of regular public infrastructure, NL budgeted a continued high level of capital investment in the 2012 budget. The province has been investing more than the value at which capital has been depreciating and building net assets (see *Figure 11*). There was a 50 per cent jump in spending between 2010 and 2011. This infrastructure net investment was done at the same time that public debt decreased, both in absolute and percentage of GDP terms. Given that NL underinvested in lean years, we would applaud this direction.

The Government of Alberta learned the hard way that a booming economy is an expensive time to build infrastructure. Alberta did not make counter-

FIGURE 11 Newfoundland and Labrador Capital (Tangible) Expenditures

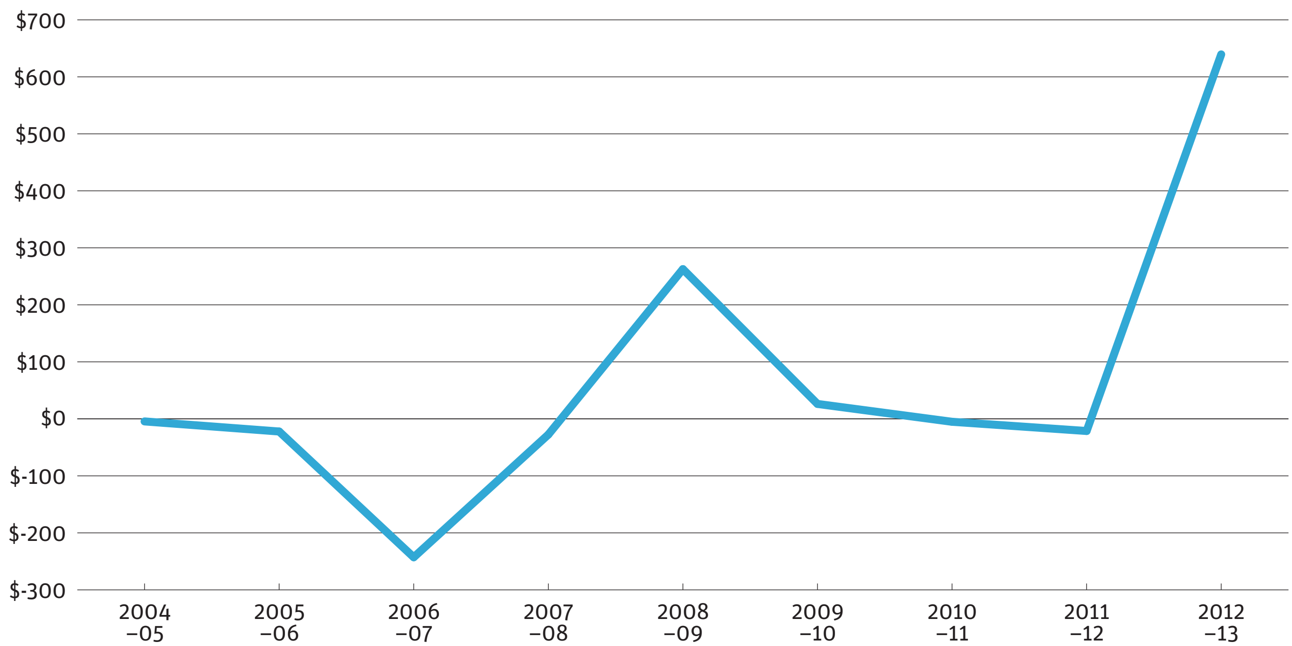


cyclical spending on infrastructure before the boom heated up. As a result of cutting back during the deficit hysteria of the Klein era, Alberta entered the boom years with a large physical and social infrastructure deficit; close to $7 billion in 2006 according to Alberta's Department of Infrastructure, as reported by the Parkland Institute. Costly nursing shortages and long emergency room wait times were clear indicators on the social side. On the capital side, Alberta paid a high premium for waiting to build infrastructure as the construction cost index ramped up into the boom. Thus, the province paid almost a 30 per cent premium for the infrastructure it built. This cost Alberta between $3 billion and $4.8 billion.[11]

Though properly maintaining and building an adequate stock of physical infrastructure is important, this should not be done at the expense of social programs. Public sector cuts should not be driven by capital investments. Given that capital investments are offset by assets that depreciate over time, the value of that investment should not impact on the deficit significantly.

NL also needs to keep an eye on private investment and the construction cost index. Engaging in high levels of public sector capital investment at the same time as high levels of private sector capital investment will drive up costs for both sectors. NL has record levels of private capital investment

FIGURE 12 Newfoundland and Labrador Realized Net Investment ($ Millions)



on the books, while housing starts are ramping up. The province is already seeing a mismatch between unemployed workers and the skills needed for new developments. Employers report having difficulty finding skilled workers and are contemplating looking outside NL for workers.[12] Alberta should not be an example to follow, with over 50, 000 temporary foreign workers filling jobs, not to mention those workers from other provinces such as NL.

Staging public and private sector investments would create construction jobs over the longer term rather than as one large, expensive boom. This would also help support NL's laudable goal of attracting younger workers and encouraging Newfoundlanders and Labradorians to return home. It would allow NL to plan the workforce accordingly. It would provide cost predictability for public and private investors and keep developments more affordable for both parties. Alberta has seen cost escalations that have been hugely expensive, not only to public sector capital projects, but for private sector investment. Muskrat Falls has already seen cost escalation and the province would not want to be a driver of further escalation due to poor planning.

Investments

The province uses accrual basis accounting — whereby revenues are recorded when earned and expenses are recorded when liabilities are incurred. Budget estimates for 2012–13 include a $664 million transfer to Nalcor for the Muskrat Falls development.[13] The accounting for this investment is included in the capital account, where expenditures whose benefits normally extend over more than one fiscal year are still counted as expenses in the current year.[14] This is a huge increase given the investments in NL, as illustrated in *Figure 12*. This transfer to Nalcor is an initial disbursement with additional figures committed for subsequent fiscal years. The payback on this investment will be years hence and will be accounted for in future budgets.

Revenues

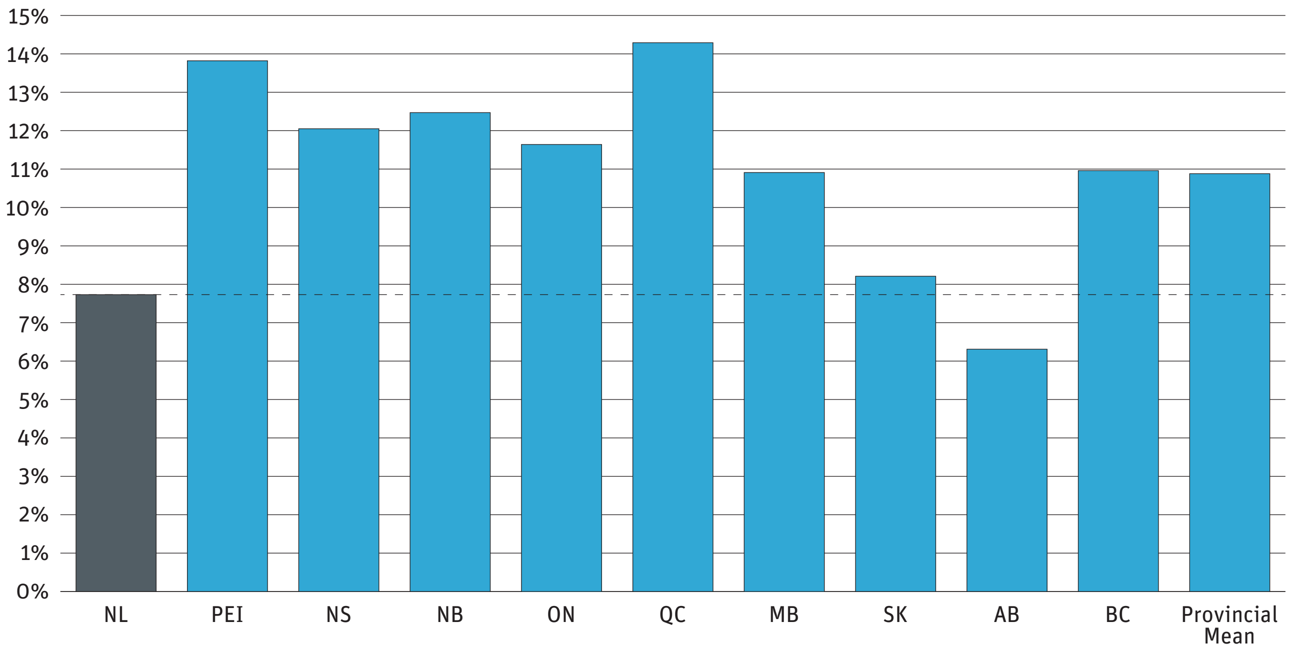
Forecasting

Tax revenues as a percentage of GDP are quite low in NL compared to other provinces. *Figure 13* compares the total tax revenue of each province in Canada collected in 2008 (*after* NL's first tax rate cuts). NL tax revenue as a percentage of GDP is lower than all provinces except Alberta (a province that inexplicably prides itself on its reliance on oil royalties and not taxes). As mentioned earlier, Alberta is not a particularly good comparator, as the province is in its third year of deficit, in the middle of a debate about revenue reform, and will likely see its tax mix changed and taxes go up in 2014.

Thus, in terms of revenue reform, there is still considerable room for NL to increase taxes. If the province collected the percentage of GDP at the level of the Canadian average, it would have brought in over $3.6 billion in 2012. At current revenue capture, NL only collected $3 billion.[15] Just by moving to the average ratio of revenue to GDP of the other provinces, NL could have $600 million more in revenue. Moving up to a ratio on par with that of PEI would increase revenues by almost three times that amount, or well over $1 billion.

The analysis represented in *Figure 14* indicates that NL's personal income tax rates applied to NL tax filer incomes realizes less revenue than using the tax rates of Prince Edward Island, Nova Scotia, Quebec and Manitoba. Overall, the tax rate schemes in the other provinces would generate less revenue. All provinces except Alberta have higher tax rates on higher incomes

FIGURE 13 Tax Revenue as a Per Cent of Gross Provincial Product (2008)



Note Tax revenue includes all income taxes, consumption taxes, property and related taxes

than NL (see *Table 2*). Therefore, a fairer approach to increase personal tax revenue would be to increase tax rates on high income, or add new higher marginal rates on high incomes. This approach may be particularly appropriate given the increase in high-income earners with the development of the oil industry in NL.

For example, there is some room for increasing personal income taxes, especially on high-income earners. *Figure 14* presents an interesting perspective on comparative personal tax rates. This analysis takes the NL tax filers data for 2010, applies each province's tax rate regime to the reported incomes (by income class), and calculates the tax revenue that would be produced.

Foregone Revenues

NL is foregoing revenues in a number of ways: first, through tax cuts and second, by not having the right tax mix to capture revenues that may otherwise leave the province.

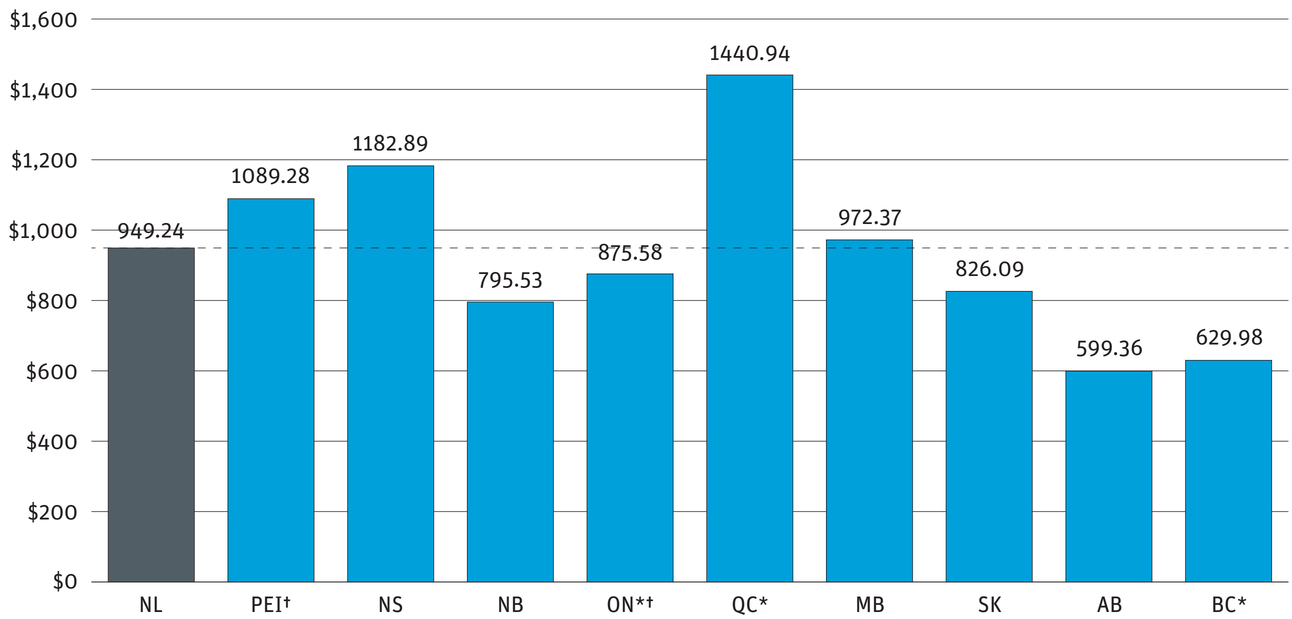
TABLE 2 Federal and Provincial/Territorial Personal Income Tax Rates, Brackets and Surtaxes For 2013

	Personal Basic Amount	Tax Brackets				
Federal	$11,038	15%	22	26	29	
		Up to $43,561	43,562–87,123	87,124–135,054	135,055 and over	
British Columbia	$10,276	5.06%	7.7	10.5	12.29	14.7
		Up to $37,568	37,569–75,138	75,139–86,268	86,269–104,754	104,755 and over
Alberta	$17,593	10.00%				
		All income				
Saskatchewan	$15,241	11.00%	13	15		
		Up to $42,906	42,907–122,589	122,590 and over		
Manitoba	$8,884	10.80%	12.75	17.4		
		Up to $31,000	31,001–67,000	67,001 and over		
Ontario	$9,574	5.05%	9.15	11.16	13.16	
		Up to $39,723	39.724–79,448	79,449–509,000	509,001 and over	
Quebec	11,195	16.00%	20	24	25.75	
		Up to $41,095	41,096–82,190	82,191–100,000	100,000 and over	
New Brunswick	$8,451	9.10%	12.1	12.4	14.3	
		Up to $38,954	38,955–77,908	77,909–126,662	126,663 and over	
Nova Scotia	$8,481	8.79%	14.95	16.67	17.5	21
		Up to $29,590	29,591–59,180	59,181–93,000	93,001–150,000	150,001 and over
Prince Edward Island	$7,708	9.80%	13.8	16.7		
		Up to $31,984	31,985–63,969	63,970 and over		
Newfoundland and Labrador	$8,451	7.70%	12.5	13.3		
		Up to $33,748	33,749–67,496	67,497 and over		

With regard to tax cuts, the province's February 2013 pre-budget consultation document states that $500 million of the deficit is due to tax cuts.[17] Though a reduction in taxes for lower income NL citizens can be positive in terms of their ability to participate more in the local economy, the same is not true for tax breaks for high-income individuals. As discussed in detail later, their marginal propensity to spend locally is much less; in other words, they will more likely spend their money either on debt, savings, or their condo in Florida.

The tax cuts in 2007 were heavily in favour of the top income brackets. Effective July 1, 2007, the following reductions were made to the province's personal income tax rates:

FIGURE 14 Comparison of Possible Newfoundland Revenue Based On Other Provincial Personal Income Tax Rates, Estimated From Individual Newfoundland and Labrador Tax Filers, 2010 Personal Income ($ Millions)[14]



* Also collect a health care premium
† Include surcharges on provincial tax paid

- Tax on the first income tax bracket was reduced from 10.57 to 8.7 per cent;
- Tax on the second bracket was reduced from 16.16 to 13.8 per cent;
- Tax on the third bracket was reduced from 18.02 to 16.5 per cent; and
- The 9 per cent surtax imposed upon middle- and high-income earners was eliminated.

The 2010 budget had further tax cuts for second and third tax brackets:

- Those in the bracket between $31,278 and $62,556 per year saw a rate cut of 0.3 per cent; and
- Those with incomes above that bracket saw their rate cut by 2.2 percentage points.

FIGURE 15 Newfoundland & Labrador Personal Income Tax Rates

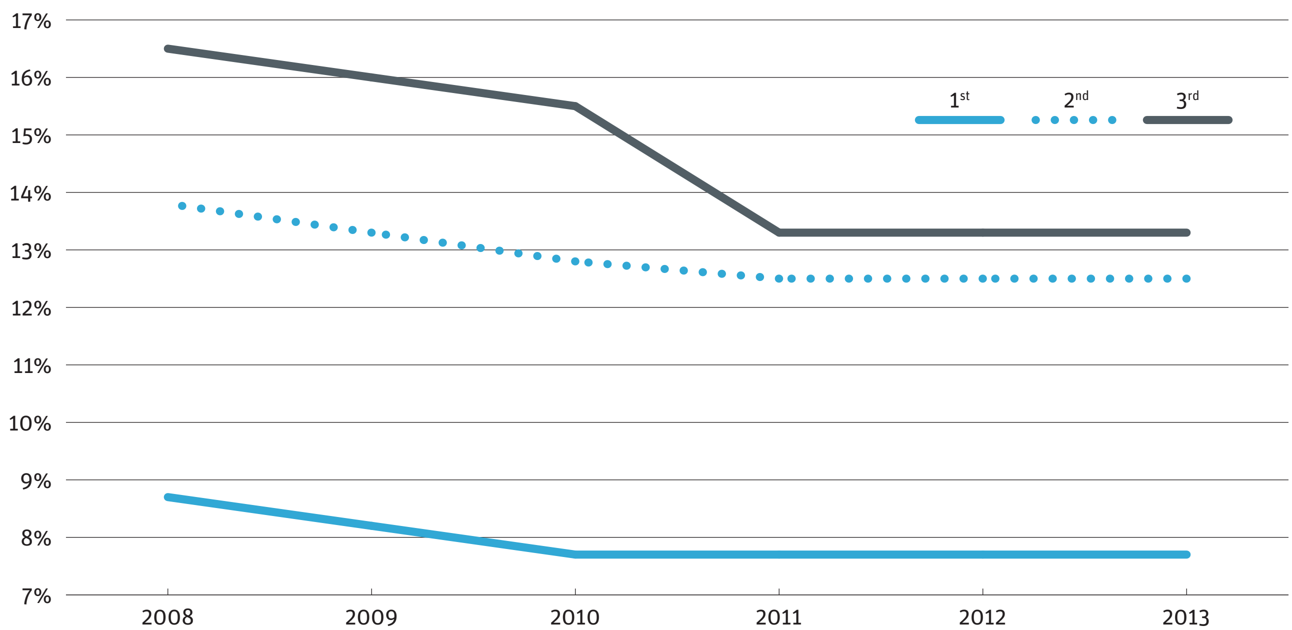


Figure 15 illustrates this history of tax reductions, especially in the two higher income classes.

Other tax reductions included a tax break to seniors by changing the age amount from $3,681 to $5,000 and a change in the small business tax, cut from 5 to 4 per cent effective April 1, 2010.

According to the government's Budget 2012 estimates, over a three-year period the cost of tax cuts for Newfoundlanders and Labradorians exceeded three-quarters of a billion dollars.

As mentioned above, there is room to increase taxes by creating a new higher income tax bracket, moving closer to other provinces. The section on spending verses tax cuts below explains how this would be a much more effective use of those funds.

The pre-2007 rates had a greater tax burden on those with higher incomes, therefore are more fairly distributive. Tax rate reductions have been greatest in the third bracket (highest income class).

If a fourth tax rate of 16.5 per cent is added for those earning, for example, greater than $100,000, while keeping the lower rates at the current 2013 values, this would result in increased revenues of $59 million and make NL's

FIGURE 16 Comparison of Possible Newfoundland Revenue Based on Previous NL Tax Rates Estimated From Individual Newfoundland and Labrador Tax Filers, 2010 Personal Income ($ Millions)

tax regime more progressive. The point being, NL should consider making its tax system a little fairer by implementing a fourth tax bracket.

Foreign Ownership and Corporate Profits

Foreign national or multinational corporations are doing the bulk of the resource extraction in NL. ExxonMobil is one of the key investors in the Hebron project and is majority foreign owned. Other major partners in the deal are also foreign owned:

- Chevron Corp, U.S. headquartered;
- Suncor Energy Inc., 56.8 per cent foreign owned; and
- Statoil ASA, 98.3 per cent foreign owned.[18]

In other projects, the same majority foreign ownership structure prevails as well. Husky, a player in White Rose, Hibernia and Hebron, is 90.9 per cent foreign owned.

TABLE 3 Revenues and Expenditures, Offshore Oil and Gas

($ Millions)	2008	2009	2010	Total Since 1995
Eastern Offshore Value of Producer Sales (NL and Nova Scotia)	13746.864	7173.885	8861.971	82422.94
Net Cash Expenditures Offshore NL	4273	3553.4	3723.2	32650
Net Cash Expenditures Offshore Nova Scotia	844.6	1015.7	946.9	12344.3
Revenues after Expenditures	12902.264	1885.185	4361.671	37428.64

Source Canadian Association of Petroleum Producers Statistical Tables. Net cash expenditures of the petroleum industry (NL and Nova Scotia), and Table 4.2.a Value of Producers' Sales (Eastcoast Offshore).

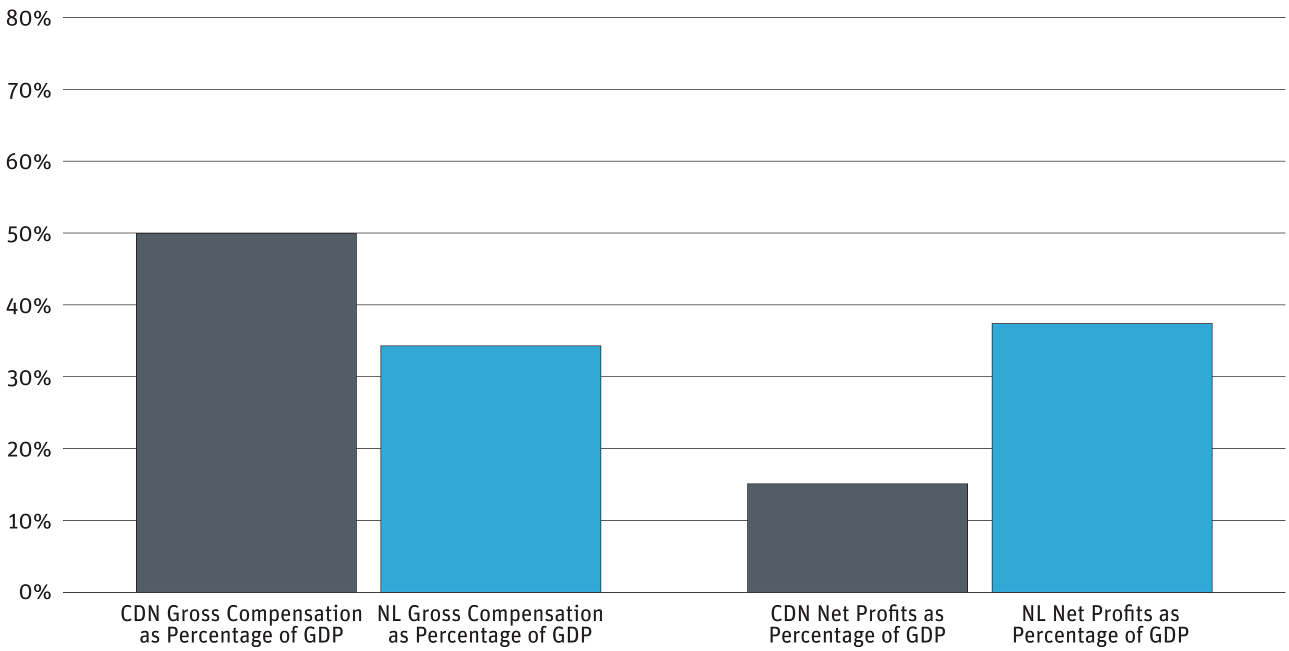
The profits in oil and gas are very high. These companies are not operating with tight margins; ExxonMobil alone netted over $30 billion in profits on its global operations in 2011. Exxon (Imperial in Canada), Suncor and Husky have taken advantage of higher refining margins and performed well despite challenges in the markets.[19]

Table 3 illustrates revenues and expenses in offshore oil and gas for NL and NS in 2010 based on industry data from the Canadian Association of Petroleum Producers (CAPP).[20] The table reveals that the offshore sector made before-tax net revenues of over $4 billion in 2010, the bulk of which was from production in NL. To account for initial capital investments, the final column includes total revenue and expenses for the period 1985 to 2010, and reveals a before tax net revenue of over $37 billion. This includes royalty payments as expenses, but not taxes. According to a Conference Board of Canada study, the effective combined tax and royalty payments by the offshore sector are complex but, overall, low due to both a royalty structure that provides excessive deductibility for investment costs and the federal Atlantic investment tax credit — in fact, they obtain a fiscal subsidy with a combined "negative" tax and royalty obligation.[21]

Mining is no different in terms of the ownership profile and profits are leaving the province and the nation from that sector as well. With Brazilian Vale mining company as the key investor in the Voisey's Bay project, the concentration will increase.

Given the high rate of profit in the offshore sector shown in the table, it is not surprising that corporate profits have been capturing a growing share of GDP. The tax and royalty structures in NL have been much less effective than those of other provinces at capturing these profits, as shown in *Figure 17*. It also shows, for contrast, how this compares to the share of NL's economy that goes to wages.

FIGURE 17 Profits and Wage Shares as a Per Cent of GDP: Canada Vs. Newfoundland and Labrador



Source CANSIM Table 384-0037 Gross domestic product, income-based, provincial and territorial, annual (dollars×1,000,000)

With existing foreign ownership structures, NL has little capacity to ensure corporate profits are reinvested in the local economy. Employment and local procurement can be useful instruments, but as explained in detail later in the report, they are not particularly effective in the case of oil extraction. This industry is very capital intensive. Few of those profits are redistributed into the economy through employment. Procurement is also not a solution. Though there is some local procurement, it is limited mostly to the construction phase and short term in nature, with limited impact on job creation. Allowing the excess profits to leave the province and the country is a significant lost opportunity for the citizens of NL.

The high foreign ownership of NL's capital-intensive resource industries means the province is foregoing a large potential revenue source. Deficit projections show that the province can ill afford to give away that level of revenue. Corporate taxes are important instruments to capture excess profits in the case of a capital intensive, resource extraction industry that is majority foreign owned. For NL to maximize the benefits of the industry to local citizens, higher corporate taxes and a tax on excess profits need to be considered.

TABLE 4 Comparative Corporate Tax Rates

Province or territory	Lower rate	Higher rate
Newfoundland and Labrador	4.0%	14%
Nova Scotia	4.0%	16%
Prince Edward Island	1.0%	16%
New Brunswick	4.5%	10%
Ontario	4.5%	11.5%
Manitoba	nil	12%
Saskatchewan	2.0%	12%
British Columbia	2.5%	10%
Yukon	4.0%	15%
Northwest Territories	4.0%	11.5%
Nunavut	4.0%	12%

Table 4 details the comparative corporate tax rates for the provinces and territories as of January 1, 2012. As can be seen, higher cost regions like PEI and the territories have higher corporate tax rates than NL. It is also worth noting that BC plans to raise its corporate tax rate back up to 11 per cent in 2014. A case could be made for NL to have amongst, if not the highest, corporate tax rate in the nation due to the foreign ownership of its resource sector. With a low tax rate for small businesses, this tax would hit only larger corporations and could be an important instrument in keeping profits from leaking out of the country.

The federal government has been cutting the corporate tax rate consistently, opening up room for NL. The general federal corporate income tax rate was cut from 28 per cent in 2000 to 15 per cent in 2012. This means that the combined federal rate for NL is 29 per cent as of 2012. For comparison, in January 2012, the combined federal and state corporate tax rate across the United States averaged 39.2 per cent. Canada currently maintains the lowest corporate tax rates among G8 countries.[22]

Undercutting U.S. taxes only results in more money to the U.S. Treasury, as the U.S. mandates minimum tax payment even for corporations paying taxes in other jurisdictions. Thus, the difference between Canada's tax rate and the U.S. rate actually gets paid by the corporation to the U.S. Treasury.[23]

Another instrument effective at capturing extraordinary profits from foreign corporations is a special tax on those profits. It is not uncommon for jurisdictions with large multinational firms making high profits to implement an extraordinary profits tax. Often referred to as a 'tax on unearned income' or a 'windfall profits tax', the tax ensures that the province and citizens share in the windfall if commodity prices suddenly make for higher than anticipated profit margins. Numerous jurisdictions have such a tax in a variety of different definitions and structures. Even the United States implemented a windfall profits tax in 1980. Ronald Regan later repealed the tax, but it has surfaced again under President Obama. Some jurisdictions structure it as a straight additional tax on profits, while others adjust for profit levels.

Norway captures this revenue by a straight-up 50 per cent corporate profits tax on oil extraction, which is in addition to the 28 per cent corporate tax all sectors pay. In effect, Norway charges a 78 per cent corporate tax for oil companies. Norway has not been short of investors even at that rate.

Australia has recently introduced a Minerals Resource Rent Tax (MRRT). This tax of 30 per cent on net profits applies only to companies with net profits of more than $75 million in a year. The basic MRRT rate is 30 per cent, but it is reduced by a 25 per cent extraction allowance, making the effective tax rate 22.5 per cent. The tax applies only on extraction, not value added; upstream not downstream. Australia has a base corporate tax rate of 30 per cent.

Does investment leave or strike when taxes are raised? Alberta saw lease sales go up after royalty reforms were announced, a clear indication that investors were not scared off.[24] Norway has clearly shown that higher taxes do not mean less investment in the long term. Given that such a tax would apply only to large and highly profitable corporations, and only to net revenues, experiences elsewhere indicate this can be done in NL without hurting the economy.

The appropriate type of tax for capturing windfall or excess profits in NL needs more research and debate. Certainly the province needs to closely examine the tax mix in order to re-establish the proper ratio of GDP to corporate profits and ensure that natural resource wealth is shared fairly with the province and citizens of NL.

Employment and Economic Costs of Austerity

THIS SECTION LOOKS at the employment and economic impacts of revenue and spending options for Newfoundland and Labrador and details the jobs and economic impacts that further public sector jobs would have. Austerity has impacts far beyond direct jobs in the public sector.

Job Impacts of Public Spending

Public sector spending and employment have benefits far beyond the direct services those employees deliver. There are impacts that permeate the private sector as well. Conversely, cuts can have impacts well beyond the loss of direct jobs and services, including across the private sector.

Direct Effects

Government spending creates jobs directly, by providing employment in construction, in administrative, professional and consulting services, and other sectors — both inside and outside of government. These are often called good jobs — jobs that pay enough to support families and communities. Good jobs allow parents to spend more time with their children, rather than requiring both parents to hold down multiple jobs and work double shifts. Good jobs allow people to work in the communities where they live, rather than flying into remote work sites and being away from their families for days or weeks on end. When governments cut spending, they directly kill good jobs — and harm families and communities.

Indirect Effects

Government spending also creates jobs indirectly. A network of industries provides supplies that enable the 'direct effect' workers to complete their tasks. These industries employ people in manufacturing, transportation, warehousing, retail and other sectors. When governments cut spending, they also kill jobs in these indirect supply industries.

Induced Effects

Government spending creates a third set of jobs. When workers employed directly or indirectly spend their money on local goods and services, that spending induces higher levels of employment in other sectors of the local economy — retail, food services, hospitality, and others. Conversely, when government spending is cut, that employment is cut as well.

Thus, government spending cuts don't just create unemployment in government. Cuts create unemployment in a range of other industries. Austerity not only means job losses in the public sector, but ripple effects of job losses across the private sector. This impacts GDP, as economic activity is tied to those jobs and incomes across the public and private sectors. Fewer workers spending salaries locally on goods and services means less economic activity and lower GDP.

Tax Cuts Versus Public Spending

Oil and gas is capital intensive, not labour intensive; it is not a job creation strategy. Though resource revenues are boosting NL's economic growth and revenues, oil and gas is not a big employer, as can be seen in *Table 5*. This figure shows the amount of jobs created for every million dollars invested in different sectors of the economy. It shows that public sector spending creates up to 20 times the jobs per dollar invested as oil and gas extraction. This

TABLE 5 Jobs Created Per $1 Million Invested

	Number of Full-Time Equivalent Jobs
Oil and Gas Extraction	0.38
Support Activities for Mining and Oil and Gas Extraction	6.48
Transit and Ground Passenger Transportation	13.74
Professional, Scientific and Technical Services	9.96
Administrative and Support Services	12.67
Waste Management and Remediation Services	10.83
Educational Services	20.54
Health Care and Social Assistance	15.54
Arts, Entertainment and Recreation	14.86
Accommodation and Food Services	16.25
Repair and Maintenance	16.26
Hospitals and Residential Care Facilities	12.50
Universities and Government Education Services	11.83
Other Municipal Government Services	10.76
Other Provincial and Territorial Government Services	10.35

Source Statistics Canada, "Provincial Multipliers — M-Level" Direct and Indirect, Full Time Equivalents (December 15, 2011), www5.statcan.gc.ca/bsolc/olc-cel/olc-cel?lang=eng&catno=15F0046

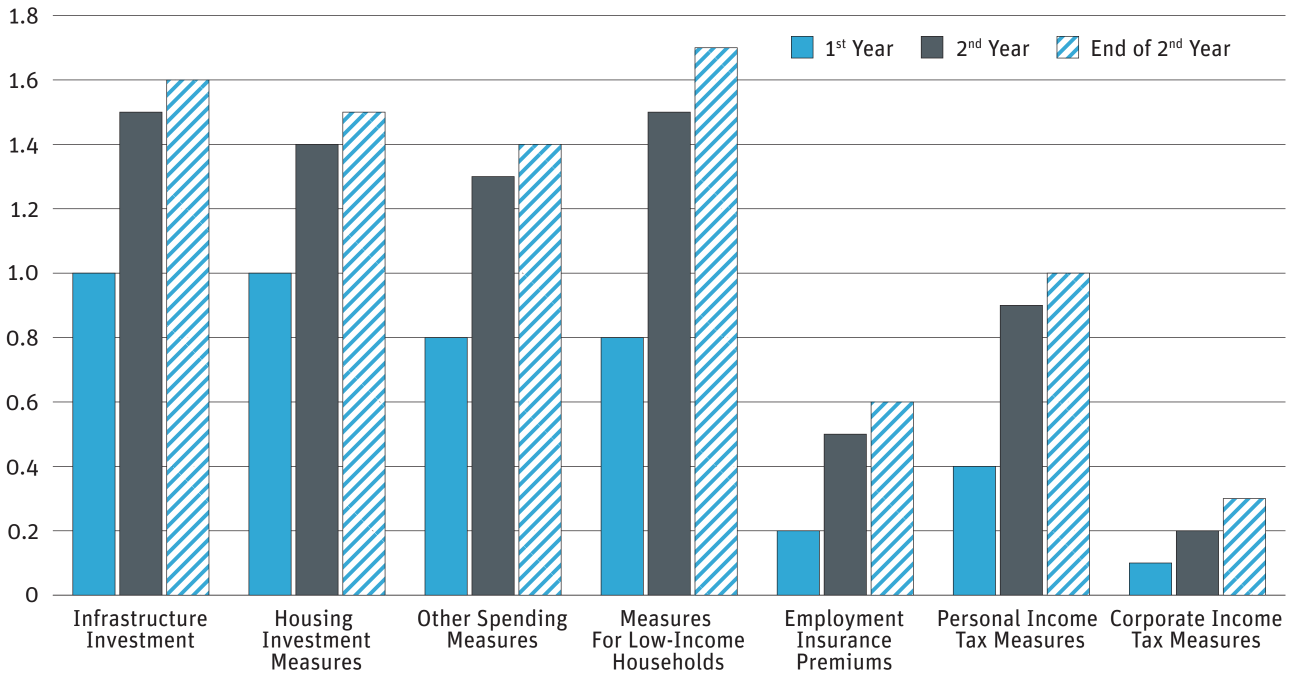
explains what was seen earlier in *Figure 17*, where a very low percentage of GDP goes to wages and a very high percentage goes to corporate profits.

These statistics show that the revenue and spending decisions of government have significant implications for employment across the economy, especially in a province increasingly dependent on oil extraction as an engine of growth.

Revenue decisions are an important part of this equation as well. The NL government has noted that tax reductions have contributed to the deficit. However, those tax cuts were also not likely very helpful in boosting employment and GDP.[25] That money would have created more jobs in the hands of government, according to multiplier statistics.

In considering the implications of spending cuts, it is important to compare those impacts with the alternative: raising revenues. Job and economic multipliers indicate that the best bang for your buck in terms of job and economic growth is keeping taxes higher for revenues to go to job-creating sectors. According to the federal government, tax reductions provide far less GDP boost than spending provides (see *Figure 18*). The numbers are similar

FIGURE 18 Dollar Change In GDP Per Permanent Dollar Increase In Fiscal Measures



Source Department of Finance Canada[31]

in the United States, with the Congressional Budget Office concluding that government spending and transfers to individuals provided two to three times the level of stimulus as tax reductions,[26] a finding similar to that of the Chief Economist of Moody's Economy.com in congressional testimony.[27] The OECD has come to similar conclusions for developed countries generally,[28] as did a study for the International Monetary Fund, concluding that employment multipliers for spending were approximately double those for tax reductions.[29] Canadian studies have also concluded that government spending creates roughly twice as many jobs per dollar spent as tax cuts.[30]

Corporate tax reductions are a poor job creator because corporations don't necessarily need to spend money locally. As mentioned earlier, the foreign ownership profile in mining and oil and gas in particular guarantees that these companies export a lot of their profits. Where the majority of the profits that shareholders receive goes out of the province, failing to adequately tax those profits simply allows more money to flow out of NL. The multipliers above indicate what those revenues could do for jobs and economic growth if they were captured by the government and spent directly.

Much of the money that oil and gas companies reinvest in production pays for equipment, not jobs, particularly beyond the construction phase. The oil and gas industry is generally capital-intensive, rather than labour-intensive; it spends relatively more of its money on equipment and other capital goods, rather than on employment. And of course, much of that capital spending leaks out of NL, paying for imported capital goods. Because it is capital-intensive and not labour-intensive, and relatively reliant on imports, the oil and gas industry creates fewer jobs per dollar spent than almost any other industry in Newfoundland (see *Table 5*). Clearly, allowing excess profit to stay in the hands of resource companies is not a cost-effective way to create employment.

Corporate tax reductions have been an especially bad job creator since the financial sector crash in 2008, as corporations have been hoarding their tax cut savings rather than reinvesting in higher productivity. By early 2012, the pile of cash had grown to $562 billion in Canada, up nearly 50 per cent since 2009.[32] This hoarding comes at the expense of low investments in research and development,[33] resulting in losses to Canada's productivity and competitiveness. The Governor of the Bank of Canada has referred to this as "dead money" and, along with the Federal Finance Minister, has repeatedly urged companies to invest this money productively.[34] Continuing to allow foreign corporations to keep extraordinary profits is essentially throwing good money after bad.

Whether due to exporting profits to foreign shareholders, or exporting spending on capital goods, or hoarding cash, tax cuts for corporations create very few jobs. On the other hand, increasing tax rates for large corporations will have a very limited impact on employment, while the resulting revenues would create many jobs and services.

Taxing High-Income Individuals

> "The largest short-run impact on aggregate demand is likely to come from government spending measures, but where tax cuts are implemented they are most effective if targeted at households that are likely to be liquidity-constrained." — OECD, Economic Outlook[35]

When lower-income people receive money, they tend to spend virtually all of it on goods and services. This creates jobs for others and stimulates the economy. In particular, lower-income people tend to spend their money locally, and so the employment and economic benefits are felt in the local economy.

When wealthy people receive money, they don't need to spend it all locally, and they don't. Some of the money wealthy people receive is simply saved. Some of it is spent on luxury imported goods. Some is spent on travel overseas. Some is sent to offshore bank accounts.

Thus, handing money to wealthy people is not a good strategy for creating local jobs or boosting the local economy. As mentioned earlier, bringing NL's personal income taxes in line with those of other provinces and territories could raise significant revenue, without having an immediate significant impact on employment. Other jurisdictions are reinstating progressive income tax rates and surtaxes: Ontario is increasing the rate for top incomes by 2 per cent, BC also by 2 per cent, and Quebec by 1.75 per cent (see *Table 2*). This reflects a much larger trend; KPMG notes that top marginal rates have been rising around the world.[36]

Balancing the Books and Protecting Employment

This section has shown that both jobs and economic growth in the public and private sectors would be impacted by austerity measures. Given these costs, it is important not to make such a decision based on short-term problems; it is important not to base long-term decisions on one-time events.

The government stated in pre-budget consultation documents that production declines are a driver of the deficit. However, the bulk of the production drop off was due to temporary shut downs. Government figures on oil and gas indicate that oil production is expected to decline 21.3 per cent to 76.6 million barrels due to reduced production at all three projects:[37]

- Hibernia (including AA Blocks and HSE Unit) is expected to produce 51.8 million barrels, 4.5 million barrels less than in 2011;
- Terra Nova is expected to produce 10.5 million barrels, 5.2 million barrels less than in 2011 due to natural declines and a 21-week maintenance shutdown; and
- White Rose (including North Amethyst and West White Rose) is expected to produce 14.2 million barrels, 11.0 million barrels less than in 2011, due primarily to an 18-week maintenance shutdown.

Almost 80 per cent of that drop in production, a total of about 16.2 million barrels of oil, is due to maintenance and is not a long-term budget issue. With production at 97 million barrels in 2011, that is a significant portion of production. The government's Budget 2012 estimates indicate that the drop associated with production declines is at $576 million.[38] With 80 per cent of that being due to temporary production down time, this explains a large portion of the deficit.

The scale of the financial challenge posed by the projected deficit has been exaggerated. Nevertheless, the threat of possible future deficits does need to be taken seriously: over the long term, government operations need to be carried out on a break-even basis. Thus, the government needs to look at the budget to ensure revenues are adequate to cover spending.

From the perspective of jobs and local economic activity, if the provincial government needs to reduce the deficit, the best way is through two specific budget reforms: increasing taxes for high earners and introducing a special tax on extraordinary profits. These reforms are fairer, as they focus on those who are most able to pay (wealthy people and big corporations), rather than those least able to pay (lower income people). They are also likely to have the least immediate impact on jobs in NL.

It is worth noting that spending had already been contained in the 2012 budget. "In preparation for Budget 2012, all departments were asked to identify potential savings to reduce expenditures without negatively impacting program or service delivery," noted the 2012 budget speech. "As a result of that review, savings of $38.8 million have been incorporated in the 2012–13 estimates."[39]

Austerity's Inequality Impacts

NL needs to keep an eye on the risk of rising inequality that is inherent in resource wealth, known as the paradox of plenty.[40] Alberta suffers from this and now has Canada's richest rich alongside the nation's most intense poverty. Alberta also has the highest percentage of working families using food banks in the nation. Statistics Canada data released in January 2012 revealed that the Atlantic provinces are already well down the path to rising inequality. All are significantly less equal today than they were in 1982. Given the expansion of the oil sector and cuts to taxes for the wealthy, this is not surprising for NL. Undermining progressivity in the tax structures is a significant factor in growing inequality in Alberta and a risk for NL.[41]

TABLE 6 Median Total Income, By Family Type, By Province and Territory (All Census Families), 2010

Canada	$69,860
Newfoundland and Labrador	$62,580
Prince Edward Island	$63,610
Nova Scotia	$64,100
New Brunswick	$62,150
Quebec	$65,900
Ontario	$71,540
Manitoba	$66,530
Saskatchewan	$72,650
Alberta	$85,380
British Columbia	$66,970
Yukon	$86,930
Northwest Territories	$101,010
Nunavut	$62,680

Source Statistics Canada, CANSIM, table 111-0009.

Note Census families include couple families, with or without children, and lone-parent families.

Newfoundland has the highest inequality in market income in the nation. This inequality is mitigated by the tax and transfer system: NL is not the most unequal in after-tax and transfer income.[42] However, recent changes have made the tax system less progressive and begun to undermine the effectiveness at overall redistribution of income in NL. Given the high level of market income inequality, this will be a driver of increased inequality.

It was mentioned earlier that NL measures high on indicators of poverty and still has relatively high unemployment. These, as well as income inequality, are critical factors in the conversation of how the province is sharing the wealth. Despite economic growth, NL still has the second lowest median income in the nation (*Table 6*). Given the low job multipliers in oil and gas, the government will need to stay cognizant of the need to redistribute the benefits of the boom and share the wealth. Austerity takes the province in the wrong direction.

Research, such as *The Spirit Level* by Richard Wilkinson and Kate Pickett, has clearly shown that income inequality is bad for the well-being of all.[43] However, research has also shown that it is bad for the economy. Recent work by researchers at the IMF examining factors in the duration of growth identified that the factor most significantly correlated with longer-term economic growth is equality of income distribution. Levels of income equality showed a higher correlation with economic growth than stability of political institutions, trade openness, exchange rate competitiveness, external debt, or foreign direct investment. The IMF's conclusion was that "…income distribution survives as one of the most robust and important factors associated with growth duration."[44]

NL would be well advised to focus on mitigating the risks and downside of a resource boom and ensuring that natural resource wealth does not drive income inequality. Progressive tax structures and solid social programs, as well as social infrastructure spending, will be critical pieces of that puzzle. Allowing an increasing share of the economy to go to large foreign corporations and the wealthy while cutting spending on social programs and public employment will take the province the wrong direction.

The province would be well advised to focus on programs that both share the wealth and reduce inequality while strengthening the economy. For example, a public child care program similar to other provinces would not only enable more Newfoundlanders and Labradorians to engage in the workforce, especially women, but also attract younger workers back to the province and improve the quality of life for all working families. Such a program has considerable support.[45]

Conclusions and Recommendations

THE NEWFOUNDLAND AND Labrador government is gravitating toward public spending cuts in response to current deficit forecasts. This report has shown the province's fiscal strength and explained why we would not recommend such actions. It illustrates that NL has some revenue options and that the costs of spending cuts across the private sector should not be underestimated.

The data indicates that NL is a significantly more expensive jurisdiction than other provinces, meaning that spending per capita should be higher. It also details how the levels of spending are affordable by measures of spending to GDP and that the province is actually a relatively low spender by that measure.

The report illustrates that due to the low multipliers for employment in oil and gas and relatively high unemployment in NL, many are not benefiting directly from the boom. For them, social spending is a critical instrument for ensuring that they share in the benefits of the boom. In this context, it is reasonable for citizens to expect their government maximize revenues before turning to social spending cuts.

The report illustrates that there is some room for Newfoundland and Labrador to capture revenues from high earners and foreign multinationals; revenues that are leaving the country. Reinvesting those funds in the province will create more jobs and economic growth.

Importantly, this report also exposes the temporary driver of the 2012–13 deficit: production drop offs. Certainly, temporary production changes should not drive public sector spending cuts. The province also identifies tax cuts as being responsible for $500 million of the revenue drop. Tax cuts should not be driving public sector spending cuts. Not only is this imprudent from a long-term financial position, but it has the potential to significantly damage the economy. As this report clearly describes, direct government spending has much better job creation and economic growth impacts than tax cuts.

Other indicators of economic strength remain strong: personal income tax revenue, capital investment, retail sales and housing starts are all up. Capital investment is expected to rise by 30.1 per cent to an unprecedented $9.6 billion, representing the strongest investment growth in the country. The province will benefit from private sector investments, such as mining expansion in Labrador West. Construction activity on Vale's nickel processing facility is expected to peak this year.[46]

Overall we recommend that NL *stay the course* on public spending and employment. Overreacting to temporary budget changes by significantly cutting spending would increase volatility in an already volatile economy, increase reliance on the resource sector to drive the economy and, thus, reinforce vulnerabilities.

Also recommended is that the province develop a solid long-term human resource strategy that is associated with the skills mix needed for planned developments. The province should also consider staging those developments (public and private) in such a way that they create the maximum long-term skilled employment for Newfoundlanders and Labradorians.

Notes

1 We acknowledge the limitations of GDP per capita as a measure of wellbeing, but use it here as a measure of the growth in wealth of the province for context. The report addresses the issues of how this GDP is captured and redistributed.

2 For example, the Newfoundland and Labrador Employers' Council has called for spending cuts, http://www.cbc.ca/news/canada/newfoundland-labrador/story/2013/02/15/nl-pre-budget-consultations-215.html.

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5 Based on the public accounts of provincial and federal governments. Due to differences in accounting and reporting practices, figures are not strictly comparable between provinces. Moreover, a province's accounting and reporting practices may have changed over time, limiting the extent to which historical comparisons can be made. Data compiled by RBC Economic Research, January 21, 2013.

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15 Province of Newfoundland and Labrador, Schedule 10, Revenue by Source, for the year ended 31 March 2012.

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25 Employment growth was due to massive oil and gas extraction. Unemployment remains high in Newfoundland, at 13.7 per cent in January 2013 (Newfoundland & Labrador Statistics Agency www.stats.gov.nl.ca).

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31 Department of Finance, "Budget 2009 — Annex 1 Economic Action Plan: Employment and Output Impacts" www.budget.gc.ca/2009/plan/bpa1-eng.html. See also similar (more aggregated) Canadian multipliers at Organization for Economic Cooperation and Development, "OECD Economic Outlook Interim Report" p. 138 www.oecd.org/economy/outlook/42421337.pdf. Note that, as with other effects, the effect of corporate income tax reductions should be higher as time passes, due to its impact on investment. However, as other passages in this paper show, the reality is that corporations have not been making much investment; rather they are hoarding cash. Thus, it is unclear that corporate income tax reduction effects are actually rising over time in Canada.

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