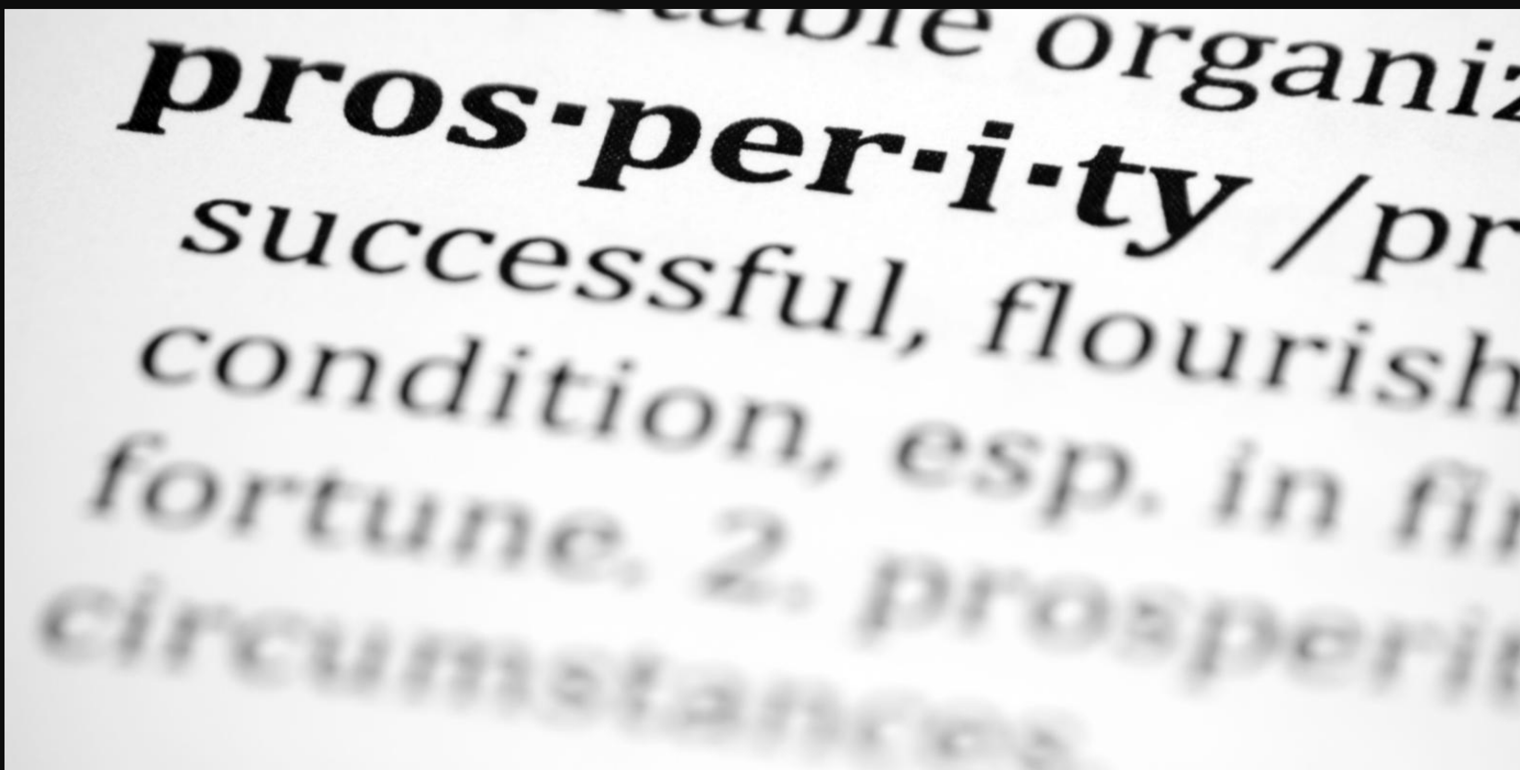
A Plan for **Sustainable**



NEWFOUNDLAND & LABRADOR employers' COUNCIL

Submission to the Liberal Economic Assessment Project (LEAP)

May 13th, 2015

A PLAN FOR SUSTAINABLE PROSPERITY

Competitiveness is key

The key to long term economic success is to create a competitive business environment that will diversify our economy, attract increased investment and allow local businesses to thrive. The competitiveness of a jurisdiction is measured by productivity. Productivity allows a jurisdiction to support high wages, attractive returns to capital, and a high standard of living.

The Employers' Council recently commissioned the Conference Board of Canada (2015) to benchmark the economic environment in NL against peer jurisdictions. When comparing us against peer jurisdictions on the four competitive building blocks of innovation, investment, human capital and business policy environment, NL is falling behind. In fact, out of 32 benchmarking indicators used by the Conference Board, NL came in the bottom half of all peer jurisdictions in 21.

The general public understands the importance of creating a competitive business environment in NL. In their survey of Newfoundlanders and Labradorians in August 2014 Corporate Research Associates found that:

- 75% agree that business success in Newfoundland & Labrador will result in prosperity and increased quality of life for all of us.
- 83% believe that it is important that we have a competitive business environment compared to similar regions that are our direct competitors.
- 80% support government policy that encourages private sector business growth and investment in Newfoundland and Labrador.

The need for fiscal discipline

The general public also wants government to show fiscal discipline. Sixty-four percent NLers feel it is important to reduce government spending and 79% feel it is important to reduce provincial government debt (CRA, 2014).

To build and maintain a strong economy, governments must commit themselves to sound management of public finances. A low debt-to-GDP ratio, a "right size" public sector, and reasonable government spending allow government the flexibility to respond to unexpected economic downturns when they occur. Responsible fiscal management and competitive tax policies encourage employers to invest and grow, creating jobs and contributing to a higher standard of living for all Newfoundlanders & Labradorians.

The Auditor General, multiple think tanks and business organizations (including the NLEC) have raised the alarm bells about government's spending on multiple occasions. According to our Auditor General in early 2014, government spent about 40 per cent more per person than any other province in Canada and the province would have to cut $2.3 billion from its budget to reach the national average of spending per person (The Canadian Press, 2014).

The problem lies in government's program spending. NL has the *highest* per-capita expenditures on programs and services in the country. These costs have grown dramatically over the last decade and have ballooned since the recession. Newfoundland & Labrador spent $13,300 per person on program and service delivery in 2013-14 - the all-provincial average was $8,917 (Conference Board of Canada, 2015). Spending continued at a level of $13,200 per person in 2014-15.

It is not surprising that program spending in NL is so high, when you consider the size of our public service. The Fraser Institute reported that between 2007- 2011 NL had the highest average provincial and local government employment as a percentage of total employment of any jurisdiction in North America, at 26% (Karabegović, Gabler, & Veldhuis, 2012). Salaries and employee benefits represented 49 per cent of government operating spending in 2014 and according to the CFIB, inflation-adjusted spending on salaries and employee benefits increased by 61 per cent between 2003 and 2014. A recent study by the Atlantic Institute for Market Studies (Eisen & Fantauzzo, 2014) found that if public sector employment rates matched the national average in Newfoundland and Labrador, it would have reduced the province's wage bill by **$880 million** in the 2012-13 fiscal year – nearly our entire deficit for last year.

Pension and post retirement benefits provided to our large public sector are also driving the province into debt. Unfunded public sector pension liabilities account for the bulk of Newfoundland Labrador's net debt. The Conference Board states that: "Public sector employment has risen "tremendously" in recent years, and combined with the impacts of an aging population, public sector pension demands are set to increase even further." In fact, they are expected to account for 85% of all debt by 2016-17 and are the second highest of any province in the country.

"Spending up" when times are good has created an expectation of program and service delivery and an inflated civil service with salaries and benefits that are not sustainable when commodity prices decrease. The recent drop in oil prices has clearly demonstrated to the public that budgeting provincial spending on the high end of these volatile prices is not sustainable.

Reform spending and return to surplus as soon as possible

While spending reform should be well thought out, given our growing provincial debt and the cost of servicing it, it is important that NL return to surplus budgets as soon as possible. To plan for five years to return to surplus is simply too long. Increased borrowing should not be the plan to balance the books. Meaningful spending reform is needed in this province to reduce reliance on oil royalties, and some decisive short term pain will provide long term economic benefit.

Some special interest groups have raised concern about the economic spill-over effects of constraining government spending. The NL Employers' Council recently asked the Fraser Institute to calculate the impact of spending cuts to the overall provincial economy. Their analysis illustrates that while some short term pain may be felt from expenditure reform, it will not devastate our province, particularly given the optimistic outlook of future development projects and a rebound in commodities prices long term. They estimated that a $1 billion cut from provincial expenditures represents roughly 2.8 percent of provincial GDP of $35.8 billion, based on 2013 data. Depending on what multiplier assumptions are made to account for economic spin off of cuts, the net economic effects range from roughly 1.4% (less than the spending cut) to a maximum of 4.5% of the provincial economy. While a reduction of the provincial economy by 4.5% in one year would not be advisable, if these cuts are implemented over three years, the effective reduction is substantially less.

In the 1990s many governments across the country acted decisively to enact spending reductions to bring government expenditures in line with revenues and achieve balanced budgets within two to four years including the Federal Liberals and the Ontario, Saskatchewan and Alberta provincial governments. Such actions, while difficult in the short term, lead to better results in the medium and long term, including balanced budgets, declining debt, lower interest costs, and a more prosperous economy that contributed significantly to Canada's outstanding economic performance from 1997 to 2007 (Veldhuis, Palacios, & and Lammam, 2012).

Recommendation #1: Significant spending reform must occur for a return to surplus budgets and debt reduction by 2018.

Develop a plan to save for the future

The Conference Board of Canada study (2015) found that many of NLs comparator jurisdictions with non-renewable resource based economies, including Norway, Texas, North Dakota, Alberta and Saskatchewan have already created, or are in the process of creating, a Sovereign Wealth Fund. Such a fund sets aside a portion of resource revenues for future use, whether to avoid deficits during economic downturns or to be saved for future generations. Such funds protect competitor jurisdictions from fluctuations in resource prices and will allow future generations in those jurisdictions to benefit from the same quality of life from the resource long after the resource is depleted.

As long as NL has resource revenue, establishing a sovereign wealth fund should be the ultimate goal. Meaningful spending reform should target debt reduction and creation of a sovereign wealth fund so future programming can rely more on interest and less on oil prices.

Recommendation #2: Target the creation of, and contribution to, a sovereign wealth fund by 2018.

The framework for permanent and meaningful spending reform

Continue to invest in infrastructure

The mix of spending in this province is not aligned with creating a competitive environment that will generate further prosperity for the next generation. Government spending in NL is too focused on programs and services spending, while infrastructure investment has not kept pace with GDP growth. The Conference Board found that Newfoundland and Labrador ranked 8 out of the 10 provinces on government investment in fixed capital as a share of GDP, and as of 2012 Newfoundland and Labrador's average age of its public infrastructure was 16.7 years, second oldest of any province in the country.

Capital investments are just that – investments. They will provide returns to our economy that will pay dividends for years to come. High levels of strategic government investment in infrastructure can support the economy by allowing goods to move more efficiently to markets (in the case of transportation investments), or by strengthening human capital with better access to health and education institutions. Utilities, including electricity, water, and sewage, all support business activities, making it less costly to open a plant in a location where these services are available. An extensive telecommunications network connects people between communities and with the world; ensuring businesses have access to information.

The Conference Board has said that these lower levels of government investment in infrastructure have put the province at a disadvantage. If the true goal is sustained prosperity and continued economic success, in the long term, resources should be reallocated away from other less productive expenditures that do not provide the economic benefit and towards infrastructure. Infrastructure investment decisions should, however, be made in a strategic manner to grow the economy. The decision to invest in a hospital or school in a region may not always be the best decision if perhaps better health or education outcomes could be achieved by investment in transportation infrastructure, technology or improved program delivery.

Recommendation #3: Spending reform must include a shift in spending towards strategic infrastructure investments and away from programs and services.

REORGANIZE PROGRAM DELIVERY TO IMPROVE OUTCOMES AND REDUCE THE SIZE OF THE PUBLIC SERVICE

Newfoundland & Labrador simply cannot afford, and does not need to have, the largest public service in North America. It is the private sector, not the public sector that creates wealth. Many policy think tanks and economists have demonstrated clearly that a larger public sector leads to poorer outcomes in the labour market, reduced productivity, and poorer economic performance (Di Matteo, 2013). The public service does not need to administer every program and service that citizen's demand.

Program and service delivery in NL must be reorganized and the size of our public sector must be reduced to be more efficient and outcome focused. This does not mean cutting a percentage off the top for the sake of cutting costs. Across the board cuts to the public service are not an effective means to reduce expenditures. A long term approach needs to be taken to reorganizing and reducing the public service to permanently sustainable levels that are in line with the Canadian average. Government must look at each program or service to make sure that program spending is efficient but effective at meeting expected and targeted outcomes. Are taxpayers getting the value for their investment? If not, then the program should be reengineered to be delivered more efficiently, or eliminated altogether. In some cases, this may also mean that certain programs or services receive an *increased* investment or additional staffing, depending on its ability to efficiently meet desired outcomes or create opportunities for cost savings in other areas. As an example, investments in technology in order to more efficiently deliver programs and services could provide cost savings from a staffing perspective.

Recommendation #4: Spending reform must include a reorganization of program and service delivery and a reduction of the size of the public service to sustainable levels in line with the Canadian average.

More outcome focused service delivery

Education is a prime example of the need for structural reform in the way programs and services are delivered to be more outcome focused. When comparing education spending per student (full-time equivalent) in public elementary and secondary schools across the country, NL's spending was the fastest growing in the country over the five year period 2007-08 to 2010-11, making it the third highest spending in the country in 2010-11. Since that time it has grown 20 per cent higher (Conference Board, 2015). Despite this spending, NL scores in the middle to low end of the pack in terms of education and skills indicators amongst students in the K-12 school system. In the Conference Board report, NL students earned a C on reading and, although they received a B in science, still ranked 5th out of 9. The lowest score for NL students was in Math, ranking 7th out of 9. NL also does not seem to be achieving outcomes within the university system. NL scored a D in the Conference Board report on university completions, and continues to graduate the least amount of university students of all competitors – despite a tuition freeze and significant investment in university education by the province. In contrast, British Columbia has some of the lowest levels of education spending in the country, but amongst the highest outcomes.

Education is one of the most important services provided by government. Business leaders and economists all agree that ensuring a highly educated population is imperative to ensuring the future economic success of NL. No one would argue with these levels of spending if it were clear that students were receiving the desired outcomes. However, putting more money into a government system doesn't necessarily improve outcomes, sometimes it just creates a more expensive system.

Government systems should be proactive and centered on the outcome for the citizen, not on the institutions and practitioners within the system. Careful examination of spending should include consideration of different models of delivery and reengineering of work processes to be outcome oriented. By doing this, access to and quality of services can be enhanced despite the need to restrain spending. Innovative solutions to providing government services more efficiently, including productivity focused goal setting, alternative service delivery models, regionalization of programs and services, and performance based incentives for government employees should all be considered.

Recommendation #4a: Reorganization of program and service delivery must include a focus on improving outcomes and providing value for taxpayer's dollars.

Government should steer, not row – The need for alternative service delivery

To meet NL's fiscal challenges, we must re-evaluate the fundamental role of government in service delivery and seek new business models. Focus must be shifted away from processes and placed on how best to achieve desired outcomes. Cost savings can be achieved in many areas without sacrificing service quality by partnering with the private and not-for-profit sectors to deliver public services through Alternative Service Delivery (ASD). These types of partnerships provide real cost savings to government by connecting government with private sector innovations and improving productivity, which is vital in a context of growing demands for services and increasing fiscal pressure on government.

ASD is not privatization, which refers to the transfer of ownership of a public sector enterprise to the private sector. ASD separates policy direction from service delivery. In ASD arrangements, government makes the policy decisions and regulates while the service provider operates the program. The separation of policy and delivery provides several benefits. First, it allows governments to focus on policy design and define desired outcomes. Second, it can foster competition between service providers and harness the private sector's capacity to innovate and find efficiencies. Third, it can encourage flexible service delivery capable of responding to changing circumstances (Osborne & Gaebler, 1992). ASD is not divestment of government responsibility for the delivery of public goods. Instead, ASD is a partnership.

The discussion of private and not-for-profit sector involvement in publically funded long term care has met with resistance from union leaders. While special interest groups like to focus on a few examples of unsuccessful public-private partnerships, there are over 200 successful P3s currently happening in Canada right now. The Conference Board of Canada has concluded that P3s have "a strong record of on-time, on-budget delivery" and average cost savings of 13 per cent compared to traditional projects. The Fraser Institute has arrived at similar conclusions.

The general public also supports ASD. A study entitled "The P3 Pulse," conducted by Nanos Research for the Canadian Council for Public-Private Partnerships (CCPPP), found that 62 per cent of respondents, including 57 per cent of public-sector union members, supported the P3 concept for the delivery of public infrastructure. Some 56 per cent even supported the use of P3s to deliver services such as issuing drivers' licences and administering programs. We must not let the over politicized language of 'private health care' hijack the important discussion that's needed about expanding access to publicly funded services and addressing the fiscal and infrastructure challenges facing government services. There are multiple successful examples of ASD happening in Canada right now with best practices NL can model, including Bridgepoint Active Healthcare in Toronto, British Columbia's health and benefits processing, Ontario's Electronic Land and Registration System, and Ontario's Driver Examination Centres. All have resulted in significant productivity gains and improved outcomes to citizens.

Recommendation #4b: Reorganization of program and service delivery must include use of alternate service delivery models that involve the private and not-for-profit sector in the delivery government services, as has been successful in other jurisdictions.

Focus on Immigration

One of the biggest risk factors to NLs sustained prosperity is our ageing population. NL has the fastest aging population and the lowest rate of in-migration of all of our competitors. The Conference Board of Canada's long-term economic forecast (2014) predicts that if nothing is done, 30 percent of the population will be 65 or older by 2035. Not only will skill shortages worsen, our aging and shrinking population will squeeze the working age population economically, socially and fiscally.

The attraction and retention of immigrants has traditionally been a challenge for our province. There is a strong need to narrow the scope of the labour market initiatives of the Department of AES and provide fewer, more focused programs that meet the needs of employers. In a study commissioned by the NL

The Impact of Different Types of Taxes on Economic Growth

In today's global economy with increased mobility of capital and labour, setting the right tax mix is extremely important to a jurisdictions' economic success. In an OECD study (Johansson, 2008) on the design of tax structures that promote economic growth, a ranking of taxes confirmed results from earlier studies regarding the impact of different types of taxes on GDP:

Corporate taxes are found to be the most harmful for growth, followed by personal income taxes, and then consumption taxes.

Recurrent taxes on immovable residential property appear to have the least impact because they have less effect on decisions to supply labour, to invest in human capital, to produce, invest and innovate. Taxes on financial and capital transactions are highly distortionary.

Broadening the base of consumption taxes is a better way of increasing revenue than rate increases, because a broad base improves efficiency while a high rate encourages growth of a shadow economy.

Tax exemptions or reduced statutory corporate tax rates for small firms may be much less effective in raising productivity than a generalized reduction in the overall statutory corporate tax rate. Lowering statutory corporate rates will lead to particularly large productivity gains in firms that are dynamic and profitable, and can make the largest contributions to GDP growth.

High top marginal rates of personal income tax can reduce productivity growth by reducing entrepreneurial activity.

Taxes on labour can have adverse effects on labour utilization by affecting both labour supply and labour demand. Lower taxes bring down labour costs and firms respond by increasing labour demand.

Lower corporate and labour taxes may encourage inbound foreign direct investment, which in turn is found to increase productivity of local firms. Multinational enterprises are attracted by tax systems that are stable and predictable, and are administered in an efficient and transparent manner.

Generally, most taxes would benefit from a combination of base broadening and rate reduction, versus rate increases.

Business Coalition in 2013, the majority of surveyed industry respondents were not very familiar with most of the current initiatives. Employers also feel the majority of programs had a great deal of red tape in terms of applications, a lengthy waiting period, and elaborate reporting requirements. Priorities for employers included immigration followed by a youth strategy and apprenticeship programs for those relevant industries, up-skilling workers, and providing greater education-employment alignment. Online resources and wage subsidies have potential but need improvements, and supply-side initiatives such as the Career Work Centres and other stop-gap measures that result in people taking jobs that don't suit their aptitudes or skill sets were viewed as low priorities. Efforts to deal with supply of labour will only work if pulled by employer needs versus pushed by government.

Credential recognition, both inter-provincially and internationally, will also be important to successful immigration policy.

Recommendation #5: Economic development must include a stronger focus on immigration. Government resources should be redirected away from low priority labour market initiatives and towards immigration as the number one priority.

Tax or fee increases to private citizens and businesses are not the solution

Business costs such as payroll, transportation and utility costs are exceptionally high in Newfoundland Labrador. Competitive taxation is essential if we are to attract investment and allow local businesses to compete globally and expand. Given NLs high statutory labour costs, even a small increase in the corporate tax rate or sales tax would quickly make NL uncompetitive on total tax rate as compared to competing jurisdictions.

Based on Corporate Research Associates August 2014 public opinion polling, the general public understands the importance of this issue. Sixty-one percent those surveyed felt it was important to **DECREASE** tax rates to businesses to encourage investment, jobs and wage growth.

Recommendation #6: Maintenance of competitive tax levels are essential to future economic development and sustained

prosperity. Tax dollars must be spent in the most efficient and prudent manner possible to avoid increases.

Remove trade barriers to increase competition

In the Conference Board of Canada study, NL scored low on all innovation indicators – one of the four key pillars of productivity and competitiveness. There is a strong link between competition and innovation. Greater competition forces innovation, which in turn increases productivity. A report from the Council of Canadian Academies' expert Panel on Business Innovation found that Canadian sectors with exposure to international markets had the same levels of R&D intensity and innovation as their international counterparts. Meanwhile, sectors in which competition is curtailed and foreign entrants impeded had much lower levels of innovation. Protected industries do not generally produce global leaders.

Lowering interprovincial and international trade barriers will breed more competition and also allow the province's industries to integrate into global and national supply chains and expand their market reach. Several international trade deals are currently being negotiated by the federal and provincial governments (including the Comprehensive economic and Trade Agreement [CETA] with the European Union) and these will help broaden competition outside of North America. One of the key provisions in these trade deals is labour mobility and investment protection. This deal would facilitate increased opportunities for Newfoundland and Labrador businesses in Europe, including engineering, marine, and oil and gas extraction sectors.

Recommendation #7: International and interprovincial trade barriers must be removed to increase competition and improve innovation, by signing on to CETA and other free trade agreements.

CONCLUSION

The key to long term economic success is to create a competitive business environment that will diversify our economy, attract increased investment and allow local businesses to thrive. The competitiveness of a jurisdiction is measured by productivity. Productivity allows a jurisdiction to support high wages, attractive returns to capital, and a high standard of living.

The NL Employers' Council has seven recommendations for economic and fiscal policy that will improve the competitive position of NL and ensure sustained economic prosperity:

Recommendation #1: Significant spending reform must occur for a return to surplus budgets and debt reduction by 2018.

Recommendation #2: Target the creation of, and contribution to, a sovereign wealth fund by 2018.

Recommendation #3: Spending reform must include a shift in spending towards strategic infrastructure investments and away from programs and services.

Recommendation #4: Spending reform must include a reorganization of program and service delivery and a reduction of the size of the public service to sustainable levels in line with the Canadian average.

> **Recommendation #4a:** Reorganization of program and service delivery must include a focus on improving outcomes and providing value for taxpayer's dollars.
>
> **Recommendation #4b:** Reorganization of program and service delivery must include use of alternate service delivery models that involve the private and not-for-profit sector in the delivery government services.

Recommendation #5: Economic development must include a stronger focus on immigration. Government resources should be redirected away from low priority labour market initiatives and towards immigration as the number one priority.

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