Government of the Northwest Territories
2008-2009 Budget Cuts:

A Review

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Introduction

In January 2008, the Government of the Northwest Territories (GNWT, Government) announced that it would make major public service cuts, then reported to be at $135 million to be cut over two years - in excess of 10% of the total budget.

At that time, and throughout winter and spring, it failed to publish any documents describing or clarifying the cuts, or providing calculations showing the need for the cuts and lack of possible alternatives. This was despite media stories reporting criticism of the cuts, reports casting doubt on the financial need for the cuts, protests from labour and other organizations, and finally, growing unease among MLAs who appeared not to have been apprised of relevant details of the cuts, let alone involved in their creation.

In late May, the Government introduced in the Legislative Assembly a budget that made significant cuts.

This report discusses the Government's proposed budget in light of the cuts. The first section reviews the announcement of the cuts and the reports and discussion about their financial need. The following sections review the government's revenues, expenditures, and surplus, in light of the potential need for the cuts. This report concludes that the cuts are unnecessary, and premature.

The cuts announcements

The Government announced in January 2008 that it would cut approximately $135 million in expenditures over the next two years. The media reported that the cuts would result in 135 layoffs, plus a further 88 currently vacant positions being eliminated, for a total loss of 223 civil service jobs.[1]

In early May 2008, the Parkland Institute released a report entitled "Public Service Cuts in the Northwest Territories: Economic Imperative or Political Choice?"[2] The Parkland Report reviewed the announced cuts in light of the Government's finances and the health of the underlying economy of the Northwest Territories (NWT), using numbers from Government publications.

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[1] See, for example, media stories cited in "Public Service Cuts in the Northwest Territories: Economic Imperative or Political Choice?" (Parkland Institute, May 6, 2008) at p. 4, available at http://www.alternativesnorth.ca/pdf/ParklandReportOnNWTPublicServiceCuts.pdf and http://www.ualberta.ca/PARKLAND/.

[2] Idem.

The Report found growing revenues, significant surpluses, an eliminated net financial debt, and significant borrowing capacity. It further examined the NWT economy, and found that it is very strong, growing faster than any economy in Canada, and projected to grow tremendously in future years. The Report found that this growth will likely lead to increased revenues that can support the government's claimed needs for higher infrastructure investment without any spending cuts or tax increases (though there is room for tax increases if needed). Based on government documents, there appeared to be no existing economic case for budget cuts.

The GNWT did not respond in writing to the Report, but instead chose to react through the media. A subsequent document[3] addressed the comments made by Government representatives in the media. This follow-up document responded to each of the reported comments of the Premier and Finance Minister, and the Deputy Finance Minister, one-by-one. It concluded that the findings of the Report stand. Based on the Government's own numbers, and taking account of its comments in the media, there appeared to be no financial case for budget cuts.

In its Budget Address in late May 2008, the Government stated that it wasn't so much planning to cut the $135 million over two years, as "re-align" it.[4] In its Fiscal Review, the government noted that $75 million of that sum would be reallocated to spending priorities, thus presumably resulting in a net cut of $60 million. $33 million of the expenditure reductions will be made in the 2008-2009 fiscal year,[5] with the balance presumably in the next year.

Revenue Side

The Fiscal Review states that "[t]axation revenues are forecast to decrease $26 million in 2008-09, primarily due to a projected decrease in Corporate Income Tax revenues."[6] Total GNWT revenues for 2008-2009 are predicted to drop by over $58 million from projected revenues for the previous fiscal year.[7]

Revenue options

Despite this significant predicted revenue drop, the Government's Budget Address spends very little time considering its revenue options – specifically four short paragraphs. Three of these paragraphs are actually about the subsequent year's revenues. The first paragraph is the only one that matters in this respect, and it is brief:

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[3] "Appendix – Response to Government Comments", available at http://www.alternativesnorth.ca/pdf/ResponseToGovernmentFinal.pdf.
[4] Budget Address 2008-2009 at p. 7 http://www.fin.gov.nt.ca/documents/2008-09%20Budget%20Address%20and%20Papers.pdf (accessed June 3, 2008).
[5] Fiscal Review 2008-2009 at p. B.5 http://www.fin.gov.nt.ca/documents/2008-09%20Budget%20Address%20and%20Papers.pdf (accessed June 3, 2008).
[6] Fiscal Review 2008-2009 at p. B.4.
[7] $1.230 billion vs. $1.288 billion. Fiscal Review 2008-2009 at p. B.16.

"Mr. Speaker, this Budget includes no changes to NWT tax rates for 2008-09."[8]

Consideration of revenue options has been put off until next year. The Budget Address indicates that the Government will seek $10 million in new revenues for the 2009-2010 fiscal year. The Government states that it will engage in consultation with Regular Members (non-Cabinet MLAs) and then the public, *prior to* making decisions on the revenue increases. [9] It is notable that such consultations were not undertaken with respect to the cuts already announced.

The prospect of $10 million in new revenues needs to be put into perspective:

- the average NWT? Government underestimate of surpluses in recent years is approximately twice as large;[10]
- the cuts that the Government has already embarked upon are several times larger; and,
- the $10 million is less than one percent of the overall budget.

It is clear that the Government is still not seriously addressing revenue options to address its claimed future revenue shortfalls.

Likely revenues

Nonetheless, it likely that the Government has again underestimated 2008-2009 revenues. GDP has been rising (it rose by 13.1% in 2007), and this will probably have an impact on own-source revenues.

Furthermore the Government's apparent budgeting for zero future one-time grants from the federal government seems unrealistic in light of it claiming to have received one-time revenues "each year" for the past several years.[11]

Finally, it should be noted that for the last few years the Government has underestimated revenues by several tens of millions of dollars.[12]

[8] Budget Address 2008-2009 at p. 7.
[9] Idem.
[10] $20 million. See below.
[11] Parkland Report, op.cit. at p.10.
[12] The Government has also underestimated expenditures, though not by as much: the mean average annual surplus underestimate over recent years is approximately $20 million. Fiscal Review 2008-2009 at p. B.17; "Public Accounts of the Government of the Northwest Territories for the Year Ended March 31, 2007 [and for years 2006, 2005, and 2004]: Section I Consolidated Financial Statements - Statement of Operations and Accumulated Surplus," available at http://www.fmbs.gov.nt.ca/expenditures/public_accounts/index.htm (accessed April 16, 2008).

Spending Side

Considering that the government has identified the need to cut spending as a high priority, the current budget places a great deal of emphasis on making spending announcements. The Budget Address contains eight pages of spending announcements for 2008-2009, compared to four paragraphs on revenues.[13]

The spending announcements are mainly presented under the headings of the five strategic priority areas identified by the government. And although these take up the majority of the budget speech, they constitute less than 6% of the budget. They could thus be regarded as the political aspect of the budget speech, as opposed to the policy aspect.

Opportunistic number selection?

The Government continues to imply that spending has been growing faster than revenues. However, since 2002-2003 (the base year the Government used in its most recent annual Financial Statements, released July 2007), this simply has not been the case.[14] In this Budget, however, the Government has now reached back further in time – back to 2000-2001 – in order to show spending as rising faster than revenues over that total period of seven years.[15] This seems an opportunistic revision of the Government's starting points; fluctuating revenues in the first two years after separation of the Territories meant revenues dropping significantly. They have not dropped once in the five years since then.

In another possible example of opportunistic number-choosing, the Government claims in the first two paragraphs of its Budget Highlights document that:

- spending in the new Budget will be up by $64 million, or 5.5% over last year; and
- revenues will be down about $60 million or 4.5%.

This of course "fits" with the Government's story that there is a large and growing gap between revenues and expenditures (a negative gap).

However, upon closer examination of the actual budget numbers,[16] it appears that the Government has used inconsistent figures:

- On the revenue side, the Government used the Revised Estimates for 2007-2008, to compare year-to-year revenue. If the Government had used the Main Estimates, it would have shown that year-to-year budgeted revenues are down only $800,000, rather than approximately $60 million.
- More interestingly, on the spending side the Government is using the Main Estimates as the comparator for 2007-2008 (not the Revised Estimates). If the Government had used the Revised Estimates, as it used for revenues, spending would not be shown as up by $64 million, but *down* by $19 million.

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[13] As noted earlier, only one of these four paragraphs related to 2009-2010 revenues.
[14] Parkland Report, at p.6.
[15] Fiscal Review 2008-2009 at p. B.2.
[16] Fiscal Review 2008-2009 at p. B.16.

It is, of course, up to the government to choose which number to compare for previous fiscal year – Main Estimates or Revised Estimates. However choosing them inconsistently, while supporting the Government's story about a revenue gap, is misleading.

Program review - cart before the horse?

As noted earlier, there has been no justification presented as to the size of the cuts. The number was simply announced.

It would have made some sense if the cuts had been calculated as a result of an internal program review. Such a review could have identified programs or community supports that were no longer needed, or areas where greater efficiency could be achieved. If such a review had been conducted, then there might have been an appropriate rationale for some cuts.

However, with the release of the budget, it became clear that no such review had been conducted. Indeed, the budget calls for the creation of a program review, and the establishment of a Program Review Office, in the coming year.[17]

By announcing the cuts, and then conducting the program review, the Government appears to have put the cart squarely before the horse.

From slowing spending growth to cutting: a leap of logic

The Government has reiterated the claim, many times, that it needs to slow the rate of spending growth.

It may be stating the obvious to point out that slowing the rate of spending growth does not require actual cuts. Slowing the rate of spending growth requires, quite simply, slowing the rate of spending growth. Claiming that it requires cuts, on the other hand, is a leap of logic.

However, slowing the rate of spending growth also means making fewer new spending announcements. And as noted above, new spending announcements are the politics of a budget – the way to secure votes that otherwise may not be forthcoming.

Surpluses

In the Parkland Report, it was noted that the Government had been in surplus since 2004-2005, and that it has tended to underestimate surpluses (by an average of $19 million in recent years).[18] In the last fiscal year, 2007-2008, it now appears the surplus will again be higher than

[17] Budget Address 2008-2009 at p. 15.
[18] Parkland Report, at p.7.

originally forecast. Instead of the predicted $44 million surplus noted in the 2007-08 budget, the 2008-09 budget shows a revised forecast of $69 million in surplus,[19] which brings the mean average underestimate up to $20 million per year.

It is important to note that the Government is projecting this surplus in a year when it spent nearly $193 million on capital - $84 million more than it had budgeted. It is also worth noting that this level of investment is far in excess of the $150 million annual goal for capital investment,[20] and more than double the 2006-2007 capital spending.[21]

Furthermore, this level of capital investment was carried out without using debt; indeed the total debt for year end is now projected to be $29 million *lower* than initially budgeted. There is no direct Government debt remaining; the only debt is the debt of the various corporations that the Government is required by law to guarantee.[22]

Even more notably, these capital investments and debt reduction in 2007-2008 were achieved without any budget cuts.

"One-time revenues"

The Government continues to claim that past surpluses were boosted by one-time revenues,[23] and that there is a need to discount one-time revenues in the future. However, once again, the Government has not said the same of one-time expenditures.[24] Nor has the Government provided a comprehensive overview of one-time revenues or expenditures, so that a complete picture can be publicly examined and debated.

Once again, it appears that the Government is opportunistically choosing numbers: focussing on one-time revenues, while sidelining one-time expenditures. And again, doing so lends the appearance of support for the Government's story of high spending and low revenues.

Forecasts

In the end, the entire argument of the Government (that it needs to cut spending in order to avoid deficits and exceeding its debt limits) hinges on its revenue forecasts.

The Government currently forecasts revenue growth until 2012 of just 1.8% per year.[25]

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[19] Fiscal Review 2008-2009 at p. B.16.
[20] See comments of the Deputy Minister of Finance reported on CBC May 8, 2008, cited in "Appendix – Response to Government Comments" op.cit. at p.3.
[21] Fiscal Review 2008-2009 at p. B.18.
[22] Fiscal Review 2008-2009 at p. B.21.
[23] Fiscal Review 2008-2009 at p. B.1.
[24] See Appendix – "Response to Government Comments" op.cit. at pp. 5-6.
[25] Or 3%, counting one-time revenues. Fiscal Review 2008-2009 at p. B.2.

This is in stark contrast to recent GDP growth of 13.1%, and a Bureau of Statistics forecast that the NWT economy will grow vigorously in the coming years, roughly *doubling* its GDP by 2014.[26] As the Premier and Finance Minister declared a year ago, the NWT's economic growth will be "enormous… unprecedented." [27]

Clearly if the Government is not capturing a greater proportion of GDP growth in its existing tax structure, then it needs to adjust that structure. For instance, a carbon tax could capture $100 million per year. An increase in payroll taxes, rebated to NWT residents, could reduce the leakage of GDP from the Territories while raising revenues.[28] To merely contemplate a $10 million revenue increase (subject to consultations) is to fail to take the issue of revenue leakage seriously.

Smart debt

Not all debt is a bad thing. Clearly, borrowing to support ordinary operating spending is risky under many conditions.[29] However, borrowing to make an investment is wise.

Indeed most businesses and households would be unable to operate without borrowing. Roger Gibbins, President and CEO of the Canada West Foundation, noted that it is often wise for governments to incur public debt, likening it to personal debt:

> "[There is] little that is reprehensible about debt held as mortgages. ... If we had to save the full purchase price before buying a house, most of us would be renters for life. Some kinds of debt, therefore, are not only acceptable but desirable in that they enable us to achieve goals that otherwise would be next to impossible. The only questions we ask is whether we can afford both the interest and payments on the principle, and if we can weather a future increase in interest rates. If we can, then no moral evil is attached to carrying a mortgage, or perhaps even a car loan."[30]

As noted above, the GNWT 2008-2009 Budget includes $33 million in expenditure reductions. It also includes a $13 million surplus. This alone suggests that the cuts could be reduced to $20 million, while still returning a balanced budget. To the predictable complaint that this doesn't leave a surplus in the budget, it could be replied that the aim of Government is not to turn a profit, but to have a balanced budget. Furthermore, the surplus likely has been underestimated, as in previous years, and thus a surplus would likely result in any event.

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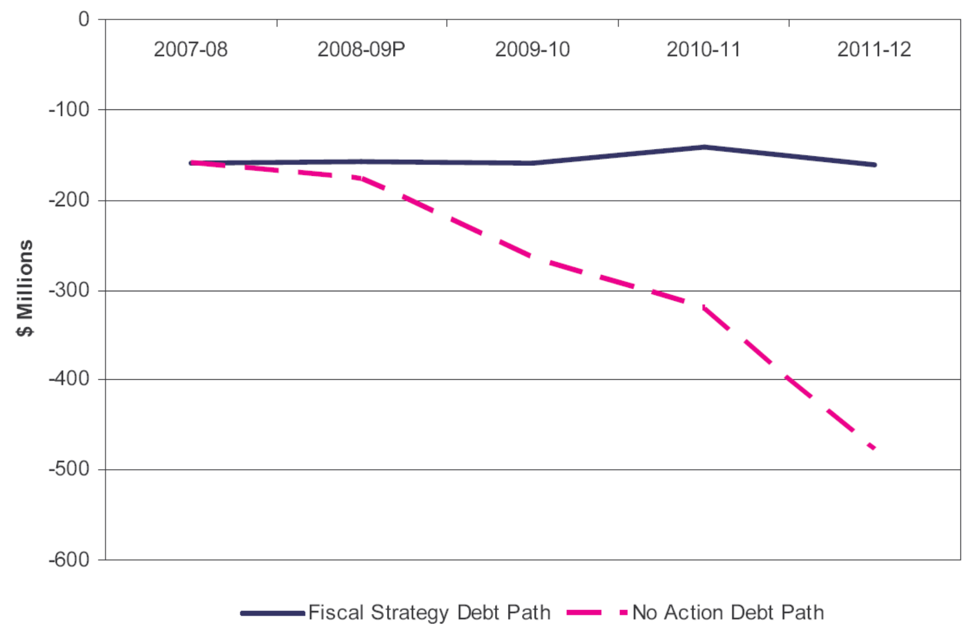
[26] See Report, at p. 13.
[27] See Report, at p. 153.
[28] These and other ideas are briefly outlined in the Parkland Report at pp.17-20
[29] Unless the spending will create a financial return that covers the debt incurred, or inflation is projected to erode the principal owing in relation to future revenues.
[30] Comments in Calgary Herald, February 10, 2002, as cited in Alberta Financial Management Commission, "Moving from Good to Great" (July 2002) at pp. 60-61 http://www.finance.gov.ab.ca/publications/other/2002_0708_fmc_final_report.pdf (accessed June 11, 2008).

Refusal to employ debt wisely

It appears that the Government is going to make its capital investments in the coming year without any borrowing.[31] It is unclear why it needs to avoid using debt financing for these investments. Over $340 million is available for borrowing,[32] and the Government's own policy allows for 50% of capital investments to be financed by debt.

Furthermore it appears that the Government plans to make its $500 million in capital investments over the next several years without using debt. The figure below suggests that the Government's Fiscal Strategy will result in debt remaining roughly at current levels through 2012.[33]

Comparison of GNWT Debt – Fiscal Strategy and if No Action Taken



- Source: Fiscal Review 2008-2009[34]

The Government does not need to avoid debt altogether in making its announced capital infrastructure investments. Presumably these investments will provide a financial return to the Government to cover their initial costs, and thus using debt is a reasonable financing strategy.

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[31] Budget Address 2008-2009 at p. 6.
[32] Fiscal Review 2008-2009 at p. B.21.
[33] The Budget Address at p.6 states that new debt by 2012 will be only $17 million. The "No Action Debt Path" line in the figure describes a potential future debt path that the Government claims would result if not for the cuts. It again fails to provide any calculations supporting this path.
[34] Fiscal Review 2008-2009 at p. B.3.

If, on the other hand, these "investments" are not projected to generate a return adequate to cover their costs, then the Government should not be describing them as investments. In such a case, these outlays are better described as spending.

Assuming that the Government has described these outlays accurately as investments, then it can easily employ debt financing to cover a portion of their costs, and avoid making the spending cuts. Even using the Government's pessimistic assumptions, debt financing to replace the cuts is entirely feasible within the borrowing capacity of the Government.

Replacing all the cuts with borrowing would result in a cumulative debt increase of only $226 million by 2012,[35] which would still leave the GNWT with more than $100 million of borrowing capacity. And assuming the Government's intended infrastructure outlays are actually investments, the returns on those investments will pay off those debts.

Conclusions

There is even less need for the cuts now than there was in January. Since the cuts were announced, the Federal Government has announced $35 million per year of infrastructure spending for the NWT, for a period of seven years. Statistics Canada has released a study showing a GDP growth rate for the NWT of an astounding 13.1% - the highest in Canada, and far higher than that of China. And the surplus for 2007-2008 is now projected to be higher than forecast.

The draft budget materials make it clear that the added infrastructure investments that the Government seeks to make can all be accomplished without cuts. Given this, the cuts seem hasty and premature. It is worth remembering that families and communities will be affected by these cuts, arguably the most marginalized of NWT citizens.

The better course would be for the government to introduce a new budget that eliminates the cuts, to proceed with its program review, and to wait and see if cuts are actually warranted.

[35] This calculation assumes: the Government's revenue and spending figures; the announced cut of $33 million in 2008-2009; the projected further cut of $27 million next year, for a total of $60 million; $60 million in cuts for all subsequent years; and an interest rate of 6% on the debt.