DISCUSSION PAPER

TITLE: Deficit Management

PROBLEM:

Large unanticipated expenditures and revenue declines have placed the Government of the Northwest Territories in a significant deficit position for 1993-94. This deficit may carry forward to future fiscal years unless a plan of action can be agreed upon by the Legislative Assembly.

BACKGROUND:

The Government of the Northwest Territories commenced the 1993-94 fiscal year with the intention of a balanced budget. Unanticipated developments over the course of the year have resulted in a revised forecast of a deficit which may approach 35 million dollars. One-time impacts in 1993-94 include additional funding of 9 million dollars for forest fire suppression, and 10 million dollars for social housing programs. Ongoing requirements have arisen in the areas of social assistance, court services, education and the implementation of a new gender neutral job evaluation system.

Many of the causes of the 1993-94 deficit are of a one-time nature. Others causes are ongoing and may lead to deficits in future years if counteracting measures are not taken.

In addition, the GNWT is at some risk financially pending the outcome of a number of major areas of dispute or litigation. These include the Hospital Billings dispute with Canada, the attempted intrusion of the Canadian Human Rights Commission into GNWT jurisdiction regarding pay equity, and the withdrawal of federal funding for NWT social housing.

THE CHOICES:

The basic options that are available for any government facing ongoing deficits are limited. Essentially the options are one or a combination of:

A) Reduce Spending,
B) Increase Revenues, and/or
C) Incur Deficits (and finance them through borrowing).

A FRAMEWORK FOR MAKING CHOICES:

Making a decision on the degree to which each of these options should be relied on to address the deficit situation would be aided by a decision on the overall government objectives and priorities. Following is an illustration:

If the government selects the following macro objectives:

1) short and medium term economic stimulation,

2) sustainable long term economic growth,

3) treatment of urgent social problems,

4) investment in social rehabilitation,

5) constitutional and governance reform,

6) fiscal stability.

Note that most governments probably attempt to achieve all of these objectives.

Then how these objectives are ranked in importance can provide some guidance in selecting the best deficit management strategy for an organization. For example:

> If sustainable long term economic growth and fiscal stability are primary objectives, a heavy reliance on spending reductions may be chosen as the primary means to deal with a deficit.
>
> If short or medium term economic stimulation and treatment of urgent social problems are priorities, then allowing a deficit to occur and even continue may be seen as a lesser of evils.
>
> If making large investments in social rehabilitation and constitutional and governance reform are the highest priority objectives, then a greater tax burden may seem justified in view of the higher objectives being served.

The only purpose of this example is to illustrate that some agreement on objectives and priorities should be achieved to guide the subsequent choice of deficit management actions.

OPTIONS AND ACTIONS:

A) *Reduce Spending*

Spending reductions can be made in both operations and maintenance (O&M) and capital programs. When considering reductions legislative and contractual constraints must be taken into account.

If capital reductions are chosen, reductions should be program and project specific as projects are costed based on design and savings cannot be achieved without redesigning the project. In order of importance, the capital program priorities used by the Financial Management Board are:

- Housing Programs
- Education Programs
- Health, Social and Cultural Programs
- Municipal and Recreational Programs
- Transportation and Tourism Programs
- Other Government Programs

If O&M spending reductions are selected some of the basic actions that may be taken are:

Reducing civil service costs through:

1. Downsizing, with resultant service reductions (e.g., student teacher ratio, program elimination, building and vehicle maintenance levels, administrative services).

   Many civil servants are direct providers of service in both institutional and community based modes. Other are required to support and manage the government's current array of programs and services and/or the delivery structures already in place. Reductions to the number of civil servants affect program and service delivery and/or requires structural change in how programs are delivered (e.g., consolidation, streamlining, reductions in the numbers of boards and agencies, etc.)

2. Salary and Benefits Reductions

   There are a number of means to accomplish such reductions. Base salaries can be rolled back (e.g., percentage reductions or unpaid leave), or specific benefits can be reduced or eliminated (e.g., Vacation Travel Assistance, Housing Allowance, etc.).

As the vast majority of these items are covered under collective agreements, any changes must be negotiated with the unions representing the employees or legislation must be introduced.

Reducing program costs through:

a) Service or support reductions (e.g., reduce levels of social assistance, student financial assistance, business development funding, legal aid, etc.), or

b) Elimination of total programs (e.g., child care program, fuel for seniors program, homeowners property tax rebate, etc.)

Every program currently being delivered has some client who benefits from it and will be impacted by the reduction or elimination of that program. When making these types of difficult choices, it is important to go back to the government's basic objectives and priorities for guidance.

Reduce costs through streamlining and efficiency, for example:

a) Implement further energy efficiency measures. Often these require capital investment or introduction of some form of user pay or rate restructuring.

b) Reduce management and administration costs through measures such as travel restraint, cutbacks on training and development, less technical assistance and support. These measures have been relied on heavily in the past and excessive reductions can lead to greater costs and ineffective program delivery.

c) Streamline the organization through consolidation, elimination of more boards and agencies, privatization, etc. These measures generally take time and resources to implement but the long term yield is quite good. They invariably generate debate as they involve shifts in responsibility and authority from one group to another, and have significant impacts on staff.

B) *Increase Revenues*

The means for increasing government revenues have been reviewed previously, primarily through a Tax Options Paper publicly circulated a few years ago. There are three primary ways to increase revenues:

1. Increase taxes or introduce new taxes (e.g., Personal Income Tax, Fuel Tax, Payroll Tax, Tobacco Tax, Corporate Income Tax, Sales Tax, etc.).

   The economic impact of tax changes should be thoroughly assessed prior to choices being made. It is felt that many "sin taxes" are currently at high levels where further increases do not generate more revenue but force consumers to alternatives (e.g., smuggling, illegal manufacture, more damaging substitutes).

2. Introduce or increase User Pay (e.g., increase rent charges, increased lease rate, timber fees, introduction of tolls).

   With user pay consideration must be given to the user behavior changes that will result and the desirability of such changes, as well as to the equity of the charges made.

3. Expand existing tax bases (e.g., economic stimulation or development can result in larger personal and corporate income tax bases, potential royalty revenues, etc.. Taking actions to create new tax sources such as revenues from licensing gambling institutions, etc.).

   Incentives to take action of this nature are limited. The current provisions of the Formula Financing Agreement with Canada do not encourage these types of actions due to the way the formula adjusts revenues for the relative " " tax effort " of the government. In addition, much of the necessary jurisdiction still resides with Canada, and often there are undesirable side effects of liberalizing/legalizing certain activities.

C) *Incur Deficits and finance them through borrowing*

A short term solution at best. This approach has been used in other Canadian jurisdictions with negative results. Deficit financing is difficult to control and recover from as it is predicated on better times ahead. This assumption has not held up well over the last two decades.

Many creative variations to borrowing have been tried in other jurisdictions. These include leasing facilities rather than building them, creating crown corporations to hold and acquire assets and not show the consolidated affect on the government's financial position, and other measures of a similar nature. Although these types of measures may provide some short term advantages, most of these actions still constitute borrowing and often at a higher "interest rate" than the government could achieve by borrowing directly.

Nevertheless, allowing deficits and borrowing to finance them is still an option and depending on the government's objectives and priorities may be selected as a component of the government's deficit management plan.

CONCLUSION:

The Government of the Northwest Territories faces a significant deficit which may continue and grow in future years if a deficit management plan is not agreed to.

To provide guidance in the development of a deficit management plan it is important that the government identify its fundamental objectives and priorities. Specific actions can then be selected and developed for subsequent approval and implementation.