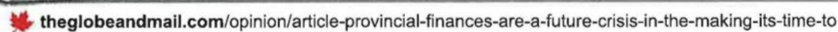
InfoSabius

Sujet traité : Les finances provinciales sont une crise en devenir. Il est temps de commencer à trouver une solution / Provincial finances are a future crisis in the making. It’s time to start work on a solution

Source : The Globe And Mail   Date : 27 mars 2024

Provincial finances are a future crisis in the making. It’s time to start work on a solution



Andrew Coyne   27 March 2024

opinion

Andrew Coyne
Published Yesterday
For Subscribers

Open this photo in gallery:

Newfoundland and Labrador Premier Andrew Furey listens as Finance Minister Siobhan Coady delivers the provincial budget in St. John's on March 21. The PBO forecasts for Newfoundland and other provinces are worrisome, with projected net debts in 25 years’ time exceeding 50 per cent or even 70 per cent of GDP.Paul Daly/The Canadian Press

A decade or so ago Europe was in the throes of a political and economic crisis over the finances of a single, tiny country: Greece.

InfoSabius

Though it accounted for a mere 1.5 per cent of the European Union's GDP, Greece's massive debts, arthritic economy and dysfunctional politics provoked speculation that it would default on its debts, withdraw from the euro, or both. And if Greece might, would other member states? Would the EU bail it out, to avoid this fate? Or would this amount to rewarding Greece for its fecklessness, and thus simply invite others to follow its example?

Knowledgeable observers smirked at Europe's dilemma. Hadn't they brought this on themselves? Wasn't this the inevitable consequence of a basic flaw in the EU's design – that, although it is a monetary union, it is not, to this day, a fiscal union?

Most of its member states, that is, have surrendered their national currencies to the euro, and control over monetary policy to a single European authority. They have not done the same with fiscal policy. And yet, monetary policy is difficult to disentangle from fiscal policy. The more heavily a country borrows the greater the pressure, other things being equal, on interest rates. If it were to get too far into debt, the central bank might be forced to buy its bonds, with obvious (though not inevitable) implications for inflation.

A government in a unitary state can readily ensure its fiscal policy remains consistent with its monetary policy. But a federation like the EU faces a serious collective action problem. How much any individual state borrows would clearly affect all the rest, so far as it added to the total. But absent any external constraint, it would have every incentive to load up with debt. In the short run, it could free-ride on the credit rating of the stronger members. And in the long run? The consequences of default would be so horrible that the others would have to bail it out.

A monetary union thus implies some limits on the borrowing of member states. And indeed, at the euro's outset, Europe had imposed such limits: deficits of no more than 3 per cent of GDP, total debt of no more than 60 per cent. But these had not been enforced. Greece, and the euro crisis, were the result. Silly Europe. Tut, tut, tut.

Except … that's also the case in Canada. Australia co-ordinates the borrowing of its member states through a federal-state body known as the Australian Loan Council. American states have self-imposed limits on their ability to take on debt. German Länder (states) are constitutionally prohibited from running deficits. But in Canada, provinces can borrow as much as they like, in any currency they like. Like Europe, we are a monetary union without a fiscal union. Until lately that hasn't posed much of a problem. It is about to become one.

Every year the Parliamentary Budget Office issues a Fiscal Sustainability Report on the debts of the federal and provincial governments. Half the provinces, it finds in its latest instalment, have debts that are "not sustainable over the long term," meaning they are likely to grow faster than the economy. Its projections are, of course, conditional on the assumptions it plugs into its model, and as such tend to jump about from year to year. Nevertheless, the forecasts for Newfoundland, Manitoba, Prince Edward Island and, of late,

InfoSabius

British Columbia are consistently worrisome, with projected net debts in 25 years' time exceeding 50 per cent or even 70 per cent of GDP. When Saskatchewan nearly hit the "debt wall" a generation ago, its debt-to-GDP ratio was in the high 40s.

University of Calgary economist Trevor Tombe, co-director of the invaluable Finances of the Nation website, is even gloomier. He projects the provinces generally face a "fiscal gap" over the next 25 years on the order of 2.5 percentage points of GDP. That's the amount they would have to either raise taxes or cut spending – not over the long run, but "immediately and permanently" – to bring their debts under control.

In B.C., according to Prof. Tombe, the gap is between 4 per cent and 5 per cent of GDP. To recoup that much through revenues alone, B.C. would have to double its personal income tax, or triple its sales tax. But Newfoundland, PEI and Nova Scotia are, on his calculations, not far behind.

All of which makes the insouciance of recent provincial budgets in Canada's largest four provinces a little hard to bear. Take B.C., which not long ago had the most rock-solid finances of any province but whose fiscal future, after years of rapid spending growth under the province's NDP government, Prof. Tombe now rates as "bleaker than any other." The province's latest budget projects a deficit of nearly $8-billion for the current fiscal year, with similarly hefty deficits to follow – nearly doubling the province's debt-to-GDP ratio in four years.

Yet spending has been growing even faster under Alberta's United Conservative government, already among the highest-spending governments in the country, per capita. The only reason it is not running deficits is because of an enormous windfall in expected revenues, notably from oil and gas royalties – the same roller coaster the province has been on for decades. As the richest province in the country, Alberta can amply afford to spend more than other provinces. What it cannot afford is to spend at levels that assume current peak revenues will carry on indefinitely.

The same lack of fiscal discipline has returned to Quebec, which in recent years had been making some effort to rein in its historic appetite for debt. No longer: the province's latest budget projects the deficit will triple this year, to $11-billion – the highest in Quebec's history, pushing the province's net debt-to-GDP ratio above 40 per cent – second only to Newfoundland.

Or perhaps third, after Ontario. That province's Conservative government also announced a tripling of the deficit, to near $10-billion – a far cry from the modest surplus projected just a year ago. The province's debt now stands at nearly half a trillion dollars – $439.1-billion, to be precise – "the largest," as it is often said, "of any subnational jurisdiction in the world."

InfoSabius

Defending this performance, Ontario's Finance Minister, Peter Bethlenfalvy, sounded like any of his Liberal or NDP counterparts. The problem, he complained, was not his government's torrid spending, but a shortfall of revenues. "Global economies have slowed, the cost of everything is higher, and so we have two choices: Put the brakes on, or keep going," Mr. Bethlenfalvy said in his budget speech. "Mr. Speaker, we choose to keep going."

Perhaps this might be defensible, if the revenue shortfall were temporary. It is not. As we are all acutely aware by now, the slow growth that is crimping government revenues across the country is not a cyclical phenomenon, but is likely to be more or less permanent – absent the sort of radical, pro-growth reforms no government seems willing to implement. Treating this as a short-run problem is the inverse of Alberta's mistake, treating a short-term revenue windfall as permanent.

Neither are the pressures on the provinces' spending likely to abate – especially for health care. As it is, the provinces are typically spending nearly half their own-source revenues on that one department. True, they have succeeded in slowing the growth in health spending, somewhat – but at the cost of much longer wait times: At an average of 27.7 weeks, from referral to treatment, they are three times as long, according to the Fraser Institute's latest "Waiting Your Turn" report, as they were 30 years ago.

And it's only going to get worse: The baby boomers are only part way through their progression into old age and beyond. As a rule of thumb, per capita consumption of health care doubles for every decade past the age of 55. Even the richest, youngest provinces, like Alberta, are going to find this challenging. But what of the poorer provinces, with much older populations, in Canada's East? The risk is of a continuing spiral, as younger workers, eyeing a future of higher and higher debt and higher and higher taxes, decamp for points west.

That's not just a risk to them. In a monetary union without a fiscal union, it's a risk to everyone. Large provinces such as Ontario or Quebec, with diversified economic bases, aren't likely to run short of creditors. But what if one of the smaller provinces, some years hence, were to run into trouble? What if it were to default on its debt payments? What if it were even at risk of doing so?

Credit markets do not wait until the event: they react in advance. And not long after they had begun to mark up the interest rates on the bonds of whichever province ran into difficulties first, suspicion would begin to fall on others. At high enough levels of debt, and high enough interest rates, speculation could become self-fulfilling, pitching provinces into default who might otherwise have survived.

This is far from certain, of course. A crisis, if it comes, would be decades hence, and in the interim provinces have every opportunity to take the sorts of actions needed to prevent it. But will they, though? It's human nature to put off difficult decisions, in politics most of all (in the

InfoSabius

long run, as it has been said, we are all out of office). But they are especially unlikely to do so if they think that, in the event, they can count on Uncle Ottawa bailing them out.

It's time, then, for a national discussion on how to avert this. One part of this, surely, should be a transfer of tax room from the federal government to the provinces: a permanent increase in the provinces' fiscal capacity, with the accountability – to their own taxpayers, not to the feds – that goes with it.

But a second part – a condition of the first – must be some sort of co-ordination of federal and provincial borrowing, to forestall the kind of collective action problem I've described. Together, these would make credible a third element: an absolute ban on federal bailouts. If we want to avoid a euro-style crisis, we need to bring in, and enforce, the kinds of rules Europe neglected to make stick.