

WHY WILLIAMS WALKED, WHY MARTIN BALKED: THE ATLANTIC ACCORD DISPUTE IN PERSPECTIVE



Christopher Dunn

In a province where no premier ever lost votes by standing up to Ottawa, Danny Williams has become the latest in a long line of provincialist champions from Newfoundland and Labrador. When he walked out of a First Ministers' Meeting last October, he had carefully chosen his fight with Paul Martin over the Atlantic Accord, which allows Newfoundland and Labrador to keep 100 percent of its offshore revenues. Yet 70 percent of those revenues are clawed back by Ottawa under the equalization formula. In the election campaign, both Stephen Harper and Jack Layton promised to end the clawback. Martin made a similar campaign promise, but balked when federal finance officials turned stingy. From St. John's, Christopher Dunn appraises the political landscape, and fallout, from the Atlantic Accord disaccord, and finds Martin between the Rock and a hard place.

Dans une province où aucun premier ministre n'a jamais perdu le moindre vote en défiant Ottawa, Danny Williams est le tout dernier d'une longue liste de champions provinciaux. En claquant la porte de la rencontre des premiers ministres en octobre dernier, il a soigneusement choisi son combat contre Paul Martin, l'Accord atlantique qui prévoit que Terre-Neuve-et-Labrador conserve la totalité de ses revenus extracôtiers. Or, 70 p. 100 de ces revenus sont récupérés par Ottawa suivant l'actuelle formule de péréquation. En campagne électorale, tant Stephen Harper que Jack Layton ont promis de mettre fin à cette situation. Paul Martin avait fait une promesse analogue, pour finalement reculer sur les conseils de ses responsables financiers. Depuis St. John's, Christopher Dunn évalue les répercussions politiques du désaccord sur l'Accord atlantique, de même que l'ampleur du dilemme auquel est confronté le Premier ministre canadien.

Prime Minister Martin: "You can't walk out of this meeting."

Premier Williams: "Just watch me."

So began, last October 26, another of the periodic political dramas that convulse the province of Newfoundland and Labrador and the Ottawa establishment. This time it involved the premier's proposal that there be a new offset provision in the Atlantic Accord allowing Newfoundland and Labrador to retain 100 percent of the benefit of the offshore petroleum revenues it receives, notwithstanding the treatment of those revenues under the equalization program, which provided that 70 percent of these revenues be clawed back to the federal treasury.

The premier had set an October 26 deadline, the date of the First Ministers' Meeting (FMM) on equalization, for the prime minister to honour a pledge to that effect that he had

made to the province's electors during the 2004 federal election. Williams was annoyed by an October 24 letter from Finance Minister Goodale which qualified the federal offer by limiting it to eight years (2004-2012) and provided that "no such additional payments result in the fiscal capacity of the province exceeding that of the province of Ontario in any given year." Coincidentally, Goodale had redefined the province's fiscal capacity with "top-ups" that the province found unacceptable. Failing to meet with Martin before the FMM, Williams turned on his heel and left the capital.

Then he did it again: different capital, different offer, same walk. Meeting in Winnipeg on December 22 with Mr. Goodale, Mr. Williams said that the new federal offer was even worse and that the province was breaking off negotiations with the federal government altogether. The province said that the prime minister had reiterated the principle that the annual off-

set payment should be equal to 100 percent of any reductions in equalization payments resulting from offshore revenues, but had added conditions which eroded the 100 percent commitment.

Among the most striking, later publicized by the province, were those that stated that the federally proposed offset arrangement would terminate in any year in which NL is off equalization; the federal transition mechanism which is

Then what slippage in support affecting the premier was swept away by an intemperate, prejudiced column on January 6 by Margaret Wente of *The Globe and Mail* (rural Newfoundland was “probably the most scenic welfare ghetto in the world”). Outrage followed. The premier’s support was once again consolidated, by default, riding a wave of nationalist feeling. He wisely raised the flags during this episode.

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Far from aberrational, his behaviour was perfectly rational; in fact, Williams had no choice. His actions were driven by the appalling state of provincial finances, a nationalist consensus and a federal consensus.

Danny Williams was sworn in on November 6, 2003 as the ninth premier of Newfoundland and Labrador. The Williams cabinet, hours into its first meeting, made a decision to undertake a third-party review of the province’s financial situation. The PricewaterhouseCoopers review results were announced in a State of the Province address broadcast on January 5, 2004. The review pegged the current-

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triggered when the new offset terminates is the inadequate one embedded in the existing Atlantic Accord; there would be no extension of the agreement for another eight years to 2020 if the province was off equalization in year seven or eight, or if there was no balanced budget in year eight, or if the province’s debt/GDP ratio moves ahead of one other province.

Even if an extension did occur, the same criteria (two years off equalization, improved debt/GDP ratio, failure to balance budget) could end the arrangement in any year, and there was no chance of extension beyond year sixteen. The revenues from other potential new oil fields will not be included.

To emphasize the province’s case, the next day Williams ordered that Canadian flags be lowered from provincial government buildings. They would stay down for close to three weeks. During this time, provincial public opinion careened wildly. Originally united behind the premier on the offset issue, it began to divide on the “flag flap.” Sensing that the flag tactic was threatening the offset strategy, on January 3 Williams indicated his openness to further talks with Martin (and emphatically not Goodale), who then retorted in effect no flag, no talks.

In a January 14 letter, the prime minister, apparently reversing a stance that Goodale was the point on this file, agreed to talks. January 28 was to be the new date for “PM to premier” discussions. However, the letter hinted he would be unbending on extending an agreement past 2020 and making “additional and continuing 100 percent offset payments even if the province no longer qualifies for Equalization,” which he called “in practice indistinguishable from Equalization payments.”

What can explain this apparently aberrant behaviour? Shortly after the October walk, I was at an academic conference in Ottawa and was asked, by more than one person there, if the premier was unsteady. The poor dears. After all this time, they still don’t get Newfoundland politics. Hence, yet another screed on the subject.

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year deficit, on an accrual basis, at \$827.2 million (up from the Liberals’ \$666 million). It also noted that in the absence of restraint measures, (1) the average deficit would exceed \$1 billion annually for the next four fiscal years (2004-05 to 2007-08); and (2) the debt of the province would increase to \$15.8 billion from \$11.6 billion by 2007-08.

An audit of the financial statements of the province for the year ending March 31, 2004, in fact saw the government record a deficit of \$913.6 million — the highest ever reported by the province — and a net debt of \$11.5 billion. The auditor general also noted that interest costs amounted to \$1.1 billion or 25.4 percent of total revenue in that year — the highest interest costs as a percentage of total revenue of any province in Canada. The unfunded pension liability at \$3.75 billion continued to worry government.

The effects of this appalling financial state of affairs had, and are still having, repercussions. Nineteen departments became 14 in February 2004, and 10 departments were restructured. In a January 2004 State of the Province address, Williams announced there would be “a change in the programs that are offered and a change in the size of government.” As many as



CP Photo

The giant offshore drilling rig, 600,000 tonnes and 224 metres tall, being towed from Trinity Bay to the Grand Banks in 1997. For a province drowning in a sea of deficit and debt, offshore revenues promise hope of financial rescue. But ownership of the resource is also symbolic. "There is," writes Christopher Dunn, "a profound sense of resources as both patrimony and potential."

4000 positions in the public service have been targeted for elimination.

However, the state of provincial finances is such that even achieving "efficiencies" in public services will fall far short of the mark. A radical revenue infusion, or a series of them, is necessary. A new Atlantic Accord deal would be a critical first step. In this light the premier's actions are not aberrant, but totally rational. Goodale had, after all, been bandying around pitiable offers like \$1.4 billion over eight years. This just isn't on.

The province has never made public a detailed analysis of what a new, better deal could mean in terms of revenues: estimates, yes, but the rationales, no. However, we have some ideas of what orders of magnitude are involved. In a (St-John's) *Telegram* article interview last October 26, Finance Minister Loyola Sullivan noted that if oil revenues remained healthy, Ottawa's proposal (with the Ontario cap, since bargained out) would have

seen the province relinquish \$3 billion in clawed-back revenue over the next eight years. Privately, Sullivan talks about figures like \$4.5 billion over eight years and \$6.5 billion over 21 years accruing to the province if it gets a deal it considers just, and the dollar and oil revenues remain steady. Yet extra money would not go just to debt reduction, Sullivan notes: there would be a balanced approach — some for the debt, but much for needed infrastructure, like ferries, hospitals and schools.

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Such issues are immediately put in context in this province. There is a profound sense of resources as both patrimony and potential, and so the Atlantic Accord and its fate are part of the larger and more complex warp and woof of

provincial history. The province's experience has taught it that the federal authorities are insincere partners to have when vast financial or resource issues are at stake. It is telling that in his first speech to the people of the province upon his return from Ottawa, Williams made reference to one of them, namely Churchill Falls. But there are others.

Term 29: Term 29 was a one of the Terms of Union that governed Newfoundland's joining Canada, and was inserted in light of the difficulty of predicting the financial consequences of provincehood. It was an early precursor of equalization, which in fact later rendered it redundant, but its intent was to allow the province to provide public services at the level and standard of those prevailing in the Maritime provinces, keeping in mind the province's ability to pay. The federal McNair Royal Commission which was mandated to recommend a level of transition grant, suggested in 1958 an amount rising to \$8

million annually by 1962, thereafter to remain in perpetuity. Two issues surfaced: the amount was well short of the \$15 million a 1953 Newfoundland Royal Commission had said Newfoundland required to meet the objectives of Term 29, and Prime Minister Diefenbaker decided the grants should end in 1962.

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The fact that Diefenbaker extended the payments in 1961 for another five years, and that the succeeding Pearson Liberal government honoured the claim for the full amount, and in perpetuity, put the issue to rest. However, it had shown the new province that its claim had justice, that it had to struggle in the federation for what it got, and that a constitutional guarantee was no automatic guarantee of equitable treatment.

The fishery: The principle jurisdiction over the groundfish fishery is federal, under s. 91(12), but there is a provincial regulatory role under the property and civil rights clause s. 92(13). In 1992, the federal minister of Fisheries and Oceans placed a moratorium on groundfish stocks in Atlantic Canada, especially in those adjacent to Newfoundland and Labrador. The fishery has not rebounded as quickly as expected, and there are continuing moratoria on key groundfish stocks in some areas (species like cod, American plaice, witch flounder, redfish, haddock). The average annual landing of groundfish in 2003 was 10 percent what the average landing was from 1977 to 1991. As a result, some fish plants have had to shut permanently, or reduce their workloads, or turn to other species. Troubles in the fishery contributed to the continuing depopulation of rural Newfoundland; the population of the

province is about 10 percent lower than it was in 1991. The collapse of the fishery was a social and ecological phenomenon that cannot be attributed to a particular government or factor. Nevertheless, as the province's Young Royal Commission reported in 2003, "the fact remains that this environmen-

tal, social and economic tragedy occurred on the federal government's watch and as a result of its failure to manage the resource properly."

The Churchill Falls Development: The Churchill Falls Development is an enormous hydroelectric resource located in the province; but the principal beneficiary by far is Quebec, to the tune of about \$850 million a year. This anomalous result profoundly disturbs the people of Newfoundland and Labrador. Size mattered, but manifestly should not have. The federal government was plainly not sympathetic to a small province that could deliver few seats in Parliament, and preoccupied with a large province that could. As the Young Commission noted, "The federal government placed Hydro-Quebec in a monopolistic position during the Churchill Falls negotiations of the 1960s by not enacting legislation that would have allowed for a power corridor through Quebec. Without such federal legislation, negotiations on the Churchill Falls project took place in a situation in which virtually all the power and energy had to be sold to Hydro-Quebec." And it was to be sold at rates from the 1960s and for 65 years, without an escalator clause, which proved to be fatal when in the international energy crisis hit in the 1970s and Hydro-Quebec enjoyed windfall profits. *The Independent*, a weekly newspaper in St. John's, recently estimat-

ed that "While Hydro-Quebec has gathered an estimated \$23.8 billion in revenues from the sale of electricity since the Upper Churchill came on stream in 1972, Newfoundland and Labrador has taken in less than three percent of that — about \$680 million." There is a moral imperative for federal authorities to atone for their lack of assistance in the Upper Churchill case by offering financial backing to develop the Lower Churchill at the Gull Island or Muskrat Falls sites. For three decades they have not.

Equalization: There have been a number of adjustments over the years that Newfoundland claims has affected its bottom line. In 1982 the federal

government included non-renewable natural resources in the calculation of fiscal capacity, but removed Alberta's non-renewable natural resources by going to a five-province standard. In order to prevent a situation where Newfoundland and Nova Scotia would face no net increase in revenues due to this new method of calculation, there were, over time, two options provided.

- To operate outside of the equalization program: a series of declining "offset payments" provided through the Canada-Newfoundland Atlantic Accord of 1985 (and a Nova Scotia arrangement in 1986) and to kick in for a 12-year period once an oil production trigger was reached, now effectively 1999-2000 to 2011-2012.
- To operate within the equalization program: the "generic solution" introduced by the new Chretien government in 1994, which shields 30 percent of a province's revenue from the calculation of its fiscal capacity if that province has 70 percent or more of a single revenue source, thus limiting the decline in equalization somewhat. (Newfoundland's offshore oil resources are a unique source in the equalization formula so, by definition, Newfoundland has 100 percent, and the generic solution applies.)

Neither of these two options is entirely satisfactory. The Accord doesn't provide offset provisions (revenue protection) for a long enough period; the offsets decline over that limited time; and the Accord doesn't operationalize the meaning of principal beneficiary. As for the generic solution, it can protect no more than 30 percent of revenues and it can be reduced or eliminated at federal government discretion.

The province has to choose one or the other. Because the Atlantic Accord offsets would decrease in importance over the decade, and because the equalization program has no "Newfoundland as 'principal beneficiary'" language to it, as the Accord did, the solution was to amend the Atlantic Accord.

Early in 2004, Premier Williams began discussions with the feds designed to achieve what he called "100 percent of our offshore revenues" outside of the equalization program. This would be achieved by changing the equalization offset provisions of the Atlantic Accord to "provide a payment equal to 100 percent of the net direct provincial offshore revenue," such net direct revenue defined as "Royalties and Corporate Income Tax which is generated in the NL offshore area, less the Equalization clawback (currently at 70 percent)." In June, when in Newfoundland, Martin stated that he had accepted the premier's proposal. (For a review of the wording, go to CBC News: <http://www.cbc.ca/story/canada/national/2004/06/05/offshore040605.html>).

One can see that the Accord issue, when woven into the cloth of Newfoundland discontents, takes on a weighty baggage of grievance.

Still another reason that Williams walked is because he could. It was a low-risk tactic. Conservative leader Stephen Harper and the NDP's Jack Layton had promised deals that made Liberal inaction on the clawback seem definitely trifling.

Last May, during a swing through Newfoundland in the federal election, Harper said "non-renewable resources

such as oil and gas are among the most promising avenues for real growth in Atlantic Canada.... When the federal government taxes [offshore oil and gas] revenues away by 70 cents to a dollar, however, they jeopardize the opportunity to establish longer term growth." His solution was to remove non-renewable resources from equalization to allow the Atlantic provinces to benefit from these revenues, a ten province standard for equalization, with a phase-in ensuring that no recipient province would receive less money during the transition to the new formula than the current formula provides.

Earlier, in an April 25 letter to Premier Williams, Layton promised NDP support for "Newfoundland and Labrador receiving 100 percent of its offshore oil and gas revenues to make it the 'principal beneficiary' of these resources based on the principles set forth in the Atlantic Accord." He also said Newfoundland and Labrador should have an ownership stake in offshore oil and gas developments as equity partners, that an ownership stake would be a pre-condition to all future developments, and that the government of Canada should transfer its 8.5 percent equity share of the Hibernia project to the province.

It wasn't as if promising Newfoundland it would be the major beneficiary from offshore energy was something new, either. Past leaders had seen the need to correct a resource anomaly and fiscal problem at the same time. In 1979, the Clark minority Progressive Conservative government even promised to transfer ownership and jurisdiction of offshore mineral rights to coastal provinces. In a September 1982 offshore revenue proposal, Trudeau stated that "Newfoundland should enjoy the major share of the revenue that offshore resources are expected to generate," until the province reached a level of fiscal and economic capacity well above the national average. The Mulroney-Peckford MOU of June 14, 1984, which preceded the Atlantic Accord, recognized "the right of Newfoundland and Labrador to be the principal beneficiary of the wealth of the oil and gas off its

shore, consistent with a strong and united Canada," and stated that "Newfoundland would be entitled to establish and collect resource revenues as if these resources were on land."

All in all, the weight of promises and policies was in the direction of a substantial federal consensus. Why did Martin hesitate?

Martin balked because he became aware that the Accord issue was awash in repercussions and implications. The Martin stance was now governed by Finance's fears that side deals could weaken the integrity of the national equalization program, by departmental fears over the change in the economic paradigm governing Atlantic Canada, and by the same fear of losing windfall petroleum profits that galvanized the Trudeau government in the 1980s. Plus, the future electoral ramifications have to be sussed out.

Imperial Finance, as the federal central agency is known in Ottawa, doesn't buy the asymmetrical reasoning that lay behind the Atlantic Accord. How many other provinces will have the right to claim side deals? Over which resources? The feds' delay in resolving this is because of a battle over Finance's hegemony and its preference for standard principles, regardless of what effect they have in the particular.

The economy fragment of the federal bureaucracy has an image of Atlantic Canada that is something like that of Michael Bliss's "Old Canada" — the old economy, subsidy-gobbling east — juxtaposed uncomfortably alongside "New Canada," the more entrepreneurial, new economy, cluster-oriented centre and west of the country. It can be led out of this policy wilderness (witness the anomalous Atlantic Innovation Program) but the leadership is seen as, surprise, federal. If the autarkic implications of the Accord are translated into provincial-led economic development, a national presence, federal jobs, and Liberal seats are in jeopardy.

Petroleum politics bring out the law of the jungle in Canadian federalism. There are, in effect, none of the genteel

rules that govern other aspects of inter-governmental relations. It is survival of the fittest. Ottawa reacted to the wind-fall profits of the 1970s petroleum era with a series of revenue grabs. When Alberta didn't like the NEP, it demanded and got a tax regime that saw its share increase. What didn't emerge however was a principle of sharing. That was to be determined by power politics. Oil prices rose at one point to \$55 a barrel. Martin had to reassess a promise made when they were half that amount earlier in the year.

Yet the effects of this issue are even wider than perhaps Martin imagines. This is a big deal. All sorts of issues are in play.

1. The offshore oil patch is expanding. The \$6-billion Hibernia project had started producing oil in 1997 and the \$3-billion Terra Nova project began production in January of 2002. In March of 2002, the province's third major offshore energy project began when Husky Energy announced the go-ahead on the \$2.3-billion White Rose offshore oil development, and production is forecast to start in late 2005 or early 2006. But there may be more on the way. Husky Energy has announced its intention to drill one offshore exploration well in the South Whale Basin in 2004. The provincial finance department estimates that Newfoundland and Labrador could see as many as 10 wells drilled over the next several years. The implications for federal and provincial revenues are important. The new offset provisions Williams is proposing would continue "over the life of the offshore petroleum production."

2. The Atlantic Accord has the potential to be a wedge issue. Atlantic Canada is one of the legs of the three-legged stool of Liberal electoral success (Ontario and Quebec of course being the others); in the 2004 election it even yielded more seats for the Liberals than did Quebec. Stephen Harper sees the Accord issue as one that could achieve two of his long-standing aims: to wean the eastern provinces off the Liberals, and off equalization dependency, simultaneously. It is the first regional issue to face the new

Conservative Party since its founding in October 2003, and has the added advantage of appealing to the Atlantic rump of former PC MPs and voters. Plus, at the next election, doubtless the point will be that the Atlantic Accord was made by federal and provincial Conservative governments.

It also fits in with Harper's coalition-building nature and reveals his understanding of what it takes for a right-of-centre party to achieve electoral success in Canada. Political Scientists Eric Belanger and Jean-Francois Godbout have argued that since the 1980s, federal party competition in Canada has revolved around two policy dimensions, economic (left/right) and regional (centralization/decentralization).

The Liberals have ruled for decades by occupying the political centre on the economic dimension. Opposition parties have two options: wait (usually for a long time) for the ruling party to stumble on the economic dimension, or try to find a faster way: say, a regional issue that creates alternative electoral cleavages and coincidentally deflects attention away from a right of centre economic stance.

Thus the Atlantic Accord issue fits the bill: it applies to two of the four Atlantic provinces and responds to an historic sense of grievance in the east. It provides a potential area for new regional alliances: West meets East, and the twain mix. It is also telling that we haven't seen Atlantic Canada's "culture of defeatism" rap successfully pinned on Harper since he was seized of the Accord issue. All the things that should make him scary (at least in Liberal eyes) — he was a disciple of Hayek, a policy advisor to Preston Manning, a soul-mate of Tom Flanagan, an ex-president of the National Citizen's Coalition, a co-author of the "Firewall Letter" — don't, particularly.

3. This Accord episode shows how to frame an issue. The Liberals have lost control of the Atlantic Accord issue, and the Newfoundland Tories own it, at least for the present. The Newfoundland case is premised on a few by now well-known contentions. The principle that

Newfoundland and Labrador should be the principal beneficiary of offshore petroleum resources has been violated by the feds getting the lion's share of these revenues (86/14 percent, according to the Williams government, 75-80/20-25 percent says the Young Royal Commission report), and the existing offset payments in the accord declining before the offshore yields its maximum benefits. Plus, non-renewable resources deserve special treatment. The province has never strayed from these contentions, while Ottawa modified its negotiating stance many times, to the extent that its philosophic point of reference is indistinguishable. One knows however that it is driven by the dictates of petroleum politics.

The irony of the provincial stance however is that it has never revealed the calculations behind the revenue shares. In a sense, it doesn't have to. Williams said that he was watching the federal election based on this one issue. He waited. The Conservatives and New Democrats responded promptly, as wished. The Liberals responded at the eleventh hour, dictated to by a provincial premier, who said Newfoundlanders should vote only for those who supported his stance. Then Williams focused the province's attention on this issue for the next half-year. Then he artfully continued to make this a matter of federal-provincial summitry by bombing the bridges under Minister Goodale and Regional Minister John Efford, and manipulating the flag issue to smoke out Martin as the principal federal interlocuter. The Liberals are like a deer caught in the headlights.

Given the nature of petroleum politics, it is likely that there will be a saw-off, with Newfoundland getting not all, but at least substantially more than it is now being offered. Given the financial straits in which it now finds itself, and the federal resource record so far, this can only be for the best.

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