

Measuring the Impact of the 2017 Election on Uncertainty in British Columbia

by Lydia Miljan



SUMMARY

- Political uncertainty and policy uncertainty are linked and amplified under minority governments. Uncertainty in both spheres leads to lowered business investment and acts as a drag on the economy.
- This bulletin uses a proxy measure of newspaper coverage of the terms “uncertain” and “British Columbia” from 2009-2017 to show which events and policies increase uncertainty.
- The British Columbia measure shows that provincial elections have brought with them varying levels of political uncertainty, which were heightened in 2013 when there were concerns that the Liberal government might not win a fourth mandate, and in the most recent election held in May 2017, which resulted in no clear majority winner.
- The 2017 election saw proportionately the highest number of stories that include the word “uncertain.” After previous elections, the uncertainty measure dropped dramatically and immediately, but that did not happen after the 2017 election.
- The 2017 election stories focus on both the uncertainty of who will govern and about the policy uncertainty created by the alliance of the NDP and Green parties.
- The policies most likely to be associated with uncertainty after the election were connected to energy and pipeline policy, taxation, and the economy.
- If the government proceeds with its commitment to electoral reform, British Columbia could face more coalition governments, which would lead to persistent political uncertainty and more policy uncertainty.

Introduction

The May 9, 2017 provincial election in British Columbia left the political and economic climate in the province in a state of heightened uncertainty. Political uncertainty came from the hung legislature which came about when no party received the majority of seats and with it, a firm mandate to govern. The uncertainty was amplified by the fact that the NDP and Green parties voted against the Liberal party to form a government, only to enter into an agreement that could be marred by similar instability. The combined NDP/Green seat count is only one more than the Liberals received. An added element that is sure to cause future uncertainty is the NDP/Green commitment to adopt a new, proportional representation (PR) electoral system. If this initiative is successful and PR is adopted, it could result in a similar result in subsequent elections: no one clear winner, leaving the province in a persistent state of heightened political uncertainty.

The NDP/Green alliance has also led to economic uncertainty in the province, specifically, concerns that business friendly policies under the former government will change. While all jurisdictions that elect a new government face some degree of policy uncertainty, coalition or alliance governments, as is the case in BC, tend to have higher degrees of uncertainty due to the very nature of coalitions. American economist Robert Higgs coined the term “regime uncertainty” to explain how private investment decreases when governments pursue policies that threaten property rights. Threats to property rights need not stem from fundamental constitutional changes, but instead can involve any type of government policy or action that makes investors wary that future government decisions may jeopardize their investment or commercial interests (Higgs, 1997). The net ef-

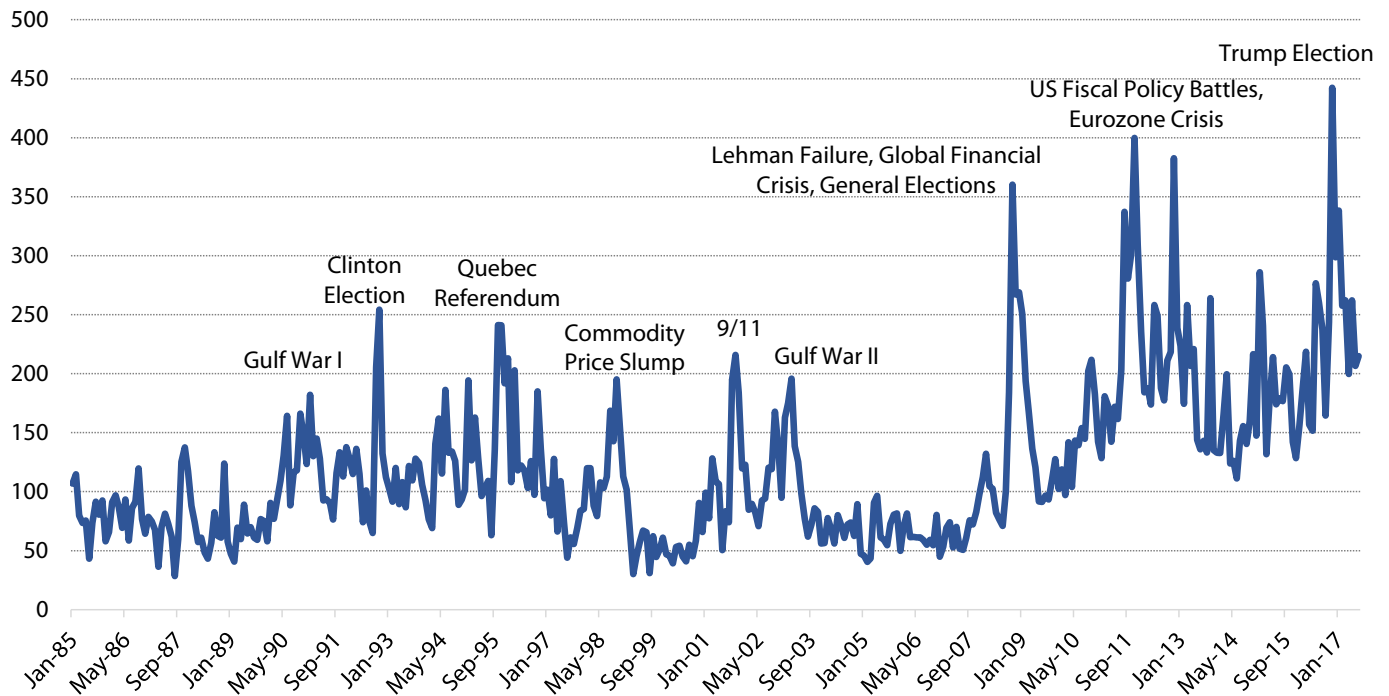
fect is that regime uncertainty results in lower business investment. The NDP/Green alliance is advancing several policies that could heighten regime uncertainty, specifically with respect to the province’s financial climate, such as increasing the rates for personal income tax, business tax, and carbon tax, stopping the Kinder Morgan pipeline, and setting the minimum wage at \$15 per hour (Greens of British Columbia, 2017). In other words, the pursuit of these policies could signal to investors that British Columbia is not an attractive place in which to conduct business and invest.

This bulletin will argue that political uncertainty and policy uncertainty are linked and amplified under minority governments. The paper first reviews the theory on how regime uncertainty leads to lowered investment. Then, using a proxy measure of newspaper reporting, the paper measures uncertainty in British Columbia. The measure will demonstrate that while elections are typically periods of heightened uncertainty, some decisions can increase policy uncertainty, and in some instances, regime uncertainty. Finally, the bulletin presents evidence on the fiscal costs of coalition governments. It concludes by arguing that if the NDP/Green plan to proceed with PR actually succeeds, then both political and policy uncertainty may become a permanent fixture for BC.

Regime uncertainty and investment

We have all heard the cliché that markets hate uncertainty. The reason that uncertainty is problematic for investors is that they perceive the risks to be higher when conditions are uncertain and as a result, they pull back on their investments until there is greater certainty and the risks drop. All business ventures have some element of risk; the challenge for government is to create a policy climate that ensures that

Figure 1: News-Based Policy Uncertainty Index, Canada, 1985–2017



Source: Economic Policy Uncertainty, 2017.

capital investment is not threatened by policy change. What Higgs demonstrated in his analysis of the Great Depression was that actions the government took to alleviate the depression had exactly the opposite effect, precisely because a number of the policies it put forward threatened the ability of private investors to realize gains from their endeavours. Tariff protections, taxation on earnings, and multiple other policies all drove investment away. While Higgs used the Great Depression as a convincing case study to advance his argument about regime uncertainty, the problem remains that there is no reliable macroeconomic indicator to measure the concept. Nonetheless, an emerging body of evidence suggests that regime uncertainty can indeed create a climate of investment indecision, which in turn leads to reduced in-

vestment and can therefore act as a brake on the economy (Le, 2004; Von Laer and Martin, 2016).

Despite the lack of macroeconomic indicators, there are other ways to measure uncertainty. Scott Baker, Nick Bloom, and Steven Davis (2016) have created an economic policy uncertainty index which uses newspaper coverage of policy-related economic uncertainty. In their seminal study, the authors examined the effects of economic policy uncertainty in the United States from January 1985 to December 2012 and found that an increase in their uncertainty index foreshadows a 6 percent decline in investment, 1.2 percent fall in industrial production, and a 0.35 percent drop in employment. Meanwhile, in an analysis of the effects of political uncertainty on German firms, Riem (2016)

found that an increase in measured uncertainty decreased the investment ratio by 10.5 percent.

Economist Steve Hanke (2017) has suggested that the Baker, Bloom, and Davis index is a proxy measure for Higgs' regime uncertainty. In addition to an American policy uncertainty index, Baker, Bloom, and Davis provide an historical index for 19 other countries, including Canada. They create the Canadian index by obtaining a monthly count of newspaper articles that contain all three words: "economy," "policy," and "uncertainty." The counts are scaled and standardized by newspaper by month, and normalized (Baker, Bloom, and Davis, 2016). As figure 1 indicates, the index, which is based on newspaper searches of Montreal's *Gazette*, the *Globe and Mail*, Canadian Newswire, the *Ottawa Citizen*, the *Toronto Star*, and the *Vancouver Sun*, shows periods of heightened uncertainty associated with global and national events from 1985 to July 2017. Apart from illustrating the impact of US policy on Canadian news reports on policy uncertainty, the figure also highlights important Canadian events, such as the 1994 Quebec referendum and national elections. Because the search terms the authors use cast a very broad net, the index picks up both political and economic uncertainty. Thus, in some cases, the increase in uncertainty is a result of political and global events, but at other times it comes from policy changes, including regime uncertainty. The index is very broad in scope so does not provide regional variation.

Measuring uncertainty in British Columbia

This analysis seeks to refine the Baker, Bloom, and Davis measure to capture provincial policy uncertainty. To do so, we completed a text

search of the words "uncertain*" ¹ and "British Columbia" from January 2009 to July 2017 for three newspapers in the ProQuest newspaper database: the *Vancouver Sun*, the *Globe and Mail*, and the *National Post*. We could not isolate stories about British Columbia by using only Baker, Bloom, and Davis's original search terms, "economy," "policy," and "uncertainty." Furthermore, the words "economy" and "policy" emphasized national as well as regional stories. To ensure that we counted stories on provincial government policy only, a human coder scanned the headlines and stories manually and eliminated any that were outside the search parameters. The newspapers were selected to include both national and regional coverage. Unlike the Baker, Bloom, and Davis methodology, the results were not indexed. They do, however, provide a raw count total from the three papers. The most important element to focus on—which these raw data provide—is the trend over time rather than the specific number of stories.

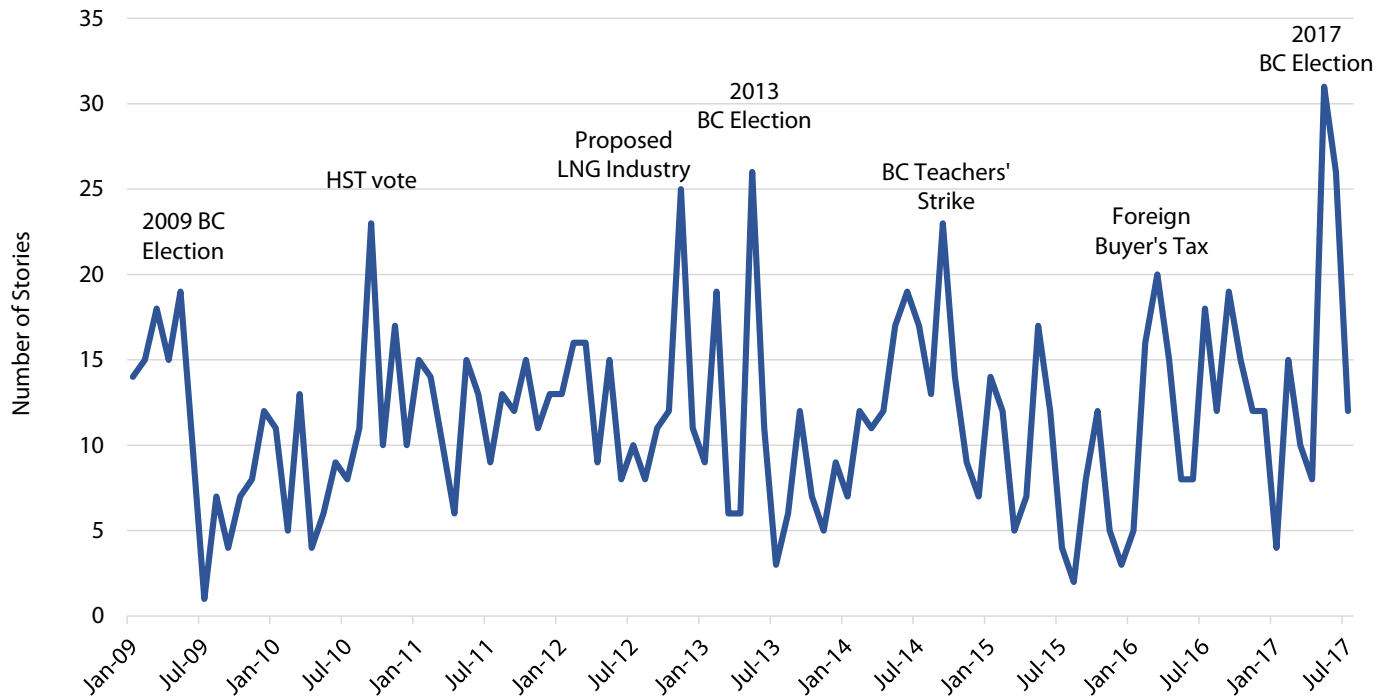
Stories about uncertainty in BC

Figure 2 plots the number of stories about the province and uncertainty from January 2009 to July 2017. While it shows that there were high levels of uncertainty during the recession that began in 2008 and when other significant national and international events occurred, there are also events specific to British Columbia that have changed the levels of uncertainty in the province. For example, the British Columbia measure shows that provincial elections have brought with them varying levels of political uncertainty, especially in 2013 when there were concerns that the Liberal government might

¹ The asterisk indicates that we conducted a "wild card" search of "uncertain" in order to pick up variations of the word, such as uncertainty, uncertainly, etc.

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Figure 2: BC Newspaper Count of “Uncertain,” January 2009 – July 2017



not win a fourth mandate, and in the most recent election held in May 2017, which resulted in no clear majority winner.

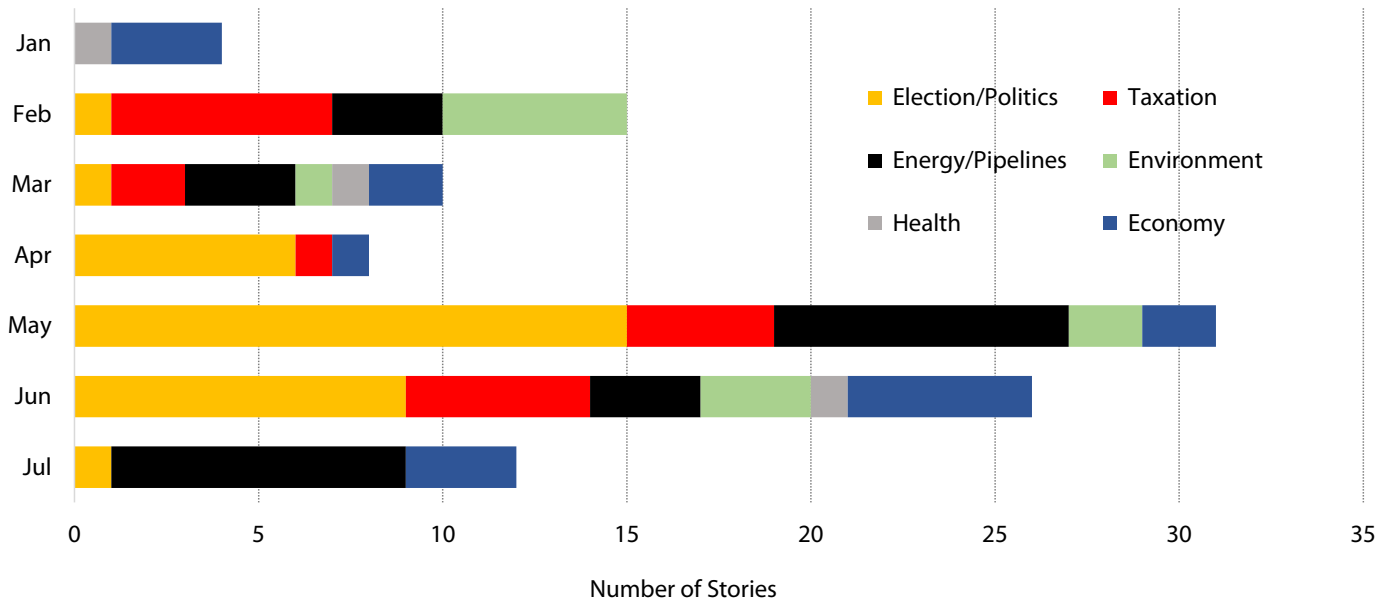
Not only did the most recent election in BC have the highest level of uncertainty of the other measured provincial elections, but the resulting minority legislature sustained the coverage, partly because of uncertainty about which party the Greens would support, and partly because of uncertainty about the policy direction the province would take in the event of an NDP/Green alliance. The 2017 election saw proportionately the highest number of stories that include the word “uncertain.” After previous elections, the uncertainty measure dropped dramatically and immediately, but that did not happen after the 2017 election. For example, in 2009, stories on uncertainty in BC went from 21 in May, to 10 in June, to 3 in July.

Similarly, in 2013, there were 16 stories mentioning uncertainty in May, 12 in June, and 3 in July. In contrast, in 2017 there were 31 stories discussing uncertainty in May, 26 in June, and 12 in July.

There have been relatively long periods during which policy uncertainty was not much reported on in the news. For example, after each of the previous two provincial elections, which led to majority governments, there were months where uncertainty was low: from July 2009 to July 2010, and from July 2013 to April 2014.

The 2017 election stories are about both the uncertainty of who will govern and the policy uncertainty arising from the NDP/Green alliance. Figure 3 isolates the stories on uncertainty from January to July 2017. It identifies the story topic and shows the increase in election

Figure 3: Uncertainty Topics in British Columbia, January – July, 2017



uncertainty in the April to June period. However, it also illustrates that in May, June, and July, there was increased policy uncertainty, especially with respect to energy and pipeline policy, taxation, and the economy. In other words, there were just as many stories about uncertainty in energy and pipelines in May as there were in June. This policy uncertainty did not occur after the previous two elections.

The fiscal cost of coalition governments

Although minority governments are rare in Canada's first-past-the-post (FPTP) electoral system, and coalition governments even more so, this is not the case in jurisdictions with other electoral systems, such those based on Proportional Representation (PR). PR systems are said to be more democratic because they allow minority voices to be heard. While minority parties are more likely to achieve electoral success, this success comes at a cost. PR systems

have more effective competing political parties. This means they are more likely to have members elected, and so are more likely to result in coalition and minority governments (Clemens, Jackson, LaFleur, and Emes, 2016). More importantly, proportional representation electoral systems produce governments that spend more than plurality or majoritarian systems. One main reason for this increase in government spending is the political dynamics that take place with a coalition government. It has been well documented that minority governments that require either formal or informal coalition partners to remain in power often spend more and incur higher debts than do majority governments that do not need to make these concessions (Bejar, Mukherjee, and Moore, 2011; Bawn and Rosenbluth, 2006; Saiegh, 2009). The *Confidence and Supply Agreement* between the NDP and Green parties is not a formal coalition, but it does have some elements consistent with a coalition government in that support from

the minor party requires policy and consultation, notably, the commitment that “Consultation will occur in a timely fashion to ensure BC Green Caucus views can be incorporated into final decision-making” (Greens of British Columbia, 2017). Even though the NDP campaigned on running balanced budgets over their entire mandate, the promises they have kept with the Green party support have not been costed out, and it is highly doubtful that they will be able to fulfill all the commitments without incurring deficits or raising additional taxes.

There are generally three explanations for the pattern of increased spending under coalition arrangements. First, these arrangements have a “common pool resource” problem in that it becomes difficult to control spending as more parties are involved in decision making (Martin and Vanbert, 2013). In other words, each partner has its own set of spending priorities that are attached to its constituents. Because of the nature of the agreements, none of the partners can be held primarily accountable for the spending decisions. As a result, each pushes for its preferred spending priority, which leads to increased spending overall. The nature of the coalition makes it difficult for any one party to be held responsible for the increase in government debt and deficits.

The second reason for increased spending in coalitions derives from the fact that the government requires support from multiple parties to stay in power. In a formal coalition, each of those parties has veto power, which results in higher government spending (Von Hagen and Hallerberg, 1999; Tsebelis and Chang, 2004). Although the Green party will not have veto power in the BC case, the arrangement does require extensive consultation with the minor party. Moreover, the consultation will include both “broad budget parameters” and “events/

policy changes with provincial or budgetary implications” (Greens of British Columbia, 2017). Even though the Greens won’t be sitting at the cabinet table, the established mechanisms do provide for “deputy minister and ministry staff briefings.” This type of consultation, and the generally agreed upon policies of higher spending and brakes on investment about which both parties agree, will make it difficult to point to either one as the primary driver of added spending.

Third, coalition governments spend more and have higher debt ratios because they operate with shorter time horizons than do majority governments. Ironically, while all governments are coalition governments (in that any major political party is comprised of a coalition of interests), there nonetheless remains a difference in policy outcomes between the long-term coalitions of “big tent” parties, and the short-term coalitions of multiple parties (Bawn and Rosenbluth, 2006). What makes large parties so successful is that they create consensus and compromise between the various factions within the party itself over the long-term. Because of the desire to have long-term political power, formal coalitions grouped under the banner of a single political party tend to engage in more prudent spending. In contrast, coalitions of parties that form government typically do so with a short term perspective and as a result tend to be less fiscally accountable to the electorate. Notwithstanding the BC Green Party’s commitment to support the NDP over the next four years, given the razor thin difference in the number of seats between the new alliance government and the opposition Liberals it is unlikely that this arrangement will last for the full mandate.

Therein lies the problem with minority governments. As Bejar and his colleagues (2011) argue, one of the reasons for the increase in spending

under coalition governments is precisely because they generally operate with short-term mandates. Their expected short time in office creates an incentive for the coalition partners to increase spending. In their analysis of 24 OECD and 87 non-OECD countries, Bejar and his colleagues note that coalitions are both shorter in duration and higher spenders than single-party governments.

The anecdotal reasoning for the higher government spending is that coalition partners, knowing their time in office is limited, will increase spending on social benefits to improve their electoral fortunes. Moreover, precisely because their tenure is short, the burden of paying for the higher spending can be pushed on to the shoulders of future governments. And when governments incur debt, this will leave businesses and households uncertain about future tax hikes, and that uncertainty impedes investment and entrepreneurship today.

Conclusion

Any government can increase economic policy uncertainty. In British Columbia, the previous majority Liberal government initiated periods of uncertainty by implementing certain policies, including, for example, the foreign home buyer's tax. The tax was designed to introduce an element of regime uncertainty and thereby limit foreign investment in Vancouver's housing market, causing home prices to level off. There are numerous examples from other Canadian provinces where majority governments have increased government debt or created an uncertain investment climate. However, this bulletin argues that minority governments will have greater negative impacts on business investment than majority governments. Given the current composition of political parties in BC, if the NDP/Green party commitment to adopt

proportional representation goes ahead, we can expect to see coalition governments and more policy uncertainty in British Columbia's future.

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