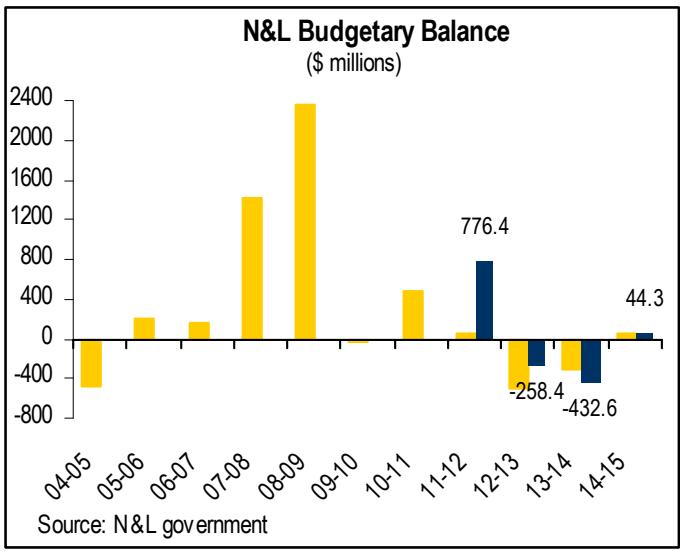
LBS Economic Research

Provincial Budget

April 25, 2012

The 2012 Budget Newfoundland and Labrador: Spending restraint to tackle temporary lower revenues

On April 24th, Thomas W. Marshall was the last Minister of Finance in Canada to release his 2012 budget. It forecasts two years of deficits – FY 2012-13 and FY 2013-14 -- followed by two years of surplus. In fact, Newfoundland and Labrador was able to generate hefty surpluses in 4 of the previous 5 fiscal years, for a cumulative total of approximately $5.1 billion. In FY 2011-12, the surplus finally reached $776.4 million, well above expectations and largely reflecting upward revisions to offshore royalties. This year (FY2012-13), renewed pressure on revenues will lead to a $258 million deficit but which is still lower than anticipated in last year's budget. The net debt at the end of March 2013 will grow to almost $8.5 billion, which is also lower than planned in the 2011 Budget. Finance Minister Tom Marshall sticks to the Government's plan to balance the books by 2014-15, and moreover, he expects a surplus for this fiscal year closely similar to the one anticipated in last year budget ($44 million) despite an even larger deficit of $123 million in 2013-14 ($433 million). Regardless of these improvements in the sort run, the Province will have to deal with the same long run challenges already identified last year.

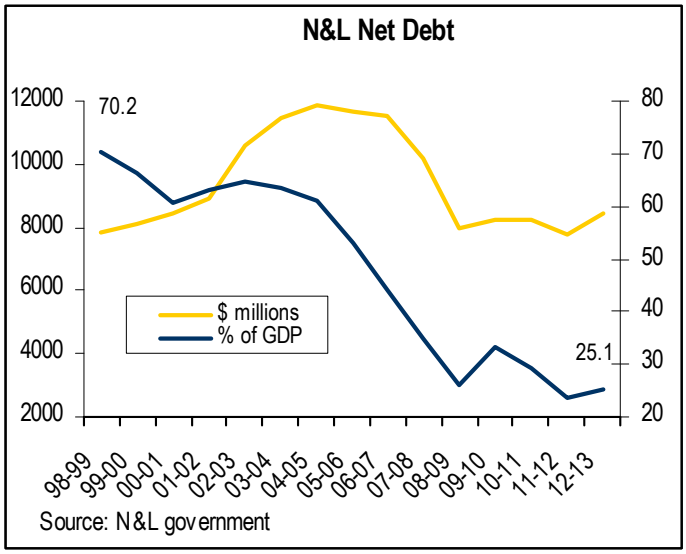


In fact, on the revenue side, the Province will take a couple of hits over the next year: oil production will drop since two of the province's main oil fields will shut down for maintenance (Terra Nova and White Rose).

As a consequence, the drop in production will squeeze royalty revenues by $591.5 millions or 20% compared to the previous year. Nevertheless, these revenues are supposed to jump right back by 2014-15, helping the Province return to the black. Lower oil production will also push down real economic growth this year to only 0.2%, as anticipated by the Department of Finance, a sharp deceleration following 4.3% in 2011.

The other significant reason why the Province is projecting deficits this coming year, on top of oil production losses, comes from the end of Atlantic Accord payments. This joint offshore management program had brought in about $536 million last year. The end of this program, along with the loss of oil royalties puts a significant $1.1 billion hole in provincial finances this year. In fact, the Province relies on offshore oil earnings for roughly one-third of its revenues. The Muskrat Falls project, a portion of the Lower Churchill River hydroelectric development announced in late 2010, is a good example of the diversified energy blueprint the Province wants to put in place in order to gradually reduce its "oil addiction".

Given reduced revenues, some concessions will have to be made on the spending front, such as job cuts in the public sector: 45 temporary posts. In addition, $38.8 million in savings has been identified from a review of government departments' budgets.



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Overall, the budget presented on April 24th was not as austere as could have been anticipated given the Premier's recent warnings. Nevertheless, program spending will rise by just 1.7 %, a strong moderation and lower than inflation, which is a rare situation in the province on an historical basis. At this pace, spending growth is relatively low compared to the 2000s where average annual growth almost reached 6%. The budget also includes strategic investments such as approximately $3 billion to enhance access to health care, almost $900 million for infrastructure improvements, almost $200 million for businesses to facilitate growth and development and nearly $151 million for poverty reduction. It is noteworthy that the Province has managed to maintain last year's measures that have lowered the tax burden. Hence, there were few pocketbook issues in this year's budget — no tax increases or decreases, although some fees were reduced for seniors. The government will keep investing in its workforce, by enhancing its development through apprenticeship training and supporting post-secondary education.

Still, this budget, even without being particularly austere, shows some changes have started to take place in Newfoundland & Labrador, after several years as a "have province". With deficits now expected for at least a couple of year, spending restraint has become the major theme.

Moreover, the government openly admits that further improvement is required since per capita net debt amounts to about $15,000, among the highest in the country and is expected to decline to only $14,000 over the next decade. The startling growth of unfunded pension liabilities is another issue, also openly discussed by the government. According to the budget documents, unfunded pension obligations and other post-retirement obligations make up two-thirds of the net debt! On account of this, government intentions to invest the equivalent of one-third of the surplus to fund public pension plans is welcome.

Despite challenges coming from the natural resources sector, the government's financial position is perfectly manageable: net debt as a percentage of GDP should be at 25.1% on March 31, 2013, a significant improvement, compared to the unsustainable high of 70.2% in 1999-98. N&L has not borrowed in the markets since 2007 and S & P raised the credit rating assigned to the province from 'A' to 'A+' in March 2011. This is the highest rating that S & P has ever given to N&L.

In conclusion, Newfoundland and Labrador has slipped into deficit as offshore oil production dips due to maintenance, and payments from the Atlantic Accord dry up. Oil will unfortunately not be there forever, and this is something that Premier Kathy Dunderdale's Government is well aware of. Diversification of the Newfoundland and Labrador economy is therefore the key and is the one theme the government will pursue relentlessly in the years to come.

Marie-Claude Guillotte, Economist

Newfoundland & Labrador Fiscal Position

	2008-09	2009-10	2010-11	2011-12*	2012-13**	2013-14**	2014-15**
				$ millions			
Own-source revenue	6,074	5,751	6,272	6,810	6,484	n/a	n/a
Federal transfers	2,558	1,545	1,760	1,282	727	n/a	n/a
Total Revenue[1]	8,632	7,296	8,032	8,092	7,211	7,189	7,744
% change	12.1	-15.5	10.1	0.7	-10.9	-0.3	7.7
Program expenditures	5,537	6,439	6,723	6,525	6,638	6,701	6,635
Debt Servicing	745	890	823	790	831	855	865
Total expenditures	6,282	7,329	7,547	7,315	7,469	7,622	7,700
% change	9.8	16.7	3.0	-3.1	2.1	2.0	1.0
Budgetary Balance	**2,350**	**-295**	**485**	**776**	**-258**	**-433**	**44**
Net Debt	**7,968**	**8,220**	**8,218**	**7,769**	**8,460**	n/a	n/a
Net Debt as a % of GDP	**25.9**	**33.2**	**29.2**	**23.5**	**25.1**	n/a	n/a

[1] Include net incorme of Government Business Enterprises; *Revised; **Estimates

Source: 2012 N&L Budget; *LBS Economic Research*