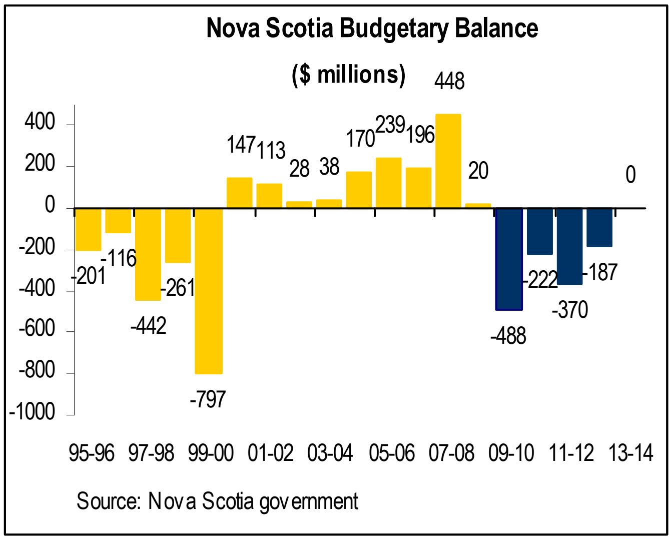
LBS Economic Research

Provincial Budget

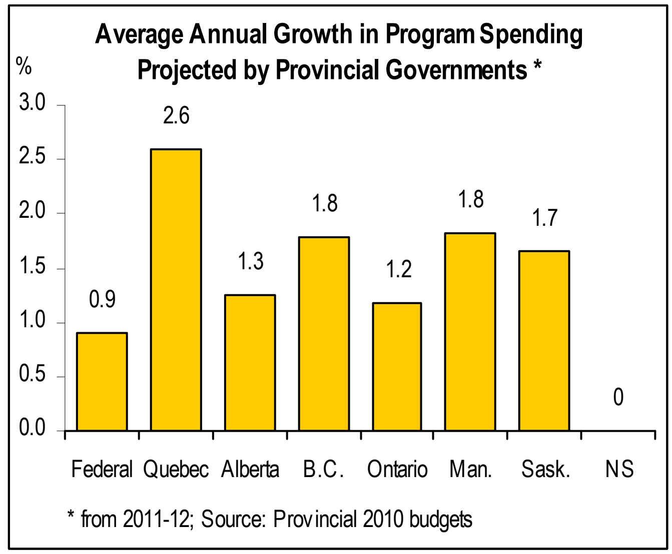
April 8, 2010

The 2010 Nova Scotia Budget: 4-Year Balanced Budget Plan

It was Nova Scotia's turn to unveil its roadmap to restore fiscal balance. Earlier this year, experts on the Economic Advisory Panel identified that Nova Scotia could face a $1.4 billion structural deficit under a status-quo scenario. In this context, the 2010 Budget was an opportune time to propose a painful but imperative 4-year plan to return to a balanced budget by 2013-14.



The $1.4-billion shortfall will be eliminated mostly by finding $1.1 billion in expenditure restraint. Most savings will be found through the *Expenditure Management Initiative* established last year by the NDP government. Notably, the civil service will be reduced by 10 % through attrition by 2013 while a series of modifications will address the unfunded public service pension liability (31%, or $1.5 billion unfunded). Symbolic cost-cutting measures include a freeze on MLA and senior officials' salaries and a reduction in MLA spending allowances. Overall, the goal is to hold total spending virtually flat in the next four years to approximately $9 billion annually, a major downward shift from the 5% annual increase registered in recent years. In comparison, other provinces do not intend to curb spending growth as much, proposing a small positive increase in program spending over the next few years. The intent to restrain spending is the main operational risk of this fiscal outlook.



In addition to curb spending growth to virtually zero, NS Finance Minister Graham Steele needs to generate more revenue. On July 1st, Nova Scotians will face a 2 percentage points hike in the provincial portion of the HST (from 13% to 15%), bringing close to $250 million in provincial coffers annually. With this move, Nova Scotia will be the home to the highest sales tax rate in the country. This was the biggest initiative on the revenue front. Other measures introduced in the 2010 Budget are small. They won't have a large impact on the fiscal outlook. For example, the 2010 Budget brings the introduction of a new income tax bracket for high-income earners (the PIT rate will be 21% instead of 17.5% for taxable income above $150,000, effective January 2010). This measure will translate in only $30 million in additional revenue per year amid the relatively small number of high-income earners in Nova Scotia.

By keeping spending in check and increasing slightly the tax burden of Nova Scotians, the NDP government projects small deficits:

- $222 million in FY 2010-11 (-0.6% of GDP).
- $370 million in FY 2011-12 (-1.0% of GDP).
- $187 million in FY 2012-13 (-0.5% of GDP).
- A balanced budget in FY 2013-14.

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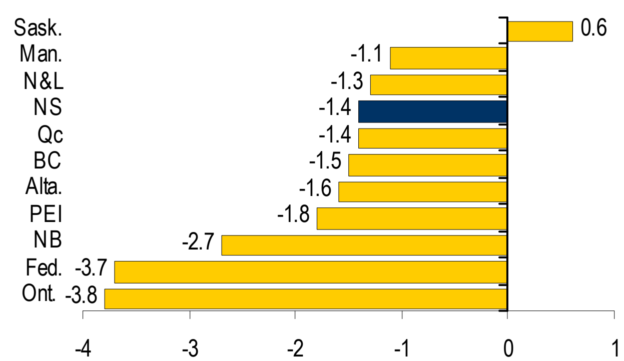
Similar to other provinces, the starting point to restore balance is better than previously projected, thanks to the stronger-than-expected recovery. The shortfall is estimated at $488 million in FY 2009-10 (-1.4% of GDP), a better figure than the $592-million tally anticipated last fall. Overall, the 2010 Budget season clearly revealed the uneven race among jurisdictions to clean up their deficits: Saskatchewan should be able to avoid deficits. Thanks to royalties, Alberta could get rid of red ink quickly by FY 2012-13. Then, NS, BC and Quebec are targeting balanced books for FY 2013-14; Manitoba and Ottawa aim for FY 2014-15; Ontario is lagging behind, looking to bring the books back to balance by FY 2017-18. Put simply, the provincial NDP government's objective of getting back to balance by FY 2013-14 is respectable, in the middle of the pack.

Budgetary Balances in FY 2009-10 *
(as a % of nominal GDP)

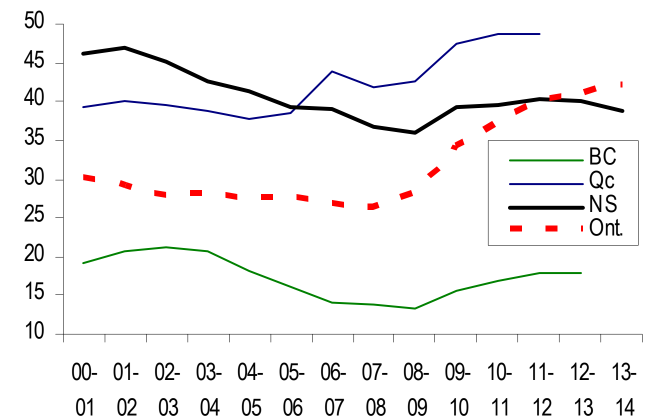


* Before withdrawal from rainy-day funds; As of April 7th, 2010; Sources: Provincial and federal governments

One of the goals underlying decisions presented in the 2010 Budget is to avoid a major run-up in the debt-to-GDP ratio. The net debt-GDP ratio will only rise moderately from a low of 36% at March 31, 2009 to 40% at March 31, 2012, well below the 45-48% range observed during the mid-1990s. If the plan is respected, the debt-to-GDP ratio of NS could be slightly lower than in Ontario by FY 2013-14. For the time being, NS is still home of the second highest debt burden in the country. Note that the NS government fully eliminated the foreign currency exposure in its debt.

Finally, the 2010 Budget reveals a slight increase in funding requirements, with a borrowing program in the tune of $2 billion in FY 2010-11 and another $2 billion in FY 2011-12, up slightly from $1.835 billion in FY 2009-10. Due to this higher borrowing program, interest debt payments will rise smoothly to return closer to $1 billion annually.

Provincial Debt-To-GDP Ratio *



* Taxpayer-sup. debt for BC, net debt for Quebec and Ontario; net direct debt for NS; Source : provincial governments

In summary, Nova Scotia was, to a lesser extent than Quebec, one of the rare provinces to raise the tax burden of consumers in order to help eliminating the fiscal hole. Similar to other provinces, imposing a strong diet on spending is certainly easier said than done. The effectiveness of governments' plan will be in making public services more efficient, and this is what investors should keep an eye on going forward.

Nova Scotia Fiscal Projections

	2009-10	2010-11	2011-12	2012-13	2013-14
Total Revenue	**8,089**	**8,391**	**8,406**	**8,616**	**8,723**
% change	-0.6	3.7	0.2	2.5	1.2
Operating Expenditure	8,139	8,085	8,190	8,161	8,079
Debt Servicing	872	959	974	1,044	1,061
Total Expenditure	**9,011**	**9,044**	**9,164**	**9,205**	**9,140**
% change	5.8	0.4	1.3	0.4	-0.7
Consolidation and Adjustments	76	83	31	31	31
Gov. Bus. Enterpr. Net Income	358	349	357	371	386
Surplus/Deficit (-)	**-488**	**-222**	**-370**	**-187**	**0**
Net Direct Debt	**13,319**	**14,002**	**14,603**	**14,897**	**14,878**
As a % of GDP	39.4%	39.6%	40.2%	40.0%	38.9%

Source: Nova Scotia Budget 2010

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