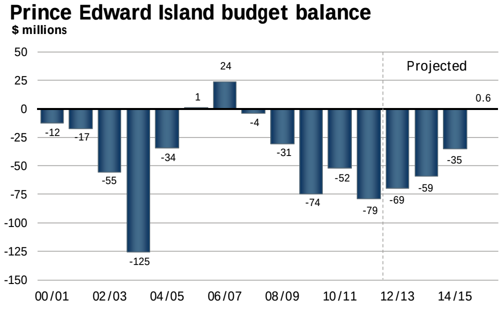
PRINCE EDWARD ISLAND BUDGET 2013

March 28, 2013

Prince Edward Island budget balance



Source: Prince Edward Island Ministry of Finance, RBC Economics Research

A longer road to balance

Prince Edward Island announced yesterday in its 2013 provincial budget, that its three-year path to budget balance first presented last year will be extended by one additional year. A return to balance is now expected in 2015/16 (with a small surplus of $0.6 million) instead of 2014/15 as was previously projected. The delay is caused by a softer revenue growth profile, and the eventual balance will be achieved by the government holding the line on expenditure growth beyond 2013/14. Program spending growth will be limited to health expenditures, with growth projected at 3.1% annually through to 2015/16. Other department spending will remain effectively constant over the fiscal plan (at -0.03% to be precise) with an outright spending decline projected in 2015/16 of -1.2%. Annual expected revenue growth is now 3.1% for the three-year plan compared to 3.4% in the previous plan. That being said, the introduction of the harmonized sales tax (HST) on April 1 of this year will constitute a stronger revenue source going forward and is expected to “spur growth and new opportunities” in the province by making the sales tax system more efficient. Budget 2013 re-iterated tax adjustments and various rebates to ease the transition to the HST (which was announced in last year’s budget).

Fiscal year 2012/13

Despite larger deficits projected over the forecast horizon, the province is expected to reach its budget target for the 2012/13 fiscal year. Revenues remain essentially unchanged relative to the Budget 2012 projection, coming in slightly below (-0.04%) at $1.5 billion. Higher capital revenues (23.5% to $16 million) and larger surpluses from the province’s Crown corporations (16.5% to $58 million) are offsetting declines in own-source revenues (-1.3% to $0.85 billion) and revenues from federal sources (-0.2% to $0.6 billion). Steep declines in Employee Benefits (-14.7% to $55 million) and General Government spending (-47.1% to $4.1 million) are supporting a small pullback in program expenditure, estimated to be -0.7% below the Budget 2012 target at $1.42 billion. The plunge in General Government spending is attributed to lower than expected spending in the Contingency Fund and Salary Negotiations; however, spending for the fund is expected to spike in 2013/14 to cover unforeseen program requirements and projected salary negotiations with the public service. Total expenditures in 2012/13 have been revised downward by 0.1% from the Budget 2012 estimate with interest on debt charges tracking 3.6% higher at $114 million.

Softer revenue profile

The weaker projected fiscal results in the new three-year plan are in part due to a softer revenue growth profile. Revenues are projected to rise 3.1% annually, on average, through to 2015/16 (was 3.4% previously) with growth of 2.7% expected in 2013/14. Own-source revenues are forecasted to rise a strong 5.5% in 2013/14, more than offsetting declines from other revenue sources, including a 0.3% drop in federal transfers (caused by an $11 million decline in the Federal Transitional Assistance for the HST to $14 million). The move to the HST will contribute to a 16.3% increase in net sales tax revenues (to $251 million), while personal and corporate income taxes are projected to rise 3.8% and 19.3%, respectively, to $302 million and $46.9 million. Total tax revenues will increase 6.1% to $814 million. With the transition to a harmonized sales tax, sales tax revenues are net of various rebates and credits which amount to $27 million in 2013/14. With respect to other revenue sources, declines are anticipated in investments/sinking fund as cash earnings in the fund are projected to fall nearly 29% to $8 million. For the remainder of the fiscal plan, total revenues are ex-

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pected to rise 3.5% in 2014/15 and 3% in 2015/16.

Greater expenditure restraint expected

In last year's three-year fiscal plan, total expenditures were projected to rise 1.6% annually, on average, with higher spending growth in the two outer years of the plan. In Budget 2013, however, a greater degree of restraint is projected with total expenditures rising 1.5% on average per year during the next three years, with growth slowing beyond 2013/14 to a projected rate of 0.8% in 2015/16. For the upcoming fiscal year 2013/14, total expenditures are forecasted to increase 1.9% to $1.6 billion with interest charges on debt falling -0.5% to $113 million. Program expenses are slated to rise 1.9% to $1.4 billion. Accounting for 39% of program expenditures in the province, spending for Health PEI is expected to rise 2.9% to $566 million, including increases of 5.9% for home based and long term care (to $99 million) and 2.4% for provincial acute care (to $154 million). Education and Early Childhood Development, composing 16% of program expenses, is projected to see a small 1.0% increase to $230 million. A 22% decline in funding allocated to infrastructure spending is expected to contribute to a pullback in Transportation and Infrastructure Renewal, falling 5.8% to $101 million.

Capital spending to fall

The capital budget, released in November 2012, signalled plans to reduce the net capital expenditure in the province by more than $25 million (or 27%) in 2013/14. The largest decrease is expected in Health PEI with capital expenditures falling from $38 million to $18 million, a sharp 54% drop. A smaller 4% drop is projected for Education and Early Childhood Development, falling to $18 million. At 47% of total capital expenditures, Transportation and Infrastructure renewal is expected to fall just below $40 million from $44 million (-11%) in 2012/13.

Implementing the HST

To ease the transition to a harmonized sales tax that will be implemented April 1, 2013, yesterday's budget confirmed various tax adjustments and a system of refundable tax credits.

✦ Beginning in July 2013, low and modest income households will receive a $200 annual credit to compensate them from "any financial burden" posed by the new tax structure. This, along with point of sale exemptions (for heating oil, children's clothing and footwear and printed books) is expected to cost $27 million or 9.7% of gross sales tax revenues.

✦ Currently at 1%, the province's small business tax rate will rise to 4.5% effective April 1, 2013. According to the government, the 1% rate was designed to compensate small businesses for the absence of a harmonized tax, which will no longer be needed. The dividend tax credit is also expected to be adjusted to "improve the integration between corporate and personal income tax systems".

To accommodate the harmonized tax, Budget 2012 stated adjustments to provincial and excise taxes would be introduced leading up to the implementation of the tax on April 1, 2013. In March 2013, changes to gas and tobacco taxes were announced. As of April 1, 2013, the "maximum cap on the ad valorem rate of tax applied to the "average wholesale price" of gasoline is decreased from 8.7 cents to 6.0 cents per litre". Tobacco tax rates will also be adjusted as of April 1, 2013, declining to 22.5 cents per cigarette. Thus, partially offsetting the impacts of the inclusion of a 9% provincial sales tax under the HST (previously gas and tobacco were exempt from the PST).

Real GDP growth to strengthen in 2013

The government forecasts real GDP growth of 1.6% in 2013, in line with RBC's forecast for 1.7% growth. Growth is expected to largely stem from strength in manufacturing and exports, offset by slower growth in domestic demand.

Net debt to peak in 2014/15

The province's net debt is projected to rise from $1.97 billion at March 31, 2013, to $2.05 billion at the same date in 2014 (an increase of 4%) after ballooning 46% over the past five years. The province's net debt will rise further to $2.08 billion in 2014/15 before a return to a small surplus is expected to support a decline to $2.07 billion in 2015/16.

Prince Edward Island fiscal plan

$ millions	Actual	Estimate	Forecast	Projection		
	2011-12	2012-13	2012-13	2013-14	2014-15	2015-16
Revenue	1,490	1,525	1,524	1,566	1,620	1,668
Expense	1,569	1,595	1,594	1,625	1,654	1,668
Surplus/ (deficit)	-79	-70	-69	-59	-35	1

Source: Prince Edward Island Ministry of Finance, RBC Economics Research