



## NOVA SCOTIA BUDGET 2010

April 7, 2010

Robert Hogue  
Senior Economist  
(416) 974-6192  
robert.hogue@rbc.com

David Onyett-Jeffries  
Economist  
(416) 974-6525  
david.onyett-jeffries@rbc.com

## Back to balance involving both tax increases and spending cuts

Yesterday, Nova Scotia Finance Minister Graham Steele presented his government's first "own" budget since being elected last summer. Budget 2009, released in September, was substantially the same as the previous government's defeated budget in May, given that it came halfway through the fiscal year and "there was little room to alter the course that had already been set", as the Minister indicated at the time. Since then, the new government received reports from external advisors that point to troubling diverging paths between revenues and expenses in coming years that would lead to a substantial budget shortfall of \$1.4 billion by 2012-13 if nothing is done. Guided by the advice of a panel of economic advisors and building on extensive consultation across the province during the past few months, the 2010 Nova Scotia budget puts forth a plan to steer the government ship back into the balanced book harbour by 2013-14. The plan relies on significant spending restraint and new tax measures, including an increase in the Harmonized Sales Tax (HST) rate and the introduction of an additional income tax bracket applicable to high-income earners.

Claiming back the sales tax "room" left by federal government cutting the GST since 2006 echoes a similar measure in Quebec's budget last week — although Nova Scotia's increase will be rolled out faster — and should be seen as a reasonable approach if raising taxes is unavoidable. However, also adding to the personal income tax burden is a departure from the other provincial/federal budgets presented so far. While the addition of a tax bracket is "intended solely to assist in the return to balance" and set to expire once that goal is achieved, it would undermine the province's tax competitiveness in the longer term if it becomes permanent.

In 2010-11, the budget projects a deficit of \$222 million, or less than one-half the downwardly revised \$488 million shortfall now estimated in 2009-10 (it was previously projected at \$592 million). The deficit does jump up to \$370 million in 2011-12 but drops again to \$187 million in 2012-13 and to approximately zero in 2013-14.

## Budget highlights

**Own-source revenues** are expected to grow by 7.4% to \$5.2 billion in 2010-11, thanks to a \$233 million (19.7%) increase in HST revenues and, to lesser extents, rises of \$67 million (3.7%) in personal income tax revenues, \$63 million (57%) in petroleum royalties. The jump in HST revenues will result in large part from a 2 percentage point hike in the provincial portion of the HST on July 1, 2010, thus "restoring" the overall HST rate in Nova Scotia to 15% (i.e., the level it was before the federal cut its portion of the tax starting in July 2006). The tax on the sale of used motor vehicles or other "designated tangible personal property", such as boats, aircraft, and boat trailers will also rise from 13% to 15% on the same date. To minimize the impact of the higher HST, the government will introduce new point-of-sale rebates for children's clothing, footwear and diapers, as well as for feminine hygiene products. It will also offer an HST credit to households earning less than \$34,800 per year.

Nearly one-half of the rise in personal income tax revenues, or \$31 million, will be generated by the introduction of an additional — albeit temporary — income tax bracket targeting high-income earners. Effective January 1, 2010, a fifth bracket of 21% will be applicable to taxable income exceeding \$150,000. This will replace the 10% surtax applied to residents with provincial personal income taxes payable of more than \$10,000, which is being eliminated. Minister Steele indicated that this new bracket would expire “when balance is reached”.

The partial rebound in offshore petroleum royalties (they plummeted by more than 75% last year) is due entirely to stronger prices for natural gas and crude oil; the maturing of offshore fields will cause production volumes to decline in the province.

**Federal source revenues** are projected to fall by 1.7% to \$3.2 billion on lower equalization payments and Crown share adjustment payment.

**Program expenditures** are projected to dip by 0.3% to \$8.1 billion, primarily as a result of a \$389 million drop in “Assistance to Universities” (reflecting the government’s decision to close out the memorandum of understanding with universities in last fall’s budget). This will more than offset spending increases on health (up \$235.9 million or 6.9%), community services (\$32.3 million or 3.4%), economic and rural development (\$31.4 million or 40.5%) and education (\$25.9 million or 2.0%).

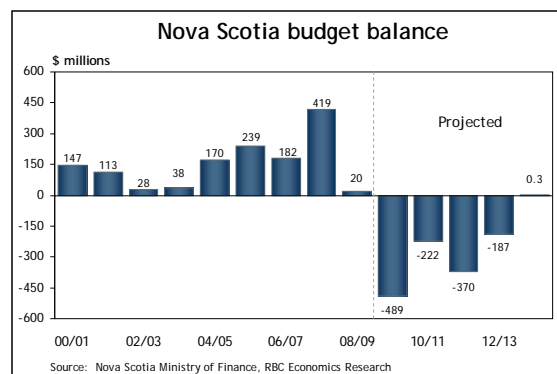
In terms of **capital spending**, the Province is proceeding with Year Two of its two-year infrastructure stimulus plan. It intends to spend \$710 million in 2010-11 on various infrastructure projects after it invested \$724 million in 2009-10.

## Conservative assumptions

Budget 2010 is based on conservative economic assumptions. The government expects real GDP growth of 1.9% in 2010 and only 1.2% in 2011. The current year compares closely to RBC’s forecasts of 2.2% but the projection for 2011 is substantially weaker than our forecast of 2.9%. Partly explaining the government’s dimmer growth outlook next year is the inclusion of the impact of fiscal austerity that will start to quicken then and the extent of which was not fully captured by our forecast released in early March.

## Medium-term plan

To achieve a balance by 2013-14, Budget 2010 provides a four-year plan which calls for significant belt tightening on the part of government. Total expenses are scheduled to decline by an average of 0.4% per year during the next four years, which would contrast starkly with the previous four years’ average growth of 7.7%. The government indicates that it will rely on its Expenditure Management Initiative “to help achieve savings in a variety of areas in the medium term”. This initiative will evaluate hundreds of government programs for cost con-



trol and cost-savings opportunities. The government also intends to cut the total number of civil servants by 10% by 2013 through attrition and voluntary departures, and keep wage increases to under 1%. In all, expenditure management efforts are projected to generate annual savings of \$772 million by 2013-14, helping to close most that year's estimated fiscal gap. The various tax measures (most notably the HST increase) will bring in less than one-half of that amount in extra revenues (once tax rebates and credits are netted out).

## Provincial debt

The string of deficits will push Nova Scotia's net debt-to-GDP ratio up from 39.4% at the end of 2009-10 to 40.2% in 2011-12 before easing back to 38.9% in 2013-14. Total borrowing requirements for 2010-11 are estimated to be \$2.5 billion. The budget documents stated that the government looks to "maintain access to a diversity of borrowing sources, both domestically and in foreign markets". Slightly more than one-third of required borrowing in 2009-10 was made through international markets.

## Nova Scotia's fiscal plan

\$ millions	Actual	Actual	Estimate	Forecast	Projection	Projection	Projection
	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Revenue	8,179	8,135	8,089	8,391	8,406	8,616	8,723
Expense	8,133	8,521	9,011	9,044	9,164	9,205	9,140
Program spending	7,208	7,654	8,138	8,085	8,190	8,162	8,080
Interest on public debt	925	867	872	959	974	1,044	1,061
Consolidation adjustments	29	46	76	83	31	31	31
Government Business Enterprises	344	360	358	349	357	371	386
Surplus/ (deficit)	419	20	-488	-222	-370	-187	0.3

Source: Nova Scotia Ministry of Finance, RBC Economics Research

The material contained in this report is the property of Royal Bank of Canada and may not be reproduced in any way, in whole or in part, without express authorization of the copyright holder in writing. The statements and statistics contained herein have been prepared by RBC Economics Research based on information from sources considered to be reliable. We make no representation or warranty, express or implied, as to its accuracy or completeness. This publication is for the information of investors and business persons and does not constitute an offer to sell or a solicitation to buy securities.