



HIGHLIGHTS

- Austerity was the theme of the 2011 New Brunswick budget.
- The government is anticipating deficits of \$740 million in FY 10-11 and \$449 million in FY 11-12.
- A plan to return to surplus by FY 14-15 was committed to, but details were lacking on how this will be achieved.
- Spending cuts of \$220 million in FY 11-12 will be imposed. Examples of initiatives include a new generic drug policy and a continued wage freeze for politicians.
- Will cancel the former government's previously announced personal and corporate income tax rate reductions.
- Small business general corporate tax rate will decrease from 5% to 4.5% in 2012.
- Hikes to fuel and tobacco taxes, effective midnight, should bring in \$70 million annually to provincial coffers.
- Credit rating agencies, markets and investors will assess the credibility of the medium-term fiscal plan when further details are released later this year.

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WELCOME TO LIFE IN FISCALLY-CONSTRAINED NEW BRUNSWICK

By all accounts, today's provincial budget is a defining one for the new Alward government and austerity was certainly the theme of the day. In an attempt to rein in the Province's sizeable deficits, \$220 million in new spending cuts and \$100 million in new revenue-generating measures are to be in effect for FY 11-12. To curtail program spending, the budget described several measures including a new generic prescription drug pricing policy and several wage compensation initiatives. On the revenue front, the government opted not to hike its Harmonized Sales Tax (HST) – a commitment Premier-to-be Alward had made on the campaign trail. Instead, the Province will cancel the previously announced general corporate income tax cuts, lower the small business general corporate tax rate, and hike fuel and tobacco taxes. With these efforts, the New Brunswick government is anticipating deficits of \$740 million in FY 10-11 (2.6% of GDP) and \$449 million in FY 11-12 (1.5% of GDP). A plan to return to surplus by FY 14-15 was committed to, but details were lacking on how this will be achieved (e.g., outside the government planning horizon).

Spending restraint and austerity measures

Shortly after coming into office, the government found itself in a much larger shortfall than was thought to be the case. Over the last several months, senior government officials travelled the province seeking suggestions on how to improve the fiscal position and what kind of measures would be most appropriate. In this budget, the government revealed that it has chosen a combination of revenue generating measures and spending restraint initiatives to rein in its relatively large deficits.

On the expenditure front, the government has announced several new measures to help curtail budgetary outlays. In particular, \$220 million has been earmarked for savings in FY 11-12 from some of the following measures:

- a 10% reduction in the number of Deputy Ministers and Assistant Deputy Ministers;
- the implementation of a new generic drug policy for the provincial Prescription

NEW BRUNSWICK GOVERNMENT'S FISCAL POSITION				
Millions of C\$ unless otherwise indicated				
Fiscal Year	Actual		Budget	
	08-09	09-10	10-11	11-12
Revenues	7,113	6,990	7,483	7,642
% change	2.2	-1.7	7.1	2.1
% of GDP	26.0	25.4	26.2	25.9
Expenditures	7,305	7,728	8,223	8,091
% change	6.2	5.8	6.4	-1.6
Program spending	6,703	7,240	7,580	7,411
% change	6.4	8.0	4.7	-2.2
Debt charges	603	617	642	680
% of revenues	8.5	8.8	8.6	8.9
Surplus (+)/Deficit (-)	-192	-738	-740	-449
% of GDP	-0.7	-2.7	-2.6	-1.5
Net Debt	7,388	8,353	9,588	10,218
% of GDP	27.0	30.4	33.5	34.6

Source: New Brunswick Department of Finance, Budget 2011.

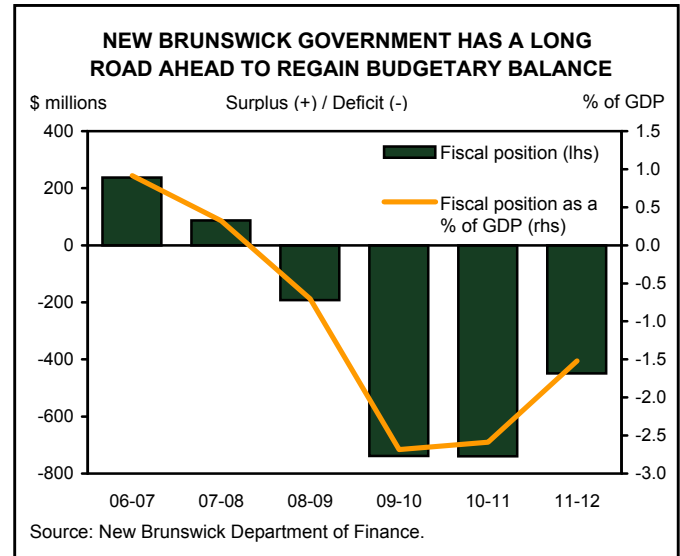
Drug Program;

- a third year of wage freezes for all members of the Legislative Assembly and a continuation of the hiring freeze for civil servants;
- a one-year suspension of the salary progression increases and performance pay increases for qualified management and non-unionized employees across government; and
- no new funding for the Provincial Capital Commission and the transfer of functions of two public agencies to line departments.

These measures will be in addition to the expenditure restraint initiatives announced in last year’s fall update. To recall, this included a call to all departments to find savings of 1% in FY 11-12 and 2% in each of the three subsequent years. The budget’s one-year fiscal forecast assumes that these savings can be achieved, at least for the first year.

A total of \$100 million net new revenue generating measures were included in today’s documents. The government will follow through on its platform commitment to lower the small business corporate income tax rate by half over four years. As a first step, this rate will be reduced from 5% to 4.5%, effective January 1, 2012. The rate reduction should deliver savings of \$1 million in FY 11-12 and \$4 million in FY 12-13 to small businesses. The remaining measures hiked rates to help boost government coffers.

- As of midnight tonight, tobacco and fuel taxes will increase. In the case of the tobacco tax, the rate will be increased by 5.25 cents to 17 cents per cigarette. The gasoline tax rate will increase by 2.3 cents/litre and the diesel rate will increase by 2.3 cents/litre. These two measures are likely to bring in almost \$70 million in additional revenues.
- For 2010, the marginal tax rate on high-income earners in the current top bracket will increase to 14.3%. In addition, the personal income tax reductions scheduled for 2012 by the previous government are now delayed. Combined, these personal income tax measures are expected to bring in approximately \$21 million in FY



11-12 and \$35 million in FY 12-13 to coffers.

- Effective January 1, 2011, the provincial general corporate income tax rate will fall to 10%. The government has opted to hold the line at this rate and cancel the previously announced reductions to 8%. The budget estimates that altering the tax reduction plan will bring in \$18 million in additional revenues by FY 12-13.
- The operating grant to public universities will increase by 2% in FY 11-12, while tuition fee increases for university and college students will be held to \$200 per full-time student.
- The budget states that the NB Liquor Corporation will increase its net income by \$10 million in FY 11-12, but no further details were provided.

Return to balance within four years

Last fall, citing the growing debt burden and deteriorated fiscal position, several credit rating agencies downgraded the provincial outlook from “stable” to “negative”. Even with the shift in outlook, the government retained its double-A minus rating, but this remains one of the lower ratings among provinces.

With today’s budget, New Brunswick is forecasting deficits of \$740 million in FY 10-11 and \$449 million in FY 11-12. Somewhat surprisingly, no medium-term fiscal plan was presented. Instead, the government has committed to return to balance by FY 14-15 and cited four main pillars on which it will deliver this plan: (1) change the way government spends by developing a culture of cost control, accountability and providing value for money; (2) manage expectations of the public in terms of ability to fund

NEW BRUNSWICK ECONOMIC ASSUMPTIONS				
[Per cent change unless otherwise noted]				
	TD ECONOMICS		2011 BUDGET	
	2011	2012	2011	2012
Real GDP	2.1	2.2	1.5	2.2
Nominal GDP	5.1	4.0	3.2	4.6
Unemployment rate (%)	8.9	8.6	9.4	9.4
Employment	0.8	1.0	0.4	0.6

Source: New Brunswick Government, TD Economics.

essential, high-quality services; (3) increase revenues in a fair and efficient manner; and (4) provide the environment for growing the economy and creating jobs and prosperity.

Last fall, a failure to communicate and implement clear, realistic and effective fiscal consolidation plans led to downward rating pressure for the New Brunswick government. Other than the pillars described previously, the budget did not lay down a comprehensive and clear plan to balance. Admittedly, the slew of revenue generating and spending restraint measures will help. However, much of the heavy lifting required to accomplish this feat remains. Further details and a concrete four-year plan will add enhanced credibility to the government's fiscal planning efforts.

In the interim, concerns to the fiscal plan centre primarily on debt affordability and the receipt of federal transfers. For the former, with rising interest rates, debt servicing costs will increasingly swallow a larger share of the revenue intake. A risk to all provincial fiscal plans is the expiry of the legislation governing federal-provincial fiscal arrangements in 2013. With nearly 40% of its revenues coming

from the federal government, the New Brunswick bottom line will be particularly sensitive to any changes made to the funding allocation formula. Lastly, moderate provincial growth forecasts restrain the upside potential to own-source revenues over the near term.

Bottom line

The headlines for today's budget will be a \$300 million improvement in the deficit tally for FY 11-12. With its revenue-generating and spending restraint measures introduced today, the Province will shift from being the second worst in terms of its fiscal position to being somewhere in the middle. However, much of the heavy lifting remains to get the New Brunswick government back to balance in four years time. The Province aims to release its plan to accomplish this feat over the course of the year. Markets, investors and credit rating agencies will certainly be tuned in to gauge the credibility and feasibility of the action plan that is ultimately delivered.