



TD Economics

The 2008 New Brunswick Budget

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HIGHLIGHTS

- **FY 2007-08 budget surplus revised down to \$18 million**
- **Modest \$19 million surplus projected in FY 2008-09**
- **Debt-to-GDP ratio to edge down**
- **Taxes left unchanged, but overall structure under review**

In a surprising move, last year's budget had increased businesses taxes in a reversal from the previous administration and against the general trend of federal and other provincial budgets across Canada. Today's budget was, however, uneventful.

Fiscal 2007-08 surplus estimated at \$18 million

Initially estimated at a modest \$37 million in last year's budget and more than double that amount (at \$79 million) in December, the latest surplus estimate is only half the initial projection. In December, an improved revenue performance had once again boosted the underlying government surplus, as multiple factors came in stronger than expected. Strong employment (+2.1%) and economic growth (+2.3%) in the 2007 calendar year contributed to an additional \$36 million in revenues. Elevated zinc prices translated into higher natural resource royalties to the tune of \$30 million. Lastly, federal government transfers were \$50 higher due mostly to increased fiscal capacity in other provinces. In all, revenues were estimated to come in \$120 million higher than forecast in last year's budget. What happened since then?

First, even back in December, it was clear that the revenue boost would not entirely flow to the bottom line. Expenditures were also higher than initially expected. Overall program expenses would be \$78 million more than budgeted in 2007. Still, since December, a significant downward shift (-\$61 million) in the expected surplus has taken place, from a perceived improvement of \$42 million in

NEW BRUNSWICK GOVERNMENT'S FISCAL POSITION				
Millions of dollars unless otherwise indicated				
	Actual		Est.	Projected
	05-06	06-07	07-08	08-09
Revenues	6,323	6,649	6,919	7,104
% change	6.1	5.2	4.1	2.7
Expenditures	6,088	6,412	6,901	7,085
% change	3.4	5.3	7.6	2.7
Discretionary Expenditures	5,493	5,842	6,318	6,488
Debt-Service Costs	595	570	583	597
Surplus/Deficit (-)	235	237	18	19
Net Debt	6,714	6,578	6,976	7,094
% of GDP	27.8	26.1	26.2	25.6

Source: New Brunswick Budget 2008

December to a deterioration of \$19 million today. This is because the improved revenue (+\$242 million since budget 2007) has allowed the government to make year-end spending decisions. Spending has increased by \$261 million, 42% of which is directed towards universities, with the remainder going to regional development and health in roughly equal amounts. In all though, the fiscal books will not dip into the red for fiscal 2007-08.

Spending and revenue outlook for fiscal 2008-09

Spending in all areas for fiscal 2008-09 will rise by 2.7% from 2007-08. The lion's share of spending increases is in education (+7.2%), health care (+5.4%), and social services (3.4%), as these expenditure areas continue to take centre stage. University tuition rates will be frozen for a year. While tuition is high in New Brunswick relative to other provinces and enrolment rates are relatively low, the Québec experience suggests that freezing tuition rates even at very low levels is no guarantee of improvement. We suspect the government will have to take a longer-term view and be more creative on this issue.

To square the circle, revenues are estimated to increase by 2.7% from last year's budget. Recall that in view of

the government's desire to provide further support to priority areas, taxes were increased in the previous budget in order to help keep revenues in line with spending. Most were a reversal of cuts implemented by the previous government's last budget. As taxes will not increase in fiscal 2008-09, own-source revenues are only estimated to grow by 0.3%.

The recent challenging economic environment facing New Brunswick is likely to intensify during the upcoming fiscal year. Continued adjustment to the high value of the Canadian dollar is still hurting manufacturers and the sector will continue to struggle. Most importantly, the U.S. housing market – a major source of demand for New Brunswick lumber products – is in the midst of a severe correction while growth in the overall economy is projected to remain sub-par. The government has used a conservative real GDP growth projection of 1.8% for 2008 that lies a shade under our 1.9% forecast at the time of pre-budget consultations. Unfortunately, the outlook has weakened since then, and our latest forecast calls for a growth rate of only 1.1%. Nominal GDP growth, a better proxy for the expansion of the tax base, will arguably not take as big a hit as real GDP growth. But this will largely depend on what happens to energy prices during the course of this year. With world growth expected to slow, most commodities have little room for upside in 2008.

While the debt-to-GDP will fall from its current 26.2% to 25.6%, the heavy lifting is being accomplished by GDP growth. The province's net debt will still increase by about \$500 million from year-end 2007 to reach \$7.1 billion in by 2009. The debt increase is largely due to soaring capital costs for highway improvements.

While a major overhaul of the tax system seems to be underway, no major tax changes are expected before 2009. The government will table a tax reform Green Paper in April.

Mirroring a recent move by B.C. that will bring the combined federal-provincial statutory corporate income tax (CIT) rate to 25%, we expect that the government will ultimately slash its general CIT rate down to 10% from its current 13%. Indeed, the government acknowledged that

NEW BRUNSWICK ECONOMIC ASSUMPTIONS				
	TD ECONOMICS		2008 Budget	
	2007	2008	2007	2008
Real GDP %	2.3	1.1	2.3	1.8
Unemp. Rate	7.6	8.5	7.6	7.4
Employment %	2.1	1.0	2.1	0.7
Source: New Brunswick Government, TD Economics				

it supports the federal goal of a combined 25% general CIT rate.

It would likely accomplish this by shifting the tax mix, increasing sales and fuel taxes and thereby improving the efficiency of the tax system. In the context where the federal government has reduced the GST from 7% to 5% in the last two years, it is not unreasonable for the provincial government to take up that sales tax room for itself, contingent on reducing the income tax burden to individuals and/or businesses. Meanwhile, the continued phasing out of capital taxes for non-financial businesses, tax relief worth \$15 million in fiscal 2008-09, will definitely improve investment incentives in the province. The capital tax on non-financial businesses is on schedule to be eliminated in 2009, by which time New Brunswick would join the ranks of the other six provinces without such a punitive capital tax.

Bottom Line

The government is maintaining its long-term sights on raising the economy's ability to grow over the next two decades in order to achieve self-sufficiency, a laudable objective. While an appointed Task Force will report in April on how to help move New Brunswick towards that end, today's budget took a status quo approach, including keeping the budget balanced while providing new money for the all-important areas of education and health. The need to keep taxes down, contain health care costs, wrest more savings out of non-priority areas, and address strategic needs provides the government with a busy 'to-do' list. We look forward to the government's Green Paper in April in the hope that it will propose a significant overhaul of the tax system, helping to put New Brunswick back in the lead on fiscal matters among its peer provinces.

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