February 2, 2016

NEW BRUNSWICK SETS PLAN IN PLACE TO TACKLE STRUCTURAL DEFICIT

Highlights

- The New Brunswick government kicked off budget season today, tabling its FY 2016-17 Budget Plan. In its second budget since elected, the government introduced a medium-term road map to deal with the significant challenges faced by the province and bring New Brunswick's fiscal house back in order.
- In order to deal with the economic headwinds and tackle its deficit and growing net debt, the New Brunswick government opted for large measures on the revenue side, so as to uphold its election promise not to make any major cuts to health care, education or social programs. Revenue generating measures in the budget consist of a number of tax hikes, including raising the HST and corporate tax rates, introducing a new tax bracket on high income earners, and increasing the property land transfer tax and tobacco tax – all together estimated to generate an additional $293 million per year.
- The province also introduced new measures to cut expenses by a further $296 million through identifying efficiencies, not program cutting
- Under this plan, New Brunswick expects to bring the deficit down from an estimated $466 million last year to $347 million in FY 2016-17 and balance its books by FY 2020-21. Net debt is expected to increase by $468 million in the upcoming fiscal year, bringing the net debt-to-GDP ratio to 39.9%, still one of the highest across the country.

New Brunswick kicked off the provincial budget season today, tabling its 2016-17 Budget Plan. The New Brunswick government has been facing some of the toughest long-term fiscal challenges among Canadian provinces, with an economy that's been stagnating since 2011 alongside a rapidly aging population. The deficit clocked in at $466 million for 2015-16, with the province registering one of the highest deficit-to-GDP and net debt-to-GDP ratios across the country last year, estimated at 1.4% and 38.3%, respectively.

The New Brunswick government made its first step in bringing the provincial finances towards a more sustainable path in last year's budget, with a number of revenue-generating and expense-cutting measures. Building upon that plan, the government has gone through extensive program reviews and consultations through the Strategic Program Review over the last year to help map out a medium-term plan to rein in deficits and borrowing. Many of these initiatives were introduced in the budget tabled today. The budget outlined a plan to boost revenues by $293 million and cut spending by an almost equal $296 million. Under this plan, New Brunswick expects to bring the deficit down to $347 million in 2016-17 (just 1% of GDP) and balance its books by 2020-21.

NEW BRUNSWICK GOVERNMENT FISCAL POSITION

Millions of C$ unless otherwise indicated

		Est.	2016 Budget
Fiscal Year	14-15	15-16	16-17
Revenues*	8,340	8,296	8,719
% change	7.2	-0.5	5.1
% of GDP	26.0	25.1	25.8
Expenditures	8,729	8,662	8,966
% change	4.2	-0.8	3.5
Contingency Reserve	--	-100	-100
Surplus (+)/Deficit (-)	-389	-466	-347
% of GDP	-1.2	-1.4	-1.0
Net Debt	12,422	12,990	13,458
% of GDP	38.8	39.2	39.9

Note: *Includes contribution to and from Fiscal Stabilization Fund.
Source: New Brunswick Department of Finance, Budget 2016.

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NEW BRUNSWICK ECONOMIC ASSUMPTIONS [Per cent change unless otherwise noted]				
	2016 Budget			
	2015*	2016	2017	2018-19
Real GDP	1.3	0.4	0.3	0.7
Nominal GDP	3.3	1.9	1.6	1.9
Population	-0.1	-0.1	-0.2	-0.3
Unemployment rate (%)	9.8	9.8	10.2	10.1
Employment	-0.6	-0.2	-0.4	0.2

*GDP numbers are estimates.
Source: New Brunswick Budget 2016.

The economy is the number one challenge facing New Brunswick

When the Liberal government tabled its first budget this time last year, it was anticipating a notable pick-up in average annual nominal GDP growth to close to 3.5% to 4.0% over 2015-2020. However, given significant demographic challenges, a weak overall Canadian economic backdrop, declining natural gas prices and the closing of the Piccadilly Project (a sizeable potash mining project), that economic improvement has failed to materialize. The government is now projecting nominal GDP to grow by less than 2% over the 2016 to 2020 projection period, about half the growth rate expected at the time of last year's budget.

In order to deal with the economic headwinds and tackle its deficit and growing net debt, the New Brunswick government opted for larger measures on the revenue side in order to stick to its promise not to make major cuts to health care, education or social programs. The Budget plan highlighted a number of tax hikes for both households and businesses to help lift revenues, with the majority taking effect in 2016-17. These include:

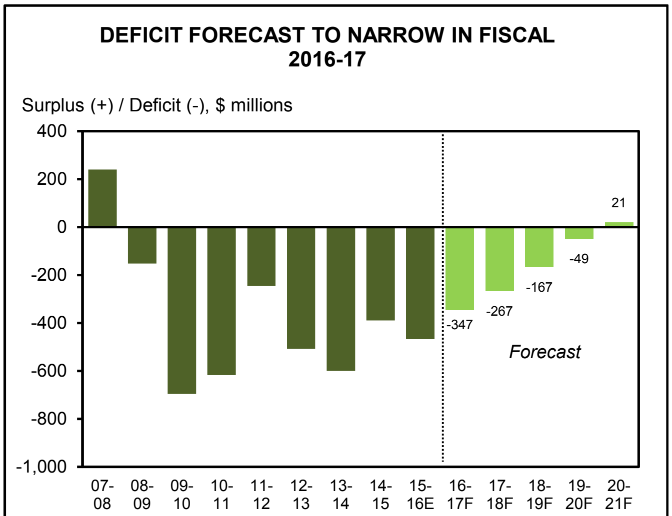
- A two percentage point increase in the harmonized sales tax, bring the combined provincial and federal rate from 13% to 15%, effective July 1st, 2016. In addition, the government outlined a tax credit system to help shield lower and middle income households from the tax hike. A refundable tax credit of $300 per person, $300 for spouse or equivalent and $100 for a child under 19 will be offered. A family making less than $35,000 annually will be eligible for the full credit, while it will be scaled back by two cents for every dollar of income over $35,000
- The provincial general corporate income tax rate will be lifted to 14%, from 12%, while the financial corporation capital tax rate will increase from 4% to 6%, effective April 1st, 2016.
- The real property transfer tax will be increased to 1%, from 0.5% for an additional $10 million in revenue. For the average price home in New Brunswick, the land transfer tax will increase by $820.
- An increase in the tobacco tax of 6.52 cents per cigarette or gram of loose or fine tobacco. An increase of 3.26 cents will take effect at midnight tonight, and the remainder will come into effect February 1st, 2017.
- In contrast the New Brunswick government gave some relief to top income earners in the province, lowering the marginal income tax rate on incomes worth more than $150,000. This move was meant to offset higher tax rate introduced by the Federal Goverment for incomes greater than $200,000.

The New Brunswick government is also looking at ways to monetize its assets, by allowing individuals to purchase the naming rights to, and place advertising around, some government assets. The government will even consider the outright sale of some properties, including the Larry's Gulch fishing lodge and the Mactaquac Provincial Park Golf Course. Combined, these measures would double revenue growth in 2016-2017. The government estimated that revenues will grow by 5.1% in the current budget year. However, without the above one-off measures, revenues would have only grown by 2.3% in the year.

Expense control means identifying efficiencies, not program cutting

Revenue generation will go a long way in bringing down the deficit, but more is still needed. Since the government intends to stick to its mandate of investing in the economy, education and health care, expense cutting will instead come through identifying potential efficiencies. The proposed measures, which should yield an estimated $296 million, can be bucketed into three categories:

- The first is waste elimination, which includes getting rid of underused government services, modernizing services (more online options) and eliminating 30% of senior and middle management positions deemed redundant. The job losses will take place by March 31st, 2016. The government also plans to reduce labour costs by wiping out the retirement allowance that will secure annual savings of $29 million, along with initiatives to reduce sick leave, carry over of vacation benefits and benefits related to workplace injuries.
- Second, the government plans to save $46.4 million by re-organizing and merging departments in areas where



Source: New Brunswick Department of Finance. *15-16 is expected value.

they have found duplication of activities. The government also plans to save $20 million in making NB Liquor more efficient and profitable.

- Third, the government has developed the Alternative Service Delivery (ASD) unit to help assess what government programs should be privatized. They have already decided to privatize the property, motor vehicle and corporate registry as well as outsourcing the pension and benefits administration and pension investment functions.

Some of these initiatives will extend out to municipalities and government funded organizations to help limit the amount of provincial government transfers needed to support them. While the Province vouches not to cut health care and education program spending, both will be subject to similar cost cutting measures whenever cost savings and efficiency gains can be made. The focus will be on how to get the right programs to those who need them in the most efficient manner. For instance, the government has put a freeze on grants given to universities. Instead, the government plans to invest in education through a newly introduced program called the Education and New Economy Fund. Through this program, New Brunswick will offer tuition assistance to those in financial need, and create a new funding formula for universities based on performance.

The purpose of these cost cutting measures were to free up some fiscal room for the government to continue investing in health care, education and the economy and not to slash spending on programs the government deems important for the province. Overall, this spending, alongside some one-time factors, will keep expenditures growing by 3.5% this fiscal year, before slowing to an annual growth pace of 1.8% out to 2021.

Revenues to rise faster than expenses

Under the current plan, revenues are expected to rise faster than expenses helping bring the budget back into balance by 2020-21. This is a 5-year time line similar to that adopted by other major provinces including Ontario and Alberta. While the majority of the revenue generating measures will be implemented in the current budget year, the deficit reduction will occur gradually (about $100 million to $120 million per year) over the next 5 years. The budget includes a contingency, or rainy day, fund of $100 million in the current budget year, which will be reduced by $25 million in the following three fiscal years. Even with the deficit narrowing net debt is expected to continue to rise in the upcoming budget year, reaching $13.5 billion or 39.8% of GDP.

Bottom-line

In its second budget since being elected, the Liberal government has introduced a medium-term plan to put the fiscal position on a more sustainable path. The plan appears achievable give it is set against conservative economic assumptions and has introduced some hefty revenue generating and expense control measures. The strategy should keep rating agencies at bay for now. Ultimately, execution will be critical, with much of the heavy lifting awaiting future budgets.