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Fiscal Pulse

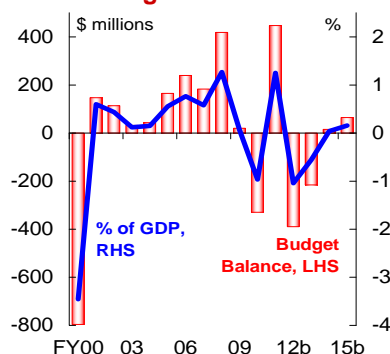
FY2011-12 Highlights

Nova Scotia

- A record \$447 million surplus (1.2% of GDP) is announced for fiscal 2010-11 (FY11), a \$670 million reversal of the *Budget* estimate of a \$222 million deficit, and a \$350 million improvement on the \$97 million surplus from the December 2010 *Update*.
- For FY12, a return to red ink is projected with a forecast \$390 million shortfall (-1.0% of GDP), followed by a \$216 million deficit in FY13 en route to small surpluses of \$15 million and \$64 million in FY14 and FY15.
- Net debt as of March 2011, as measured by the Province, is estimated to be \$13.1 billion, \$0.9 billion below last year's forecast given a better-than-expected FY10 deficit and an FY11 surplus sufficiently large to avoid new borrowing for infrastructure and reduce the net debt in FY11 by \$38 million. The net debt in March 2011 did not surpass 39% of GDP as projected a year ago, but instead dropped towards 36%, below the 38.2% level reported for March 2010.
- For FY12, the government expects its net debt to rise by \$679 million towards 37% of GDP, and then decline relative to GDP, with the longer-term *Budget* estimates indicating that an absolute reduction in net debt could reoccur as early as mid-decade with moderate in-year improvements.
- With the HST hike adopted in mid-2010, Nova Scotia's fiscal repair now rests more heavily on sustaining moderate economic growth and accomplishing further spending restraint. Encouraging is the Province's recognition of the need for ongoing expenditure management after the books are balanced in FY14.
- Long-term borrowing of \$1.95 billion in FY11, close to the \$2.0 billion *Budget* estimate, offers \$0.6 billion of pre-borrowing for FY12. Combined with a \$0.5 billion discretionary sinking fund withdrawal and a \$0.6 billion rise in short-term financing, the FY12 long-term requirement is curtailed to \$1.61 billion as maturities climb to \$1.6 billion. Long-term borrowing is forecast to subside to \$1.35 billion in FY13 and an average of \$0.7 billion in FY14 and FY15.

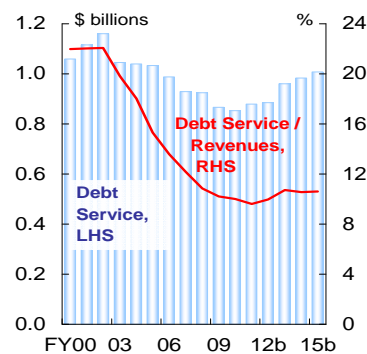
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Nova Scotia's Budget Balances ...



Source: Nova Scotia Finance; nominal GDP forecasts: Scotia Economics.

... and Debt Service



Source: Nova Scotia Finance.

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Overview

The surge in the FY11 surplus, beyond the one-time absence of university funding topping \$300 million, reflects an \$80 million decrease in the forecast debt service and a \$416 million in-year revenue gain. The latter consists of \$196 million of prior-year adjustments plus \$220 million of additional receipts emerging during FY11. As well, for the second straight year, program spending in FY11 is below *Budget* as Departments trimmed their expenses by \$134 million on top of \$39 million in other savings.

Revenues in FY12 are forecast to slide 3.0%, following the 7.5% jump in FY11. Federal transfers, as Ottawa's two-year stimulus is largely completed by March 2011, are expected to drop 4.6% while Nova Scotia's own-source receipts slip 2.2%. The \$350 million boost to Harmonized Sales Tax receipts from raising the Province's rate from 8% to 10% on July 1, 2010, was largely realized in FY11.

Petroleum royalties, on a declining trend since FY09 given subdued natural gas prices and falling output from the Sable Offshore Energy Project (SOEP), are forecast to drop 35% in FY12, with the accrual of abandonment costs that interest holders can deduct from royalties adding to the erosion of these receipts as of 2012. Even if the scheduled start of Deep Panuke in Q4 2011 was incorporated into the *Budget* estimates, its revenue stream is not expected to fully replace SOEP receipts. To attract new offshore exploration interest, the Province is investing \$6 million in collecting offshore geology information and \$0.6 million this year to develop a marketing program to share the offshore data.

The forecast of federal transfers for FY12

incorporates a number of details specific to Nova Scotia. The slide in the Province's offshore royalties lowers the Crown Share Adjustment Payment from Ottawa for FY12 by \$8 million to \$22 million and, through the Equalization formula, decreases federal Offshore Oil & Gas Payments by \$59 million to \$168 million. These latter payments consist of a \$34 million cash payment and a \$134 million notional payment that completes the accrual of the \$830 million upfront payment from the first phase of the *2005 Offshore Accord*. The Province is assuming that Nova Scotia will qualify for the second phase of this *Accord* and will receive payments on a cash basis from FY13 to FY20.

For Equalization, Nova Scotia in October 2007 negotiated an additional payment from Ottawa until FY20 if the cumulative transfers from the Equalization formula in effect when the *2005 Accord* was signed (the Interim approach) exceeds the cumulative value under the Expert Panel formula. From FY09 to FY11, the cumulative value under the Expert Panel formula was larger, but in FY12, using the Interim approach, Nova Scotia anticipates an additional \$18 million payment. To raise its major federal transfers to FY10 levels, Nova Scotia in FY11 and FY12, is receiving top-ups of \$250 million and \$158 million under Ottawa's *Total Transfer Protection* program.

Program spending is expected to climb 6.8% in FY12, but if the resumption of annual university funding totalling \$327 million in FY12 is excluded, the anticipated increase is only 2.6%. Omitting the pension valuation

Nova Scotia's Budget Arithmetic*

\$ millions except where noted

	FY11		FY12
	Budget	Rev.	Budget
Personal Income Tax (PIT)	1,897	1,945	1,981
Corporate Income Tax (CIT)	344	399	394
Harmonized Sales Tax (HST)	1,413	1,483	1,621
Total Tax Revenue	4,096	4,296	4,463
Royalties - Petroleum	174	170	110
Offshore Licenses Forfeitures	0	0.4	0
Gov.Bus.Enterprises - Net Income	349	357	355
Other Own-Source Revenue	921	1,182	944
Total Own-Source Revenues	5,540	6,005	5,872
Federal Transfers	3,200	3,151	3,007
of which: Crown Share Payments	33	30	22
Total Revenue	8,740	9,156	8,879
Program Spending	8,085	7,915	8,451
Debt Service	959	879	885
Total Spending	9,044	8,794	9,337
Consolidation & Adjustments*	83	85	69
Budget Balance	-222	447	-390
Borrowing Requirement	1,996	1,948	1,613
Memo Items, %			
Tax Revenue / GDP	11.4	12.0	12.0
Own-Source Revenue / GDP	15.5	16.8	15.8
Program Spending / GDP	22.6	22.1	22.7
Budget Balance / GDP	-0.6	1.2	-1.0
Debt Service / Revenue	11.0	9.6	10.0
Annual Change, %			
Personal Income Tax (PIT)	3.8	6.4	1.9
Corporate Income Tax (CIT)	11.3	29.2	-1.3
Harmonized Sales Tax (HST)	19.0	25.0	9.3
Total Tax Revenue	9.0	14.3	3.9
Total Own-Source Revenue	5.0	13.9	-2.2
Federal Transfers	-1.2	-2.8	-4.6
Total Revenue	2.6	7.5	-3.0
Program Spending	0.7	-1.4	6.8
Total Expenditures	1.8	-1.0	6.2

* Consolidation of health & hospital boards, school boards and other entities plus accounting adjustments. Source: Nova Scotia Finance; nominal GDP forecasts: Scotia Economics.

adjustment, that reversed from -\$23 million in FY11 to +\$32 million in FY12, further trims the planned rise in program outlays to 2.0%. Given selected priorities, such as the government's *Better Care Sooner* health strategy to improve emergency care, its *jobsHere* plan to spur employment and growth and its reinforcements for the social security net, the \$198 million cost reduction objective for FY12 will not be fully achieved. Yet considerable restraint is proceeding, such as the 1% annual wage increase negotiated with unions, the Departments' challenge of absorbing this wage increase and other inflationary costs and the ongoing 1,000 reduction in full-time-equivalent civil service positions by FY14. Other government-wide measures include trimming cell phone and travel costs, extending to all agencies and boards the ban on unbudgeted end-of-year expenditures, known as March Madness, and adopting efficiency projects under a change and innovation fund. For the future, the government will integrate its Expenditure Management Initiative within Treasury Board.

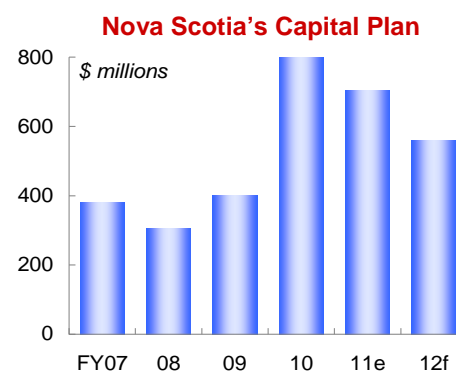
For Health and Wellness, operating costs plus health capital grants are expected to rise just 1.2% in FY12. To offset new care initiatives, savings include a revised compensation agreement for Doctors and virtually no increase in District Health Authority budgets (*see text box p. 4 for sector spending details*). Funding for regional school boards will drop by \$17½ million in FY12, mirroring the 7.1% projected fall in the student population from 2009-10 to 2013-14, following sizeable declines over the past decade. For universities, with negotiations beginning on a new funding arrangement, the Province's grant in FY12 will be trimmed by 4% (-\$14 million). Student assistance, however, will be bolstered by a \$42½ million investment, tuition increases will be capped at 3% and the Graduate Retention Rebate will be retained.

Limiting new borrowing in FY12 is the drop in capital investment to \$560 million from just over \$700 million in FY11 (*see chart below*). To take advantage of historically low interest rates and provide some insulation from the risk of future rate hikes, Nova Scotia has favoured long-term, fixed-rate financing, resulting in the term to maturity of its gross debt portfolio averaging 11.0 years in March 2011. After a \$772 million USD Global debt issue in FY11 swapped to Canadian floating interest rates, Nova Scotia in FY12 plans to rely primarily on the domestic market. After the planned rise in short-term borrowing did not proceed in FY11, a \$600 million increase is slated for FY12 to raise the share of variable-rate financing to the mid-point of its 0-35% target range.

Outlook

Nova Scotia's medium-term outlook in this *Budget* is based upon more optimistic economic projections than last year's forecast and assumes real GDP growth averaging 1.8% annually from 2000 to 2015 and nominal GDP gains from 2012 to 2015 averaging 4.0%. The assumption of a more gradual tightening of monetary policy results in annual savings on the debt service averaging slightly more than \$80 million from FY12 through FY14. Even with a more solid economic expansion, the challenge in Nova Scotia's four-year deficit reduction plan is rebalancing its books with moderate, not robust growth. Increases in Nova Scotia's personal income are expected to lag national gains, while the province's declining share of Canadian corporate profits combined with its tax credits and the small business rate reduction will dampen advances in its corporate income tax receipts. Nova Scotia's projected annual revenue growth of 2.3% from FY13 to FY15 requires expenditure gains averaging just 0.5% to achieve the forecast budget balances. With the debt service expected to climb from \$885 million in FY12 to just over \$1.0 billion in FY15, there is virtually no room for program spending to rise.

The Province is aware of the future risks to its federal transfers with the current agreements for the Canada Health and Social Transfers and Equalization expiring after March 2014. Just the scheduled shift to equal per capita cash payments under the Canada Health Transfer after FY14 will put downward pressure on Nova Scotia's receipts. Thus, the Province's ongoing expenditure reviews and restructuring are prudent, and the recognition that expenditure restraint must extend beyond balancing the books is encouraging. Proposals to achieve further savings after FY14 include achieving greater value-for-money from contracts and increased shared services. In fact, the Province's potential restructuring and innovation over the next couple of years will frame Nova Scotia's options for the second half of this decade.



Source: Nova Scotia Finance, *Capital Plan 2011-2012*, December 2010.

Budget Highlights and Major Policy Developments

Revenues (revenue impact for FY12 in brackets)

The personal income tax (PIT) Basic Personal Amount, for the fifth straight year, will rise by \$250, with proportional increases in other non-refundable PIT credits. For Seniors receiving the federal **Guaranteed Income Supplement (GIS)**, effective for the 2010 taxation year, the provincial PIT is removed (-\$9.2 million). For 2010, these Seniors will receive a PIT refund. **For high income residents**, the replacement of the 10% surtax on provincial PIT payable of more than \$10,000 with a fifth PIT bracket carrying a 21% rate for taxable incomes exceeding \$150,000 will continue until the Province's budget deficit is eliminated (+\$27.5 million).

The Corporate Income Tax (CIT) small business rate, cut from 5.0% to 4.5% on January 1, 2011 will be dropped to 4.0% as of January 1, 2012 (the combined impact is -\$6.5 million for FY12 and for a full year at the 4% rate, the revenue loss is estimated at -\$11.0 million).

The Large Corporations Capital Tax rate, as previously announced, will fall from 0.10% to 0.05% as of July 1, 2011, and the entire tax will be eliminated on July 1, 2012.

Fees, with a few exceptions, will rise 2% effective April 1, 2011, reflecting cumulative inflation of -0.2% in 2009 and +2.2% in 2010.

Expenditures

Better Care Sooner, the health strategy to improve emergency care, has introduced measures such as the 811 nurse line, treatment in nursing homes by extended-care paramedics and nurse-practitioners, investment in Emergency Department upgrades and pilot "pre-hab" clinics for orthopedic surgeries. This year, \$1.5 million will place nurse-practitioners across Nova Scotia's health system. Nova Scotia has implemented provincial standards for its emergency departments with regular *Accountability Reports*, and the opening of the first four Collaborative Emergency Centres is planned. A drug management policy unit aiming for better prescription drug use will soon be operational and legislation is imminent to ensure lower prices for Pharmacare drugs. While advancing patient care and the Province's mental health strategy, budgets for the nine district health authorities in FY12 are virtually flat-lined. Doctors Nova Scotia has voted to amend their master agreement that began April 1, extending it two years to March 2015 and accepting a 1% annual fee increase for the next two years, saving the Province \$45 million.

Post-secondary student assistance will be reinforced with a \$42½ million outlay, of which \$30 million will be allocated to student bursaries to replace the expired Nova Scotia University Student Bursary Trust. A debt "cap" will be set, permitting some students a decrease of up to 36% in their total debt. As well, the Province will raise its loan-to-grant ratio from 20% to 30%. The in-study earnings exemption on student loans will be increased from \$50 to \$100 per week and the amount allowed for the purchase of books will climb from \$1,000 to \$1,500.

In Social Services, a new 211 phone system, in partnership with the United Way, will offer residents access to a full range of social services within their local communities. The FY12 *Budget* increase for Community Services costs will be limited to 1.4%.

For Seniors, the *Budget* expands on the Caregiver Benefit Program, ends security deposits for seniors in long-term care facilities and continues to invest in these facilities.

For residents receiving income assistance, starting July 1, they will be able to retain a larger share of their income, providing a greater incentive to enter and remain in the workforce (FY12 cost: \$2.8 million).

The government's "jobsHere" strategy aimed at job creation and economic growth, will focus \$200 million of new and reallocated funds on learning, education and competitiveness. Initiatives include a new \$0.8 million International Commerce Strategy, a 10-year plan called *Homegrown Success* to foster innovation and competitiveness in agriculture, and the \$25 million Productivity Investment Program. The capacity of the current Workplace Education Initiative will be doubled, the number of co-operative education positions will be tripled and increased funding will permit improvements to the apprenticeship system. More than \$30 million in loans have been approved under the Credit Union Loan Program to support ownership and succession planning for small business. A new regional venture capital fund will be

Budget Highlights and Major Policy Developments — continued

established, with the first contributor the government, providing \$15 million. Nova Scotia is pursuing the opportunity to become a Centre of Excellence under the National Shipbuilding Procurement Strategy. The Province also recently announced that it has achieved the targeted 20% reduction in its regulatory burden.

For temporary foreign workers, Nova Scotia has signed an agreement with the federal government that will allow the Province to assume a greater role in helping employers bring temporary foreign workers to Nova Scotia as well as a greater responsibility for the workers' well-being.

An upcoming Natural Resources Strategy offers an integrated approach to managing forests, biodiversity, provincial parks, and geological resources. Plans to ensure a sustainable forest products sector include a recent 50% reduction in clear-cutting, and \$5 million in this *Budget* is provided for innovation and diversification of products and markets.

In the 2011-12 Capital Plan, in addition to the five-year Highway Improvement Plan, one-time investments include \$15 million for dredging Sydney Harbour, benefitting Cape Breton industry, plus \$3 million for ambulances and \$6 million for school buses. At the Halifax Stanfield International Airport, a \$28 million runway extension is proceeding.

Environmental issues include the Province's decision to conduct an environmental review of hydraulic fracturing on shales, with recommendations expected in early 2012 in advance of potential applications. Issues include the impact on ground and surface water, soils, waste management, additives in fracturing fluids and site restoration plus financial security and insurance issues.

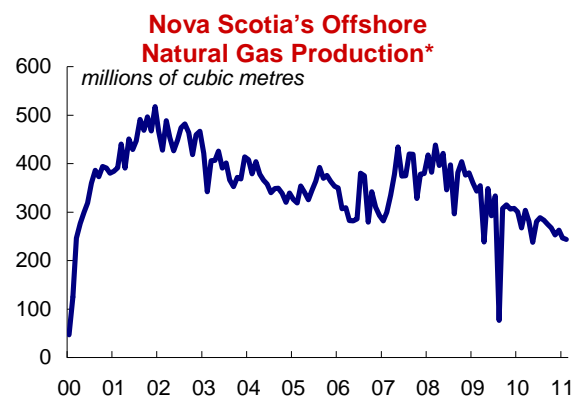
Nova Scotia Power, as it switches from carbon intensive generation to renewables, is forecasting capital investment approaching \$3 billion from 2010-15. With the recently announced Lower Churchill hydroelectricity project, Nova Scotia is now more confident of its ambitious goal of 40% renewable energy by 2020 and will incorporate this target in legislation. To encourage smaller renewable energy projects, the Province is providing community-focused feed-in tariffs for smaller centres and First Nations. Nova Scotia, aiming to acquire the expertise, experience and infrastructure to become a North American leader in tidal energy projects, announced in early February that an international consortium will test one of the world's largest tidal turbines in the Bay of Fundy. This summer, subsea transmission cables will be installed to connect the pilot tide turbines to the Province's electrical grid.

For municipalities, provincial funding for FY12 will be held at FY11 levels. Starting in FY13, however, the Province will cease to take on additional costs for public housing, corrections and education. In 2007, a Memorandum of Understanding between the Province and the municipalities led to a seven-year funding arrangement whereby the Province would gradually assume municipal payments towards public housing and corrections and municipal contributions to education would be limited to CPI inflation.

The Gas Market Development Fund (established with funding from the Sable Offshore Energy Producers) is helping Dalhousie University switch from heating oil to natural gas.

For Nova Scotia's Public Service

Superannuation Pension Plan, the reforms in last year's *Budget* are expected to save \$160-\$200 million annually, addressing the \$1½ billion unfunded liability by trimming benefits such as automatic indexing and refinancing \$536 million of the liability at a lower interest rate.



* Data through to February 2011.
Source: Canada-Nova Scotia Offshore Petroleum Board.