

Nova Scotia: 2018–19 Budget

A CAREFULLY MANAGED PLAN

- **The Budget confirms the anticipated string of modest surpluses** through fiscal 2021–22 (FY22) that build upon the black ink reported for FY17 and FY18 (side table and chart).
- **Balanced books are now offering Nova Scotia the flexibility** to take advantage of one-time revenues to address specific priorities.
- **Net debt**, as measured by the Province, is forecast to trend steadily lower from the March 2014 peak of 38.2% of GDP to an estimated 35.0% this month and towards 32% by March 2022 (chart, p.3), in sight of the Province's 30% target in 2024. Relatively restrained capital investment over the next four years plus the projected surpluses are expected to hold annual growth in net debt outstanding to a modest 0.8% average.
- **Term debt borrowing requirements** remain broadly similar to the September *Budget* forecast, shifting higher after FY18 given maturities that jump from \$0.5 billion this fiscal year to an average \$1.5 billion annually from FY19 to FY22.

THE ADJUSTED ESTIMATES FOR FY18

The substantial completion of the **Halifax Convention Centre** in February allows Nova Scotia to recognize the federal and municipal contributions totalling \$110 million as one-time Tangible Capital Asset revenue in FY18. Rather than commit to ongoing program expenses with one-time funds, the \$110 million will be used to create fiscal capacity for the QEII Health Sciences redevelopment following the government's stated plan when this revenue was expected in FY17 (table, p.2).

Overall, the \$2 million increase in Nova Scotia's revised FY18 surplus results from in-year events raising revenues by \$167 million and expenditures by \$163 million, while the Consolidation and Accounting Adjustment is narrowed by \$2 million. FY18 revenue growth is elevated to 5.2% from the *Budget* estimate of 3.6%. Part of this boost stems from a rise of nearly 6.0% in federal transfers with Equalization payments as of December ahead of *Budget* by \$44 million. This transfer is based upon Nova Scotia's election of the Expert Panel formula and a \$16½ million Cumulative Best-of Guarantee payment.

Nova Scotia also benefits from a positive \$107 million Prior Years' Adjustments on its own-source revenues in FY18. Alongside a sizeable negative Adjustment for Prior Years' personal income taxes, the Province also reports \$250 million received from an arbitration process on transportation costs that impact royalties from the Sable Offshore Energy Project (SOEP).

To use the one-time receipts of \$250 million, the government is investing about \$244 million in growth and community initiatives (table, p.3). Measures to broaden and deepen Nova Scotia's growth account for just over three-quarters of the funding, and in both categories, trusts and other structures are intended to extend their positive impact over a decade. These initiatives, allocated across multiple departments, raise FY18 program spending by a hefty 6.2%.

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Nova Scotia's Budget Balances

Fiscal 2016–17 (FY17)

Final: +\$150mn (+0.4% of GDP)

FY18

Sep. Budget: +\$132mn (+0.3% of GDP)

Q2: +\$139mn

Q3: +\$134mn (+0.3% of GDP)

FY19

Budget: +\$29mn (+0.1% of GDP)

FY20 **FY21**

Budget: +\$39mn +\$61mn

FY22

+\$75mn (+0.2% of GDP)

Borrowing Requirements

FY17

Final: \$750mn

FY18

Sep. Budget: \$684mn Rev.: \$813mn

FY19

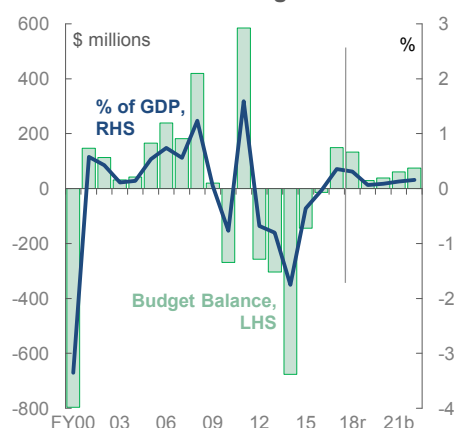
Budget: \$1.36bn Budget: \$1.73bn

FY21

Budget: \$1.22bn Budget: \$1.12bn

Source: Nova Scotia Finance; Statistics Canada; nominal GDP forecasts: Scotiabank Economics.

Nova Scotia's Budget Balances



Among the growth measures, improving high-speed internet across Nova Scotia is the largest project, but the other projects are varied and sizeable such as: extending offshore work in petroleum geoscience for another four years; increasing air connections to Asia, Europe and northeastern & central United States to spur trade, tourism and immigration; creating a broad research trust; establishing DeepSense, an ocean data analytics platform; and pursuing innovation and entrepreneurship with several formats.

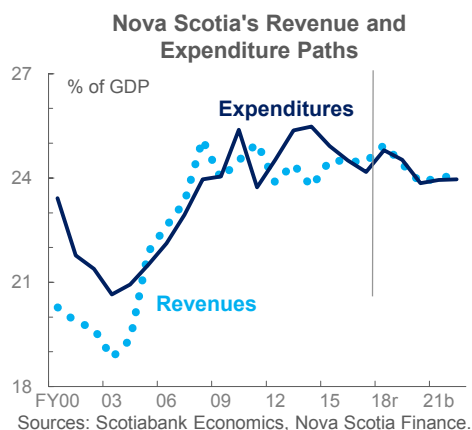
Other expenditure areas adding to FY18 program spending growth include the Digital Media, Digital Animation and Film Industry tax credits. The Pension Valuation Adjustment is \$32½ million ahead of *Budget* after updated actuarial reports and changes in actuarial assumptions.

REVENUE AND SPENDING GROWTH EASE IN FY19

Forecast receipts for FY19 advance by a modest 0.6% following the one-time revenues in FY18, and the planned program spending increase is constrained to 1.3% (bottom chart). The government assumes that provincial real GDP growth will slip from an estimated 1.4% in calendar 2017 to 1.0% this year and 0.8% in 2019, a trend roughly similar to Scotiabank Economics' forecast. Consequently, increases in nominal GDP are assumed to slow from 3.3% last year to 2.9% both this year and next.

Personal income tax receipts anchor the projected 0.7% rise in own-source revenues, though they are dampened by the expanded Basic Personal Amounts as of January 2018. From the Cannabis Tax, \$10½ million is estimated as the federal government collects an additional duty of \$0.75 per gram for the Province alongside the federal excise duty of \$0.25 per gram. HST receipts of \$10½ million also are anticipated from the HST on recreational cannabis sales. For the Nova Scotia Liquor Corporation, the Province's designated recreational cannabis retailer, initial expenses in FY19 result in a break-even forecast on cannabis sales for the year.

Offshore petroleum royalties are expected to drop to \$6 million in FY19 as the SOEP and Deep Panuke natural gas projects near their technical end dates and SOEP interest holders accrue decommissioning costs. *Offshore Accord* receipts from the federal government edge lower in FY19 and with reduced offshore profitability, the Crown Share is expected to be just over \$1 million. The second phase of the *2005 Offshore Accord* ends in FY20.



Nova Scotia's Budget Arithmetic

\$ millions except where noted

| | FY18 | | FY19 |
|--|---------------|---------------|---------------|
| | Budget | Rev. | Budget |
| Sept. | | | |
| Personal Income Tax (PIT) | 2,711 | 2,741 | 2,816 |
| Corporate Income Tax (CIT) | 507 | 541 | 531 |
| Harmonized Sales Tax (HST) | 1,829 | 1,798 | 1,858 |
| Other Tax | <u>647</u> | <u>646</u> | <u>663</u> |
| Total Tax Revenue | 5,694 | 5,726 | 5,868 |
| Prior Years' Adjustments | 0 | 107 | 0 |
| Royalties - Petroleum | 12 | 11 | 6 |
| Gov.Bus.Enterprises - Net Income | 379 | 388 | 381 |
| Other Own-Source Revenue | <u>943</u> | <u>954</u> | <u>980</u> |
| Total Own-Source Revenue | 7,027 | 7,186 | 7,236 |
| Equalization (+Best-of Guarantee*) | 1,751 | 1,795 | 1,820 |
| Offshore Accord | 20 | 20 | 18 |
| Crown Share | 3 | -0.3 | 1 |
| Other Federal Transfers | <u>1,773</u> | <u>1,740</u> | <u>1,735</u> |
| Federal Transfers | 3,546 | 3,555 | 3,574 |
| Total Revenue | 10,574 | 10,741 | 10,810 |
| Program Spending | 9,662 | 9,838 | 9,969 |
| Debt Service | <u>850</u> | <u>838</u> | <u>894</u> |
| Total Expenditures | 10,512 | 10,676 | 10,863 |
| Consolidation & Adjustments | <u>70</u> | <u>68</u> | <u>82</u> |
| Provincial Balance | 132 | 134 | 29 |
| Contribution to Fiscal Capacity | <u>110</u> | <u>110</u> | <u>0</u> |
| Net Position | 21 | 23 | 29 |
| Term Debt Borrowing Requirement | 684 | 813 | 1,363 |
| of which: Debt Maturities | 460 | 460 | 1,261 |
| Memo Items, % | | | |
| Tax Revenue / GDP | 13.2 | 13.3 | 13.2 |
| Program Spending / GDP | 22.4 | 22.9 | 22.5 |
| Budget Balance / GDP | 0.3 | 0.3 | 0.1 |
| Debt Service / Revenue | 8.0 | 7.8 | 8.3 |
| Annual Change, % | | | |
| Total Tax Revenue | 2.2 | 2.7 | 2.5 |
| Personal Income Tax (PIT) | 2.8 | 4.0 | 2.7 |
| Corporate Income Tax (CIT) | -1.2 | 5.4 | -1.7 |
| Harmonized Sales Tax (HST) | 2.9 | 1.1 | 3.4 |
| Total Revenue | 3.6 | 5.2 | 0.6 |
| Program Spending | 4.3 | 6.2 | 1.3 |
| Total Expenditures | 4.2 | 5.8 | 1.8 |

*For FY09-FY20, Equalization under Expert Panel formula plus cumulative shortfall vs the Interim formula in place when *Offshore Accord* negotiated. Source: Nova Scotia Finance; Statistics Canada; nom.GDP fcst: Scotiabank Economics.

Equalization also contributes to the soft 0.5% rise forecast for federal transfers in FY19. The Cumulative Best-of Guarantee payment can supplement for Nova Scotia the transfer calculated under the Expert Panel approach until FY20. In FY13, it assisted the Province with a payment approaching \$300 million. Subsequently this additional payment has steeply declined, and though the negative amount initially calculated for FY18 was reversed in late 2017, a steeper negative payment is estimated for FY19.

Spending by government departments in FY19 is constrained to a 0.4% aggregate increase. Larger gains are expected for several smaller items such as refundable tax credits (+27.5%) and for the Pension Valuation Adjustment, a doubling from the FY18 level is forecast.

THE FY20–FY22 OUTLOOK

A subdued 0.5% advance is projected for FY20 revenues, in part reflecting downward pressure from the Cumulative Best-of Guarantee. To retain black ink, program spending is held virtually flat, with some assistance from declining interest charges, a rare expectation among Provinces given the anticipated environment of rising interest rates. For Nova Scotia, however, gross debt servicing costs are forecast to fall from \$894 million (8.3¢ of every revenue dollar) in FY19 to \$776 million by FY22 with the maturing of high-coupon issues from FY19 through FY22.

In FY21 and FY22, growth in receipts is expected to pick up to an average 3.4% with a stronger economic expansion anticipated early in the next decade with the commencement of the second phase of combat vessel construction at the Halifax Shipyard.

CAPITAL SPENDING AND BORROWING REQUIREMENTS

Capital investment for this fiscal year, as of the December *Update*, was expected to be \$21 million (-3.0%) less than *Budget* at \$663 million, with slower-than-expected outlays on buildings and IT projects and a reduced contingency. For FY19, a more significant decline to \$605 million is planned, though this still includes priorities such as constructing nine schools and purchasing three other schools.

In FY18, Nova Scotia's entire borrowing of \$813 million was in Canadian Dollar Offered Rate (CDOR) floating rate notes in five- and seven-year terms. In FY19, in addition to the payout of the Long Term Service Awards, borrowing needs are boosted by maturities climbing to more than 2½ times the FY18 level.

OUTLOOK

As a small open economy reliant upon trade in goods & services, Nova Scotia's measured approach to fiscal planning appears prudent. The Province assumes future growth at the Halifax Shipyard, but other, more tentative plans, are not incorporated. The two instances of one-time receipts in FY18 offer an opportunity to accomplish key projects that would otherwise be largely beyond the reach of Nova Scotia's disciplined 'balanced books' model. The compilation of growth Initiatives (table above) looks to Nova Scotia's existing strengths, including its skilled work force, multiple post-secondary institutions and growing reputation as an East Coast hub.

With a relatively heavy tax burden as the US implements broad tax reforms, one option for Nova Scotia would be to use the unexpected FY18 revenue upswing for additional tax relief after the personal income tax reductions announced last September and implemented in January 2018. Yet the one-time nature of the 'extra' FY18 revenues likely makes them insufficient to sustain lower taxes, particularly with North America's and Nova Scotia's outlook for slowing growth. For now, Nova Scotia has other competitive advantages, notably its very affordable living costs.

Nova Scotia's FY18 'Investments'

\$ millions except where noted

Supporting Economic Growth

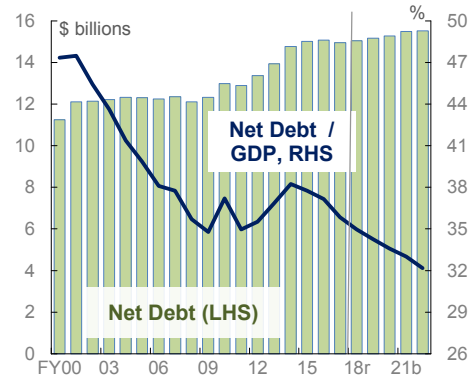
| | |
|--|--------------|
| Nova Scotia Internet Funding Trust | 120.0 |
| Research Nova Scotia Trust | 20.0 |
| Offshore Growth Strategy | 11.8 |
| International Air Service Investment | 11.1 |
| Saint Mary's University Innovation Hub | 11.0 |
| DeepSense Big Data/Oceans | 5.0 |
| Innovation Team | 1.5 |
| Ninth Sandbox for Nova Scotia | 0.9 |
| Other* | 4.8 |
| Total: Growth Initiatives | 186.1 |

Supporting Communities

| | |
|---------------------------------------|-------------|
| Health Investments* | 18.2 |
| Energy Efficiency: Low-Income Homes | 12.2 |
| Opioid Use & Overdose Framework | 1.6 |
| Employment Coaching: Autistic Workers | 1.4 |
| Other** | 25.0 |
| Total: Community Initiatives | 58.4 |
| Total | 244 |

*Details to be finalized. **Includes shelter initiatives, sports & community events plus projects still being finalized. Source: Nova Scotia Finance.

Nova Scotia's Net Debt



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

Selected Program Developments

The QEII Health Sciences redevelopment continues with \$32 million approved for construction and renovation of the third and fifth floors at the Halifax Infirmary to permit new technologies in surgical procedures. Also underway are the Dartmouth Hospital expansions and upgrades; new operating rooms at Hants Community Hospital; and a new community outpatient centre at Bayers Lake.

As part of the Provincial Nominee Program, Nova Scotia has received federal approval to recruit international doctors and specialists to the province, with one priority further expanding family practice units.

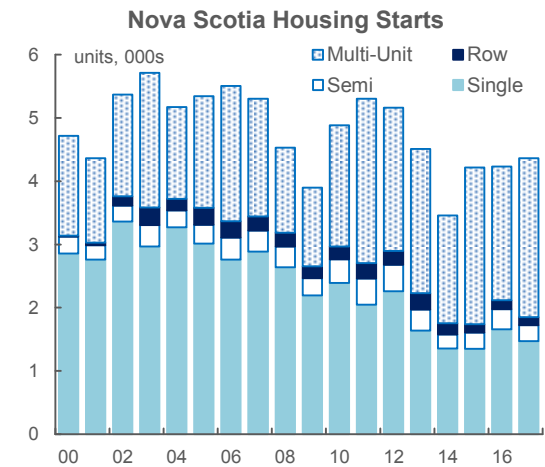
Nova Scotia's English school boards will be dissolved on March 31, 2018, and the functions and offices will be transitioned to "regional education centres", with the \$2.3 million savings from Board member salaries reinvested in schools. After the first year of a pre-primary early learning program, further expansion this year is planned en route to a full roll-out by September 2020.

A report commissioned by the Council of Atlantic Ministers of Education and Training reports that Atlantic post-secondary institutions recorded strong increases in their respective shares of international students. On the East Coast, NS led with a jump from 6% to 15% over 15 years. Statistics Canada reports that international students choose business, management, public administration, science and math engineering at twice the rate of domestic students.

Atlantic Canada's Oceans bid sponsored by the private sector and post-secondary institutions was one of five superclusters selected by the federal government to share federal funding of up to \$950 million over the next five years, matching the private-sector funds raised.

The \$1.7 billion, three-year Innovate to Opportunity program was launched in mid-February, assisting small- and mid-sized firms to hire graduate students to strengthen their export performance through innovation.

The Halifax Convention Centre has booked 100 events for the first year, including 44 national and international conventions. The latter are expected to bring more than 80,000 delegates to the province.



Sources: Canada Mortgage and Housing Corporation.

Nova Scotia's Cap and Trade Program

Nova Scotia embarks on a cap-and-trade carbon pricing system having already met the national 2030 target of a 30% reduction in greenhouse gas (GHG) emissions from 2005 levels. The proposed cap-and-trade framework will operate for now within Nova Scotia with no links to Ontario's or Quebec's frameworks or the Western Climate Initiative.

Regulations and standards, effective February 15, launch the first round of GHG emissions reports that are due May 1 this year and henceforth each June 1, with outside verification required each September 1. Filing these reports is expected from all companies emitting 50,000 tonnes or more of carbon dioxide equivalent, including power producers. Petroleum product suppliers and natural gas distributors also are expected to participate. The first round of corporate reports will be used to identify firms to be included in the cap-and-trade program.

Finalizing how the allowances will be distributed, and other details such as the pace of reducing the caps is anticipated in coming months. With competitiveness and trade concerns, the distribution of the bulk of the allowances for free is under consideration. This would limit firms' costs, and provide more time for them to explore and implement energy and emissions efficiencies, while still incenting emissions reductions over time. The cap-and-trade program is currently scheduled to commence in January 2019.

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