



## **FISCAL FRAMEWORK 2010-11: CURRENT STATE OF THE ECONOMY**

*Background Brief for Halifax Regional Council  
February 23, 2010*

### **INTRODUCTION**

The past two fiscal years have been a period of dramatic shifts, due in large part to the global recession and the availability of large amounts of federal economic stimulus funding. These funds allowed HRM to undertake many important projects, although it meant making changes to debt policy and redirecting funds from other areas in order to fully leverage stimulus funds. HRM maintains its strong credit rating of A Positive. On the whole HRM has been fortunate that its stable and diversified economy has allowed it to weather the recession well – even ranking as the strongest economy in the country according to CIBC World Markets and the Bank of Commerce. Gains in employment have been strong and business confidence is high, second only to British Columbia.

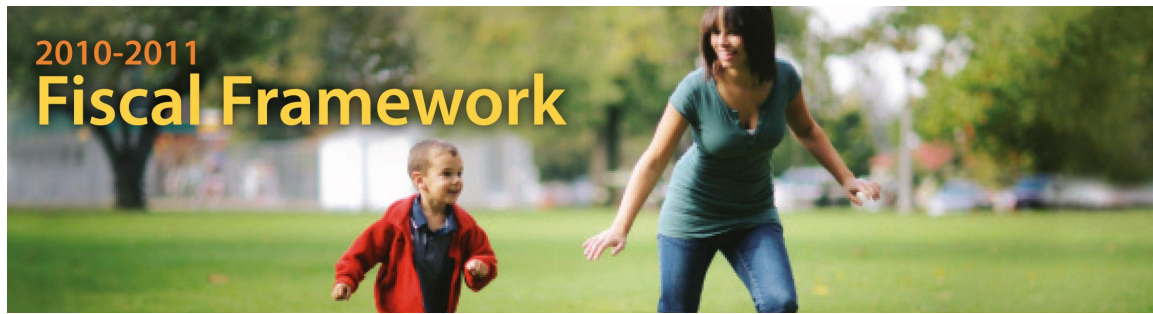
Recovery from the recession began in 2009, though progress was weak. Nation-wide, the December 2009 survey of private sector forecasts for the federal Department of Finance indicates the economic recovery will gain momentum throughout 2010. Canada's Real and Nominal GDP is expected to grow 2.6% and 4.9% respectively (compared with declines of 2.5% and 4.6% in 2009). Nominal GDP is used as an indicator of the government's tax base and so its return to growth is positive for the federal government's revenue streams.

As HRM heads into the 2010-11 budget and business planning process, it may helpful to consider the general state of the economy, major issues facing our government funding partners, and the observations of a few key policy observers. Their priorities and actions will have an impact on HRM's budget and key initiatives over the coming fiscal year.

### **PROVINCIAL PRIORITIES**

The Minister of Finance is currently undertaking a cross-province public consultation process on how to "get back to balance." As the new government's review of finances last summer demonstrated, Nova Scotia's spending is rising at the same time as revenues are decreasing. The deficit caused each year by borrowing enough to make up the shortfall is due to increase from the \$525 million currently, to \$1.4 billion in 2012-13.

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Interest payments on the debt are already the fourth largest provincial expense, after health care, education and community services - at \$1 billion per year, interest costs are larger than most departments' annual budgets. If the deficit continues to rise unchecked the province will no longer be able to afford to fund its core services like health and education. As such, reducing and eliminating the deficit is the Provincial government's top priority over the next three to four years.

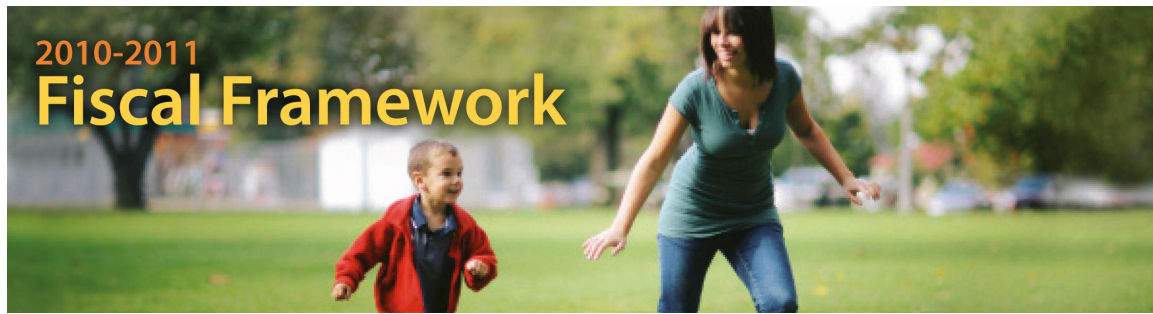
Shrinking revenues is a main contributing cause to the growing provincial deficit. A period of extraordinary revenue growth, from offshore petroleum royalties and atypical agreements with the federal government, is coming to an end. At the same time, federal transfer payments may be set to shrink in line with Nova Scotia's decreasing population, and possibly also due to a review of the Canada Health and Social transfers coming in 2014. As 40% of the provincial budget comes from federal transfers, any change in the amount received would have a major impact.

The Province is undertaking a two-year program and service review of all government departments, aimed at identifying efficiencies and cost-savings to assist in eliminating the deficit. As part of its pre-budget process the Province is considering cutting spending on programs and services, increasing taxes such as the HST, tobacco and high-income surtaxes, and ways to grow the economy in the long-term through enhancing education and increasing immigration numbers. The Provincial budget is expected sometime in late March or early April.

## **FEDERAL ISSUES**

The federal budget will be released on March 4, 2010. The federal government is preparing to look at its growing deficit and there have been a number of comments in the press from federal Ministers noting that fiscal restraint and "considerable sacrifices" are to be expected. The President of the Treasury Board has said that the March 4 budget will identify some areas for cost-cutting, while other areas will be more general as the federal government seeks input from Canadians. The federal government has already stated that no more stimulus funding will be forthcoming and that they intend to focus on maximizing the benefits of the projects already underway. The deadline for completing projects that received stimulus funding is March 31, 2011, after which time the federal government plans to shift its focus to eliminating the deficit. The Federation of Canadian Municipalities has discussed this matter with the federal government and agrees with their approach, saying the priority for all orders of government is to create as many jobs and complete as many projects as possible by the March 2011 deadline.

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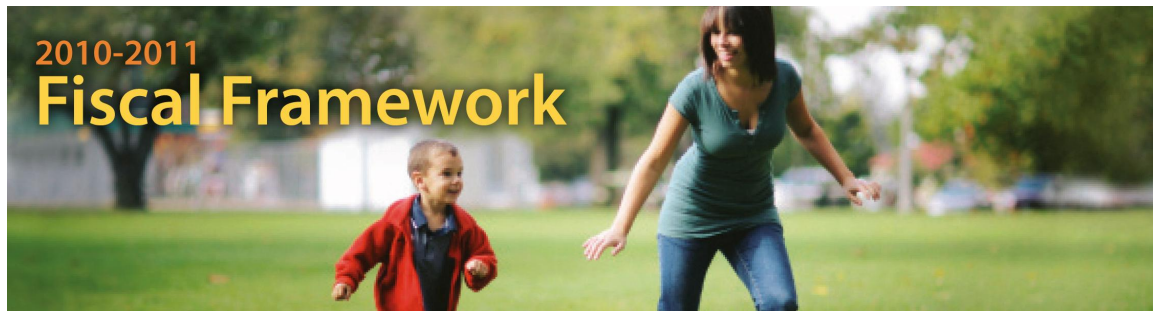
In November 2009 both the federal Minister of Finance and the Parliamentary Budget Officer released deficit projections for the coming years. The Finance Minister predicted a deficit of \$5.2 billion by 2014-15, which could eventually be eliminated through economic growth. The Parliamentary Budget Office estimated \$19 billion – a substantially larger amount, due to structural issues that mere economic growth will not overcome. Either way, the federal government is facing an increasing deficit that it is under pressure to eliminate. Similar to the Nova Scotia government, it plans to look at spending cuts and growing the economy in the long term. However, more drastic measures may be needed. On February 18, 2010, the Parliamentary Budget Office released its Fiscal Sustainability Report with more details on the long-term structural deficit caused by the aging population. Rising health care costs, a shrinking labour force, and slower economic growth and productivity all lead to decreased government revenue. The current fiscal structure is not sustainable without taking steps to address the coming demographic challenges, and the PBO estimates between 1.0% and 1.9% of GDP must be found on a permanent basis to close the fiscal gap – either through reduced program spending or tax increases. While most government plans are looking at medium-term plans up to 2013-14, it could reasonably be expected that longer-term considerations may come into play.

## **POLICY / STAKEHOLDER VIEWS**

As noted above, the FCM's short-term goal is to ensure as many stimulus projects as possible are completed on time. However after the stimulus programs end in March 2011, the FCM wants to focus on ensuring core funding programs are protected and maintained, such as the Gas Tax Fund, the 100% GST rebate and affordable housing programs. To that end, the FCM surveyed Canadians in January 2010 and found that 96% of Canadians want the government to maintain or increase support for local infrastructure, and that 69% of Canadians regard local infrastructure as the most important priority for continued spending (second only to health care). The survey found that Canadians want the federal government to work towards a balanced budget in the medium- and long-term, but that infrastructure funding should not be sacrificed to achieve this.

Another finding from the FCM survey was that Canadians are more supportive of tax increases when they are tied to tangible benefits in the communities – 70% would support a GST increase to fund local infrastructure, versus 32% support for a GST increase to eliminate the deficit. This funding is somewhat at odds with another recent survey done by EKOS in February 2010. The EKOS poll also found that a majority of Canadians

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want the federal government to eliminate the deficit in the medium- to long-term, but raising taxes was the least preferred option. Instead, 46% of those surveyed felt spending cuts were the best method to deal with the deficit, versus 14% in favour of tax hikes. However, if there is one clear opinion that has emerged over the past months, it is that Canadians expect their governments to live within their means and eliminate deficits in an expeditious manner.

One last view comes from the Atlantic Provinces Economic Council (APEC). Its “Outlook 2010 Conference Report” released in November 2009 is intended to support government and business in their business planning. This report echoed comments that the Atlantic region has weathered the recession better than most parts of Canada, but noted that the region is facing a much broader economic shift. Resource- and manufacturing- based industries are disappearing as globalization becomes more prevalent, and Atlantic Canadian governments need to consider how best to improve their future prospects. The first step noted by APEC is to balance provincial budgets so that the economy is on a strong footing. The second step focuses more on growing the long-term economy by developing human capital through education, skills and training. Transforming the region into a knowledge-based economy is seen as essential for economic sustainability. This sentiment was echoed by business leaders consulted by APEC, who highlighted initiatives aimed at improving productivity and ensuring long-term competitiveness.

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