HALIFAX CHAMBER OF COMMERCE

2006 Provincial Pre-Budget Submission

Presented by:
Provincial Affairs Committee

February 08

INTRODUCTION

The Halifax Chamber of Commerce is a best-practice business advocacy organization representing the interests of its 1,700 members and over 90,000 employees across HRM. The Chamber continuously strives to make metro Halifax an even better place in which to live, work and play. The health and prosperity of our capital region is very important to the health and prosperity of our Province.

The Chamber's provincial affairs goals are to further develop policy and an approach on issues of importance to our members within the purview of the Provincial Government. This includes, but is not limited to, provincial budget matters, regulatory review, etc. The Chamber also aims to develop and maintain relationships with key decision makers within the Provincial Government structure and to communicate Chamber policy to those decision makers and to the Chamber membership.

It is within the context of these Chamber priorities that we have developed this submission. We look forward to on-going dialogue and a continued working relationship on these and any areas of mutual concern.

The last twelve months have brought ups and downs for the Province. The signing of the Atlantic Accord in February 2005 and the agreement to move the teachers' pension plan to a joint trusteeship are expected to help maintain the downward trend of our Province's Debt-to-GDP ratio. Our unemployment rate declined, housing starts remained high and construction for the liquid natural gas terminal at Bear Head received the green light. We also experienced severe flooding in May and skyrocketing fuel costs throughout the year. A strengthening Canadian dollar (relative to the US), the cancellation of the Scotia Prince ferry service and high fuel costs likely contributed to the number of Americans visiting Canada hitting a 25 year low.

The business performance of Chamber members is directly impacted by the current and future strength of our province and the Provincial Government's budgetary decisions. To that end, we submit to the Province our key considerations for your 2006/2007 budget as follows:

- Debt
- Program Spending
- Taxes
- Energy

DEBT

The Chamber's pre-budget submission has consistently called on the Province to reduce its debt to a level at or near to the national average Debt-to-GDP ratio. The Minister and his department should be aware that the level of Nova Scotia's debt burden has been and continues to be the primary provincial-affairs concern for the Chamber.

In past submissions the Chamber has urged the Province to put in place a viable plan for debt reduction, repatriate foreign debt, deliver balanced budgets and use excess monies to pay down debt. The Province has initiated programs for all of these and we acknowledge the Government's efforts and successes in reducing the province's risk profile – foreign debt as a percentage of total debt is now less than 20% and the rating on the province's long term debt has improved – allowing for further future reduction of debt servicing costs as debt is refinanced at lower interest rates. The Province's adherence to prudent fiscal policy has been paying off. It has balanced its budget since 2000/2001 – something unheard of in many of the other provinces – and has recently received a positive outlook from yet another of the pre-eminent bond rating agencies: Standard & Poors. It had already received a positive outlook from Moody's and Dominion Bond Rating Service.

In September 2005, the province released its audited financial statements that revealed a $165 million surplus – almost all of which was unexpected. Fortunately, the Province did apply some of these funds against the debt. This extraordinary payment had the effect of reducing the net direct debt ahead of schedule by $19.1 million – the first reduction in net debt in nearly 30 years. We congratulate the Government on this accomplishment and are looking forward to the province's debt reduction update. We recommend that the province include in its semi-annual Forecast Update a revised schedule for its debt reduction plan to clarify what the long-term effects are on unexpected surpluses. Moreover, if extraordinary payments are not expected to change the debt reduction schedule, we would ask for clarification on why.

The debt reduction plan indicates that extraordinary revenue is applied to the debt management fund. The definition of the term "extraordinary" is understood when considering asset sales but when surpluses are involved, the Financial Measures Act leaves room for discretionary spending. It is not clear to the Chamber if some of the Province's surplus revenues were applied to the debt because they were considered "extraordinary". For example it is not clear if either the $165 million surplus noted above or this year's forecast $15 million excess Provincial Surplus qualify as extraordinary revenue.

In last year's pre-budget submission, the Chamber identified its concern that there is a "lack of defined control processes and there are no checks and balances in the legislation to ensure monies allocated to the Debt Retirement Fund will in fact be applied against the debt rather than be reallocated for political gain." We would like to reiterate our position and urge the province to provide more clarity into its use of surplus funds – to provide checks and balances on this process - and we urge the province to use this year's entire $15 million surplus toward debt reduction.

The Government's commitment to apply the $830 million negotiated under the offshore agreement to the province's debt had been estimated to free up a projected $32 million in debt servicing costs in 2005-2006.[1] Earlier estimates were close to $50 million[2]. The Government, in its December 2005 Forecast Update indicated savings of only $21.4 million which were offset due to a change in accounting assumptions in the pension plan. We are concerned by this apparent discrepancy and urge the government to communicate clearly and accurately on all matters financial.

Balanced budgets are to be applauded but the continued increase of net direct debt, continued high debt servicing costs and a potential slowdown in the economy, the positive outlook is somewhat tempered. We currently are experiencing the benefit of our offshore natural resources but we cannot expect this to last forever.

Its ratio of debt to GDP is a key measure of a Province's ability to service its debt and the Chamber believes very strongly that this measure must be further improved in order to restore our Province to financial health. In 2003 the NS public accounts showed a

[1] BMO Financial Group, Provincial Outlook December 2005.
[2] 2005 Halifax Chamber of Commerce Pre-Budget Submission.

debt to GDP level of 44.7% - the third highest in the country. In 2005, debt to GDP, (according the DBRS[3]) was approximately 41% - again the third highest in the country. There were high hopes in FY06 for a reduction in Debt to GDP to drop below 40% (forecast 2007-2008 to be at 36.5%) but given the increase in net direct debt combined with a slower than expected real GDP growth[4], we are not confident that the debt reduction plan will be achieved as planned. The Province should be proud of it accomplishment in reducing debt to GDP from 51.4%[3] to its current level but it should not take its eye off the Chamber's recommendation to reduce Debt/GDP by 2-3% annually and achieve the provincial average Debt/GDP of 33.5%[5].

The province's December forecast update indicated an unexpected increase of $3.3 million in Net Debt Servicing Costs as compared to budget. This increase is explained in the December 2005 FY06 Fiscal Update as an increase due to "interest on pension, retirement and other obligations". Assuming we can only expect these obligations and the resultant interest payments to increase in the coming years, this serves to underscore the vital importance of aggressive, regular and legislated debt management. As we have in previous submissions, we urge the Province to consider legislating improving targets for Debt/GDP or debt servicing costs/total revenues and use provinces with similar economies, such as Manitoba and Saskatchewan, as performance benchmarks such as:

- Establishing a set amount to be paid into the fund each year. The Debt Retirement Fund contribution of $6M per year represents two thirds of one percent of the annual debt servicing costs;
- A requirement that at least once every five years, the monies in the debt retirement fund be applied against the debt;
- A requirement that all earnings from investments of the fund be kept in the fund; and
- Establishing a Debt Retirement Fund committee to oversee and provide accountability for the fund.

We also encourage the government to legislate a requirement not only for annual deposits to the debt management fund but also to legislate that the Debt Management fund money periodically be allocated against the debt.

PROGRAM SPENDING

In previous pre-budget submissions, the Chamber has called on the Province to maintain a tight rein on spending. We have also encouraged the Province to ensure departments manage within budget and be accountable for overspending. We understand the pressure on the Province to manage the costs while meeting its responsibilities to the province's residents nonetheless we believe there is room for tighter spending controls. Spending in 2004/2005 was $115 million over budget and cost growth exceeded revenue growth by 1.7 percentage points[6] (for a differential in FY03 – FY04 cost growth over revenue growth of over $60 million). To put this in perspective, this $60M excess in spending exceeds the annual contribution to the debt retirement fund by a factor of 10 and

[3] DBRS Province of Nova Scotia Credit Rating Report, June 28, 2005.
[4] Nova Scotia Department of Finance December 14 Forecast Update.
[5] The provincial average, excluding Alberta, Newfoundland and Quebec is 31.8% and the total median is 31% per DBRS.

[6] Represents *Ordinary Revenue* and *Net Program Expense.*

exceeds the Offshore Agreement offset by almost $3 million.

The December 14 FY06 Forecast Update indicated that education and healthcare spending were on track to meet budget. We would like to give credit to the Province and encourage you to stay the course in meeting targets in these two areas of spending that together accounted for approximately 70% of budgeted program expenses.

Although the Forecast Update shows the Government meeting budget in a majority of its programs categories, total program spending is exceeding total program budget - as it usually does. The year 2005, however, was tough on lower-income households as the combination of a long and cold winter and skyrocketing oil prices warranted budget amendments to deal with the Province's social assistance and energy efficiency plans.

Notwithstanding overspending in the Energy Department, overspending is a chronic problem. The total undiscounted over-budget spending since FY00 is $470 million. The June 2005 Report of the Auditor General identifies a possible culprit of discrepancies between budget and actual financial numbers as stemming from a disconnect between the Department of Finance's revenue plans and those of Government generally and government departments specifically. While the Auditor General's report focused more on underestimates of government revenues – attributed in part to government use of national economic assumptions instead of provincially developed estimates and in part due to communications failures between the various departments and the department of finance - we would be interested to know the impact of these same factors (particularly departmental vs. finance estimates of program expenditures) on budget estimates. The economics between how much you earn and how much you spend are interrelated so we urge the Province to follow the auditor general's recommendations that key economic assumptions used for revenue estimates be those approved by executive council, that the Department of Finance be revenue estimates reflect the most current information available and that the budget process be reviewed to ensure the Department of Finance is made aware of all potential revenue line items when determining the Province's estimated revenues and related disclosures. We understand the Treasury Policy Boards' position that strategic spending is often required to meet the pressing needs of Nova Scotians but note that there is always a total budget overspend and never a total budget under spend.

Heath Care and Education are always the largest yearly investment the Government makes in our province's people. Education costs are growing at approximately the rate of the province's revenue growth and slightly lower than the nominal growth in GDP. Healthcare costs, however, increased by 9.4% or more than $200 million between FY04 and FY05 and have grown at a 3 year compound annual growth rate of nearly 9%. They are currently budgeted to be 46.5% of net program expenses up from 41% on FY02. What should the number be? The current budget of 46.5% of total costs is at least three percentage points greater than Manitoba and Saskatchewan budgets and four percentage points greater than the last 4 years' median for these provinces. The 'sweet spot' is debatable but what is clear to us is that at the current growth rate, health care will command 60% of the provincial spend by 2015 if there are not measurable actions put in place to control the floodgates.[7]

The Chamber urges the Government to work more closely with the Departments in developing revenue targets and budgets, to develop guideline targets for program spending budgets so the larger spend categories don't consume our entire budget, and to encourage Government and departmental budget accountability.

Taxes

The Chamber maintains its position that tax cuts should only be delivered to Nova Scotians when the Provincial Government is able to establish that the Province's finances are on a stable, sustainable footing and the debt is under control.

We commend the Government on eliminating the Business Occupancy Tax (BOT). Ours was the only province with this type of tax and we felt it had a negative impact on the business community. Businesses cheered the elimination of the tax and although businesses in the higher BOT bracket have to wait for the full benefits over the phase out period, the Chamber believes business will benefit from the elimination of this tax and businesses that would have otherwise chosen to locate elsewhere, now can include Nova Scotia on their lists.

Small businesses often bear a higher relative tax burden than do large businesses and we therefore again applaud the Government in increasing the small business deduction threshold to $350,000 with plans to further increase it to $400,000 in April 2006. We suggest that the Province reviews the small business deduction periodically to ensure that it keeps up with the nominal pace of inflation.

[7] Based on a 5.8% Net Expense growth rate and a 9% Health Care cost growth rate

The Chamber believes that without encouraging investment and innovation, our Province may be missing out on an opportunity for long-term growth and sustainability. The combination of rapid technological change and policy liberalization is a global trend. For Nova Scotia to compete in this global playing field we need to support the key drivers of economic growth – employment and productivity. Economies must take advantage of increasing rewards from innovation as both global competition and the speed of technological change increase. Our province's GDP per capita is trailing the rest of Canada and we believe that high levels of innovation and R&D are crucial factors in maintaining high and stable growth.

The Premier's Council on Innovation echoed our sentiments in its October 2005 Interim Report when they stated:

"Unless we soon identify a strategic focus, and build where we have the broadest knowledge base, our province and indeed our region will fall behind in quality-of-life opportunities, relative to other advanced regions of this continent and the world."

The Chamber therefore strongly supports the Government in raising the provincial component of the scientific research and development tax credit from its current level of 15% to 40%. If the Province is considering tax cuts in its upcoming budget, the Chamber, as it has in the past, call for an open public consultation process to review all possible forms of tax cuts.

Energy

As a footnote to our annual Pre-Budget Submission, the Chamber urges the Province to consider the effect of increasing energy costs to Nova Scotia Businesses. Fuel taxes and electricity charges are both among the top five negative charges facing small businesses in Nova Scotia.[8] There was a small piece in the energy bill dedicated to helping businesses in last year's budget but we would look forward to seeing more support to our business community in the upcoming budget.

In summary, the Chamber calls on the Government to

- Set improving and achievable Debt-to GDP targets and strategies (which would include reducing the debt and or increasing GDP);
- Legislate the regular application of sinking fund monies to the debt;
- Apply fiscal surpluses to the debt;
- Provide semi-annual updates to our adherence to the debt reduction plan;
- Work with departments to establish budgets and keep within their annual limits;
- Establish new health care spending controls as soon as possible;
- Continue with the plan of increasing the small business limit to $400,000;
- Periodically inflation-adjust the small business limit;
- Increase the R&D tax credit to promote innovation and growth; and
- Develop an actionable plan to help businesses deal with rising energy costs.

We thank you for the opportunity to present our pre-budget submission and we look forward to a continued working relationship with your organization.

Chamber Advocacy Work

More information about the Chamber and its advocacy work can be accessed by contacting the office or visiting the Chamber web site:

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[8] Canadian Federation of Independent Business research, November 2005.