The Manitoba Budget and Analysis

Prepared for the Manitoba Federation of Labour

By

Michael Benarroch (PhD)
Dean and CPA Chair in Business Leadership
Asper School of Business
April 16, 2017

The Budget and Analysis

The 2017/18 Budget states that government will "pursue responsible recovery." This will involve a plan that "avoids drastic measures choosing instead to steadily pursue and achieve improvements year-over-year."

The budget confirms the government's commitment to return to balance by end of their second term.

The budget re-affirms the government's commitment to remove the 1% PST increase.

The budget contains some moderate spending cuts together with projections for improvements in revenue.

The budget forecasts 2% growth in real GDP for 2017/18, 2018/19 and 2019/20. The 2% rate is equal to the average rate forecast by the five largest Canadian banks.

Nominal GDP is forecast to grow at 3.6% in 2017/18, and 3.8% in 2018/19 and 2019/20.

The Budget includes contributions to the Fiscal Stabilization Fund of $10M in 2017/18 and $50M in both 2018/19 and 2019/20.

The 2017 Manitoba Budget estimates that the 2016/17 deficit for Manitoba will be $872M. This is below the projected deficit previously estimated to be $911M initially forecast for 2016/17. It is difficult to decipher from the information provided in the budget whether the reduction in the deficit was due to incorrect forecast, unexpected increases in revenue, or government expenditure measures. In all likelihood, it is a combination of higher revenue and cost cutting measures introduced over the past year.

In 2017/18, the deficit is projected to be only $32M less at $840M. This amounts to a modest 3.6% decrease in the deficit. This minor decrease in the deficit is achieved through cuts in department spending together with slightly higher than expected revenue. Growth in government expenditures is projected to increase by +3.1% while government revenue will rise by +4%.

The projected deficit in 2018/19 is forecast at $698M, while in 2019/20 the deficit is forecast to be $549M. These forecasts are based on modest 2% growth in Real GDP together with 3% growth in government revenue and 2% growth in government expenditures per year.

The growth rate for Real GDP is forecast at 2% over the next three years. GDP growth has been difficult to forecast since the financial crisis in 2008. However, the rate of real GDP growth utilized in the budget is modest and below the average rate in Manitoba since 2011. In all likelihood, this will represent the lower end of growth in Manitoba over the next three years.

The projected size of the annual deficits for the next three years remains manageable. The deficit to GDP ratio will decline from 1.4% of GDP in 2016/17 to 1.37% in 2017/18, 1.11% in 2018/19 and 0.86% in 2019/20. As a point of comparison, Saskatchewan had deficit to GDP ratios of 1.7% and 1.9% over the past two years, Alberta 2.0% and 3.5% and Canada 1.1% and 1.4%.

A challenge for the government will be to maintain expenditures at 2% year over year. To accomplish this goal the government will have to find savings in Health, Education and Family Services, the three largest components of government expenditures in Manitoba.

Government revenue is predicted to grow by 3% per year for the next three years. In 2017/18 government revenue is forecast to rise by 3.0% on nominal GDP growth of 3.6%. Nominal GDP is forecast to rise in 2018/19 to 3.8%, 0.2% higher than in the previous year. Higher Nominal GDP is likely to lead to a rise in revenue implying that the budget forecasts may be overestimating the future deficits.

It is unclear from the 2017/2018 Budget whether the provincial government has incorporated the potential 3.5% increase in Federal Government funding for healthcare, plus funds for homecare and mental health, into its future revenue projections. Without a formal agreement between the two levels of government, a more precise estimate of future federal transfers cannot be calculated.

Surprisingly, the government has decided to increase contributions to the Fiscal Stabilization Fund by $10M in 2017/18 and $50M per year in 2018/19 and 2019/20. This is equivalent to borrowing $110M over three years. The intent is to grow the fund from $115M to $225M by 2019/20.

The fund was created to try and help balance out government borrowing requirements over time. The intent is to grow the fund during times of surplus and contract it in times of deficit to lessen the requirement for external borrowing. Borrowing $110M to contribute to a savings fund, runs counter to the objectives of the government and their aim to balance the budget. In fact, it adds directly to the deficit.

Rather than contribute to the fund, the government should be moderately drawing down the fund by $15 to $20M per year for the next five years. This would lessen the borrowing requirements on the province and remain consistent with the intent of the fund. Once the province returns to balance, the government can begin to contribute positively to the stabilization fund.

Without the contributions to the Fiscal Stabilization Fund, the deficit to GDP ratio would be lower than currently forecast falling to $499M or 0.7% of GDP by 2019/20. For a government intent on balancing the budget, it is unclear why it would borrow an additional $110M over three years, adding to the deficit, in order to hold cash within the Fiscal Stabilization Fund.

It is not possible to determine the impact of the Bill 28, *The Public Services Sustainability Act,* on government expenditures or the deficit. The budget provides no information on the direct impact of Bill 28 on government expenditures.

Budget 2017/18 estimates that a 1% increase in Manitoba Public Sector salaries results in a $100M increase in public sector wages. This amount cannot be verified with the current information available. Public sector salary expenses were last published by Statistics Canada in 2011. Based on projections from the 2011 Stats Canada report for Manitoba, a 1% increase would result in approximately a $73M increase in provincial public sector salaries. This amount however, would not reflect the actual savings to provincial government expenditures. A portion of the salaries are paid by publicly funded organizations whose wage bills are not accounted for in government expenditures. Direct salaries paid by the provincial government are well below the total of the public service as defined by Stats Canada.

Bill 28 disproportionately places the burden of budget cuts on public servants. While undoubtedly salaries are a significant component of government expenditures, government services and programs benefit all Manitobans. The provincial debt is the responsibility of all Manitobans not just public servants. Public servants ensure that services and programs are provided to Manitobans. Bill 28 places the burden on one sub-sector of the province to disproportionately contribute to deficit reduction.

Budget 2016/17 indexed personal income tax brackets and the basic personal amount to inflation. The indexing of the lowest tax bracket and basic personal amount, will result in a $34.1M reduction in government revenue in 2017/18. This amount will increase over the next two years and is cumulative over time.

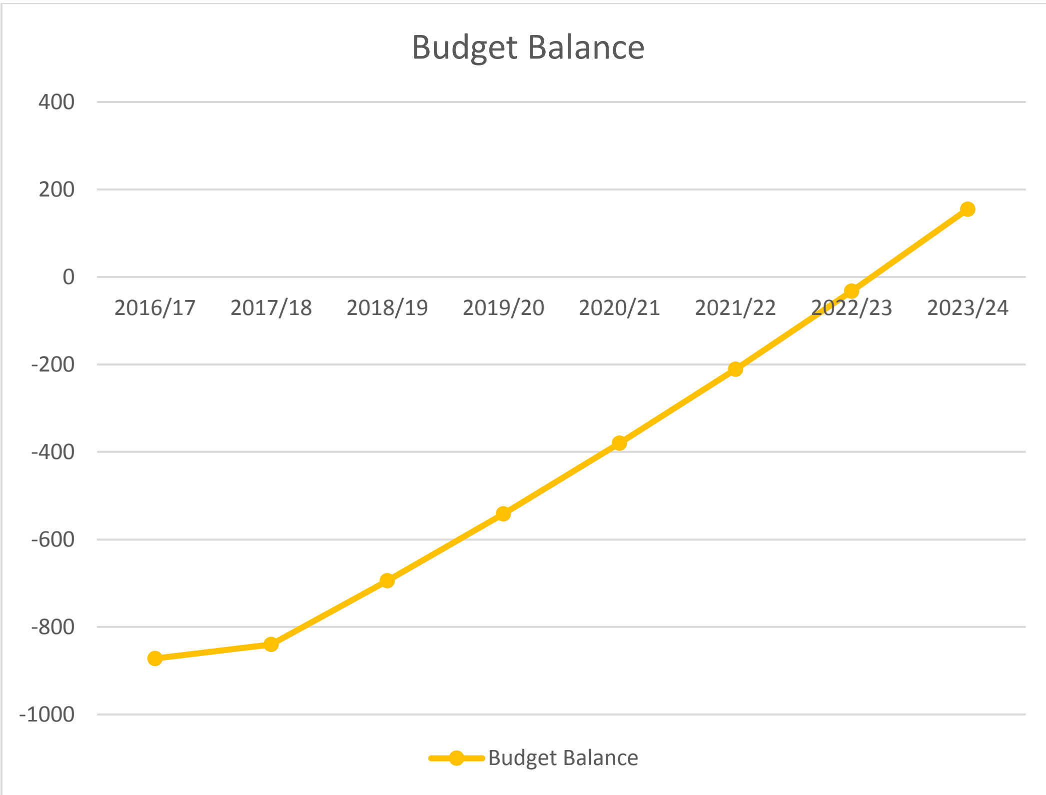
While there are many good reasons to index tax brackets to inflation, tax cuts do add to the deficit in the short run.

Raising the annual political contribution credit from $650 to $1,000, will add to the deficit. While the amount is not large, it does reduce future government revenue.

By 2019/20 the government will have reduced revenue by $170M as a result of policies to index personal income tax brackets and basic personal amount to inflation, add to the fiscal stabilization fund and increase the political contribution credit. Without these measures the deficit would fall to $379M from $549M or just 0.57% of GDP.

Rolling back the 1% PST increase will further, hamper the ability of the government to balance the budget. A 1% decrease in the PST will reduce provincial government revenue by approximately $350M. This is more than the entire reduction in the deficit, $323M, projected to occur between 2016/17 and 2019/20.

The current government estimates of 3% growth in revenue and 2% growth in expenditures, all else equal, will result in a balanced budget for Manitoba in 2023. This includes government contributions to the Fiscal Stabilization Fund and indexing of tax brackets to inflation. Further, no allowance has been made for potential (currently unbudgeted) revenue reductions (e.g. PST rollback) or increases (e.g. new revenue from carbon pricing, regulated marijuana sales, or federal transfers).



Conclusion

Manitoba is on path to balance the provincial budget within the next seven years. The provincial deficit remains manageable and is comparable to other jurisdictions in Canada. Debt servicing costs represent only 5.7% of government expenditures. The 2017/18 budget incorporates modest rates of growth for both real GDP and government revenue. The rate of growth is below the average growth rates in Manitoba over the past five years. If revenue rises as predicted in the budget, the government will have to hold the line on spending increases to 2% per year. Tax cuts, contributions to the fiscal stabilization fund, and an increase in the political contribution credit are reducing revenue and driving up the deficit. Rolling back the PST would further exacerbate the ability of the provincial government to balance the budget. It is not possible to estimate the impact of Bill 28 on provincial government finances or the deficit at this time. Tax cuts, higher tax credits and contributions to the fiscal stabilization fund however, have a combined negative impact on the deficit that is several times larger than a 1% increase in public service salaries. Finally, unless offset by other new revenues or expenditure reductions, rolling back the PST will exacerbate the government's deficit and delay a return to budget balance.

Appendix

Budget Revenue and Expenditures

Budget 2016/17 indexed personal income tax brackets and basic personal amount to inflation. While this tax measure lessens the tax burden on lower income Manitobans, it results in a $34.1M reduction in government revenue. Together with the extension of Manufacturing Investment Tax Credit of $38.8M, the government must find significant new sources of revenue to offset these measures. It is important to note that these tax measures are cumulative and apply to future budgets.

Budget 2017/18 provided a series of tax measures to offset the indexing of personal income and extension of other tax credits. The tax cuts introduced in the 2016/17 budget have been offset through the removal of a series of tax credits and the reduction in the value of some tax credits. Specifically, the following summarizes the tax measures in the 2017/18 budget:

Personal Taxes:

- Personal income tax brackets and basic personal amount are indexed to inflation.
- Tuition income tax rebate phased out. In 2017 cap is $500 and zero in 2018 and beyond. Eliminated for tuition after April 2017
- Annual caregiver tax credit capped at $1400
- **Political contribution annual credit raised from $650 to $1,000.**

Business Taxes

- Research and Development Tax credit lowered to 15% from 20%
- Manufacturing Investment Tax Credit reduced from 10% to 9%
- Mineral Exploration Tax Credit extended to Dec. 31, 2020
- Interactive Digital Media Tax Credit extended to Dec. 31, 2022
- Crowns and Government entities no longer eligible for paid work experience tax credit

The following tax credits are eliminated for contributions or expenditures after April 11, 2017:

- Cooperative development tax credit
- Odour control tax credit
- Nutrient management tax credit

The following tax credits are eliminated immediately (no data on revenue loss):

- Riparian tax credit
- Neighborhoods Alive tax credit
- Data processing investment tax credits

The net effect of all the tax changes results in $13.2 increase in government revenue on an annualized basis.

2017/18 Revenue Changes

The Budget projects that revenue will increase by $626 million, 4.0%, from 2016/17. This is based on a projected of 2% real growth in GDP, equivalent to the average forecast of the five major Canadian Banks. The sources of the revenue increases are as follows:

Income tax revenue + $326 million

- +$312 million individual income tax revenue
- +$14 million corporation income tax
- Other tax revenue +$101 million, or 2.3%, (mostly sales tax and corporation taxes)
- Fees and other revenue +$87 million, or 3.9%
- Federal transfers +$55 million, or 1.3%.
- Net income of Government Business Enterprises +$31 million, or 4.6%.
- Sinking funds and other earnings +$26 million.

2017/18 Expenditure Changes

The budget projects that expenditures will increase by +$520 million, +3.1%, from 2016/17.

Expenditure Increases by Major Area:
Health expenditure +$177 million, 2.7%
Education expenditure +$119 million, 2.8%
Families +$122 million, 6.0%
Community, economic and resource development +$10 million, 0.7%
Justice and other expenditure sectors + $12 million, 0.9%
Debt servicing +$80 million
Executive Council -6%
Growth Enterprise and Trade, -$4 million, -4.2%
Indigenous and Municipal Relations -$7 million, -1.4%
Sport, Culture and Heritage -$1 million, -4.5%
Sustainable Development -$1 million, -0.3%
Fiscal Stabilization Fund, $10 million

Policy Measures in Budget

To control expenditures the Government is introducing Bill 28, *The Public Services Sustainability Act*. Budget estimates that each 1% increase implies a $100M in wage settlements across the "broader public service." The Budget is silent on the impact of Bill 28 on government expenditures and the deficit.

To manage regulatory requirements Bill 22, *The Regulatory Accountability Act* introduced. According to the Act "(a) until the fiscal year ending March 31, 2021, eliminate at least two regulatory requirements for each regulatory requirement implemented during the fiscal year;

(b) beginning with the fiscal year commencing on April 1, 2021, eliminate at least one regulatory requirement for each regulatory requirement implemented during the fiscal year".

To control government spending and deficits the government introduced Bill 21, *Fiscal Responsibility and Taxpayer Protection Act*. The Act requires government to run a smaller deficit than in the previous year.

Overall Assessment of Summary Deficit and Budget Balance

2016/17 Summary Deficit below projected $872M versus $1,004M

2017/18 Summary Deficit projected at $840M (MFL projection $819M)
- $10M to Fiscal Stabilization Fund

2018/19 Summary Deficit projected at $698M (MFL $701M)
- Revenue growth 3%
- Expenditure growth 1.94%
- $50M to Fiscal Stabilization Fund

2019/20 Summary Deficit projected at $549M (MFL $574M)
- Revenue growth 3%
- Expenditure growth 2%
- $50M to Fiscal Stabilization Fund

GDP Growth and Deficit to GDP

Based on a modest 2% growth in GDP per year the deficit to GDP will fall from 1.4% to 0.86% in 2019/20. Without the contribution to the Fiscal Stabilization Fund this could be as low as 0.7% in 2019/20.

2016/17 14% Real GDP, 2% Nominal GDP
- Summary Deficit to GDP 1.4%

2017/18 2% Real GDP, 3.6% Nominal GDP
- Summary Deficit to GDP 1.37%

2018/19 2% Real GDP, 3.8% Nominal GDP
- Summary Deficit to GDP 1.11%

2019/20 Estimate 2% Real GDP
- Summary Deficit to GDP 0.86%