

# State of the NL Economy and Budget 2016

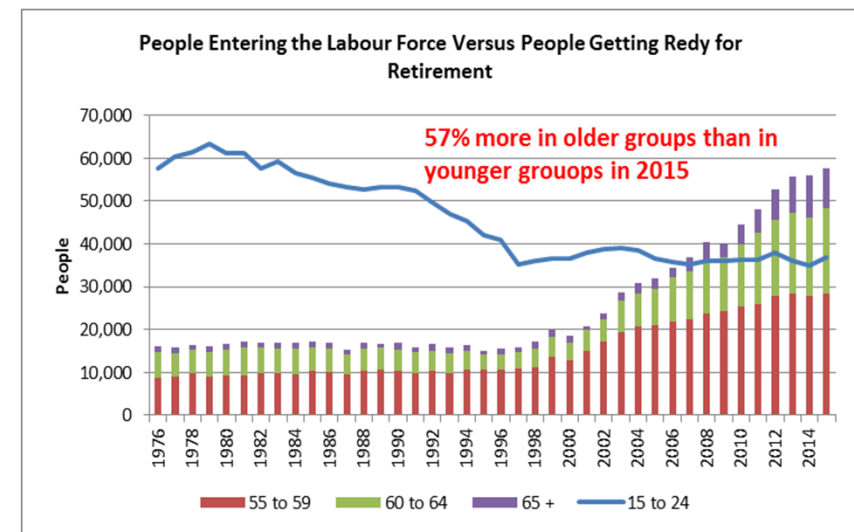
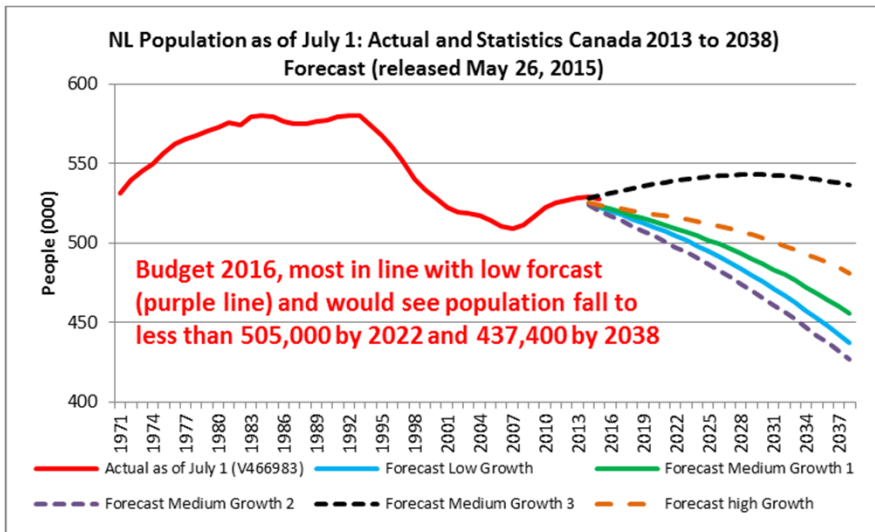
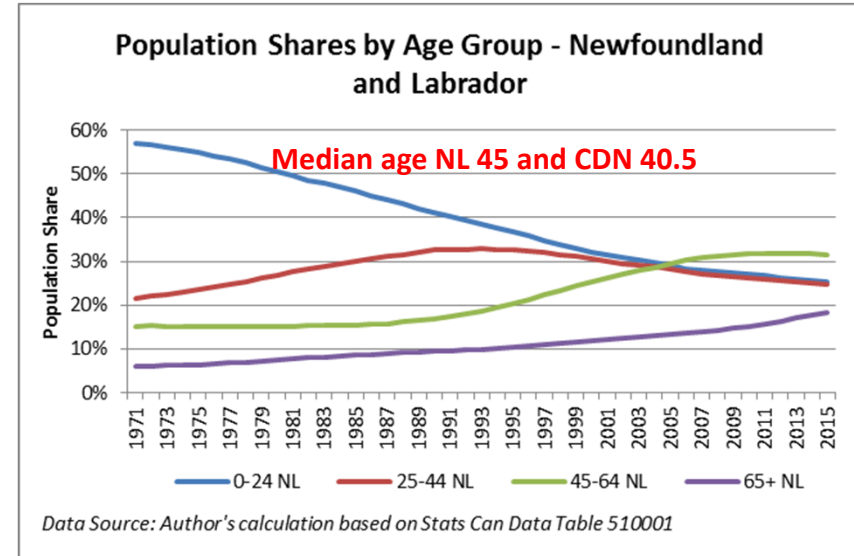
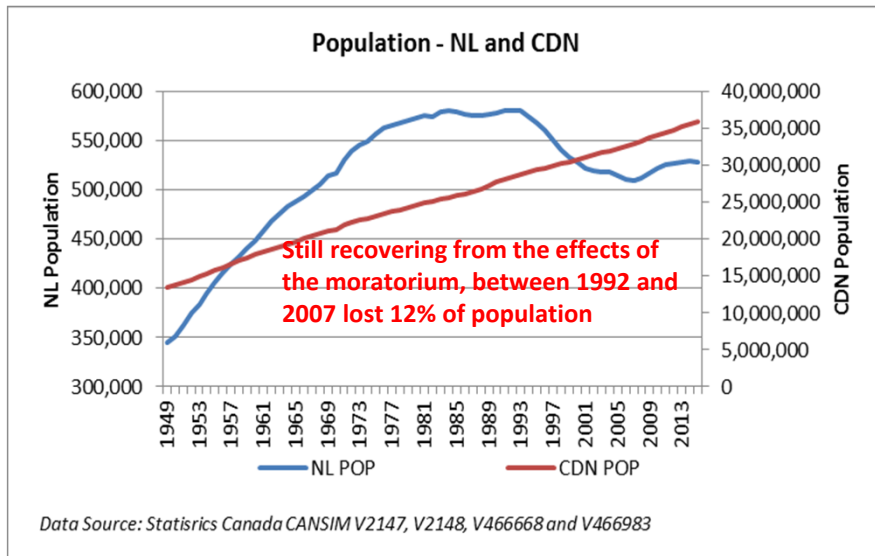
A presentation to the Rotary Club of St. John's East

Wade Locke

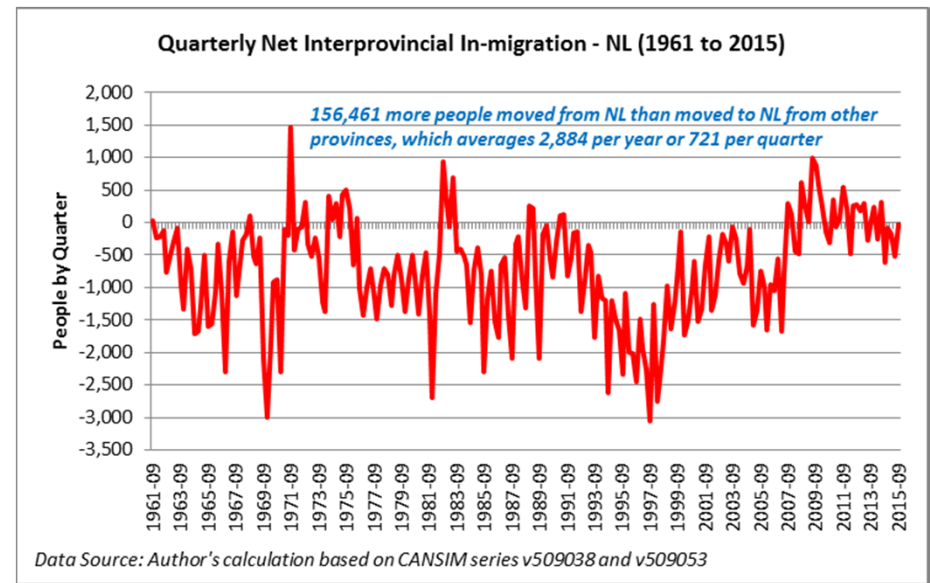
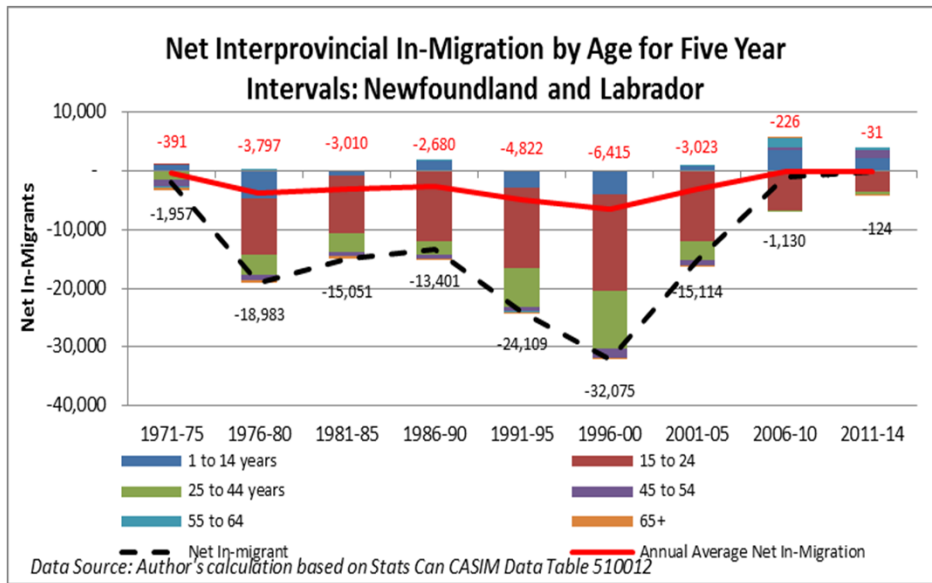
Department of Economics, Memorial University

Friday, May 13, 2016

# Demographic Time Bomb: Declining and Aging Population



# Net In-Migration by Age Group

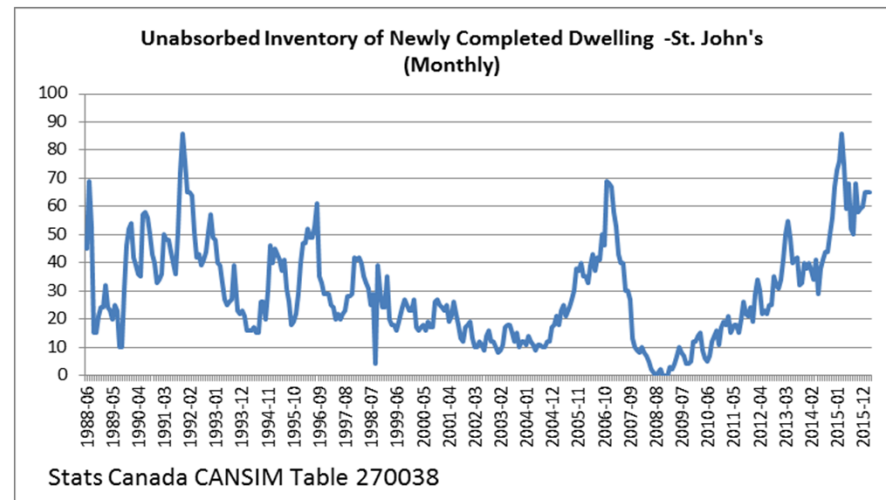
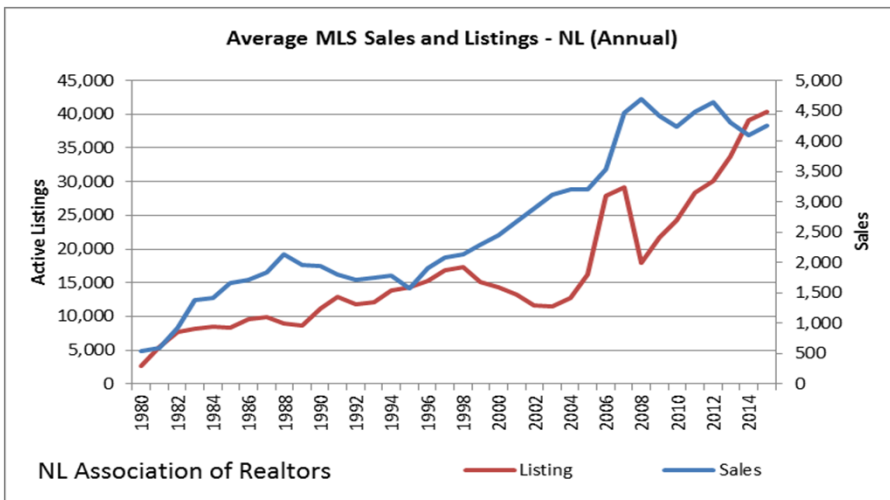
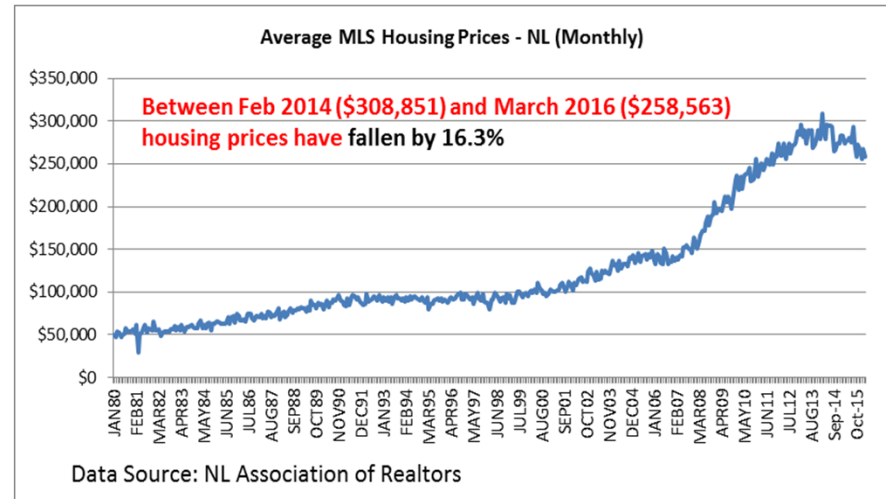
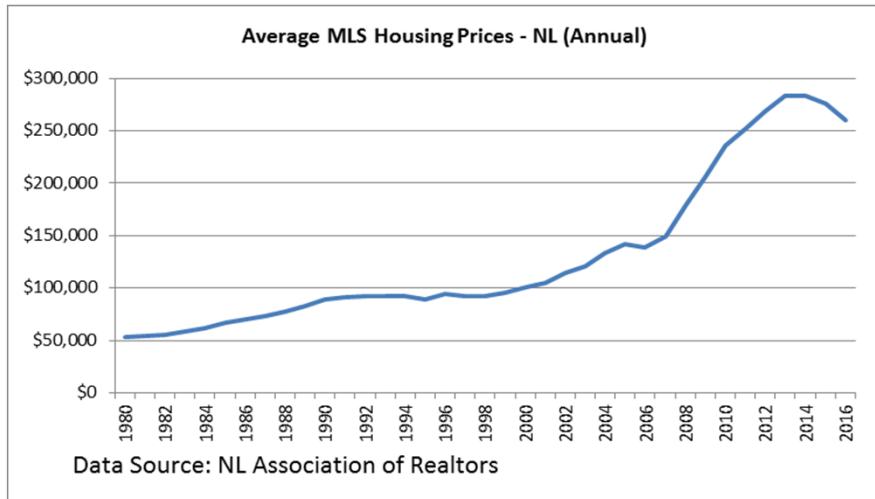


Between 1961 and 2015, 156,461 more people left NL than moved to NL from other provinces, which average 2,880 per year or 720 per quarter

After the moratorium, we lost a lot of young people who would be of child bearing age currently

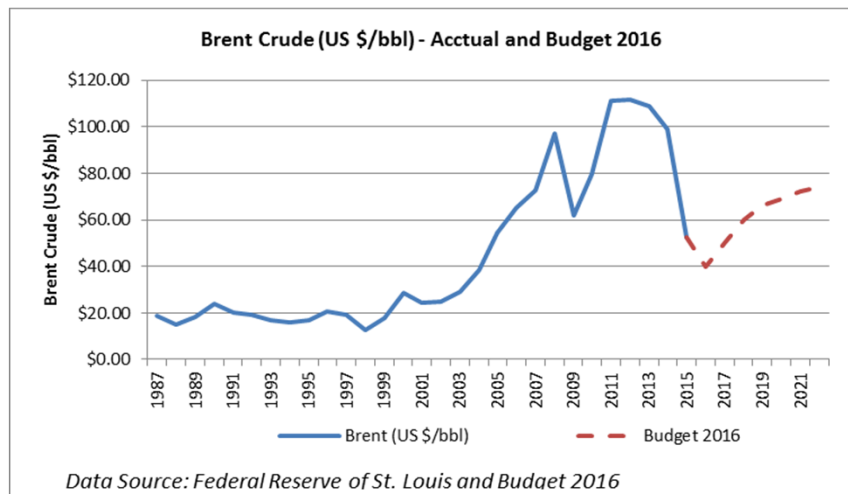
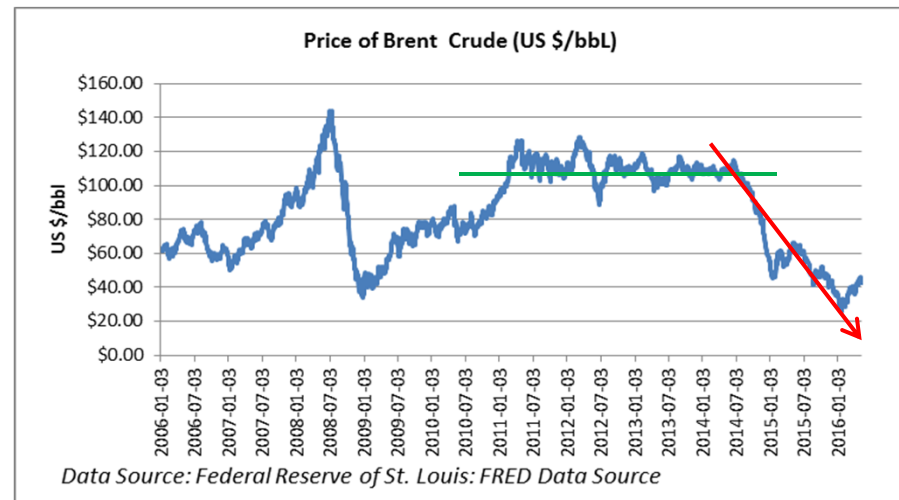
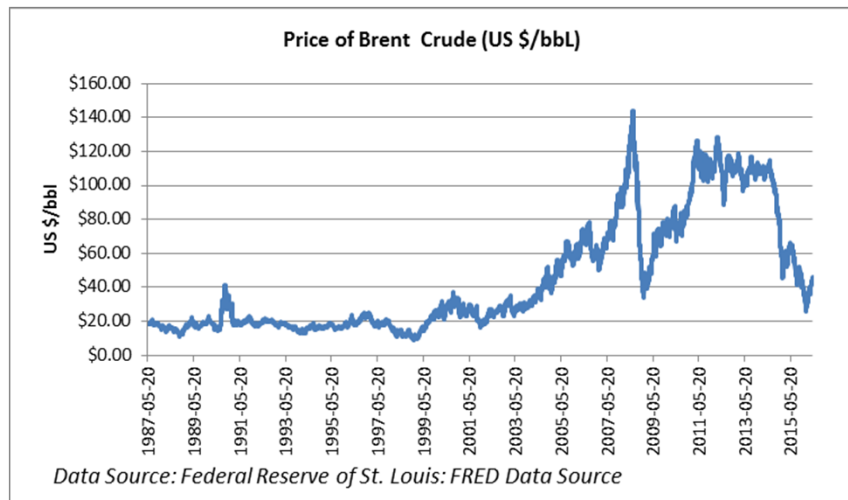
Unless this trends turns around dramatically (so that 2,800 people per year moved to the province), we should expect a lower population within the province for years to come

# NL Housing Market



**Aging population, lower employment, higher taxes (including HST), lower expenditures and lower confidence do not bode well for the housing market**

# Oil Prices



**Between Jan 3/11 and Sept 4/14, the price averaged \$109.92 US/bbl**

**Between Sept 4/14 and May 9, 2016, the price averaged \$54.43 US/bbl**

**Prices are on an upward trend, the price assumptions in the budget are likely conservative and we will probably do better.**

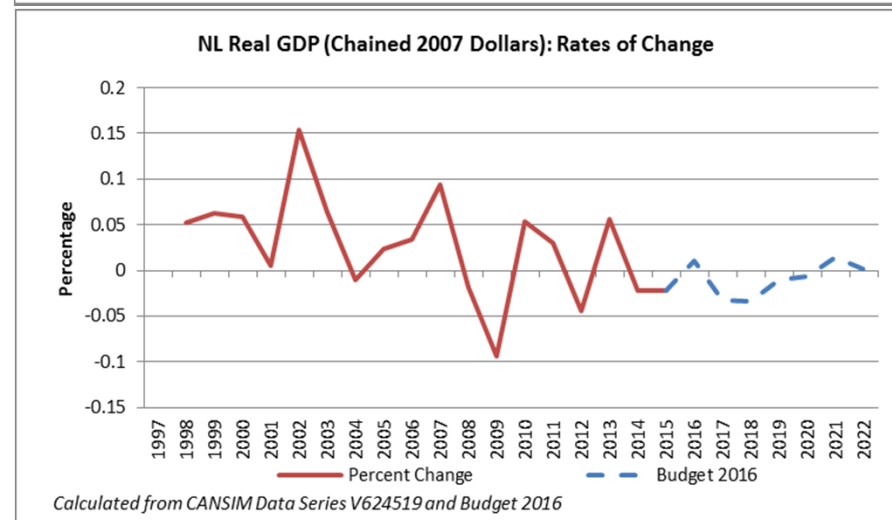
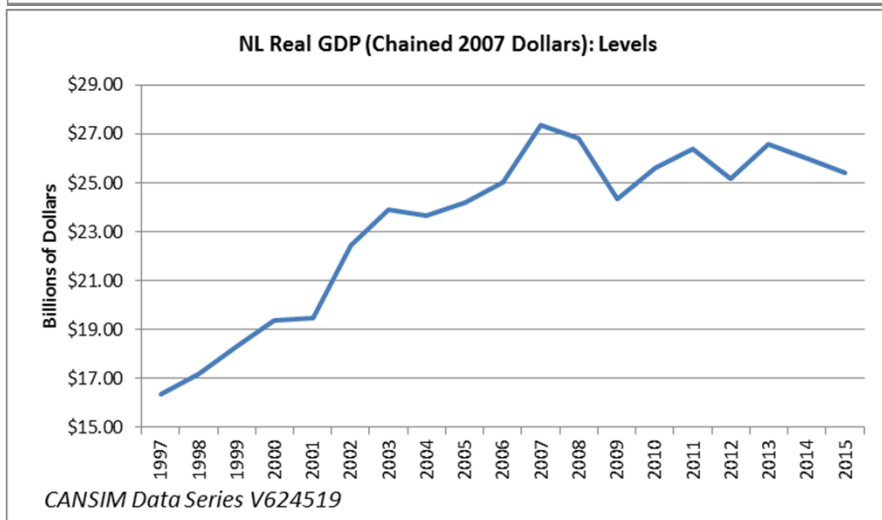
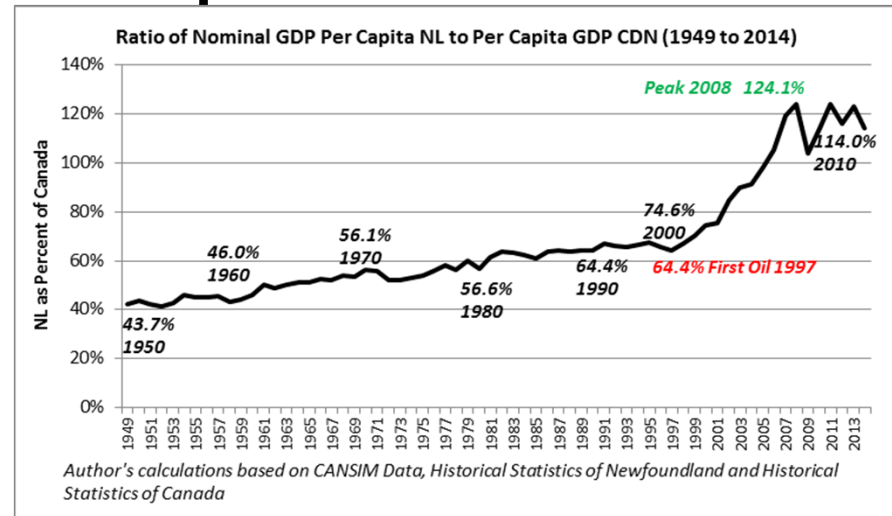
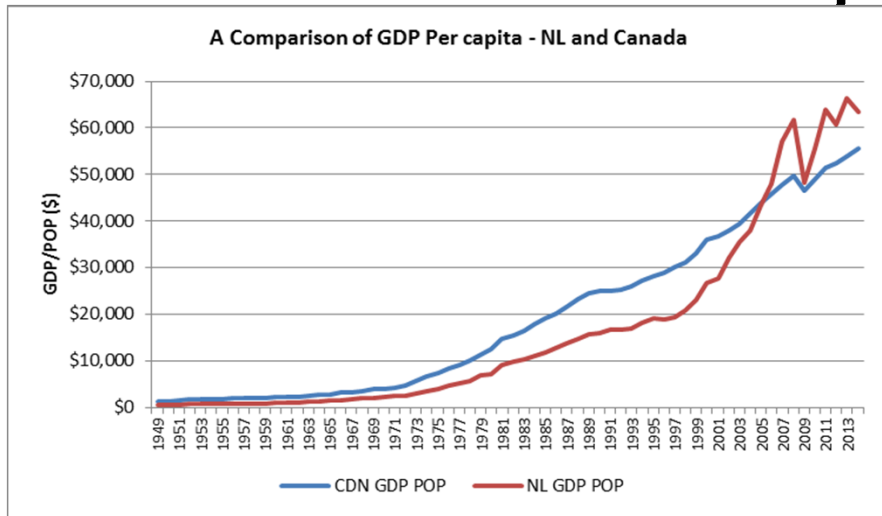
**However, this will do nothing to address the expenditure issue**

# Interesting Statistics – NL Offshore

Production (millions bbls) March 31 2016	1,604
Brent Price (US \$/bbl) average monthly	\$59.64
CDN/US \$	1.2446
US \$/CDN	0.8035
Value of Output (M \$ CDN)	\$115,000
Value of Output (M \$ US)	\$103,000
Cumulative Royalties to 2014-15	\$18,800
Investment (M \$ CDN) (to 2014)	\$45,551

- 1.60 billion barrels of oil produced (source: CNLOPB)
- \$18.8 billion in provincial royalties to 2015-16 (public accounts & prov budgets)
- \$45.6 billion invested in offshore (source: CNLOPB)
- \$115 billion in output produced (author's calculation)

# GDP per Capita

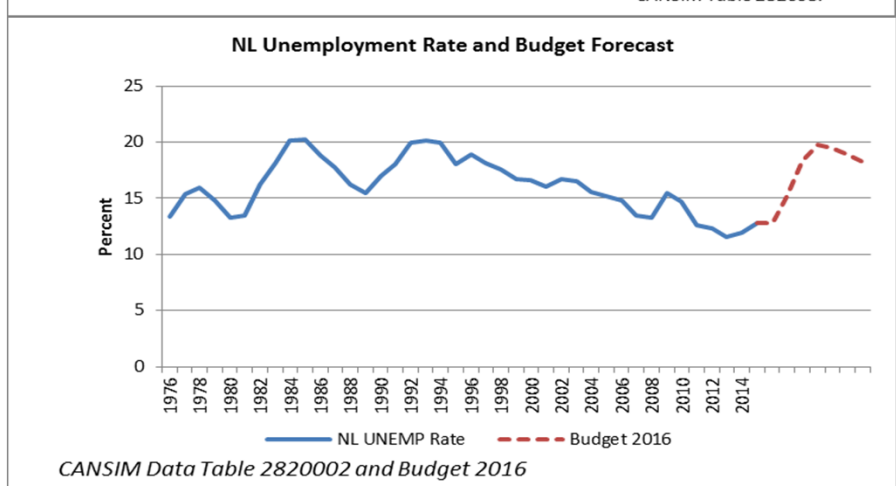
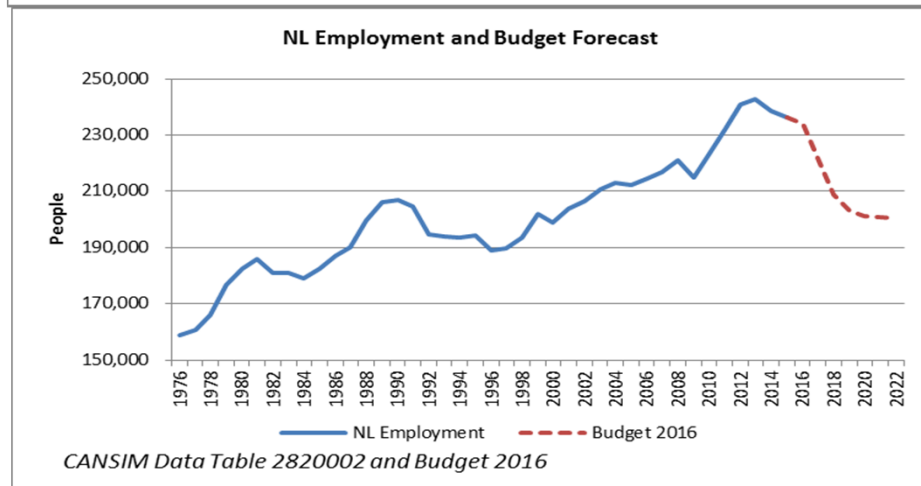
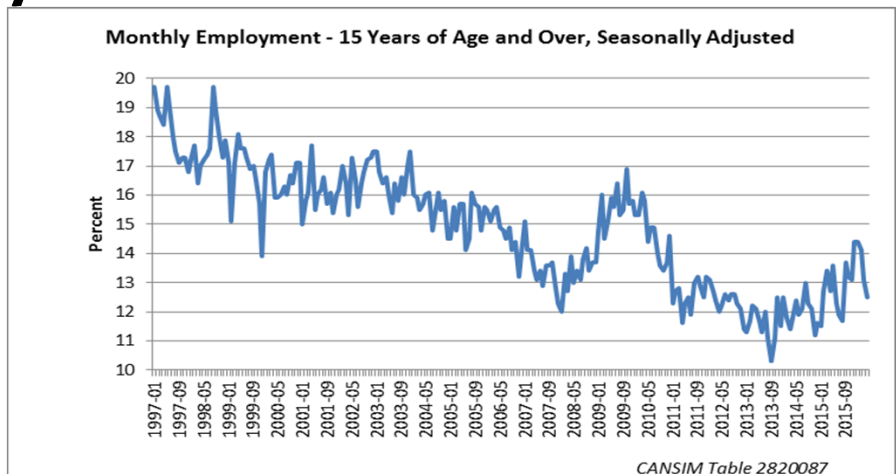
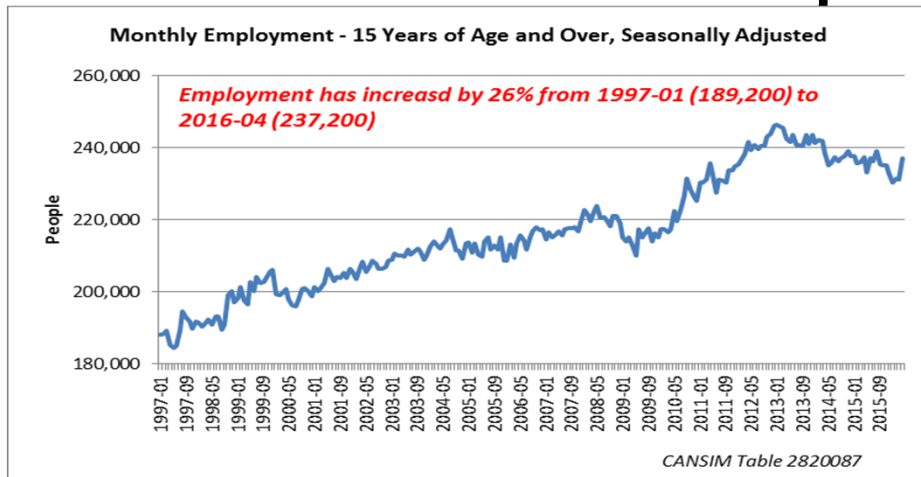


NL's absolute and relative position have improved over time.

We are starting to see the impacts of lower oil prices with two years of real decline in GDP

The budget is forecasting several years of negative growth

# Employment

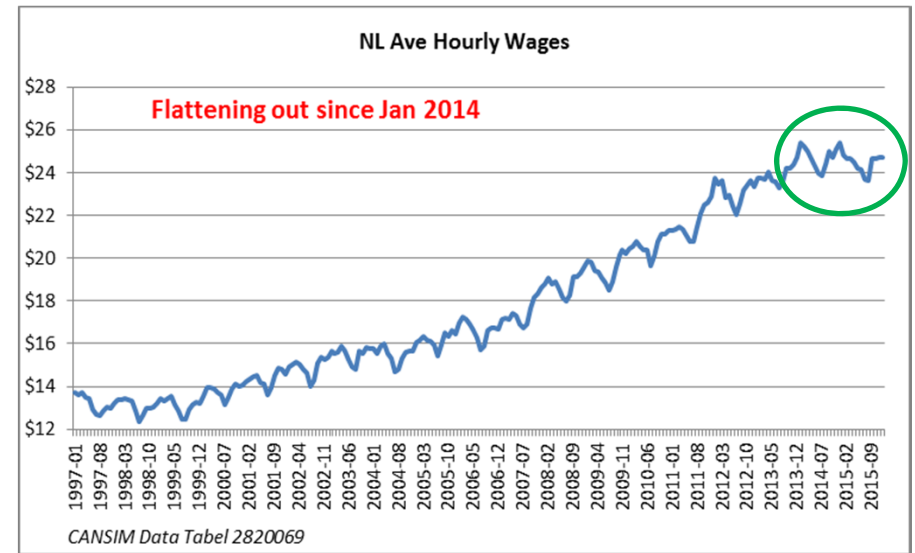
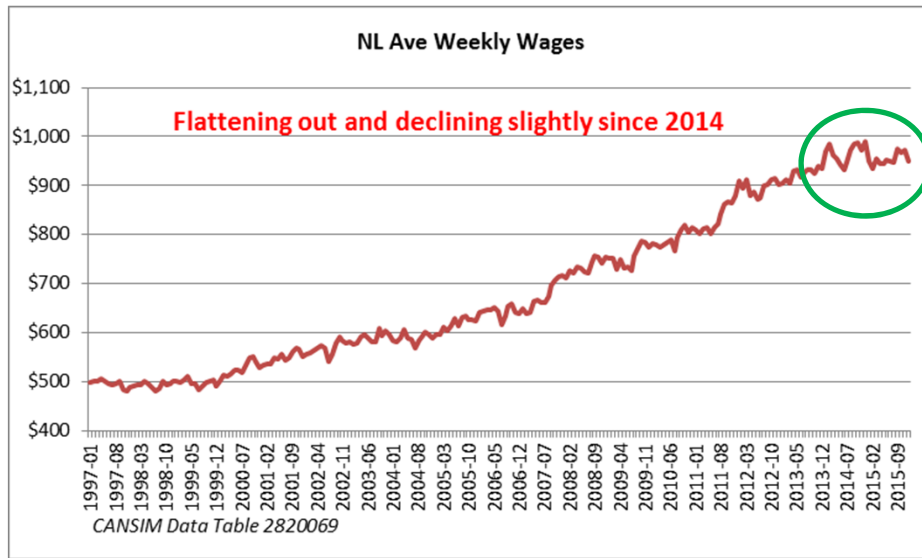


There is a noticeable decline in employment and a noticeable increase in the seasonally adjusted unemployment rate in the last three years, which pre-dates the fall in the price of oil. Hard to know how much of it is caused by oil price falls, but certainly some of the deterioration is due to a slow down in the oil economy

Significant deterioration in the labour market predicted in the budget for the next few years

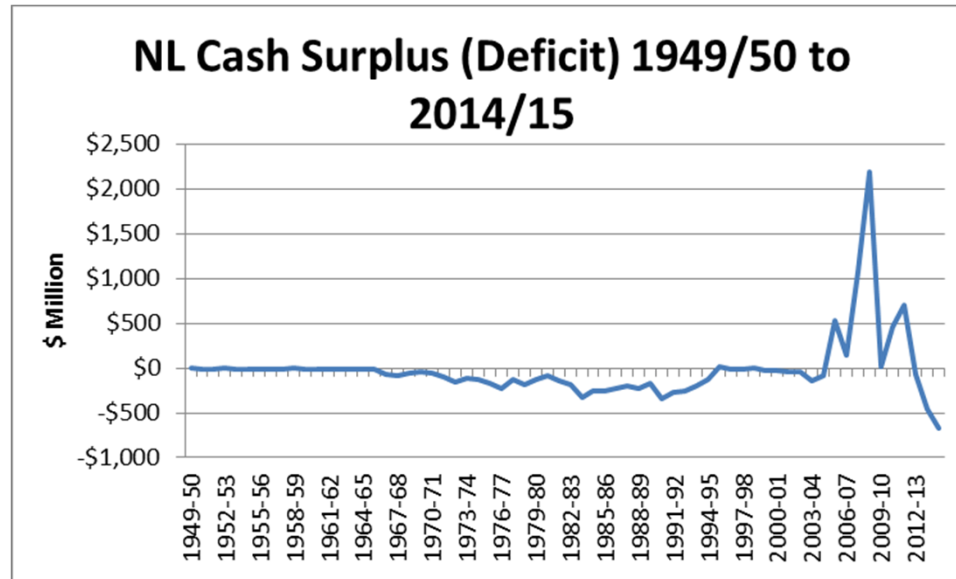


# Wages – NL Relative to CDN



**Wages starting to decline relative to CDN average and are flattening out in absolute terms. This will have implications for revenues measures introduced in the budget**

# Deficit – Longer Run



**Except for the period after 2006, NL was running deficits for every year except three. From 1949-50 to 2004-05, cumulative deficit was \$5.5 B**

**Clearly, the current deficit is not a new phenomenon, but the size of it is historic**

# Returning to Balance – Budget 2016

## 7 Year Forecast

### Fiscal Outlook (\$ millions)

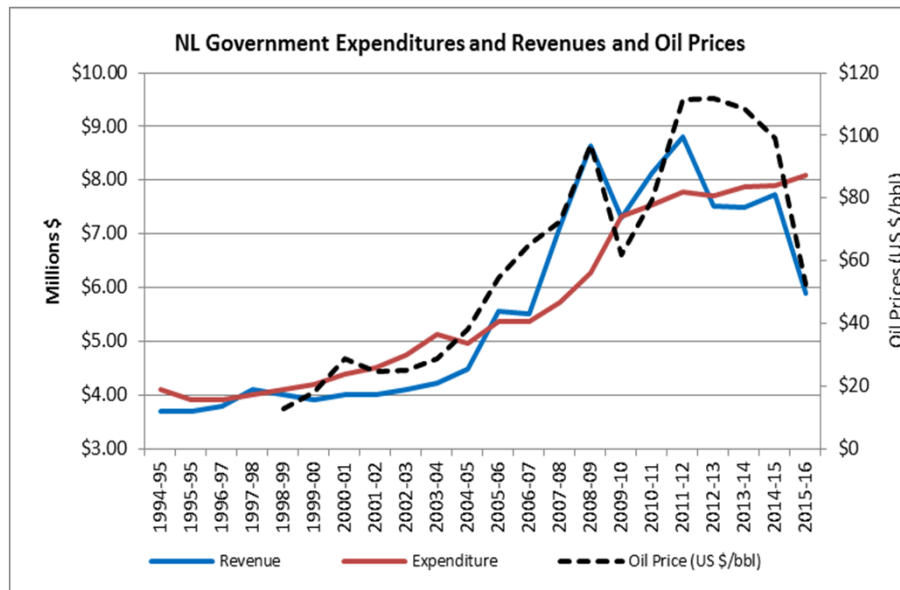
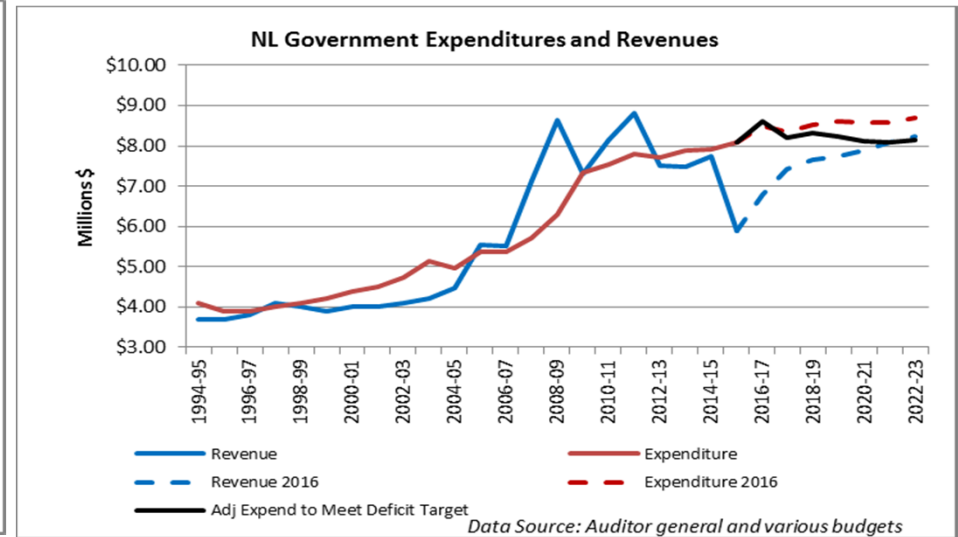
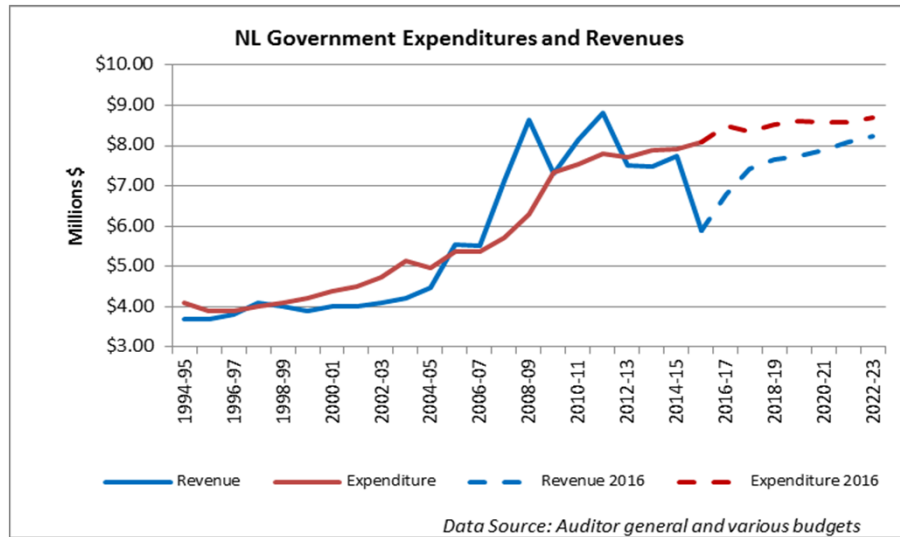
	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23
Total Gross Revenue	6,776.3	7,409.6	7,659.2	7,737.0	7,871.8	8,096.6	8,245.1
Gross Expenses:							
Program Expenses	7,499.0	7,307.3	7,390.3	7,432.5	7,406.7	7,362.9	7,397.7
Debt Servicing Expenses	982.3	1,033.5	1,125.2	1,166.7	1,181.8	1,229.1	1,283.1
Total Gross Expenses	8,481.3	8,340.8	8,515.5	8,599.2	8,588.5	8,592.0	8,680.8
Surplus/(Deficit)	(1,705.0)	(931.2)	(856.3)	(862.2)	(716.7)	(495.4)	(435.7)
Revenue Risk Adjustment	(125.0)	(125.0)	(125.0)	(125.0)	(125.0)	(125.0)	(125.0)
Adjusted Surplus/(Deficit)	(1,830.0)	(1,056.2)	(981.3)	(987.2)	(841.7)	(620.4)	(560.7)
Surplus/(Deficit) – Target	(1,830)	(800)	(650)	(500)	(250)	(0)	100

Presented on an Accrual Basis

Note: Adjusted Surplus/(Deficit) - Revenue Risk adjustment provides a contingency against revenue impacts encompassing potential commodity price fluctuations.

**To get to balance, \$1.3 B (\$8.1 B - \$6.8 B) in additional revenue to get to balance plus \$140 M (7.50 B - \$7.36 B) in indicated program reduction (1.8%) and another \$620 M in implied program expenditure cuts (8.3% reduction) for a total implied reduction on program expenditure of \$760 M (10.1% reduction) – if the revenue risk adjustment is ignored, program expenditure would still need to be reduced by \$635 M**

# Government Revenues and Expenditures



**Between 2004-05 and 2014-15, revenues increased by 73% and expenditures increased by 59%.**

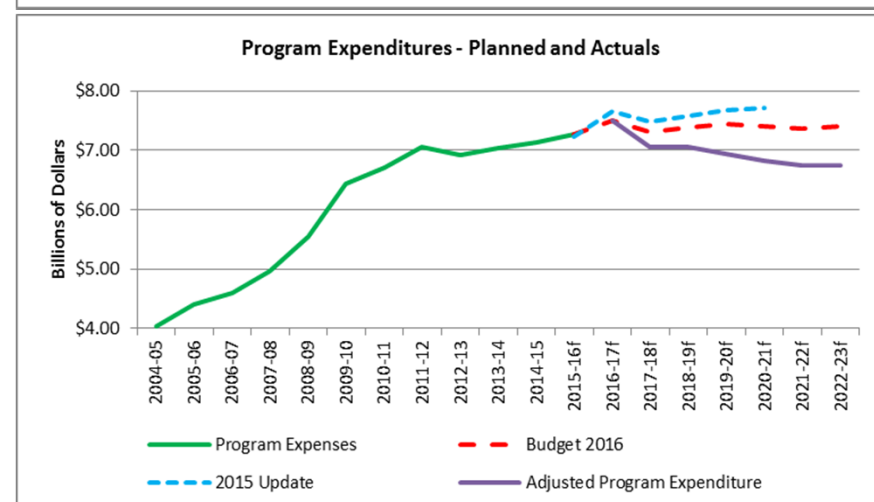
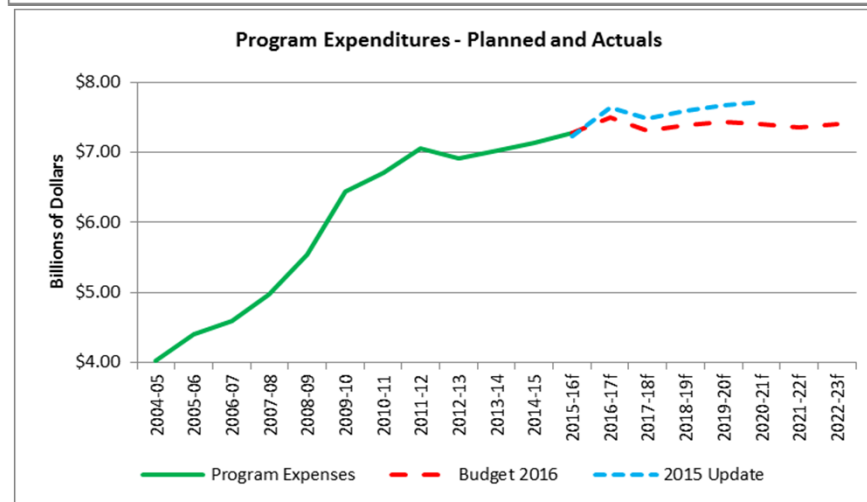
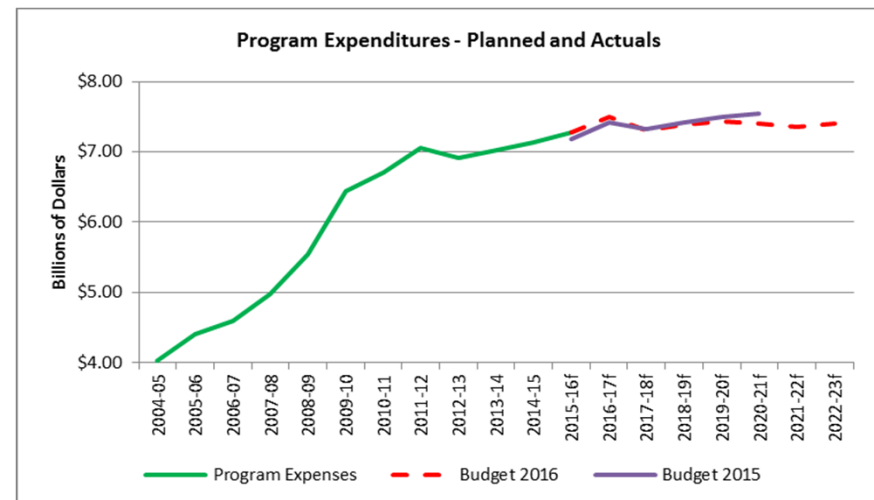
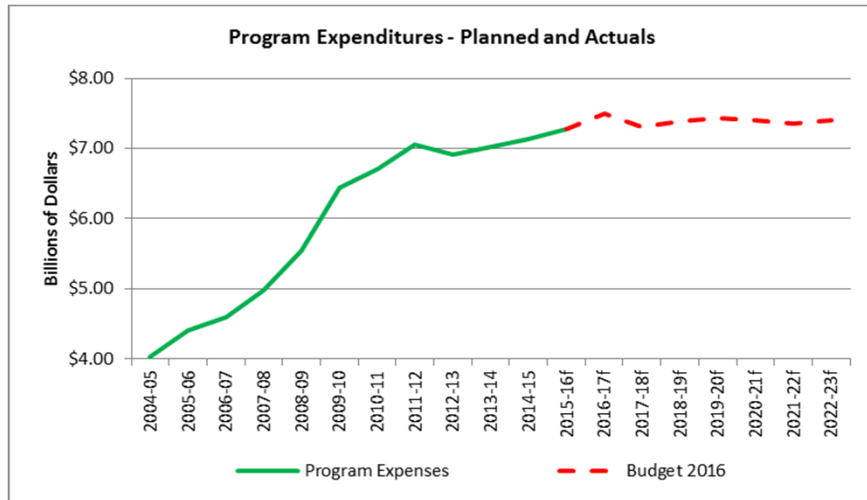
**Most of the heavy lifting in Budget 2016 is being done through assumed revenue increases, rather than expenditure cuts. However, if revenue is not sustained in the future, then we will be in the same spot as we are currently.**

**In 2012-13, production fell by 28%, causing value of oil produced to fall by 24% and revenues fell by \$1.3 B (\$8.8 B to \$7.5 B). The province ran a deficit of \$200 M, despite prices being approximately \$112 US/bbl.**

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**2012-13 was the year the Accord stopped as well.**

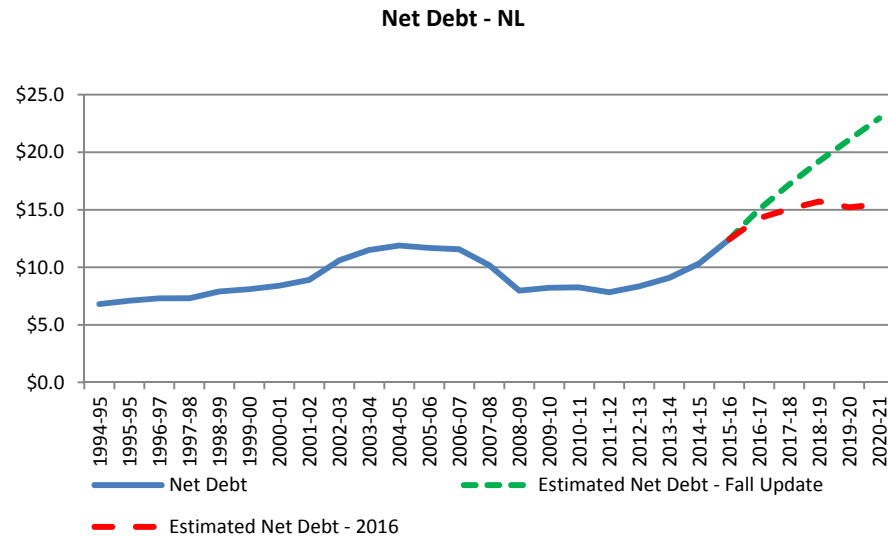
# Program Expenditures – A Closer Look



**To meet targets specified in budget, there will be substantial reductions in program expenditure and that is to simply holds us in place.**

**It does not really get at the bigger problem of higher expenditures than can only be sustained with elevated revenue levels.**

# Net Debt Government of NL



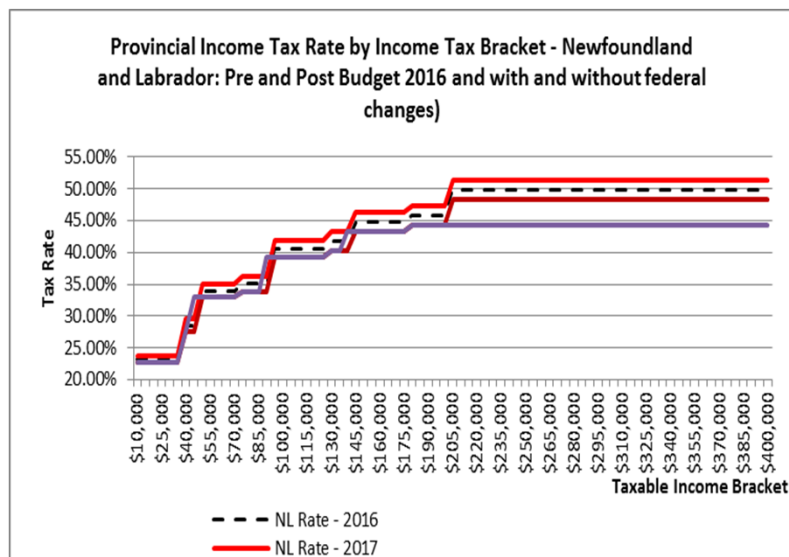
**Net debt has come down in recent years, but with lower oil prices, deficits are higher and net debt is rising.**

**The 2016 budget, if the targets are met, we will see a slowdown in debt accumulation; it will not see debt reduced.**

# The Budget: My Summary

- From 2015/16 to planned balance in 2021/22, the budget assumes an increase of revenue of \$2.2 B (\$882 M in 2016/17).
- Planned program expenditure is expected to increase by \$87 M and debt serving is expected to \$411 M.
- There would be a deficit of \$495 M and to that \$125 M in risk revenue would be added for an expected deficit of \$620 M.
- To meet the planned balance in 2021/22, this would have to come from additional revenue or reduced program expenditure.
- If it comes from program expenditure, then between 2016/17 and 2021/22, program expenditure would have to fall by \$760 M (i.e., \$7.5 B to \$6.7 B) or 10%.
- If the expenditure were made up by cutting people, then, utilizing an average wage of \$60,000, this would imply a reduction of 12,667 full-time equivalent jobs.
- Note, approximately 50% of program expenditures consists of wages and salaries and if that share were maintained for the implied reductions in program expenditures, then it would require a reduction in employment of 6,333 full-time equivalents, which is significantly more than 10% of the public sector employment in NL.
- While revenue could increase, there needs to be some explanation from where the additional \$2.8 to \$2.9 B (over 2015/16 levels) will come. It is not obvious what would be the source of additional revenue.

# PIT Changes



	NL Rate - 2016	NL Rate - 2017	NL Rate (pre-2016)	NL Rate (Old Fed Pre 2016)	Change from 2015 to 2017 (Prov and Fed)	Change from 2015 to 2017 (Prov only)	Change from 2015 to 2017 (Fed only)
\$30,000	23.20%	23.70%	22.70%	22.70%	1.00%	1.00%	0.00%
\$40,000	28.50%	29.50%	27.50%	27.50%	2.00%	2.00%	0.00%
\$50,000	34.00%	35.00%	34.50%	33.00%	0.50%	2.00%	-1.50%
\$100,000	40.55%	41.80%	39.30%	39.30%	2.50%	2.50%	0.00%
\$150,000	44.80%	46.30%	43.30%	43.30%	3.00%	3.00%	0.00%
\$200,000	45.80%	47.30%	44.30%	44.30%	3.00%	3.00%	0.00%
\$250,000	49.80%	51.30%	48.30%	44.30%	7.00%	3.00%	4.00%

The highest combined marginal rate is 15.8% higher than it was in 2015

- This is likely to lead to behavioral adjustments with a reduced revenue raising potential for the PIT changes

Expected to raise an addition \$204 M from PIT changes

Deficit level is estimated to raise \$125 M per year (annualized)

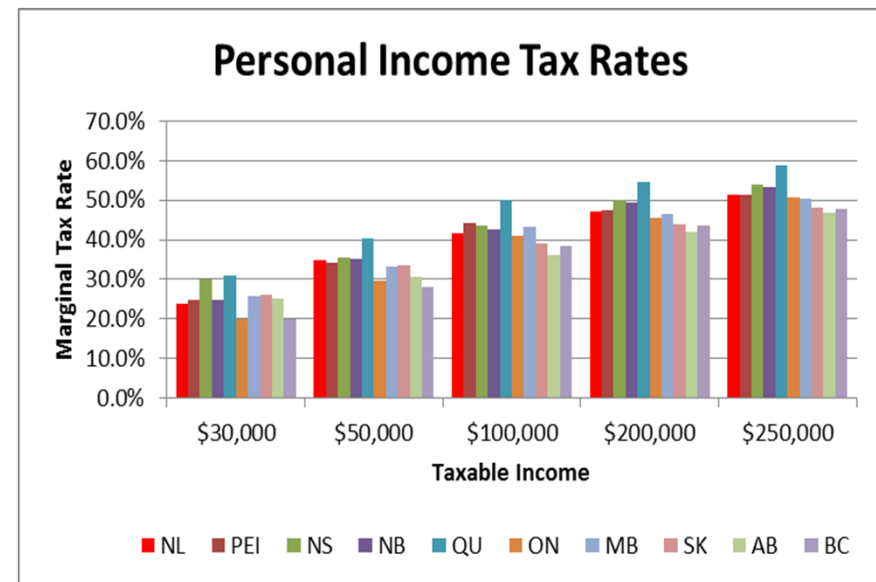
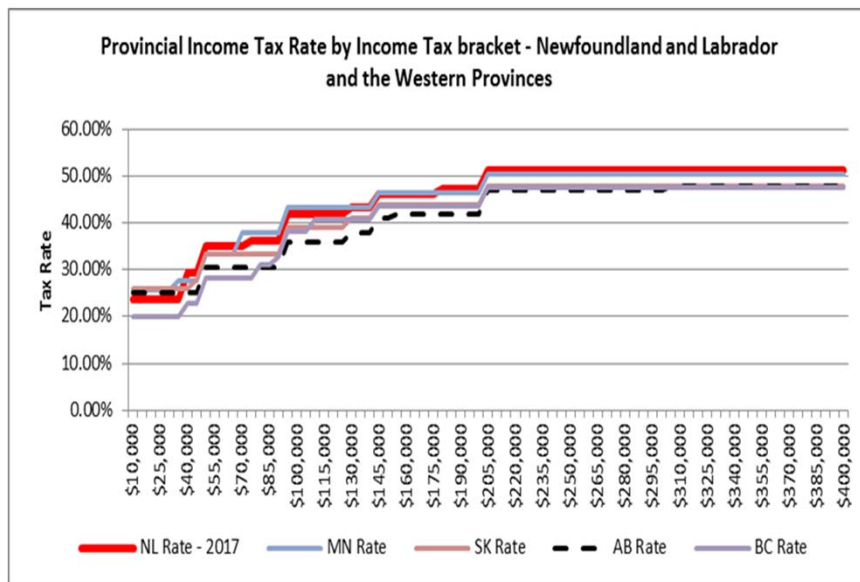
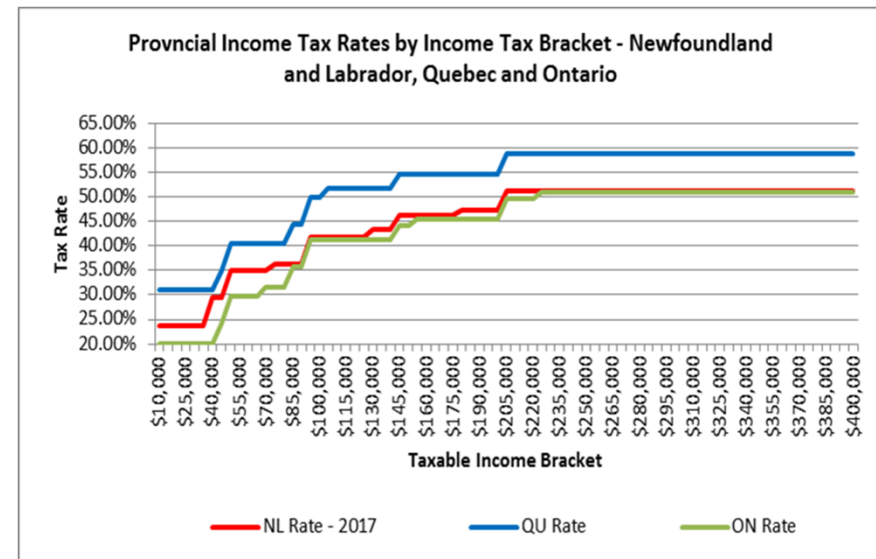
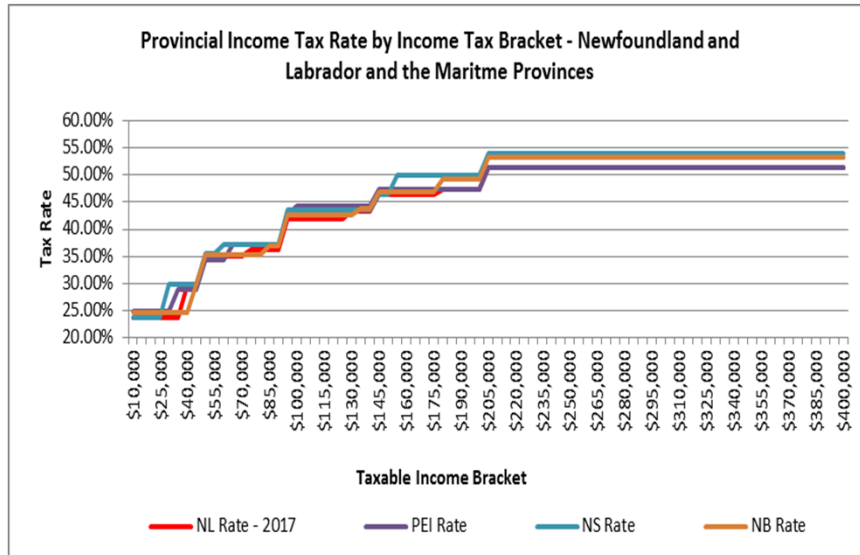
A 10% surtax PIT would have raise approximately \$150 M and may have been more acceptable than the levy

- at the top bracket, the marginal rate would have been 51.6% rather than 51.3%

Taxable Income	Deficit Reduction Level
<20,000	0
20,000 to 25,000	\$0.1 to \$300
25,001 to 36,000	\$300
36,001 to 38,500	\$300.01 to \$450
38,501 to 47,000	\$450
47,001 to 49,500	\$450.01 to \$600
49,501 to 72,000	\$600
72,001 to 74,500	\$600.01 to \$750
74,501 to 200,000	\$750
200,001 to 202,500	\$750.01 to \$900
>202,500	\$900

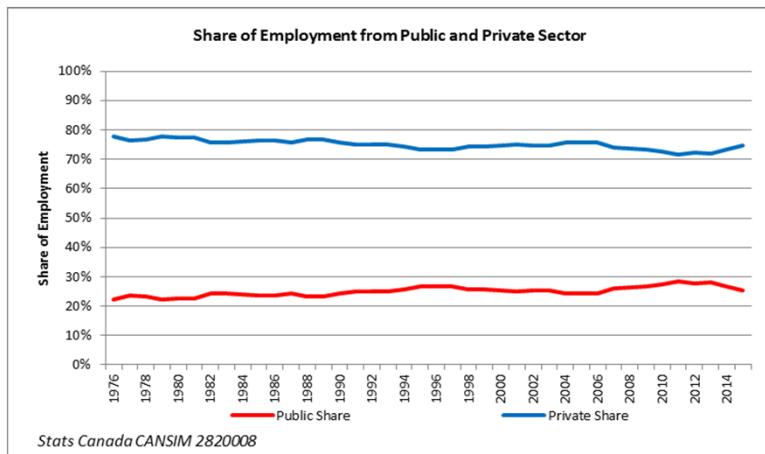
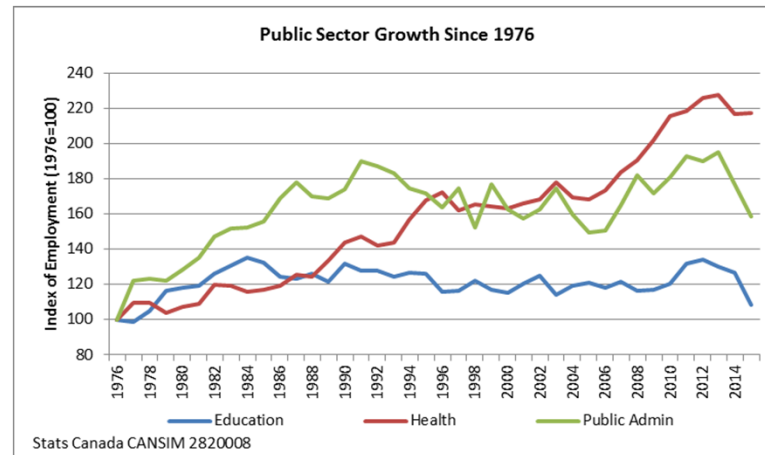
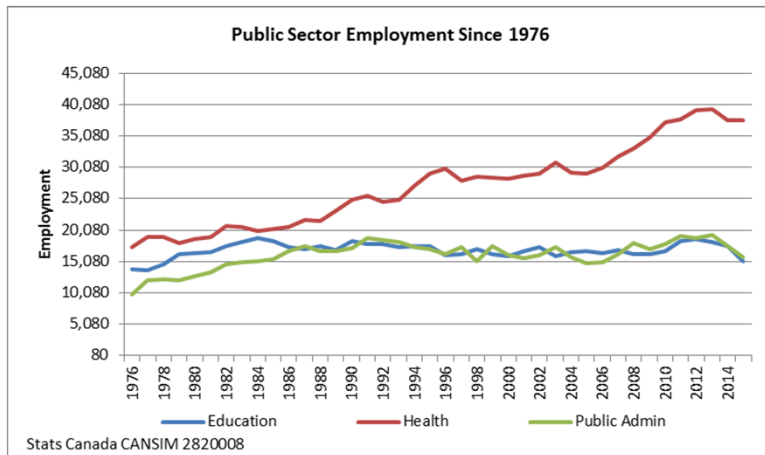


# PIT – NL and Other Provinces



**NL is now in the middle of the pack on PIT for taxable income brackets**

# Employment



**Education grew by 9% from 1976 to 2015, public administration grew by 59% but health grew by 117%**

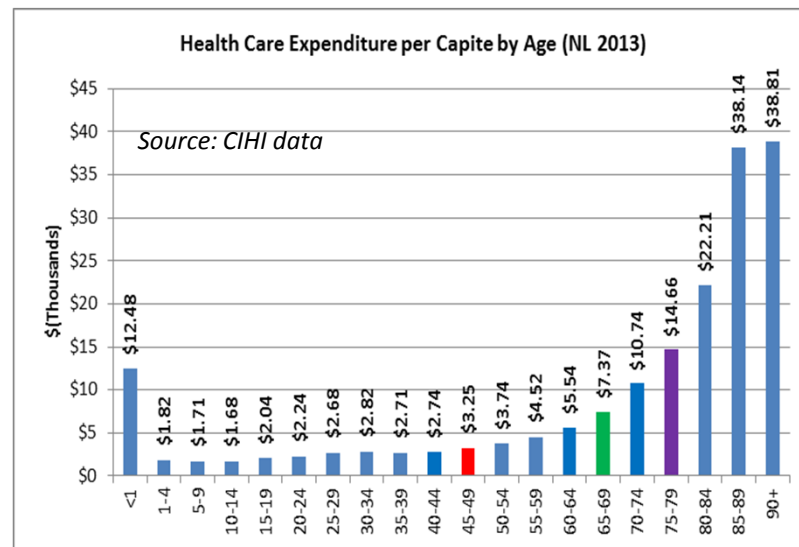
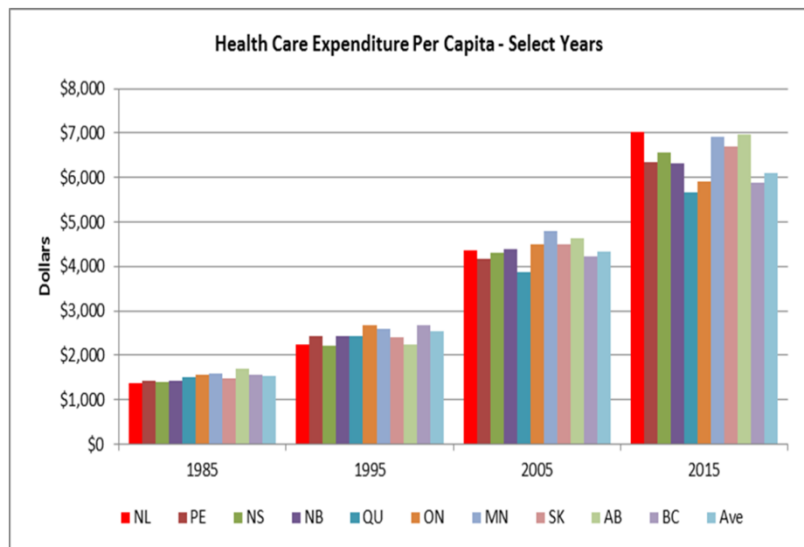
**While employment in the health care sector has grown noticeably, public administration and education have not grown significantly in the last 20 years.**

**In fact, employment in education and public administration has declined in last two years.**

**As a share of total employment, the public sector has been relatively constant**

- 26.7% in 1996, 24.2% in 2005 and 25.3% in 2015

# Per Capita Expenditure on Health Care – NL (2013)



An aging population would normally be expected to put more pressure on health care costs

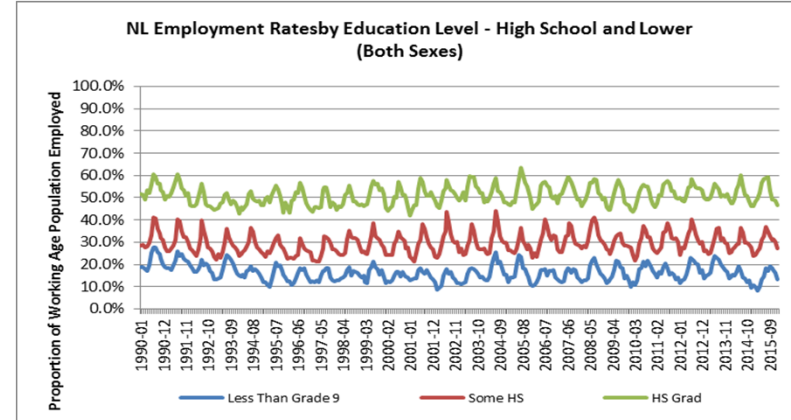
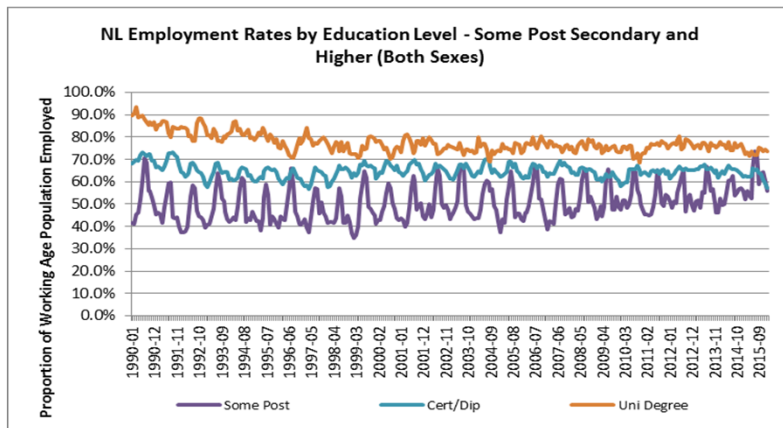
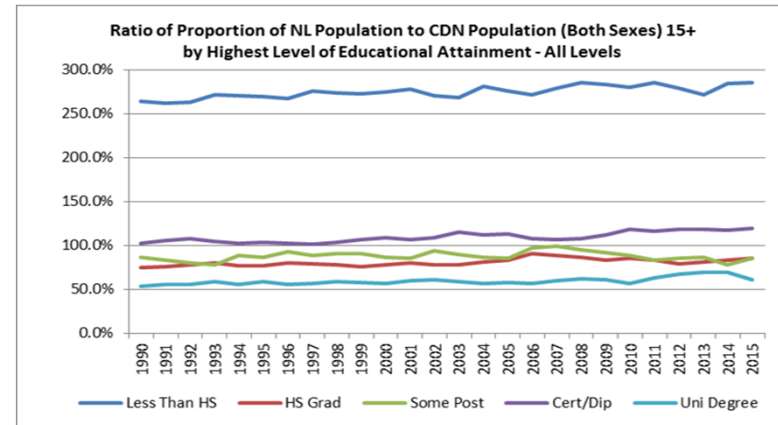
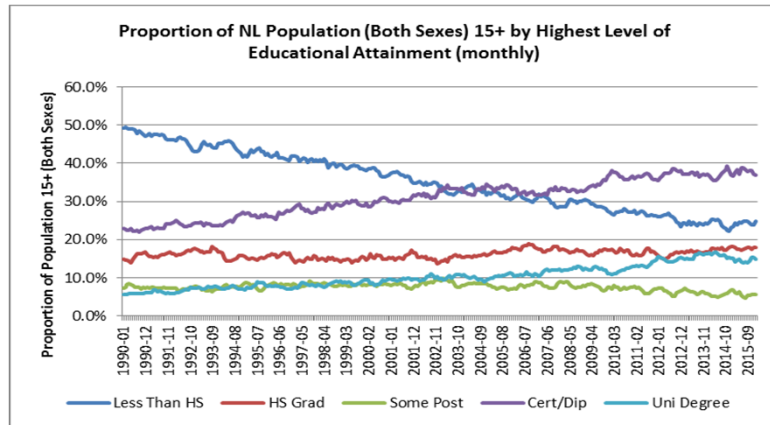
On average, it costs NL \$5,061 per capita for health care costs

If no other cost drivers change (doctor's salaries, cost of band aids, etc.), then in 20 years the median age (currently 45 years) person's health cost will more than double and will nearly double yet again in another 10 years after that

Health care is so important to Newfoundlanders and Labradorians and is the biggest expenditure in the budget (36% of expenditure on the Health Care Sector)

It is one of the most significant cost drivers for the government and it may be time to have a Royal Commission to look at all aspects of health care (funding, delivery, infrastructure and what we want and can pay for)

# Educational Attainment



NL has relatively higher proportion of our population with lower levels of educational attainment and this translates into higher unemployment rates and lower employment rates

Education is a real issue that has to be kept in mind in dealing with fiscal issues

# Conclusion

- While one can legitimately debate what the appropriate way is to deal with the fiscal problems we are now facing, there ought to be no debate that we are facing a serious problem.
- We have other problems – an aging and declining population, which will drive costs in the future
- However, the fiscal situation is a big problem that will have huge implications for the economy.
- It may be difficult to meet the deficit targets set in the budget; especially if there are behavioral responses to the elevated taxes.
- It is important to note that the targets, as ambitious as they maybe, only get us to a point where debt stops accumulating. It does not lower NL's indebtedness.
- It is equally important to recognize that the best way to deal with an expenditure problem is to address your expenditures directly.
- It is easy to be critical of how any particular person deals with a problem, but it is not helpful if there are no feasible alternatives offered. The problem belongs to all of us and we all need to share in the solution!

Thank you for listening