Manitoba

2013-2014 Budget Preview

As a think tank dedicated to improving the long-term prosperity of western Canada, the Canada West Foundation is paying close attention to the signals being sent by the region's provincial governments and the federal government in their 2013/14 budgets.

Western Canada is facing a number of challenges that governments must address including sluggish productivity growth, looming labour shortages, gaining access to new markets and enhancing the performance of the public sector. We need to be investing in the future, not just spending in the present.

Manitoba will be the last of the western provinces to release its 2013/2014 fiscal plan, with its budget to be tabled on April 16.

With the above challenges in mind, there are four areas we hope to see addressed in Tuesday's budget:

1) A balance between near-term deficit elimination and critical investments in long-term economic competitiveness.
2) Action to address current and future labour shortages.
3) Steps to improve value for money in government service delivery.
4) Tax reforms that remove impediments to growth.

Our post-budget analysis—available on April 17, 2013—will assess the degree to which the budget addresses these and other long-term strategic issues.

1

Fiscal Responsibility: Returning to budget balance in the near-term

Although the Manitoba economy emerged from the 2008-2009 recession relatively unscathed, the impact was enough that the provincial government saw its string of five consecutive budget surpluses evaporate.

In 2010, the province introduced a 5-year plan to return to fiscal balance by 2014/15. A year later, however, that plan went off the rails because of record floods in the southern portion of the province. An expected $448 million deficit in 2011/12 ballooned into a shortfall of almost $1 billion.

The 2012 budget included measures intended to get the province out of the red including efforts to secure spending efficiencies and indirect tax increases to help finance flood repairs and mitigation strategies.

Later in the year, however, the government began to soften its stance on the timing of deficit elimination. Mid-year estimates suggested that Manitoba's fiscal shortfall in 2012/13 would be larger than initially forecast due to slower-than-expected economic growth and unbudgeted program spending.

Balancing the budget is an important goal. From the perspective of intergenerational equity, it is essential that the province be on a sustainable fiscal path; a large debt burden effectively passes the cost of current and past spending onto future generations.

At the same time, a preoccupation with eliminating the deficit as soon as possible should not preclude taking important steps to improve Manitoba's long-term economic competitiveness such as productivity-enhancing infrastructure investments, additional flood-mitigation capital spending and measures to address water contamination.

These competing interests speak to the need for *balance* in Manitoba's approach to deficit elimination. It is critical that the province be on a sustainable fiscal footing in the medium-term. However, meeting an arbitrary deficit elimination deadline matters less than setting the province on a path to future prosperity.

It is prudent to eliminate the deficit in the near-term, but it is not necessary to do so by 2014/15 if it undermines economic competitiveness or requires delaying important infrastructure investments.

2

Addressing Labour Shortages: Acting now to meet current and future labour force needs

The need to address labour shortages has been a consistent theme in all of our provincial and federal budget analyses. In Manitoba, the need for skilled workers has been somewhat overshadowed by shortages in Alberta and Saskatchewan, but is no less present. Manitoba has one of the lowest unemployment rates in Canada and labour force participation is well above the national average. Moreover, as in other provinces, there is a growing mismatch between the skills students are acquiring in school and the skills employers actually need.

Manitoba faces two other challenges in labour force recruitment. First, the province typically loses a significant number of residents to other provinces. Over the past five years, there was a net outflow of nearly 17,500 Manitoba residents to other provinces. A disproportionate share was between the ages of 18 and 30.

Second, like other provinces, Manitoba faces the demographic challenge of an aging population and a baby boom generation poised to leave the labour force. Compounding this challenge is a large, young and fast-growing Aboriginal population that is relatively disengaged from the labour force.

The Manitoba government has recognized the need to address Aboriginal education and training as well as labour and skills shortages in general. In its recent *Speech from the Throne*, the province set a target of adding 75,000 workers to the labour pool by 2020 – an increase of 13% over present levels. This is to be achieved by focusing on four policy themes: excellence in education; apprenticeships and training in skilled trades; First Nations and Métis labour force development; and increasing immigration.

The Manitoba government has identified the most important areas where meaningful policy action could help address labour shortages in the province. The next step is to put the words into action.

Considering the importance of skilled labour to future economic growth in Manitoba, the budget should include concrete steps to address future labour shortages and skills training requirements. Particular emphasis should be placed on Aboriginal engagement in the labour force.

3

Tax Reform: Improving conditions for growth

A competitive business tax structure is critical to long-term economic growth. In recent years, Manitoba has taken some important steps in that direction. In 2012, it became the first province to eliminate its small business tax. A year later, it eliminated the general corporation capital tax for all businesses except banks, other lending institutions and Crown corporations.

Another step the province could take to further improve business competitiveness would be to phase out its payroll tax. Manitoba is one of the few remaining provinces that levies such a tax. Businesses with an annual payroll of less than $1.25 million are exempt from paying the Health and Post Secondary Education Tax Levy. However, if a business's payroll expands beyond $1.25 million, it becomes subject to the tax, which rises to 2.15% when a payroll exceeds $2.5 million.

There are two economic concerns about a payroll tax. The first is that it is an impediment to growth, effectively penalizing companies for adding workers or increasing salaries. This discourages investment, expansion and job creation. Second, companies must pay the tax regardless of whether they are profitable or not. This is an added challenge to companies that may wish to expand operations and take losses in the near-term in the hopes of longer-term gains.

In order to improve economic competitiveness in the province and remove an impediment to growth, Manitoba should phase out its payroll tax.

Another way for the Manitoba government to further improve business competitiveness would be to harmonize the provincial sales tax with the federal GST. A harmonized sales tax would do much to improve Manitoba's tax competitiveness vis-à-vis other provinces. It would reduce the overall tax burden businesses face (by no longer requiring business to pay the tax on the purchase of inputs) and lower administrative costs. The fact that consumers would bear a disproportionate burden as a result could be rectified by other tax measures.

Implementing a harmonized sales tax would take time and, as the BC experience has demonstrated, would require the support of Manitoba residents. The potential upside is significant, so at least starting a conversation about a harmonized regime makes sense.

Given that a harmonized sales tax would improve business competitiveness and help generate economic growth and investment, the Manitoba government should initiate steps to seriously consider introducing a harmonized system.

4

Getting Value for Money : Improving government performance

In proportion to its population, government spending in Manitoba is higher than almost anywhere else in the country. According to the Royal Bank of Canada, government spending in 2012/13 is estimated to be about $10,800 per person, second only to Newfoundland and Labrador. Moreover, per capita program spending in Manitoba has increased considerably – by 86% over the past decade. Again, only in Newfoundland and Labrador is that number higher. The provincial civil service has also been expanding rapidly in recent years, offsetting declines in the early 2000s.

Rapid expansion in the size of government is not necessarily a bad thing, provided that Manitobans are getting value for their money. The Manitoba government has taken steps in recent years to examine and improve the efficiency of government operations. Most recently, in the November 2012 *Speech from the Throne*, the government announced the following plans:

- to reduce the civil service by 600 over three years;
- to consolidate government offices to reduce costs and modernize services; and,
- to adopt best practices to reduce procurement costs across government.

The idea of efficient delivery of services is not an argument for or against a certain size of government. It is, however, important because when a government spends more than is necessary to deliver a certain level or type of service, this represents money not being saved for the future or foregone benefits today. As such, this focus on improving efficiency in Manitoba is welcome. It also complements efforts in the 2012 budget to find $128 million in administrative savings.

Another option that could yield widespread benefits would be for the government to conduct a review of existing government services. Such reviews are necessary from time to time to determine which programs are working well, which are redundant and which are no long needed.

The introduction of outcome-based performance measures and the consideration of best practices in other jurisdictions would help the Manitoba government ensure that its existing programs are necessary, effective and providing Manitobans with value for their money. The *Speech from the Throne* recognized the need for improved government efficiency. The 2013 budget should introduce specific measures to keep moving in this direction.

2012 Budget Review

Manitoba's 2012 budget was the first following the devastating floods that swept through the province. As noted above, Manitoba was beginning the third year of a five-year plan to return to budget balance by 2014/15. However, flood cleanup and repair costs drove the 2011/12 deficit to just under $1.0 billion, more than double the projected level from the previous year's budget.

In spite of this setback, the Manitoba government remained committed in the 2012 budget to its deficit-elimination target. To get back on track, the province implemented a broad series of small tax increases as well as some modest efforts at securing efficiencies in service delivery and containing expenditure growth in non-priority areas. All told, the 2012 budget called for a summary budget deficit of $460 million for 2012/13.

The 2012 budget projected revenues to grow by 0.3% in 2012/13. Revenue growth was expected to be modest largely because 2011/12 revenues were inflated by a spike in federal transfer payments to help deal with the flood. Removing federal transfers from the equation, Manitoba expected its own-source revenues to grow by 5.3% in 2012/13. To achieve these revenue growth objectives, the province chose to raise minor taxes and user fees while also reducing the number of goods and services that were exempt from the Provincial Sales Tax. Existing legislation prevents the province from increasing any major tax rate without first holding a referendum.

On the expenditure side, overall program spending was forecasted to decrease by 4.2% in 2012/13, reflecting the withdrawal of emergency flood-related spending measures. Health and education spending were budgeted to grow by 5.4% and 3.7%, respectively, while the government held the line in most other spending areas.

Manitoba's posted budget figures do not include all government transactions or capital requirements. As such, the provincial debt is projected to grow more quickly than deficit figures suggest.

2012-2013 Fiscal Update

In December, the Manitoba government released its fiscal update for the first half of the 2012/13 budget year. As was the case across the West, Manitoba's update presented a deteriorated view of the province's finances, projecting a revised annual deficit of $567 million compared to the budget estimate of $460 million.

Unlike other Western provinces, however, Manitoba's larger deficit is not the result of weak resource revenues, but of an inability to contain expenditure growth. Core government spending in Manitoba is projected to come in $145 million over budget.

It is difficult to pinpoint the exact areas where cost overruns are taking place. As part of Budget 2012, the Manitoba government introduced a Program Portfolio Management Review to find $128 million in savings while protecting key programs and services. The December fiscal update notes that $115 million in savings were realized but does not state where they occurred, making it difficult to assess how actual spending matches up with budget projections.

Higher program spending was partially offset by stronger-than-expected revenue growth. Core government revenues are projected to be $62 million higher than initially forecast. This increase is almost entirely because personal and corporate income tax revenues exceeded expectations.

This budget preview was prepared by Canada West Foundation Senior Economist Michael Holden. The opinions expressed in this report are those of the author and are not necessarily those of the Canada West Foundation's Board of Directors, funders or advisors.

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