Saskatchewan

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.

Saskatchewan will be the third of the western provinces to release its 2013/14 fiscal plan, with its budget to be tabled on March 20.

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

1) Measures to reduce dependence on resource revenues.

2) Action to address current and future labour shortages.

3) Strategic investments in export-related infrastructure and market development initiatives.

4) Tax reforms to improve business competitiveness.

Our post-budget analysis – available on March 21 – will assess the degree to which the budget addresses these issues.

1

Fiscal sustainability: Reducing dependence on resource revenues

Like Alberta, Saskatchewan received an unpleasant reminder last year of the downside of an overreliance on volatile non-renewable resource revenues to fund current spending. The potash industry makes Saskatchewan somewhat more diversified within its resource base compared to Alberta. On the whole, however, the province is even more reliant than its neighbour on income from non-renewable resources. Over the past five years, non-renewable resources accounted for an average of 25% of government revenues in Alberta compared to 26% in Saskatchewan.

Based on third quarter results, Saskatchewan's resource revenues will come in $563 million lower than expected in the 2012/13 budget. Potash revenues alone will be 44% lower than expected, while crude oil revenues will be hit by the same price differentials that have punished Alberta's bottom line.

It is difficult for provinces to balance budgets and make long-term strategic plans for building a prosperous economy when dependent on a highly inconsistent revenue stream. Saskatchewan's Fiscal Stabilization Fund helps to buffer the province against year-to-year revenue fluctuations but it is not a long-term solution.

A forward-looking budget would contain steps to begin reducing or eliminating the Saskatchewan government's reliance on non-renewable resource revenues to finance current operational spending. Resource revenues should be treated as one-time asset sales and not simply poured into general revenues and spent as they come in.

One way to reduce the government's reliance on volatile resource revenues, and to protect the interests of future generations, is to save resource revenue and transform an unpredictable and non-renewable asset into a permanent financial asset that can generate revenue in perpetuity and do so with greater predictability.

Resource revenues have contributed to Saskatchewan's recent string of budget surpluses. These have allowed the Saskatchewan government to greatly reduce the size of the net provincial debt, thus improving the province's credit rating, lowering interest payments and freeing up money for other purposes. Saskatchewan's net debt (net financial asset position) stood at $4.5 billion in 2011/12 – half of what it was in 2003/04.

Paying off the provincial debt is one way to benefit future generations – by not saddling them with the burden of paying for past spending. Another option is to begin saving a portion of non-renewable resource revenues in an instrument akin to Alberta's Heritage Fund or BC's proposed Prosperity Fund.

In October 2012, the Saskatchewan government released the *Saskatchewan Plan for Growth* – a vision document identifying the principles, goals and actions needed to generate economic growth that secures a better quality of life for Saskatchewan residents. Among the priorities identified in that document was to establish the Saskatchewan Heritage Initiative to identify options for how best to use the province's non-renewable resource revenues once the debt has been retired.

Although a tough sell, a plan in the 2013 budget to begin saving non-renewable resource revenues *even before Saskatchewan is debt-free* would be a visionary step forward for the province. Ideally, all non-renewable resource revenues will eventually be committed to a sovereign wealth fund, building a revenue stream for future generations.

2

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

A combination of economic growth, capital investment in natural resources and demographic changes is creating both current and future labour shortages in Saskatchewan. Saskatchewan already has the lowest unemployment rate in Canada and shortages are contributing to rapidly-increasing wages in the province. Wage gains are good news for workers, but unless they reflect productivity growth, they could end up undercutting the province's long-term economic competitiveness.

Labour shortages are the single largest factor limiting economic growth in Saskatchewan. Whether it be the expansion of small businesses or manpower for large-scale capital expansion projects, there is a tremendous need for workers in the province.

The *Saskatchewan Plan for Growth* identified labour shortages and skills training as a looming issue in the province. It outlined a number of steps the government plans to take to address labour issues. These include increasing immigration, improving Aboriginal engagement in the workforce, opening new apprenticeship spaces and introducing measures to proactively address critical labour shortages for large-scale capital projects. The province also promised to deliver a new labour force strategy in the fall of 2012, but it has not yet been released.

Given the debilitating effects of labour shortages on the economy, the budget should include concrete measures for addressing this problem.

3

Improving market access: Export-related infrastructure and market development initiatives

More than any other province in western Canada, Saskatchewan relies on international trade to fuel economic growth and maintain its standard of living. Exports of goods and services account for 44% of provincial GDP, the highest level in the West and second highest in the country, behind only New Brunswick.

Saskatchewan's ability to develop new markets for its products is limited by the fact that the province does not have international treaty-making power. However, the province has several other policy options at its disposal to cement its presence in existing markets and to increase its foothold in new ones. These options include trade and investment promotion missions, an expanded presence in strategic markets, providing export-readiness assistance to businesses. The Saskatchewan Trade and Export Partnership (STEP) is a unique government/industry partnership involved in many of these areas.

International trade and investment is a critical determinant of long-term economic prosperity in Saskatchewan and across the West. The 2013 budget should contain specific initiatives to support exporting businesses, to reduce trade barriers, and to attract investment and labour to the province.

Also critical is building the necessary export-related transportation and logistical infrastructure to reach markets as quickly and efficiently as possible. The Global Transportation Hub (GTH) is an important example of such an initiative.

A commitment to strategic investments in export-related transportation infrastructure would be a step in the right direction. Doing so ensures that Saskatchewan businesses can access international markets as efficiently and effectively as possible.

4

Creating the Conditions for Growth: A competitive business tax regime

The *Saskatchewan Plan for Growth* identified tax competitiveness as one area where governments can create the necessary conditions for growth. The Saskatchewan government highlighted, in particular, the need for business taxes to remain competitive with those in Alberta and BC. To that end, the *Saskatchewan Plan for Growth* committed to lowering the province's corporate income tax rate from 12% to 10% over three years, beginning in the 2013/14 budget.

The budget should honour the government's commitment to reducing the incorporated business tax rate.

Saskatchewan residents also face a higher personal income tax burden compared to Alberta and BC. However, the government has confirmed that its immediate priorities are to invest in infrastructure, lower the debt and improve business tax competitiveness. Given the province's reliance on resource revenues and the importance of infrastructure investment to generate and accommodate growth, reducing income taxes is likely not a prudent action at this time.

However, one way for the Saskatchewan government to further improve business competitiveness would be to harmonize the provincial sales tax with the federal GST. The Canada West Foundation proposed this reform in its 2010 paper, *A Tax Framework for Saskatchewan's Continuing Prosperity*. At the time, the Saskatchewan government rejected that proposal on the grounds that it shifted too much of the tax burden onto consumers.

A harmonized sales tax would do much to advance Saskatchewan's stated objective of improving its 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. It would also improve clarity and equity as the current tax structure includes a series of sales tax input credits for some sectors but not others. 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 would require the support of Saskatchewan residents. There is, however, much to be gained by at least starting the conversation.

In the 2013 budget, the Canada West Foundation hopes to see the Saskatchewan government initiate a dialogue on introducing a harmonized sales tax. Such a tax would forward the government's stated objective of improving tax competitiveness in the province and would help generate economic growth and investment.

2012 Budget Review

Saskatchewan was the only province to present a balanced budget for 2012/13, forecasting a small $47 million surplus for the fiscal year, along with a $48 million payment into its Fiscal Stabilization Fund.

Saskatchewan has had by far the best fiscal record of any province in recent years. It has consistently posted budget surpluses since 1994/95. However, like other provinces, Saskatchewan keeps certain transactions off-budget that, if included, transform some of those surpluses into deficits.

The 2012 budget projected revenues to increase by 1.9% in 2012/13. Growth was projected to be modest because the previous year's revenue figures had been inflated by special one-time payments from Crown entities for flood relief, as well as federal money for disaster assistance and infrastructure spending. Excluding those non-recurring items, revenues were budgeted to increase by 5.4%, mostly because of anticipated strength in natural resource income. Resource revenues were forecast to increase by 14% in 2012/13, led by an expected sharp recovery in potash revenues.

On the expenditure side, the Saskatchewan budget called for modest program spending increases of 1.6% in 2012/13 – below the combined rate of inflation and population growth. The most significant increases came in social services and health care, with budgeted spending growth of 7.7% and 5.8%, respectively. That growth was offset by spending cuts in the Environment Ministry and in Corrections, Public Safety and Policing.

For the most part, however, the focus of the 2012 budget was on securing efficiencies in public service delivery and other public sector renewal initiatives. Several programs were eliminated, and the province continued with the third year of its four-year plan to cut the size of the public service by 15%. This focus on decreasing the number of public employees seems to be successfully reducing costs without harming service delivery. It is also strategic given the province's labour-constrained environment.

2012/13 Fiscal Update

In mid-February, Saskatchewan released its fiscal update for the third quarter of the current budget year. The province remains on track to be the only province to post a balanced budget in 2012/13, although its fiscal position deteriorated considerably over the course of the year. Saskatchewan projects a $54.4 million surplus for the current year. However, instead of making a $48 million contribution to the Fiscal Stabilization Fund, it will need to withdraw $46 million from that account. It also transferred an unscheduled $120 million dividend from provincial Crown corporations to improve the bottom line in the general revenue fund.

Most of that deterioration was the result of lower-than-expected resource revenues. Saskatchewan's oil revenues are projected to come in about $278 million under budget. In addition, the expected recovery in potash royalties failed to materialize, resulting in an additional $308 million revenue shortfall.

While higher-than-expected income tax revenues softened the blow, Saskatchewan also faced additional claims under its Provincial Disaster Assistance Program as well as higher gaming agreement payouts due to increased casino profits.

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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