British Columbia

2013-2014 Budget Analysis

Key Findings

- British Columbians are best served when provincial budgets emphasize long-term planning and strategic investments rather than have a singular focus on fiscal balance.
- New investments in education and skills training will help the province meet future labour needs.
- Business tax increases are intended to raise revenues in the short term but could undermine the province's competitive position down the road.
- The BC government missed an opportunity to set the parameters and objectives of a Prosperity Fund and to begin the transition to saving non-renewable resource revenues.

The Canada West Foundation is dedicated to building a western Canada in which our children will thrive and prosper. Our focus on provincial and federal government budgets reflects that priority. We are primarily concerned with the long-term directions that governments are setting in their budgets and less preoccupied with year-to-year changes in spending or in fiscal balances.

Detailed Analysis

In its budget preview, the Canada West Foundation identified five steps the BC government could take that would lead toward a more prosperous future for all British Columbians. Those steps were:

1) A clear commitment to balancing the books without undercutting the economy in the process.

2) A plan for addressing future labour shortages.

3) A pledge to put all natural gas revenue into the Prosperity Fund.

4) No significant increases to business taxes.

5) The absorption of medical premiums into the income tax system.

1

Fiscal Responsibility: Eliminating the deficit in the near term

It is not critical to balance the budget every year, but it is in British Columbians' long-term interests for the provincial government to be on a sustainable fiscal path.

The BC government presented a balanced budget for 2013-2014 by containing projected expenditure growth while boosting revenues through tax increases and the one-time sale of government assets. In spite of this reported balance, however, the province will have to borrow more money every year for the next three years under this fiscal plan. The reason is that, like many other governments, BC does not include off-budget capital expenditures in its bottom line.

In total, the BC government forecasts revenue growth averaging 3% per year over the next three years. For 2013-2014, it will achieve its fiscal targets largely through asset sales which, will be replaced on the ledger by a series of tax increases to be phased in over the next calendar year. Notable among these are a one-percentage-point increase to the corporate income tax rate, adjustments to royalty schedules, a hike in personal income taxes for those earning more than $150,000 and a 4% increase in medical premiums.

For its part, spending growth will be limited to an average of 1.5% per year over the next three years. Health care spending – the single largest expenditure item – is budgeted to grow at an average of 2.6% per year over that period.

The BC government has been successful in recent years at containing health care costs, but it may have a difficult task achieving its new target. From 2005-2006 to 2008-2009, health care spending grew by an average of 6.6% per year, slowing to 4.9% per year from 2008-2009 to 2011-2012. It now plans to cut spending growth nearly in half again. This is an ambitious target, especially given the impact that an aging population will have on demand for health services. Additional reforms in health delivery may be necessary to achieve these goals.

Containing spending growth may be a challenge for the BC government, but the economic growth assumptions underpinning its projections are appropriately conservative. For 2013, the government is assuming 1.6% growth in the provincial economy – a figure at the lower end of private-sector forecasts. The BC government expects growth to accelerate modestly in 2014 and 2015.

2

Planning for the Future: Acting now to address potential labour shortages

If unaddressed, the combination of an aging population and an ambitious natural gas development agenda could lead to future labour shortages and limit long-term economic growth in BC.

The budget included several new investments to expand education and skills training capacity in the province. While these investments fall short of a comprehensive strategy to address future training requirements, they are an important step in that direction.

Notably, many of the announced projects are clearly intended to develop the workforce necessary for the province's natural gas and LNG infrastructure, and for its shipbuilding industry. Hundreds of new training positions will be opened for technology programs and metal, mechanical and marine trades.

3

Using Today's Wealth to Benefit Future Generations: The British Columbia Prosperity Fund

Establishing a Prosperity Fund that captures the wealth from selling BC's non-renewable resources and converts it into a lasting benefit allows both present and future generations of British Columbians to gain from the province's resource wealth.

There was no new information in the budget about the Prosperity Fund. The sole mention of the fund was a restatement the broad idea as set out in the Speech from the Throne.

BC is still years away from exporting natural gas overseas, so there is still time for the government to set the parameters and objectives of a Prosperity Fund. However, the transition to budget surpluses in 2013-2014 would have offered an opportunity to begin the transition to saving non-renewable resource revenues. With each budget surplus, the government would be able to siphon off royalties to build the fund.

The Canada West Foundation will watch for additional progress to be made in this area.

4

Driving Growth: Broad-based economic competitiveness

In the long term, business competitiveness is a critical facet of a prosperous British Columbia and must be preserved to ensure future economic growth.

The BC budget contained a number of tax measures that are designed to raise revenues in the short term but could undermine the province's competitive position down the road.

Independent of the budget, the PST was already going to increase the cost of doing business in the province in 2013. In addition to administrative costs, businesses will have to pay PST on all purchases of inputs whereas under the HST, they could apply for a rebate.

Not only did the 2013 budget provide no transitional assistance to re-adjust to the PST, it also contained a number of business tax increases. Most notable among them is a hike in the corporate income tax (CIT) rate. Last year's budget contained a provisional arrangement to raise the CIT rate to 11% (from 10%) in 2014 if the revenues were needed to balance the budget. That provisional tax increase was implemented and implemented a year early. Other measures include the phase-out of some business tax credits and the introduction of a 3% minimum royalty for all natural gas wells that qualify for the Deep Well Royalty Credit Program.

In isolation, none of these measures threaten the long-term competitiveness of the BC economy. Together, however, the impact adds up. In particular, the combination of the PST, the CIT rate increase and changes to the royalty regime all affect the natural gas industry, which is facing the additional challenge of trying to turn a profit in the face of near-historic low prices.

BC is pinning its long-term economic hopes on building an industry around the overseas export of liquefied natural gas (LNG). The combination of tax increases presented in the 2013 budget could be enough to affect future investment decisions and slow the pace of natural gas development in BC. In short, it increases the burden on an industry that does exist yet.

5

Equitable Tax Reform

Medical Service Plan premiums place a disproportionate tax burden on low-income British Columbians. Absorbing premiums into the income tax system would more equitably distribute the overall tax burden.

MSP premiums were not rolled into the income tax system. In fact, the inequity of the present system was magnified by a 4% increase in premiums retroactive to January 1st. A family earning more than $30,000 will now pay just under $1,600 per year in MSP premiums, up from $1,536 last year. A family earning ten times that amount will pay the same fee.

The budget offers no mention of planned increases to MSP premiums beyond 2013-2014. However, it is worth noting that the BC government has budgeted for an additional 5.4% increase in total MSP revenues in 2014-2015. This growth is only achievable through another rate increase next year.

The Canada West Foundation will continue to look for progress towards greater tax transparency and tax equity in next year's budget.

BC Budget by the Numbers

BC is reporting a balanced budget with a surplus of $197 million in 2013-2014. Yet the province is also reporting that its net financial position will deteriorate by $1.454 billion next year. In other words, debt will grow even when the budget is balanced.

The reason is that, like most provinces, BC does not include the full value of its annual capital spending in the year those funds were actually expensed. Instead, it chooses to spread those costs out over several years. The practice of off-budget capital spending is generally accepted in public finance, but it does not truly reflect government spending obligations in any given year.

When the full value of capital spending is included (and amortization costs removed), the BC budget has a deficit of $1.382 billion on a cash basis. Other minor adjustments, duly noted by the province in its budget documents, bring the total shortfall up to $1.454 billion.

In other words, at the end of the day, BC will need to find $1.454 billion in additional funds if it is to accomplish its spending plans for 2013-2014. This will be secured either by drawing on savings and reserves, or by issuing new debt. The government's net worth is also projected to fall in 2014-2015 and in 2015-2016, although the deterioration will slow each year.

The good news is that even though the province's debt is still rising, it will decrease relative to the size of the economy. In 2012-2013, BC's net debt (net financial assets) represented about 17.2% of provincial GDP. By 2015-2016, that will fall to 16.6% of GDP, assuming the province's economic growth assumptions are met.

Fiscal Information and Budget Projections → British Columbia

($millions)

	2010-2011	2011-2012	2012-2013e	2013-2014f	2014-2015f	2015-2016f
Tax Revenue	20,802	22,084	23,230	23,705	24,886	25,824
Non-Tax Revenue	19,974	19,883	19,221	20,682	20,100	20,553
Total Revenues	40,776	41,967	42,451	44,387	44,986	46,377
Program & Capital Expenditures	38,773	41,424	41,227	41,480	41,869	42,714
Interest on Debt	2,252	2,383	2,402	2,510	2,681	2,878
Total Expenditures	41,025	43,807	43,629	43,990	44,550	45,592
Basic Balance	**-249**	**-1,840**	**-1,178**	**397**	**436**	**785**
Forecast Allowance	0	0	-50	-200	-225	-325
Reported Balance	**-249**	**-1,840**	**-1,228**	**197**	**211**	**460**
Less: Amortization Expense	2,065	2,146	2,085	2,138	2,167	2,181
Add: Off-Budget Capital	4,111	3,572	3,728	3,717	3,481	3,189
Adjusted Balance	**-2295**	**-3,266**	**-2,871**	**-1,382**	**-1,103**	**-548**

Source: CWF calculations using data from BC Budget 2013

Net Financial Asset Position → British Columbia

($millions)

	2010-2011	2011-2012	2012-2013e	2013-2014f	2014-2015f	2015-2016f
Financial Assets	32,427	34,385	37,174	40,063	42,130	43,958
Financial Liabilities	64,589	70,358	76,042	80,385	83,656	86,119
Net Financial Assets	**-32,162**	**-35,973**	**-38,868**	**-40,322**	**-41,526**	**-42,161**
Change in Net Asset Position	**-2,666**	**-3,811**	**-2,895**	**-1,454**	**-1,204**	**-635**

Source: CWF calculations using data from BC Budget 2013

This budget analysis 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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