British Columbia

2013-2014 Budget Preview

As a think tank dedicated to improving the long-term prosperity of western Canada, the Canada West Foundation will be 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.

BC will be first out of the gate with its 2013/14 budget being tabled on February 19.

With the above challenges in mind, there are five things we hope to see in Tuesday's budget:

1) A clear commitment to balancing the books even if this is not possible in the coming year.

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.

Our post-budget analysis will assess the degree to which progress is being made in these areas.

The Canada West Foundation's post-budget analysis will be available on February 20, 2013.

1

Fiscal Responsibility: Eliminating the deficit in the near term

The BC government is committed to eliminating the deficit in the upcoming budget as per its balanced-budget legislation. The province was on track to meet this goal a year ago, but the 2012-2013 deficit will be larger than forecast last year because of lower-than-expected resource revenues and lower property-related income. The re-introduction of the PST presents an additional challenge; the PST is expected to reduce government revenues by $500 million in the 2013-2014.

It is not vital that the BC government balance the budget in this fiscal year, especially if it must sacrifice economic competitiveness to do so. However, deficit elimination is an important near-term goal. Deficit spending is sometimes necessary during low points in the economic cycle. However, a large debt burden effectively passes the cost of current and past spending onto future generations. From the perspective of intergenerational equity, it is important that the province be on a sustainable fiscal path.

The fact that BC has frequently missed its deficit targets in recent years is an ongoing concern. In addition, posted deficits in BC do not always reflect the province's borrowing requirements because it keeps capital spending outside of its operating budget.

The Canada West Foundation would like to see the BC government eliminate the deficit in the near term, but does not think it necessary to do so in 2013-2014 if it means undermining economic competitiveness. It hopes to see credible and prudent expectations for revenue growth and achievable expenditure targets. It will also look for budget documents to be transparent and reflect capital spending as well as operating costs.

2

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

In its recent Throne Speech, the BC government emphasized the importance of developing the province's natural gas reserves to secure its long-term economic future. Recognizing that it needs access to overseas markets for that to happen, BC has set a target of completing construction of three liquefied natural gas (LNG) plants and associated transportation infrastructure by 2020. It hopes to have two other plants operational some time thereafter.

Achieving this goal will require a significant construction effort. However, demographic shifts and potential skilled labour shortages are likely to emerge as major stumbling blocks to achieving this goal. Moreover, neighbouring provinces have identified similar concerns about their workforces, meaning that there may not be a significant pool of out-of-province workers to draw upon. A lack of skilled labour would not only slow construction and reduce or delay the economic benefit of these projects, but would also create inflation and raise costs for all British Columbians.

In the 2013 Budget, the Canada West Foundation is looking for a detailed plan to address future skills training requirements in British Columbia, especially given the province's ambitious natural gas development agenda.

3

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

The government has announced that it will establish a British Columbia Prosperity Fund to capture the fiscal benefits of its natural gas development agenda. Revenue from royalties, corporate income taxes and a proposed new tax on LNG production will all be included in the fund. The focus of the fund will be to pay down the provincial debt, improve social services and build alternative revenue sources for the government.

On the surface, the idea of a Prosperity Fund is a good one. It allows future generations to benefit from the one-time sale of BC's non-renewable resources and could help reduce the province's fiscal exposure to volatile commodity prices. However, details on how the fund would operate and be managed are scarce.

In the 2013 Budget, the Canada West Foundation is looking for a plan to eliminate government reliance on non-renewable resource revenues to fund current expenditures. It hopes to see all natural gas royalty revenue committed to the Prosperity Fund to build a revenue stream for future generations.

Premier Clark has suggested that measures will be put in place to ensure future BC governments aren't tempted by profligacy and use non-renewable resource revenues to fund current expenditures. As the Alberta experience shows, however, it can be difficult for governments to resist this temptation.

The Canada West Foundation would like to see specific measures to actively discourage future governments from siphoning off Prosperity Fund investments to finance current spending.

In the Throne Speech, the BC government suggested that one possible use of Prosperity Fund revenues in future is to eliminate the provincial sales tax. Provided that they are well-designed and not regressive, consumption taxes are economically preferable to income taxes because they do not penalize savings and work effort.

If future Prosperity Fund dividends are used to reduce the tax burden on British Columbians, the Canada West Foundation believes they should focus on lowering income taxes and not consumption taxes.

4

Driving Growth: Broad-based economic competitiveness

A healthy business sector is critical to future economic development in BC and to generating the wealth needed to fund core services in the province. For the most part, BC is well-positioned in this regard. It has taken steps to reduce the regulatory burden on businesses and it has some of the lowest corporate taxes in Canada.

However, changes to the tax regime could threaten that position. The re-introduction of the PST will increase the cost of doing business in the province and the proposed new tax on LNG production—which would be levied on top of existing corporate taxes—risks undermining the economic competitiveness of that industry before it even gets off the ground. There is also the possibility that the government will implement a corporate income tax hike to address any potential revenue shortfall in the coming year. If all these measures come into effect, they could damage the economic competitiveness of the BC economy and put future growth at risk.

The Canada West Foundation would like the 2013 Budget to include a strategy to maintain or enhance economic competitiveness across the province. It believes that significant tax increases on BC businesses could undermine their competitive position.

5

Equitable Tax Reform: Absorbing MSP premiums into income taxes

The BC government argues that it has the lowest tax environment in Canada, but this is only true because the province does not consider the fees and premiums it charges British Columbians to be taxes. In particular, the province collects a significant amount of revenue from Medical Services Plan (MSP) premiums. According to a recent study, a two-income family earning $60,000 pays more in MSP premiums than it does income taxes. Moreover, while tax rates have fallen in recent years, MSP premiums have increased by 85% since 2000.

The MSP is not only a tax by another name, it is a flat tax that penalizes lower-income British Columbians. Any person or family earning more than $30,000 pays the same premium. As a result, an individual earning $200,000 pays a far lower share of his or her income in MSP premiums than someone earning one quarter that salary. One way to address this issue is to absorb MSP premiums into the income tax system. Since income taxes are progressive, this would help ease the overall tax burden on lower-income British Columbians.

The Canada West Foundation would like to see MSP premiums absorbed into the income tax system in order to more equitably distribute the overall tax burden on British Columbians.

2012 Budget Review

British Columbia's 2012 budget was designed to eliminate the provincial deficit by 2013-2014, in compliance with the province's balanced budget legislation. From $2.5 billion in 2011-2012, the deficit was expected to fall to $968 million in 2012-2013. The province planned for a small surplus of $154 million for the coming fiscal year.

The province opted for a balanced approach to achieving this target, with a combination of restraint on the spending side as well as several new revenue-generating initiatives. On the expenditure side, the BC budget called for program spending cuts of 1.5% for 2012-2013 and modest growth of 0.5% for the upcoming year. These targets were to be achieved by limited growth in health care spending to 3% per year, while freezing public sector wages and cutting program spending elsewhere.

On the revenue side, the government budgeted for a 2.8% increase in income last year and a 3.5% increase for the coming year. This growth was to be achieved through a combination of asset sales, growth in gas royalties, higher health care premiums and the cancellation of previously-announced tax reductions. The province also announced that it would re-implement the Provincial Sales Tax (PST) at the beginning of the 2013-2014 fiscal year.

2012-2013 Fiscal Update

In late November 2012, the BC government released its fiscal update for the first half of the current budget year (April-September). Deficit projections for 2012-2013 were revised from $968 million to just under $1.5 billion.

This deterioration in the province's bottom line is almost entirely from the revenue side of the equation. BC has maintained a tight lid on expenditures through 2012-2013, but resource revenues fell in the first half of the year due to lower-than-expected prices for natural gas, coal and other minerals. In addition, the weakening housing market lowered property-related tax revenues and delays were encountered in the sale of certain assets. Offsetting those, to some degree, were income tax revenues which have been stronger than expected through the first half of the year.

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.

CANADA WEST FOUNDATION
900, 105 – 12 Avenue SE
Calgary, Alberta, Canada T2G 1A1