



Publication

BUSINESS ALERT

February 21, 2007

2007 BC BUDGET: NEW INITIATIVES AND UNFINISHED BUSINESS

In the midst of the strongest economic upswing in three decades, Finance Minister Carole Taylor's 2007 budget delivered a significant reduction in personal income tax and also found room to boost spending on health, education and social programs. With housing affordability deteriorating and concerns over homelessness on the rise, the Minister opted to provide some targeted assistance to help address these issues. Although it was billed as a "housing legacy" budget, the majority of the claimed assistance for housing came in the form of the personal income tax cut.

Notably absent from Budget 2007 was anything aimed at improving BC's poor record on productivity.

Economic Setting and Outlook

Consistent with Minister Taylor's past practice, Budget 2007 is built around conservative economic and revenue assumptions. It sees the BC economy expanding by 3.1% (after inflation) this year and 3.0% in 2008. Given slower global economic growth and the uncertain outlook for the United States, it is prudent to expect a downshift from last year's 3.9% increase in real provincial GDP. The baseline forecast, however, is lower than the consensus view of 3.4% GDP growth in 2007. Regardless of the final figure, BC is positioned to stay near the top of the provincial growth rankings for at least the next two years.

Budget 2007 identifies a number of downside risks. The potential for further fallout in the US

housing market is probably the greatest concern. A rising shortage of workers is also an issue for many employers. Other risks relate to the prospect of weaker than expected global growth and a stronger Canadian dollar. On balance, however, given strong momentum on the domestic side of the province's economy, these relatively small risks do not pose much threat to the Ministry of Finance's growth forecast.

Table 1 Economic and Financial Assumptions for British Columbia (annual per cent change unless otherwise indicated)					
	2006	2007	2008	2009	2010
Real GDP - BC	3.9	3.1	3.0	3.1	3.3
Nominal GDP	5.9	5.0	4.9	5.0	5.2
Cdn 3-mnth T-bill (ann. avg. %)	4.0	4.0	4.1	4.4	4.9
Cnd 10 yr gov't bond (ann. avg. %)	4.2	4.1	4.5	5.2	5.7
Real GDP Canada	2.7	2.0	2.7	2.8	2.8
Real GDP US	3.4	2.1	2.8	3.0	3.0
Real GDP Japan	2.2	1.7	1.9	1.5	1.5

Source: 2007 BC Budget and Fiscal Plan



The Current (2006/07) Fiscal Year

Turning to the current fiscal year, which comes to a close on March 31, 2007, government expenditures are on target to reach \$34.9 billion. Somewhat uncharacteristically, this is \$976 million more than first projected in February 2006.

But thanks to the robust provincial economy, higher-than-expected revenues have kept the 2006/07 fiscal year comfortably in surplus. Personal income tax, corporate income tax, sales tax, and property transfer tax revenues are all coming in above budget. In addition, BC has received some additional funds from the federal government in the current year.

Altogether, provincial revenues are now expected to total \$38.0 billion, some \$2.7 billion more than originally anticipated. The bottom line is a 2006/07 operating surplus in the range of \$2.9 billion – a figure that could very well go higher once the final numbers are in.

The New Fiscal Plan

For the coming fiscal year, the government is looking for another budget surplus of \$400 million, with an additional \$750 million forecast allowance on top of that. The smaller surplus reflects declining federal government transfers – including the phasing out of equalization payments – as well as the revenue-dampening effect of the tax measures introduced in the new budget.

On the other side of the ledger, government spending is slated to rise by \$1.35 billion in 2007/08, much of which consists of the previously announced \$785

million injection for health care. Advanced education gets another \$124 million, while K-12 education benefits from a \$123 million budget boost even as public school enrolments continue to fall. Altogether, provincial government spending on health and education is set to climb 5.8% in 2007/08, followed by 2.5% and 3.0% increases in the subsequent two years. Additional funding is also being set aside for environmental, income assistance and other social and community support programs.

Table 2 BC Government Fiscal Position (millions of dollars unless otherwise indicated)				
	<u>06-07</u>	<u>07-08</u>	<u>08-09</u>	<u>09-10</u>
Revenues	38,040	37,390	37,870	39,075
% change	5.8	-1.7	1.3	3.2
Expenditures	34,890	36,240	36,720	37,875
% change	6.1	3.9	1.3	3.1
Surplus before forecast allowance	3,150	1,150	1,150	1,200
Forecast allowance	300	750	1,000	1,050
Surplus	2,850	400	150	150
Taxpayer-supported capital spending	3,468	3,864	3,308	2,851
Total capital spending	4,516	5,156	4,916	4,567
Taxpayer-supported debt	26,545	27,803	28,692	29,171
(% of GDP)	14.8	14.8	14.6	14.1

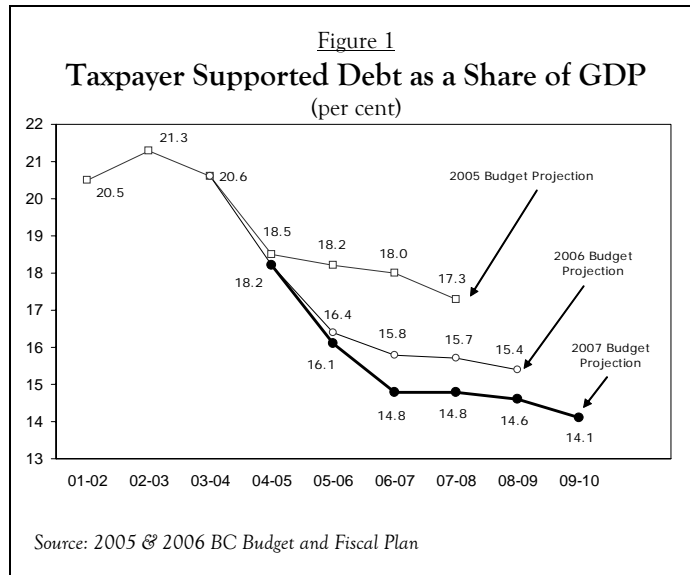
Source: 2007 BC Budget and Fiscal Plan



Capital Spending

Budget 2007 provides for a \$640 million lift in capital spending, of which \$396 million is taxpayer supported (the other \$244 million is supported by revenue generating crowns and agencies). This will push total taxpayer-supported capital outlays up to \$3.9 billion, before retreating to \$3.3 billion in 2008/09 and \$2.9 billion in 2009/10.

The government's ambitious capital spending plan will increase taxpayer-supported debt to \$27.8 billion next year, up from \$26.5 billion in 2006/07. Investing in long lived assets is prudent and necessary to meet the infrastructure and service delivery needs of BC's growing population and economy. The good news is that on the key metric of taxpayer-supported debt relative to GDP, BC's debt burden remains both the second lowest in Canada and on a downward trend. Taxpayer-supported debt as a share of GDP now stands at 14.8% of GDP, compared to 21.3% at the peak in 2002. Budget 2007 predicts that the figure will ease to 14.1% by the end of the decade. In light of the government's sound fiscal record and the conservative economic assumptions underlying Budget 2007, the debt-to-GDP ratio will likely fall faster than anticipated.



Tax Measures

One focus of Budget 2007 is to tap the fiscal surplus to help individuals and families in British Columbia, particularly those with housing affordability challenges. The most important new measure, however, is the proposed 10% personal income tax cut that will apply to all income up to \$100,000. On a full year basis, this will yield aggregate tax savings of \$515 million. On top of the tax cut, a number of other items address housing issues more directly:

- The threshold for the property transfer tax for first-time buyers is raised, for an aggregate savings of \$21 million.
- The threshold for phasing out of the homeowner grant is increased to \$950,000 (from \$780,000), in order to keep 95% of homeowners eligible for the grant.
- The age at which a homeowner may defer property taxes on their principal residence is lowered to 55 years from 60 years.
- Significant additional provincial funding is being provided for social housing, shelter beds, transitional housing, and initiatives to assist the homeless.



The Budget contains little in the way of new measures to improve business competitiveness and productivity. A few items are worth noting:

- An enhanced Mining Exploration Tax Credit (from 20% to 30%) for grass-roots mining exploration in Mountain Pine Beetle affected areas.
- A package of previously announced training tax credits for employers and employees. The main focus is on non-Red Seal apprenticeship occupations. There are also completion credits and credits to encourage greater participation in trades training by First Nations and persons with disabilities.
- Various small-scale statutory and policy changes to the retail tax system are expected to produce savings of \$40 million per year for businesses across BC.

Conclusion

Although Budget 2007 does not break new ground on economic policy or vision, it reflects a balanced approach that seeks to share the benefits of a strong economy with British Columbians in their twin roles as taxpayers and consumers of public services.

The new personal income tax cut means that British Columbia will have the lowest personal tax rates on earned income up to \$108,000 of all provinces. This is a significant accomplishment, particularly when one recalls the sizable tax reductions implemented by the Liberals shortly after they were elected.

The budget also reinforces the government's already enviable fiscal track record. BC has been consistently posting budget surpluses starting in 2003/04, and is on course for continued surpluses through the end of the decade.

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