BC BUDGET 2019 ANALYSIS

Business Council of British Columbia
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BUDGET 2019 DELIVERS SOME PROMISING PROGRAM SPENDING BUT LITTLE TO ADDRESS B.C.'S DETERIORATING COMPETITIVENESS

HIGHLIGHTS

- Finance Minister Carole James tabled a budget outlining modest surpluses over the next three fiscal years. There is some degree of cushion built into the projections.
- The government is putting more resources into a variety of program areas, including child care, housing, anti-poverty initiatives and measures linked to the CleanBC plan. The result is that total program spending grows by 4.5% in 2019-2020, somewhat higher than the spending increases recorded over the past ten years.
- The Budget increases taxpayer-supported capital spending from $4.8 billion in 2018-19 to $6.3 billion in 2019-2020. Taxpayer-supported capital outlays rise further to $6.8 billion in fiscal 2020-21. Much of this increase is directed towards schools and hospitals, but there is also additional funding for transportation infrastructure.
- The Business Council is concerned that policy-makers are underplaying signs of softening growth globally and in North America while program spending is rising.

The 2019 provincial Budget is a bit of a ho-hum document that contained no major surprises. As expected, it introduces additional program spending to help fulfill the government's commitment to expand and strengthen social supports for families and lower income households. What is concerning is the absence of significant new measures or announcements to help address growing competitiveness challenges in the province. The government continues to run small operating surpluses over the course of the updated three-year fiscal plan. There is a stepped-up pace of borrowing to fund capital projects, which adds to the accumulated net debt. However, the net debt-to-GDP ratio remains manageable and at the lower end among the provinces.

The Business Council believes that policy-makers are underplaying the need to improve the competitive environment. The Budget overlooks the impact of rising business costs, an inability to advance major projects, and uncertainty for investors and firms looking to expand. At the same time, Budget 2019 bakes in higher future costs, many of which do not fully materialize for some time due to the time required to implement programs or because they are phased in. Having said that, the near-term spending increases outlined over the three-year fiscal plan are sizable.

ECONOMIC BACKDROP

The Budget is built around reasonable economic growth projections of 2.4% (real GDP) in 2019 and 2.3% in 2020. But it breaks with the longstanding practice of shaving two-tenths of a percentage point off of the growth forecast produced by the independent Economic Forecast Council and instead uses a growth rate just one-tenth of a percentage point below the Council's projection for 2019.

TABLE 1: **BUDGET 2019 ECONOMIC ASSUMPTIONS AND FORECASTS**
(ANNUAL PER CENT CHANGE UNLESS OTHERWISE INDICATED)

			FORECASTS		
	2017	**2018**	**2019**	**2020**	**2021**
B.C. Real GDP (chained $2012)	3.8	2.2	2.4	2.3	2.1
B.C. Nominal GDP	6.9	4.6	4.4	4.3	4.0
B.C. Export Goods & Services (chained $2012)	3.4	2.3	1.2	1.6	1.7
B.C. Retail Sales	9.3	2.4	3.9	4.0	3.9
B.C. Housing Starts (000s of units)	43.7	40.8	34.0	31.8	30.5
Cdn 3-month treasury bill (annual average %)	0.71	1.40	2.05	2.45	2.75
Cdn 10-year gov't bond (annual average %)	1.79	2.26	2.49	2.83	3.38
Canada Real GDP (chained $2012)	3.0	2.0	1.6	1.6	1.6
U.S. Real GDP (chained $2012).	2.2	2.8	2.2	1.7	1.7
U.S. Housing Starts (000s of units)	1,203	1,265	1,270	1,300	1,300
Real GDP Japan (chained Yen 2011)	1.9	0.7	0.8	0.3	0.7
Real GDP China (U.S.$2010)	6.8	6.6	6.0	5.8	5.8

Source: 2019 B.C. Budget and Fiscal Plan.

In 2020, the Budget builds in more prudence by adopting a growth forecast number three-tenths of a percentage point lower than the Economic Forecast Council's.

We would caution that the risks to the economic outlook are tilted towards the downside. The global economy is slowing, pulled down by a weaker growth path in China and near-recession conditions in parts of Europe. The long U.S. economic expansion is running out of gas, with many forecasters anticipating a recession within the next 18-24 months. And economic momentum is clearly ebbing in Canada. All of this creates a somewhat gloomy external backdrop for B.C.

FISCAL RECAP — MEASURED SPENDING INCREASES (FOR NOW)

Minister of Finance Carole James delivered a balanced budget. The projected surplus for the upcoming 2019-20 fiscal year is a skinny $274 million, which does not include a $500 million forecast allowance. A similar sized surplus is projected in the following fiscal year, but in this case the forecast allowance cushion is smaller at just $300 million. These allowances do not provide a lot of wiggle room on a $60 billion budget.

Total revenues are projected to rise 4.3% in fiscal 2019-20, followed by a more modest 1.7% next year. The healthy gain in the first fiscal year of the Budget plan, and slower revenue growth the following year, largely reflects the fact that MSP premiums are still being levied in 2019-20 but are eliminated in 2020-21. The Budget also foresees some additional moderation in resource revenue, which is weighing on overall government revenues. The simultaneous application of the new Employer Health Tax (which kicked in on January 1st) and MSP premiums provides the government with an additional $1 billion in revenue in 2019-20. Without this "double dipping," the budget would not be balanced given the current spending configuration.

The government is putting more resources into a variety of worthwhile program areas, including child care (notably via a new B.C. Child Opportunity Benefit), housing, anti-poverty initiatives and measures linked to the CleanBC plan. The result is that total program spending grows by 4.5% in 2019-2020. This increase is above inflation and population growth, and is above the average annual 4% spending increase recorded over the past decade. In the following year, spending is slated to rise by a below-average 2%. While this Budget enriches social programs and spending, it generally does so in a graduated manner.

As outlined in the Budget, the provincial debt load remains manageable and low in comparison to other provinces. Total provincial debt is projected to increase by $14.5 billion over the three-year fiscal plan, all of which is due to borrowing for capital projects. The amount of debt supported by taxpayers rises by $10 billion, while the other $4.5 billion is extra debt incurred by self-supporting Crown Corporations.

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The additional capital spending and borrowing means the taxpayer-supported debt-to-GDP ratio edges up from 14.9% to 16.1% by the end of the three-year plan. The Business Council has advocated for more investment in infrastructure and is comfortable with the planned jump in capital spending.

TABLE 2: **B.C. GOVERNMENT THREE YEAR FISCAL PLAN**
(MILLIONS OF DOLLARS UNLESS OTHERWISE INDICATED)

			FORECAST		
	2016/17	**2017/18**	**2018/19**	**2019/20**	**2020/21**
Revenues	52,020	56,636	59,047	60,038	62,458
% change	*1.1*	*8.9*	*4.3*	*1.7*	*4.0*
Expenditures	51,719	55,762	58,273	59,451	61,573
% change	*6.2*	*7.8*	*4.5*	*2.0*	*3.6*
Forecast Allowance	-	500	500	300	300
Surplus	301	374	274	287	585
Taxpayer-supported debt	43,607	43,957	46,384	50,454	53,986
% of GDP	*15.5*	*14.9*	*15.0*	*15.7*	*16.1*

Source: 2019 B.C. Budget and Fiscal Plan.

SOME DETAILS ON NEW PROGRAM SPENDING

Budget 2019 earmarks $679 million for the **CleanBC** plan to reduce carbon emissions and promote the use of clean energy. The Business Council supports the measures to help reduce provincial emissions and foster low-carbon economic development. However, the government's 2018 commitment to safeguard the competitiveness of B.C.'s trade-exposed industries amid a rising carbon tax and increasingly costly environmental and energy regulations has yet to materialize. We had hoped for stronger and earlier government action to address the deteriorating competitive position of the province's leading export industries in the natural resource and manufacturing sectors, owing to the direction of climate and carbon policies.

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There is some new funding directed toward **higher education and skills training**, but the funding amounts are surprisingly small. The Budget allocates just $45 million in additional resources to this area over the planning horizon, with just $12 million allocated in the upcoming fiscal year.

A welcome measure is some new **funding for local communities**. The new Northern Capital and Planning Grant will provide $100 million in the upcoming fiscal year to 26 local governments along the LNG corridor and near Kitimat to help meet their infrastructure needs. Another $50 million is available to help close the gap in high speed internet access between rural and urban areas. All totaled, this Budget directs another $279 million over the next three years to supporting local communities.

The Business Council is pleased to see new monies directed towards **reconciliation with First Nations**. Most of the $303 million over the three-year fiscal period is because Budget 2019 provides for gaming revenue-sharing payments totaling $297 million.

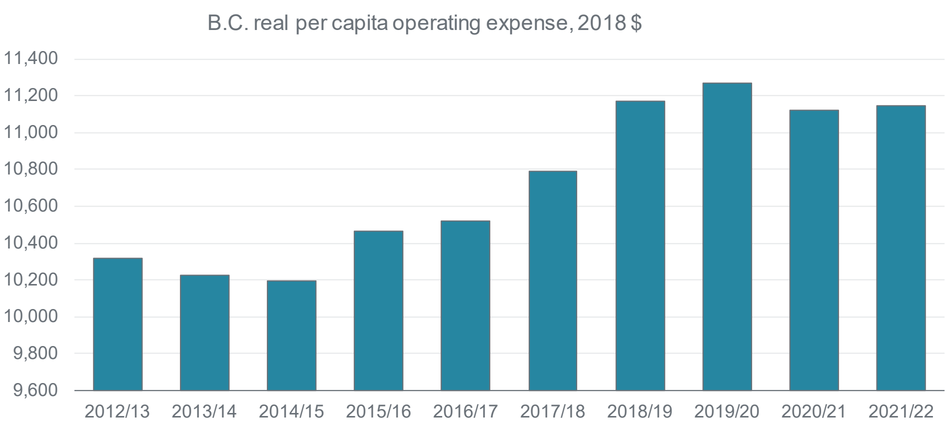
Budget 2019 allocates an additional $77 million over three years to help address "significant **housing challenges** facing British Columbians, as a result of increasingly unaffordable house prices and lack of affordable and market rental." This funding is in addition to the $7 billion over 10 years announced in last year's Budget. The difficulty with the current policy framework is some of the measures the government has implemented to help cool the housing market are at odds with the objective of making housing more affordable. Home sales have fallen sharply in the province. Some of the downturn is due to higher interest rates and more stringent federal lending rules for mortgages, but the housing taxes (as intended) are also weighing on sales. The slowdown in housing sales means home building has also fallen off. According to government's own projections, housing starts in B.C. will fall sharply this year (down 17%) and decline further in 2020 and 2021. In addition to the general downturn in housing which is curtailing development activity, the additional school tax and increased property transfer tax introduced in last year's budget currently apply to development lands and thus add to the cost of new construction and make some projects unviable. If new developments do proceed the tax measures get built into the price of new homes, compounding affordability challenges.

The Budget allocates $14 million over three years to support the "transformation of the Employment Standards Branch in the Ministry of Labour, and to update employment standards…." The funding will also be used to implement the Temporary Foreign Worker Protection Act and create a registry of licensed foreign worker recruiters and employers looking to hire temporary foreign workers. This is a very small line item in the context of the provincial budget, but we mention it because it confirms the government is moving ahead with reforming and updating the provincial Employment Standards Act.

LITTLE TO BOLSTER B.C.'S COMPETITIVENESS

The Budget contains little that will strengthen the province's economic fundamentals or improve our competitive position over the medium-term. There are no tax reductions or new regulatory reforms to address competitiveness challenges. The Budget does cite a figure of $800 million of "tax incentives" over three years and indicates the province is "joining with the federal government to support business competitiveness." In this case, "joining" the federal government means the province is simply accepting the revenue hit resulting from the enhanced capital cost allowance deductions that Ottawa unveiled last year; no specific action is being taken by B.C. Nonetheless, allowing Ottawa's already-announced business tax measures to flow through to the province's bottom line will support new investment in capital assets, such as buildings, machinery and equipment.

FIGURE 1: **PER CAPITA OPERATING EXPENSES RISING**



Source: 2019 B.C. Budget and Fiscal Plan, B.C. Ministry of Finance.

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PUBLIC SECTOR CAPITAL SPENDING

The Business Council is pleased to see the government devoting additional funds to provincial infrastructure. The Budget sees taxpayer-supported capital spending ramping up from $4.8 billion in 2018-19 to $6.3 billion in the next fiscal year. Taxpayer-supported capital outlays rise further to $6.8 billion in fiscal 2020-21. Much of the additional capital spending is on schools and hospitals. Over the next three years, the province will invest $2.7 billion on K-12 facilities. The post-secondary system receives an even larger capital increase of $3.3 billion over the same period.

New and expanded hospital facilities are also a significant part of the capital budget with $4.4 billion being channeled into upgrading hospitals and other health facilities around the province.

An additional $6.6 billion over the next three years is budgeted for transportation infrastructure. Some of the larger projects in this area include: the Pattullo Bridge replacement, the Broadway corridor Skytrain extension, and the four-laning of Highway 1 through the Kicking Horse Canyon. The Budget earmarks funds to make safety improvements to the Massey Tunnel (improved lighting, resurfacing, drainage and enhanced lane markings). After cancelling the bridge project that was to replace the tunnel, spending additional money on the tunnel suggests this government does not view the tunnel replacement as a high priority.

FINAL THOUGHTS

As indicated at the outset, the 2019 Budget contains no surprises. The government came to power with a commitment to expand and strengthen social supports for families and that is what the Budget delivered. Some of the new spending commitments hold promise. But taken together, the Business Council is concerned they will result in rising costs going forward. As the figure above shows, real per capita program spending – that is program spending adjusted for inflation and population growth – has already risen substantially over the past couple of years.

Another shortcoming is that the Budget offers nothing to help bolster the adoption of technology. The digital transformation continues to re-shape the economy and the labour market, and governments and businesses are struggling to respond to the challenges and opportunities associated with accelerating technological change. The Business Council believes the province would benefit from a forward-looking innovation agenda that supports and encourages companies to scale-up, and one that supports faster productivity growth across the economy. Based on this Budget, it is clear that there is still work to be done to make B.C. an innovation leader.

In summary, the Business Council is concerned that policy-makers are underplaying signs of softening growth globally and in North America. Increasing costs, an inability to advance major projects, and significant uncertainty for investors and firms looking to expand are eroding confidence and overall competitiveness in B.C. These trends pose a risk to the outlook for growth, particularly in export-driven sectors that play a vital role in sustaining high wage jobs, supporting local communities, and generating the revenues that governments rely on to pay for services.

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