Business Alert

Business Council of British Columbia

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BC Budget 2014: Balanced and Uneventful

Highlights

- The new Budget projects a small surplus for the upcoming fiscal year, followed by slightly larger surpluses in the following two years of the fiscal plan
- There is an abundance of caution built into the Budget including conservative growth assumptions for the provincial economy and BC's trading partners, sizable forecast contingencies, and below consensus projections for the future path of natural gas prices
- The government has been effective at containing spending, which is reflected in very limited increases in overall expenditures
- There were a few modest tax increases: MSP premiums go up 4%, smokers will pay more and the threshold for the homeowners grant was lowered
- In keeping with the government's Families First agenda, a tax credit of $55 per month for children under six years of age was announced (overall $350 million is directed towards lower income individuals, families and communities)
- The tax credit for eligible research and development spending was extended, which is good news for the province's technology sector and other industries with significant research agendas
- The provincial debt climbs higher, but the key taxpayer-supported debt-to-GDP ratio begins edging lower this fiscal year
- Somewhat surprisingly, there was nothing significant in the Budget relating to skills training
- A proposed two tier income tax structure for the LNG industry was announced, with some flexibility to ensure the tax regime is globally competitive and the details to be finalized by the fall

Operating within a very tight fiscal framework, Finance Minister Mike de Jong tabled a budget on Tuesday that projects a small surplus for fiscal 2014-15, followed by larger surpluses in the two subsequent planning years. Given the limited fiscal maneuvering room, the Budget contained only a handful of modest spending measures and a few small tax initiatives. Notably, there was nothing major in the area of skills training.

While some commentators will be critical of the limited spending increases, we recognize the accomplishment of keeping the budget in the black without imposing significant tax increases – something few other provinces are managing to do. Running surpluses puts BC in a strong fiscal position, especially at this juncture of the business cycle. The Business Council believes BC's competitive position has eroded in recent years. Although fiscal circumstances prevented the government from cutting or restructuring taxes, this is an area the province will have to address in the future as some BC industries face challenges linked to the province's move

Table 1
Budget 2014 Economic Assumptions and Forecasts for British Columbia
(annual per cent change unless otherwise indicated)

			Forecast		
	2012	**2013**	**2014**	**2015**	**2016**
BC Real GDP (chained $2002)	1.5	1.4	2.0	2.3	2.5
BC Nominal GDP	2.3	2.6	3.6	4.3	4.4
Exports Goods & Serv. (chained $2002)	0.0	1.3	2.1	3.4	3.3
Retail Sales	1.9	1.2	3.0	3.5	3.7
Housing Starts (000s of units)	27.5	27.1	24.9	25.4	26.0
Cdn 3-mnth T-bill (ann. avg. %)	1.0	1.0	1.0	1.2	2.1
Cdn 10 year gov't bond (ann. avg. %)	1.9	2.3	2.9	3.5	4.4
Real GDP Canada (chained $2007)	1.7	1.6	1.9	2.3	2.5
Real GDP US (chained $2005)	2.8	1.9	2.2	2.6	2.6
US Housing Starts (000s of units)	781	923	950	1,000	1,025
Real GDP Japan (chained Yen 2005)	1.4	1.6	1.3	1.0	1.0
Real GDP China (US$ 2000)	7.7	7.7	7.1	7.0	6.9

Source: 2014 BC Budget and Fiscal Plan

back to the antiquated Provincial Sales Tax (PST), while others are grappling with the steepest carbon tax in North America, skilled labour shortages, onerous municipal property taxes on industry, and steadily escalating electricity costs.

Economic Backdrop Set to Improve

Following a tepid growth performance in 2013, the economic backdrop for Budget 2014 is set to improve. The consensus outlook from the BC Economic Forecast Council is for real GDP growth to reach 2.3% in 2014, followed by 2.7% in 2015. In what has now become common practice, the Minister adopted more conservative assumptions, building the Budget around projected real GDP growth of 2.0% in 2014 and 2.3% for 2015.

At the Business Council we are slightly more optimistic about the next two years. Our forecast is for real GDP to increase by 2.4% in 2014 and 3.2% in 2015.

Another layer of prudence can be found in the Budget's assumptions about economic growth for BC's major trading partners. The consensus outlook for the US economy sees real GDP advancing by 2.8% this year. The Ministry of Finance is using a lower figure, 2.2%. Similarly with China, the Ministry assumes GDP growth of 7% for planning purposes, while private sector forecasts are closer to 7.5% in 2014. The Minister also relied on very conservative price projections for estimating revenues from natural gas royalties.

Although much of the risk that has overshadowed the global economy in recent years has dissipated, there is still concern about the extent of the slowdown in emerging markets and the possibility of a further flaring up of the sovereign debt and banking crisis in some Euro-zone countries.

While the Budget's baseline outlook is quite conservative, this seems appropriate given the external risks and unsettled global economic backdrop that persists.

It is worth noting that there is also some ***upside risk*** for the BC economy related to the Canadian dollar. For budgeting purposes the Ministry is using an exchange rate that averages 93.2 US cents per dollar in 2014. With the dollar already trading below this mark, the weaker Loonie may bolster exports and deliver an upside surprise to the government's GDP growth and revenue projections.

Spending Restraint Continues

Given the tight fiscal framework, it was inevitable that spending growth would be limited. For fiscal 2014-15, the government plans on increasing overall spending by just 1.7%. This means the province will be going through two years of very lean spending increases because expenditure growth for 2013-14 was held to 1.1%. To some extent, planned spending increases are back-end loaded as provincial operating expenditures are poised to rise by 2.7% and 2.4% in the subsequent two fiscal years.

Spending on health care climbs to $18.7 billion in 2014-15, a 2.9% increase over the previous year. K-12 funding was notched up slightly (0.4%), while the budget for the Ministry of Advanced Education decreases in both 2014-15 and the following year. The latter is of concern given the critical importance of post-secondary education and training in building a skilled workforce and an innovative, knowledge-based economy. We were somewhat surprised to see no significant new initiatives in the Budget relating to skills training in light of the government's focus on natural resource and infrastructure development and the extensive backlog of projects in the Major Projects Inventory.

Spending on natural resource and development will inch up in the coming fiscal year but is still well below previous levels. The government has also allotted $29 million over three years to developing the administrative and program delivery capacity to support the nascent LNG industry.

Keeping with the theme of fiscal restraint, the province will trim staffing levels again

Table 2

BC Government Three Year Fiscal Plan

(millions of dollars unless otherwise indicated)

	2012/13	2013/14	2014/15	2015/16	2016/17
Revenues	42,055	43,950	44,800	46,032	47,464
% change	0.5	4.5	1.9	2.8	3.1
Expenditures	(43,201)	(43,675)	(44,416)	(45,601)	(46,688)
% change	2.7	1.1	1.7	2.7	2.4
Surplus/Deficit before forecast allowance	(1,146)	275	384	431	776
Forecast allowance	-	(100)	(200)	(225)	(325)
Surplus/Deficit	(1,146)	175	184	206	451
Taxpayer-supported debt	38,182	41,875	43,075	44,468	45,459
(% of GDP)	17.4	18.5	18.4	18.2	17.8

Source: 2014 BC Budget and Fiscal Plan.

this year. The number of full time equivalent employees in government Ministries is targeted at 26,300 in 2014-15; five years ago there were 31,353. The reductions will be accomplished through attrition and hiring freezes.

While we endorse the rigorous management of staffing levels and the associated costs, the government must have the capacity to strategically develop policy and manage the flow of activities affecting front-line Ministries and regulatory agencies, particularly those whose work touches on economic development. This is an area we intend to monitor closely going forward.

A Handful of Tax Measures

One benefit of spending restraint is that the budget can be balanced without significant tax hikes. In Budget 2014, the most notable increase is the 4% jump in MSP premiums in 2015. On a full fiscal year basis, this generates $93 million in revenue. A higher tax on cigarettes yields $50 million annually. A decrease in the threshold for the homeowner grant will raise an additional $11 million for the government.

There were also a few positive tax changes in the Budget. The government has decided to extend the Scientific Research and Experimental Development Tax Credit program (SRED) for three years. In a full fiscal year, this will save companies undertaking eligible R&D$180 million.

To support families and community safety, the government found an additional $350 million over three years for individuals with developmental disabilities, some social housing, and additional policing. The most notable initiative in this area is the BC Early Childhood Tax Benefit, amounting to $55 per month per child under six years of age. This is projected to save families with young children a total of $146 million annually.

Adding it all up, there were more tax cuts than tax increase in Budget 2014, resulting in a net revenue loss of $181 million annually. As shown in Table 2, revenues are projected to increase by just 1.9% in 2014-15. With nominal GDP growth expected to accelerate, actual revenue growth may exceed the government's forecasts for 2014-15 and over the full fiscal plan.

More Details on LNG Development

The Budget also provided more information on the proposed fiscal framework for the emerging LNG industry. Later this year, the government will introduce a two-tier income tax structure for the industry. In the initial years, LNG operators will pay 1.5% on their net proceeds (revenue less expenses). The Tier 2 rate could be up to 7%, but is still being finalized. The higher Tier 2 rate does not apply until an operator's "capital investment account" has been depleted. This will allow companies to retain more of the profits while they recoup the billions of dollars in capital investment necessary to establish these facilities. The LNG income tax is paid in addition to other applicable federal and provincial taxes, including basic corporate income tax.

Important additional cost considerations, such as GHG policies, labour supply, regulatory systems, infrastructure needs and First Nations agreements, all remain to be finalized in the coming months and will play an important part in ensuring BC establishes a competitive policy framework judged against other jurisdictions competing for the same capital.

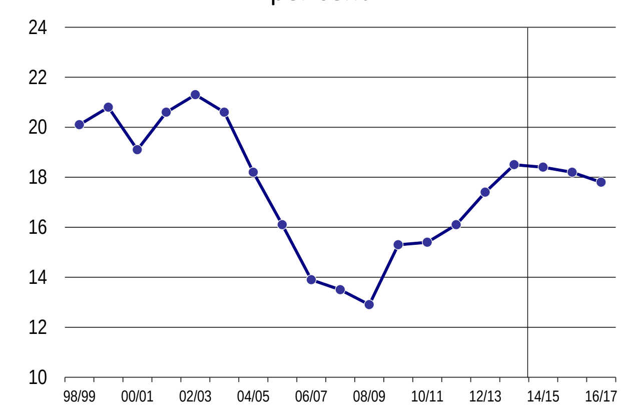
Debt and Capital Spending

Total capital spending in the province rises from $5.97 billion to $6.62 billion in fiscal 2014-15. The main reason for the increase is capital outlays in the post secondary area. Additional investment by BC Transit and BC Hydro also contribute to the overall increase. Capital spending declines modestly over the following two years of the fiscal plan.

Total provincial debt, which includes tax-payer supported debt as well as self-supporting debt (mostly issued by Crown Corporations) is set to reach $64.7 billion in 2014-15. The taxpayer-supported portion increases to $43.1 billion, up from $41.9 billion in 2013-14. Importantly, the taxpayer-supported debt-to-GDP ratio begins to decline in the next year as nominal GDP growth outpaces the planned increases in debt. The net debt-to-GDP ratio for this year will edge down to 18.4% before declining to 17.8% by the end of the fiscal plan. British Columbia continues to have a relatively low net debt-to-GDP ratio by Canadian standards.

Taxpayer Supported Debt-to-GDP Ratio

per cent



Source: BC Fiscal and Economic Review and 2014 BC Budget

The composition of taxpayer-supported debt is seldom talked about but is interesting and relevant to assessing the province's overall debt position. Debt from government operations (the accumulation of past deficits) amounts to $9.8 billion, or 22% of all taxpayer-supported debt. The remaining $33.2 billion is attributable to capital investments in highways, transit, hospitals, and schools. In other words, the majority of BC's taxpayer-supported debt results from past investments in necessary and productive long-lived assets.

Conclusion

The new provincial Budget contained no real surprises. Government has delivered on its promise to balance the books, and given the prudence built into the Budget and the government's track record of managing spending, the projected surplus targets will almost certainly be achieved – and likely bettered. This will give the government more scope to address issues such as competitiveness and skill shortages in the next few years.

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