Business Alert

Business Council of British Columbia

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BC Budget 2015: Few New Measures …But An Era of Surpluses Lies Ahead

Highlights

- BC has shifted firmly into surplus territory. Budget 2015 projects a ~$1 billion operating surplus for 2014-15, a modest flow of black ink for the following year, and then slightly larger surpluses in the remaining two years of the fiscal plan.
- BC may be the only province in the country to report an operating surplus in 2015-16.
- The Budget forecasts that BC's economy will grow by 2.3% this year and by 2.4% in 2016; these are below the private sector consensus. Generally, there is an abundance of caution built into Budget 2015, including conservative growth assumptions for BC's economy, below consensus projections for the US, and cautious assumptions about the dollar and interest rates.
- Overall program spending is slated to increase in line with inflation and population, rising by 2.5% annually over four years. Expenditure growth is tilted towards health care (+2.9% per year).
- K-12 education also gets some additional funding, most of which will go to pay for compensation costs based on recent contract settlements.
- Revenue growth tracks slightly ahead of expenditure growth over the projection period.
- Government capital spending remains around $6.2 billion annually for the next three years, rather than being reduced by 20%, as was planned in last year's budget.
- Taxpayer-supported debt rises over the coming three years, due to capital spending, but net debt as a share of GDP declines. BC continues to have a low debt-to-GDP ratio compared to most other Canadian jurisdictions.

The benefits of BC's diverse and resilient economy were evident as Finance Minister Mike de Jong tabled a Budget on February 17 that calls for a modest surplus for 2015-16, followed by slightly larger surpluses in the two subsequent years. This places BC in the position of being possibly the only province to balance its books in the coming year.[1] Fiscal circumstances, however, remain tight, and the Budget featured few new spending or taxation initiatives. Spending increases that did make it into the Budget were concentrated in health care and to a lesser extent education, along with a few targeted measures aimed at lower income households. The government opted to advance capital spending over what it had planned last year, in line with the Business Council's advice.

Keeping the operating budget in the black without tax increases is a rare achievement in

[1] There is a small chance that Saskatchewan may also avoid a deficit.

Table 1

Budget 2015 Economic Assumptions and Forecasts for British Columbia

(annual per cent change unless otherwise indicated)

			Forecast		
	2013	2014	2015	2016	2017
BC Real GDP (chained $2007)	1.9	2.2	2.3	2.4	2.3
BC Nominal GDP	3.2	3.9	3.8	4.3	4.3
Exports Goods & Serv. (chained $2007)	2.5	2.1	3.3	2.7	2.8
Retail Sales	2.4	5.4	3.3	3.7	3.6
Housing Starts (000s of units)	27.1	28.4	27.6	27.5	27.0
Cdn 3-mnth T-bill (ann. avg. %)	1.0	0.9	1.1	1.8	2.3
Cdn 10 year gov't bond (ann. avg. %)	2.3	2.2	2.5	3.1	3.8
Real GDP Canada (chained $2007)	2.0	2.3	2.0	2.0	2.2
Real GDP US (chained $2009)	2.2	2.4	2.5	2.5	2.5
US Housing Starts (000s of units)	925	1,006	1,000	1,025	1,050
Real GDP Japan (chained Yen 2005)	1.6	0.0	0.8	0.8	1.0
Real GDP China (US$ 2005)	7.7	7.4	6.7	6.6	6.6

Source: 2015 BC Budget and Fiscal Plan.

today's still uncertain economic climate. Surpluses put BC in a strong fiscal position, which is a good place to be six years into the recovery phase following the 2008-09 economic downturn.

While we broadly support the Budget, the Business Council remains concerned about the erosion of BC's competitive position. The decline in the Loonie has made our products and tradable services more competitive in the North American marketplace. But this should not be the basis of a competitiveness strategy. There is nothing in the Budget to address challenges for business posed by the shift back to the Provincial Sales Tax (PST). The cement industry did receive some targeted relief from the carbon tax, but other energy-intensive, trade-exposed sectors are still grappling with the effects of BC's decision to impose the steepest carbon price in North America. Nor did the new Budget earmark more funding for skills training. In short, this is very much a stay-the-course Budget that offers stability but without many new initiatives or ideas.

Economic Backdrop to Improve

Following estimated growth (real GDP) of 2.2% in 2014, the economic backdrop for Budget 2015 is slightly better. The government chose to build the Budget around a real GDP growth projection of 2.3% for this year and 2.4% in 2016; both are below the projections published by the Economic Forecast Council. A below consensus economic outlook for BC provides one layer of "prudence" in the government's fiscal plan.

Another layer can be found in the Budget's assumptions about external economic conditions. The Ministry of Finance believes the US economy will expand by 2.5% in 2015-16, whereas many private sector forecasters are looking for 3.0% or more. The Ministry sees the beleaguered Canadian dollar averaging 85 US cents in 2015. At this point

US 80 cents seems more realistic, and some leading forecasters expect the Loonie to lose even more ground. The Budget's exchange rate forecast supplies another dollop of prudence, because a weaker Loonie bolsters BC's net exports and results in stronger overall economic growth. For every one cent drop in the exchange rate with the US dollar, the BC government realizes an extra $25-$50 million in revenue. The Budget also sees interest rates edging upward at a faster pace than most private sector forecasts, which is yet another source of prudence. Finally, Budget 2015 contains healthy forecast allowances and contingency reserves, giving the government scope to offset the effect of adverse shocks that could dampen revenue collections or push spending higher.

There are some downside risks to the macroeconomic backdrop, notably around growth in emerging markets and the possibility that Greece will default on its debts and exit from the Eurozone. But from our perspective, the province's baseline economic outlook is very conservative and provides ample protection against any downside developments.

Modest Spending Restraint

The government's determination to balance the operating budget is reflected in the continued tight management of program spending. Over the four year period 2014-15 to 2017-18, spending grows at an average annual rate of 2.5%. On an inflation adjusted, per capita basis, spending will be flat or edge down slightly over the planning horizon. Because of the likelihood of upside surprises on revenues in the coming years, we expect that expenditures will be adjusted higher in future Budgets.

Much of the jump in spending is aimed at health care. Health care outlays climb by an average of 2.9% over the next three years. Funding for K-12 education is boosted by $106 million this year and by $200 and $258 million in the following two years. The majority of this is to cover the cost of labour settlements.

Revenue Growth

Over the same four year period noted above, total provincial revenues grow by an average rate of 2.7%, a bit faster than spending. Some of the major sources of revenue, such as

Table 2

BC Government Three Year Fiscal Plan

(millions of dollars unless otherwise indicated)

	2013/14	2014/15	2015/16	2016/17	2017/18
Revenues	43,728	45,772	46,365	47,646	48,617
% change	4.0	4.7	1.3	2.8	2.0
Expenditures	(43,375)	(44,793)	(45,831)	(46,920)	(47,868)
% change	0.4	3.3	2.3	2.4	2.0
Surplus/Deficit before forecast allowance	353	979	534	726	749
Forecast allowance	-	(100)	(250)	(350)	(350)
Surplus/Deficit	353	879	284	376	399
Taxpayer-supported debt	41,068	42,302	43,182	44,126	44,733
(% of GDP)	17.9	17.7	17.4	17.1	16.6

Source: 2015 BC Budget and Fiscal Plan.

personal and corporate income tax, retail sales tax, and property tax, are expected to grow more rapidly than total revenue. Federal transfers are pegged to increase by 5.1% annually over the three year fiscal plan.

Weighing down on total revenue growth is the government's prediction that proceeds from the property transfer tax will fall (10.7%) this year, reflecting an anticipated slowing in housing market activity. Forest revenue is projected to increase at an annual rate of 6.2% over the next three years. Overall, however, natural resource revenue is forecast to decline in the coming year, mainly due to decreasing natural gas royalties. After 2015-16, aggregate resource revenue is projected to rise modestly.

In light of the prudence built into the Budget's economic projections and assumptions, we suspect the government will realize more revenue than the Budget forecasts in each of the next three years.

Capital Spending Plan

In the lead up to the Budget, the Business Council encouraged the government to re-think its three year capital spending plan as described in Budget 2014. That plan envisaged a significant drop in total provincial capital outlays over three years. With interest rates and government borrowing costs at all-time lows, now would seem to be an odd time to reduce public sector capital outlays on infrastructure development, other new physical assets, and the refurbishment and maintenance of existing assets. The International Monetary Fund, the Organization for Economic Cooperation and Development, and the G20 Leaders' summit in Australia last November all called for increased infrastructure investment by governments blessed with strong balance sheets. That describes Canada, and also BC.

We are thus pleased that the province has tweaked the capital spending plan it unveiled a year ago. According to Budget 2015, overall capital spending will reach $6.25 billion in 2015-16, unchanged from 2014-15, and then stay at roughly that level through 2017-18, a trajectory that is more closely aligned with the Business Council's recommendations. Budget 2014 had penciled in a 20% drop in capital spending between 2014-15 and 2016-17.

Tax and Spending Measures

Budget 2015 is largely a stand-pat effort, but it does contain a handful of new spending and taxation measures, summarized in the accompanying box. None are terribly significant in a $46 billion budget, or in relation to an economy with a nominal GDP approaching $250 billion. Media attention has focused on the government's decision to end the claw-back of child support payments from low-income single parents. The Budget also includes a small tax reduction for lower income taxpayers – a step expected to benefit 500,000 British Columbians.

On the business side, the mining and film production/digital media industries will welcome the extension of previously legislated tax incentive programs. The mining sector will also benefit from additional funding allocated to the Ministry of Energy and Mines to drive efficiencies around permitting and regulatory oversight. A one-time injection of $3 million to augment the Small Business Venture Capital tax credit should help to leverage new equity financing for small technology companies.

Revenue and Spending Measures

- MSP premiums rise 4%
- Training tax credits extended for three years ($31 million annually)
- BC mining flow through share tax credit extended to the end of 2015
- Interactive digital media tax credit extended for three years (total $50 million annual reduction in tax)
- Children's fitness equipment credit is introduced
- New funding for mining and LNG development ($10 million annually for three years)
- Support for implementing the *Water Sustainability Act* (~ $15 million annually)
- Funding to help the cement industry reduce air emissions
- $150 million over three years to support families in need
- An additional $106 million over three years for Community Living BC
- Exempt child support payments from income assistance claw backs
- An additional $20 million in funding for income assistance
- High income personal surtax to be eliminated, as previously pledged

Extension of the training tax credit is expected to stimulate more private sector training (although we would like to see a published evaluation of the effectiveness of this tax credit, which was initially introduced a decade ago). A new initiative aimed at persuading more global shipping companies to locate their offices in BC may reverse the outflow of such firms seen over the past several years.

The government confirmed an earlier pledge to spend $5 million over five years to support growth in the aerospace industry. It is hard to imagine that this will make much difference; of interest, Washington State recently adopted 30-year incentive package totalling US$8.7 billion to entice Boeing to manufacture its new Dreamliner jet at production facilities within the State. A recent study found that state and local governments in the United States are now spending $80 billion annually to lure specific business projects and investments to their jurisdictions.[2] Canada as a whole, including BC, is struggling to attract greenfield investments, notably in the manufacturing and advanced technology sectors, amid the torrent of incentives and subsidies available south of the border.

Medical Services Plan (MSP) premiums will increase another 4% starting next January (bringing in an extra $100 million or so for the treasury on a full year basis). The large majority of employers who pay MSP premiums for their employees and their families will feel the pinch, along with the self-employed and non-working residents with incomes too high to qualify for premium assistance. British Columbia is the only province that levies a separate tax/premium charge for health coverage; in the coming year, it is expected to generate $2.4 billion, enough to cover 13.7% of the budget of the Ministry of Health in 2015-16.

[2] Council on Foreign Relations, "Curtailing the Subsidy War Within the United States," Policy Innovation Memorandum No. 45, May 2014.

Overall Assessment
… and Some Unfinished Business

British Columbia is in a strong fiscal position compared to most other provinces. The government is poised for a few years of (smallish) operating surpluses, at a time when many other jurisdictions are working to stanch the flow of red ink; BC's tax-supported debt is expected to diminish as a share of GDP, from an already relatively low level; and compensation/labour cost pressures in the broad public sector appear to have been managed well – a point that warrants mention, since 57% of all BC government spending is eaten up by wage/salary, benefit and other labour costs.

Then too, the economic picture in BC is reasonably favourable. Falling oil prices, a depreciating Canadian dollar, a rebounding American economy, and record low interest rates are four macroeconomic trends that all promise to have a positive impact on GDP and employment growth in the province. A rising population and high levels of major project-related construction spending are also contributing to a decent economic growth rate.[3]

True, there are a few worrisome signs on the economic front, foremost among them a record high and still rising household debt burden that is poised to increase further thanks to exceptionally low interest rates. Excessive household debt represents a source of vulnerability for the BC economy (and for Canada) over the medium-term, as emphasized by the Bank of Canada.[4] The outlook for large-scale LNG investments has dimmed amid the turmoil gripping global energy markets.

Looking beyond the near term, we also have some concerns in the areas listed below:

Eroding competitiveness: A number of BC industries have seen their competitive positions deteriorate, due to the extra production and compliance costs attendant upon the return to the PST following the elimination of the HST; higher fuel costs caused by BC's carbon tax; growing regulatory complexity and delays in advancing projects; issues linked to the ability to gain access to Crown land and resources in a province where the Crown controls more than 90% of all land; and challenges around access to capital in the advanced technology sector. All of these areas require ongoing, focused attention from policymakers as part of a commitment to strengthen BC's competitiveness.

Advanced education: The province's Skills for Jobs strategy is intended to bring the supply of skills into better alignment with labour market demand. We support the strategy, including the increased focus being put on skilled trades and technical occupations. But over time, as fiscal circumstances improve, we also believe it will be necessary to increase funding for post-secondary education (PSE) and research to ensure that BC maintains a high quality and well-integrated PSE system.

[3] The government's Major Project Inventory reports $83 billion of current construction activity in BC, up from $63 billion a few years. This figure does not include "potential" or "proposed" projects.

[4] Bank of Canada, Financial System Review, December 2014.

Innovation and productivity will also demand greater attention in upcoming Budgets. While there is some overlap with competitiveness and advanced education, the province should be looking at policies and programs that can stimulate innovation and higher productivity. Later this year the Business Council will publish a white paper on Innovation and Productivity that will include some specific recommendations in this area.

Child poverty is also a concern. By most measures, BC lags behind other provinces on metrics gauging child poverty. The Budget did include some targeted measures to help low income households with children, but we are convinced that more resources, both directly and through related government programs, need to be found and channeled towards improving the circumstances and life chances of children living below the poverty line.

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