BC BUDGET UPDATE ANALYSIS

Business Council of British Columbia
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BC BUDGET UPDATE SIGNALS MODEST TAX CHANGES AND ADDITIONAL SPENDING MEASURES

HIGHLIGHTS

- The Budget Update outlines three more years of operating surpluses of roughly $250 million each year. There is also a reasonable fiscal cushion built into the Update to help ensure budget targets are met.
- The Update contains a mix of tax relief and tax increases. Larger companies, especially those with energy-intensive production processes, face a higher tax burden. The small business tax rate is trimmed.
- Many households will enjoy some tax relief, but this varies depending on existing MSP premium payments. Eliminating tolls means frequent users of the Port Mann and Golden Ears bridges will see significant annual savings.
- Social assistance payments are increased by $100 per month.
- Over the three-year fiscal plan, overall capital spending falls slightly, mostly reflecting the shelving of the Massey Tunnel replacement project.
- Overall the Budget Update can be viewed as a balanced document which reflects steps to meet some of the NDP's campaign promises.
- Looking ahead, however, fulfilling more costly promises such as subsidized universal day care and a very large increase in rental and low income housing units will be more challenging within the current fiscal framework.

After more than 16 years in opposition, the NDP government introduced its first budget earlier this week. More accurately, Finance Minister Carole James unveiled a Budget Update, with the more comprehensive budget and fleshed out fiscal plan to come next February.

Nevertheless, the Update provided an opportunity for the new government to act on some of its campaign promises and set the tone for its approach to managing the province's finances. The Finance Minister announced some moderate tax increases, a couple of tax reductions, and higher spending in a few priority areas — notably education, housing, and social services. Unlike its predecessor, the NDP government is less attracted to fiscal austerity and likely won't use future operating surpluses to reduce the stock of accumulated debt.

Minister James was in the enviable position of having a sizable surplus to work with. This permitted her to boost spending while keeping tax increases modest and the budget in rough balance. There were no major surprises in the Budget. Most of the measures were either outlined in the NDP's election platform, or included in the agreement with the Green party. There are, however, a number of expensive NDP campaign promises — including universal subsidized child care, a new renter's rebate, large investments to build rental and low income housing, and the full elimination of MSP premiums — that are not addressed in this Budget.

ECONOMIC SETTING

BC's economy is on a solid footing. The new government is benefitting as the positive momentum continues, with real GDP growth for 2017 now pegged at 2.9%. Next year, however, the economy is expected to downshift to 2.1%. These figures reflect the province's long-standing practice of trimming the consensus forecast provided by the government's Economic Forecast Council to provide a layer of budgeting prudence. When the former government introduced its last Budget back in February, it was based on economic growth of 2.1%. That the BC economy has remained stronger than anticipated is the main reason why the NDP government had a sizable surplus to work with in preparing its September 2017 Update.

For 2018, the government sees economic growth easing to 2.1%, which approximates BC's long-term "potential" growth rate and is also in line with the views of most private sector forecasters. In our assessment, economic growth will decelerate as the stronger Canadian dollar begins to take some of the steam out of the export sector, higher interest rates dampen housing-related activity, job growth slows from its recent unsustainable pace, and consumers in BC cut back on what has been a spending splurge. The BC economy has been growing above potential for at least three years and is overdue for some degree of cooling.

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TAX CHANGES

The Budget Update contained a number of tax measures that, taken together, will see the tax burden for many businesses and all higher income individuals rise. These were all previewed in the NDP's election platform and so do not come as a surprise. Briefly recapping, the Budget Update announced:

- An increase to the general corporate income tax rate from 11% to 12%, effective January 1, 2018. This measure generates another $103 million for the treasury over the final months of the current fiscal year and an extra $313 million in 2018-19.
- The provincial income tax rate for Individuals making over $150,000 climbs from 14.7% to 16.8%, effective January 1, 2018. This is projected to raise an additional $218 million in the first full fiscal year.
- The BC carbon tax is set to rise by $5 per tonne for each of the next four years, reaching $50 by 2021. The first increase effective April 1, 2018 will produce an additional $212 million in revenue for the government in 2018-19. The NDP intends to change the legislation underlying the carbon tax to remove the requirement for "revenue neutrality" embraced by the previous government.

The Budget Update also included a handful of tax reductions.

- The government intends to meet its election promise to phase out Medical Services Plan premiums, with an initial 50% cut in 2018. This comes with an initial price tag of $1.2 billion for the 2018-19 fiscal year. An expert panel will be appointed to examine how to make up the revenues lost as MSP premiums are reduced to zero over four years.
- In February, the Liberals pledged to phase out the Provincial Sales Tax (PST) on electricity purchased by industrial and commercial businesses, and the NDP intends to follow through on this – a welcome step. The first phase results in savings of $80 million for business in the full fiscal year 2018/19. The PST on electricity will be fully eliminated by April 2019.
- The already low BC small business tax rate is lowered from 2.5% to 2.0%, retroactive to April 1, 2017, saving small businesses $80 million annually.

There are a few other revenue changes (some previously announced and others new) in the Budget Update.[1] Adding them all up, the overall impact of the entire suite of revenue measures is a reduction in government receipts of $880 million on a full fiscal year basis.[2] Overall revenue, however, is still higher than the previous fiscal year due to economic growth. So it is incorrect to claim that the NDP's first budget has increased the aggregate tax burden on BC residents, judged against the February 2017 budget.

[1] For example, the maintenance of favourable tax treatment for BC credit unions, extension of the Scientific Research and Development tax credit and the training tax credit, and the elimination of the International Financial Activities Act.

[2] As reported on page 61 of the Budget document.

But it is true that large businesses and higher-income households will be paying more.

From the Business Council's perspective, it is unfortunate that the long-awaited break on PST applied to electricity purchases by business will be more than clawed back in the form of higher income and carbon taxes. In the next full fiscal year, the reduction in the PST on electricity collectively saves all businesses $82 million, while the first $5 increase in the carbon tax yields another $212 million, of which energy intensive businesses pay a disproportionate amount. In addition, energy-intensive exporters operating in BC will now face a higher corporate income tax on their profits. We continue to have concerns about BC's waning industrial competitiveness and the attractiveness of the province as a place to deploy capital in the natural resource, manufacturing and transportation industries that are the backbone of the export economy.

TABLE 1: **BC GOVERNMENT THREE YEAR FISCAL PLAN**
(MILLIONS OF DOLLARS UNLESS OTHERWISE INDICATED)

			FORECAST		
	2015/16	**2016/17**	**2017/18**	**2018/19**	**2019/20**
Revenue	47,602	51,459	52,407	52,557	53,677
% change	*3.3*	*8.1*	*1.8*	*0.3*	*2.1*
Expense	46,791	48,722	51,861	52,029	53,070
% change	*5.3*	*4.1*	*6.4*	*0.3*	*2.0*
Forecast Allowance	-	-	300	300	350
Surplus	811	2,737	246	228	257
Taxpayer-supported debt	42,727	41,506	44,853	47,031	48,642
% of GDP	*17.1*	*15.8*	*16.2*	*16.4*	*16.3*

Source: 2017 BC Budget Update.

SPENDING RISES

The Budget Update confirms several new spending measures highlighted in the NDP's election platform, with a focus on enhancing services and improving affordability for British Columbians. Altogether, these new initiatives add another $1.8 billion to overall spending in the next three fiscal years.

- One factor pushing up spending is higher compensation for all unionized employees and other eligible groups in the broader public sector, flowing from the Economic Stability Mandate adopted by the previous government.
- A $100 increase in social assistance and disability assistance rates will cost $472 million over three years.
- To deliver more affordable housing, an additional $172 million over three years is allocated to fund the operating cost of 2,000 new modular units to house the homeless.
- Another $521 million over three years goes to the Ministry of Education to hire another 3,500 teachers.
- The health budget goes from $17.9 billion in 2016-17 to $19.6 billion in 2018-19 to cover rising compensation costs and also to help address the fentanyl crisis.
- For 2017-18, an extra $668 million is earmarked to fight forest fires.

Eliminating the tolls on the two Metro Vancouver bridges was a campaign promise that the new government acted on quickly. The estimated net operating cost to government is a hefty $479 million over three years. The shelving of the George Massey Tunnel replacement project has resulted in a write-off of $52 million of spending that has already occurred.

CAPITAL SPENDING

The Budget Update sees capital spending supported by taxpayers rise to a cumulative $14.6 billion over the next three years — $930 million higher than outlined in the Liberals' February budget. The additional capital spending is mainly for health facilities and new housing investment. Self-supported capital spending — primarily by BC Hydro — is projected to total $8.5 billion over the same three-year period. Self-supported capital spending is now $2.3 billion lower than projected in February. The net result is that total provincial capital spending is now estimated to amount to $23.1 billion over three years, a bit less than what was expected in February. The Business Council has long pressed for stepped up capital spending, especially for transportation infrastructure which is fundamental to moving goods and people around and through the province.

Looking ahead, we wonder how the NDP government will finance its ambitious medium-term campaign commitments and stated policy priorities.

PROVINCIAL DEBT

BC's total provincial debt will increase by $6.9 billion over the next three fiscal years. Most of this is attributable to borrowing undertaken to finance taxpayer-supported capital projects. Eliminating tolls on the two Metro Vancouver bridges means $3.5 billion of previously "self-supported debt" is being reclassified as taxpayer-supported debt. However, at 16.2% of GDP in 2017-18, BC's taxpayer-supported debt remains both manageable and low by the standards of most other Canadian provinces.

FINAL THOUGHTS

The NDP's first Budget contained no surprises. It reflects a move away from tight fiscal management and operating surpluses that characterized the last few years of the Liberal government[3] to a period of somewhat higher spending — largely on K-12 education, social programs and affordable housing.

The new government has made a political choice to allocate more financial and administrative resources to support low and moderate-income households, while still maintaining a balanced budget. All of the important measures unveiled in the Update were referenced in the NDP's platform and/or in the agreement with the Green Party.

The mix of tax increases and tax cuts in the Budget Update means revenues are somewhat lower than they otherwise would have been. At the margin, the tax burden shifts to large and mid-sized businesses and upper-income households. Most smaller businesses, individuals who pay their own MSP premiums, and regular users of the Port Mann and Golden Ears bridges will enjoy net savings. Businesses in the natural resource, manufacturing and transportation sectors are not so fortunate.

Looking ahead, we wonder how the NDP government will finance its ambitious medium-term campaign commitments and stated policy priorities. The current economic environment in BC is as "good as it gets," with GDP and job growth expected to slow in 2018-19 and a recession possible by the end of the decade. In this setting, it is hard to see where the additional revenue to pay for subsidized universal day care, a big expansion in the stock of affordable rental housing, a new renter's rebate, and the full elimination of MSP premiums will come from. Part of it will come from a rising carbon tax. But we see a risk of further significant tax increases over the next few years — a scenario that causes us to worry both about the province's overall competitiveness and what the future may hold for some of the industries that produce the bulk of BC's exports.

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[3] It should be noted that while the Liberal government recorded several years of budget surpluses, the financial health of two major Crown Corporations – ICBC and BC Hydro – has deteriorated significantly since 2012, in part due to decisions made by the former administration.