Business Council of British Columbia

Business Alert

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2012 BC Budget: Fiscal Caution Amid Economic Turbulence

Against an unsettled external economic backdrop, this week's provincial budget saw Finance Minister Kevin Falcon reaffirm the government's commitment to balance the operating budget by fiscal 2013-2014. Meeting this objective – which is mandated by current law – will require downshifting spending growth to about half the pace set during the years preceding the 2008-09 recession. While it featured a few new measures, the dominant theme of Budget 2012 is spending discipline while seeking to maintain core government services. To help address funding pressures across the provincial public sector, resources continue to be reallocated to higher priority areas such as health and education, and efforts to find efficiencies within existing budgets are accelerated.

To move back to a balanced budget within the timeframe stipulated by existing legislation, the government needed to find some additional revenue. The shortfall will be made up by keeping the small business tax rate at 2.5%, rather than cutting it to zero as previously planned. The government also has provisional plans to notch up the corporate income tax rate by one point (to 11%) in 2014, if growth is weaker than anticipated. Additional revenue is also to be generated from the sale of surplus real property assets. Consistent with the approach the BC Liberals have taken in the past, Budget 2012 is based on conservative economic assumptions and includes various contingencies to ensure the balanced budget objective is met.

While some commentators may have been looking for more substantial spending increases, we believe Budget 2012 represents a practical plan amid a challenging and uncertain economic climate.

From our perspective, it is impossible to ignore the contrast between what is happening in Ontario and BC. British Columbia's Budget comes just a few days after the Drummond Report delivered the sobering message that status quo fiscal policy will leave Ontario on course for its deficit to swell to an alarming $30 billion (3.7% of GDP) by fiscal 2017-18. Pulling no punches, the Drummond report concludes that Ontario has been living well beyond its means and must institute sizable absolute spending cuts – as opposed to simply slowing the growth of spending – in order to stem the tide of red ink. In contrast, Finance Minister Kevin Falcon will be able to balance BC's budget by restraining spending growth and introducing a few minor revenue measures. The difference between the fiscal situations and outlooks for the two provinces could hardly be more striking and serves to underscore the importance of sound fiscal management.

The Economic Backdrop

A notable feature of Budget 2012 is the cautious economic assumptions it is built around. The Ministry of Finance projects that BC's economy will grow by 1.8% (after inflation) this year and by 2.2% in 2013. In comparison, the consensus view reflected

Table 1

Budget 2012 Economic Assumptions and Forecasts for British Columbia

(annual per cent change unless otherwise indicated)

			forecast		
	2010	**2011**	**2012**	**2013**	**2014**
BC Real GDP (chained $2002)	3.0	2.0	1.8	2.2	2.5
BC Nominal GDP	5.9	4.3	3.7	4.1	4.4
Exports Goods & Serv. (chained $2002)	6.0	4.5	2.5	3.0	3.1
Housing Starts (000s of units)	26.5	26.4	25.0	26.0	26.7
Cdn 3-mnth T-bill (ann. avg. %)	0.6	0.9	1.0	1.6	2.6
Cdn 10 year gov't bond (ann. avg. %)	3.2	2.8	2.4	3.0	3.9
Real GDP Canada (chained $2002)	3.2	2.3	1.5	2.0	2.5
Real GDP US (chained $1996)	3.0	1.7	1.4	1.8	2.5
US Housing Starts (000s of units)	587	607	580	700	800
Real GDP Japan (chained Yen 2000)	4.5	-1.2	1.5	1.0	1.0

Source: 2012 BC Budget and Fiscal Plan

by the Ministry's Economic Forecast Council is for economic growth of 2.2% in 2012 and 2.5% in 2013. At 2% in 2012, the Business Council's most recent forecast is between the two, but still higher than what the Ministry is expecting.

Developing the Budget around a slower growth forecast is a prudent approach, especially in light of ongoing downside risks in Europe. The Ministry is also cautious about the US outlook. In spite of some positive economic news emerging from south of the border, for budgeting purposes the government assumes the US economy will grow by just 1.4% in 2012, well shy of the private sector consensus of 2.2%. Similarly in 2013, the Ministry forecasts US real GDP growth of 1.8% compared to the consensus view of 2.5%

Consistent with this muted growth outlook, the Ministry assumes US housing starts will decline slightly in 2012 before rising in 2013. For most economic indicators, growth assumptions and commodity price projections that feed into the budgeting process, the Ministry of Finance has adopted conservative assumptions to help ensure that fiscal targets are realized (and probably exceeded).

Last Year's Targets Not Met Because of Repayment of HST Transition Funding

With the current fiscal year nearly over, the Ministry of Finance is now projecting a deficit of nearly $2.5 billion for 2011-12. It is fair to say, however, that the initial plan outlined in last year's budget is actually more or less on track. Excluding the impact of booking the repayment of HST transition funding to the federal government, this year's deficit would be $898 million, only $27 million ahead of the last year's target.

Restrained Spending Growth Ahead

To meet its balanced budget commitment the government plans on containing the growth in program expenditures to 2.0% per year over the three year fiscal plan. By our reckoning, this is about half of the average annual pace of spending growth

Table 2
BC Government Three Year Fiscal Plan
(millions of dollars unless otherwise indicated)

	2010/11	2011-12	2012/13	2013/14	2014/15
Revenues	40,752	41,945	43,101	44,603	45,711
% change	6.9	2.9	2.8	3.5	2.5
Expenditures	41,061	42,793	43,869	44,199	45,111
% change	2.7	4.2	2.5	0.8	2.1
Surplus/Deficit before forecast allowance and HST funding repayment	(309)	(848)	(768)	404	600
Forecast allowance	--	(50)	(200)	(250)	(350)
HST Funding Repayment	--	(1,599)	--	--	--
Surplus/Deficit	(309)	(2,497)	(968)	154	250
Taxpayer-supported debt	31,855	34,786	38,736	41,656	43,702
(% of GDP)	15.7	16.4	17.6	18.2	18.3

Source: 2012 BC Budget and Fiscal Plan.

seen in the years preceding the recession, and is also less than the 3% average growth in expenditures recorded between 2009-10 and 2011-12. With the population increasing by about 1.5% per year and inflation running near 2%, the revised fiscal plan has program spending **falling in real per capita terms**. More so than in the past, the text and discussion in Budget 2012 places a heavy emphasis on restraining expenditures and on realizing a more sustained bending of "cost curves" downwards.

To realize budget targets (as well as manage expenditures over the longer term), the restraint theme extends into health and education, which together chew up over two-thirds of all expenditures. Over the three-year fiscal period, Budget 2012 foresees spending on health and education growing by an average of 2.4%, which is significantly slower than the pre-recession era (6.3% on average) as well as the previous three recession/recovery years (4.2%). Outside of the health and education areas, spending will be held flat or increased only very slightly in the coming years.

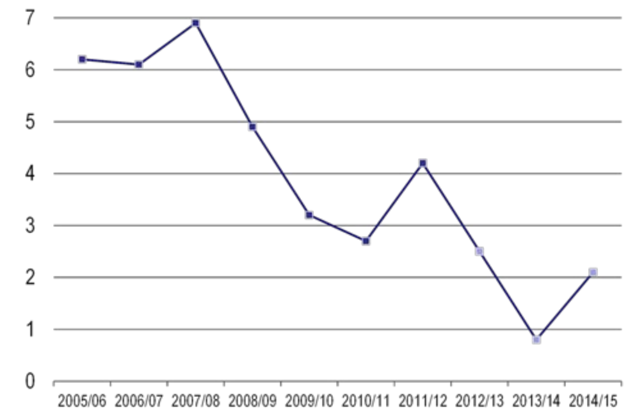
Despite Modest Revenue Growth Budget Will Be Balanced

The modest growth environment translates into subdued revenue gains. As detailed in Table 2, revenues are projected to increase by just 2.8% in 2012-13. The anticipated pick up in the economy is the main factor behind the stronger revenue growth for 2013-14. Revenues will be dampened by a 5.3% decrease in federal cash transfers in 2012-13 and by continued relatively low natural gas prices.

The budgetary shortfall for fiscal 2012-13 is pegged at $968 million, equal to 0.4% of GDP. In comparison, Ontario's deficit is on track to reach at least 2.3% of GDP next year. Note, too, that BC's projected deficit includes a $200 million forecast allowance. If this cushion is not required, the deficit for 2012-13 will come in at $768 million.

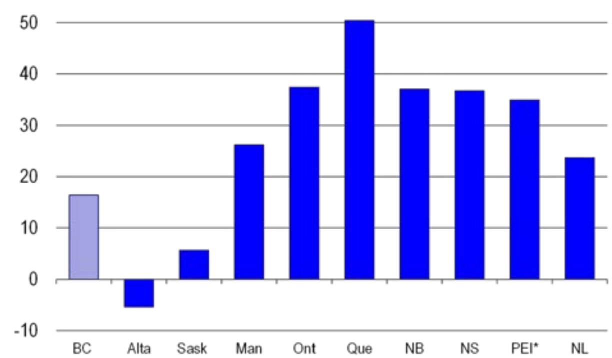
Debt continues to climb over the fiscal plan. Taxpayer-supported debt is projected to grow from $34.7 billion in fiscal 2011-12 to $43.7 billion by 2014-15, mostly reflecting significant investments in capital spending over the next three years as the operating deficits are relatively small and will be eliminated by 2013-14. The increase in the debt load is large enough that the net or taxpayer-supported debt-to-GDP ratio rises from 16.4% to a peak of 18.3% of GDP in 2014-15. It is important to note that BC's debt load remains very manageable compared to most other provinces. BC currently has the third lowest debt-to-GDP ratio among the provinces, and will retain this position even as the ratio inches up to 18% in the next two years.

Growth in Provincial Expenditures
per cent



Source: RBC Fiscal Reference Tables

Provincial Debt-to-GDP Ratios, 2011/12
per cent



Source: RBC Fiscal Reference Tables *PEI 2010/11 ratio

PST Transition Strategy Clarified

The Budget contained specific details and timelines regarding the transition from the HST back to the PST. As of April 1, 2013 British Columbia will return to the PST/GST system. New housing is one area where uncertainty around the shift back to the old tax system has caused concern. To help alleviate these concerns and provide more certainty for the industry the government is increasing the threshold for HST rebates on new home purchases from $525,000 to $850,000 as of April 1, 2012. The maximum rebate available to purchasers rises from $26,250 to $42,500. Because it takes time to build homes and sell dates range from pre-sales to many months after construction is completed, a Temporary Housing Transition Tax and Temporary Housing Transition Rebate will be introduced to provide equitable treatment of housing purchases and mitigate the loss of provincial revenue. Finally, it should be noted that once the PST has been re-instituted, the personal income tax burden will increase as tax relief measures introduced in tandem with the HST – i.e., a higher basic personal exemption, and the

HST credit for low-income families – are reversed effective April 2013.

A Few New Tax Measures

Within the restrictive spending framework set out in the Budget, the government did announce a number of measures in support of economic growth and competitiveness.

As previously announced, the BC Training Tax Credits are extended for an additional three years to the end of 2014. The province is also introducing a new training tax credit for the shipbuilding and repair industry. Employers will be able to claim 20% of wages paid, up to a maximum of $5,250 per apprentice, in the first 24 months of an eligible apprenticeship program.

In support of new home construction, the province is introducing a bonus for first-time buyers of **new** homes. The bonus came into effect on budget day and amounts to 5% of the purchase price up to a maximum credit of $10,000. This initiative is temporary, lasting for one year only. A Seniors' Home Renovation Tax Credit will also provide a modest amount of economic stimulus. It is designed to help seniors stay in their homes by providing some tax relief (up to $1,000 annually) for permanent renovations that improve accessibility and for items such as ramps, lifts, elevators and other renovations that allow for first floor occupancy or secondary suites.

We were pleased to see that beginning April 1st the tax exemption for jet fuel used for the cargo portion of a flight is being expanded to all international passenger and cargo flights. This is an important step that will make BC's airports more competitive and enhance the province's status as a gateway. Although it will not impact provincial revenue, the Business Council is also pleased the government will be introducing legislation to make the existing cap on municipal property tax rates for ports permanent.

In order to close the budgetary shortfall by 2013-14 the government opted for a number of minor tax increases. As noted at the outset, keeping the small business tax rate at 2.5% will boost revenues relative to what had been assumed last year. Medical Services Plan premiums will also be increased by about 4% (about $2.50 per month for a single person). At the same time premium assistance will be enhanced to mitigate the impact on lower income British Columbians. Because many employers pay MSP premiums for their employees, the increase represents a rise in benefit costs for employers.

The province recently undertook a review to identify assets that no longer provide a financial or strategic benefit. The results will see a number of surplus assets and properties sold in the coming years. While specifics are scarce, the review identified over 100 properties and assets whose sale will raise an estimated $700 million over the fiscal plan. The intention to sell the Liquor Distribution warehousing facility is one of the more substantial planned sales.

Carbon Tax

Two significant announcements related to the provincial carbon tax were contained in

Tuesday's budget. The first is that there will be no further increases once the rate is increased to $30/ton on July 1, 2012. From the Business Council's perspective this is a prudent move, as the carbon tax represents a significant cost for many businesses in BC – a cost that is not present in other jurisdictions. The second announcement is that the government intends to undertake a comprehensive review of the carbon tax and its impacts on British Columbians. The review will cover all aspects of the tax, including revenue neutrality and competitiveness.

Capital Spending

Consistent with the winding down of fiscal stimulus, capital spending on schools, hospitals, roads, hydro-electric projects and other infrastructure is slated to ease slightly. This also reflects the completion of a number of projects such as the roof on BC Place and the soon-to-be completed Port Mann Bridge project. That said, provincial capital spending remains in the $7 billion range for 2012-13 but then drops to $6 billion the following year.

Concluding Thoughts

Budget 2012 is solid effort that is appropriate in the current economic setting and builds on the government's reputation for competent fiscal management. Most importantly, it lays out a credible plan, which includes conservative economic assumptions and some budgetary cushions, for returning to a balanced operating budget in a timely manner. BC's situation and fiscal plan look especially good when contrasted with what is happening in many other advanced jurisdictions.

That said, this is a tough budget in the sense that planned spending increases are notably smaller than in the past, with government outlays declining measured in per capita inflation adjusted terms. We see some scope for upside surprises in the second and third years of the plan, meaning that the austerity theme could be tempered in subsequent budgets.

Understandably, Budget 2012 contained little to address the negative impact on BC's competitiveness resulting from the loss of HST and the return to the PST in 2013. There were a few modest tax items that will trim costs for particular industries, but the new Budget has no broadly-based measures focusing on competitiveness. The government has established an expert panel to review competitiveness and develop policies to help mitigate the negative impact of reverting to the PST. In the spring, the Business Council will be presenting a detailed submission to the expert panel.

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Jock Finlayson, Executive Vice President and Chief Policy Officer (Jock.Finlayson@bcbc.com)
Ken Peacock, Chief Economist and Vice President (Ken.Peacock@bcbc.com)