A 'Balanced' but 'Challenging' Provincial Budget

In his inaugural budget, BC Finance Minister Mike de Jong delivered on the government's long-standing promise to balance the operating budget by fiscal 2013-14. While some additional funding is provided for health care and a smattering of small-scale initiatives in support of the government's Families First agenda, meeting the balanced budget target overshadowed all other aspects of the budget. Eliminating the fiscal shortfall of more than $1 billion on schedule required a combination of tax increases, provincial asset sales, and a hefty dose of spending restraint.

While we commend the government for its record of sound fiscal management, the Business Council is concerned about the timing of the new tax increases. Any additional tax burden on business promises to further erode BC's competitive position – which is about to be dealt a serious blow when the province reinstates the PST in April. Some BC industries also face challenges linked to the province's carbon tax – the steepest in North America – as well as the strong Canadian dollar, skilled labour shortages, and escalating electricity costs.

Provincial asset sales are a notable feature of the plan to balance the books. Budget 2013 pencils in average expenditure growth of just 1.5% per annum over the next three years, led by a very thin 0.8% increase in the upcoming fiscal year. The Liberal government has a decent record of achieving its expenditure targets. The cost containment goal in Budget 2013, however, may prove to be a bridge too far, considering that spending growth has already been restrained in recent years.

Economic Backdrop Still Soft

Budget 2013 is based on what we view as very prudent economic growth forecasts. While critics will be looking to cite overly optimistic growth projection as a factor in the government's balanced budget, the economic assumptions underpinning the budget are cautious and should afford the government some wriggle room in meeting its fiscal targets. The consensus outlook from the BC Economic Forecast Council is for real GDP to expand by 2.1% in 2013 followed by 2.5% in 2014. In comparison, the government predicts BC's economy will grow by just 1.6% in 2013 and 2.2% in 2014. Of interest, the Business Council's real GDP growth projections for the next two years (2.3% and 2.6% respectively) are slightly above the consensus.

Consistent with its conservative approach, Budget 2013 anticipates growth of just 1.6% in the US in 2013 (compared to a consensus view of 2.0%) and a very modest increase in US housing starts. US home construction is one area where the province may benefit from an upside surprise. Similarly with China, the Ministry has adopted growth assumptions below most private sector forecasts.

Table 1

Budget 2012 Economic Assumptions and Forecasts for British Columbia

(annual per cent change unless otherwise indicated)

			Forecast		
	2011	**2012**	**2013**	**2014**	**2015**
BC Real GDP (chained $2002)	2.8	1.9	1.6	2.2	2.5
BC Nominal GDP	4.5	3.5	3.5	4.3	4.5
Exports Goods & Serv. (chained $2002)	3.5	2.5	1.8	2.5	3.0
Retail Sales	3.1	2.7	3.5	4.0	4.0
Housing Starts (000s of units)	26.4	27.5	24.7	24.9	27.3
Cdn 3-mnth T-bill (ann. avg. %)	0.9	1.0	1.0	1.6	2.4
Cdn 10 year gov't bond (ann. avg. %)	2.8	1.9	2.1	2.7	3.6
Real GDP Canada (chained $2007)	2.6	1.9	1.5	2.1	2.5
Real GDP US (chained $2005)	1.8	2.2	1.6	2.3	2.6
US Housing Starts (000s of units)	609	780	800	870	900
Real GDP Japan (chained Yen 2005)	-0.5	1.5	0.2	0.5	1.0
Real GDP China (US$ 2000)	9.3	7.8	7.4	7.4	7.2

Source: 2013 BC Budget and Fiscal Plan

In response to Tim O'Neill's report that examined the province's revenue assumptions, the Ministry reduced its projections for natural gas prices and revenues going forward.

Spending Restraint a Key Feature

Given the tight fiscal framework, it was inevitable that spending restraint would be a key theme in the budget. But the degree of spending restraint is notable. Government program outlays are slated to rise at an annual rate of 1.5% over the three year fiscal plan -- half the pace of the preceding four years. And the restraint is tilted toward the beginning of the period with total expenditures projected to inch ahead by a miniscule 0.8% in 2013-14. Apart from health care and education, most Ministries will be operating with flat or smaller budgets for the upcoming fiscal year. With the capacity of some Ministries already limited, it is somewhat worrisome to see funding cuts in Energy, Mines and Natural Gas as well as Forests, Lands and Natural Resource Operations. The budget for the Ministry of Advanced Education, Innovation and Technology is also being trimmed in 2013-14.

As part of the restraint program, the government will trim staffing levels. The number of full time equivalent employees falls from 27,228 in 2011-12 to 25,805 in 2014-15, largely through attrition.

Budget 2013 highlights a number of measures and strategies to save resources in the area of health care, including the use of "patient focused funding" incentives, steps to reduce drug costs, and plans to negotiate the Physician Master Agreement which sets financial arrangements between the government and the BC Medical Association in a manner that is consistent with the Ministry's budget. While the government has been successful in bending

Table 2

BC Government Three Year Fiscal Plan

(millions of dollars unless otherwise indicated)

	2011/12	2012/13	2013/14	2014/15	2015/16
Revenues	41,967	42,451	44,387	44,986	46,377
% change	2.9	1.2	4.6	1.3	3.1
Expenditures	(42,208)	(43,629)	(43,990)	(44,550)	(45,592)
% change	2.9	3.4	0.8	1.3	2.3
Surplus/Deficit before forecast allowance and HST funding repayment	(241)	(1,178)	397	436	785
Forecast allowance	--	(50)	(200)	(225)	(325)
HST Funding Repayment	(1,599)	--	--	--	--
Surplus/Deficit	(1,840)	(1,228)	197	211	460
Taxpayer-supported debt	34,692	38,337	42,557	44,493	46,070
(% of GDP)	15.9	17.0	18.2	18.3	18.1

Source: 2013 BC Budget and Fiscal Plan.

the health care cost curve down, it will be challenging to meet the goal of holding health care outlays to average annual growth of 2.6% over the three-year fiscal plan.

Targeting Additional Revenues

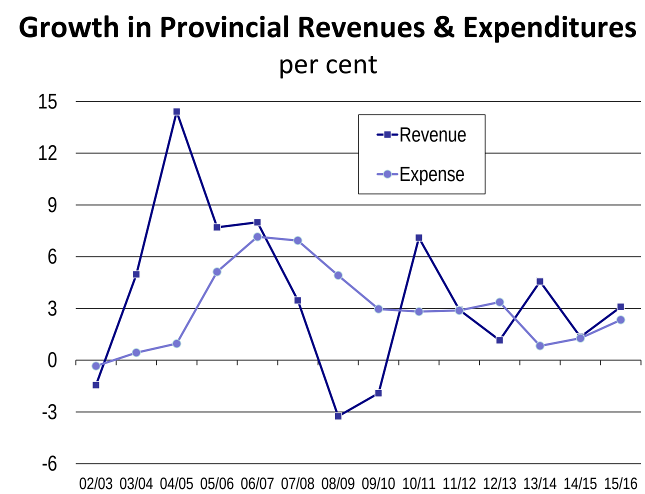
The government is implementing a number of measures to boost revenues so as to accelerate the shift back to a balanced budget. In total, the tax measures are expected to raise an additional $327 million in fiscal 2013-14 and $585 million the following year.

The most noteworthy increase is the rise in the general corporate income tax rate from 10% to 11%. This was announced as a provisional measure in last year's budget, effective April 1, 2014 if needed, but the increase is now being advanced to April 1, 2013. The one percentage point hike generates approximately $200 million in additional revenue in each of the next two fiscal years. The Finance Minister also unveiled a new top personal income tax bracket for incomes over $150,000; this is presented as a "temporary measure" that will generate $204 million by 2014-15 and then expire. The tax rate in the new bracket is 16.8%, up from the existing top tax bracket of 14.7%. Premiums for the medical services plan are also climbing, garnering $23 million in 2013-14 and $95 million in 2014-15. Smaller amounts of extra revenue will come from higher tobacco taxes and the phasing out of the school property tax credit for light industry (class 5).

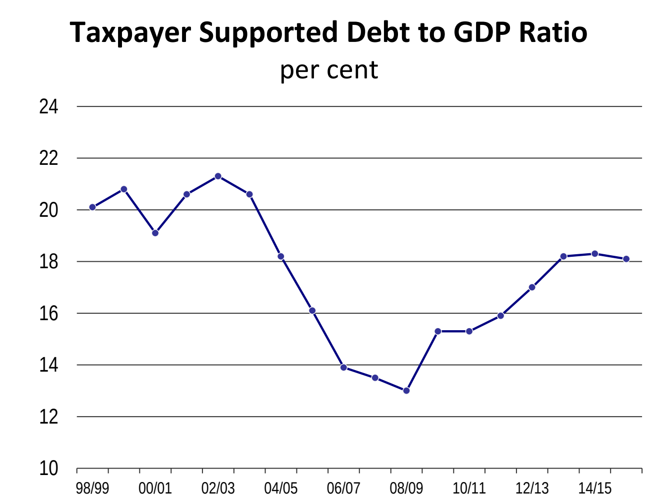
Although many will view the tax increases as relatively modest, we are concerned that in light of the fragile economic climate and the imminent return of the PST, the new tax measures will hurt the province's competitive position and send a negative signal to companies and entrepreneurs.

The selling of provincial assets is the other revenue source underpinning the plan to balance the budget. The government has identified over 100 properties as "surplus," with work underway to sell them. In the upcoming fiscal year asset sales are expected to raise $475 million, with another $150 million in the following two years. As the budget document describes, the public sector routinely disposes of assets considered to be surplus. Since 1981, 1,500 surplus properties have been sold.

While we support routinely reviewing the government's portfolio of assets, one-time asset disposals do not generate revenues to fund ongoing programs. In this sense the asset sales can be viewed as flattering the province's near-term budgetary position. Having said that, governments regularly incorporate other revenue windfalls – from unusually high commodity prices, strong earnings at Crown Corporations, or transfers from other levels of government – into their budgets.



Source: BC Fiscal and Economic Review and 2013 BC Budget



Source: BC Fiscal and Economic Review and 2013 BC Budget

Debt Continues to Climb, but Remains Manageable

The debt continues to grow over the course of the fiscal plan. Taxpayer-supported debt is projected to rise from $38.3 billion in 2012-13 to $46.1 billion by 2015-16. With small operating surpluses projected over the three-year period, the increase reflects the impact of borrowing to fund capital spending. Because the growth in debt outpaces that of GDP, the taxpayer-supported debt-to-GDP ratio is expected to edge up from 17.0% to reach 18.3% by 2014-15. BC's debt load remains manageable – the third lowest among the provinces. In Quebec and Ontario, the comparable provincial government debt burdens are in the vicinity of 50% and 40% of GDP, respectively.

Capital Spending

Consistent with the overall restraint theme, capital spending on schools, hospitals, roads, hydro-electric projects and other infrastructure is poised to diminish slightly. Taxpayer-supported capital spending falls by just $10 million in 2013-14, while capital spending by self-supporting Crown Corporations drops by $520 million. Some of the reduction reflects the completion of a few big projects such as the roof on BC Place and the Port Mann Bridge. Total provincial capital spending falls from $6.7 billion in 2012-13 to $6.2 billion in 2013-14, and then to $5.8 billion by 2015-16.

Concluding Thoughts

Budget 2013 is built around the goal of eliminating the operating deficit. Apart from this, it is a thin document. From a business community perspective there are some unwelcome, if modest, tax increases. Perhaps more worrisome, the budget is almost totally silent on competitiveness and signals no plan by the government to address the negative consequences of returning to the PST. In the coming months the Business Council will be working on issues pertaining to provincial competitiveness. Those looking for more government program spending will also be disappointed. The small amount of new funding directed towards supporting families and children's education and training will be judged by many as insufficient.

That said, the new budget should be viewed in the context of the current economic climate. That BC is firmly on the path to eliminating its operating deficit must be counted as an accomplishment in a world where many jurisdictions are drowning in red ink. The government went to unusual lengths to base the budget around credible economic and revenue projections. In our assessment the economic forecasts are credible and likely err on the conservative side. Where the budget is more susceptible to missing targets is on the expenditure side. While spending is still slated to rise, the proposed increases are small when one considers the pressure for wage increases in the public sector, ongoing demands in the health care system, population growth of 1% per year, and an underlying rate of inflation that is expected to remain in the range of 2% per year.

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