BC BUDGET 2020 ANALYSIS

Business Council of British Columbia
Est. 1966

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BUDGET 2020: BALANCED...BUT LITTLE TO IMPROVE B.C.'S COMPETITIVE POSITION

HIGHLIGHTS

- The provincial Budget is balanced over the three-year fiscal planning horizon
- The projected surpluses are very thin, but the Budget does include contingency funding and a forecast allowance. The Budget is also built around prudent economic assumptions
- With the economy gearing down, revenue growth is modest, leaving the Minister of Finance with limited maneuvering room. The money that was available was scattered around in small amounts
- Housing starts are projected to fall sharply over the next three years, despite increased government investments in social housing and the demand stemming from high levels of in-migration
- The government increased the top personal income tax rate to 20.5%, from 16.8%. This is a sizable increase that puts B.C.'s combined (federal and provincial) top marginal tax rate close to 54%
- Public sector capital spending on infrastructure continues to rise. Most of the new funding is directed to hospitals, schools and transportation infrastructure. With the construction sector operating near full capacity, there is a risk that the jump in public sector projects will put added upward pressure on costs
- The Budget contained very little to address B.C.'s waning competitiveness and the ongoing challenges that B.C.'s energy intensive exporters face

In her third full Budget, Finance Minister Carole James delivered an underwhelming effort containing few surprises. Budget 2020 continues the NDP government's focus on incrementally strengthening social programs, expanding the supply of non-market housing, and bolstering childcare services. In contrast to her earlier budgets, spending increases were modest.

With the economy gearing down, Minister James found herself with little maneuvering room. There are very few new spending announcements, instead Budget 2020 is tilted toward reiterating previously announced spending commitments. While all governments follow this practice, Budget 2020 is chock full of reannouncements. The new funding that's been made available is liberally sprinkled in small drops across a wide array of program areas. Working within a more constrained fiscal framework, Minister James did manage to forecast skinny operating surpluses over the three-year fiscal plan. However, B.C.'s tax-supported debt is climbing steeply owing to a stepped-up pace of spending on infrastructure and other capital projects.

The Business Council is supportive of sound management of the province's finances. But we are concerned about what was not in the Budget. For some time, we have argued that policy-makers in Victoria have been underplaying the need to improve B.C.'s fraying competitive position in a fast-changing world – a world in which Canada has been losing ground on many key performance metrics. Regrettably, Budget 2020 fails to tackle the weaknesses that threaten the foundations of the province's long-term economic prosperity. It ignores the problems of rising business costs, the difficulty of

TABLE 1: **BUDGET 2020 ECONOMIC ASSUMPTIONS AND FORECASTS**
(ANNUAL PER CENT CHANGE UNLESS OTHERWISE INDICATED)

			FORECASTS		
	2018	2019	2020	2021	2022
B.C. Real GDP (chained $2012)	2.6	1.8	2.0	1.9	1.9
B.C. Nominal GDP	4.5	3.7	3.9	3.9	3.9
B.C. Export Goods & Services (chained $2012)	4.2	-1.1	0.6	1.4	1.6
B.C. Retail Sales	2.0	0.5	3.0	3.3	3.5
B.C. Housing Starts (000s of units)	40.8	44.9	35.0	32.0	30.5
Cdn 3-month treasury bill (annual average %)	1.40	1.66	1.50	1.52	1.88
Cdn 10-year gov't bond (annual average %)	2.26	1.55	1.66	1.93	2.19
Canada Real GDP (chained $2012)	2.0	1.6	1.4	1.5	1.6
U.S. Real GDP (chained $2012).	2.9	2.3	1.5	1.6	1.7
U.S. Housing Starts (000s of units)	1,250	1,290	1,270	1,280	1,300
Real GDP Japan (chained Yen 2011)	0.3	1.1	0.1	0.5	0.7
Real GDP China (U.S.$2010)	6.8	6.1	5.6	5.5	5.5

Source: 2020 B.C. Budget and Fiscal Plan.

advancing significant projects, and the uncertainty facing investors and firms looking to expand in B.C.

Of particular concern is that the Budget does nothing to address the high and rising costs that B.C.'s leading export sectors are grappling with due to the province's carbon pricing system. For more than a year, the Business Council has worked with the province to develop a plan that reduces greenhouse gas emissions while also keeping B.C.'s natural resource, manufacturing and transportation industries reasonably competitive. Disappointingly, Budget 2020 does nothing to bolster B.C.'s industrial competitiveness to ensure that our natural resource and manufacturing industries continue to invest in and refurbish operations.

Many of B.C.'s biggest leading export products and commodities have half the carbon intensity of competing jurisdictions. Yet these industries -- vital to middle class jobs in rural and urban regions of B.C. – currently are at a unique economic disadvantage relative to North American and other global competitors. That is because of the absence of any provincial measures to mitigate the impact of escalating tax-inclusive energy costs on the economic viability of industrial operations in B.C.

ECONOMIC BACKDROP

The economic setting is more challenging now than in the past two years. Growth in the provincial economy has downshifted. We now expect B.C.'s economy to grow by just 2.0% this year – and even that figure doesn't account for the downside risks associated with the coronavirus that has gripped China, the world's second largest economy. The Budget is based on the same 2.0% economic growth forecast. The Minister has also followed the longstanding practice of allocating a cushion (a $300 million annual forecast allowance and a $600 million "contingency" for 2020-21) to provide room to deal with unforeseen expense pressures or weaker-than-expected revenue growth.

There are also a couple of upside risks to the outlook for B.C., including the large number of capital projects underway in the province and the possibility that new home construction will exceed the very modest projections used in the Budget. The government expects housing starts to tumble from almost 45,000 last year to around 35,000 in 2020 – before dropping to 30,000 in the later years of the fiscal plan. We suspect actual housing starts will be higher.

FISCAL RECAP — TIGHT FISCAL FRAMEWORK TRANSLATES INTO MEASURED SPENDING INCREASES

Minister of Finance Carole James is planning for a small surplus on the operating budget -- $227 million in 2020-21 (representing less than four-tenths of 1% of total spending). Similar-sized surpluses are expected for the following two years.

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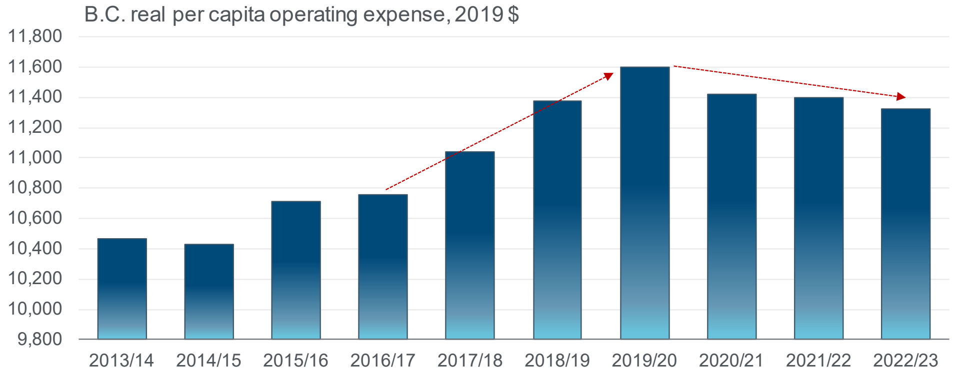
The impact of slower economic growth is evident in the revenue side of the Budget. Total revenues are expected to climb by just 2.1% in 2020-21, roughly in line with inflation. Next year, revenue growth is projected to pick up slightly but will remain subdued compared to the increases recorded during periods of stronger economic growth. Moreover, the modest revenue gains that the government is anticipating include the effect of tax hikes – e.g., a new, higher top personal income tax bracket, more increases in the carbon tax, and additional taxes on carbonated drinks and digital services.

On the other side of the ledger, total expenditures are set to grow 2.1% to $60.1 billion in 2020-21. Limited revenue increases and a desire to keep the operating budget balanced mean there was little scope for major new spending commitments. As noted above, much of the program spending discussed in the Budget represents previously announced funding.

In short, the government continues to channel more resources into a variety of worthwhile program areas, including childcare (notably via the previously announced B.C. Child Opportunity Benefit), housing, anti-poverty initiatives and measures linked to the CleanBC plan (about which more below). But the extra funding allotted to these areas is limited. In fact, most of the additional spending reflects the impact of inflation and wage increases. On a per capita basis, real government spending will fall slightly over the coming three years.

FIGURE 1: **REAL PER CAPITA PROGRAM SPENDING EASES OVER THE THREE-YEAR FISCAL PERIOD**



Source: 2020 B.C. Budget and Fiscal Plan, B.C. Ministry of Finance.

We are troubled by the absence of meaningful action to address the serious competitiveness challenges facing B.C.'s trade-exposed industries amid a steadily rising carbon tax and an increasingly costly regulatory environment for the natural resource, manufacturing and transportation sectors.

As outlined in the Budget, the province's net debt is rising but it remains relatively low in comparison to other provinces. The total provincial debt is projected to jump by $17 billion over the three-year fiscal plan, all due to borrowing to fund infrastructure and other capital projects. Despite the record level of aggregate debt, the net or taxpayer-supported debt will stay well below 20% of GDP. The interest rate bite on taxpayer-supported debt amounts to 3.1% of provincial revenues, the lowest in 10 years. This speaks to the positive impact of exceptionally low interest rates and rock-bottom government bond yields on the public finances.

BUDGET 2020: SOME FURTHER DETAILS

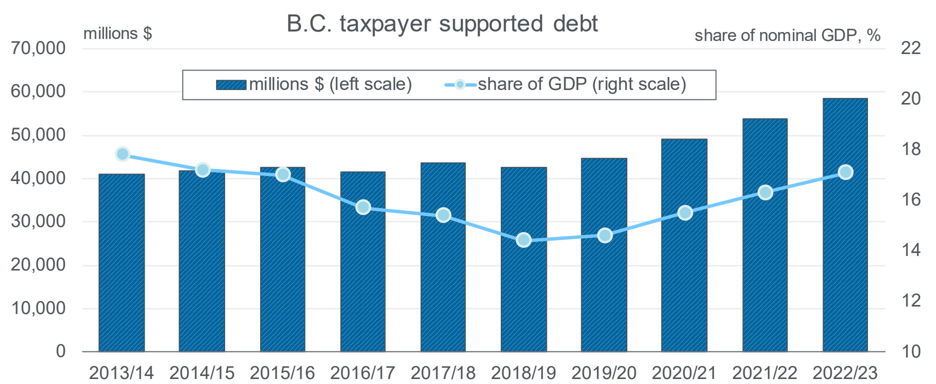
Budget 2020 earmarks new funding amounting of $419 million for **CleanBC** to help reduce emissions and promote the use of clean energy. Much of this lift is due to revenue from B.C.'s rising carbon tax which by 2021 will be among the highest in the world. The Business Council supports measures to tamp down emissions and foster lower-carbon economic development. However, we are troubled by the absence of meaningful action to address the serious competitiveness challenges facing B.C.'s trade-exposed industries amid a steadily rising carbon tax and an increasingly costly regulatory environment for the natural resource, manufacturing and transportation sectors that form the bedrock of the province's export economy. Budget 2020 fails to deliver on the results of the low-carbon industrial strategy work that the Business Council has done jointly with the province over the past 14 months. We will now reassess whether continued engagement with the government on these issues is worthwhile.

TABLE 2: **B.C. GOVERNMENT THREE YEAR FISCAL PLAN**
(MILLIONS OF DOLLARS UNLESS OTHERWISE INDICATED)

			FORECAST		
	2018/19	2019/20	2020/21	2021/22	2022/23
Revenues	57,128	59,326	60,585	62,366	64,211
% change	*9.8*	*3.8*	*2.1*	*2.9*	*3.0*
Expenditures	55,593	58,823	60,058	61,887	63,537
% change	*7.5*	*5.8*	*2.1*	*3.0*	*2.7*
Forecast Allowance	-	300	300	300	300
Surplus	1,535	203	227	179	374
Taxpayer-supported debt	42,681	44,569	49,202	53,929	58,598
% of GDP	*14.4*	*14.6*	*15.5*	*16.3*	*17.1*

Source: 2020 B.C. Budget and Fiscal Plan.

FIGURE 2: **TAXPAYER SUPPORTED DEBT-TO-GDP RATIO REMAINS LOW**



Source: 2020 B.C. Budget and Fiscal Plan, B.C. Ministry of Finance.

B.C. stands alone in the world as a jurisdiction that has priced carbon emissions while doing essentially nothing to safeguard the competitiveness of its export-oriented industries exposed to the impact of escalating energy costs. Within Canada, even provinces that are fighting the federal government's climate plan in court have ended up with more protection for their trade-exposed industries than B.C. offers, thanks to Ottawa's carbon pricing backstop regime that applies in provinces which lack robust carbon management systems.

The province is directing a modest amount of additional funding to **higher education and skills training**, a focus that we welcome. We agree with greater financial assistance to enable more young adults from low and middle-income families to access post-secondary education. Going forward, we believe the province should also support efforts by B.C.'s 11 public colleges to further develop their capacity to undertake applied research – an area where B.C. institutions can leverage existing federal government programming. Ontario provides an example of how a provincial commitment can allow post-secondary institutions to access federal government funding. Ontario is well ahead of B.C. in forging partnerships between colleges and industry to solve commercial and operational problems in a way that benefits researchers, businesses and students.

With the ongoing crisis in forestry, Budget 2020 provides a small dollop of additional **funding to assist workers and local communities affected by layoffs, mill closures and less harvesting activity**. Unfortunately, the government is doing little to stabilize or increase the available timber supply or to reduce the crippling regulatory costs which the province itself has imposed on the industry.

Budget 2020 highlights the importance of **reconciliation with First Nations against the backdrop of the government's adoption of UNDRIP**. However, other than revenue-sharing from gaming, we worry that the province is not providing enough resources to build the capacity and governance structures needed to successfully implement UNDRIP. In fact, the budget for the Ministry of Indigenous Reconciliation is set to decline in 2020-021.

Budget 2020 also allocates some additional funding for **housing**, but the extra amount is modest while earlier announcements are recapped in detail. Still, this Budget did find an additional $118 million to fund housing operations and $56 million for capital funding. There is also $50 million over three years to expand programs and services to support people without a home or at risk of becoming homeless.

REVENUE MEASURES

There are a handful of revenue measures in the Budget. In total, the announced tax changes will generate an additional $245 million (net) in 2020-21. Most of this comes from the introduction of a new personal income tax bracket of 20.5% for individuals earning over $220,000 annually. Prior to this move, the top provincial tax rate was 16.8%. Now, the combined federal-provincial top personal income tax rate in B.C. will be 53.5% -- among the highest rate in all advanced industrial economies considering the income levels where top rates apply. We believe the government's inclination to squeeze every last dollar out of the most productive individuals in the economy is ill-advised and misaligned with what the province needs to do to build a more productive, innovative and diversified economy. We predict the new higher tax bracket will backfire by triggering a loss of high-paying jobs, corporate head offices and other high-value business activity. We also believe the province will collect less revenue from the new bracket than it is forecasting.

PUBLIC SECTOR CAPITAL SPENDING

The Business Council is pleased to see the government devoting additional funds to provincial infrastructure. Taxpayer supported capital spending will total $22.9 billion, which is the highest level ever over a three-year period. The three-year total is $2.8 billion higher than what was outlined in last year's Budget. Most of the additional funds will be invested in the areas of health, education and transportation.

Capital investment in transportation now totals $7.4 billion over the next three years. The replacement of the Patullo Bridge and the construction of the Broadway SkyTrain line are among the larger projects.

Investments in the health sector are the next largest allocation of new capital spending. A total of $6.4 billion (over three years) will be channeled to the construction and upgrading of new health facilities, diagnostic equipment and information management systems.

As noted above, the government's ambitious capital plan creates an added risk that high levels of non-residential construction activity will strain the capacity of the B.C. construction sector and lead to escalating costs. We encourage the government to carefully manage the timing and sequencing of its capital plan to reduce this risk.

SUMMARY THOUGHTS AND WHAT IS MISSING FROM BUDGET 2020

As noted at the outset, the 2020 Budget contains few surprises. The government came to power with a commitment to expand and strengthen social supports for families and the new Budget keeps the government on this path.

Overall, Budget 2020 is a disappointment. It contains little that will strengthen the province's economic fundamentals or improve its competitive position over the medium-term. There are no meaningful tax or regulatory initiatives directed at accelerating productivity growth (the essential precondition for higher wages), supporting the scaling up of B.C. companies, fostering economic diversification, or creating a more competitive environment for our export-oriented industries. It is hard to see how this Budget will contribute to attracting top talent, driving innovation, or retaining and growing head offices in the province.

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