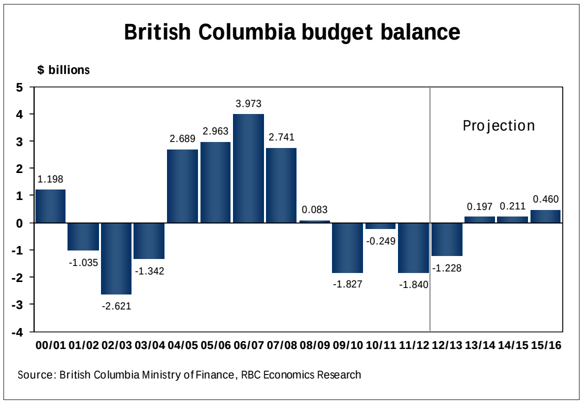
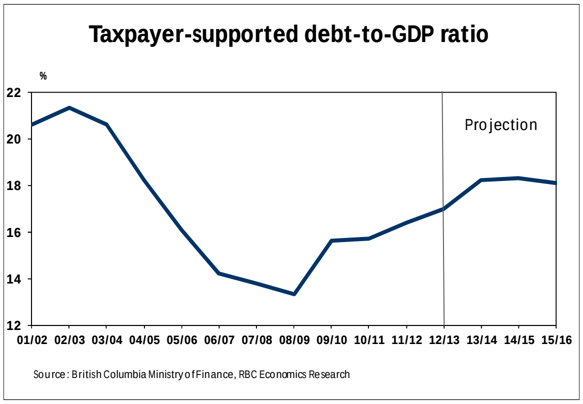
BRITISH COLUMBIA BUDGET 2013

February 20, 2013

Taxing, selling its way to balance

Pressures on British Columbia's fiscal situation clearly mounted in the last year. Lower-than-expected natural gas prices were the main cause of these pressures, as they significantly reduced royalties collected by the province. In quarterly updates since Budget 2012, BC Finance Minister Michael de Jong warned that the 2012/2013 deficit would come in substantially higher than originally projected – $1.5 billion at last count compared to the original $970 million shortfall expected in last February's budget. He also put forward a number of measures (including salary and hiring freezes, and travel budget cuts) to mitigate the impact of lower revenues and reducing the shortfall. Budget 2013, thus, was presented with a tough challenge to balance the provincial books by 2013/2014 as previously planned.





Despite much adversity, Budget 2013 yesterday reaffirmed the BC government's commitment to a balanced budget in 2013/2014. In fact, Minister de Jong projected a small surplus of $197 million in the coming fiscal year, followed by surpluses of $211 million in 2014/2015 and $460 million in 2015/2016. Furthermore, he lowered the estimated deficit for 2012/2013 to $1.2 billion. His government is tackling the weakness in natural resource revenues by selling assets, raising corporate taxes and personal income taxes on wealthy individuals (temporarily), and maintaining a strict line on spending.

Whether this budget plan will actually go forward is uncertain, however. There will be provincial elections this May and it will be up to the next legislature to vote on this Budget 2013 or, possibly, an alternate budget.

Budget highlights

Total revenues are projected to rise by 4.6% in 2013/2014 to $44.4 billion. Own-source revenues are expected to increase by 4.6% to $36.9 billion despite a loss of 2.5% in sales tax revenues due to the repeal of the HST (larger tax base) and the reinstatement of the provincial sales tax (smaller tax base) on April 1, 2013. Provincial revenue growth will be maintained in part by the sale of provincial government properties and assets, which is forecast to bring in $475 million in 2013/2014 (and an additional $150 million in 2014/2015 for a total of $625 million over these two years). Federal transfers are set to rise 4.1% to $7.5 billion, reflecting an increase in health and social transfers.

Total revenue growth will slow in 2014/2015 to 1.3%, however. While personal income taxes and corporate income taxes will accelerate by 7.6% and 7.3%, respectively, there will be a declining contribution from property and asset sales – the 2013/2014 revenues from this source will be mostly non-recurring. Revenue growth then will accelerate to 3.1% in 2015/2016. Over the three year fiscal plan, revenues are projected to grow on average 3% per year.

To fulfill its mandate of a balanced budget by 2013/14 and contribute to

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modest surpluses through the three year fiscal plan, Budget 2013 presented key tax initiatives aimed at generating $1.2 billion in additional tax revenue through to 2015/2016. These include:

- The General Corporate Income tax rate will rise by 1 percentage point to 11% on April 1, 2013, one year earlier than announced in Budget 2012 (as a provisional measure until the BC economy generates stronger revenues for the government). The tax increase is projected to boost corporate tax revenue by $158 million in 2014/2015.
- The Personal Income Tax rate will rise temporarily by 2.1 percentage points to 16.8% for those earning more than $150,000 annually as of January 2014. This measure is expected to contribute $204 million to tax revenues in 2014/2015 and $158 million in 2015/2016 before expiring in December 2015.
- With the phasing out of the HST, the tax rate on tobacco will be adjusted upward to keep overall tobacco prices constant. Effective October 1, 2013, an additional $2 tax will be charged for a carton of cigarettes, contributing to a 14.9% increase in tobacco tax revenues (to $709 million in 2013/2014 and $726 million in each of the two following years).

For the 2012/2013 fiscal year, lower natural gas royalties, a delay in completing the sale of the Little Mountain Property and softer property transfer taxes as the housing market moderates prompted the government to revise total revenues downward by 1.5% to $42.5 billion relative to last year's budget of $43.1 billion. A boost to personal income tax revenues, reflecting mainly higher 2011 assessments, provided a partial offset.

Total expenses including debt charges are projected to rise 0.8% to $44.0 billion in 2013/2014, followed by increases of 1.3% in 2014/2015 and 2.3% in 2015/2016. These rates of growth would represent a significant slowdown in expenditure growth relative to the average pre-recession growth rate of 5.7% between 2005 and 2009. The government aims to achieve $1.1 billion in savings over the three-year fiscal plan and this will involve significant program expenditure restraint. In 2013/14, a 0.6% rise in program expenses to $41.5 billion will reflect increases of $583 million (3.3%) for health care and $205 million (1.8%) for education. Excluding education and health care, however, program spending will decline by 4.6%, while debt charges are expected to edge up 4.5%.

For the fiscal year ending March 31, 2013, total expenses have been revised down by $240 million (-0.6%) to $43.6 billion, reflecting declines across spending programs, including education, health care and social services. Expenses related to debt servicing are expected to fall by 4.5% to $2.4 billion thanks to lower than expected interest rates.

Taxpayer-supported capital spending is projected to total $10.4 billion over the three-year fiscal plan with $3.7 billion planned for 2013/2014, a decline of 0.3% from the previous year. Capital spending will further moderate over the projection period, declining to $3.5 billion in 2014/2015 and $3.1 billion in 2015/2016. For 2013/2014, modest spending increases are expected for BC Transit, BC Transportation Financing Authority and capital infrastructure for school districts. Self-supported capital spending is expected to drop much more substantially by 17.4% in 2013/2014 as spending winds down on the Port Mann/Highway 1 project. As a result, total capital spending will fall 8% in 2013/2014 (from a downwardly revised 2012/13 estimate of $6.8 billion) and remain relatively flat in 2014/2015 (-0.4%) before declining a further 5.6% in 2015/2016.

Taxpayer-supported debt is projected to rise from $38.3 billion (17.0% of nominal GDP) in 2012/2013 to $42.6 billion (18.2%) in 2013/2014, $44.5 billion (18.3%) in 2014/2015 and $46.1 billion (18.1%) in 2015/16. **Total provincial debt**, which includes commercial crown self-supported debt, will grow from $56.1 billion (24.9% of GDP) in 2012/2013 to $69.4 billion by 2015/2016 (27.3% of GDP). In both cases, the profile is slightly higher than previously projected.

The BC government expects to **borrow $8.4 billion** and retire $2.3 billion worth of debt in 2013/14. Net borrowing is projected to slow to $6.0 billion in 2014/2015 and $4.9 billion in 2015/2016. Direct borrowing by Crown corporations and agencies are scheduled to be $296 million in 2013/14, down from $325 million in 2012/2013.

Assumptions vetted by expert

With respect to the reasonableness of the economic and other assumptions underlying the 2013 budget, the BC government took the unusual step of mandating Dr. Tim O'Neill, a prominent business economist, to review the Ministry of Finance's processes and methodologies. In his report submitted prior to the budget's release, Dr. O'Neill found "no glaring problems or inadequacies that need to be addressed" and "appropriate caution applied in the work that goes into producing the revenue projections". He did suggest however, that additional prudence be incorporated into the natural gas revenue projections, to which the government responded in this budget by basing its natural gas assumption on the 15th lowest percentile of private sector forecasts (it previously based its assumption on the median forecast).

Budget 2013 assumes real GDP growth in the province of 1.6% in 2013 and 2.2% in 2014, which we consider quite conservative. RBC's forecasts for British Columbia in the December edition of Provincial Outlook were 2.3% and 2.6% in 2013 and 2014, respectively. As in previous budgets, the current plan maintains the two extra layers of prudence: a forecast allowance, which will rise from $200 million in 2013/2014 to $225 million and $325 million in 2014/2015 and 2015/2016; and contingencies totalling $225 million in each year of the plan. While the size of these budget ‘buffers’ is modestly smaller than what was used in last year’s budget, they should be sufficient to protect against minor slippage on the expenditure and asset sale fronts to ensure the elimination of the deficit by 2013/14.

British Columbia's fiscal plan

$ billions	Actual	Forecast	Estimate	Plan	Plan
	11/12	**12/13**	**13/14**	**14/15**	**15/16**
Revenue	42.0	42.5	44.4	45.0	46.4
Expense	42.2	43.6	44.0	44.6	45.6
Surplus (before fcst allowance)	-1.840	-1.178	0.397	0.436	0.785
Forecast allowance	0	-0.050	-0.200	-0.225	-0.325
Surplus	-1.840	-1.228	0.197	0.211	0.460
Total capital spending	6.5	6.8	6.2	6.2	5.9