British Columbia's 2017–18 Fall Budget Update … Initial Initiatives

- British Columbia's new NDP government projects annual surpluses averaging $244 million (0.1% of GDP) from fiscal 2017–18 (FY18) to FY20, roughly matching the average annual balances projected in BC's February 2017 *Budget* (top chart) with similar layers of prudence incorporated into the estimates.
- New initiatives, largely focused on making life in BC more affordable for all households, are partly financed by reinstating a higher-income personal income tax bracket and hiking the income tax rate for large corporations.
- Taxpayer-supported debt as measured by BC is higher in the September estimates (bottom chart), even with a strong final FY17 hand-off confirmed in the summer. Compared with the February forecast of a $1.8 billion rise during FY18, the September forecast outlines a $3.3 billion jump, primarily due to reclassifying the Port Mann bridge debt of $3.5 billion from self-supported to taxpayer-supported after the elimination of tolls on September 1. BC's direct operating debt, however, is forecast to approach zero by March 2019.
- After modest FY17 gross borrowing requirements of $2.0 billion, FY18 financing needs are a subdued $3.6 billion, with $0.6 billion completed. In FY19 and FY20, however, projected funding requirements climb to $6.9 billion and $5.2 billion, respectively.

THE GOVERNMENT'S NEW INITIATIVES

With its three priorities of making BC more affordable, enhancing critical provincial services and building a strong economy, the NDP government kicks off its first term with a carefully constructed *Budget Update.* Selected cost reductions and service enhancements for taxpayers are funded by riding the wave of the strong FY17 final results, benefitting from this year's robust economic expansion or introducing higher taxes.

Many of the new measures funded in this *Update* were pre-announced, such as eliminating the tolls on the Port Mann and Golden Ears Bridges as of September 1 ($224 million of FY18 revenues foregone) and a $100 monthly increase in social and disability assistance payments starting in late September (a $104 million FY18 cost). To accelerate BC's affordable housing supply, $208 million over four years will be invested in more than 1,700 affordable rental units and $291 million over two years will be used to construct 2,000 new modular units for the homeless, with $172 million to operate them for three years. *Medical Services Plan* premium relief is broadened to a 50% premium cut for all residents in 2018 (an annual saving of up to $450 per adult), en route to entirely eliminating the premiums within four years.

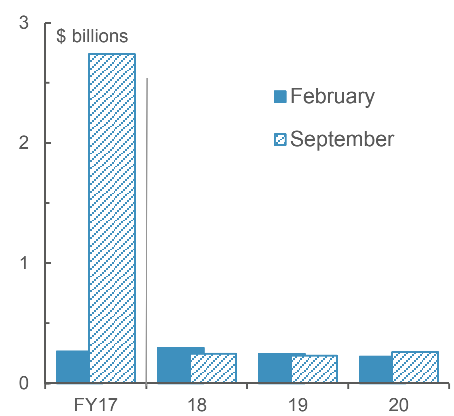
In terms of meeting critical needs, the *Update* directs an additional $322 million to the fentanyl emergency for three years, with $265 million for health services, $25

CONTACTS

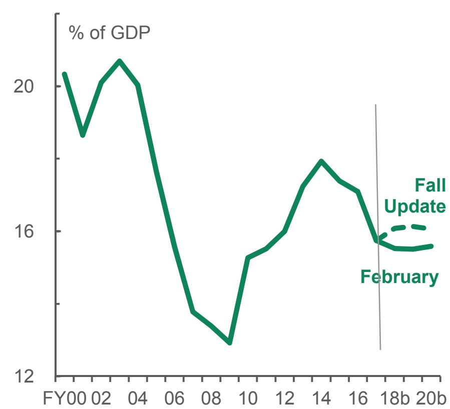
Mary Webb
416.866.4202
Scotiabank Economics
mary.webb@scotiabank.com

Marc Desormeaux
416.866.4733
Scotiabank Economics
marc.desormeaux@scotiabank.com

BC Still Projecting Balanced Books...



... With A Modest Rise in the Taxpayer-Supported Debt Burden



Source for charts: BC Finance.

million to establish the Ministry of Mental Health and Addictions and $32 million for police and coroner services.

One-time events can be expensive, most notably the 2017 wildfire season with firefighting adding more than $600 million in cost pressures to BC's *Budget*. The government has invested $235 million in the Forest Enhancement Society of BC and over $140 million will be directed to wildfire risk reduction and reforestation.

Climate action, a special interest, is a factor in BC's carbon tax decision. The current rate at $30 per tonne of carbon dioxide equivalent emissions will rise by $5/tonne starting in April 2018 until it reaches $50/tonne in April 2021 (top chart, p.3), exceeding the carbon pricing requirement in Ottawa's Pan-Canadian framework and yielding $212 million of additional revenue in FY19. Modest-income families will be protected by a $40 million enhancement to BC's low-income climate action tax credit. The revenue neutrality aspect of the Carbon Tax will be dropped, to support families and fund additional green initiatives.

For credit unions, the NDP is restoring their preferential provincial tax treatment, reducing government revenues by $17million through FY18 and FY19.

FUNDING THE NEW INITIATIVES

A top personal income tax bracket will be reinstated for taxable income over $150,000, at a 16.8% rate versus the current 14.7% rate for 2018. This raises BC's top federal-provincial marginal rate close to 50% and generates $273 million of additional revenue in FY19.

The general corporate income tax (CIT) rate also is raised as of 2018 from 11.0% to 12.0% for an estimated FY19 revenue boost of $306 million. BC's rate now equals Alberta's and Manitoba's, but is slightly higher than Saskatchewan's, Ontario's and Quebec's.

The government is proceeding with the February *Budget's* major tax relief, notably lowering the small business CIT rate from 2.5% to 2.0% effective retroactively to April 1, 2017 (a $81 million FY19 revenue loss) and phasing out the sales tax on businesses' electricity purchases by April 1, 2019, reducing FY19 revenues by $82 million.

THE REVENUE AND EXPENDITURE ARITHMETIC

For FY18, the Fall *Update* raises revenues by $1.57 billion relying on BC's buoyant own-source receipts to accommodate a $1.67 billion hike in spending, primarily program outlays. The remaining $0.1 billion gap results in a $50 million decrease in the forecast allowance and a $49 million cut in the surplus.

British Columbia's Budget Arithmetic

$ millions except where noted

	FY17	FY18	
	Final	February	Sept.
Tax Revenue	27,093	26,804	28,180
Natural Resource Revenue	2,711	2,320	2,413
Commercial Crown Corp. Net Inc.	2,525	2,915	2,959
Other Own-Source Revenue	10,963	10,482	10,483
Federal Transfers	8,167	8,317	8,372
Total Revenue	**51,459**	**50,838**	**52,407**
Health	19,689	20,629	20,747
Education	12,468	13,124	13,376
Social Services	4,243	4,619	4,745
Other Program Spending	10,679	10,135	11,224
Program Spending	**47,079**	**48,507**	**50,092**
Debt Service*	1,643	1,686	1,769
Total Expenditure	**48,722**	**50,193**	**51,861**
Forecast Allowance	0	350	300
Surplus**	**2,737**	**295**	**246**
Capital Outlays: Taxpayer-Supp.	3,659	4,804	4,956
Self-Supported	2,725	3,279	2,701
Taxpayer-Supported Debt	41,506	43,302	44,853
Absolute Annual Increase	-1,221	1,796	3,347
Annual Change, %			
Tax Revenue	*11.4*	*-1.1*	*4.0*
Natural Resource Revenue	*5.4*	*-14.4*	*-11.0*
Total Own-Source Revenue	***8.4***	***-1.8***	***1.7***
Federal Transfers	*6.8*	*1.8*	*2.5*
Total Revenue	***8.1***	***-1.2***	***1.8***
Health	*2.5*	*4.8*	*5.4*
Education	*2.1*	*5.3*	*7.3*
Social Services	*3.3*	*8.9*	*11.8*
Other Program Spending	*13.9*	*-5.1*	*5.1*
Program Spending	***4.9***	***3.0***	***6.4***
Total Expenditure	***4.1***	***3.0***	***6.4***
Memo Items, %			
Own-Source Revenue / GDP	16.4	15.2	15.8
Program Spending / GDP	17.9	17.4	18.0
Total Expenditure / GDP	18.5	18.0	18.6
Budget Balance/ GDP	1.0	0.1	0.1
Taxpayer-Supported Debt / GDP	15.7	15.5	16.1
Taxpayer-Supp. Debt / Revenue*	81.8	87.6	87.8
Debt Service* / Revenue*	3.2	3.4	3.5
Resource Price Assumptions			
Natural Gas, Plant Inlet, C$/GJ	1.19	1.61	1.60
Production, % ch	3.4	-2.3	11.3
Western Lumber***2x4s,US$/mfbm	308	326	377

* Taxpayer-supported basis. ** Includes allocations of $100 mn in FY16 & $400 mn in FY17 to the Prosperity Fund. *** Spruce-pine-fir, calendar year.
Source: BC Finance; Statistics Canada; nominal GDP forecasts: Scotiabank Economics.

Growth in FY17 own-source receipts is revised from the February estimate of -1.2% to 1.8%, with the largest upward revisions in the CIT, Provincial Sales Tax and the Property Transfer Tax. The Province has raised its assumption of real GDP growth for calendar 2017 from 2.1% in February to 2.9% given BC's upbeat expansion this year. The forecasts of a 2.1% expansion in 2018 and 2.0% annually from 2019 to 2021 are unchanged.

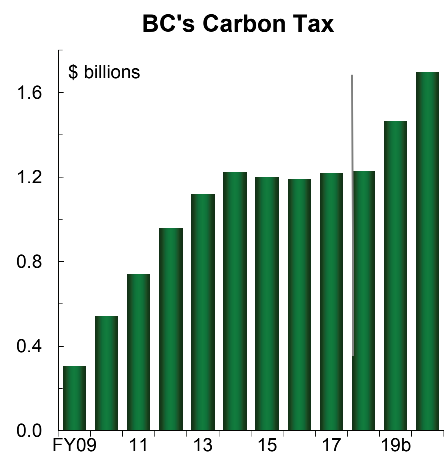
Natural resource receipts, however, are expected to drop 11.0% in FY18 with a further 8½% decrease over the following two years (bottom chart). While prices for natural gas and natural gas liquids are strengthening and production volumes are climbing, revenues from bonus bids and leases are forecast to fall, weaker coal prices and overall stumpage rates are anticipated and total harvests of forests on Crown land will likely be flat.

Commercial Crown corporations' FY18–FY20 net income stabilizes at about $2.9 billion, dampened by net losses at the Insurance Corporation of British Columbia. In addition to their revenue consequences, these two corporations are essential to the government's affordability commitment, as ICBC grapples with restraining auto insurance premium increases and BC Hydro focuses on staying the course on its *Ten Year Rates Plan.*[1]

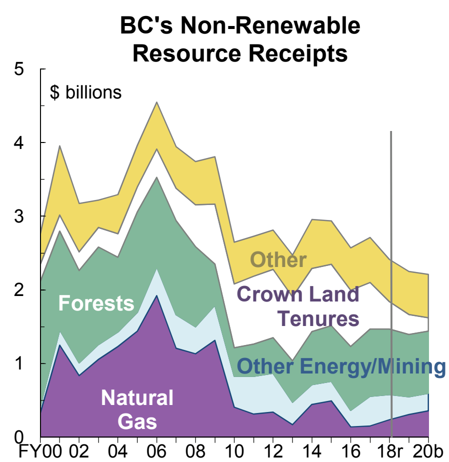
Program spending growth for FY18 elevated from the February estimate of 3.0% to 6.4% in the *Update*. New Ministry budget allocation for FY18–FY20 is $0.7 billion for improving affordability, $1.1 billion for enhancing services and $44 million for building a more sustainable economy. A $479 million three-year expense results from eliminating the bridge tolls due to foregone revenues and transition costs. Additional future costs depend upon negotiations with Translink.

Expenditures in the *Update* also incorporate $521 million through FY20 to fund the final *Memorandum of Agreement* reached with the BC Teachers' Federation in mid-March. The expense includes hiring 3,500 teachers.

Incorporated prudence in this *Update's* estimates, in line with BC's longstanding practice, includes annual forecast allowances and Contingencies vote allocations; plus assumptions of real GDP growth and natural gas prices less than private-sector forecast averages. In addition, project reserves of $196 million in the three-year capital plan are intended to cover unforeseen costs and ministries' emerging capital demands.



Source: BC Finance.



Source: BC Finance.

CAPITAL SPENDING PLANS AND THE BALANCE SHEET

Relative to February's *Budget*, **taxpayer-supported capital spending presented in the September *Update* is $0.9 billion higher** for a three-year total of $14.6 billion, in part due to new investment in housing. The $2.3 billion decrease in self-supported capital expenditures is largely attributable to the cancellation of procurement for the BC Transportation Investment Corporation's $3½ billion George Massey Tunnel Replacement project. BC's ageing hydroelectric system, the majority of which was built between the 1960s and 1980s, also requires a broad range of upgrades.

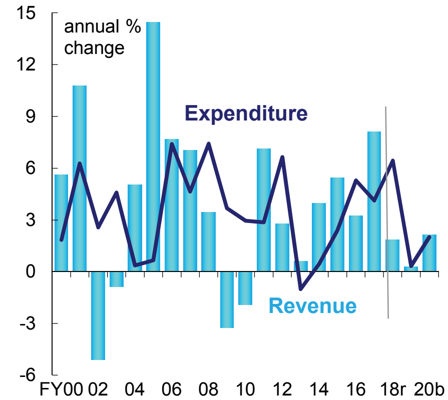
Taxpayer-supported debt is expected to end FY2020 $1.4 billion higher than the level projected in February, in large part due to the reclassification of some $3.5 billion of the Transportation Investment Corporation's Port Mann Bridge debt. Excluding reclassified Port Mann Bridge obligations, taxpayer-supported debt is expected to finish FY18 some $1.9 billion lower than the previous fiscal plan's projection, but rise by 8.8% this fiscal year—well above the 3% growth assumed in February.

[1] See Fiscal Pulse, p 2–3, August 31, 2017, here.

OUTLOOK

For now the books are balanced and British Columbia is approaching zero direct operating debt. The September *Update* details multiple risks, but the steepest adjustment may be the moderating growth anticipated for the BC economy as of 2018 after the annual real GDP expansion surpassing 3.0% annually over the four years to calendar 2017. The *Update* projects revenue growth of only 0.3% in FY19, despite the new tax hikes, followed by a 2.1% FY20 increase (side chart). This automatically restricts FY19–FY20 program spending growth to 1.0% annually, possibly lower if a rising interest rate environment pushes up BC's debt service.

BC Revenue & Expenditure Paths



Source: BC Finance.

In the meantime, the new NDP government is undertaking multiple studies to implement its far-ranging objectives. Underway are multiple studies to develop new strategies,[2] suggesting that the government's announcements to date are only a first step. The investment in over 3,700 affordable units for rent or the homeless, for example, is the first instalment in the government's commitment to provide 114,000 social housing units over the next decade.

The issue for British Columbia's new government will be developing fiscally sustainable expenditures in the slower growth environment anticipated after 2017. Much of the possible tax room already is occupied by the three different levels of government. The FY18 projections, given BC's current strong expansion, appear relatively solid. the greater hurdles emerge as the NDP more fully rolls out its comprehensive policy plan in the February 2018 *Budget*.

[2] See Fiscal Pulse, September 8, 2017, here.