BRITISH COLUMBIA BUDGET 2018

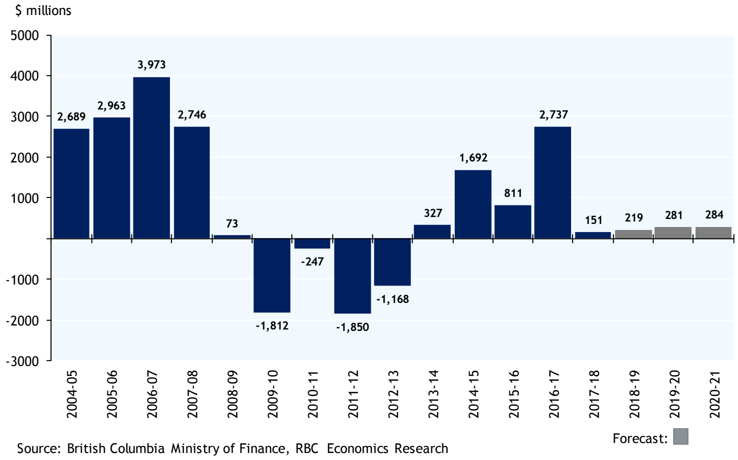
February 26, 2018

A new plan from the New Democrats

Overview

On February 20th, British Columbia's NDP government released the first budget of their mandate. Budget 2018 builds on the themes of last fall's budget update finding new money to improve affordability and services and to stoke economic growth. The government came into this budget with room to maneuver thanks to a rapidly growing tax base delivered by a strong economy. This allows the province to maintain a slim but comfortable operating surplus despite new spending outpacing new revenues. In all, the budget introduces \$5.4 billion of new spending measures partially offset by \$4.4 billion of new tax measures over 3 years. The upshot is cumulative surpluses of \$0.8 billion over the next three years after allowing for forecast variability. Despite these surpluses, the province's debt totals will continue to grow as the government borrows steadily for new capital investments.

British Columbia Budget Balance



Source: British Columbia Ministry of Finance, RBC Economics Research

Revenues

British Columbia's rapidly growing economy and tax base will sustain provincial revenues over the next three years. The Province forecasts overall revenues to rise by an average of 4% per year powered by an 8% annual increase in tax revenues. A hike in the highest tax bracket last year is contributing, as is an increase in the carbon tax. Starting in April, British Columbia's carbon tax, long held at \$30 per tonne of CO_2 emitted, will begin to rise by \$5 per year toward a new \$50/tonne target by 2021. Some of the new carbon revenues will be lost to an incentive program to rebate carbon taxes back to emitters with GHG intensity below targets. The budget also fulfills one of the government's election promises by eliminating Medical Services Plan (MSP) Premiums in 2020 and replacing them with a tax of up to 1.95% on employer payrolls.

Table 1: Budget Summary and Fiscal Plan

	Forecast	Estimate	Plan	
($ millions)	2017-18	2018-19	2019-20	2020-21
Revenue	**53,365**	**54,877**	**57,580**	**58,566**
Total Expenses	**(51,818)**	**(53,624)**	**(56,778)**	**(57,762)**
Forecast Allowance	(100)	(350)	(500)	(600)
ICBC Impacts	(1,296)	(684)	(21)	80
Surplus (Deficit)	**151**	**219**	**281**	**284**
Taxpayer-supported Capital Spending	4,197	5,174	5,160	5,442
Self-supported Capital Spending	2,614	4,061	3,079	3,285
Total Capital Spending	**6,811**	**9,235**	**8,239**	**8,727**

Source: British Columbia Minsitry of Finance

The government is also making changes to the tax code to tackle housing affordability. Budget 2018 contains four housing-related tax measures which together aim to take steam out of the market. To tackle demand issuing from foreign investors, the government is implementing a new speculation tax of 2% of a home's assessed value on those owners who do not live or pay taxes in British Columbia and raising the additional property transfer tax – commonly known as the foreign buyer tax – from 15% to 20% and broadening the tax from the Vancouver area to cover more of the province. To shift the tax burden to the owners of expensive properties, the province is beefing up school and property transfer taxes on properties valued over \$3 million.

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Expenditures

To complement tax actions designed to curb housing demand are measures to build supply. In her budget address, Finance Minister Carole James identified a drastic shortage of affordable housing especially for seniors, students and those reliant on social housing. The government intends to spend $2 billion through the forecast horizon (and $6 billion over 10 years) preserving the existing stock of social housing and building 34,000 new units across the province. Moreover, the province intends to boost transfers to low-income people through its two programs designed to help people afford rent.

Yet addressing affordability doesn't just apply to housing. Budget 2018 also includes over $1 billion in new spending on child care. This includes an enlarged subsidy for child care and expanding the number of spots by 22,000. The government is also introducing, or in some cases reintroducing, new measures to improve health care, education and other government services including money for cheaper bus passes ($214 million) and in-home senior care ($548 million).

The ICBC

The Insurance Corporation of British Columbia (ICBC) is a provincial crown corporation that provides auto insurance. Over the past two years, a low interest rate environment coupled with a rising number of claims caused the corporation to see mounting losses. The ICBC's annual net income is included in the Province's revenues and therefore impacts the fiscal plan. The corporation is reforming its insurance products and expects to close the shortfall by 2019-20, but this year the corporation's losses meaningfully reduce the projected surplus.

Capital Spending

Budget 2018 includes $484-million worth of new measures to "build a strong and sustainable economy", but the largest economic measure in the budget is a substantial ramp up in capital spending. Over the three-year fiscal plan, capital spending by government and crown corporations is expected to total $26.2 billion – an increase of $1.2 billion over the Fall Update and the largest such plan in the province's history. The government estimates that 50,000 jobs, both direct and indirect, are supported these projects which include building and renewing schools, hospitals, roads, and bridges. Also counted among the total is $9.8 billion in spending by BC Hydro to address ageing infrastructure and fund the Site C project, a power station on the Peace River.

Table 2: Provincial Debt Summary

	Forecast	Estimate	Plan	
($ millions)	2017-18	2018-19	2019-20	2020-21
Taxpayer-supported Debt	43,680	45,198	47,554	50,257
Self-supported Debt	21,484	23,824	25,027	26,197
Forecast Allowance	100	350	500	600
Total debt (including forecast allowance)	**65,264**	**69,372**	**73,081**	**77,054**
Debt as a percent of GDP				
Direct Operating (%)	0.4	0	0	0
Taxpayer-supported (%)	15.6	15.5	15.7	15.9
Self-supported (%)	7.4	8.3	8.4	8.5
Total (%)	**23.4**	**23.8**	**24.1**	**24.4**

Source: British Columbia Minsitry of Finance

Table 3: Provincial Borrowing Requirements

	Forecast	Estimate	Plan	
($ millions)	2017-18	2018-19	2019-20	2020-21
Total provincial debt at beginning of year	**65,883**	**65,264**	**69,372**	**73,081**
New Borrowing	1,866	7,668	5,910	6,825
Direct borrowing by Crown corp. & agencies	103	64	72	133
Retirement provisions	(2,688)	(3,874)	(2,423)	(3,085)
Forecast Allowance	100	250	150	100
Net change in total debt	**(619)**	**4,108**	**3,709**	**3,973**
Total provincial debt at year end	**65,264**	**69,372**	**73,081**	**77,054**

Source: British Columbia Minsitry of Finance

Debt and Borrowing

Budget 2018 is a balanced budget on the operating side, but the ramp up in capital spending means the province will continue to accrue new debts through the fiscal planning horizon. Total provincial debt is broken down into taxpayer supported (owed by the government directly) and self-supported (owed by crown corporations and agencies). Taxpayer-supported debt is forecast to rise by $6.6 billion to $50.3 billion by 2020-21 driven higher entirely by the capital budget. Indeed British Columbia is on track to eliminate its non-capital related debt burden entirely in 2018-19 marking the first time in 40 years that the operating side of the government is debt free. Despite significant borrowing for the infrastructure plan, the province's debt-to-GDP ratio will remain essentially flat over the next three years thanks to a rapidly growing economy.

The government's total borrowing requirements over the next three years will total $20.7 billion. Of this total, capital investments account for $7.8 billion, crown corporations and agencies for $8.6 billion, and the refinancing of maturing debt $4.3 billion.

Our Take

Over the past few years, British Columbia has held an enviable place among provinces. A roaring economy and housing market poured new revenues into provincial coffers and the province is among the least burdened by past debts. Against that backdrop, the NDP government has flexibility and is making steps toward delivering on a number of their campaign promises. Childcare measures in Budget 2018 are the first steps toward an ambitious, and doubtless expensive, plan for province-wide universal childcare. Over the next three years, measures to expand supply and support renters ($1.9 billion) are largely financed by new housing taxes ($1.3 billion). In our view, the budget's housing measures are a mixed bag. New taxes may sap demand from the market, but the speculation tax — perhaps necessary for Vancouver — may prove an obstacle to the development of the province's cottage communities once fully implemented. On the supply side, the government is touting its investments in social housing, but what is also sorely needed is expanding private supply. To that end, the budget creates the *HousingHub* to facilitate partnerships between government and other stakeholders to help identify and redevelop land. Still, more must be done to speed up the approval process for new housing development.

In our view, British Columbia's slim surpluses are secure ones. The economic assumptions underpinning the budget are reasonable and the budget includes an ample forecast allowance totaling $1.5 billion over three years. Government calculations suggest that a 1 percentage point hit to nominal GDP growth would have a $200-million impact on the bottom line (midpoint estimate). While the budget does have the province's debt load increasing slightly over time, this could be forgivable for a province with such a low debt burden to start with. Still, the government should be circumspect. They may find that after 8 years of rapid economic growth and with a record low unemployment rate new infrastructure jobs may be hard to fill, extending timelines and raising costs.