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Towards a More Democratic and Credible BC Budget

Submission to the Select Standing Committee on Finance and Government Services, Legislative Assembly of British Columbia

BC Budget 2008 Consultation

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Summary

The CCPA estimates that the current year's surplus will be approximately \$3.4 billion for 2007/08 — more than eight times the size of the stated surplus in Budget 2007.

The provincial surplus will continue to grow to \$4.1 billion in 2008/09 and \$4.9 billion in 2009/10.

Revenue forecasts in the budget are now so conservative that the province would run a deficit only if a catastrophic economic collapse occurred.

The opportunity cost of large surpluses has been a failure to address pressing social problems, such as abject poverty, social exclusion, addictions, mental illness and homelessness, and failure to make needed strategic investments for the future, through early learning and child care programs, public transit, and environmental initiatives.

1. Introduction

The BC Budget is perhaps the most important act of the legislature each year. Over the past decade, concerns about budgeting practices have led to major reforms, from both the Liberals and NDP, in financial reporting, such as the presentation of the full summary accounts (including Crown corporations, schools, hospitals, etc), the conversion to GAAP, and greater transparency in expenditure projections. The budget is also presented on a fixed date each year to avoid political manipulation.

While these reforms are important, the BC Budget has lost a great deal of its credibility by consistently ending the fiscal year with “unexpected” large surpluses far in excess of what was projected on budget day. Budgeting is a challenging task under the best of circumstances, and no one should expect perfect accuracy in forecasts. However, the degree to which year-end numbers have differed from those tabled at budget time is striking. Voters should be able to expect a reasonable degree of accuracy in budget forecasts if they are to be considered credible.

The core problem is that the government has deliberately underestimated revenues by billions of dollars each year. In fact, estimates of revenues bear little resemblance to the underlying economic projections of the budget. **It makes little sense for the provincial government to convene its Economic Forecast Council to inform its macroeconomic assumptions if those estimates are then ignored in making the budget’s revenue forecasts.**

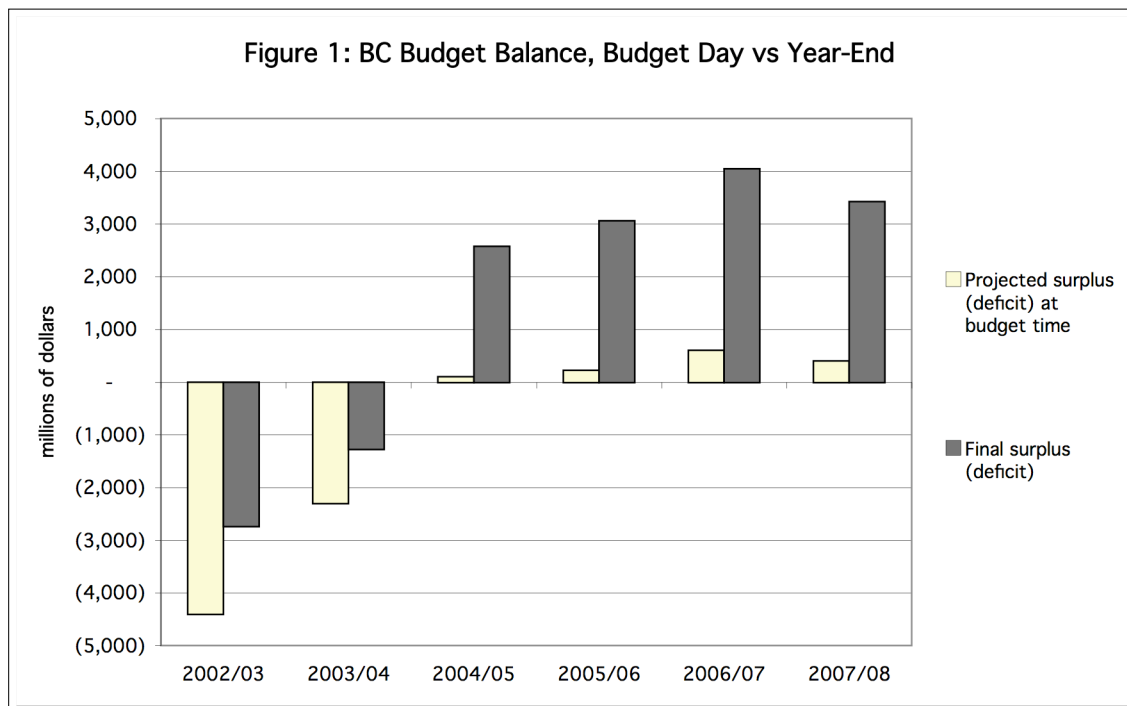
Similarly, the great deal of time and money expended — on the part of MLAs, staff and presenters — for the Finance Committee to gauge the budget priorities of the public is wasted if those recommendations are left off the table by the Finance Minister and Treasury Board staff due to overly pessimistic forecasts. **The Finance Ministry’s systematic practice of low-balling revenues clearly undermines the work of this Committee and reduces the responsiveness of the provincial government to democratic consultation.** In effect, the government is inviting the public to offer its views on how to apportion the surplus, based on a surplus estimate that is a fiction (we also point out that estimates of the available surplus in the budget consultation document differ from those in the First Quarterly Report and the 2007 Budget as tabled). The charade must stop and we urge this Committee to make that a core demand.

Budget credibility concerns have been raised in recent years at the federal level, led by the CCPA’s Alternative Federal Budget, and later by a broad community of budget watchers from all parts of the political spectrum. **These concerns about budgeting practices have led to the creation of a new Parliamentary Budget Office, modeled on the Congressional Budget Office in the United States. The mandate of the office is to provide independent forecasts of the federal budget position.**

We believe it is time for a similar office to be established in British Columbia in order to improve the transparency of the provincial budget and the legitimacy of the consultative process, and to ensure that the budget reflects the needs of British Columbians. In this submission, we review the recent history of budget surpluses, make some revised estimates of the fiscal framework moving forwards, and speak to a number of opportunities to improve the lives of British Columbians that have been sidelined by ultra-conservative budgeting practices.

2. Revenue Projections and BC's Surplus

Figure 1 shows the contrast between the projected surplus (or deficit) at budget time and the final year-end results, going back to 2002/03. If anything the problem of abnormally large year-end surpluses has gotten worse over time. Over the past four budgets (2004/05 to 2007/08), comparing the surplus as stated at budget time with year-end numbers shows a cumulative error of \$12 billion (revised CCPA estimate for 2007/08).



Note: Final figures are before accounting adjustments. The "final" number for 2007/08 is the updated CCPA estimate.

Sources: Ministry of Finance budget documents, various years.

The dwindling credibility of budget estimates is illustrated by the 2006 BC Budget:

- In February 2006, the budget was tabled ostensibly as a \$600 million surplus, albeit with a large forecast allowance of \$850 million for a total surplus of \$1.45 billion. This was criticized at the time by the CCPA as greatly understated, largely on the basis of revenue projections that called for a slight fall in total revenue received, in spite of forecasts of robust economic growth.
- By September's First Quarterly Update, the estimated surplus had been revised upward to \$1.2 billion (plus a \$550 million forecast allowance, for a total of \$1.75 billion).

- Two months later, the Second Quarterly Update re-estimated the surplus at \$2.25 billion (plus \$550 million forecast allowance for a total of \$2.7 billion).
- At the time of the 2007 Budget, the Third Quarterly Report put the surplus at \$2.85 billion (plus \$300 million forecast allowance for a total of \$3.15 billion).
- By fiscal year-end, the final surplus came in at just over \$4 billion. This was the largest surplus in BC history in both dollar terms and as a percentage of GDP. In fact, at 2.3% of GDP it is alarmingly large.

We see this same pattern happening again this year. The press release accompanying last week's First Quarterly Report claimed that the province's fiscal position had improved — even though economic growth forecasts as of September were essentially identical to those made at budget time. The revised surplus of \$1.6 billion (\$2.1 billion with forecast allowance) is up from \$400 million (\$1.15 billion with forecast allowance) at budget time. While it may be defensible to have a forecast allowance built into the budget for unforeseen contingencies, the combination of the forecast allowance AND extremely pessimistic revenue assumptions together is inappropriate.

We anticipate that the surplus will be revised upwards yet again in subsequent financial reports. In the CCPA's *Alternative Federal Budget* and our *BC Solutions Budgets*, we forecast revenues on the straightforward but effective assumption that, in the absence of policy changes, the share of own-source revenues to GDP remains relatively constant from year to year. This technique has proved to be a highly successful one, federally and provincially, with CCPA budget estimates being much more accurate than either the federal and provincial Ministries of Finance. We use the Ministry of Finance's own economic forecasts. For 2007/08 to 2009/10, we project revenues at 16.3% of GDP, a level slightly lower than the most recently completed fiscal year.

On this basis, **the CCPA estimates that the current year's surplus will be approximately \$3.4 billion for 2007/08** (Table 1) — more than eight times the size of the surplus in Budget 2007 and almost three times the available surplus in the budget consultation document. Beyond 2007/08, based on prevailing economic assumptions and the expenditure path set out in the government's three-year fiscal framework, **the provincial surplus will continue to grow to \$4.1 billion in 2008/09 — dramatically more than the \$600 million set out in the budget consultation paper — and \$4.9 billion in 2009/10.** While two future budgets will weigh in on new taxation and expenditure priorities for those years, our estimates find that there are substantial latent surpluses available for priority initiatives.

TABLE 1: RE-ESTIMATED REVENUE AND EXPENDITURE FRAMEWORK

(figures in millions of dollars unless otherwise stated)

| | Actual | | | Revised estimates | | |
|---|---------------|---------------|---------------|-------------------|---------------|---------------|
| | 2004/05 | 2005/06 | 2006/07 | 2007/08 | 2008/09 | 2009/10 |
| BC nominal GDP | 157,540 | 168,855 | 179,701 | 189,944 | 199,251 | 210,210 |
| BC own-source revenues-to-GDP ratio | 16.2% | 16.6% | 16.4% | 16.3% | 16.3% | 16.3% |
| Estimated own-source revenues | 25,590 | 27,963 | 29,471 | 30,961 | 32,478 | 34,264 |
| Contributions from government enterprises | 2,412 | 2,198 | 2,685 | 2,757 | 2,682 | 2,659 |
| Federal transfers | 5,231 | 5,786 | 6,386 | 6,137 | 5,734 | 5,979 |
| Total revenues | 33,233 | 35,947 | 38,504 | 39,855 | 40,894 | 42,902 |
| Status quo expenditures (government's current fiscal plan) | | | | | | |
| Health | 11,642 | 12,414 | 13,250 | 14,211 | 14,410 | 14,866 |
| Education | 8,511 | 8,943 | 9,519 | 9,846 | 10,216 | 10,478 |
| Social services | 2,665 | 2,724 | 2,892 | 3,141 | 3,208 | 3,282 |
| Protection of persons and property | 1,215 | 1,379 | 1,329 | 1,499 | 1,448 | 1,458 |
| Transportation | 1,308 | 1,196 | 1,251 | 1,331 | 1,258 | 1,324 |
| Natural resources and economic development | 1,670 | 1,599 | 1,663 | 1,697 | 1,572 | 1,660 |
| General government | 505 | 644 | 768 | 685 | 648 | 666 |
| Debt service | 2,294 | 2,182 | 2,234 | 2,276 | 2,318 | 2,417 |
| Other | 848 | 1,806 | 1,542 | 1,744 | 1,752 | 1,824 |
| Total expenditures | 30,658 | 32,887 | 34,448 | 36,430 | 36,830 | 37,975 |
| Surplus | 2,575 | 3,060 | 4,056 | 3,425 | 4,064 | 4,927 |

Notes: Nominal GDP growth rates are based on most recent Ministry of Finance updates in the First Quarterly Report.

Contributions from government enterprises, federal transfers and all expenditures for the current three-year plan are from the First Quarterly Report.

In fact, the revenue forecasts in the budget are now so conservative that the province would run a deficit only if a catastrophic economic collapse occurred. In addition to our central estimates, we have “stress-tested” the budget for the possibility of an economic slowdown (Table 2). Each of the three scenarios is successively more pessimistic in its outlook, but even in the third scenario, a two-year recession (i.e. *real GDP growth* falling below zero — 1% nominal growth less 2% inflation in each of 2008 and 2009), the surplus only drops to \$1.7 billion in 2009/10.

TABLE 2: SLOWDOWN SCENARIOS

| (figures in millions of dollars unless otherwise stated) | | | |
|--|---------------|---------------|---------------|
| | 2007/08 | 2008/09 | 2009/10 |
| Scenario 1 | | | |
| Nominal GDP growth | 5.5% | 3.0% | 4.0% |
| Own-source revenues | 30,902 | 31,829 | 33,103 |
| Total revenues | 39,796 | 40,245 | 41,741 |
| Surplus | 3,366 | 3,415 | 3,766 |
| Scenario 2 | | | |
| Nominal GDP growth | 5.0% | 2.0% | 3.0% |
| Own-source revenues | 30,756 | 31,371 | 31,998 |
| Total revenues | 39,650 | 39,787 | 40,636 |
| Surplus | 3,220 | 2,957 | 2,661 |
| Scenario 3 | | | |
| Nominal GDP growth | 4.0% | 1.0% | 1.0% |
| Own-source revenues | 30,463 | 30,768 | 31,075 |
| Total revenues | 39,357 | 39,184 | 39,713 |
| Surplus | 2,927 | 2,354 | 1,738 |

Notes: All scenarios are based on status quo expenditures as set out in the First Quarterly Report. All assume a constant ratio of own-source-revenues-to-GDP of 16.3%. Nominal GDP growth assumes inflation of 2% per year.

3. Foregone Opportunities

The opportunity cost of large surpluses has been a failure to address pressing social problems, such as abject poverty, social exclusion, addictions, mental illness and homelessness, and failure to make needed strategic investments for the future, through early learning and child care programs, public transit, and environmental initiatives. Instead of action, we have seen only token measures, such as the 2007 “housing budget”, which issued an income tax cut that was three times larger than the budget’s housing initiatives.

The government has made reducing the province’s debt-to-GDP ratio a central policy imperative. Yet, if surpluses had been fully allocated to social and environmental spending, provincial debt-to-GDP would still have continued to fall, just at a slower rate. If all surpluses in the past four years had instead been balanced budgets, debt-to-GDP (taxpayer-supported) would be 14.9% at the end of 2007/08, rather than 13.8% under the current fiscal plan, both down from 20.6% in 2003/04.

Upon the release of the 2006/07 public accounts, the Minister of Finance argued that provincial surpluses are paying for new capital projects, rather than debt reduction. Such statements confuse accepted accounting principles by conflating the operating budget and the capital budget. The operating side of the budget includes current expenditures, with revenues net of

expenses yielding the surplus or deficit. To get to final debt numbers, spending in the capital budget (on infrastructure, schools, hospitals and other long-lived assets) is added. These capital expenditures are expensed in the operating budget over the lifetime of the asset (due to accrual accounting). The Minister is technically correct that the surplus is being used to finance infrastructure, but these capital projects were being built anyway, and are already accounted for in the operating budget. This is a disingenuous spin to cover up an embarrassingly large surplus that should have been spent on program expenditures as part of the operating budget. Alternatively, the surplus could have been used to finance new capital projects that were not previously part of the budget plan (as the CCPA has urged in the past for large year-end surpluses, with a focus on early learning and child care spaces, affordable housing, long-term care and public transit).

Table 3 shows the main expenditure areas of the BC budget as a percentage of GDP, starting with levels in 2001/02, followed by updated estimates for 2006/07 through to 2009/10. As can be seen, expenditures relative to GDP have fallen significantly since 2001/02, and based on the current fiscal plan will continue to fall. Despite repeated concerns about health care, spending has declined as a share of GDP, as has education. The largest relative hit is in the area of social services. The health care figures should put to rest the false alarms about unsustainable increases in spending.

| TABLE 3: EXPENDITURES AS A PERCENT OF GDP | | | | |
|--|----------------|----------------|----------------|----------------|
| | 2001/02 | 2007/08 | 2008/09 | 2009/10 |
| All expenditures | 23.0% | 19.2% | 18.5% | 18.1% |
| Health | 8.0% | 7.5% | 7.2% | 7.1% |
| Education | 6.2% | 5.2% | 5.1% | 5.0% |
| Social services | 2.6% | 1.7% | 1.6% | 1.6% |

Sources: CCPA calculations based on Ministry of Finance. GDP data from BC Economic Accounts and Ministry of Finance projections.

For Budget 2008, there are a number of priorities that must be addressed through the available surplus room. These are spelled out in more detail in our annual Solutions Budgets, and **all are attainable within the three-year budget plan if credible surplus estimates are used:**

- Last year at this time we presented a broad-based anti-poverty strategy that would increase social assistance rates and eligibility, expand social housing, child care, training and education, and transportation allowances. Based on figures in the BC budget, to increase the budget for income assistance benefits by 50% would cost an additional \$500 million based on current caseloads. However, caseloads would rise if the government took action to reduce eligibility barriers for income assistance, at a cost of an additional \$200 million. We urge the province to follow the leads of the governments of Newfoundland and Quebec and adopt a comprehensive poverty-reduction strategy with clear targets and timelines.

- A comprehensive early learning and childcare program, including provisions for special needs and pay increases for child care workers, is a high priority for the province. Because of the creation of new infrastructure, there is a one-time capital cost associated with this program of \$650 million. Thus, it would take several years for this program to be rolled out. Fully built-out, a universal program for one to five year olds would require an additional \$1.5 billion in public funds. Adding in before-and-after-school care for children up to age 12 would cost another \$500 million. Thus, a full system would ultimately cost \$2 billion per year in new public funding.
- Housing affordability has become a top issue for many British Columbians. The reality is that the market fails to build affordable housing for low- to middle-income families and vulnerable populations, and thus public solutions are required. The cost of 3,200 units of supportive housing recommended to VANOC by the Inner-City Inclusivity Table, is approximately \$640 million, or less than one-sixth of last year's \$4 billion budget surplus. The province, however, should be even bolder by restoring the traditional amount of new social housing that used to be built annually. To create 2,000 new units of social housing per year a capital cost of about \$400 million per year would be required (assuming land must be purchased). An additional operating cost of about \$8 million to subsidize rents for these units is also needed.
- The budget for health care needs to grow by 5% per year in order to stand still; that is, to accommodate population growth, aging and health care inflation with no real loss in services. This amounts to \$700 million for 2008/09. Expenditure increases beyond 5% per year enable the expansion of services (for example, more residential care beds per capita).
- The K-12 education sector is experiencing annual declines in enrolment of about 1% but faces inflation pressures of just under 3%. Thus, a 2% increase (about \$200 million) is minimally required for the system to maintain existing service levels. Additional funds above and beyond this amount could reduce class sizes and improve funding for special needs, and would also mitigate the growing use by school boards and schools of fundraisers and appeals to parents, fees for services, contracts for vending machine rights, and enticement of foreign students to bolster budgets.
- Post-secondary fees (mostly tuition fees) are projected to be just under \$1 billion next year, more than double the amount in 2001/02. Fees are equivalent to half of the size of the overall advanced education budget, so some reallocation is in order to place more of the cost of post-secondary education in the public realm.

- Services for children and families have been in crisis mode for a number of years. Investments in vulnerable children are likely to have huge paybacks over time. A \$200 million increase for the Ministry of Children and Families would enhance the ranks of social workers, boost support allowances in foster care, and provide additional assistance for children with special needs. This should be viewed as a step in a multi-year plan to better address the needs of vulnerable children.

4. An Equitable and Sustainable Climate Plan

Like other British Columbians, the CCPA is excited that BC is in the process of developing an overarching strategy on climate change. More work is needed on a detailed fiscal plan tied to targeted reductions in GHG emissions. Much action could be achieved through regulatory measures, and changing incentives through eco-taxes and subsidies for sustainable alternatives. As we contemplate new fiscal measures, however, **we need to seriously consider the inequality impacts of climate measures.** Green taxes will need to be offset by income transfers to the least well-off and/or public spending on transit, etc in order to heed off regressive impacts. Just as progressive taxation is based on ability to pay, so should the climate change plan. In addition, just transition strategies for workers in affected industries will be of utmost importance.

As a political issue, there are also some important implications to how the provincial government develops its policy responses to climate change. **If the public feels that policy measures are inequitable — that the load is not fairly shared — there is a high risk that public support will wane.** Of concern is that the government may have a blind spot with regard to inequality or distributional issues. Some prominently-mentioned solutions — such as carbon taxes, road pricing and “tax shifting” — may further exacerbate rising inequality, unless measures are taken to ensure otherwise.

There are important equity design considerations that should be built into solutions to climate change, and these must be on the table at the outset or else they may be ignored by policy-makers. Already, measures at the federal level such as the creation of tax credits for transit passes or rebates for fuel-efficient vehicles, have been designed in a way in which the poor do not benefit (because they do not have large enough taxable income to benefit from a tax credit, or because they cannot afford to buy and service a car). Instead, refundable credits would be a better policy move to mitigate inequality impacts while addressing the core problem.

The potential consequences of climate change are already apparent in a number of areas:

- The devastation of the province’s forestry resource base by the mountain pine beetle is perhaps the most visible and costly example. To date, the economic impact has been more than offset by accelerated cutting in response to the beetle kill, but down the road the potential job losses are staggering. The looming negative impacts on forestry-dependent communities and rural areas will be immense.
- A rash of storms in southern BC late in 2006 pointed to economic costs in the tens of millions of dollars, associated with power outages, boil-water advisories, impacts on

infrastructure, loss of commercial operations, as well as intangibles like the loss of thousands of trees in parks and on streets.

- Still another example is the decline of salmon runs, a major concern to First Nations communities on the coast of BC. This trend is having a major impact on traditional ways of life and in economic terms is significantly diminishing the value of fishing rights.

All of these current examples entail real economic costs of climate change that have associated distributional impacts. In particular, these shocks affect poor people disproportionately, whereas others with greater financial resources are able to better insulate themselves from short- to medium-term impacts. The latter group, statistically speaking, bears a greater responsibility for the current crisis, as their affluence in no small part derives from unsustainable practices, both as consumers and as owners/shareholders of greenhouse-gas-emitting enterprises.

In response to the pine beetle epidemic, the provincial government has narrowly focused on increasing logging rates to capture income from the beetle-attacked trees before the trees lose their economic value. Comparatively little has been said or done about the need to invest in our forests, where those investments should be focused, and from where the funds to pay for those investments should come. Substantial increases in reforestation investments must be made now and the provincial government, in particular, should properly shoulder that responsibility — one it has shunned in recent years. The government must also do much more to promote new research and management regimes that help to restore a greater diversity of tree species and tree ages to our Interior forests, because it is with diversity that we are better protected from the kinds of devastating events we are witnessing in our forests today.

The CCPA will have more to say on the topic of addressing climate change in an equitable manner in the months leading up to Budget 2008.

5. Conclusion

BC has the resources to make a difference. But as this brief has emphasized, current budgeting practices are biased against making the investments that British Columbians want and need. Deliberately understated surpluses remove from the table options that would improve our quality of life and the health of our communities.

To enhance the credibility of forecasts made in the Budget, we recommend that the government create an independent and arms-length Legislative Budget Office. This new entity would be responsible for making budget forecasts before the legislature's Finance Committee hits the road to consult with British Columbians. The new LBO would provide a more reasoned basis for the Committee to reflect the will of British Columbians back to the government.

