

# 2009 BC Budget Reality Check

## *Planning for a Recession*

**SUMMARY** There is now widespread agreement that deficit spending is necessary not only to weather the current economic storm, but also to reduce the length and severity of a recession. Debate in BC now hinges on the questions of how deep and how long is the downturn likely to be, what magnitude of stimulus is needed, and what form that stimulus should take.

BC enters the recession in strong fiscal health, with the lowest debt-to-GDP ratio of any province other than Alberta. Too many individual British Columbians and their families, however, are more vulnerable than their counterparts in other provinces. BC has the highest poverty rate in Canada, high levels of household debt, relatively weak social services, and an interior economy already hard-hit by recent forestry woes.

This reality check models three budget scenarios for government finances: baseline (using the latest Economic Forecast Council projections), minor recession, and major recession. Given that the baseline scenario is overly rosy, the 2009 BC Budget should be premised on the assumption that the province will be in recession this year.

- Even with no changes in tax or spending policies, a minor recession would mean deficits of approximately \$0.8 billion in 2009/10 and \$1.3 billion in 2010/11.
- A major recession would push status quo deficits to approximately \$1.9 billion in 2009/10 and \$2.7 billion in 2010/11.
- A meaningful stimulus package will require significantly larger deficits.

Recommendations for the 2009 provincial budget:

- Get money into the hands of people with low and modest incomes—they will spend it quickly and locally. Public spending has a greater stimulative impact than tax cuts.
- Adopt a comprehensive poverty reduction strategy to protect the most vulnerable and ensure poverty and homelessness in BC don't go from bad to worse.
- Increase spending at rates that will, at minimum, protect existing public services.
- Given the current degree of economic uncertainty, the budget should err on the side of doing too much rather than risk doing too little.
- Focus infrastructure spending on green projects and meeting urgent social needs.
- Resist the temptation to favour capital projects (whose costs are spread out over many years) over equally important investments in health, education and social services.

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**CCPA**  
CANADIAN CENTRE  
for POLICY ALTERNATIVES  
BC Office

# Introduction

A stimulus package should protect families and communities while making investments for a cleaner and greener future.

THE FEBRUARY 2009 BC BUDGET will be tabled amid a growing global economic crisis. While many private sector forecasters continue to hold out hope that BC will avert a recession, forecasting is a notoriously inaccurate business. The 2009 BC Budget should be premised on the assumption that the province is or will be in recession (and with the provincial election a few months away, all political parties should be planning likewise). The risks of taking a position of denial are far greater than those associated with prudent planning.

In this economic and fiscal reality check, we review the most recent economic data for BC and take a close look at the implications of a recession for provincial government finances. We also consider the key components of a stimulus package that would protect families and communities while making investments for a cleaner and greener future. In a recession, the top priority for government should be to protect incomes and employment, not to balance the budget.

Indeed, this reality check finds that even a mild recession quickly results in a drop-off in revenues that, without any new spending announcements, moves the provincial budget into deficit. Such a “cyclical deficit,” however, is not the same as a stimulus package. A meaningful stimulus package will inevitably lead to an even larger deficit.

Given the times and BC’s excellent fiscal health, British Columbians need not fear their province going into deficit. BC’s relatively low debt-to-GDP ratio means our government can afford to increase spending to mitigate the impact of the global economic downturn. Indeed, most economists advise governments to run deficits when faced with a recession.

The need for active fiscal policy to counter the downturn, even if it leads to substantial budget deficits, is now widely recognized. The BC government’s admission of these facts, and the need to run deficits for the next two years, is welcome. The simplistic insistence on a balanced budget is irresponsible in the face of a major economic downturn. It would involve massive public sector budget cuts that would deepen the crisis and increase unemployment.

# BC's Economy in 2009 and Beyond

OVER THE SECOND HALF OF 2008, the economy became the number one issue, as falling prices for housing and equities led consumers and investors around the world to scale back spending plans. The US has already been in recession for a year, and conditions continue to worsen. The Canadian economy was flat through 2008, and begins 2009 in recession.<sup>1</sup>

Looking forward, there are two camps. A number of private sector forecasters and the Bank of Canada, having completely missed the oncoming downturn as late as September, now concede that a recession (defined as two consecutive quarters of negative growth) is upon us, but argue that it will be concluded by the end of 2009, followed by a return to growth. Other economists have suggested that current developments, based on the collapse of bubbles in housing and stocks, could mark the beginning of a longer period of stagnation, similar to what Japan experienced in the 1990s.

The outcome will depend on the policy responses of central banks and governments around the world, and the extent to which they can achieve better coordinated monetary and fiscal policies. Thus far, the emphasis has been on lower interest rates and providing liquidity and loan guarantees to the financial sector. But many are now tabling fiscal stimulus packages—a mix of spending increases, tax cuts, growing deficits, and targeted loan supports to key industries.

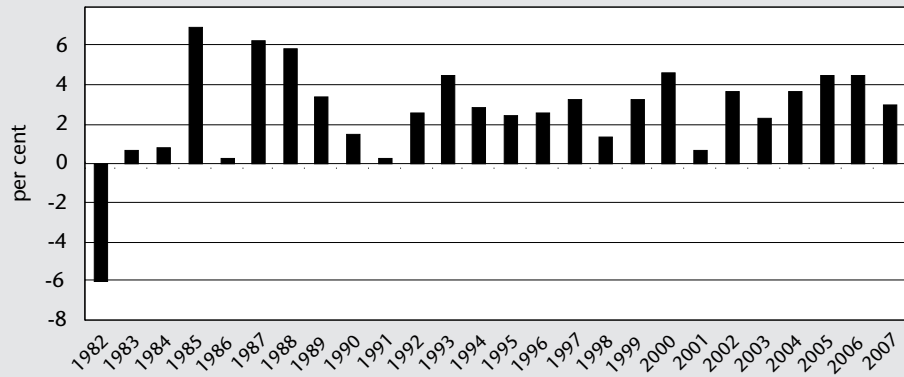
The recent federal budget tabled a stimulus package valued at just over 1 per cent of GDP, a number that falls short of the 2 per cent target called for by the International Monetary Fund and the Organization for Economic Cooperation and Development. Much of the focus of the federal plan is on infrastructure projects that require matching funds from provinces and municipalities. It will be vital for BC to push the federal government to ensure that funds flow in a timely manner, and to ensure they are used for projects with a strategic long-term focus. Unfortunately, the federal plan does little to protect the most vulnerable from the effects of the recession.

Because the federal response is inadequate the provincial government's role in fighting the recession is even more important, in particular as it relates to protecting incomes and employment.

Looking back, one could excuse British Columbians for forgetting what a recession looks like. BC has experienced a period of uninterrupted economic growth going back a quarter-century. There have been slowdowns, most notably in 1991 and 2001, and the occasional weak year, but no actual period of recession since 1982, when BC's real GDP dropped an

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Figure 1: BC GDP Growth, 1982 to 2007



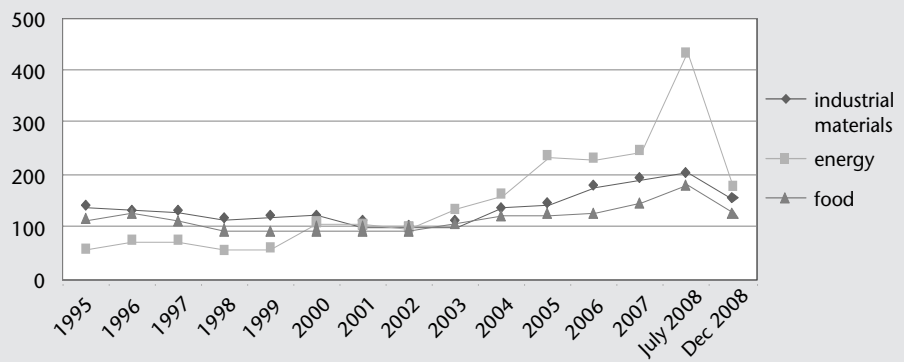
Source: BC Economic Accounts, BC Stats

astonishing 6 per cent. Figure 1 shows a relatively consistent pattern of economic growth in spite of efforts to politicize the economy as an issue. For instance, the average rate of growth under the BC Liberals has been 3.1 per cent, whereas the so-called “lost decade” under the NDP saw average growth that was only slightly lower, at 2.8 per cent (and results for Canada as a whole would show a similar difference between the 1990s and the 2000s).

The recent expansion since 2002 has been driven in large part by high commodity prices, a housing boom, and strong US and Asian demand for BC exports. In 2009, these factors are changing dramatically, and it is hard to imagine what major external forces might lead a strong recovery by the end of the year. The recent depreciation of the Canadian dollar has brought some relief and the upcoming Olympics may provide a temporary boost, but they are hardly sufficient to reverse the downturn.

The overall picture for commodity prices is one of decline after a period of significant price increases (Figure 2). Energy prices, in particular, spiked in June and July of 2008, and have since come down substantially. Lumber prices have been dropping for two years, with a one-third drop between 2006 and 2008,<sup>2</sup> and are now at their lowest levels since 1991.<sup>3</sup>

Figure 2: Commodity Price Index, 1995 to 2008 (2002=100)



Source: Bank of Canada

The downturn in commodity prices, coupled with a major decline in US demand, has spelled layoffs and mill closures.<sup>4</sup> Arguably, BC's Interior is already in recession.

In housing, the extremely low interest rates that prevailed in the aftermath of 9/11 reduced the cost of holding a mortgage, and drew many people into the real estate market. As prices went up, others wanted to get in on the action "or get priced out forever." Before long, bullish sentiment overwhelmed rational thinking: prices went through the roof, with a doubling and in some cases tripling of resale prices between 2001 and 2007 in Vancouver.

On the way up, increasing asset prices created a "wealth effect"—those lucky enough to see the value of their home go up so much were more inclined to spend money and borrow on the basis of their new wealth, thereby stimulating the real economy. Moreover, rising home prices led to spectacular new residential construction, providing more jobs and more income. In the US, onto this fire was tossed the fuel of toxic mortgages provided to people who could not afford them.

The jaw-dropping economic events in the US are the gears thrown into reverse: a vicious cycle of falling home prices, with homeowners sitting on mortgage debt greater than the market value of their homes. New residential construction is at half of 2005 levels, undercutting employment, and home prices are down about 25 per cent. The effects of the US housing crisis were magnified by the complex and under-regulated financial industry, whose irresponsible lending practices brought about the subprime mortgage fiasco.

BC (and Canada) has lagged developments in the US. But housing prices in BC have already dropped by 11 per cent since their peak in March 2008.<sup>5</sup> By December 2008 the value of building permits issues had collapsed by 65 per cent from the year before. BC housing starts in 2009 are projected to be almost half of levels in 2007 and 2008. That translates into about 3.5 per cent of BC's GDP, a huge hit to the provincial economy. With over 200,000 employed in construction, half the work is equivalent to a doubling of the unemployment rate.<sup>6</sup>

Accompanying these developments, consumer confidence has dropped off significantly since the beginning of 2008,<sup>7</sup> suggesting that consumers are slowing their spending and delaying big ticket purchases. In addition, high levels of consumer debt mean BC families are more vulnerable to an economic downturn. BC household debt was on average \$1.26 for every dollar of disposable personal income in 2007, compared to \$1.05 in Ontario and \$0.95 for the country as a whole.<sup>8</sup> Retail revenues in BC have been declining since the summer of 2008, and by November (the latest data available by publication time) they had dropped by 5 per cent compared to the previous November.<sup>9</sup>

As a result of these trends, economic forecasts have been lowered in each of the past few months. At the end of last summer, the average private sector forecast was 2.8 per cent real GDP growth for 2009. Those estimates were lowered through the Fall and, as of January, the average forecast is for zero growth in 2009.<sup>10</sup> To the extent that members of the Economic Forecast Council (a BC advisory body of private sector forecasters) see a slowdown, they say it will be short and the province will resume its previous growth course in 2010 (average estimate of 2.8 per cent GDP growth).

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Other data suggest that BC's economic prospects for 2009 are much dimmer than most private sector forecasters have suggested. EI claims in November were up 25 per cent over levels of a year before, and welfare caseloads have also increased over the last year. Given the pervasive uncertainty of the current economic environment, the province should plan for Budget 2009 accordingly, using different scenarios involving more pessimistic forecasts.

From the big economic picture it is clear that if both consumption and investment trend downwards, a recession can be averted only by increased government spending or growth in net exports. BC's exports have, surprisingly, remained strong through 2008, although they have not really grown. This leaves government as the only major sector of the economy in a position to pick up the slack. In the absence of action, the recession will be longer and deeper.

Going forward, the most pressing concern is unemployment. The BC unemployment rate in January 2008 was 4.1 per cent; a year later it had risen to 6.1 per cent. This represents 50,000 more unemployed workers in BC compared to a year ago, an increase of 50%. By industry, job losses have been concentrated in goods-producing sectors and ancillary services such as transportation and warehousing. Construction employment in January dropped by 32,000 jobs from its peak last September.

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It is likely that unemployment will rise steadily in 2009. For every job we lose in primary activities, on average another will be lost elsewhere in the economy. The provincial government should be prepared to create jobs, particularly if unemployment in construction rises significantly as current projects complete but new ones are not forthcoming or are put on hold. Planning for infrastructure projects should begin now, as they require extensive preparation, logistics, and cooperation among levels of government. As construction employment drops off, infrastructure projects could take their place.

Thus, while it is possible to paint a rosier picture of BC's economic situation, there are enough dark clouds on the horizon to warrant serious concern. The 2009 BC budget must meet these challenges and, if anything, err on the side of doing too much. The upcoming 2010 Winter Games are pointed to as a stimulus, but it is important to remember that these projects are already nearing completion. They will not prevent a recession, and in total dollars are relatively small in the context of BC's almost \$200 billion economy.

Finally, it is also worth noting that even during the good times, not all British Columbians were part of the boom. A recent Statistics Canada study found that almost the entire growth in average wages in BC between 1997 and 2007 could be explained by the increase in the earnings of managers, who saw a 15 per cent pay raise compared to virtually zero earnings growth for all other employees.<sup>11</sup> It is hardly surprising, then, that poverty did not drop in any meaningful way, and inequality worsened over this period. While the national rate of child poverty has steadily decreased in recent years (and now stands at 11.3 per cent), BC's child poverty rate of 16.1 per cent is higher now than in 2001. The boom is over, but it was an unbalanced expansion that made substantial investments in luxury items we did not need (from Olympics training facilities to high-end condos) at the expense of basic necessities and wise investments for the future.

# BC's Fiscal Situation

BC'S RECENT EXPANSION was accompanied by a period of unprecedented budget surpluses. Beginning in 2004/05, BC recorded five consecutive surpluses, ranging from \$2.7 billion to just over \$4 billion (between 1.5 and 2.2 per cent of GDP). The provincial government is still anticipating a surplus for fiscal 2008/09.

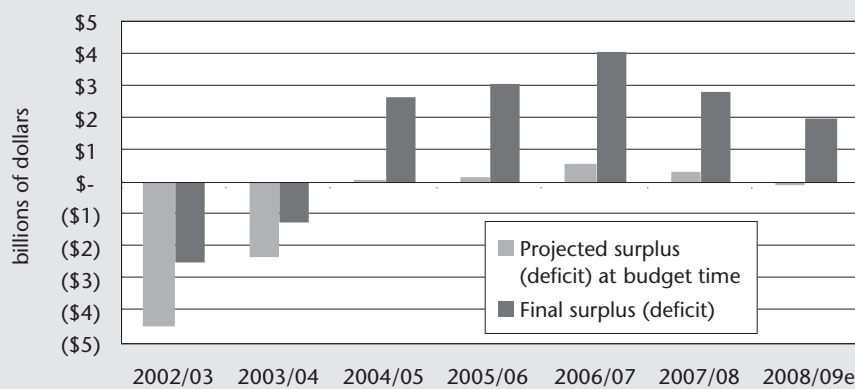
These surpluses are the deliberate product of extremely conservative budgeting practices that underestimated revenues and economic growth—with the result that negligible surpluses tabled at budget time turned into multi-billion-dollar surpluses by fiscal year end. Figure 3 shows the comparison between these two figures, with a cumulative error of almost \$15 billion over the past five budgets. The budget itself has become increasingly unreliable as a source of information about government finances. Only when the books are audited and Public Accounts released is the true state of the province's finances apparent.

This practice undermines democratic debate over how the province should move on public policy issues and partly explains inaction on issues of concern to British Columbians such as poverty and homelessness.

Surpluses have primarily been used to finance capital spending (which appears in a separate account and is expensed in operating budgets over the life of the asset rather than in the years money is spent), with the remaining funds used to reduce the province's debt. Total provincial debt fell from a peak of just under \$37.7 billion in 2003/04 to \$34.6 billion in 2007/08. Relative to GDP, a better measure of affordability, total provincial debt fell from a

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Figure 3: BC Budget Balance, Budget Day vs Year-End



Note: Final figures are before accounting adjustments. The "final" number for 2008/09 is the updated CCPA estimate.

Sources: Ministry of Finance budget documents, various years.

peak of 27 per cent in 2003/04 to 18 per cent last year (and even lower, to 13.8 per cent, if we exclude debt from “self-sustaining” Crown corporations like BC Hydro that have their own revenue streams). Apart from oil-rich Alberta, BC has the lowest debt-to-GDP ratio of any province, a fact that positions the province well for the looming downturn.

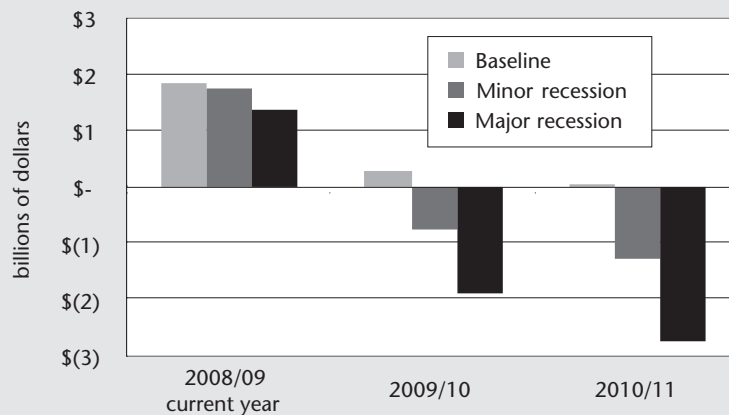
Social services remains the weakest area of provincial spending, and funding levels in nominal terms still have not caught up with pre-2001 levels. Indeed, cutbacks in social assistance made in the mid-1990s and early 2000s have greatly undermined this “automatic stabilizer” as we head into a downturn.

BC has been able to make easy choices in recent years about the mix of taxation and expenditures. Revenues swelled by an average of 11 per cent per year between 2004/05 and 2007/08, enabling both small tax cuts and higher spending in most areas of the provincial budget. Social services remains the weakest area of provincial spending, and funding levels in nominal terms still have not caught up with pre-2001 levels. Indeed, cutbacks in social assistance made in the mid-1990s and early 2000s have greatly undermined this “automatic stabilizer” as we head into a downturn. Given such robust provincial revenues, this was clearly a political choice, one that increased hardship among the poorest in the province.

To get a better handle on the BC budget looking forward we model three scenarios: the first models the most recent estimates of the Economic Forecast Council; the second is more pessimistic and models a minor recession; and the third is more pessimistic still and models a major recession. For expenditures and some revenue categories we take as given the status quo estimates of the most recent BC budget position (from the Ministry of Finance’s First and Second Quarterly Reports). However, we revise the estimates for taxation revenues based on GDP and historical shares of tax revenues relative to GDP. The government’s recent budgets have failed to link revenue projections to their own GDP forecasts, which largely explains why recent budget estimates have so widely missed the mark. In the recession cases we also make adjustments to natural resource royalties, as these can swing widely. (The three scenarios are presented in Figure 4, and in the Appendix table, which outlines the assumptions behind each scenario.)

In our revised baseline case, we take the growth estimates from the Economic Forecast Council (February 2, 2009 update), and use these to adjust our estimates of the BC budget status quo balance (i.e. assuming no other changes to revenues or expenditures in the current or future years). We assume GDP inflation consistent with estimates made for Canada as

Figure 4: Scenarios for 2009 BC Budget



Note: See appendix table for assumptions.



a whole from the Federal Budget 2009, and in addition we revise downwards our estimate of natural resource revenues to levels more consistent with the mid-2000s. If BC experiences only zero growth in 2009 (but not a recession), the provincial budget balance remains in surplus in 2008/09, although at about half the level seen in recent years, then surpluses essentially vanish in the next two fiscal years. Under this scenario, we estimate a surplus of \$1.9 billion in 2008/09, falling to \$0.3 billion in 2009/10, and \$0.1 billion in 2010/11.

Note that these estimates are additionally conservative on the expenditure side by taking the government's estimates as given. If a recession were to unfold, there would be upward pressure on social assistance as an automatic stabilizer. The BC Budget notes that every 1 per cent increase in the temporary assistance caseload increases expenditures by \$3 million. During a major recession it would not be unrealistic to project that this could translate into cost pressures in the hundreds of millions of dollars.

Given the challenges facing the BC economy, even the lower estimate from the Economic Forecast Council may be too rosy. To model a minor recession we estimate a 1 per cent contraction in real GDP for 2009, followed by a recovery of 1.5 per cent in 2010. For 2009/10 and 2010/11 we also lower the anticipated share of tax revenues-to-GDP, and further revise downwards our estimate of natural resource revenues. In this minor recession scenario the budget balance changes very little for 2008/09, but the surplus turns into deficits of \$0.8 billion in 2009/10, and \$1.3 billion in 2010/11.

Our third scenario models a major recession, with real GDP declining by 2 per cent in 2009 and weak recovery of only 0.5 per cent growth in 2010. This scenario may be pessimistic, but it is not implausible. It is similar to some recent private sector forecasts, and the provincial government should ready itself for such a downturn. It is worth noting that in 1982, BC's real GDP shrank by 6 per cent. Even though BC's economy is much changed a quarter-century later, the recent boom was in large part due to commodities and construction — both areas that can undergo major contractions, with ripple effects felt in other parts of the economy.

A major recession in BC would push the provincial budget into deficit, and quickly. BC would swing from a surplus of \$1.4 billion in 2008/09 to a deficit of approximately \$1.9 billion in 2009/10, growing to \$2.7 billion in 2010/11.

If the government tried to balance its budget under these circumstances it would penalize the victims of the recession and worsen the underlying economic situation. In our third scenario this amounts to effectively withdrawing almost 1 per cent of GDP from the economy in 2009/10 and more than 1 per cent in 2010/11. This would turn a 2 per cent fall in GDP into a 3 per cent decline.

The prudent approach is for BC to plan for deficits in 2009/10 and 2010/2011. The size of those deficits will be a function of how poorly the provincial economy performs. BC is well-prepared financially, with the lowest debt-to-GDP ratio of any province save for oil-rich Alberta. In concert with other provinces, the federal government and other developed countries around the world, BC must do its fair share to increase overall GDP by stimulating the economy. Moreover, a fiscal stimulus is not just the status quo deficit arising from the state of the economy; a real stimulus requires increasing public expenditures and capital spending.

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# The State of Economic Stimulus Plans

The premier's announcement did not include new measures to help low-income people deal with the crisis.

IN OCTOBER, BC PREMIER Gordon Campbell made a live televised address about the impact of the financial and economic crisis on the province, and outlined his government's ten-point plan to deal with it.

Public infrastructure is the most important plank of the plan, although few details have been announced. Outside of infrastructure, the ten-point plan consists mostly of speeding up already-announced tax cuts that favour those in higher income brackets (\$56 for those earning \$40,000 a year, \$140 for earners above \$70,000), and that were to be part of the revenue recycling regime of the carbon tax. The tax cuts are being financed out of the current year's surplus, and were included in the Second Quarterly Report. But they are relatively small in magnitude, totalling \$271 million in 2008/09, and \$485 million over three years.

The premier's announcement did not include new measures to help low-income people deal with the crisis. Other pieces of the plan included an increase in protection for deposits over \$100,000 at BC credit unions, a temporary reduction in ferry fares (now ended), and a vague new publicly-administered savings vehicle for British Columbians who do not have private pension plans — none of which will have an impact on the current crisis.

In addition to the ten-point plan, the premier also announced "economic summits" in Prince George and Vancouver, a new (and highly unrepresentative) advisory panel, and—bizarrely—faster implementation of the BC-Alberta Trade, Investment and Labour Mobility Agreement (TILMA). This move is essentially meaningless given there are few, if any, bona fide barriers to trade within Canada (indeed, they are banned by the Constitution). In the case of Alberta, TILMA is at best a gimmick—the BC government has never produced a list of "barriers" and the agreement has largely been implemented. At worst, TILMA entrenches a process of regulatory harmonization that could weaken environmental, labour and consumer regulation.

In a measure promoted as a tax savings, property tax assessments for 2008 were frozen at 2007 levels. However, unlike income or sales taxes, property tax rates are changed annually to meet revenue targets; freezing them will have no impact on the taxes paid by homeowners. This measure also means that millions of dollars of work done by the Crown corporation BC Assessment for 2008 was essentially wasted.

The NDP economic plan, announced the day after the premier's address, includes maintaining all of the tax cuts promised by the Liberals, plus elimination of the BC carbon

tax. The opposition has articulated the need for major public infrastructure investments, including public transit and home retrofits to create “green jobs.” Spending to seismically upgrade schools and build new affordable housing would be fast-tracked. Additional action on education includes enhancing post-secondary budgets, restoring student grants, and reducing the interest rates on student loans by half. The opposition stimulus package for rural BC includes additional infrastructure spending, a ban on raw log exports, and a rural economic development fund.

We can expect more details about these ideas from both the government and opposition when the budget is tabled and in the leadup to the election. One challenge in moving forward stems from modern accounting rules that show capital expenditures (including buildings, hospitals, and other infrastructure) in a different budget account. In the annual operating budget, these expenses are spread out over many years to reflect the lifetime of major assets. While most media coverage focuses on the “balance” in the operating budgets,<sup>14</sup> what really matters for the long-term health of provincial finances is the public debt and its size relative to GDP.

Although infrastructure investments are certainly needed as part of a stimulus package, the danger is the bias against needed program spending. As a result, we may build more classrooms (capital expenditure), but not provide adequate funds for services for students, or build new hospitals without funding the hospital staff needed to treat patients.<sup>15</sup>

BC’s balanced budget legislation is a major impediment to a good economic plan—it will make economic conditions worse by further reducing incomes at a time of economic weakness. Rather than just amending it for Budget 2009, it should be repealed at the first available opportunity. It is worth recalling that BC went from surplus to deficit in 2002/03, in part due to the economic slowdown and in part due to aggressive provincial tax cuts. The current situation is much more compelling in terms of the need for a deficit.

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## Axe or Fix? BC's Carbon Tax and the 2009 Budget

The carbon tax is probably the most controversial provincial fiscal change in recent memory. The tax works out to 2.34 cents per litre when buying gas, an amount that is more symbolic than behaviour-changing. Indeed, between the time the tax was introduced last February and the time it was implemented, prices at the pump increased by 40 cents per litre, almost 20 times the size of the tax. That the price spike coincided with the carbon tax likely explains much of the public outcry about it.

The carbon tax is now a divisive issue. It sparked debate over whether such taxes work, at what level they should be set or phased-in, and if so, the best use of revenues. The BC government has generally overstated the benefits of the carbon tax, while the opposition has demonized it. Both overstate the tax's impact.

On its own, BC's carbon tax is regressive, meaning low-income families pay a larger share of their income to the tax than high-income families (even though high-income families will pay more in straight dollars).

But distribution is also affected by how the proceeds of the tax are recycled back to households in the form of personal and corporate income tax cuts and a new low-income tax credit. In 2008/09, the overall carbon tax regime delivers a modest net gain in dollar terms for the bottom 40 per cent of households (about \$40 per household on average, or 0.2 per cent of income). These amounts are relatively small because the carbon tax starts out at such a low rate.

A major concern, however, is that the low-income credit is not scheduled to grow in line with the carbon tax. The credit of \$100 per adult will grow to \$105 by July 2009; no further increases are scheduled. But the carbon tax itself will rise 50 per cent in July, and by a total of 300 per cent (from \$10 per tonne to \$30) by 2010/11. As a result, the progressive outcome in 2008/09 disappears next year, and by 2010/11 the carbon tax regime becomes regressive.

This problem is relatively easy to fix if the 2009 BC Budget commits that the low-income credit will grow in line with carbon tax revenues. Indeed, because low-income families need real options for taking climate-friendly actions, the credit could be increased much more.

A second concern is that tax cuts undermine a progressive outcome at the top of the income scale. In 2008/09, personal and corporate income tax cuts lead to an average net gain for the top 20 per cent of households that is larger, in dollar terms, than for the bottom 40 per cent. This problem, which will worsen in future years, is a perverse outcome since top earners tend to have larger carbon footprints.

If BC continues to have a carbon tax, personal and corporate income tax cuts should be dropped from the recycling regime, the low-income credit should be expanded, and the remaining carbon tax revenues should fund other programs to reduce BC's greenhouse gas emissions, including major public transit expansion, transition programs for workers, and energy efficiency programs.

Eliminating the tax altogether also raises concerns. Taking global warming seriously means we must accept higher prices for activities that emit greenhouse gases. Whether we use carbon pricing or regulation, there will be higher prices passed on to consumers, and we will need a way to offset the impact on low-income people. One of the main benefits of a carbon tax is that it generates revenues that government can use to offset adverse impacts on low-income households.

One thing is clear: there will be substantial costs associated with meeting the climate change challenge. Governments should not limit themselves to "revenue neutral" strategies. In the coming years, BC will need to raise significant new revenues (and/or take on new debt) if we are to adequately fund public transit, building and home retrofits, incentives to reduce carbon emissions, and other needed climate expenditures.

# Priorities for BC Budget 2009

THE RECESSION DEMANDS that all governments take a more active role in propping up output to offset weakness in consumer spending and business investment. BC must act in concert with the federal government and other provincial governments (and Canada in turn must work with other countries, most of whom have announced or are planning their own stimulus packages). The BC government must also work with municipalities facing their own fiscal pressures. Above and beyond the cyclical deficits we are likely to see even in the absence of new spending, BC needs a stimulus program with both operating and capital expenditures to bolster demand through a difficult period.

The key point in the period ahead is to get money into the hands of those who will spend it quickly. Broad-based tax cuts are a poor source of stimulus compared to government spending. In uncertain times, the tendency of most tax-cut recipients will be to save rather than spend—and much of what is spent will be on imports rather than boosting local economies.<sup>16</sup>

**FIRST, DO NO HARM.** The single worst action the BC government could take in a recession is to cut spending to balance the budget. Protecting the budgets of key public services is a top priority; this will require minimum increases just to maintain current service levels:

- Health care funding needs to increase by 4.3 per cent per year to maintain services for a growing and aging population and keep up with health-care specific inflation.<sup>17</sup>
- K–12 education funding needs to rise by approximately 2 per cent to keep up with inflation and maintain current service levels; further increases are required if the province wants to address unmet needs in the system. Declining enrolment may ease funding pressures somewhat, but it can also cause problems if it results in reduced provincial funding for schools, because operating costs at the school level typically do not fall as fast as enrolment.
- Post-secondary institutions may be confronted with growing enrolment as people, mostly younger adults, transfer back to school from the labour force in the face of the downturn. Budget cuts in the university sector announced by the province should be reversed and new funding added. To the extent possible, new funds should be used to accelerate skills development for a new generation of “green jobs.”

The key point in the period ahead is to get money into the hands of those who will spend it quickly. Broad-based tax cuts are a poor source of stimulus compared to government spending. In uncertain times, the tendency of most tax-cut recipients will be to save rather than spend—and much of what is spent will be on imports rather than boosting local economies.

**SECOND, SHORE UP AUTOMATIC STABILIZERS.** A recession would mark the first real test of BC's social assistance program since cuts were made in the mid-1990s to early 2000s under NDP and Liberal governments. As part of a coherent poverty-reduction strategy with legislated targets and timelines, the government should commit to immediately increasing income assistance and disability benefit rates by 50 per cent and indexing them to inflation.<sup>18</sup> Income supports must be accessible to those in need by removing the arbitrary barriers that discourage, delay, and deny financial help to people in need. If parties are concerned about the cost of such programs, they could be financed by an increase in taxes on upper-income families. The provincial government should also work closely with the federal government to improve access to employment insurance (EI) and strengthen its re-training provisions.

**THIRD, THE DANGER IS IN DOING TOO LITTLE.** We should not wait until unemployment rises to unacceptable levels before taking action. Planning for capital projects should be underway as quickly as possible, as many larger projects require coordination among multiple levels of government, development approval processes, and environmental assessment. The P3 model should be abandoned. It is more costly over the long run, plagued by legal complexities that add considerably to the lag time of ramping up projects, and requires private financing that is currently in very short supply.

**FOURTH, INFRASTRUCTURE SPENDING SHOULD BE GREEN AND MEET SOCIAL NEEDS.** A major campaign of new capital spending offers the opportunity to green BC's infrastructure, from large transportation projects to seismic upgrades for schools and retrofits of homes. In recent years, public infrastructure projects have suffered from substantial cost overruns as labour shortages and construction material prices drove up costs. With these pressures now greatly reduced, it is an opportune time to roll out major infrastructure projects. One of the biggest contradictions between the government's Climate Action Plan and other policy areas is the emphasis on highway expansion, which would undermine long-term GHG reduction objectives. In forestry, an action plan is needed for the massive beetle-kill lands. An aggressive program of reforestation should be implemented, an investment that would create jobs while restoring the land base for future economic activity (and CO<sub>2</sub> capture).

Budgets are about the choices we make as a society. In the face of a recession that could have negative impacts for communities and families across the province, we need a government committed to action, and in particular, to protecting incomes and employment.

Proposals for stimulus packages also tend to be biased towards work traditionally done by men. Expanding BC's infrastructure for early learning and child care is just one example of social investment with large long-term payoffs that also benefit women. Educational investments should also not be neglected, as many young people will go back to school in a downturn.

Social housing is another key area where workers can be employed in construction. BC should get back to its history of building 2,000 new units of social housing per year. We could also add to our health care infrastructure by building new residential (long-term) care facilities. These facilities would meet urgent social needs and reduce costly pressures in other parts of the system, such as emergency wards.

Budgets are about the choices we make as a society. In the face of a recession that could have negative impacts for communities and families across the province, we need a government committed to action, and in particular, to protecting incomes and employment. While government cannot do everything, it must not do nothing. The opportunity still exists to build a more equitable and sustainable British Columbia.

## NOTES

- 1 Official GDP figures for the fourth quarter of 2008 are not yet released, but in a December 9, 2008 press release announcing an interest rate cut the Bank of Canada declared the Canadian economy to be in a recession.
- 2 BC Ministry of Finance, First Quarterly Reports, 2007 and 2008.
- 3 As reported by Bob Burgdorfer in the National Post on January 13, 2009, "Lumber price at 1991 low and falling."
- 4 Ibid. According to the article, forecasters expect lumber demand to fall by 14 per cent in 2009 to its lowest level since 1982.
- 5 BC Real Estate Association, January 12, 2009 press release "BC Home Sales Decline by One-Third in 2008" accessed at [www.bcrea.bc.ca/news\\_room/2008-12.pdf](http://www.bcrea.bc.ca/news_room/2008-12.pdf).
- 6 These figures are based on projections made by businesses and government in late 2007, and may be revised downward when the data is updated in late February 2009.
- 7 The Conference Board of Canada's index of consumer confidence in BC fell from a peak of 117.6 in February 2008 (cited in the BC Ministry of Finance Second Quarterly Report) to 77.1 in December 2008 (cited in the Vancouver Sun, December 23, 2008).
- 8 Institute for Chartered Accountants, 2008 BC Check UP; note that a different number for Canada was released by Statistics Canada's national accounts.
- 9 Statistics Canada. 2009. "Retail Trade." *The Daily*. Jan. 22. Catalogue no. 11-001-XIE. [www.statcan.gc.ca/daily-quotidien/090122/t090122a1-eng.htm](http://www.statcan.gc.ca/daily-quotidien/090122/t090122a1-eng.htm).
- 10 BC Ministry of Finance, Second Quarterly Report, and December 5, 2008 news release. January estimates at: [www.fin.gov.bc.ca/Jan\\_update.htm](http://www.fin.gov.bc.ca/Jan_update.htm).
- 11 Renee Morissette. 2008. "Earnings in the Last Decade." *Perspectives on Labour and Income*, Statistics Canada, Vol. 9, no. 2: 12-24.
- 12 See *BC's Growing Gap*, a forthcoming CCPA study by Igljka Ivanova on income inequality trends in BC.
- 13 As measured using Statistics Canada's low income cut-offs after tax (Statistics Canada, CANSIM Table 202-0802). The latest available data is for 2006.
- 14 The *Vancouver Sun's* Vaughn Palmer being a notable exception.
- 15 A point raised by economists Paul Beaudry and Jon Kesselman in a recent opinion piece in the *Vancouver Sun*. "Budgeting acrobatics: Gordon Campbell's penny-wise push is pound foolish, guided by notions from a Dickensian era." Oct. 28, 2008. Available online at [www.canada.com/vancouver\\_sun/story.html?id=e8fb9513-02ac-4856-9623-11cb9f87b754&p=3](http://www.canada.com/vancouver_sun/story.html?id=e8fb9513-02ac-4856-9623-11cb9f87b754&p=3).
- 16 Recent estimates of stimulus from different tax and expenditure options include: The Economic Impact of the American Recovery and Reinvestment Act, Mark Zandi, Moody's Economy.com, and the Federal Budget 2009.
- 17 Updated estimate based on methodology in *Is BC's Health Care System Sustainable?*, by Marc Lee, 2006.
- 18 The CCPA recently released a comprehensive poverty-reduction strategy for BC that reviews this history and makes recommendations on targets and timelines for poverty reduction, and policy recommendations for achieving those targets. See Seth Klein et al., *Poverty Reduction Plan for BC*, 2008.



# APPENDIX TABLE

Re-estimated Revenue and Expenditure Framework													
	Baseline: revised estimates (Economic Forecast Council)												
	actual			Minor recession				Major recession					
	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2008/09	2009/10	2010/11	2008/09	2009/10	2010/11
(figures in millions of dollars unless otherwise stated)													
<b>Macroeconomic assumptions</b>													
Real GDP growth	3.6%	4.4%	4.4%	3.0%	1.3%	0.0%	2.8%	1.0%	-1.0%	1.5%	1.0%	-2.0%	0.5%
GDP inflation	4.7%	3.0%	3.5%	2.4%	2.0%	-0.4%	1.7%	2.0%	-0.4%	1.7%	2.0%	-1.0%	1.0%
Nominal GDP growth	8.3%	7.4%	7.9%	5.4%	3.3%	-0.4%	4.5%	3.0%	-1.4%	3.2%	3.0%	-3.0%	1.5%
BC nominal GDP	157,540	168,855	182,743	192,528	198,881	198,086	207,000	198,304	195,528	201,784	198,304	192,355	195,240
BC tax revenues-to-GDP ratio	10.4%	10.6%	10.7%	10.9%	10.5%	10.4%	10.4%	10.5%	10.2%	10.2%	10.5%	10.0%	10.0%
<b>Revenues</b>													
Taxation revenues	16,382	17,911	19,542	20,963	20,883	20,601	21,528	20,822	19,944	20,582	20,822	19,235	19,524
Natural resource revenue	3,973	4,567	3,982	3,778	4,387	4,000	4,000	4,387	3,600	3,600	4,000	3,200	3,200
Other revenues	5,228	5,450	5,909	6,185	5,905	6,028	6,196	5,905	6,028	6,196	5,905	6,028	6,196
Contributions from government enterprises	2,412	2,198	2,685	2,974	2,697	2,734	2,756	2,697	2,734	2,756	2,697	2,734	2,756
Federal transfers	5,231	5,786	6,386	5,931	5,919	5,960	6,155	5,919	5,960	6,155	5,919	5,960	6,155
TOTAL REVENUES	33,226	35,912	38,504	39,831	39,791	39,323	40,635	39,730	38,266	39,289	39,343	37,157	37,831
<b>Status quo expenditures (government's current fiscal plan)</b>													
Health	11,642	12,414	13,250	14,236	14,983	15,640	16,544						
Education	8,511	8,943	9,487	9,989	10,295	10,538	10,632						
Social services	2,665	2,724	2,892	3,046	3,345	3,377	3,402						
Protection of persons and property	1,215	1,379	1,326	1,579	1,493	1,522	1,521						
Transportation	1,308	1,196	1,251	1,379	1,383	1,423	1,481						
Natural resources and economic development	1,670	1,599	1,641	1,974	1,816	1,765	1,741						
General government	505	644	768	669	693	675	668						
Debt service	2,294	2,182	2,269	2,231	2,129	2,266	2,414						
Other	848	1,806	1,542	1,842	1,802	1,819	2,167						
TOTAL EXPENDITURES	30,658	32,887	34,426	36,945	37,939	39,025	40,570	37,939	39,025	40,570	37,939	39,025	40,570
Surplus (deficit)	2,568	3,025	4,078	2,886	1,852	298	65	1,791	(759)	(1,281)	1,404	(1,868)	(2,739)

Assumptions for each scenario in this table are on the following page.

See assumptions on the following page.



## APPENDIX TABLE

### ASSUMPTIONS FOR EACH SCENARIO

**BASELINE:** Assume tax revenue-to-GDP of 10.5% in 2008/09 and 10.4% in the next two years. Nominal GDP growth estimates based on Economic Forecast Council estimates, released February 2, 2009 plus estimated GDP inflation of 2% in 2008/09, -0.4% in 2010/11, and 1.7% in 2009/10 (latter years based on average estimates in Federal Budget 2009). Other components of revenues and expenditures taken as given from Second Quarterly Report (2008/09) and First Quarterly Report (2009/10 and 2010/11), except we downgrade the projection for natural resource royalties for 2009/10 and 2010/11.

**SLOWDOWN 1:** We model a minor recession by lowering real GDP growth estimates to 1% in 2008/09, -1% in 2009/10 and 1.5% in 2010/11 and using same GDP inflation projections as the baseline. We also reduce estimates of tax revenue to GDP to 10.2% in 2009/10 and 2010/11 (slightly less than 2004/05 levels), and further downgrade the projection for natural resource royalties for 2009/10 and 2010/11.

**SLOWDOWN 2:** To model a major recession with a slow recovery we further lower real GDP growth estimates to -2% in 2009/10 and 0.5% in 2010/11. Because of the recession, we also reduce our GDP inflation estimates to -1% in 2009/10 and 1% in 2010/11. We lower tax revenue to GDP to 10.0% (slightly higher than it was in 2002/03, the lowest level in recent years) and further downgrade natural resource royalties in 2009/10 and 2010/11 to levels similar to the early 2000s.

All scenarios take expenditures, other own-source revenues, Crown revenues and federal transfers as provided in most recent quarterly update. Note that social assistance expenditures will rise during a recession, an impact we do not consider in this table.



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