



# Behind the NUMBERS

economic facts, figures and analysis

## Dear Prudence: BC's Budget Situation is Better than Many Realize

By Marc Lee

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The 2000 BC Budget document was packed full of “something for everyone”: a smattering of tax cuts and spending initiatives; new moves to ensure the transparency and credibility of the budget process; and, a multitude of debt and deficit numbers. Buried in the detail, however, is a story about what happened in the 1999/00 Budget year that has some interesting implications for the province's fiscal health.

While 1999's Budget made big headlines with its large deficit projections, economic recovery made a huge dent in the actual deficit. What remains on the books still looks large, but mostly represents four one-time write-downs of government assets. Despite another large projected deficit in the 2000 Budget, there are good reasons to believe that the books are hiding a stronger fiscal position than suggested by media headlines.

### Reviewing the 1999 Budget

When Joy MacPhail stood in the Legislature a year ago and projected a deficit of \$1.5 billion,<sup>1</sup> BC was coming off of a bad year in 1998. Hit by the twin shocks of low international commodity prices for BC exports and the Asian financial market meltdown, most private sector forecasters tagged 1998 as a recession. This gloomy sentiment lasted until November 1999, when Statistics Canada reported that BC eked out 0.2% growth in 1998—not great, but much higher than the private sector average estimate of -0.5%.

At the time of the 1999 Budget, the outlook for the coming year was similarly pessimistic, and rife with uncertainty. Given this atmosphere, the government lowballed its

estimates and projected a \$1.5 billion deficit. The business community reacted with despair, but this was simply good fiscal policy for the prevailing economic climate—amounting to a fiscal stimulus to the economy of 1.3%.

As it turned out, 1999 was a much better year than anticipated. Final GDP numbers will not be released until later this year, but many signs point to a recovery. Exports in 1999 were up 10.2% to a record high of \$29.7 billion, as Asian economies regained strength and commodity prices rose. Employment growth was strong, with the unemployment rate falling to 7% in February 2000, the lowest level since 1981.

On the heels of this, increases in tax revenues and resource royalties have meant that government revenues were a full \$1 billion higher than projected in the 1999 budget. The most recent projections for the 1999/00 fiscal year (ending March 31, 2000) are for a deficit of just over \$1 billion, after accounting for a \$100 million forecast allowance.

**1999/00's deficit is still large, but is also half a billion dollars under budget.**

### Cleaning up the Mess

The real story does not end there. The 1999/00 numbers hide a surprising underlying budgetary strength. This is because of four major one-time write-offs that were not part of the 1999 Budget, but were added onto the books near the end of the fiscal year. The first, Fast Ferries, has been well expounded in the media, and represents a failed megaproject that the new Premier is wisely distancing himself from.

The second is also a megaproject, this time from the Socred era, which expanded BC Rail infrastructure in the North-east, based on price projections of \$90 a ton for coal. With current prices at only \$40 a ton, BC Rail assets no longer have the same value, and were written off by the government to the tune of \$617 million—some two and a half times larger than the Fast Ferries write-off of \$240 million.

**Table 1: Revisiting the 1999 Budget**

	Estimate, 1999/00 Fiscal Year (\$million)
1999 Budget Forecast Deficit	1,500
<b>Revised Forecast Deficit, March 2000</b>	<b>1,145</b>
<b>Less:</b>	
Forecast allowance	100
Fast Ferries	240
BC Rail	617
Vancouver Convention Centre	70
Kemess Mine	41
<b>Underlying Deficit</b>	<b>77</b>

Source: BC Budget 2000

The final write-downs are for the failed Vancouver Convention Centre and the Kemess mine, at \$70 million and \$41 million respectively.

In total, these amount to \$968 million, all of which is going on the 1999/00 books. As Table 1 shows, **subtracting these one-time items (and the forecast allowance) means that the real underlying deficit from last year was only \$77 million—a far cry from the \$1.5 billion projected deficit announced by MacPhail.**

### “Martinizing” the 2000 Budget

This brings us to this year’s projected deficit: another big number at \$1.3 billion. However, BC has taken a move from the federal government’s playbook by building in a great deal of “prudence”. The budget contains a large

reserve cushion of \$300 million, bolstered by projections that are quite conservative.

While much ado has been made of expenditure increases of 4.2%, revenues are projected to grow by only 0.5%. This is a surprisingly small amount, given that economic growth will be stronger in 2000 than it was in 1999 (when revenue growth was 5.3%).

The 2000 budget does feature modest tax cuts, which will reduce revenues somewhat (yes, cutting taxes does indeed reduce tax revenues). But this should still be outweighed by the tax revenue gains from personal income growth due to a stronger economy.

Budget estimates of underlying economic growth are also arguably low. The government’s numbers match the average private sector estimate (from January 2000) of expected real GDP growth of 2.2%. As noted above, however, the private sector has been underestimating growth in recent years, with more than a hint of pessimism about the BC economy. More recent growth estimates are also more upbeat: the week of the BC Budget, the TD Bank announced a new forecast of 2.9% growth for BC; the week before, ScotiaBank projected growth of 2.7%.

In other words, given conservative economic assumptions and a sizable reserve cushion, we can expect the government to beat its deficit target again next year. As Table 2 shows, if revenue growth, were to be 3% instead of 0.5%, this would mean an additional \$527 million in revenues (all other things equal). **If revenue growth should reach**

**Table 2: Alternative Revenue Projections, 2000 Budget**

Projected revenue growth	Total revenues	Projected deficit	Deficit after contingency reserve
(millions of dollars)			
0.5%	21,500	(1,278)	(978)
3.0%	22,027	(618)	(318)
5.3%	22,518	(127)	173

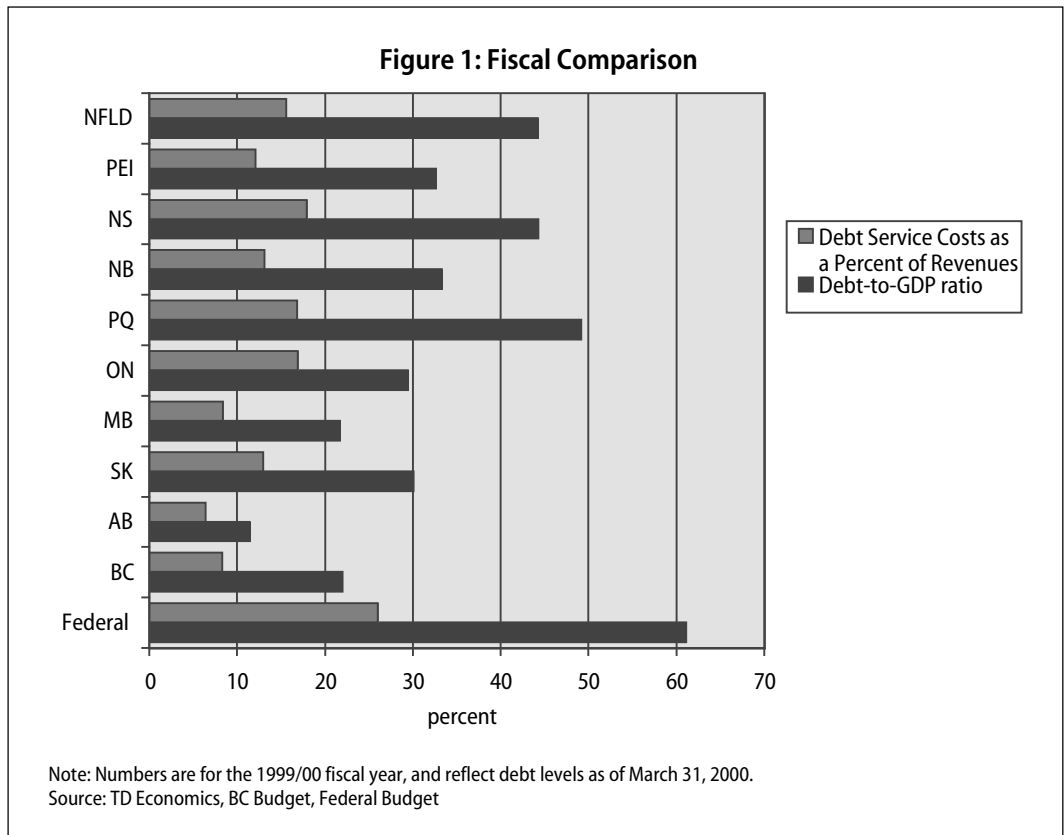
Note: These calculations maintain all of the assumptions in Budget 2000, except for the change in revenues. The Budget forecast is for 0.5% growth; in 1999, revenues grew by 5.3%. Source: Author’s calculations based on BC Budget 2000

last year's 5.3% increase, the projected deficit falls to \$127 million, and, after the \$300 million contingency reserve is accounted for, the books would actually be in the black by \$173 million.

Even a low deficit could set the stage for a 2001 Budget that is balanced. The government's budget position is clearly stronger than the numbers suggest at first glance. The media focus on the large *projected* deficit misses the mark in terms of the underlying fiscal situation.

Also important to the overall fiscal situation is that BC continues to be in an enviable position with regard to total provincial debt. As Figure 1 shows, BC's debt-to-GDP ratio, and debt service costs as a percentage of revenues, are among the lowest of any province, and are much lower than the federal government. Of course, BC cannot run deficits in perpetuity, but the province is not in any kind of crisis, despite much hysteria to the contrary.

In this context, it is disappointing that the government was not more ambitious in its plans. Decisions to add long-term care beds to take the stress off expensive beds in Emergency wards, and to move towards a more comprehensive child care system, while welcome, are modest at best. The Budget is completely silent when it comes to a much-needed anti-poverty strategy.



More action in these areas seems to have fallen victim to budget prudence. And this prudence, in turn, shifted the focus of media coverage too narrowly towards the bottom line debt and deficit projections. Looking behind the numbers, however, suggests a different story: BC's books are in fine shape. But perhaps this story will have to wait until next year.

**Notes**

1. Based on summary account, which includes Crown corporations; the announced figure at the time was \$890 million, based on the consolidated revenue fund.

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