

BC COMMENTARY

a review of provincial social and economic trends



CCPA
CANADIAN CENTRE
for POLICY ALTERNATIVES
BC Office

Volume 8 · Number 2
Spring/Summer 2005

ELECTION SPECIAL

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BC Budget 2005: A Missed Opportunity

By Marc Lee

Promising a new "Golden Decade", the 2005 BC Budget was tabled in February. Like any pre-election budget, new spending is at the forefront, with a \$1.5 billion increase over 2004/05. Most of this — about \$1.1 billion — goes to health care and education. Unlike previous years, however, there are no cuts outside health care and education.

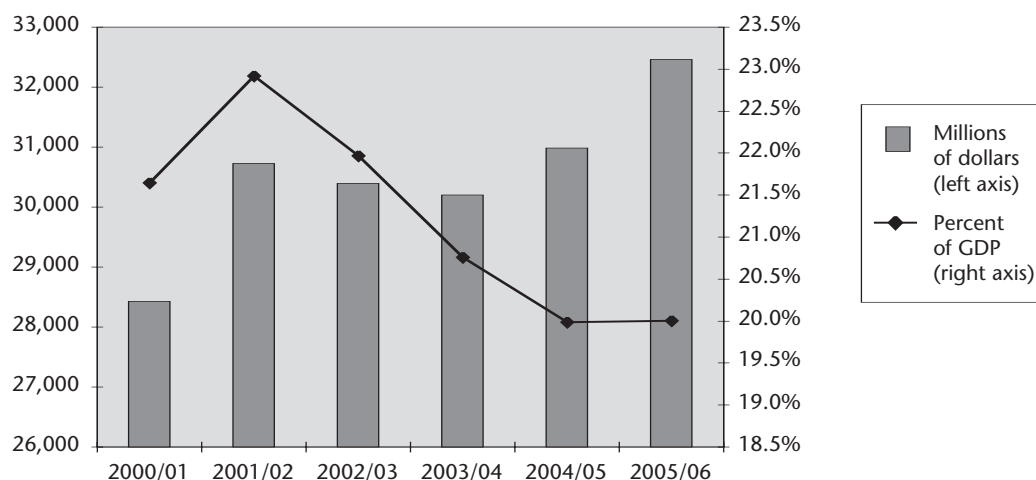
While the new spending sounds like a lot of money, it only averts a continued decline in the size of the public sector relative to the economy. As the economy grows, the public sector needs to grow too, to meet rising demand for services and increasing costs of providing them. In the context of a \$162 billion economy, provincial expenditures of \$32.5 billion in 2005/06 will be about 20%, the same as the previous year. But this is well below the 23% expenditures-to-GDP that the provincial government inherited in 2001.

Thus, this government has presided over a major shrinkage of the public sector, even though the total dollars spent was flat between 2001/02 and 2004/05, prior to the planned increase for 2005/06. Moreover, buried within the total is a reallocation of expenditures towards health care, and to a lesser extent, education, from key areas such as social assistance, children and families, and environmental protection. The 2005 budget reinforces these trends.

What's missing from the 2005 budget is a meaningful commitment to un-do the damage done over the past few years. The budget is a well-crafted attempt to paper over a chasm. It makes gestures of new spending that tacitly acknowledge the difficulties many British Columbians are facing as a result of spending cuts — but does not fess up to the damage.

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BC Government Expenditures, 2000/01 to 2005/06



Source: Calculations based on BC Budget 2005.

From the Editor

By the time you receive this issue, the BC election campaign will be in full swing. In the interests of stimulating the public debate, this "election special" highlights some recent research we have been doing on the BC Budget, key areas of provincial spending and the economy.

At the time of writing, the writ has yet to be dropped, so no official election platforms have been tabled. At this point, the closest we have to a platform is the 2005 BC Budget, subtitled "Towards a Golden Decade for British Columbia." Our BC Director, Seth Klein, likes to joke that the government must have resuscitated one of Chairman Mao's old speechwriters.

In any event, as a non-partisan research institute, our job is not to pick sides but to comment on the issues of the day, offer progressive public policy advice, and raise other issues that are getting short shrift in the public arena. Public policy is about making choices, and to that end, we hope this issue provides some analysis for an informed public debate.

As always, your comments are welcome.

Marc Lee
Editor

Even with the increases, funding outside of health care and education remains \$1.2 billion lower in 2005/06 than was the case in 2001/02.

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Instead, the government continues to hide behind the allegation that BC inherited a \$4 billion "structural deficit" that necessitated spending cuts. Yet, the massive surpluses the government is now sitting on demonstrate quite clearly that there was no structural deficit — that none of the cuts needed to happen.

In fact, the government goes to great lengths to hide how large the underlying surplus is. The budget projects a surplus of \$220 million in 2005/06. But we have to add to this some generous cushions: a forecast allowance of \$400 million and contingencies of \$270 million. In addition, revenue projections are very conservative — at least \$400 million lower than one would expect given projected levels of economic growth.

This is a case of budget prudence gone too far. Adding all of these contingencies together, the built-in surplus is well over \$1 billion.

This makes the amounts of reinvestment outside health care and education all the more difficult to take. Announced spending increases are too small and spread too thin. Even with the increases, funding outside of health care and education remains \$1.2 billion lower in 2005/06 than was the case in 2001/02.

Given the surplus, there is no reason why a stronger commitment could not have been made. New funding amounts look larger because they are announced as three-year totals. Even when it comes to new spending, there is more spin than substance.

The budget aims to distort the perception that the provincial government has been cruel to vulnerable

people in BC. For example, new funding is announced for transition houses for women fleeing abusive relationships. But this sidesteps the fact that the government eliminated funding for women's centres a few years ago. This seems like a cynical move by a government that knows it is unpopular with women.

The budget also brings in \$484 million of targeted tax cuts — although \$270 million of this amount merely represents the reversal of the 2002 sales tax increase (from 7.5% back to 7%), a move that was announced last Fall. Most newsworthy is a \$120 million tax cut for British Columbians earning less than \$26,000 per year, plus an enhanced credit for MSP premiums. While these tax cuts benefit low-income British Columbians, they cover up the fact that these same people have borne the brunt of the spending cuts, and that high-income earners were the big beneficiaries of the 2001 tax cuts.

Even the bright spots of the budget have some notable omissions. Lots of new money for health care, but no word on funding long-term care beds. Post-secondary institutions will feel a pinch later this year as new caps on tuition fees kick in (a positive development) but funding has not increased enough to support existing seats and planned new ones.

Before we can talk about a Golden Decade, there is a lot more work to be done. Instead of repairing the damage, we see some token gestures put forward before an election. Budget 2005 is a missed opportunity.

Marc Lee is an Economist in the BC Office of the Canadian Centre for Policy Alternatives.

Who Benefits? Revisiting BC's Income Tax Cuts

By Stuart Murray

On June 6, 2001 the provincial government cut personal income taxes by approximately 25% across the board. In the 2005 budget, the government announced a smaller tax cut targeted at low-income earners (it applies only to people with incomes under \$26,000).

Even with the new low-income reduction, BC's tax cuts have disproportionately benefited higher income earners. As Table 1 shows, most of the tax cut pie went to the top one-eighth of income earners. Particularly telling is the fact that the 0.4% of the population earning more than \$250,000 per year received 15.2% of the tax cut — only slightly less than the total amount for the bottom 60.8%.

Table 2 shows that by income group, the tax cut as a percentage of income grows as income rises. At \$30,000 of income, the tax cut amounts to a savings of 1.4% of income. By \$200,000, the tax cut grows to 3.9%. An exception is at the bottom, due to the 2005 low-income tax cut.

Overall, BC's tax system has become more regressive. Beyond income tax cuts, there have also been other regressive tax increases — such as MSP premium hikes, the sales tax increase (since reversed) and increased taxes on fuel and tobacco — and spending cuts that disproportionately hurt low- and middle-income earners.

Even with the new low-income reduction, BC's tax cuts have disproportionately benefited higher income earners.

Income Interval	Percentage of Tax Filers 2000	Total Income Tax Savings from Tax Cuts announced in 2001 and 2005 (\$ millions)	Share of Tax Cut Pie (%)
\$1 - \$30,000	60.8%	\$ 269.8	17.2%
\$30,000 - \$60,000	27.8%	446.9	28.4%
\$60,000 - \$80,000	6.6%	267.3	17.0%
\$80,000 - \$100,000	2.3%	128.8	8.2%
\$100,000 - \$150,000	1.5%	127.1	8.1%
\$150,000 - \$250,000	0.6%	93.3	5.9%
\$250,000+	0.4%	238.4	15.2%
Total	100.0%	1,571.7	100.0%

Note: Figures are based on final sample data for British Columbia for the 2000 tax year, and include adjustments in tax rates in 2001, 2002 and 2005 at different income intervals. Income intervals are based on gross income before deductions. These numbers are not comparable with the CCPA's previous estimates because we switched the sample from 1998 tax payers to 2000 tax filers (the latter includes people filing returns but paying no tax). Percentages may not sum to exactly 100% due to rounding.
Source: Author's calculations based on Canada Customs and Revenue Agency, Tax Statistics on Individuals, Table 2

Gross Earnings	BC Income Tax Before Tax Cut		Tax Cuts in 2001 and 2002 plus 2005 Low-Income Tax Cut	BC Income Tax After Tax Cut		Tax Cut as a Percent of Income
	(dollars)	(percent of income)	(dollars)	(dollars)	(percent of income)	
\$20,000	\$ 843	4.2%	\$ 452*	\$ 391	2.0%	2.3%
\$30,000	1,536	5.1%	430	1,106	3.7%	1.4%
\$40,000	2,429	6.1%	644	1,785	4.5%	1.6%
\$50,000	3,559	7.1%	904	2,655	5.3%	1.8%
\$60,000	4,642	7.7%	1,155	3,487	5.8%	1.9%
\$80,000	7,517	9.4%	1,947	5,570	7.0%	2.4%
\$100,000	10,989	11.0%	2,857	8,132	8.1%	2.9%
\$150,000	20,603	13.7%	5,297	15,306	10.2%	3.5%
\$200,000	30,453	15.2%	7,797	22,656	11.3%	3.9%

Note: * This \$452 dollars represents a \$236 tax cut in 2001 and 2002, plus a \$216 tax cut in 2005.
Source: Author's calculations based on information on the BC Ministry of Finance and Corporate Relations web site.

The \$150 Million Question: What Does New K-12 Funding Mean For BC's Schools?

By Marc Lee

The recent announcement by the provincial government of \$150 million in new funding for the K-12 education system was greeted with guarded optimism by many in the education community.



Over the past three years BC's education system has seen the loss of 113 schools, 2,558 teaching positions and larger class sizes.

Over the past three years BC's education system has seen the loss of 113 schools, 2,558 teaching positions and larger class sizes. The announced \$150 million holds the promise of un-doing some of this damage, and could be interpreted as an admission by the government that its funding for K-12 has been inadequate.

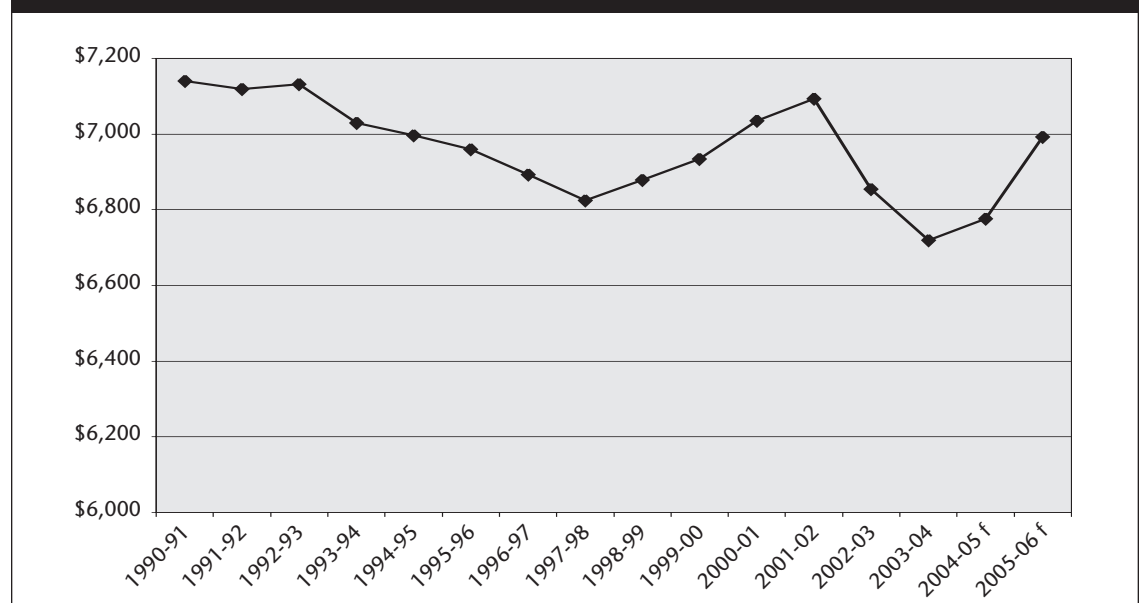
The provincial government has pointed out that education funding has been on the rise, while student enrolment has been falling. As a result, funding per student is at record highs. This is technically correct but highly misleading because it does not tell the full story.

Missing from the government's analysis is a crucial aspect of education financing: the rising cost of providing education services. In the same way that consumer prices tend to rise over time (i.e. inflation),

so does the "price" of education services. This includes the cost of salary and benefit increases for teachers, administrators and support staff, the cost of books and classroom materials, the cost of utilities such as electricity, costs related to transportation, plus other education-related supplies and services. Budgets need to rise in line with these underlying costs in order to provide the *same level* of education services.

When all three factors — operating grants, enrolment and education-specific inflation — are combined, all of the "real world" pressures experienced by educators, parents and students become apparent. We put total operating funding into real terms (deflating numbers by Statistics Canada's Education Price Index) then divide by the number of students to determine *real funding per student* from 1990/91 to 2005/06 (see Figure).

Real K-12 Funding per Student



Sources: Author's calculations based on BC Ministry of Education, Statistics Canada, and Vancouver School Board.

The 2005/06 funding increase comes at a time when real funding per student in 2003/04 and 2004/05 was at its lowest levels over the entire period going back to 1990/91. New funding begins to meaningfully restore real per-student funding, as projected real funding per student for 2005/06 will be higher than the previous three years (2002/03 to 2004/05), but remains lower than 2001/02 and 2000/01, and lower than levels in the early 1990s.

In real terms this puts 2005/06 funding at \$102 per student below 2001/02 levels and \$147 per student lower than 1990/91 levels. This means that in 2005/06 it would take an additional \$58 million (beyond the announced \$150 million) to restore funding to 2001/02 levels and \$84 million to restore funding to 1990/91 levels.

It is also worth noting that funding gains come at the expense of teachers and support staff, who are assumed to accept no wage increases in the current collective bargaining round — in effect, this is a real salary cut because of the impact of inflation.

Funding decisions in recent years have put pressure on school boards, schools and parents to find additional resources for classrooms. Some school boards, in order to stave off more service cuts at the classroom level, have cut their own administrative positions, while seeking alternative revenue sources, such as attracting international students, who pay high tuition fees for education, and running distance and continuing education programs.

Schools have also pursued exclusive contracts for vending machines and have contracted out cafeteria operations, both of which have biases towards junk foods that undermine the health of students. We commend the move by the government to eliminate junk foods from schools, but we need to

recognize at the same time why it is that schools find vending machine revenues attractive.

Parents are increasingly required to pay for school materials, field trips, music and performing arts fees, while feeling compelled to pay again to support local schools through bake sales and pizza day fundraisers. Parents are also expected to organize fundraising activities in support of their child's school. Clearly, it would be more efficient and equitable for parents to finance a good public school system through their taxes.

Teachers also factor into this cost-shifting exercise. Teachers are paying out of their own pockets for supplies required to do their jobs. And because of larger class sizes and cuts to teaching supports, they are facing tougher working conditions.

In this context, the increase in public funding for 2005/06 is most welcome, even if it is served up as an election goodie. But it is short of funding levels in place during the first year of the provincial government's mandate and levels that prevailed in the early 1990s. And any gains could easily be undone in future years if funding is restrained.

Real increases in the education budget are needed to hire more teachers, and create smaller class sizes, one of the key ingredients in increasing quality of education. More money also matters for addressing particular needs, such as ESL, children with disabilities or special needs, and those who come from vulnerable backgrounds, including Aboriginal children. BC's children deserve nothing less.

This article is an abridged version of The \$150 Million Question: What Does New K-12 Funding Mean For BC's Schools? published in March by the CCPA.

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Is the Province Equipped to Tackle the Pine Beetle's Long-term Impact?

By Ben Parfitt

As many British Columbians know, the province is witnessing one of its biggest logging booms in decades. More trees are falling than ever in the Interior, and will for years to come. But today's boom presages a dark future wherein resource-dependent communities and the provincial treasury both will be hit hard.



Beyond an immediate ramp-up in salvage logging, the province has no mid- to long-term plan for dealing with the epidemic.

Legions of beetles killing millions of pine trees are behind the boom. The provincial government, intent upon extracting economic value from those dead trees, has approved unprecedented logging increases. In the next five years, nearly 55 million cubic metres in additional timber could be logged in the Interior — enough wood to fill logging trucks lined bumper to bumper across Canada nearly six times.

But then what? The simple truth is that beyond an immediate ramp-up in salvage logging, the province has no mid- to long-term plan for dealing with the epidemic. What happens to our forests and forest-dependent communities after the fall?

Properly done, forestry is a reasonably sustainable enterprise, unlike fossil fuel extraction, which the provincial government seems overly obsessed with. But when our natural gas reserves run out, we will still have forests. The big question before us is whether we make wise investments today to ensure reasonably healthy forests tomorrow.

Sadly, the response to date is far from encouraging.

Forestry is first and foremost a provincial responsibility. Yet at almost every turn, provincial politicians like Forests Minister Mike de Jong proclaim the need for federal dollars, saying that the magnitude of the outbreak requires investments on the order of \$1.5 billion.

Given forestry's importance to the provincial economy, Victoria has offered very little, especially when compared to Ottawa. For example, the Canadian Forest Service is spearheading a \$40-million research effort aimed at understanding how we may more effectively respond to the ongoing attack. In addition, a few weeks ago Ottawa pledged another \$100 million to BC. If that commitment passes

committee, those federal dollars may be spent to help blunt the beetles' forward momentum in some key areas.

Arguments may be made that given the outbreak's severity and its potential to enter the cross-country boreal forest the feds should commit more funds. But Ottawa would be more than justified now in saying no, given Victoria's lackluster response and its drastic cuts to its own forestry staff.

In the past three years alone, BC's Forest Service has lost 800 positions. In critically important areas of historic forestry responsibility, such as inventory (the counting of trees), reforestation and research, BC's Forest Service is a shadow of its former self. Indeed, cuts in these three areas over the past decade totaled 85%, 80% and 40% respectively.

Last December, the Association of BC Forest Professionals wrote Premier Gordon Campbell lamenting his government's "minimalist, short-term thinking" and warning that the cuts undermined the ability of the Association's 3,500 members to make "sound, science-based, forest resource management decisions."

Two disquieting trends add further to a sense of unease. The first is declining public sector investments in reforestation. In 2001, under Forest Renewal BC, \$45 million went to reforest a backlog of lands that had previously been logged, burned or overrun by pests and not reforested. A year later, under the Forest Investment Account, expenditures fell to \$19 million. The next year, FIA investments were more than halved to just \$7 million. And last year they bottomed out at a paltry \$3 million. This wholesale withdrawal in public reforestation

BC's Economic Recovery

The Role of Commodity Prices

By Marc Lee

The resource rollercoaster that has for so long dominated BC's regional economies is in an upswing. High prices on international markets for BC's resource exports have been driving the recovery, and have offset the negative impacts of a higher dollar and provincial spending cuts. But caution is advised: what goes up must come down.



The Bank of Canada's Commodity Price Index shows that commodity prices in the first two months of 2005 were 54% higher than they were in 2002, and much higher than any time in the past quarter-century. Energy prices are a major driver, to the benefit of BC's northeast, with prices up 78% over the same timeframe (and 68% higher than the previous peak in 2000). But even outside of energy, resource prices have climbed significantly. The industrial materials sub-category of the Commodity Price Index, which includes forestry products, metals and minerals, is up 43% in early 2005 from 2002 levels. Even the food sub-category is up 19% over 2002.

At the same time, the Canadian dollar in early 2005 is up about 27% against the US dollar over levels in 2002, an unprecedented appreciation that is hurting central Canada's manufacturing base.

However, the increase in resource prices has more than offset any negative impacts of a higher Canadian dollar. The result is that economic growth has been stronger in the resource-dependent west and north of Canada, while growth rates have dropped in central Canada.

The big increase in resource prices reflects global market conditions, and is providing a huge boost to BC's resource sector. Combined with a push by lumber companies to expand production and export to the US in spite of countervailing and antidumping duties, this has bolstered regional employment. Timber cuts have also been greatly boosted as a response to the pine beetle epidemic in BC forests. In addition, a low interest rate environment has been stimulative, with the most notable impact on real estate markets and residential construction.

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BC Regional Unemployment Rates by Development Region

	Lower Mainland/ Southwest	Vancouver Island/Coast	Thompson- Okanagan	Kootenay	Cariboo	North Coast & Nechako	Northeast
1995	7.9	9.3	10.4	8.1	9.7	8.3	6.9
1996	8.3	9.6	10.5	8.9	8.7	7.7	7.2
1997	8.3	8.8	8.4	9.5	10.1	9.2	4.6
1998	8.2	9.8	8.3	12.0	14.6	9.8	N/A
1999	7.8	7.9	9.7	9.3	11.7	9.0	8.9
2000	6.1	7.9	9.3	10.2	9.9	10.2	5.9
2001	6.6	9.2	9.2	9.7	9.7	11.2	6.1
2002	7.8	8.8	9.5	10.1	12.8	12.8	9.0
2003	7.3	8.6	8.8	11.4	11.2	11.5	6.7
2004	6.7	7.9	6.6	9.3	9.2	11.8	5.4

Source: Statistics Canada via BC Stats

The table on the previous page shows regional unemployment rates for the past decade. A highly favourable external environment led to significant drops in unemployment rates in 2004, with the exception of the North Coast/Nechako region. The 6.6% rate in the Thompson-Okanagan for 2004 is the lowest over this time period.

The table also shows how the external environment can affect regional unemployment in a much more volatile manner than in the more diversified Lower Mainland. The impact of the 1997-99 Asian Crisis is evident in large rises in unemployment rates in the Kootenays and the Cariboo in particular. Unemployment rates also jumped in 2002 due to the combined effect of a global economic slowdown, the aftermath of September 11, the softwood lumber dispute and provincial budget cuts.

Thus, while the current situation is beneficial to regional economies, the data beg the question: what will happen when the resource rollercoaster moves downward again? Diversifying regional economies is clearly needed to mitigate vulnerability to external events. With increasing acceptance of raw log exports and de-linking the harvesting of timber from processing in local communities, the province seems to be moving down the value chain instead of up.

While the current upsurge may mask differences, BC still has "two economies": the highly diversified and populous Greater Vancouver area (plus Greater Victoria as the seat of provincial government) and the rest of the province, which continues to be vulnerable to swings in international market conditions. The December 2004 report of the BC Progress Board notes major differences between Vancouver and Victoria on one hand and the rest of BC on the other, in terms of incomes, education, housing starts and business incorporations (less bankruptcies).

Another reality check is in order: Even though unemployment rates have improved a great deal outside the Lower Mainland, employment statistics give pause for thought. In 2004, Vancouver accounted for 54.6% of total BC employment. But over the current upswing from 2001 to 2004, Vancouver

accounted for a disproportionate share of employment gains, with 61.6% of new employment.

Provincial fiscal policy has also played into the regional mix. The Lower Mainland received a bigger share of the 2001 income tax cuts than its share of the population, while spending cuts packed a bigger punch in smaller communities around the province in terms of lost jobs and reduced or eliminated public services.

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Is the province equipped to tackle the pine beetle's impact?

dollars coincided with a beetle attack that claimed 800,000 hectares of forestland in 2001 and more than seven million hectares last year.

By the province's own accounts, deforestation is escalating. Beetles are overrunning forests that won't be logged and replanted by the companies before the trees lose their economic value. If even a fraction of those lands were reforested, billions of dollars would be required. Yet in its latest budget, BC committed to spending just \$89 million over the next three years on reforestation and other undefined responses to the beetles.

In the Interior, where logging, beetles, fires and global warming are contributing to an unparalleled forest health crisis, it's time for bold action soundly grounded in research and, where appropriate, wise reforestation efforts.

Considering the province's demonstrated lack of serious financial commitment to addressing the unfolding crisis, Victoria should count itself lucky to have received a penny from Ottawa.

In the meantime, logging continues rapaciously while Victoria shows few signs of responding with the kind of dollars that signal renewal is a priority. The riches of the hinterland bleed away, perhaps never to be seen again. Forests forever? Don't count on it.

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*a publication of the BC office of the
Canadian Centre for Policy Alternatives*

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