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The Canadian Centre for Policy Alternatives – BC Office is a non-partisan, non-profit research institute dedicated to producing and promoting progressive economic and social policy research of importance to Canadians and British Columbians.

BC's Fiscal Choices

Submission to the British Columbia Fiscal Review Panel

by the Canadian Centre for Policy Alternatives – BC Office

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Introduction: Budgets are about choices

ON MAY 25, 2001, THE NEW BC GOVERNMENT ANNOUNCED THE ESTABLISHMENT of a Fiscal Review Panel (chaired by Mr. Gord Barefoot) to conduct a comprehensive review of the province's finances. Given the importance of the Panel's work and the influence it is expected to have, we are taking this opportunity to share our Centre's fiscal analysis with the Panel members.

We encourage the Panel not to sound a false fiscal alarm. We are worried that the Panel may highlight "structural deficits" that the government may in turn use to foreclose efforts to redress BC's outstanding "social deficits."

We are also concerned that the new BC government has fundamentally prejudiced the work of the Panel by announcing dramatic tax cuts before the work of the Panel is complete. Despite the Panel's mandate to offer a "status quo" three-year fiscal forecast, the tax cuts announced on June 6 have already significantly altered the status quo. These tax cuts take what was likely to be a balanced budget in 2001-02 and drop the budget into a deficit position.

It is our hope that the Panel will not declare – as Alberta's Fiscal Review Panel did in 1993 – that we have no alternatives; that BC's fiscal situation gives us no choice but to cut program spending and sell-off shared public assets. Budgets are about choices. We do have alternatives, and the choices we make about taxes and public programs tell us a great deal about our values and priorities as a society.

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The 1993 Alberta Fiscal Review Panel warned the people of that province that "Our current revenue base simply cannot support our current spending programs." Albertans were told they were living beyond their means, and the Panel set the stage for dramatic spending cuts. Looking back eight years later, it is clear that the Alberta Panel seriously over-stated the situation.

As our sister research institute in Alberta, the Parkland Institute, has noted in its book *Shredding the Public Interest* by Kevin Taft, the Alberta government could have balanced its budget without slashing public programs. As Alberta political-economists Gordon Laxer and Trevor Harrison note in their book *The Trojan Horse*, "If Alberta had had a provincial sales tax or had simply raised its existing provincial taxes to the average for other provinces, balanced budgets would have been as regular as the return of geese in spring." In hindsight, we now know that when the Klein government took office in 1992, rising resource and other revenues were already poised to eliminate Alberta's budget deficit, without the destructive cuts to health, education and welfare to which the people of Alberta were subsequently subjected.

BC's Fiscal Situation

THROUGH 1999 AND 2000, BC'S ECONOMY RECOVERED FROM A MAJOR SETBACK in the form of the Asian financial crisis that hit from late-1997 to early-1999. As a result, the provincial budget has been in surplus for two years. The province's total debt is at very reasonable levels, relative to the size of the economy and the ability of the provincial government to service it.

Table 1: Fiscal Situation 2001-02

	Debt-to-GDP ratio 2001-02 (projected)	Debt service costs as a percentage of revenues
	%	%
British Columbia	19.6	6.7
Alberta	4.7	3.3
Saskatchewan	23.7	10.6
Manitoba	21.7	6.7
Ontario	24.8	14.5
Quebec	35.7	15.5
New Brunswick	33.2	13.0
Nova Scotia	47.0	17.7
PEI	31.3	11.3
Newfoundland	44.2	14.4

Source: TD Economics; BC Budget.

Overall, BC's fiscal situation is very strong. BC's debt is projected to be 19.6% of GDP in 2001-02, only slightly higher than levels in the early- to mid-1990s. Only Alberta has a lower debt-to-GDP ratio, at 4.7%, a unique case attributable in large part to royalties derived from a booming oil and gas sector. In the 2000-01 fiscal year, Alberta received oil and gas royalties equivalent to almost half the province's total expenditures. While BC is also the beneficiary of royalties from its resource sectors, we will likely never be able to match Alberta in this regard.

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BC's strong fiscal position is also reflected in low debt service costs as a percentage of provincial revenues. BC will pay only 6.7% of provincial revenues in the 2001-02 fiscal year to service provincial debt, also second lowest after Alberta (3.3% of revenues).

The BC economy has been gaining momentum over the past two years. The most recent estimate of economic growth for 2000 is 3.4% – BC's best showing since 1994, and up from 2.1% in 1999. Economic growth in 2001 will be affected by a slowing US economy, but consensus projections for the year are still in the 2% to 2.4% range, far from a recession.

Table 2: BC Budget Recap

	1999-00 (actual)	2000-01 (revised)	2001-02 (projected)
		(millions of dollars)	
CRF Revenue	21,846	24,030	24,585
CRF Expenditure	22,200	22,727	24,295
CRF Balance	(354)	1,303	290
Net contribution of Crown corporations	406	164	(290)
Forecast Allowance	—	(150)	(300)
Joint Trusteeship Agreements	—	—	1,390
Sumary Accounts surplus	**52**	**1,317**	**1,090**

Source: 2001 BC Budget
Note: The final column represents the projected balance at the time of the spring BC Budget.

For the provincial government, this turn-around has been mirrored by a fiscal situation that is significantly better than anyone anticipated (see Table 2). Last year, budget deficits turned into surpluses – the 1999-00 final audited public accounts show that BC closed the fiscal year with a modest $52 million surplus – a far cry from the $1.5 billion deficit predicted in the 1999 Budget. If we add in a number of one-time write-offs – $617 million for BC Rail infrastructure in the Northeast, $240 million for Fast Ferries, plus a couple of smaller items – that were not in the original budget, the underlying surplus for the 1999-00 year was closer to $1 billion.

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For 2000-01, the shift has been even more dramatic. The 2000 Budget's forecast deficit of $1.3 billion is now projected to be a surplus of close to $1.5 billion. This $2.8 billion swing in provincial finances is staggering, amounting to approximately 15% of total budgetary expenditures.

The 2001 BC Budget projects a surplus of about $1.4 billion (including the contingency reserve), although this can be directly attributed to accounting changes in the budget that reflect the shift to joint trusteeship of a number of public sector pension plans. In effect, the tabled 2001 Budget is a balanced budget. All available fiscal room in the budget was allocated to spending priorities, primarily in health care, education and social services. The revenue estimates contained in the last budget were reasonable, based on recent trends and the consensus forecast.

We take issue with the implication in the Panel's terms of reference that BC's budget accounting and transparency is inadequate. The Panel was asked to examine what assumptions underlie BC's fiscal forecasts. But there is no mystery – these assumptions are all clearly laid out in the BC Budget papers. In the wake of recent reports by the auditor-general and the Enns Panel, BC's accounting transparency is now second to none in the country. The chief economist of the Bank of Montreal wrote after the last budget, "BC now has the most transparent and comprehensive financial reporting of any province."

We urge the Panel not to advise an approach to forecasting best described as "prudent-to-a-fault." Budgeting is an inexact science, the goal of which should be to be neither overly pessimistic nor overly optimistic. To be overly conservative and thus low-ball one's revenue estimates is to foreclose on spending options to alleviate poverty and homelessness, it is to forestall spending increases for existing services like education and health, and it is to rule-out new needed programs like full public home care and child care. In short, it prevents us from having a full and open debate about how to spend our money and about what our collective priorities should be.

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Prudence-to-a-fault also runs the risk of slowing the economy. If, for example, balancing the budget is deemed to be a high priority, and tax cuts are matched by spending cuts, the net effect, according to the Conference Board of Canada, would be to reduce economic growth. Such an approach would draw money out of the economy, thereby negating the hoped for economic stimulus of the tax cut. Similarly, if an overly prudent approach leads to a failure to invest in provincial infrastructure, the economy will be negatively impacted.

We urge the Panel to recognize that BC's public sector is, in fact, already lean. Public sector employment in BC (measured in per capita terms) is already the second smallest in Canada. Program spending in areas outside health and education has already been dramatically reduced, and even spending on health and education under the NDP did not keep pace with population growth and inflation. As economist David Fairey noted in a recent CCPA publication, BC government spending relative to GDP and in constant per capita dollars has been in decline since 1992. Clearly, this has put tremendous pressure on the province's public services, and more of such cuts would be ill-advised.

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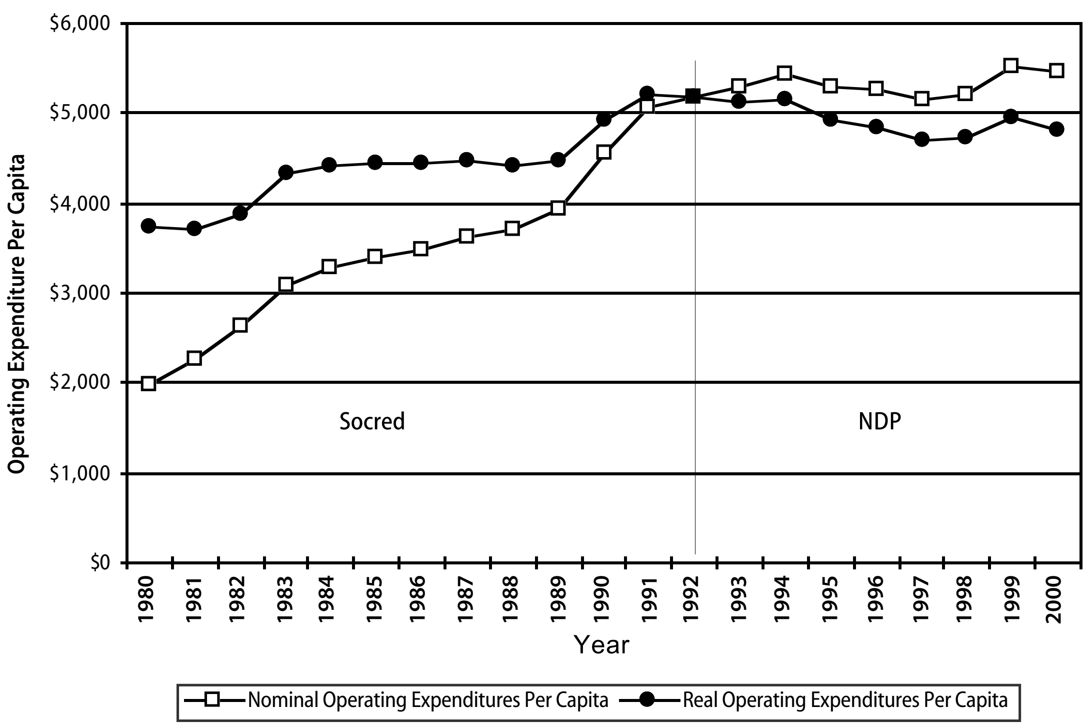
Figure 1: BC Government Operating Expenditures: 1980 to 2000



Source: Chart constructed by David Fairey, based on data from: BC Statistics, The BC Economic Accounts; Statistics Canada, Provincial Economic Accounts, Annual Estimates; Statistics Canada, The Consumer Price Index; British Columbia, Budget Reports, 1994 to 2000; British Columbia, Third Quarterly Report on the Economy, Fiscal Situation and Outlook, April - December 2000

Implications of the Liberal Tax Cuts

THE PRINCIPAL CONCERN REGARDING BC'S FISCAL SITUATION IS THE IMPACT of the recently-announced tax cuts on provincial finances and the ability to pay for public services. The tax cuts will diminish the revenues the provincial government will receive from future economic growth.

The tax cuts lived up to their promise of being dramatic, but the most surprising element in the tax cut package was that it went far beyond campaign rhetoric – that the cuts would be focused on low and middle income earners – to include very large breaks at high incomes. The tax cuts reduce the progressivity of the tax system and are unlikely to deliver on promises of both short- and long-run rates of economic growth in the province.

Even before the recent tax cuts, and in spite of reported "tax rage", BC was a very competitive jurisdiction in terms of taxes paid by both individuals and corporations. For example, an unattached individual earning between $20,000 and $100,000 would pay less income tax in Ontario and Alberta, but more tax in every other province. When total provincial taxes are considered, BC also comes out as the second or third lowest tax

Table 3: BC Tax Cuts 2001

Gross Earnings	BC Income Tax before Tax Cut		Tax Cut in 2002	BC Income Tax after Tax Cut		Tax cut as a Percentage of Income
$	$	% of income	$	$	% of income	
20,000	843	4.2	236	607	3.0	1.2
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

Source: BC Ministry of Finance and Corporate Relations.

jurisdiction in Canada (depending on income level). Finally, corporate tax levels are consistent with other provinces. Any differences in tax rates are small in magnitude and as such are unlikely to affect investment prospects given the range of other factors (such as access to markets, resources and skilled workers, and electricity costs) that are more important to investment decisions.

Table 3 shows the value of BC's tax cuts for different income levels, based on data from the BC Ministry of Finance. While the tax cuts were claimed to benefit all equally, a closer look suggests that those with higher incomes received a much larger proportionate benefit relative to their income. At the $20,000 income level, the value of the fully phased in tax cut is a mere $236, or 1.2% of income. As income rises so does the value of the tax cut, in both straight dollar terms and as a percentage of income. For those earning $200,000, the tax cut amounts to about $7,800, or 3.9% of income.

This is consistent with the government's claim of an across-the-board 25% tax reduction only because those with higher incomes paid relatively more in taxes as a share of income – the effect of a progressive tax system. The tax cuts make BC's tax structure more regressive, and hence increase after-tax inequality in the province.

Table 4: The Tax Cut Pie

Income Interval $	Percentage of BC Taxpayers %	Total Tax Savings in 2002 $ millions	Share of Tax Cut Pie %
1-30,000	48.8	180	13.4
30,000-60,000	38.3	456	33.9
60,000-80,000	7.8	237	17.6
80,000-100,000	2.5	101	7.5
100,000-150,000	1.6	104	7.7
150,000+	1.1	269	20
Total	100	1,348	100

Source: Canada Customs and Revenue Agency, Tax Statistics on Individuals, British Columbia, Table 2A
Note: Figures have been calculated based on 1998 tax data (most recent year). Percentages may not sum to exactly 100% due to rounding. Income represents gross income before deductions.

The distribution of the tax cuts looks even worse when we consider how the total tax cut pie has been allocated. Based on 1998 official tax data, it is possible to estimate the impacts of the BC tax cuts in terms of how they are spread among different income groups. The total tax savings for those earning less than $30,000 per year – 48.8% of taxpayers – amount to $180.5 million in 2002, or about 13.4% of the tax cut pie. Those earning between $30,000 and $60,000 – 38.3% of taxpayers – will receive about $456.5 million in 2002, or 33.9% of the total tax cut pie.

The big surprise is at the high end: the 13% of taxpayers making more than $60,000 will receive 52.8% of the total tax cut in 2002. And at the very high end, the 1.1% of taxpayers earning more than $150,000 will receive 20% of the total tax cut. Given the government's own claim about not knowing the full state of provincial finances, a massive tax cut that gives such a large share to high income earners can only be considered fiscally irresponsible.

The government's tax cut reveals lopsided priorities. When fully phased in next year, the tax cut will give the approximately 50,000 people in BC with incomes over $100,000 a total savings of about $370 million – an amount that could, for example, easily settle the current dispute with the BC Nurses' Union and the Health Sciences Association.

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We have grave concerns that the tax cutting is not over; the government may yet bring in corporate tax cuts and/or further personal income tax cuts. Such initiatives would further undermine BC's fiscal position and the province's ability to adequately fund existing public programs, let alone bring in needed new ones (such as child care and home care).

This Panel should dispel the notion that tax cuts increase revenues. In fact, tax cuts lower what government revenues would otherwise have been. The proposition that tax cuts will stimulate so much economic growth that they will pay for themselves is a delusion. Tax cuts do offer a small economic stimulus. But they are also plagued by "leakages", as much of the tax savings go into savings, overseas or financial investments, or is used to purchase imported good or vacations abroad. Most economists maintain that tax cuts can only recoup 20-50 percent of their cost over the medium-term through the revenues generated by this fiscal boost. The BC Business Summit, in its report two years ago, acknowledged that its desired tax cut of $1.5 billion could only recoup one third of its value – the rest would have to be paid for by cuts in government spending. Furthermore, the magnitude of the tax cut for high-income earners exacerbates these impacts – tax cuts at the high end provide less fiscal stimulus than those provided to low and middle income earners (as higher income earners are more inclined to save or spend money abroad).

It is worth noting that Washington State, which cut taxes throughout the 1990s, is now facing a severe fiscal crisis, despite years of strong economic growth (for more on this, see the Evans School of Public Affairs at the University of Washington – http://depts.washington.edu/fpc). Likewise, New Zealand is now *increasing* taxes after the previous government's tax cuts threw the country into the red and failed to stimulate growth.

With the latest tax cuts, BC has the lowest bottom two income tax brackets in Canada. The government has stated that it will maintain this standing throughout its term in office. However, at least two other provinces are promising the same – and they can't all be right. Already, one day after the BC government announced its latest tax cuts, on June 7 2001, the Alberta branch of the Canadian Taxpayers Federation issued a news release warning the Alberta government not to "lose the Alberta Advantage to B.C."

We are concerned that the latest tax cuts set in motion a competitive race-to-the-bottom. Reasonable voices must flatly reject the notion that Canadian provinces should compete with one another for investment – such beggar-thy-neighbour policies run counter to what it means to be a country.

We are concerned that the latest tax cuts set in motion a competitive race-to-the-bottom. How low will taxes be when the bidding war is over? How much will this promise cost when the race ends? We have no idea. But one thing is certain: BC cannot win a tax-cutting race with Alberta; not with the oil and gas revenues at their disposal.

Therefore, BC must be more creative. The province must invest directly in the things that business needs, like a highly educated and skilled workforce (hence the need to continue the expansion of the education system) and needed infrastructure. The province must carefully guard the advantages it currently enjoys, like cheap and reliable electricity. Most importantly, reasonable voices must flatly reject the notion that Canadian provinces should compete with one another for investment – such beggar-thy-neighbour policies run counter to what it means to be a country. We need our governments to cooperate.

BC's Social Deficits

WE URGE THE PANEL TO RECOGNIZE IN ITS DELIBERATIONS THE VERY GRAVE social deficits – the *real* structural deficits – that still plague our province.

As we noted in our BC Budget Brief in November 2000, addressing inequality and poverty should be BC's top fiscal priority. Rather than privileging tax cuts for those who need them least, the government should address the growing inequality and poverty resulting from the market by establishing an "anti-poverty fund", raising income assistance rates, and accelerating the construction of social housing.

Another *real* structural deficit facing BC is in the field of Community and Continuing Care. As our Centre highlighted in a study last year entitled *Without Foundation*, home care funding in BC is far from adequate, making this needed service increasingly inaccessible and inequitable. Likewise, the deficit of long-term care facilities and beds has undermined equity and access. Combined, these deficits are putting unnecessary stress on the acute care system, reflected in long waits at Emergency wards during peak times.

We urge the Panel to recognize in its deliberations the very grave social deficits – the *real* structural deficits – that still plague our province. Rather than privileging tax cuts for those who need them least, the government should address inequality and poverty.

BC also faces continuing *real* structural deficits with respect to education and skills training. While BC did witness an important expansion in the post-secondary system during the 1990s, this was primarily a case of catch-up – many more spaces will be needed if BC is to meet the needs of a modern economy for a highly skilled and educated workforce. And as BC's Industrial Training and Apprenticeship Commission has warned, "An innovative, proactive strategy is needed in B.C. to head off serious skills shortages in trades and technical occupations in the coming years."

Conclusion: Meeting our Shared Needs

TOO OFTEN, THE QUESTION "CAN WE AFFORD THIS PROGRAM?" IS FALSELY posed. The issue is not whether we can afford these fundamental services; it is merely how we want to pay for them – individually out-of-pocket or collectively through our taxes.

The Canadian experience with regard to numerous social programs – from Medicare to education to public pensions – is that we frequently provide necessary services more equitably *and more efficiently* when we pay for them together. The same would hold true were we to bring in universal public home care, pharmacare or child care. True, our taxes may need to be higher, but our combined personal and public per capita expenditures on these services would be less. Moreover, there is no compelling evidence that this need come at the expense of economic growth.

The evidence with respect to health care spending is perhaps most telling. As CCPA research associate and University of Manitoba heath economist Robert Chernomas has noted:

> Medicare is mandated to control three sectors of the health care system: hospitals, physicians, and administration. Since 1971, when the single-payer system was fully implemented, these three sub-sectors have seen their relative share of Canada's economy remain virtually unchanged. In other words, hospitals, physicians and administrative costs take up no greater share of the economy than they did a quarter century ago. Yet over the same period overall health care costs have risen from approximately 7% to about 9% of GDP. Where have they grown? The answer: those parts of our health care system that are privately run.

Drug costs are a key source of cost increases, yet the new government is considering eliminating the referenced-based pricing program that has helped to control these costs. Were the government to cut the health services it currently covers, the need for these services would not disappear. Rather, payment of these services would simply transfer to the private sector (individuals and businesses). Yet there is mounting evidence (reported in the *New England Journal of Medicine*, the *Journal of the American Medical Association,* and elsewhere) that private, for-profit health care delivery costs more, provides poorer quality service, and undermines equal access.

We urge the Panel to affirm that, as a society, we still have choices. We are a wealthy society that can well afford to meet our shared need for various public services, and that in so doing, we become richer, more healthy, and more equitable as a society.