C C P A
CANADIAN CENTRE
for POLICY ALTERNATIVES
BC Office

BC SOLUTIONS BUDGET 2005

SUMMARY

After setting the record for the largest deficit in BC history two years ago, the provincial government is about to close out 2004/05 with BC's largest-ever surplus, anticipated to be over $2 billion. The outlook for 2005/06 and 2006/07 is for somewhat smaller surpluses (but still large by historical standards) of approximately $1.4 billion.

BC's surpluses give us an opportunity to take stock of what has happened over the past few years, and to make important choices about our priorities in the future.

With a pre-election budget to be tabled on February 15, we hope this year's BC Solutions Budget will stimulate public debate by outlining a series of options that set out our spending priorities and how to pay for them.

The three options presented here are but a sample of what is possible. The point is that budgets are about choices, and whoever forms the next government can choose to substantially boost spending on programs that allow us to take better care of one another and the environment. We should also be paying for needed services through a more progressive tax system.

Our key recommendations for the 2005/06 budget are that:

- ➤ the government not use the surplus to pay down the provincial debt;
- ➤ the government not lock spending cuts into place with further tax cuts;
- ➤ at a minimum, the entire underlying surplus be spent on restored public programs; and
- ➤ additional revenues be raised by reversing upper-income tax cuts from 2001.

Downsizing the Public Sector

The context for the 2005 budget is a substantial downsizing of BC's public sector over the past three years. The province has also seen significant shifts both in which services are delivered and who pays:

• Total provincial expenditures are almost exactly the same in 2004/05 as they were three years before. Within expenditures there has been a reallocation of provincial spending towards health care and, to a lesser extent, education. Nonetheless, schools and health care facilities have been closed around the province due to the rising costs of providing these services.

• Other program areas, such as social assistance, children and families, environmental protection, transportation, and protection of persons and property, are down considerably. In total, annual spending outside health and education has been cut by $1.7 billion.

• Across the broad public sector, over 20,000 jobs have been eliminated or contracted out.

• Viewed as a percentage of GDP (i.e. relative to the province's annual income), the shrinkage in the size of the provincial government is more evident. On this basis all parts of the public sector are in decline, even health care. This finding underpins the need to re-invest in the public sector.

• The brunt of the cuts has been experienced by the most economically vulnerable people in the province. Yet, as the new surplus clearly shows, all of the pain and hardship associated with these cuts was unnecessary. There was no "structural deficit" that necessitated spending cuts.

• In terms of revenues, it is abundantly clear that tax cuts have not "paid for themselves." Personal income tax revenues in 2004/05 are still 15% lower than pre-tax cut levels. In fact, the loss of personal income tax revenues was closer to $2 billion, compared to Ministry of Finance estimates of $1.5 billion when the tax cuts were announced.

• BC's improved fiscal situation is strongly related to much higher federal transfer payments for health care and equalization. Crown corporation revenues are also adding to the provincial bottom line, including a 50% increase in gambling revenues. Large revenue gains also stem from MSP premium hikes, tuition fee increases, and windfalls in property transfer taxes and resource royalties.

• Like expenditures, provincial revenues relative to GDP are in decline. In particular, BC taxation revenues declined by more than a full percentage point of GDP between 2000/01 and 2004/05, and are forecast to decline further.

• BC's sweeping policy changes—the government's recipe for prosperity—have failed to produce the promised results. The bright spots in the BC economy are driven by high commodity prices and demand for BC's resource exports and by low interest rates. Capital investment outside residential construction, however, has shown little improvement—a major indictment of the government's tax cut strategy. Thus, the province has experienced a great deal of pain for minimal gain.

The combination of income tax cuts that disproportionately benefited high-income earners and MSP premium increases that had a bigger hit lower down the income ladder has shifted the task of paying for public services from upper- to middle- and modest-income earners. This shift is reinforcing rising inequality in market incomes. The provincial government has an important role to play in countering this growing gap through a more progressive tax system.

Budget 2005: BC's Fiscal Choices

The hot topic for the 2005/06 BC budget is what to do with the anticipated surplus. We estimate the underlying surplus to be at least $1.4 billion. It is not at all obvious, even in an election year, that this projected surplus will be rolled back into spending. Pressure is mounting from the corporate sector to use the surplus to further reduce taxes and to pay down provincial debt. This would be a mistake.

There is no reason why the surplus should be directed towards debt reduction or tax cuts. In spite of large deficits in recent years, BC still has a healthy fiscal situation. The province is on track to close 2004/05 with a debt-to-GDP ratio of 19.2%—exactly the same as it was in 2000/01 and second-lowest among the provinces after oil-rich Alberta. BC's tax structure is already more than "competitive" with other jurisdictions. BC has the lowest taxes in Canada for most income groups. We are greatly concerned that further tax cuts would lock in place the deep spending cuts of recent years.

We feel the opposite course is needed: the surplus must be used to un-do the damage done and re-invest in the public sector.

We would immediately use $1 billion of the projected surplus to restore capacity to those ministries outside health care and education that experienced the deepest cuts. Priority areas include the social services ministries, environmental protection and forestry.

Second, because the federal government is moving towards establishing a pan-Canadian early childhood education and care program, now is a good time for BC to get ahead of the curve. While final numbers are yet to be determined, BC's share of new federal funding will likely be about $130 million in 2005/06. If the provincial government were to match this, it would represent a significant step towards a provincial program.

Third, the K-12 education system is at great risk in

Solutions Budget Public Investment Options

	Option one: spend the surplus	Option two: anti-poverty strategy	Option three: invest in advanced education
Expenditures	(millions of dollars)		
Restoring the cuts	1,000	1,000	1,000
Early childhood education and care	280	400	400
K-12 education	250	250	300
Anti-poverty strategy		250	250
Post-secondary education			300
Training and apprenticeship			100
Total	**1,530**	**1,900**	**2,350**
Revenue options			
Existing surplus rolled into new spending	1,439	1,439	1,439
Federal funds for early childhood education and care	130	130	130
Reverse income tax cuts in top two brackets		370	370
Reverse income tax cut in middle bracket			80
Education and training payroll tax			370
Total	**1,569**	**1,939**	**2,389**
Additional contingencies	39	39	39
Balance	**0**	**0**	**0**
New capital expenditures			
Residential health care facilities	200	200	200
Social housing		200	200
Transportation			300
K-12 seismic upgrading			200
Total new capital expenditures	**200**	**400**	**900**

terms of its ability to deliver high quality services to BC's children. We would increase education funding by $250 million, a first step towards restoring funding to levels of the early 1990s.

Fourth, the new federal-provincial health care deal changes the terrain of the debate away from funding shortfalls and towards reform. As the Romanow report urged, this new money must be used to buy change in areas like primary care, home care and long-term care. We support this move with an additional $200 million in capital expenditures to grow BC's stock of residential care facilities.

Beyond the Surplus

Even if all of the surplus is used to support additional spending, BC will still be in a situation where needs will be going unmet and important investments are not being made. Given the current economic upturn, the provincial government should balance its budget. Thus, additional investments beyond spending the projected surplus should come from partially reversing the 2001 tax cuts.

Beyond our first option of spending the surplus, we outline two incremental options for an enhanced provincial public investment program. In our second option, we accelerate the implementation of a provincial early childhood education and care program and outline a broad-based anti-poverty strategy. To pay for these spending increases, this option adds $370 million in operating revenues financed by reversing the tax cuts for the top two income tax brackets. This move would thus affect only those in the province making $76,000 or more (the top 5% of taxpayers). We also add $200 million in capital expenditures for the development of new social housing. This budget option thus concretely reverses what has been a recent transfer of income from the poorest among us to the wealthiest (who received the lion's share of the 2001 tax cuts).

Our third option builds on the previous two to develop an advanced education investment plan for BC, with a focus on post-secondary education and training and apprenticeships. The transformation of BC into a high-knowledge, service-based economy requires that a greater emphasis be placed on education than in the past. Moreover, a looming skills shortage has been frequently cited by both business and labour leaders as an important priority for the province.

This education agenda requires that business step up to support new investments from which they benefit. We create a new corporate payroll tax for training and education to raise an additional $370 million in operating revenues. We also reverse the tax cuts in the third income tax bracket to 2000 levels, raising an additional $80 million above option two. This affects only those with incomes above $66,000—individuals who benefit most from advanced education investments.

These new education investments provide new operating funds to post-secondary institutions in support of a new tuition freeze to ensure that higher education remains accessible to all students.

Added to these measures, we increase capital funding for long-overdue seismic upgrading of BC K-12 schools by $200 million. We also accelerate the development of mass transit projects in BC through $300 million in new capital funding.

Assessing the Solutions Budget Options

The options outlined above may sound radical, and will almost certainly be painted as such by some politicians and commentators. But even our full package (option three) is well within historical norms. Rather, it is the shrinkage of the public sector in recent years that is truly radical. We outline a plan that is more sound economically and socially. Moreover, under the options presented, BC individuals and businesses will still be paying less in taxes than they did in 2000. Only the upper tax brackets see a reversal of their 2001 tax cuts.

As the accompanying chart shows, relative to GDP our options only avert a continued fall in the size of the public sector. Rather than expenditures dropping to

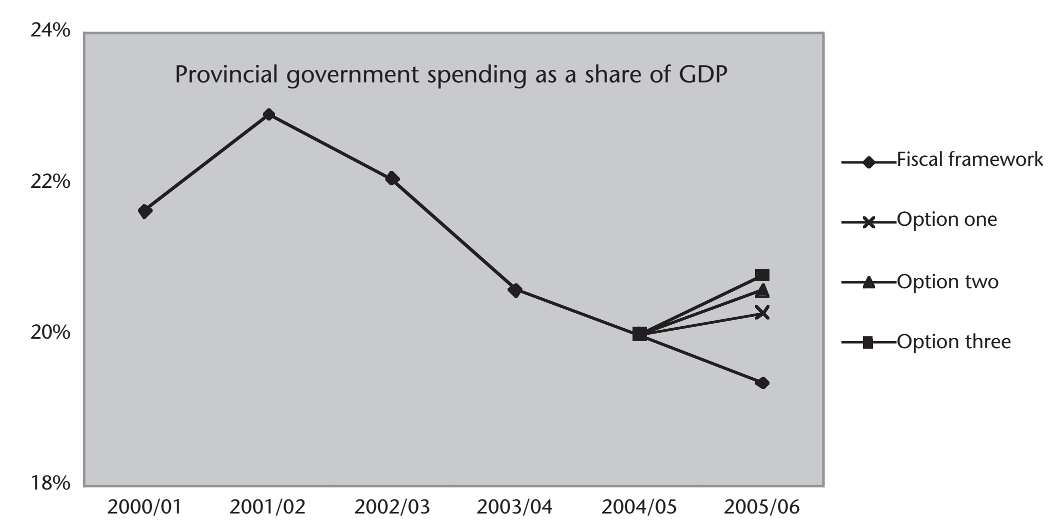
19.4% of GDP in 2005/06, spending the surplus would increase expenditures-to-GDP slightly to 20.3%, while scenarios two and three would increase expenditures-to-GDP slightly more, to 20.6% and 20.8% respectively. These numbers are lower than the actual expenditures-to-GDP for most years going back to 2000/01. In this context, our expenditure proposals are quite modest.

Our options only slow the downward trajectory of BC's debt-to-GDP ratio. The current fiscal plan estimates a fall in the provincial debt-to-GDP ratio from 19.2% at the end of 2004/05 to 17.5% next year. Even under options two and three, which include additional capital investments, debt-to-GDP will still fall to 18.7% and 19.0% respectively. Thus, these additional investments can easily be afforded given BC's current fiscal situation.

We reiterate that budgets are about choices. Our Solutions Budget scenarios are but preferred options for funding re-investments in the public sector. There are infinite possibilities for funding services and investments, and doing so in a more progressive manner.

Some will argue that higher taxes and public spending is a recipe for economic disaster. But other places in the world have made choices to greatly reduce poverty and to make investments in people without the economic sky falling down. Re-investing in public services is not an illusive dream; through a common commitment we can make it a reality. This is the conversation that British Columbians need to have.

BC Government's Fiscal Framework vs. Solutions Budget Options



C C P A
CANADIAN CENTRE
for POLICY ALTERNATIVES
BC Office

1400 – 207 West Hastings Street
Vancouver, BC V6B 1H7
tel: 604-801-5121 | fax: 604-801-5122
email: info@bcpolicyalternatives.org

The Canadian Centre for Policy Alternatives is one of the country's leading policy research institutes. Every year since 1995, the CCPA has published an Alternative Federal Budget. The CCPA's British Columbia Office opened in 1997, and now produces an annual BC Solutions Budget. These alternative budgets show that a more compassionate, yet realistic, approach to fiscal policy is possible.

Download the full *BC Solutions Budget 2005* free at:
www.policyalternatives.ca