



September 2009

# bulletin - human resource services

## September Provincial Budget Update

A revised deficit forecast of \$2.8 billion for fiscal year 2009-10 was released by Finance Minister Colin Hansen today. Further deficits of \$1.7 billion in 2010-11 and \$945 million in 2011-12 were also projected, with a return to balanced budgets expected within 5 years.

In 2008, the provincial GDP declined by 0.3%, the first such annual decline since 1982. The economy is forecast to contract a further 2.9% this year, but is projected to recover by 1.9% in 2010.

Previously announced infrastructure and accelerated spending initiatives remain in place. These initiatives cover \$21.6 billion in spending over the next three years. Of this, \$12.6 billion is comprised of taxpayer supported capital investments and the remaining \$8.9 billion by Crown corporations.

### Revenue

Today's provincial budget update reported that total government revenue declined by over \$2.3 billion in the past 6 months alone.

Leading the downturn in revenues is a decline in resource based revenue of 29% for this fiscal year. Natural gas royalties have declined by \$492 million, while other natural resource revenue declined by \$561 million. Due to a decrease in consumer and business spending, the social service tax (PST) declined by a further \$240 million. A modest decrease in personal income and a precipitous drop in corporate profits (-36.4% year over year) complete the poor revenue picture as these combined for an overall decline in provincial personal and corporate income taxes of \$1 billion.

Further contributing to the downturn in revenue is a much steeper decline in new housing starts both in British Columbia (February forecast -26%, September forecast -60.7%) and the United States (February forecast -28.8%, September forecast -42.2%).

### Expenditures

The government announced a variety of realignment of spending priorities within the September budget update. The update reflects an aggregate reduction in discretionary spending with a re-allocation of \$1.3 billion on new priority areas. Highlights include:

- Core operations (health, education) remain protected; other ministries are facing significant cuts (for example, Forestry is reduced by 12%)
- Fully cost recovered federal funding of the Labor Market Development Agreement increased by \$52 million.
- Olympic related budget expenses increased by \$165 million. The Province agreed to offset the federal security burden of \$900 million (vs. \$175 million) by subsidizing federal infrastructure agreements. This is being reported as an Olympic expense, bringing the provincial commitment to \$765 million.
- Reduction of \$650 million in expected administrative costs including discretionary grants, professional services, office and business expenses and travel.
- Increase in MSP premiums by about 6%, offset for low wage earners by changes in the premium assistance program.
- Training tax credit doubled for the first two years of apprenticeship.

- Increase of the personal basic tax exemption to \$11,000.

### Harmonized Sales Tax

The budget update provided much analysis and discussion of the implications of the HST. No new exemptions were announced despite intense lobbying by various groups. The implications of the HST vary by individual and company circumstance; however, the impact of the federal revenue sharing offset is substantial.

The province expects to receive \$1.6 billion in HST transfer payments over 3 years, with \$750 million being paid this year alone. The Minister indicated that the HST decision would have been made even without the \$1.6 billion transfer payment; however, without this revenue, the deficit this year would have been \$3.55 billion, totaling over \$7 billion over 3 years. Without the HST, significant spending cuts in government priority areas would have had to be made.

### Construction

Real business investment (including residential) increased by 1.1 per cent in 2008 – slightly lower than the 1.4 per cent observed in 2007. The main source of the 2008 increase was stronger investment in non-residential construction and in machinery and equipment offsetting weaker investment in residential construction.

Suggestive of further declines in the non-residential building sector going forward, the value of non-residential building permits, a leading indicator of non-residential investment, fell by 22.0 per cent year-to-date to June 2009. Gains in the value of institutional and government

permits were offset by substantial declines in industrial and commercial permits.

The Vancouver non-residential building construction price index, a measure of costs facing the construction industry in Vancouver that includes labour, building material costs and profits, fell by 9.1 per cent through the first three months of 2009, compared to the same period in 2008. This follows annual growth of 8.8 per cent in 2008. Central 1 Credit Union, a private sector group that frequently examines BC's construction industry, points out that overall construction costs began to fall in 2009 due to excess capacity in construction materials and services. Central 1 forecasts the decline in construction costs to continue through 2011. Undoubtedly this trend will continue to place pressure on members costs structures.

## Risks

The budget itself is very clear in setting out risks that are present going forward. For example, every dollar change in the price of lumber (per 1000 bdft) results in \$1 million revenue; for every dollar of natural gas prices (gigajoule) results in \$250 - \$300 million in revenue; every 1% of the dollar exchange rate results in \$30-40 million; every 1% in the interest rate \$82 million. The budget update is clear in its outlook – the risks are clearly weighted to the downside.

Despite this, the forecasts being utilized are optimistic. The projections are counting on realization of “pent up demand” in the US housing market and commodity markets as the global economy recovers. Despite this, unemployment is projected to remain in the 5-7% range.

As always, these projections are

made with the best information available but as we've seen, can be incorrect.

## The Bottom Line

- Infrastructure spending continues as committed.
- HST transfer funds were applied to deficit reduction.
- HST exemptions remain as announced.
- Some tax changes (increase of personal exemption) will help offset personal impacts.
- MSP premiums are increasing – this will impact members benefit costs.
- Recovery is anticipated, but remains fragile and dependent on factors outside of BC's control.