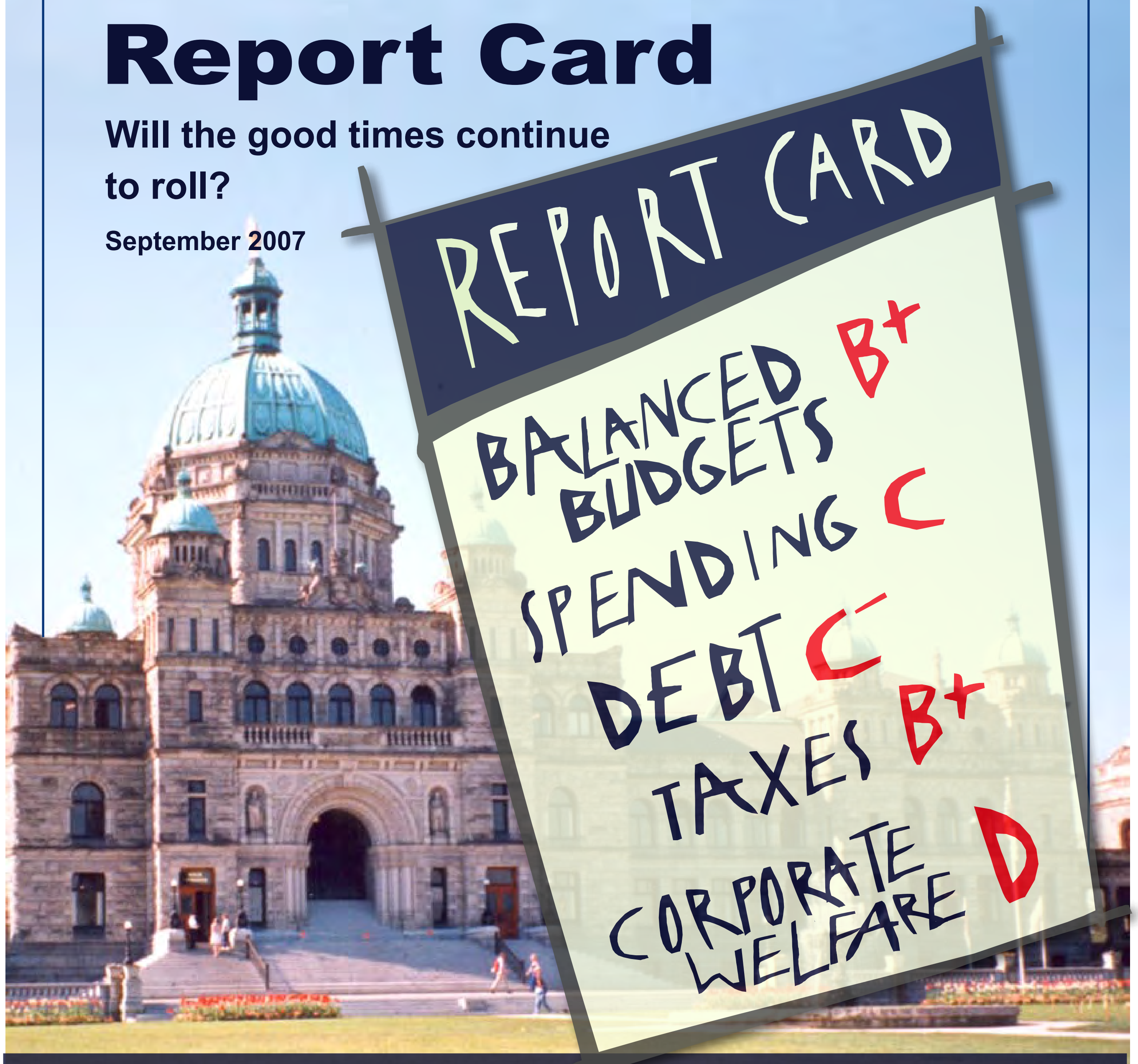
CANADIAN Taxpayers FEDERATION
Fighting for taxpayers

B.C. Liberal Fiscal Report Card

Will the good times continue to roll?

September 2007



Maureen Bader
British Columbia director, Canadian Taxpayers Federation
P.O. Box 20539 Howe Street RPO Vancouver, B.C. V6Z 2N8
Ph: (604) 608-6770 • e-mail: mbader@taxpayer.com • web: www.taxpayer.com

About the Canadian Taxpayers Federation

The Canadian Taxpayers Federation (CTF) is a federally incorporated, non-profit and non-partisan, advocacy organization dedicated to lower taxes, less waste and accountable government. The CTF was founded in Saskatchewan in 1990 when the Association of Saskatchewan Taxpayers and the Resolution One Association of Alberta joined forces to create a national taxpayers organization. Today, the CTF has over 68,000 supporters nation-wide.

The CTF maintains a federal office in Ottawa and offices in the five provincial capitals of British Columbia, Alberta, Saskatchewan, Manitoba and Ontario. In addition, the CTF has a working partnership with Montreal-based Quebec Taxpayers League. Provincial offices and the League conduct research and advocacy activities specific to their provinces in addition to acting as regional organizers of Canada-wide initiatives.

CTF offices field hundreds of media interviews each month, hold press conferences and issue regular news releases, commentaries and publications to advocate the common interest of taxpayers. The CTF's flagship publication, *The Taxpayer* magazine, is published six times a year. An issues and action update called *TaxAction* is produced each month. CTF offices also send out weekly *Let's Talk Taxes* commentaries to more than 800 media outlets and personalities nationally.

CTF representatives speak at functions, make presentations to government, meet with politicians, and organize petition drives, events and campaigns to mobilize citizens to effect public policy change.

All CTF staff and board directors are prohibited from holding a membership in any political party. The CTF is independent of any institutional affiliations. Contributions to the CTF are not tax deductible.

Canadian Taxpayers Federation

Head Office:
Suite 105, 438 Victoria Avenue East
Regina, Saskatchewan
S4N 0N7

Telephone: 306.352.7199
Facsimile: 306.352.7203
E-mail: canadian@taxpayer.com

BC Office:
PO Box 20549, Howe St. RPO
Vancouver, British Columbia
V6Z 2N8

Telephone: 604.608.6770
Facsimile: 604.608.6773
E-mail: bcdirector@taxpayer.com

Web Site: www.taxpayer.com

INTRODUCTION

Tax and spend: that is what governments do. If they do a good job, the economy flourishes, standards of living rise, and people become better off. If they do a bad job, the economy stagnates, standards of living fall, and we become worse off. The CTF's Fiscal Report Card grades the B.C. Liberal government's taxing and spending performance in five areas: balanced budgets, spending, debt reduction, taxation, and corporate welfare. B.C.'s Liberal government has done a solid job in most areas, but with increases in spending and no commitment to debt reduction, it will be challenged to continue delivering the economic gains we have experienced to date.

The Liberal government started in office with an aggressive agenda in three key areas: balancing the budget, cutting taxes and eliminating corporate welfare. Today, the budget is balanced, income taxes are down, most tax on investment is gone, and subsidies to individual businesses were eliminated. However, the government's original vision for prosperity has been sidetracked by politically motivated spending increases, a reliance on debt reduction by accident, and back-door corporate welfare schemes. B.C. is now off the equalization dole and back to "have" province status. The focus on balanced budgets and tax reduction helped to put B.C.'s economy back on track. Big spending threatens to derail those gains.

The CTF gives good grades to the Liberal government for its success in balancing the budget and reducing taxes, but poor grades on corporate welfare, spending control and debt reduction.

BALANCED BUDGETS

To ensure a commitment to balanced budgets, the Liberal government passed the Balanced Budget and Ministerial Accountability Act in April 2002. Under that law, the government may not *forecast* a deficit for a fiscal year. In fact, B.C. has had an impressive, but unforecasted surplus for three years since fiscal year 2004/05 (see table below). This is a tremendous improvement over government performance in the preceding twenty years; there were only three surplus years between 1984 and 2004 (1988, 1989, 1990).

Balanced Budget Operating Statement – 2003/04 to 2009/10

($ millions)	Actual 2003/04	Actual 2004/05	Actual 2005/06	Actual 2006/07	Est. 2007/08	Plan 2008/09	Plan 2009/10
Taxpayer-supported programs and agencies:							
Revenue	27,207	30,805	33,753	35,819	34,887	35,357	36,508
Expense	(30,353)	(30,667)	(32,173)	(34,184)	(36,240)	(36,720)	(37,875)
Nego. Framework incentive payments			(710)	264			
Taxpayer-supported balance	(3,146)	138	870	1,371	(1,353)	(1,363)	(1,367)
Crown corp. income	1,955	2,558	2,220	2,685	2,503	2,513	2,567
Surplus/(deficit) before forecast allowance	(1,191)	2,696	3,090	4,056	1,150	1,150	1,200
Forecast allowance	-	-	-	-	(750)	(1,000)	(1,050)
Surplus/(deficit)	(1,191)	2,696	3,090	4,056	400	150	150

Source: Balanced Budget and Fiscal Plan 2007/08-2009/10, p. 148, Financial and Economic Review, 2007, p. 38, 90

As shown in the table above, revenues are expected to be higher than expenses in the future, something that would put B.C. into a deficit. However, the B.C. government is expecting a $1.2

billion surplus because of expected increases in Crown corporation revenue. To reduce the forecast of a large budget surplus, the provincial government has subtracted a forecast allowance, reducing the forecasted surplus to $400 million. The forecast allowance is subtracted for "fiscal prudence" but in reality creates a "fiscal illusion" acting to buffer the demand for further tax cuts, spending increases and debt reduction. These issues are discussed below.

The 2002 Balanced Budget and Ministerial Accountability act is a law against *forecasting* budget deficits, not against *having* budget deficits. Revenues increased faster than expenses over the past five years but that is expected to change in the future. Over the next three years, revenues are forecast to increase by about 5 per cent but expenses by 10 per cent. To keep the budget balanced, government must look for areas to decrease spending.

CTF Grade	**B+**

The Liberal government misses out on an A because of a lack of budgeting honesty. The forecast allowance creates a fiscal illusion that acts to hide the ability to cut taxes further and make a concerted effort to reduce the debt. Balanced budget legislation, even if only against forecasting a budget deficit, saves the Liberals from falling farther down the grade scale.

SPENDING

Two of the biggest spending areas are health and education. Health and education accounted for 67% of total government spending in 2006/07.

Government expense by function

($ millions)	Actual 2004/05	Actual 2005/06	Actual 2006/07	Est. 2007/08	Plan 2008/09	Plan 2009/10
Health	11,529	12,430	13,250	14,115	14,391	14,383
Education	8,512	8,937	9,519	9,837	10,084	10,332
Social services	2,598	2,724	2,892	3,106	3,174	3,247
Interest	2,294	2,181	2,234	2,345	2,394	2,549
Other	1,027	1,089	1,278	1,335	1,306	1,304
Natural resources and econ. dev.	1,686	1,591	1,663	1,566	1,561	1,641
Protection of persons and property	1,206	1,381	1,329	1,418	1,441	1,453
Transportation	1,308	1,196	1,251	1,351	1,272	1,336
General government	505	644	768	668	656	668
Total operating expense	**30,667**	**32,173**	**34,184**	**36,240**	**36,720**	**37,875**

Source: Financial and Economic Review, 2007, p. 82 and Balanced Budget and Fiscal Plan 2007/08-2009/10, p. 150

Increases in health and education spending in 2006 were due primarily to increases in salaries, operations, and additional staffing. These increases, with continued long wait lists and declining enrollment, point to the need for reform in these two sectors. Without reform, spending will continue to rise, meaning the work done to balance the budget and lower taxes will be undermined.

Another area of high spending is interest, or debt servicing costs. Seven percent of total expenditures last year, $2.2 billion, or $6 million dollars per day, was on public debt servicing costs. Debt reduction, discussed below, would reduce debt servicing costs and reduce the probability of future deficits and higher taxes to pay for them. The Liberal government, however, has made no commitment to debt reduction. Uncontrolled spending increases in health and education, and unnecessarily high debt servicing costs threaten to wreck the Liberal government's success in balancing its budgets.

CTF Grade	**C**

Big spending in health care has not cured the Liberal government of the second-term big spending disease that seems to infect most second term governments. Over the past five years the CPI has increased by about 2% per year and population by just over 1% per year. Liberal spending increased by an average of 1.94% per year in its first term. It has increased an average of 5.6% per year between 2005 and 2007, and is expected to rise on average by 3.5% per year to 2010. Without a focus on spending control and debt reduction, the Liberal's performance will likely deteriorate and with it, the B.C. economy.

DEBT REDUCTION

The Liberal government should be commended for getting B.C.'s debt under control in 2006. However, it must stop engaging in debt reduction by accident and start a program of debt elimination by design. With public debt charges costing $2.2 billion this year – or $6-million each day – the Liberal government must start taking debt repayment seriously.

Even without a commitment to debt reduction, the total provincial debt has fallen each year since 2004. This is not because of a plan to reduce the debt but because of higher than expected tax revenues, or, in other words, good luck. The Liberal government's complete lack of commitment to debt reduction means the debt is expected to rise over the next three years. The Liberal government fogs the debt issue by making vague statements about a downward trend in the taxpayer–supported debt to-GDP-ratio, and paying half the forecasted surplus to debt reduction.

These measures obviously do not imply debt reduction, because the debt is expected to rise over the next three years. A falling debt-to-GDP ratio does not necessarily mean the *debt* is falling. As long as GDP is rising faster than debt, the ratio will fall. Committing half the forecasted surplus to debt reduction leaves the door open to zero debt reduction because the government lowers the forecasted surplus with a forecast allowance. This reduces any amount the government would be obliged to commit to debt reduction. Instead of relying on luck, we must reign in spending and legislate a debt reduction plan.

As shown in the table below, debt started falling in 2004/05. Total B.C. provincial debt fell to $33.35 billion dollars last year because of higher than expected tax revenue and a one time federal transfer. The Liberal government announced that it put $1 billion from the surplus towards the debt in 2006. This only brings the B.C.'s debt back to where it was in 2001, at $33.8 billion.

Total Provincial Debt

$ Millions	2003/04 Actual	2004/05 Actual	2005/06 Actual	2006/07 Actual	2007/08 Est.	2008/09 Plan	2009/10 Plan
Total provincial debt	37,735	35,839	34,385	33,347	36,837	38,681	39,981

Source: Balanced Budget and Fiscal Plan 2007/08-2009/10, p. 164 and Public Accounts 2006/07 p. 119

Vague promises will not make B.C. debt free, but a commitment to debt reduction, as the case of

Alberta shows, can lead to its elimination. Alberta legislated debt reduction in 1995 and today is essentially debt free. Alberta's 1995 Balanced Budget and Debt Retirement Act set Alberta’s debt freedom day in 2009/10. However because any budget surplus had to be used to pay down the debt, Alberta's debt was halved by 1999.

In 1999, the Alberta government came under tremendous pressure to abandon the debt repayment promise and spend surplus dollars. The Alberta government prevented this by repealing the Balanced Budget and Debt Retirement Act and introducing the Fiscal Responsibility Act which prescribed a minimum of 75 per cent of all surplus dollars be put toward debt repayment. By 2004, the debt was essentially gone. Debt freedom is achievable, but only if measures are put in place to oblige the government to follow through.

Why is debt reduction so important? Returning to the Alberta example, Alberta’s debt servicing costs once consumed 12% of its tax revenues. By Budget 2005/06, 100% of Alberta’s provincial tax revenues were available for roads, bridges, policing, schools, and hospitals. In B.C., we currently use about 7% of provincial tax revenues to fund the debt, to the tune of about $6 million dollars per day. Instead of going to bondholders, that money could fund hospitals, schools, infrastructure, and further tax cuts. As we have seen with the Alberta example, a legislated debt reduction plan is required to keep the reduction plan on track; vague promises won’t work.

CTF **Grade C-**

Debt has started to fall but by accident, not design. The total provincial debt has only now dropped back to 2001 levels. The Liberal government is only now back to where it started, but worryingly, it expects the debt to increase in the future. High debt servicing costs and the addiction to politically motivated spending create the need to force politicians to behave responsibly. Without a real plan for debt reduction, the debt will continue to rise. With a debt reduction plan, just like the legislated balanced budget plan, the government will ensure the achievement of debt freedom and all the benefits the province can derive from it.

TAXATION

Personal Income Tax

The Liberal government kept its promise to reduce personal income taxes. The commitment to introduce a dramatic cut in personal income taxes resulted in a 25% across the board personal income tax cut by 2002.

Now, for a two-income family of four earning $60,000 per year, the $1,835 paid in provincial income tax is the lowest of the 10 provinces. The total tax payable, at $12,229 is the second lowest, after Alberta, at $11,853. The difference is due to higher B.C. sales and fuel taxes.

Personal income tax cuts continue. A 10% across the board tax cut was announced in the 2007 budget. This will give B.C. the lowest tax rates for low to middle income earners in Canada starting in 2007.

It is important to note that even though personal income tax rates have fallen, revenues from income tax has gone up in each of the past four years. Total revenue from personal income tax is $6.9 billion in 2006/07, up from 5.8 billion in 2005/06. Most of this increase came from higher than expected personal income, in particular among high income earners. Lower tax rates create strong incentives to work and invest. The liberal government has made excellent progress with its personal income tax cuts.

Business Taxation

The Liberal's promise to phase out taxes on investment and productivity is off to a good start. Across the board business tax relief ensures resources flow to their most effective and valued use. The liberal government reduced the corporate income tax to 12%, and increased the small business tax threshold. It removed the capital tax for general corporations but not for financial institutions. However, the threshold for small financial institutions was increased to $10 million, from $5 million. The province will introduce a new dividend tax credit. Dividends will be grossed up by 45 per cent instead of the current 25 per cent. This will match the federal treatment of certain dividends. Broad-based tax relief will make for more efficient investment decisions and subsequent improvements in economic growth.

CTF	**Grade B+**

Across the board personal income tax relief shows a commitment to tax reform and tax honesty. This effort brings high marks, however B.C.'s tax system is still confusing and complicated, pointing to the need to a lower, simpler and flatter income tax system. Alberta has but one income tax rate while B.C. has five. B.C.'s highest marginal tax rate, at 14.7%, is topped only by New Brunswick and Nova Scotia, at 17.84% and 17.5% respectively. Future tax reform can lead to a flatter, more equitable tax system.

The CTF also commends the Liberal government for holding fast on consumption taxes. Consumption taxes are more transparent and distort people's behaviour less than income taxes. Tax relief should focus first on income taxes, as income taxes tend to punish effort and success, making everyone worse off.

The Canadian Taxpayers Federation has consistently maintained that across the board tax relief is the best way for resources to flow to their most efficient use. Eliminating the remaining capital tax capital tax on financial institutions would improve this grade.

CORPORATE WELFARE

Government's have yet to come up with a spending program more wasteful than corporate welfare. The Liberal government's plan to eliminate corporate welfare started off well. In the Liberals's 2001 campaign, they defined a subsidy as: a government program or activity that transfers a benefit to an individual-for profit business, or a selected group of businesses, beyond what would normally be provided by the marketplace.

The government identified, then eliminated, all government subsidy programs that gave an unfair advantage to *individual* businesses within a certain industry. That included programs providing grants and contributions, equity investments, loan and loan guarantees, and federal cost-shared programs where direct financial benefits went to individual companies. Subsidies to business give some firms an unfair advantage over others, possibly keeping failed businesses afloat. This makes it difficult for good businesses to operate, as they are forced to compete against taxpayer-funded operations who spend more money and time extracting taxpayer dollars from governments than working. Corporate subsidies also create the demand for equal treatment to all businesses, which would result in a massive transfer of funds from taxpayers to businesses. Most of the programs eliminated are listed below.

BUSINESS SUBSIDY PROGRAMS ELIMINATED BY 2002

Ministry	Program
Advanced Education:	Summer Student Works
Agriculture, Food and Fisheries:	Shellfish Aquaculture Working Capital Fund
	Grazing Enhancement Fund
	Fisheries Development and Diversification
	Fisheries Development and Diversification (under the former Fisheries Renewal BC)
Community, Aboriginal:	Partners in Cooperatives
and Women's Services:	Community Enterprise-micro-loans
Competition, Science and Enterprise:	Industrial Incentive Fund
	Loan guarantees under the Financial Administration Act
	Fiscal agency loans under Financial Administration Act
	Small Business Incentive Program
	First Job in Science and Technology
	Technology BC
	Technology Assistance Program
	Job Protection Commission-remissions
Energy and Mines:	Prospectors Assistance Grants
	Industrial Energy Efficiency Program
	Renewable Energy Technology Program
Human Resources:	Job Start
Transportation:	Shuswap Lake ferry subsidy
	Mt. Timothy Ski Hill-road maintenance
Water, Land and Air Protection:	Green Economy Development Fund

Although the Liberal government eliminated subsidy programs channeling funds to individual *businesses*, second-term Liberal government channeled funds to *industries* such as tourism and the arts. More significantly, it began creating a set of complicated targeted tax cuts. The Liberal government must eliminate subsidies to businesses, not just repackage them.

Targeted Tax Cuts

The only mention of a targeted tax cut program when the Liberals were first elected in 2001 was the extension of the mining exploration tax credit. Since then, targeted tax cuts have flourished, with credits to industries ranging from new media, film, digital animation, mining, oil and gas, scientific research and experimental development, venture capitalists, book publishing, and training. This type of tax cut streams resources into areas they may not naturally flow to, and for good reasons. For example, the Liberal government increased the budget for labour-sponsored venture capital tax credits in 2003 to $25 million. As shown in a recent CD Howe study (Financing Entrepreneurs: Better Canadian Policy for Venture Capital), returns on venture capital labour funds are typically low or negative, and management expense ratios high. Without subsidies, investors - who, unlike taxpayers have a choice - would stay away from those funds. Forcing taxpayers to subsidize activities they would not freely spend their money on can redistribute wealth to areas of low or negative returns. This makes society worse off.

Other targeted tax cuts include a complicated series of exemptions from the social services tax (PST). They include: machinery and parts; services to maintain and modify software; motor fuel tax exemptions for marine bunker fuel; and marine gas oil used in gas turbine powered commercial vessels. Some have had social services tax cuts. Jet and aviation fuel tax were reduced to two cents per litre, and the permitted use of coloured fuel, which is taxed at a lower rate than regular gasoline was expanded.

The Liberals also give tax credits to B.C.’s film industry to promote B.C. as a film production location. Tax credits of between 15-30 per cent are payable on the B.C. labour component of a film company’s cost. Enhanced tax credit rates for film and video productions were extended to 2008. The basic Film Incentive B.C. tax credit rate will remain at 30 per cent for productions that begin prior to April 2008 and the basic Production Services Tax Credit will remain at 18 per cent for productions that begin prior to June 2008. During 2007, the province will undertake a review of its tax credit programs and make a decision on whether to continue the tax credits beyond 2008 and, if so, at what rates. The total estimated cost of film and video tax credits in 2007 is $35 million.

Direct Handouts

At least in the case of targeted tax cuts, a company has to make money. That is not the case with taxpayer-funded subsidies, or effectively, cash handouts to industries.

Tourism

In 2005, the Liberal government announced a new provincial tourism strategy to enhance tourism marketing, and promote community and resort development. This included doubling the annual marketing budget for Tourism B.C. to $50 million, providing $25 million to the Union of B.C. Municipalities (UBCM) to create a five-year tourism marketing plan, granting $2 million to each of the six regional tourism marketing organizations; completing an action plan for resort development; and posting new welcome signs at all entrances to the province. Expecting all taxpayers, even those who may not be able to afford to take a holiday within their own province, to fund the promotion of B.C.'s tourism industry in is grossly unfair. Additionally, other industry associations pay for their own marketing, action plans and signs. The tourism industry should be no different.

Arts

For the arts, the Liberal government hands out $3 million annually to the BC Arts Council. It set up a one-time $25-million Arts and Culture Endowment Fund, established a $20-million Spirit of B.C. Fund, and the $12-million ArtsNow program through LegaciesNow to support arts and cultural components leading up to the 2010 Olympic Winter Games. Handouts to art groups create a number of problems. First, the decision regarding which artists are worthy is completely subjective. Favoured artists get subsidies, but subsidies are funded through higher taxes. Artists not given subsidies must now pay higher taxes, making it more difficult for them to make a living from their art. Second, subsidies to artists force taxpayers to pay for art they might not buy voluntarily. If an artist cannot get people to voluntarily pay for his work, then no one should be forced to pay for it through the tax system.

CTF	**Grade D**

Targeted, or boutique, tax cuts and direct cash handouts to businesses are wasteful, distortionary, and unfair to the people footing the bill - the taxpayer. Boutique tax cuts can discriminate against economically viable companies, and are difficult and expensive to administer and police. Tax relief increases economic activity, but targeted tax cuts show the government is trying to implement a social engineering agenda. As we have seen often in the past, governments are not good at picking winners, but losers are very good at picking governments. This creates waste, higher taxes and higher debt.

The rationale for subsidies to tourism, the arts, and some of the targeted tax cuts revolves around the government's desire to diversify the economy into non-resource activities. The problem comes back to who decides which industries are worthy? Given the subjective nature of worthiness, governments come under severe pressure from lobby groups to ensure that the industry they lobby for is deemed worthy. The lobbyists registered by the Council of Tourism Associations and Tourism Vancouver, for instance, are well known Liberal insiders. Lobbying leads to a considerable amount of inefficiency, as lobbyist work to take the economic gains earned by one group and give them to other groups. Groups deemed worthy by the government do not have to achieve a normal level of efficiency and performance demanded by the market because they are getting taxpayer-funded handouts. Subsidies create the appearance of a government "doing something" for business. That "something" may have unexpected outcomes, such as hurting businesses that can compete effectively without subsidies.

Governments cannot pick winners. Channeling funds into select industries, be it through tax credits or direct subsidies, slows the flow of resources to their most valued use. Government subsidies are destructive to both the industries benefiting from its largess and those that are left behind. Taxpayer funds flowing into selected industries may be wasted, and those left out are left to compete with companies with extra cash on their hands. Governments have proven again and again that they cannot pick winners, but the Liberals continue with this misguided policy, albeit in a new form. Targeted tax cuts and subsidies to business must stop.

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