
Second Quarterly Report

on the Economy, Fiscal Situation,
and Outlook

Fiscal Year 2004/05
Six Months
April – September 2004



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SUMMARY

Second Quarterly Report 2004/05

November 2004



2004/05 Updated Financial Forecast

(\$ millions)	Budget	Updated Forecast	Variance
Revenue	30,577	32,619	2,042
Expense	(30,377)	(30,375)	2
Surplus before forecast allowance	200	2,244	2,044
Forecast allowance	(100)	(300)	(200)
Surplus	100	1,944	1,844
Provincial debt:			
Taxpayer-supported debt	32,172	29,451	(2,721)
Taxpayer-supported debt as a per cent of GDP	21.9%	19.2%	(2.7%)
Total debt	39,452	37,018	(2,434)
Total debt as a per cent of GDP	26.8%	24.1%	(2.7%)

The 2004/05 surplus is now forecast to be \$1.9 billion, \$1.1 billion higher than the \$865 million surplus forecast in the first *Quarterly Report*. The higher forecast is mainly due to a net \$805 million increase in federal transfer revenues, resulting from changes to the equalization program confirmed at the First Ministers' October 26, 2004 meeting.

Other revenue changes since the first *Quarterly Report* reflect increases in corporate income tax and forest revenues and ICBC net income, offset by reductions in energy revenue and lower BC Hydro net income. The BC Hydro reduction includes approximately \$35 million in refunds resulting from a rate reduction ordered by the BC Utilities Commission, which will be credited to customer bills in January 2005. The forecast also includes the effect of reducing the provincial sales tax rate to 7.0% from 7.5% (\$120 million).

The consolidated revenue fund spending forecast is little changed from the first *Quarterly Report*. Debt interest and fire fighting forecasts are slightly lower than expected at the time of the first *Quarterly Report*. Ministries continue to forecast on-budget spending, except for this summer's fire fighting costs and the distribution of BC Rail investment partnership proceeds.

Recently announced new government initiatives that cannot be accommodated within existing ministry budgets, and require funding in 2004/05, have been included as commitments against the contingencies vote. Any additional ministry commitments will be funded out of existing

ministry budgets, the contingencies vote or, if required, additional legislative authorization in the form of *Supplementary Estimates* that would be tabled when the Legislature reconvenes in the spring.

Total government debt is forecast to be \$37 billion at year end, \$2.4 billion less than budget. The total debt-to-GDP ratio is expected to fall to 24.1%, and the key taxpayer-supported debt-to-GDP ratio is forecast at 19.2%.

The BC economy has continued to turn in positive results. For January to September of this year, annual growth rates for major economic indicators signal a strong performance for 2004 as a whole, providing upside potential to the 2004 real GDP growth forecast of 2.9%. The 2005 growth forecast of 3.0% remains prudent, given risks to the outlook created by exchange rate fluctuations and higher oil prices.

In early November, Standard and Poor's upgraded its BC credit rating to AA with a stable outlook from AA-. In making this decision, the rating agency noted BC's record for consistently meeting annual budgetary targets.

In preparation for the next budget, the Minister of Finance will be consulting with the independent Economic Forecast Council on December 3, 2004. An updated economic forecast, the third *Quarterly Report* for 2004/05 and an updated three-year fiscal plan will be released with the next budget on February 15, 2005. The plan will set out allocations reflecting British Columbians' priorities identified in budget consultations undertaken this fall.

PART ONE — UPDATED FINANCIAL FORECAST ¹

Second Quarterly Report 2004/05

November 2004

Introduction

The 2004/05 forecast received another major boost since the first *Quarterly Report* primarily as a result of a net \$805 million increase in federal transfer revenues, resulting from interim changes to the equalization program confirmed at the First Ministers' Meeting held on October 26, 2004 (see the topic box at the end of this chapter for more details).

The 2004/05 surplus is now forecast to be \$1.9 billion, an increase of \$1.1 billion compared to the \$865 million surplus forecast in the first *Quarterly Report*. As in the first *Quarterly Report*, a forecast allowance of \$300 million is included in the forecast surplus, as continued protection against revenue volatility.

In addition to the additional federal transfers, revenue changes since the first *Quarterly Report* include increases in corporate income tax and forest revenues and ICBC net income, offset by reductions in energy revenue and lower BC Hydro net income. The BC Hydro reduction includes approximately \$35 million in refunds resulting from a rate reduction ordered by the BC Utilities Commission. The rebate will be credited to customers in January 2005. The revenue forecast also includes the effect of reducing the provincial sales tax rate to 7.0 per cent from 7.5 per cent (\$120 million).

The Consolidated Revenue Fund spending forecast is little changed from the first *Quarterly Report*. Debt interest and fire fighting forecasts are slightly lower than expected at the time of the first *Quarterly Report*. Ministries continue to forecast on-budget spending, except for this summer's fire fighting costs and the distribution of BC Rail investment partnership proceeds.

Recently announced new government initiatives that require funding in 2004/05, but cannot be accommodated within existing ministry budgets, have been included as commitments against the contingencies vote. Any additional 2004/05 ministry commitments will be funded out of existing ministry budgets, the contingencies vote or, if required, additional legislative authorization in the form of *Supplementary Estimates* tabled in the spring legislative session.

The forecast for the schools, universities, colleges and health authorities (the SUCH sector) has also improved since the first *Quarterly Report* mainly due to lower than anticipated net spending by health authorities and school districts.

Total government debt is forecast to be \$37 billion at year end, \$2.4 billion less than budget. The total debt-to-GDP ratio is forecast to fall to 24.1 per cent, the lowest since 1990/91. The key taxpayer-supported debt-to-GDP ratio is forecast at 19.2 per cent, the same level as for 2000/01.

The main changes to the fiscal plan are summarized in Table 1.1.

¹ Reflects information available and government policy as at November 19, 2004.

Federal Health Care Funding

Federal-provincial negotiations on future health care funding at the First Ministers Meeting of September 15, 2004, will result in an additional \$2.3 billion in federal transfers to British Columbia over six years. The government will reinvest all additional federal health care contributions into the provincial health care system. Planning for the use of the funds is underway and will be reflected in the upcoming provincial budget to be released on February 15, 2005.

Table 1.1 2004/05 Forecast Update

(\$ millions)	Changes	Updated Forecast
Budget 2004 Fiscal Plan (February 17, 2004)		100
First Ministers' Accord on Health Care Renewal:		
Additional revenues from the federal government	148	
Additional BC commitments to health care	(148)	-
Fiscal Plan (May 20, 2004 Supply Act)		100
First Quarterly Report forecast updates: ¹		
Total revenue increases	1,173	
Total expense increases	(208)	
Forecast allowance increase	(200)	
Net change		765
2004/05 surplus – first Quarterly Report		865
Second Quarterly Report forecast updates:		
Revenue increases (decreases):		
Corporate income tax – mainly higher 2003 tax assessments	148	
Social service tax – rate reduction to 7.0% from 7.5%	(120)	
Energy and mineral sources – mainly weaker sales of Crown land leases and lower electricity prices affecting sales under the Columbia River Treaty	(75)	
Forest revenue – higher harvest volumes	31	
Impact of restoring the Columbia Basin power projects to commercial status	(63)	
Federal transfers – impact of new framework for equalization (up \$941 million) net of health and social transfers (down \$136 million).....	805	
All other taxpayer supported sources	67	
Commercial Crown corporation net income:		
BC Hydro – reflects BCUC decision, including rate increase rebates	(66)	
ICBC – primarily lower claims cost projections	137	
Other Crown corporation changes – primarily Columbia Power Corporation net income	5	
Total revenue changes		869
Less expense increases (decreases):		
Forest fire and related costs	(10)	
Interest costs – mainly reduced debt levels	(23)	
CRF expense changes	(33)	
Taxpayer-supported Crown corporations and agencies (net of internal transfers):		
Impact of restoring the Columbia Basin power projects to commercial status	(51)	
School districts – lower net spending estimates due to updated enrolment figures	(23)	
Health authorities – lower net spending estimates	(87)	
Other taxpayer-supported Crown corporation and agency changes	(16)	
Total expense changes		(210)
Net change		1,079
2004/05 surplus – second Quarterly Report		1,944

¹ Further details on the first *Quarterly Report* forecast updates are provided in Appendix Table A.2.

Revenue

The 2004/05 updated revenue forecast incorporates year-to-date results for the first six months, preliminary tax assessments from the federal government for 2003 and prior years, updated forecasts from ministries and Crown corporations, and changes to the equalization program confirmed at the First Ministers' Meeting on October 26, 2004. The forecast does not include BC's share of federal health funding announced on September 15, 2004 at the First Ministers' Meeting, pending finalization of the accounting treatment.

The revenue forecast is \$869 million higher than the first *Quarterly Report* forecast and \$2,042 million higher than budget. The main changes from the first *Quarterly Report* forecast for 2004/05 are:

- Corporate income tax revenue is up \$148 million mainly due to higher than forecast preliminary results for the 2003 tax year received from the Canada Revenue Agency as of September 30, 2004.
- Social service tax revenue is forecast to be \$120 million lower reflecting the tax rate reduction to 7.0 per cent from 7.5 per cent, effective October 21, 2004.
- Revenue from energy and mineral sources is down \$75 million reflecting weaker bonus bid sales (\$62 million) due to lower auction volumes and reduced electricity sales under the Columbia River Treaty (\$30 million) due to lower prices. These reductions are partially offset by a \$17 million increase in revenue from minerals and other sources.
- Forests revenue is forecast to be up \$31 million mainly due to higher harvest volumes. The updated forecast assumes a 1.8 million cubic metre volume increase over the first *Quarterly Report* forecast, and up 5.8 million cubic metres from budget. In the first six months, year-to-date harvest volumes were 6.6 million cubic metres higher than budget.
- The effect of restoring the Columbia Basin power projects to commercial status reduces other natural resource revenue by \$63 million. The decrease is partially offset by a \$51 million reduction in taxpayer-supported Crown corporation expense. Under commercial status, half the power project net income is reported by Columbia Basin Trust (CBT) as investment income, while the other half is reported by Columbia Power Corporation (CPC) as commercial Crown corporation net income.
- Equalization revenue (net of health and social transfer revenue reductions) is up \$805 million. Changes to the equalization program confirmed at the First Ministers' Meeting on October 26, 2004 resulted in an increase in equalization revenues of \$941 million. Because of the interaction between the calculation of equalization transfers and the calculation of health and social transfers, the increase in equalization revenue is partially offset by a \$136 million decrease in health and social transfer revenues (see the topic box at the end of this chapter for more details). The forecast does not include BC's share of the new federal health funding announced at the First Ministers' Meeting on September 15, 2004, pending finalization of the accounting treatment.

- Revenue from all other taxpayer-supported sources is up \$67 million as higher corporation capital tax audit recoveries, new forecast information on school district revenues, and improved sales from the Crown Land Special Account are partly offset by lower health-care related fees and decreased revenues from water rentals.

Commercial Crown Corporations Net Income

In total, commercial Crown corporation net income projections improved by \$76 million since the first *Quarterly Report*, primarily due to changes affecting BC Hydro and ICBC.

- BC Hydro's current projected income before deferral account transfers for 2004/05 is \$66 million less than the forecast presented in the first *Quarterly Report*. The change reflects the BC Utilities Commission (BCUC) decision with respect to BC Hydro's rate application, which included a 7.23 per cent interim increase effective April 1, 2004 and a second increase of 1.67 per cent in the fall of 2004.

The BCUC decision reduced these increases to 4.85 per cent and provided additional direction on the cost aspects of BC Hydro's operations. The forecast assumes that the rate reduction ordered by the BCUC will result in approximately \$35 million in refunds, which will be credited to customer bills in January 2005.

On September 9, 2004, the U.S. Ninth Circuit Court of Appeals directed the U.S. Federal Energy Regulatory Commission (FERC) to revisit certain of its decisions related to the California power crisis of 2000/01. The ruling may impact a number of issues previously decided by FERC, including refunds that may be ordered and Powerex's settlement on allegations of unfair trading practices. Powerex and its legal counsel continue to monitor the situation. No adjustments to BC Hydro's financial statements and projections have been made as a result of this ruling.

- ICBC's impact on the government's bottom line is forecast to improve by \$137 million over the outlook presented in the first *Quarterly Report*. Claims trends continue to positively impact projections for settling claims costs. As well, ICBC is forecasting a higher number of premiums and investment income, as well as lower insurance operations costs.

For the first six months of the fiscal year total taxpayer-supported revenue and commercial Crown corporation net income was \$913 million ahead of budget (see Appendix Table A.3).

Expense

Government expense includes spending for ministries and other programs of the Consolidated Revenue Fund (CRF), combined with the expense of taxpayer-supported Crown corporations and agencies and the SUCH sector (schools, universities, colleges and health authorities/hospital societies). The total expense forecast of \$30.4 billion is on budget and \$210 million lower than the first *Quarterly Report* (see Table 1.1).

Consolidated Revenue Fund expense

CRF spending is forecast to be \$33 million less than the first *Quarterly Report* forecast, with debt interest and fire fighting costs slightly lower than previously forecast. Excluding fire fighting costs and the distribution of BC Rail partnership proceeds, ministries continue to forecast on budget spending.

The main changes to the 2004/05 forecast since the first *Quarterly Report* are:

- Forest fire costs – based on the latest information, the updated forecast for forest fire costs will be \$165 million, \$110 million above budget. This represents a \$10 million reduction from the estimated costs in the first *Quarterly Report*.
- Management of public funds and debt (debt interest) is forecast to be \$23 million lower than the first *Quarterly Report* and \$96 million below budget, reflecting lower debt balances at the start of the year and significantly lower borrowing requirements for government operating purposes.

Except for those areas noted earlier, ministries are forecast to be on budget at the end of 2004/05. As shown in Table 1.2, other pressures being managed total \$71 million for 2004/05 and include:

- Advanced Education – pressure reflects government’s commitment to invest in the creation of the Irving K. Barber BC Scholarship Program.
- Agriculture, Food and Fisheries – pressure reflects potentially higher than forecast payments for crop insurance.
- Human Resources – pressure reflects an increase in monthly benefits paid to persons with disabilities starting in December 2004.
- Public Safety and Solicitor General – pressure reflects potentially higher than forecast costs for emergency protection related to fires and floods.
- Corporate – pressure reflects potentially higher than forecast costs for the employer portion of employee benefits.

Table 1.2 2004/05 Pressures Being Managed

	(\$ millions)
Advanced Education – Irving K. Barber BC Scholarship Program	15
Agriculture, Food and Fisheries – crop insurance.....	7
Human Resources – persons with disabilities rate increase.....	18
Public Safety and Solicitor General – emergency protection.....	6
Corporate – employee benefits.....	25
Total pressures being managed.....	71

Spending commitments and pressures totaling \$109 million have been notionally allocated to the contingencies vote (see Table 1.3). These allocations include:

- \$32 million for government's commitment to return 100 per cent of net traffic fine revenue to municipalities starting in 2004/05.
- \$25 million for government's commitment to provide community grants to the Union of BC Municipalities.
- As part of the 1995 Vancouver Island Gas Pipeline Assistance Agreement, the province is required to make payments to Terasen Inc. for the value of a volume of natural gas set out in the agreement. Higher than forecast natural gas prices are expected to increase the estimated payment required for 2004/05 by \$11 million. However, this is more than offset by increased provincial revenues resulting from the higher natural gas prices.
- Up to \$14 million for the provincial response to avian flu and Bovine Spongiform Encephalopathy (mad cow disease).
- Up to \$10 million for costs related to the Pickton, Air India and Eron trials. Potential costs were unknown at the time of the budget and will be reviewed later in the year when further information becomes available.
- \$14 million for government commitments to the BC Trust for Public Lands, Living Rivers, and Species at Risk (mountain caribou).
- \$3 million for government's commitment to the 2010 Olympics Live sites program.

Table 1.3 2004/05 Pressures Allocated to the Contingencies Vote

	(\$ millions)
Traffic fine sharing.....	32
Community grants.....	25
Vancouver Island Gas Pipeline Assistance Agreement – higher payments due to higher natural gas prices.....	11
BSE assistance.....	11
Avian flu response.....	3
Pickton trial.....	3
Air India and other trials.....	7
BC Trust for Public Lands.....	8
Living Rivers.....	5
Species at Risk.....	1
2010 Olympics Live sites.....	3
Subtotal.....	109
Unallocated.....	131
Total contingencies budget.....	240

During the first six months of the fiscal year, total CRF spending (ministries, special offices and other programs) was \$140 million lower than budget, reflecting below-budget spending in most programs and lower debt interest costs, partially offset by higher forest fire costs (see Appendix Table A.4).

Other expense

In total, taxpayer-supported Crown corporation and agency expense (net of internal transfers) is \$177 million lower than the projection in the first *Quarterly Report*. The main changes are:

- The effect of restoring the Columbia Basin power projects to commercial status reduces taxpayer-supported Crown corporation expense by \$51 million. This expense is now reflected in the power project net income amounts reported by CBT and CPC.
- School district expenses, net of transfers from government, are down \$23 million from the first *Quarterly Report*. This change reflects known enrolment numbers and revised salary and benefit cost estimates.
- Health authorities expenses, net of transfers from government, are down \$87 million from the first *Quarterly Report*.

Full-Time Equivalents (FTEs)

The updated projection for taxpayer-supported FTEs – including ministries and special offices, taxpayer-supported Crown corporations and agencies, and children and family development authorities – is down 210 FTEs from the February budget and the first *Quarterly Report* (see Appendix Table A.9).

FTE projections for ministries and special offices are down 175 FTEs from budget. This is primarily due to lower than expected staffing levels in a number of ministries, partially offset by increases for forest fire fighting and clearing highway meridians. The reduction includes a transfer of 15 FTEs to the interim children and family development authorities.

FTE projections for taxpayer-supported Crown corporations are down 50 FTEs, primarily reflecting the impact of moving the Organized Crime Agency of BC Society under the umbrella of the Combined Forces Special Enforcement Unit.

Provincial Capital Spending

Capital spending is used to build, acquire or replace assets such as roads, schools, post-secondary facilities, hospitals and related major equipment. Generally accepted accounting principles require the cost of capital to be spread out over the useful lives of the related assets through annual amortization expenses.

Total capital spending is forecast to be \$3.1 billion in 2004/05, \$150 million higher than the *Budget 2004* projection and \$125 million higher than the first *Quarterly Report* forecast (see Table 1.4 and Appendix Table A.10).

Excluding the effect of restoring the Columbia Basin power project spending to commercial status, taxpayer-supported capital spending is up \$120 million from the first *Quarterly Report*. The main changes are a \$50 million increase in health facilities spending (reflecting updated capital plans of health authorities and commencement of the Academic Ambulatory Care Centre project) and a \$109 million increase in transportation infrastructure (reflecting accelerated spending on a number of projects including the *Sea-to-Sky* Highway, the Okanagan Lake Bridge, and the Gateway strategy). These increases are partially offset by a \$39 million reduction in other areas.

