



September 8, 2011

DROPPING THE HST POSTPONES BC'S RETURN TO SURPLUSES

Highlights

- The BC government now faces a deficit of \$458 million for 2013-14, compared to the return to surplus anticipated in the May budget.
- The cumulative impact of cancelling the HST to return to a GST/PST system will be a net loss of \$2.3 billion over three years, with more than half going to the federal government to pay back transition funding.
- The Province now uses a real GDP growth forecast of 2.3% for 2012, down from 2.6% last May to reflect global economic uncertainty. Private sector forecasters adopted similar revisions over the same period.
- The GDP growth scenario remained unchanged for 2011 at 2.0%.

In British Columbia, the Harmonized Sales Tax (HST) repeal process dragged itself to an apex on September 8th as Finance Minister Kevin Falcon presented a highly anticipated update to the province's financial situation, including a first fiscal glimpse into BC's post-HST world. Abandoning the two-year-old HST to return to the old combination of a Provincial Sales Tax (PST) and the federal Goods and Services Tax (GST) represents an economic and fiscal challenge for the Province.

BC's HST: a long-running serial

From June to August, 1.6 million British Columbians voted by mail ballot in the HST referendum. This represents roughly the same level of participation as in the last provincial election. Nearly 55% of voters answered "yes" to the question asking them whether they were in favour of "extinguishing the HST and reinstating the PST in conjunction with the GST."

Just like in Ontario, Québec and the Atlantic, the original purpose of BC's HST had been to combine the federal GST with the provincial PST with the intention of simplifying and reducing the tax burden for businesses, while widening the sales tax base. The HST came into effect in 2010 but its unpopularity led to the mail-in referendum, with its binding result.

As Minister Falcon explained in his First Quarterly Report, the next step for the government will now consist of two things: (1) turning the clock back on the HST to return to the former GST/PST approach; and (2) paying back the \$1.6 billion funding received from the federal government to help with the transition to an HST regime.

Those two steps will have an economic and fiscal impact on the

BRITISH COLUMBIA GOVERNMENT FISCAL POSITION					
(C\$ millions)					
	Actual	Est.	Sept. Update		
Fiscal Year	09-10	10-11	11-12	12-13	13-14
REVENUES*	37,521	39,893	41,173	42,153	44,041
% change	-2.1	6.3	3.2	2.4	4.5
EXPENDITURES*	39,300	41,008	41,856	42,535	43,593
% change	2.8	4.3	2.1	1.6	2.5
Forecast Allowance	0	150	350	350	350
Impact of reverting to PST/GST	0	0	-1,633	-71	-610
Surplus/Deficit (-)	-1,779	-1,265	-2,778	-805	-458
% of GDP	-0.9	-0.6	-1.3	-0.4	-0.2
Taxpayer-Supp. Debt	31,169	33,388	36,872	39,842	41,510
% of GDP	16.3	16.4	17.2	18.0	18.0

Source: British Columbia Ministry of Finance. GDP forecast by TD Economics

province. Restoring the practice of applying a sales tax on business inputs is a setback with regards to long-term competitiveness. Additionally, the return to the old tax system will result in some volatility for indicators such as retail sales and inflation, but we expect it to be short-lived and have no impact on overall annual growth for the province. The reimbursement to the federal government will be another story, as it will straddle the provincial administration with a significant I.O.U. just when the provincial and national economies enter a period of economic turbulence.

Downgrade to economic assumptions

Jettisoning the HST was not the only major change in the September update compared to the May budget. During the intervening five months, increased economic and financial uncertainty has led the BC government to adopt a less enthusiastic view of its prospects in the near term. The Province now uses a real GDP growth forecast of 2.3% as a working assumption for 2012, down from the 2.6% it mentioned in May. The downgrade is in line with the revisions adopted by us and other private sector forecasters over the same period. For 2011 however, the GDP growth scenario remained unchanged at 2.0%.

Among the risks identified in the update for BC's economy, the return to recession in the U.S. and the European debt crisis come at the top of the list. A slowdown in Asian demand for BC products is also briefly mentioned, which is in line with TD Economics' recent downward revision for Asian growth over 2012 and 2013. The volatility of commodity and energy prices is also a preoccupation for the Province, but this has virtually always been the case.

BRITISH COLUMBIA ECONOMIC PLANNING ASSUMPTIONS				
Annual percent change				
Calendar Year	2011	2012	2013	2014
Real GDP growth				
Forecast				
September update	2.0	2.3	2.4	2.4
May budget	2.0	2.6	2.7	-
Nominal GDP growth				
Forecast				
September update	4.2	4.4	3.7	4.2
May budget	4.1	4.9	4.8	-
Employment growth				
Forecast				
September update	1.7	0.7	1.5	-
May budget	1.4	1.8	1.7	-

Source: British Columbia Ministry of Finance.

Negative impact on surplus/deficit

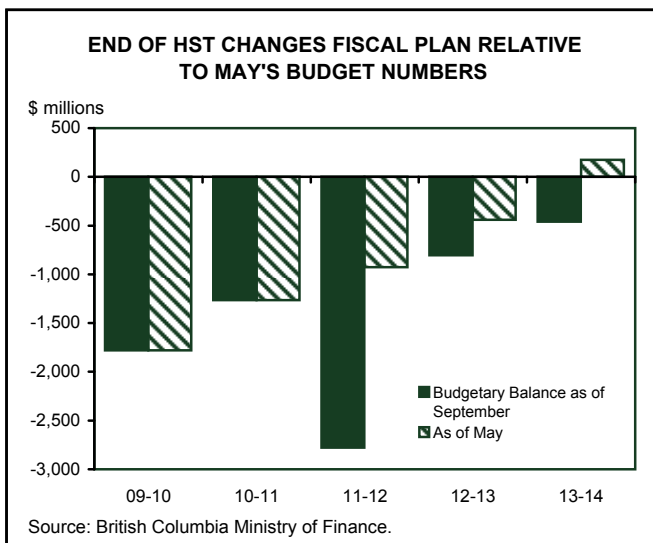
The government estimates that the cumulative impact of returning to a GST/PST system on its finances will be a net loss of \$2.3 billion over three years. The bulk of this amount consists in reimbursing the federal government for the already-paid portion of HST transition funding (\$1.0 million in prior payments and \$0.6 billion in upcoming ones). There will also be losses in sales tax revenue (\$0.8 billion) and other impacts (\$0.3 billion). On the other hand, some \$0.5 billion will be saved due to the fact that HST relief to lower income earners will no longer be provided through personal tax credits and other measures.

The May budget anticipated a return to surplus in 2013-14. Since then the forecast for average annual revenue growth over the next two years was toned down from 3.3% to 2.8%, and the government now faces a deficit of \$458 million for 2013-14. That deficit will be relatively small at less than 1% of nominal GDP, but the Province will launch public consultations to identify areas where savings could be found allowing it to get back to the breakeven point that year.

This shift into slightly deeper deficit territory results in a gradual increase in provincial taxpayer-supported debt from \$36.8 billion to \$36.9 billion. Despite this, BC continues to stack up favourably compared to other provinces. Its net-debt-to-GDP ratio of around 18% for 2011-12 places it solidly in the middle of the pack, as illustrated in TD Economics' Government Budget Balance and Net Debt tables.

Despite the combined hit of the HST drawback and increased uncertainty, the government maintains its use of lower-than-consensus GDP growth forecasting as well as the forecast allowances and contingencies that it had set out in the May budget.

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