June 2015

MONITORING FISCAL SUSTAINABILITY

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The Honourable Linda Reid
Speaker of the Legislative Assembly
Province of British Columbia
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Dear Madame Speaker:

I have the honour to transmit to the Legislative Assembly of British Columbia, *Monitoring Fiscal Sustainability*.

We prepared this report under the authority of section 11 (8) of the *Auditor General Act*.

Carol Bellringer, CPA, FCA
Auditor General
Victoria, British Columbia
June 2015

AUDITOR GENERAL'S COMMENTS

Carol Bellringer, CPA, FCA
Auditor General

FISCAL SUSTAINABILITY MEANS government can provide services and meet financial commitments – both now and in the future.

There are risks to B.C.'s long-term fiscal sustainability: an aging population, rising health care costs, climate change, the cost of maintaining and renewing infrastructure, and more. For example, in the year 2040, there are expected to be 50% more seniors in B.C. than today. Fewer people working reduces economic growth, yet the cost of health care and other services are expected to increase, given the aging population.

A long-term outlook helps government deal with fiscal pressures gradually; thereby avoiding crisis and sudden program changes. As you will read in the report, government does not report publically on its overall long-term fiscal sustainability. It does, however, report on certain aspects of long-term fiscal sustainability, such as risks and strategies for growing the economy and achieving health care sustainability. Government also reports on most aspects of its present-day financial health, which compares well against the other provinces.

Because government plans on a three-year budget cycle, it cannot demonstrate how decisions made today will result in a sustainable government over the long term. Balanced annual budgets alone are not sufficient to ensure policies and programs will be sustainable in the future.

Globally, more governments recognize the importance of planning for long-term fiscal sustainability, but this practice is still in its infancy. B.C. has an opportunity to be a leader in planning for fiscal sustainability through reporting to citizens which also better informs the decisions of legislators.

I wish to thank the staff at Treasury Board and the Ministry of Finance for their cooperation and contribution to this report.

Carol Bellringer, CPA, FCA
Auditor General
Victoria, BC
June 2015

REPORT HIGHLIGHTS

Fiscal Sustainability:
government services & financial commitments met – now & future

50% more seniors
in B.C. by 2040

British Columbia
NEEDS LONG-TERM OUTLOOK

LESS WORKERS
= less economic growth

RISKS
to B.C.'s long term fiscal sustainability

Aging population, healthcare costs, climate change, infrastructure, etc…

AGING POPULATION
= greater costs for health care/services

SUMMARY OF RECOMMENDATIONS

WE RECOMMEND THAT GOVERNMENT:

1 report publicly on its assessment of the province's long-term fiscal sustainability, including the reporting of relevant targets and results. This assessment should inform the annual budget process.

RESPONSE FROM THE MINISTRY OF FINANCE

Government would like to thank the Auditor General and her staff for the report on Monitoring Fiscal Sustainability.

Government acknowledges the importance of long-term fiscal sustainability planning to ensure the programs and services that the citizens of B.C. have come to rely on can continue to be provided in a sustainable way in the future, without increasing debt obligations on future generations or increasing tax burdens to manage the impact of an aging population, rising health care costs, climate change, and the cost of maintaining and renewing infrastructure, among others.

Government agrees with the recommendation in the report and commits to working towards additional public reporting on long-term fiscal sustainability, beyond what is currently reported (i.e. health care sustainability and strategies for growing the economy).

EXECUTIVE SUMMARY

Long-term fiscal sustainability is the ability of a government to meet its service delivery and financial commitments – both now and in the future.

Through the annual budget process, the B.C. government reports its budgeted and forecasted revenues and the cost of delivering programs for the next three years. Government also reports on the expected trend in the affordability of debt over the next three years. By publishing this information, government informs, and is accountable to, taxpayers, for its fiscal management over a medium term timeframe (three years). But are there risks to government maintaining present policies and programs over the longer term? In 20 years, will government still be able to pay for the services we currently depend on without significantly increasing taxes or increasing debt in an unsustainable manner?

There has been growing recognition internationally of the importance of a long-term outlook. Guidance on, and the practice of, governments reporting on long-term fiscal sustainability has evolved significantly during the past two decades. This shift is due to a recognition that there are significant risks to government finances, which are expected to intensify, in the decades ahead. Long-term reporting is still in its infancy in many jurisdictions, including most of the other Canadian provinces. However, given the risks emerging on the horizon, an increased focus on long-term fiscal sustainability is becoming more and more important with each passing year.

Why is a longer-term outlook important? For the same reason you look ahead while you drive a car or walk through a crowded market. You need to see far enough ahead to avoid hazards. And the slower you are to react and adjust, the further ahead you need to look. For a government, effectively responding to risks emerging in the future requires a long-term outlook. This is because adjustments to government programs generally take a long time – government programs are very complex and citizens expect that the stability of government services will be protected. Monitoring long-term fiscal sustainability helps a government to better respond to long-term pressures and risks in a gradual manner, instead of being forced to adopt sudden and disruptive policy changes.

Population aging, a risk common to advanced economies worldwide, is expected to significantly impact both government revenues and program costs in the future. As a population ages, the proportion of the population that is of working age decreases. This is expected to slow economic growth and, with it, government's ability to generate revenues. At the same time, population aging will result in increasing pressure on government's overall cost of delivering services. Fiscal pressure related to the delivery of health care, in particular, is expected to intensify further in the coming decades, due to population aging and other inflationary pressures. Health care costs have already been growing as a proportion of government's overall spending for some time. In 1999, health care costs made up 30% of the total expenses

EXECUTIVE SUMMARY

of government, and by 2014 they had grown to 41%. There are also other significant risks to long-term fiscal sustainability, including the effects of climate change and the future cost of maintaining and renewing aging infrastructure.

We found that the B.C. government reports on most aspects of its current financial health and reports forecasted financial results over the medium term (three years). These reports indicate that the B.C. government's financial health is relatively strong compared to the other provinces.

Government does not report on its overall long-term fiscal sustainability, but it reports on certain risks and strategies relevant to long-term fiscal sustainability. It reports on strategies to maintain a sustainable health care system and on measures that have, or will, be implemented to control health care cost escalation. Government also reports on strategies for growing the economy in the future.

While this information is important for understanding how certain fiscal sustainability risks are being managed, it does not provide a complete picture. For example, government does not forecast the fiscal impact of population aging on overall revenues and program costs over the longer term. And it does not project the long-term costs required to maintain and renew capital infrastructure. Therefore, government does not report on whether decisions made today are expected to result in policies and programs that are sustainable over the longer term.

Public reporting on long-term fiscal sustainability is important not only to inform the decisions of legislators, but also to inform citizens of what government is doing to ensure sustainable government programs. This reporting should include projections of future cash inflows and outflows, and a discussion of the important elements of long-term fiscal sustainability. Government's projections should also include a discussion of the principles, assumptions and underlying methodologies used, and be prepared based on current policies and future economic assumptions.

Government should report on long-term fiscal sustainability frequently enough so that the information remains relevant. Also, reporting should tie directly into the annual budget process, and link to other budget practices and procedures, including legislated budgetary requirements. This is to ensure government gives adequate attention to the potential long-term fiscal consequences of its current policies.

RECOMMENDATION 1: *We recommend that government report publically on its assessment of the province's long-term fiscal sustainability, including the reporting of relevant targets and results. This assessment should inform the annual budget process.*

PURPOSE AND SCOPE

WE PREPARED THIS report to inform legislators and the public of the importance of a long-term outlook when assessing the fiscal sustainability of policies and programs. In this information report we discuss:

- the topic of fiscal sustainability
- key principles to effectively report on, and manage, fiscal sustainability
- risks to B.C.'s fiscal sustainability
- reporting guidance and practice in other jurisdictions
- how B.C. currently reports on fiscal sustainability risks and mitigation strategies

We concluded our study in March 2015. We reviewed fiscal sustainability publications and guidance, reporting practices in other jurisdictions, and the province's current reporting practices related to fiscal sustainability. When looking at risks specific to B.C., we engaged economists as advisors. We did not audit the completeness or accuracy of the government reports we reviewed, and we did not assess internal monitoring and risk management processes related to fiscal sustainability.

DETAILED REPORT

WHAT IS FISCAL SUSTAINABILITY AND WHY IS IT IMPORTANT?

Long-term fiscal sustainability is the ability of a government to meet service delivery and financial commitments – both now and in the future.[1] Both guidance on, and the practice of, governments reporting on long-term fiscal sustainability has evolved significantly during the past two decades. This shift is occurring due to a growing recognition that there are significant risks to government finances expected to intensify in the decades ahead.

Population aging, a risk effecting advanced economies worldwide, is expected to significantly impact both government revenues and program costs in the future. As a population ages, the proportion of the population that is of working age decreases, which is expected to slow economic growth. The result is that the ability of governments to generate taxes and other revenues per citizen is expected to decline. At the same time, the overall cost of delivering government programs is expected to increase. Fiscal pressure related to the delivery of health care, in particular, is expected to intensify in the coming decades due to population aging and other inflationary pressures. Elderly citizens on average require more health care services and they will be a larger proportion of the population. This increasing cost pressure is expected to outweigh reductions in spending on youth and working age programs, such as children's benefits, education spending and social benefits.

There are other risks to long-term fiscal sustainability including the effects of climate change and the future cost of maintaining and renewing aging infrastructure (such as buildings and bridges). With revenues expected to experience downward pressure in the future, governments may need to find innovative ways to finance needed renewal of capital infrastructure.

Monitoring of longer-term risks should inform decisions made today that have implications down the road. A long-term view of fiscal policy gives government and the public confidence that gradual, necessary corrections will maintain both financial health and the stability of government services in the future.

FEDERAL AND PROVINCIAL ROLES

The roles and responsibilities of the federal and provincial governments differ. The federal government oversees national defence, foreign affairs, criminal law, employment insurance, aboriginal lands and rights, banking, and federal taxes. The provinces are responsible for education, health care, infrastructure and social programs – responsibilities that are funded, in part, by the federal government. This means that while the federal and provincial governments face different fiscal pressures, their finances are also intertwined because the provinces are dependent on federal funding. For the year ended March 31, 2014, the B.C. government received $7.5 billion dollars in contributions from the federal government, which represented 17% of total revenues.

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1 International Public Sector Accounting Standards Board (IPSASB). *Recommended Practice Guideline: Reporting on the Long-Term Sustainability of an Entity's Finances.* July 2013.

DETAILED REPORT

As noted, significant fiscal pressures in the coming decades are expected to arise in the delivery of health care. The federal government provides some of the funding for health care, but the provinces are ultimately responsible for the delivery of health care and for funding the remaining cost.[2] This means the provinces are responsible for managing the risks associated with cost escalation. Similarly, while the federal government provides infrastructure assistance and funding through various programs, the responsibility for developing, financing, and maintaining provincial infrastructure remains with the provinces.

While we have not included risks faced by municipal governments within the scope of this report, it is important to note that similar inter-relationships exist between all levels of government. Municipal governments are responsible for maintaining and renewing municipal infrastructure, and this is partly funded by grants received from the provincial and federal governments. All three levels of government also share the capacity of an economy to support tax and other government revenues. This means if one level of government increases taxes, it reduces the capacity of the economy to support tax increases by the other levels of government. These interrelationships and the fact that all levels of government serve the same citizens, means the fiscal sustainability of a government cannot be viewed in isolation.

The Office of the Auditor General of Canada and Federal Department of Finance

The Office of the Auditor General of Canada (OAG Canada) has been reporting on fiscal sustainability for over 20 years. OAG Canada has reported on the implications of population aging and other risks, published long-term fiscal forecasts and made recommendations related to the federal government's management and reporting of fiscal sustainability risks. OAG Canada recommends long-term fiscal projections to help government protect the sustainability of public finances and respond more effectively to financial pressures in the future. Though projections are not predictions, they underpin fiscal sustainability and inform fiscal policy decisions. Understanding and considering the possible future consequences of decisions made today supports sound economic development and the efficient use of available resources.[3]

In its 1995 and 1998 reports, OAG Canada emphasized the need for a longer view as most of government's discussions about controlling finances had focused on deficit reduction and balanced budgets. Government had not addressed the larger question of how much debt it could sustain over the long haul, and how debt would fit within an overall view of taxation, the role of government and its impact on the Canadian economy. OAG Canada concluded that changing demographics would continue to significantly impact individual programs, but more importantly, government finances as a whole.

2 In the year-ended March 31, 2014, B.C. received $4.3 billion in health care funding from the federal government, which represented about one quarter of B.C.'s total health care expenses of $17.9 billion.

3 Report of the Auditor General of Canada – Fall 2012

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Over the past 20 years, the federal government has made significant progress in the analysis of fiscal sustainability risks to inform decision making. In its 1998 report, OAG Canada found that specific programs, particularly the Canada Pension Plan, had started to assess the impact changing demographics would have on long-term sustainability. The *2012 Fall Report of the Auditor General of Canada* found that the Department of Finance:

- analyzed and informed the Minister of Finance about the long-term fiscal impact of budget measures
- had the tools and capacity to prepare long-term fiscal sustainability analyses when considering spending or tax measures
- performed analyses of the long-term fiscal sustainability of budget measures and considered the fiscal impact on the provinces and territories where determined necessary
- considered analysis when formulating recommendations
- since 2010, regularly prepared sound, long-term fiscal projections to inform the Minister of Finance of the budgetary balance and public debt for the federal government (these reports were not made public)

OAG Canada's 2012 report also noted areas where there was still room for improvement. The department did not prepare projections of the impact budgets would have on the federal, provincial and territorial governments in time to influence or support budget decisions. And the federal government had not followed through on its 2007 commitment to publish a long-term fiscal sustainability report.

Following OAG Canada's 2012 report, the department first reported publically on the long-term fiscal sustainability of the federal government in October 2012, and has reported each year since, in the annual fall *Update of Economic and Fiscal Projections.* However, the federal Department of Finance has not yet included the provinces and territories in its reporting of fiscal sustainability, as recommended by OAG Canada.

The annual *Update of Economic and Fiscal Projections* reports long-term economic and fiscal projections that consider demographic and economic trends projected to 2050-51. Finance Canada states that "Canada is still expected to age more rapidly than most other countries, meaning that Canadians and their governments will have to adjust to the economic and public finance implications of population aging sooner than many other advanced economies".[4] Finance Canada's projections shows that demographic change will continue to be an ongoing risk to long-term fiscal sustainability. The report discusses the nature of the projections including uncertainty, the methodology, key assumptions and sensitivity analysis.

Canada's Parliamentary Budget Officer

The Government of Canada created the Parliamentary Budget Officer (PBO) position in December 2006 with the introduction of the *Federal Accountability Act.* The PBO is mandated to provide independent analysis to Parliament on the state of the nation's finances, the government's estimates, and trends in the Canadian economy. Upon request from a committee or Parliamentarian, the PBO will estimate the financial cost of any proposal for matters over which Parliament has jurisdiction.

[4] Department of Finance Canada: Update of Economic and Fiscal Projections. November 2014.

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Since 2010, the PBO has published annually an analysis of fiscal sustainability. In September 2014, and consistent with its 2013 report, the PBO reported that the federal government is on a fiscally sustainable path, but that other levels of government are not. The federal government has mostly insulated itself from the fiscal impact of an aging population by tying the future growth in federal health care funding to the growth of the wider economy. This means provincial governments, who are responsible for the delivery of health care, will have to fund cost escalation that exceeds economic growth. This is a significant risk because health care costs have been growing faster than the economy for a number of years and the impact of population aging on health care costs is expected to intensify in the future.

CANADA HEALTH TRANSFER

Federal funding for health care is provided through the Canada Health Transfer (CHT). On December 19, 2011 the Government of Canada announced that: the CHT would continue to grow at 6 % annually until 2016-17; starting in 2017-18 the CHT would then grow in line with a 3-year moving average of nominal GDP growth (with a minimum increase of 3 % per year guaranteed); and, the CHT will be reviewed again in 2024.

The PBO reported that for Canada's provincial, territorial, local and Aboriginal governments (all commonly referred to as subnational governments), expenses continually outpace revenues, and debt continues to accumulate in an unsustainable manner. To limit or contain the growth of subnational debt, governments must increase revenues, renegotiate higher federal transfers, or find savings in health care or other programs. To address this, the PBO suggests that subnational governments need to make immediate and permanent improvements. Conversely, the PBO reported the federal government has the fiscal room needed to introduce new programs, expand existing programs, or reduce taxes, while maintaining sustainable debt. The PBO analysis looked at subnational governments as a whole and did not look at individual provinces.

RISKS TO FISCAL SUSTAINABILITY IN BRITISH COLUMBIA

Risks to the long-term fiscal sustainability of B.C. exist – some are prominent and measurable, while others depend on future events that are more difficult to predict. In this report we discuss risks related to demographic change and related cost pressures in health care. We also discuss risks related to maintaining and renewing capital infrastructure and the effects of climate change. However, there are other risks and potential risks not discussed further in this report, including future costs related to natural disasters, uncertainty surrounding First Nations land claims, risks related to the interconnectivity of the global economy, the implications of non-renewable resource depletion, and others.

Population aging

The percentage of the B.C. population over the age of 65 has grown from 9% in 1971 to 16% in 2013, and it is forecasted to grow to 25% by the year 2041.[5] Population aging is not unique to the province or even Canada – it is affecting advanced economies worldwide.

[5] BC Stats. British Columbia Population Projections: 2014 to 2041. September 2014.

DETAILED REPORT

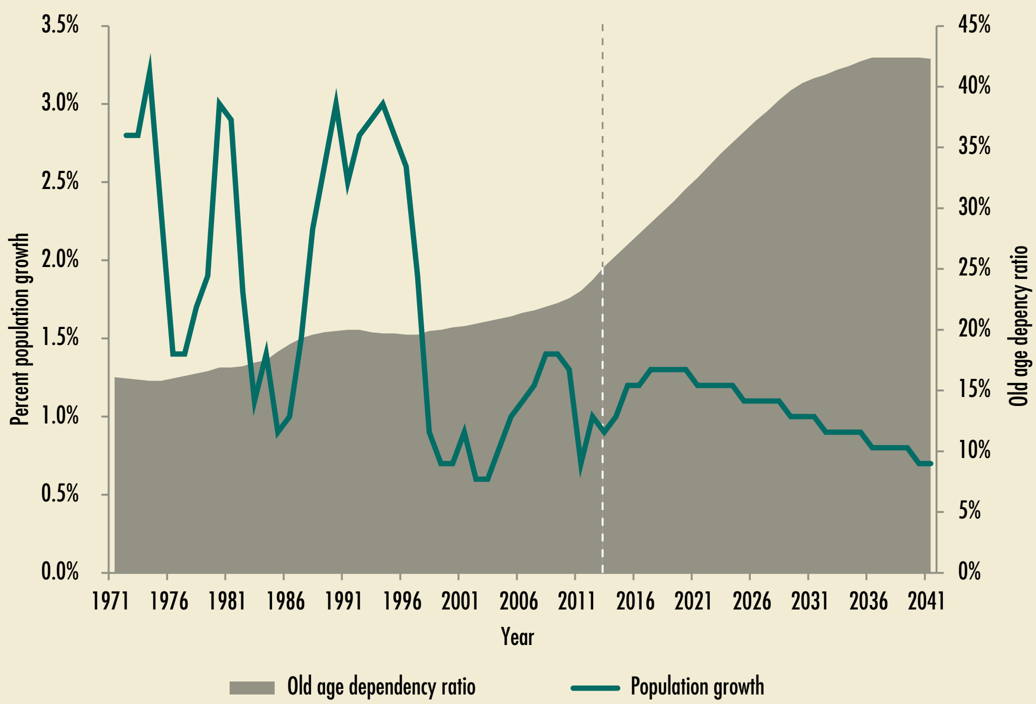
For decades, population growth of the working age population has been a major component of economic expansion. However, decline in total fertility rates since the late 1950s, coupled with increased life expectancies over the last 80 years, means the *old age dependency ratio* is increasing. Exhibit 1 presents for B.C. the historical (to 2013) and projected decline in population growth and increase in the old age dependency ratio. An increasing old age dependency ratio is expected to result in slower economic growth, which will challenge government's ability to generate revenues from taxation and other sources.

The aging and elderly on average also use government services to a greater extent than the younger population. This means that at the same time governments are expected to experience challenges generating revenues, they will also experience cost pressures related to the delivery of services.

OLD AGE DEPENDENCY RATIO

The old age dependency ratio is the number of dependents divided by the working-age population. Dependents are people over 65 years of age. The working-age population is the number of people between 18 and 64 years. This ratio shows us the size of the dependent population as a proportion of the working age population, who usually provide social and economic support.

Exhibit 1: B.C. old age dependency ratio vs. population growth (actual to 2013 and projection to 2041)



Source: Prepared by Office of the Auditor General of British Columbia using BC Stats data

DETAILED REPORT

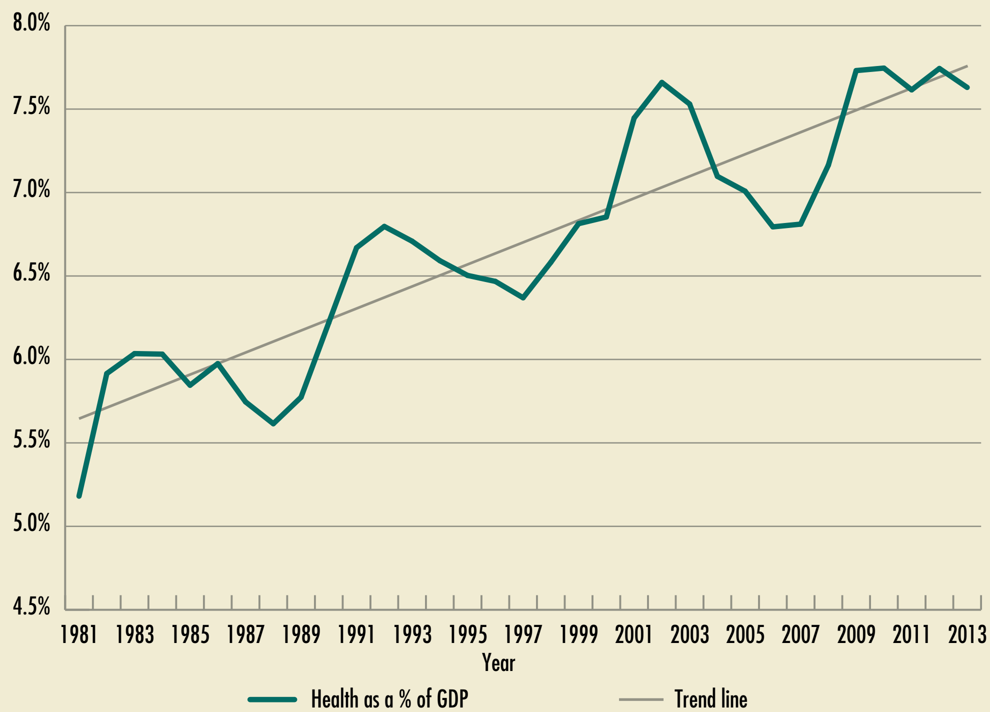
Health care costs

As discussed above, the PBO highlighted health care related costs as a risk to the fiscal sustainability of provincial governments. The Canadian Institute of Actuaries also reported that without significant government intervention, the Canadian health care system, in its current form, is not sustainable.[6] Both the PBO and the Canadian Institute of Actuaries report that reduced escalation of the Canada Health Transfer will result in significant pressure on provincial budgets and health care sustainability in future years.

THE GROSS DOMESTIC PRODUCT

The Gross Domestic Product (GDP) of an economy represents the total dollar value of all goods and services produced over a specific period of time. GDP may be inflation adjusted (real GDP) or not adjusted for inflation (nominal GDP). While its measurement is complex it can be thought of as a measure of the size of an economy. As GDP changes, so does a government's ability to generate revenues from taxation and other sources to pay for programs and service debt.

Exhibit 2: B.C.'s health care expenses as a percentage of GDP from 1981 to 2013 with trend line



Source: Prepared by Office of the Auditor General of British Columbia using StatsCan B.C. Economic Accounts Data and expenditure data from the Canadian Institute for Health Information

[6] Canadian Institute of Actuaries. Sustainability of the Canadian Health Care System and Impact of the 2014 Revision to the Canada Health Transfer. September 2013.

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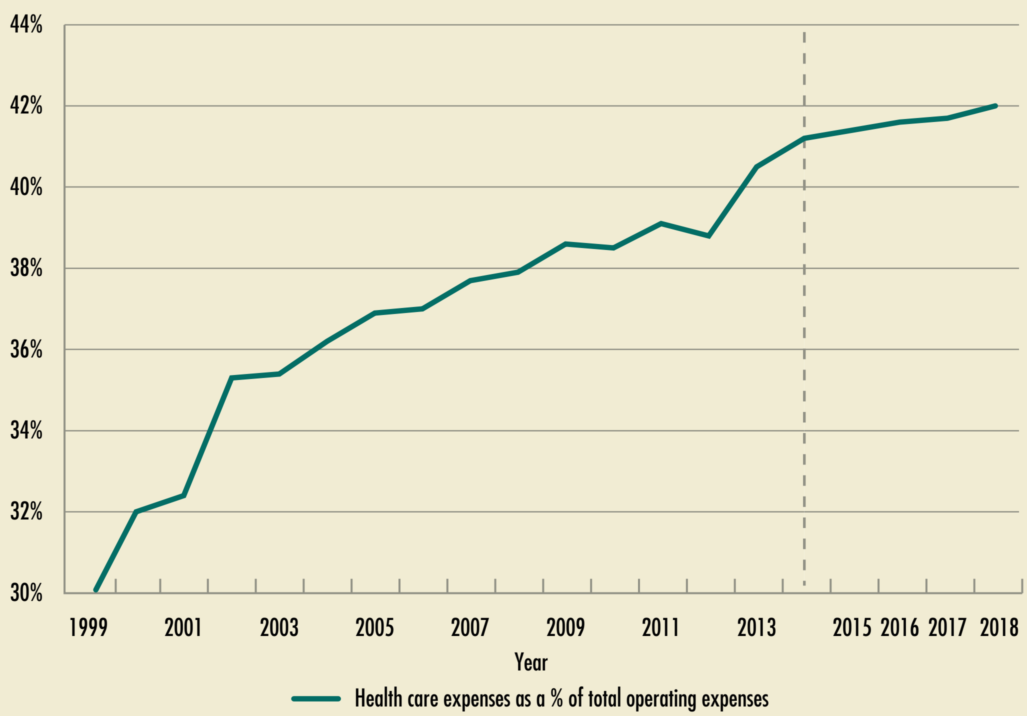
As health is the most significant component of overall spending in B.C., pressures within the health care system can have significant impacts on government's long-term fiscal sustainability. As shown in Exhibit 2, B.C. government health care expenses have been growing as a percentage of GDP. This trend is also consistent with the provinces as a whole; the PBO recently reported that for all provinces, health care spending as a percentage of GDP rose from 5% in 1975 to 7.4% in 2013.[7] As discussed later in the report, the B.C. government projects that health care spending growth will be less than GDP growth for the three fiscal years ending March 31, 2016 to 2018.

In B.C., health care expenses have also been growing faster than overall expenses and revenues. Health expenses made up 30% of total B.C. government expenses in 1999, and by 2014 it had grown to 41% (see Exhibit 3). What these changes demonstrate is that health care expenses have grown faster than both the economy and overall government operating expenses (and revenues). If B.C. is to maintain long-term fiscal sustainability, the growth in health care costs cannot exceed the growth in GDP and government revenues over the longer term.

Exhibit 3: Health care expenses as a percentage of total operating expenses by fiscal year ended March 31st (actual to 2014 and planned to 2018)



Source: Prepared by Office of Auditor General of British Columbia using data provided by the B.C. Ministry of Finance

7 PBO. Fiscal Sustainability Report 2014. September 2014.

DETAILED REPORT

Capital asset maintenance and renewal

The government of B.C. reported capital assets with a net book value (see definition box below) of $61.3 billion dollars as of March 31, 2014. This includes land, buildings, highway infrastructure, electrical generation infrastructure (BC Hydro), computer hardware and software, and other capital assets. With the exception of land, all of these assets have a limited useful life. The significant cost and importance of capital assets means it is an area of risk. This risk is compounded by the complexity involved with understanding the current condition of capital assets, and how capital asset and infrastructure needs will change in the future.

NET BOOK VALUE

The value at which an asset is recorded in the summary financial statements. It represents the cost of the asset less the accumulated recognition of amortization to reflect the depletion or use of the asset over time.

Municipal governments are also responsible for maintaining and renewing their significant stocks of capital infrastructure. While this is not the direct responsibility of the province, as discussed earlier, the interrelationships between levels of government and their common responsibility to citizens means that risk at the municipal level also needs to be considered in the province's assessment of future fiscal risks.

Climate change

B.C.'s economic base is its great endowment of natural resources. However, rising sea levels, shifting weather patterns and increasing ferocity and frequency of weather events are likely to impact key economic sectors, and the lives of many British Columbians. Forestry, mining and other natural resource exports, as well as tourism, transportation and agriculture, all face uncertainty and risk from climate change.

Preparing for Climate Change – British Columbia's Adaptation Strategy states that the Government of B.C. will increasingly need to consider climate change when protecting health and safety, maintaining public infrastructure, managing natural resources, and achieving environmental, social and economic sustainability. Smart investments that consider current climate hazards and future climate risks will reduce long-term costs for infrastructure, and contribute to the maintenance and protection of societal goods and services.[8]

[8] Preparing for Climate Change – British Columbia's Adaptation Strategy Feb 2010

DETAILED REPORT

GUIDANCE ON FISCAL SUSTAINABILITY REPORTING

Over the past few decades, there has been growing recognition of the importance of a long-term outlook, and both guidance on, and the practice of, reporting have evolved considerably. Guidance on fiscal sustainability reporting is discussed below and additional information on reporting practices in other jurisdictions is included in Appendix A.

In 2002, both the International Monetary Fund (IMF) and the Organization for Economic Co-operation and Development (OECD) published guidance that recommended a longer-term outlook. OECD recommended that governments prepare a long-term report at least every five years to assess the budgetary implications of demographic change and other potential developments over the next 10 to 40 years.[9] IMF similarly recommended the use of longer-term projections to assess sustainability.[10] Since 2002, IMF, OECD and other organizations have continued to develop guidance and the practice of publishing fiscal projections and reporting on long-term fiscal risks has increased significantly.[11]

In 2009, OECD issued the policy brief *The Benefits of Long-term Fiscal Projections* which defines fiscal sustainability as "a multi-dimensional concept that incorporates an assessment of solvency, stable economic growth, stable taxes, and intergenerational fairness. It has not only financial implications but also social and political ones related to both present and future generations". The brief states that monitoring trends in government debt is an important indicator for the medium term, but is not a sufficient measure of fiscal sustainability. This is because fiscal pressures over the long term are based on factors such as demographic change, global climate change and other

THE INTERNATIONAL MONETARY FUND

The IMF is an organization of 188 countries, working to foster global monetary cooperation, secure financial sustainability, facilitate international trade, promote high employment and sustainable economic growth and reduce poverty around the world. The IMF supports its member countries by providing policy advice, research, forecasts and analysis, and by providing loans to countries to help overcome economic difficulties.

ORGANIZATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

The OECD's mission is to promote policies that will improve the economic and social well-being of people around the world. They undertake studies and perform analyses to predict future trends that affect businesses and governments. The OECD provides a forum in which government can work together to share experiences and seek solutions to common problems and understand what drives economic, social and environmental change.

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9 OECD. Best Practices for Budget Transparency. 2002.

10 IMF. Assessing Sustainability. 2002.

11 OECD October 2009 Policy Brief – The Benefits of Long-term Fiscal Projections.

events that may occur in the future. Fiscal projections can help governments respond to long-term pressures and risks in a gradual manner, instead of being forced to adopt sudden policy changes. The OECD brief recommends that fiscal projections tie directly to the annual budget process, and link to other budget practices and procedures. This is to ensure that governments give adequate attention to the fiscal consequences of current policies. Other specific guidance recommends disclosure of key assumptions, sources of data and any changes in methodology. Sensitivity analysis (see definition box below) should also be included to show the impact of potential variability in the assumptions used.

The IMF reported in their Manual of Fiscal Transparency (2007) that "a set of policies is sustainable if a borrower is expected to be able to continue servicing its debt without an unrealistically large future correction to the balance of income and expenditure". The IMF currently has an initiative to develop a comprehensive Fiscal Transparency Code. The code includes principles of practice organized within a four pillar structure (see Exhibit 4), focused on information required for effective fiscal management and surveillance. In August 2014, IMF reported that it had completed work on Pillars I through III.[12]

Included within Pillar III is that governments report on the financial condition and performance of sub-national governments and regularly publish projections of the evolution of the public finances over the long term. The guidance developed under Pillar IV will require adapting the principles of the first three pillars to the particular circumstances of resource-rich jurisdictions.

SENSITIVITY ANALYSIS

Sensitivity analysis is also referred to as "what-if" analysis because it is a tool used in planning and budgeting to manage uncertainties. In sensitivity analysis you start with the most realistic forecast and then vary assumptions to assess the impact on the forecast. This allows the forecaster to consider the impact of the best-case and worst-case scenarios in addition to the most realistic scenario.

Exhibit 4: The IMF's Fiscal Transparency Code will have four pillars of practice

Pillar	Principle of practice
Pillar I	fiscal reporting of financial position and performance
Pillar II	fiscal budgeting and forecasting (medium term)
Pillar III	fiscal risk analysis and management, and principles related to the monitoring, management and reporting of risks
Pillar IV	resource revenue management (When developed, this will provide a transparent framework for the ownership, contracting, taxation, and utilization of natural resource endowments.)

[12] IMF. Policy Paper – Update on the Fiscal Transparency Initiative. 2014.

DETAILED REPORT

In July 2013, the International Public Sector Accounting Standards Board (IPSASB) published the *Recommended Practice Guideline: Reporting on the Long-Term Sustainability of an Entity's Finances.* IPSASB initiated this project in 2008 based on the rationale that financial statements alone cannot satisfy all the requirements needed to assess the future viability of social benefits programing.

Long-term fiscal sustainability, according to the guide, is the ability of an entity to meet service delivery and financial commitments – both now and in the future. The guideline recommends that long-term fiscal sustainability information include projections of future cash inflows and outflows, a discussion of the important elements of long-term fiscal sustainability, and a discussion of the principles, assumptions and methodology underlying the projections. Projections should be prepared on the basis of current policy assumptions, and assumptions about future economic and other conditions. Entities should also report on the capacity and vulnerability of three inter-related dimensions of fiscal sustainability: service, revenue and debt.

INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS BOARD

IPSASB is an independent standard-setting board that develops International Public Sector Accounting Standards (IPSAS), guidance, and resources for use by public sector entities around the world for general purpose financial reporting. While IPSAS is not applied by public sector entities in Canada, it is often looked to for additional guidance when interpreting Canadian Public Sector Accounting Standards.

HOW DOES THE B.C. GOVERNMENT REPORT ON FISCAL SUSTAINABILITY?

Understanding long-term fiscal sustainability requires an understanding of where we are today, where we are headed in the future, and how decisions today are informed by our understanding of future risks. We found the B.C. government reports on most aspects of present day financial condition, on risks related to health care sustainability and on strategies related to growing the economy. However, as the B.C. government does not report publically on its overall long-term fiscal sustainability, it cannot demonstrate how decisions today are informed by a robust understanding of future risks.

Long-term reporting is still in its infancy in many jurisdictions, including most of the other Canadian provinces. However, given the risks emerging on the horizon, an increased focus on long-term fiscal sustainability is becoming more and more important with each year that passes.

B.C. financial condition: Understanding where we are today

Financial condition is a government's present day financial health, measured by its ability to meet service commitments to the public, and financial commitments to creditors, employees and others.

DETAILED REPORT

The B.C. government reports on the financial condition of the province in the annual public accounts, which includes the following:

- Summary Financial Statements
- Financial Statement Discussion and Analysis Report (FSD&A)
- Provincial Debt Summary

The summary financial statements report the financial position (assets less liabilities) at the end of each fiscal year and the annual operating results (revenues less expenses). The operating results are a measurement of how financial position has changed from the previous year. In B.C., government is required by legislation to budget for an annual surplus each year. This means that each year, revenues must exceed expenses, and assets less liabilities must increase over the previous year. This requirement means that annual surplus is often the focus; however, it is only part of the story of financial health that is communicated within the summary financial statements. In June 2014, our Office published the guide *Understanding Canadian Public Sector Financial Statements* to help readers better understand public sector financial statements.

While the summary financial statements contain a wealth of information, to fully understand financial condition and how it has changed, information to supplement the basic financial statements is necessary.

THE PUBLIC SECTOR ACCOUNTING BOARD

PSAB was created to serve the public interest by establishing accounting standards for the public sector in Canada. PSAB also provides guidance for financial and other performance information reported by the public sector.

For this reason, the public sector accounting board (PSAB) has published statements of recommended practice (SORPs) related to the publication of financial statement discussion and analysis[13] and indicators of financial condition.[14]

In the public accounts, the FSD&A includes additional discussion and analysis to supplement the summary financial statements, and enhance understanding of financial position and operating results for the year. The Provincial Debt Summary provides supplementary indicators and information to help a reader better understand the affordability of debt as reported in the summary financial statements. Together, the FSD&A and the Provincial Debt Summary include indicators that are useful in assessing the financial health of the Province.

For a number of years we have provided recommendations on how government's reporting could be improved to better align with PSAB's recommended reporting practices. While government has made improvements and is providing readers with some information they need to understand financial condition, the full story is still not communicated. As a result, for the past three years in our annual report on the public accounts, we have carried forward recommendations that government:

- provide all relevant information within the financial statement discussion and analysis to explain how government performed as fiscal stewards of public funds
- present long-term trend analyses for indicators of financial condition
- continue to expand on reporting of material financial risks and uncertainties

13 SORP-1 financial statement discussion and analysis (PSAB)

14 SORP-4 indicators of financial condition (PSAB)

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Indicators of financial condition

According to guidance from PSAB, the key elements in assessing financial condition are:

- **Sustainability** – The degree to which a government can maintain its existing financial obligations, including service commitments to the public and financial commitments to creditors, employees, and others.
- **Vulnerability** – The degree to which a government is dependent on sources of funding outside its control or influence, or is exposed to risks that could impair its ability to meet its existing commitments.
- **Flexibility** – The ability to meet service and other obligations if circumstances change. For example, the ability to respond to reductions in revenues or increased costs.

Government now reports on most of the indicators of financial condition recommended by PSAB.[15] Appendix B details which indicators were reported for the year ended March 2014 and where they are found. The indicators most relevant to fiscal sustainability are those related to the affordability of debt, and specifically, the ratio of debt to GDP. This ratio is relevant because as GDP grows, so does a government's ability to generate revenues and service debt. In fact, as we discuss later in this report, long-term fiscal sustainability is best viewed as the future trajectory of debt relative to GDP.

As shown in Exhibit 5, following the financial crisis of 2008, the ratio of taxpayer debt to GDP, and total debt to GDP, increased significantly and continued to increase each year. While some of these increases occurred as debt financed operating deficits (when expenses exceeded revenues) the majority related to significant investments in capital infrastructure during this time. As reported in the February 2015 budget and fiscal plan, both taxpayer-supported debt and total debt as a percentage of GDP is projected to decline after the fiscal year ending March 31, 2014.

TAXPAYER SUPPORTED DEBT

Taxpayer supported debt excludes the debt of government business enterprises that are self-sustaining and can service their debt with revenues earned from outside of government. For example, because BC Hydro can service its debt from its own revenues, its debt is excluded from taxpayer-supported debt but is included in the total debt of the province.

It is important to note that during this time the weighted average interest rate on debt declined from 5.9% in 2009 to 4.3% in 2014, offsetting much of the costs associated with higher levels of debt. As a result, the percent of revenues used to pay interest on debt has not changed significantly – for total debt it increased from 4.3% in 2009 to 4.5% in 2014, and for taxpayer-supported debt it decreased from 4.2% in 2009 to 3.9% in 2014. However, if interest rates increase, the cost of future borrowings will increase and the cost of existing debt, where rates are not fixed, will increase. In the March 31, 2014 summary financial

[15] The only indicator recommended by PSAB which is not reported on is the trend in the ratio net book value of capital assets to the cost of capital assets. This is an indicator of how investment in capital assets compares with the depreciation (deterioration) of capital assets.

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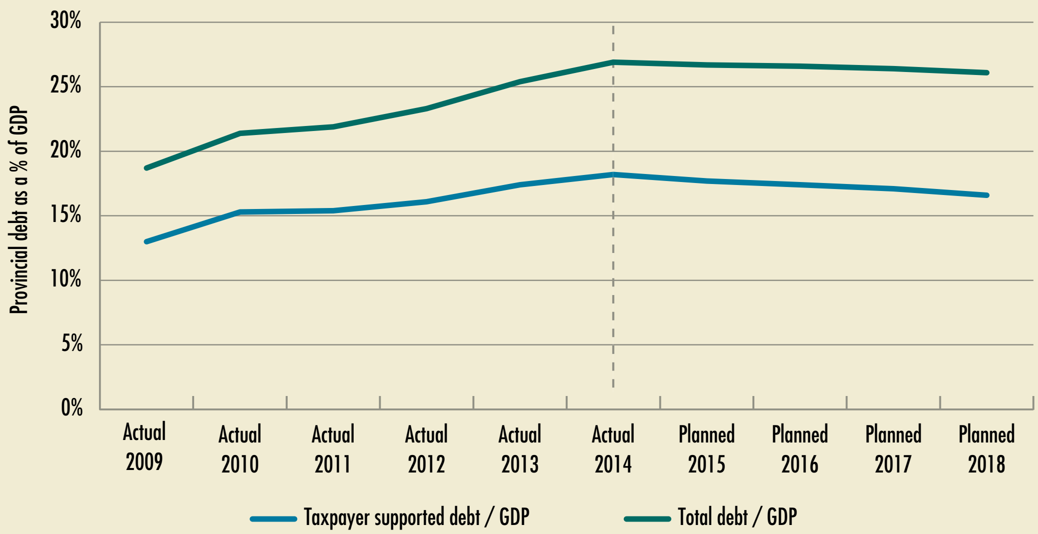
Exhibit 5: Ratio of taxpayer-supported debt to GDP and total debt to GDP (actual to 2014 and planned to 2018)



Source: Compiled by the Office of the Auditor General of British Columbia. Actual results as reported in the public accounts, and planned results as reported in the *Budget and Fiscal Plan 2015/16 -2017/18*.

statements, government reported that a 1% change in interest rates would impact annual debt servicing expense by $139 million.

Although B.C.'s taxpayer-supported and total debt to GDP ratios have increased significantly since 2008, they remain lower than most other provinces. B.C. also has a strong credit rating, when compared with the other provinces, further indicating that B.C.'s current financial condition is still viewed as relatively strong.

These indicators are relevant to understanding present day financial condition and how debt is expected to trend over the next three years of the fiscal plan. However, these indicators do not answer the larger question of whether government can maintain the affordability of debt over the long term, or if significant changes to policies and programs will be required in the future to maintain fiscal balance.

Assessment of tangible capital assets

The cost associated with maintaining and renewing capital assets can have a significant impact on public finances, and therefore, long-term fiscal sustainability. The summary financial statements include information on the original purchase price of assets, and the recognition of this cost over the life of those assets. On its own, though, this information is not sufficient to assess future costs. This is because future costs depend on how well government has maintained assets, and what condition they are in. Also, the historical cost of assets, particularly those acquired decades ago, are no longer a reflection of replacement cost or the capital needs of government in the future.

For these reasons, PSAB published a statement of recommended practice for the assessment of tangible capital assets.[16] PSAB recommends that government provide an assessment of the physical condition for each category of tangible capital assets so that readers can understand:

- the trends in the physical condition
- the adequacy of existing maintenance, replacement and renewal funding
- the extent of current and future revenues needed to maintain, renew and replace tangible, capital assets

PSAB also recommends that government report on the current cost of replacing assets and targets for desired asset condition levels, if applicable. The report should also provide other relevant information, such as planned future investment or risks, and priority investments. Reporting on facility condition can provide comfort to the public that government is not deferring the maintenance of assets into the future.

The B.C. government does not report on asset condition; however, we did note a few B.C. government organizations that report on the condition of their assets. We also note there are few examples of reporting on the condition of assets in other provinces. However, given the significance of tangible capital assets to a government's ability to provide services, supplemental reporting is necessary to fully understand the future cost of maintaining and renewing infrastructure, and the implications this has on long-term fiscal sustainability.

While a review of internal monitoring was not within the scope of this report, we understand that government uses facility condition assessments to inform decision making.

Long-term fiscal sustainability: Understanding where we are headed in the future

The B.C. government does not report on its overall long-term fiscal sustainability. It reports projected finances over the medium term (three years) and on certain risks and strategies relevant to long-term fiscal sustainability.

Budget and fiscal plan

The *Budget and Fiscal Plan* includes the budget for the next year and a forecast of revenues and spending for the two following years, along with high-level social, economic and policy information, and disclosure of forecasting risks and assumptions. It also includes planned and forecasted investment in capital infrastructure, debt levels and indicators of debt affordability (debt to GDP ratio and others). Accompanying the fiscal plan are estimates of the budget broken down by ministry and program area. Each year, government also publishes a supplementary document called the *Financial and Economic Review*

16 SORP-3 assessment of tangible capital assets (PSAB)

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that provides additional information on the state of the economy and the financial results for the past year.

While the budget and fiscal plan reports on the expected future finances of government over the medium term, it does not report on how government will manage risks that emerge over the longer term, such as those resulting from population aging. Government does report elsewhere on certain risks and strategies relevant to long-term fiscal sustainability.

Strategic and economic plans

The B.C. government publishes a strategic plan to accompany the budget and fiscal plan. The strategic plan focuses on a strong economy and fiscal discipline, with the reported objective of ensuring programs are sustainable and affordable. The strategic plan references strategies within the B.C. Jobs plan, which focus on developing and growing the economy and creating jobs. Recognizing that a skilled workforce is the foundation of a growing economy, government has also developed plans aimed at aligning the workforce with the future needs of the economy. The *British Columbia 2022 Labour Market Outlook* reflects the anticipated increase in liquid natural gas (LNG) development and other strategies in the B.C. Jobs plan, and outlines strategies from the *B.C. Skills Blueprint* to align skills training with the future economy.

Health care sustainability

In B. C., legislators and government have identified health care sustainability as a risk and are reporting on the development of mitigating strategies.

The Select Standing Committee on Health is an all-party committee of the Legislative Assembly of British Columbia. The committee is working to identify potential strategies to maintain a sustainable health care system. In the committee's October 2012 interim report the results of a study were published examining the impact of demographic trends to 2036 on the sustainability of the health care system. The committee reported that health care costs had grown as a percentage of the provincial budget for a number of years, and that this growth is expected to continue unless government closes the gap between the growth of health care costs and GDP. The gap between the annual growth of health care costs and GDP was reported to be between 1.0% and 1.5%. In addition to population aging, which is projected to contribute about 1% to annual growth for the next 25 years, the study found there are also other inflationary pressures specific to health care. To identify potential strategies to ensure the quality and sustainability of the B.C. health care system, in the fall of 2014 the committee requested written submissions from the public addressing one or more of the following questions:

- How can we improve health and health care services in rural British Columbia? In particular, what long-term solutions can address the challenges of recruitment and retention of health care professionals in rural British Columbia?
- How can we create a cost-effective system of primary and community care built around interdisciplinary teams?
- What best practices can be implemented to improve end-of-life care?

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- How can we enhance the effectiveness of addiction recovery programs?

Next, the committee will develop potential strategies and identify current public levels of acceptance.

In February 2014, the Ministry of Health published Setting Priorities for the B.C. Health System. The ministry reported that four years ago, B.C. implemented a sector-wide strategy called the "Innovation and Change Agenda" to try and drive meaningful change across the health system. The ministry reported that consolidating services, shared purchasing, and the management of pharmaceutical and laboratory costs had helped to slow the growth in spending. The ministry reported that prior to the agenda's implementation, spending was growing by about 7% a year. By comparison, health care expenses in fiscal 2014 grew by 2.1% and are forecasted to increase by 3.8% in fiscal 2015, and then on average, by 2.8% annually in fiscal years 2016 to 2018.[17] The 2016 to 2018 forecasted health expense growth is more than the forecasted revenue growth (2.0% annually on average[18]), but is less than forecasted GDP growth (4.2% annually on average[19]).

The ministry reported that government is challenged on how to meet the increasing costs of the health care system without raising taxes and cutting programs, but noted that B.C. has been successful in driving down the rate of growth to more sustainable levels. The report presents strategic and operational priorities for the delivery of health services across the province. The vision is to achieve a sustainable health system that supports people to stay healthy, and provides high quality, publicly funded health care services that meet their needs when they are sick. The ministry acknowledges the challenges of maintaining sustainability while continuing to improve quality. Among the challenges discussed, are those related to population aging. These challenges inform the priorities and strategies for the health system as outlined in the report.

Reporting by crown corporations

Although responsibility for overall financial health rests with central government, crown corporations also play an important role – particularly those responsible for managing significant infrastructure. We noted that some crown corporations reported on aspects of fiscal sustainability; however, the only comprehensive long-term plan we noted was BC Hydro's Integrated Resource Plan.

The *Clean Energy Act* requires BC Hydro to prepare an integrated resource plan every five years, setting out its long-term plan to acquire the electricity needed for the next 20 years. BC Hydro must forecast 20-year demand and capacity plans, and how it will achieve electricity self-sufficiency. Additional long-term planning includes an assessment of transmission infrastructure requirements over the next 30 years. BC Hydro has determined there are sufficient resources to meet growing energy demand over the short- to mid-term planning period (2018-2022), but there is a need to acquire new resources toward the middle to end of the planning horizon. BC Hydro has developed a long-term resource planning analysis and framework to aid in making long-term decisions.

17 Budget and Fiscal Plan 2015/16 – 2017/18 – Table A12

18 Budget and Fiscal Plan 2015/16 – 2017/18 – Table A10

19 Budget and Fiscal Plan 2015/16 – 2017/18

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Adjusting course: Understanding how decisions today impact the future

The annual budget and fiscal plan are very important documents that inform legislators' decisions and, once debated and approved by the legislature, set the priorities and spending plan of government. In the budget and fiscal plan, government projects revenues and expenses for the next three years (budgeted for one year and forecasted for two more years) and discusses the management of fiscal pressures and risks over that time period. However, the plan does not address how longer term risks (beyond three years) will impact fiscal sustainability in the future. In other publications, as discussed earlier, government reports on certain risks and strategies important to long-term sustainability (health care sustainability and economic development strategies). However, this does not provide a complete picture of long-term fiscal sustainability risks. And because the information is spread through various reports, it is difficult to access.

The *Balanced Budget and Ministerial Accountability Act* came into force on April 1, 2002, prohibiting the budget and estimates from forecasting an annual deficit. In other words, revenues must be budgeted to exceed expenses each year. Following the financial crisis, this legislation was modified to permit deficits for the years ended March 31, 2010 through to 2013. Government returned to budgeting for annual surpluses in the fiscal year ended March 31, 2014.

A benefit of balanced budget legislation is that it can be easily communicated to the public, and results in an objective benchmark. This increases the public's expectation that a clear financial result will be achieved and reduces the political cost of the decisions necessary to achieve it, such as program spending cuts. A popular argument for balanced budget legislation is that it improves intergenerational equity by preventing a government from borrowing from future revenues to pay for today's program costs.

While there are benefits to balanced budget legislation, it is not sufficient to ensure the province will be fiscally sustainable over the longer term. The Office of the Parliamentary Budget Officer (PBO) recently published a report on balanced budget legislation and how it relates to long-term financial health.[20] The PBO reported that a balanced budget plan for the medium term is neither necessary, nor sufficient, for maintaining fiscal sustainability. This is because sustainability is best viewed as the affordability of debt over the long term. And while there is a relationship between the annual budgetary balance and debt affordability, there are other important factors (see Exhibit 6). The PBO also reported on other unintended consequences that can result from balanced budget legislation (see information box on page 29).

The PBO's report also addressed the importance of managing stability through the economic cycle. The report stated that an effective fiscal framework should provide the flexibility to allow deficit spending during economic downturns, so that government is able to support economic recovery and maintain the continuity of programs. The report discussed options, such as a requirement to balance over a multi-year period to allow the flexibility needed to manage economic cycles.

[20] PBO. Federal balanced budget legislation: Context, impact and design. September 2014.

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Exhibit 6: Factors beyond the annual budget surplus or deficit that impact long-term debt affordability

GDP growth	The growth of GDP determines the affordability of debt as it corresponds with growth in government's ability to generate revenues. For example, if GDP growth is low the affordability of debt may decline even if government is balancing budgets annually. And conversely, if GDP growth is high, the affordability of debt may improve, even when government is experiencing deficit annual budgets.
Capital Investment	Investment in capital infrastructure (and other long-lived assets) is not fully reflected in the annual budgetary balance. For example, if government purchases a building with a life of 50 years, it would pay for the asset in year one, but the expense would be reflected in the annual budgets over 50 years. The result is that debt can rise significantly from capital investment, while government is still able to maintain a balanced annual budget. For the year ended March 31, 2014, the B.C. government achieved an annual surplus, but total debt (net of sinking fund investments) increased by $4.9 billion (8.9% over the previous year) due largely to capital investment.
Demographic change and other long-term risks	As discussed in this report, an aging population impacts both economic growth (because the number of people working decreases) and program costs over the longer term.

A 2005 study of Canadian fiscal forecasting undertaken at the request of the Federal Finance Minister also concluded that if annual balanced budget rules were strictly adhered to, it could require adjustments during economic downturns that would exacerbate economic weakness.[21] This report recommended that government consider adopting a fiscal rule, other than an annual balanced budget rule, that instead would increase the focus on the medium to long-term. Options discussed included achieving a balanced budget over a longer period, encompassing the economic cycle and a targeted maximum ratio of debt to GDP.

These studies illustrate that an annual balanced budget rule can shift the focus away from long-term risks and can have negative implications for fiscal policy and financial management. Therefore, government's assessment and management of long-term fiscal sustainability risks should also consider if balanced budget legislation, in its current form, results in the outcomes intended.

While B.C. has a legislated strict balanced budget requirement, this legislation was adjusted to allow deficit spending for the years ended March 31, 2010 through to 2013. As government has committed that these deficits will be repaid from future surpluses, it is, in effect, managing to a balanced budget over a longer period to accommodate the economic cycle. As discussed earlier, government also publishes a targeted ratio of debt to GDP for the next three years in the budget and fiscal plan. These controls are good tools for managing financial health over the medium term. However, they are not sufficient to ensure risks emerging over the longer term are being managed effectively.

[21] Tim O'Neill. Review of Canadian Federal Fiscal Forecasting: Processes and Systems. June 2005.

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PBO REPORT ON BALANCED BUDGET LEGISLATION

In October 2013, the speech from the Throne opening the second session of the 41st Parliament announced the federal government's intention to introduce balanced budget legislation. In September 2014, the PBO published the report Federal balanced budget legislation: Context, impact and design to help Parliamentarians assess the value of balanced budget legislation and to inform options to increase chances of success.

The PBO reported that while there can be benefits, restricting a government's fiscal discretion by law can have many costs and unintended consequences that outweigh potential benefits. In addition to the implications of a balanced budget requirement for managing economic cycles and fiscal sustainability (as described in this report), the PBO's study made other observations which we believe are relevant to British Columbia, where balanced budget legislation is in place.

Shifts the composition of spending and revenues and encourages creative accounting – compliance with balanced budget legislation can shift spending and the tax mix toward programs that offer quick budgetary successes in the short term, and away from the financially and socially optimal allocation. The effects of reconciliation measures, such as increases in taxes or spending reductions, could have economic or social consequences that outweigh the short-term benefit of balancing the budget. Balanced budget legislation can lead to a bias that shifts the allocation from operating expenses to capital expenditure where the budgetary impact is deferred into the future. It can also influence decisions to structure programs using government business enterprises, loans and loan guarantees or alternative service delivery with private sector partners. These are decisions that should be based entirely on commercial fundamentals, rather than the impact of the accounting on complying with short-term budgetary restrictions.

Encourages disposal of public assets – balanced budget legislation increases the likelihood that assets are disposed of at times and at prices that are not optimal. The PBO referenced studies that found governments facing potential non-compliance with balanced budget laws were more likely to sell public assets. Asset sales to achieve budgetary requirements could lead to a loss in economic and social welfare, if maintaining public ownership, or holding out for higher prices, would be more valuable than immediate budget room. One of the principles for constructive legislation recommended by the PBO is that windfalls from asset sales and shortfalls from unanticipated expenses such as natural disasters should be excluded from the budgetary balance when estimating compliance with legislation.

RECENT OBSERVATIONS IN B.C.

The B.C. government was required to return to a balanced budget for the year-ended March 31, 2014, and one of the strategies for achieving a balanced budget (as described in the fiscal 2014 budget) was the sale of surplus properties, resulting in the recognition of revenues from gains (a gain equals proceeds less cost). For the year ended March 31, 2014, government reported an annual surplus of $353 million, which included revenues of $601 million from the sale of assets. In the previous year, the revenues reported from the sale of assets were only $13 million. This means that government would not have achieved a balanced budget without the additional revenues from the increased sale of assets. The sale of surplus assets continued to be a measure to help balance the budget for fiscal 2015. Budget 2015 also announced that, in order to provide more funding certainty, $107 million in grants for local governments and other recipients would be accelerated into the fiscal 2015 year with corresponding reductions in subsequent years.

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The importance of fiscal forecasting

Consistent with other advanced economies, there are significant risks to the long-term fiscal sustainability of the B.C. government. A key risk relates to the impact of population aging both on the economy through reduced workforce participation and on the cost of programs. It is encouraging that government is publishing information on economic development strategies and on risks and strategies related to health care sustainability; however, this information does not form a complete picture. For example, government does not project the fiscal impact of population aging on both revenues and program costs over the longer term. And it does not project the long-term costs required to maintain and renew capital infrastructure. Therefore, it is not reported whether measures to contain costs in the shorter term are expected to be sufficient for achieving fiscal sustainability over the longer term.

Some may argue that if budgets are balanced and the ratio of debt to GDP is managed over the three year planning window, then government's financial health will be maintained into the future. While this may be true, a key objective of managing fiscal sustainability is maintaining the stability of programs by avoiding crisis and the need to make abrupt changes to programs in order to maintain fiscal balance. Reacting to pressures only once they emerge within the three year planning window is not sufficient, because government programs are very complex and citizens expect that the stability of programs will be protected. This means that changes should occur gradually, and citizens should be informed and consulted as they occur. As this cannot be achieved effectively without a long-term view, public reporting of long-term fiscal sustainability is important not only to inform decisions of legislators, but also to inform citizens of what government is doing to ensure sustainable government programs.

As reported earlier, long-term fiscal sustainability information should include projections of future cash inflows and outflows, a discussion of the important elements of long-term fiscal sustainability, and a discussion of the principles, assumptions and methodology underlying the projections. Projections should be prepared on the basis of current policy assumptions, and assumptions about future economic and other conditions.

Government should report on long-term fiscal sustainability frequently enough so that the information remains relevant. Also, reporting should tie in to the annual budget process, and link to other budget practices and procedures, including legislated budgetary requirements. This is to ensure government gives adequate attention to the long-term fiscal consequences of current policies.

RECOMMENDATION 1: *We recommend that government report publically on its assessment of the province's long-term fiscal sustainability, including the reporting of relevant targets and results. This assessment should inform the annual budget process.*

APPENDIX A:
REPORTING EXAMPLES FROM OTHER JURISDICTIONS

Exhibit 7 : Foreign jurisdictions that report on long-term fiscal sustainability

Country	Statutory reporting obligations	Most recent report	Time horizon	Periodically produced
Australia	Charter of Budget Honesty Act 1998	*Intergenerational report 2015-Australia to 2055: future challenges* (2015)	40 years	3 years
Denmark	EU Stability and Growth Pact	*Convergence Programme Denmark 2014* (2014)	Until 2070	Annually
Germany	EU Stability and Growth Pact	*Long-term sustainability of public finances in Germany: An interim update* (2014)	Until 2060	3 years
New Zealand	Public Finance Act 1989	*Affording Our Future: Statement on New Zealand's' Long-Term Fiscal Position* (2013)	40 years	4 years
Norway	None	*Long-term Perspective for the Norwegian Economy* (2013)	50 years	4 years
Sweden	None	*Sweden's convergence programme* (2014)	Until 2060	Annually
Switzerland	None	*Long-term Sustainability of Public Finances in Switzerland* (2012)	50 years	4 years
UK (Office for Budget Responsibility)	Budget Responsibility and National Audit Act 2011	*Fiscal Sustainability Report* (2014)	50 years	Annually
USA (Office of Management and Budget)	Budget and Accounting Act of 1921	*Fiscal Year 2015 Analytical Perspectives: Budget of the US Government* (2014)	75 years	Annually
USA (Congressional Budget Office)	Budget and Accounting Act of 1921	*The 2014 Long-Term Budget Outlook* (2014)	25 years	Annually
USA (Government Accountability Office)	None	*The Federal Government's Long-Term Fiscal Outlook – Spring 2014 Update*	Until 2060	Annually
USA (Government Accountability Office)	None	*State and Local Government's Fiscal Outlook – 2014 Update*	Until 2060	Annually
USA (Department of the Treasury)	None	*2013 Financial Report of the United States Government*	75 years	Annually

APPENDIX A: REPORTING EXAMPLES FROM OTHER JURISDICTIONS

REPORTING BY SUB-NATIONAL GOVERNMENTS

Ontario

Ontario's Long-Term Report on the Economy is an assessment of the province's fiscal and economic environment and is prepared every four years by the Ministry of Finance in accordance with the *Fiscal Transparency and Accountability Act*. The report's demographic and economic projections highlight the anticipated challenges and opportunities that will affect the province over the next 20 years.

The latest report, published in 2014, identifies demographic and economic trends which illustrate that labour force and economic growth are expected to slow. These trends include: an aging and moderately growing population, increased global competition, rapid technological change, and expanding global trade. Ontario's changing demographics, along with external and internal economic challenges, are also expected to put pressure on the demand for public services. A significant risk noted in the report is declining funding from the federal government, which is shifting more fiscal burden onto the provinces.

Mitigating strategies reported include investments in infrastructure, health care and education that will increase productivity and support economic growth, and strategies to manage cost pressures in the delivery of services.

Australian states

There has been more interest in long-term planning by Australian states than in other commonwealth countries. The following states have released fiscal sustainability related reports:

- Queensland released the report Economic and Fiscal Challenges in 2014 which looks ahead 10 years at challenges in the states' financial position
- New South Wales releases a fiscal responsibility report every five years, the latest release was in 2012 (NSW Long-Term Fiscal Pressures Report) which looks ahead 40 years

The reports listed above discuss state specific economic, demographic and other issues – some of which may differ from trends discussed in national reports. New South Wales created the Fiscal Responsibility Act in 2005, which requires that the state government assess its long-term fiscal gaps every five years. Queensland and Victoria do not have similar legislation requiring fiscal sustainability reporting.

APPENDIX B: INDICATORS OF FINANCIAL CONDITION REPORTED BY B.C. FOR YEAR ENDED MARCH 31, 2014

Indicator	Publication
Sustainability	
5 year trend: Expense by Function	FSD&A (Public Accounts)
5 year trend: Ratio of Expense to GDP	FSD&A (Public Accounts)
5 year trend: Net Liabilities and Accumulated Surplus	FSD&A (Public Accounts)
5 year trend: Non-financial assets as a portion of liabilities	FSD&A (Public Accounts)
5 year trend: Net Liabilities to GDP	FSD&A (Public Accounts)
5 year trend: Taxpayer-supported debt to GDP	FSD&A (Public Accounts)
Credit Rating comparison to other Provinces and Canada	FSD&A (Public Accounts)
Interprovincial comparison of taxpayer-supported debt as a percentage of GDP	Provincial Debt Summary (Public Accounts)
Interprovincial comparison of taxpayer-supported debt service costs as a percentage of revenue	Provincial Debt Summary (Public Accounts)
5 year trend (Total and Taxpayer Supported): Debt to Revenue (percent)	Provincial Debt Summary (Public Accounts)
5 year trend (Total and Taxpayer Supported): Debt per Capita	Provincial Debt Summary (Public Accounts)
5 year trend (Total and Taxpayer Supported): Debt to GDP ratio	Provincial Debt Summary (Public Accounts)
Provincial Credit Rating	Provincial Debt Summary (Public Accounts)
Budget and forecast for the next three years of: ◆ Taxpayer supported, Self Supported, and Total Debt as a percent of GDP ◆ Taxpayer-supported debt per capita	Budget and Fiscal Plan
Flexibility	
5 year trend: Own-source Revenue to GDP	FSD&A (Public Accounts)
5 year trend: Public Debt Charges to Revenue (interest bite)	FSD&A (Public Accounts)
5 year trend (Total and Taxpayer Supported): Public Debt Charges to Revenue (interest bite)	Provincial Debt Summary (Public Accounts)
Budget and forecast for the next three years of: ◆ Taxpayer Supported interest as a percent of revenue (interest bite)	Budget and Fiscal Plan
Vulnerability	
5 year trend: Government-to-Government Transfers to Total Revenue	FSD&A (Public Accounts)
5 year trend: Non-Hedged Foreign Currency Debt to Total Provincial Debt	FSD&A (Public Accounts)

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