



Business Council *of*
British Columbia

**Submission to the
Select Standing Committee
on
Finance and Government Services
in Advance of the
2007 Provincial Budget**

October 17, 2006



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**SUBMISSION TO THE SELECT STANDING COMMITTEE
ON FINANCE AND GOVERNMENT SERVICES
IN ADVANCE OF THE 2007 PROVINCIAL BUDGET**

The Business Council of British Columbia is pleased to provide this submission to the Select Standing Committee on Finance and Government Services outlining our views on the 2007 provincial budget that will be presented next February.

By way of background, the Business Council, established in 1966, is an association representing more than 200 large and medium-sized enterprises. The Council's members are active in all major sectors of the provincial economy, including forestry, mining, manufacturing, oil and gas, petro-chemicals, utilities, financial services, transportation, construction, telecommunications, information technology, hospitality and tourism, wholesale/retail, agri-food, biotechnology and life sciences, film and television production, healthcare, education and the professions. Taken together, the corporate members and associations affiliated with the Business Council account for approximately one quarter of all jobs in British Columbia.

I. ECONOMIC OUTLOOK

British Columbia's economy continues to grow at a healthy pace. Most forecasters believe that the expansion has accelerated from the very respectable 3.5% increase in real GDP recorded in 2005 to something closer to 4% this year. Many indicators point to a still buoyant BC economy. The question now is the outlook for the next couple of years. Here, there is some turbulence on the horizon. The most significant development is the unfolding economic slowdown in the United States. At a minimum, America's economy is headed for a soft patch, with some risk of a more protracted downturn. Given the time-honoured



relationship between BC's prosperity and the state of the world's largest economy, any weakness in the US is certain to dampen growth here. This leads the Business Council to be a bit more cautious than some other forecasters about the province's near-term economic prospects. In contrast to the past two or three years, when everything seemed to be lining up favourably for BC, external economic conditions have deteriorated. Most of the province's growth in 2007 will be propelled by domestic activity, as exports continue to lag.

External Conditions

The global economy is projected to remain relatively strong in 2006-2007, but growth will edge lower as the American economy loses steam. Based on recent evidence, it is likely that by the fourth quarter of 2006 the US will be growing by a modest 2% on an annualized basis. This sets the stage for a soft start in 2007 and, in all likelihood, a very modest US economic growth rate of 2.2-2.5% for 2007 as a whole.¹ Underpinning the US slowdown is the impact of the gradual ramping up of interest rates since 2002, higher energy prices, record levels of household debt, and a weakening housing market. At this stage the decline of the US housing market is the most critical issue from BC's perspective. Sales activity for both new and re-sale homes has fallen sharply, with housing prices now softening as well. In response, US builders have curtailed home construction. Lumber prices have plummeted and now hover near US \$250 per thousand board feet (down from US\$350 in early 2006) – a level where the full 15% export tax under the Canada-US softwood lumber agreement will apply.

Some economists worry that a significant unraveling of the US housing market could occur, with broader negative spillover effects. This concern is largely based on the fact that several years of robust residential construction have boosted the US economy via the direct contribution to output and employment, higher consumer spending on furnishings, appliances and other household items, and the general “wealth effect” of rising home prices. A measured retreat in the housing market would eliminate this source of economic growth. But if the housing market should go into more of a free fall, this would likely put a sizable

¹ See for example Conference Board of Canada, US Outlook (Autumn 2006).



dent in consumer confidence and spending, pushing the US economy into a period of very sluggish growth or even outright recession.

It is important to remember, however, that interest rates today are relatively low, unlike the situation at the peak of previous economic cycles. As well, corporate balance sheets are in good shape and American businesses are still investing. Furthermore, because employment growth during the 2002-2006 US economic expansion has been weaker than in past cycles, payrolls are not bloated. This lessens the likelihood of the large scale layoffs that are often the catalyst for tipping an economy into recession.

Moreover, other external factors should help to limit the global effects of a slowing American economy. One is improved economic conditions in Japan. The ongoing recovery of BC's second largest export market has finally become sustainable. Continued heady growth in China - now the world's second largest economy measured using purchasing-power-parity exchange rates - should provide support for commodity prices and BC's exports, while also fueling more activity in the province's commercial transportation industry. The pace of economic activity in the EU has also picked up. Overall, this shifting dynamic points to greater balance in a global economy that had become overly reliant on US consumption and Chinese manufacturing.

The unprecedented run-up in the Canadian dollar presents a significant challenge to many exporters in BC. In a few short years, the appreciation of the dollar against the US currency has added more than 40% to the cost of many goods shipped to the US, much of which has been absorbed by exporters on this side of the border. In some sectors (e.g., energy and mining), higher commodity prices have provided a cushion for Canadian exporters grappling with the higher dollar. However, with slower US and global growth on tap, the commodity price outlook for the next year or two is mixed.²

² See Scotiabank Global Economic Research, [Scotiabank Commodity Price Index](#) (September 29, 2006), which forecasts generally weaker commodity prices in 2007 compared to the peak levels seen in 2005 and early 2006.



While the rising Canadian dollar has created difficulties for many businesses, the province's export sector as a whole has been fairly resilient. For example, BC's film and television production industry has been able to win new business despite losing much of the US dollar cost advantage the industry previously enjoyed when the loonie was weaker. Many export-oriented businesses in BC have responded to a stronger currency by stepping up investments in productivity-enhancing machinery and equipment and turning to out-sourcing and off-shoring to lower their unit costs and remain competitive. This bodes well for the economy over the medium term.

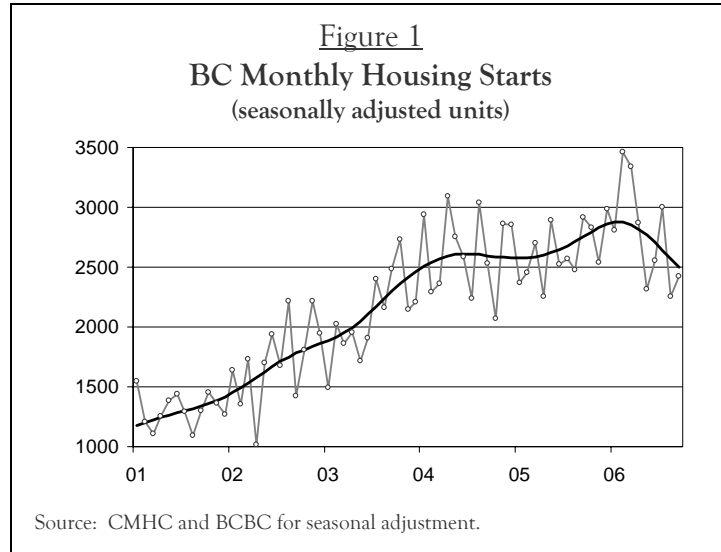
Another factor that should help to keep BC's economy on track is an expected drop in interest rates. As GDP and job growth downshift in Canada, the Bank of Canada is likely to hold its trend setting rate steady for the rest of this year, and begin trimming rates in early 2007. Even though a tighter labour market (especially in the west) has been putting upward pressure on wages, there is no indication that inflation is accelerating. This is partly because the stronger Canadian dollar is helping to keep a lid on inflation by boosting the volume and reducing the cost of imports. And with the US economy weakening, it is possible that the recent decline in oil prices may prove to be more than just a temporary reprieve. All of this suggests that short-term Canadian market interest rates could well dip from just over 4% today to 3.75% in the first half of 2007, with 10-year bond yields slipping to 4% by the end of next year.

Domestic Economic Performance and Outlook

The domestic side of the BC economy will be the predominant engine of growth in the next 18 months. But even here there is evidence that the expansion may be moderating. Most year-over-year comparisons continue to show respectable gains, which is consistent with the expectation of another year of impressive growth in 2006. But the quarter-to-quarter numbers suggest a leveling off of some key indicators – a clue that BC's economy may have lost some momentum. This is likely to translate into a slower start for 2007.



Table 1 summarizes current BC economic indicators. One area to watch is the labour market. Employment in BC is up 3.3% on a year-to-date basis. But since April employment has leveled off: annualized job growth between the second and third quarters was just 0.7%. The recent weakness in job creation is concentrated outside of Greater Vancouver. Slumping lumber markets and lower prices for certain other commodities may be slowing hiring activity in some resource-dependent communities.



	2006 year-to-date % change from same period in 2005	Most recent quarterly % change seasonally adjusted annualized rate
Employment	3.3% (Jan-Sept)	0.7% (Q3 over Q2)
Housing starts	7.5% (Jan-Sept)	-2.9% (Q3 over Q2)
Retail sales	7.7% (Jan-July)	10.0% (Q2 over Q1)
Non-residential building permits	11.1% (Jan-July)	-20.4% (Q2 over Q1)
Manufacturing shipments	3.5% (Jan-July)	-7.1% (Q2 over Q1)
International merchandise exports	4.5% (Jan-July)	-16.2% (Q2 over Q1)
International travelers to BC	-5.8% (Jan-July)	24% (Q2 over Q1)
Sources: Statistics Canada, BC Stats, CMHC.		

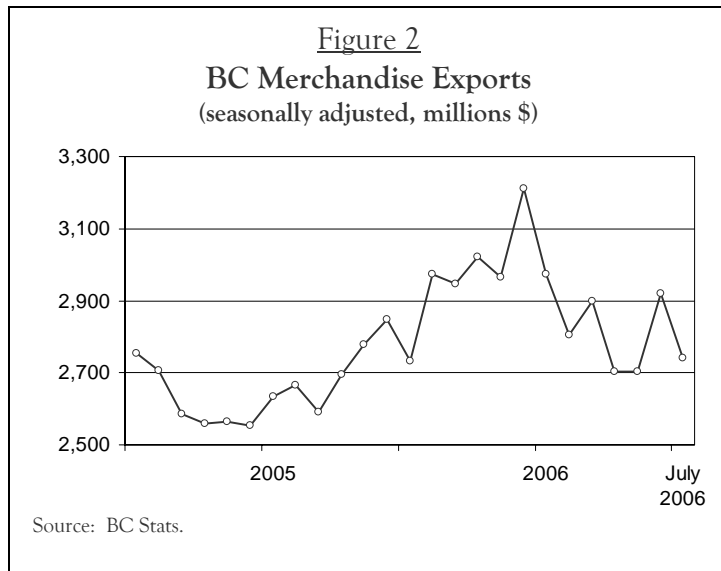
A similar picture is evident in housing starts. Year-to-date figures show an increase of 7.5% over the same period in 2005. But the month-to-month data reveal that the trend-line is edging down. The number of new homes started in the third quarter fell by an annualized 2.9% from Q2. While some of this is due to labour shortages and, in the Lower Mainland, land constraints, it is also consistent with some pull back in home sales.



The dramatic surge in non-residential construction activity in BC has been – and will remain – a major factor driving the current economic expansion. The June 2006 Major Projects Inventory counted 769 significant capital projects worth a record \$102 billion either under construction or planned in BC.³ Contrary to what some may believe, Olympic-related projects represent only a small share of the total. Investment is particularly strong in sectors such as mining, energy and transportation. So far this year, non-residential building permits are up 11% over 2005. But with non-residential construction already booming, the scope for further gains may be limited in the near-term.

Retail sales in BC continue to expand briskly, supported by past employment growth and wage and salary increases. Cumulative spending in retail outlets through July was up 7.2% over the same period in 2005. And the 10% jump in spending between the first and second quarters of this year confirms that BC consumers are still feeling confident about the economy.

The trend-line for manufacturing shipments has turned down, in large part because of falling lumber prices. Year-over-year figures still show a 3.5% increase in overall shipments, but shipment values have been weakening since the beginning of the year.



³ Ministry of Economic Development, News Release (August 21, 2006). Note that the inventory includes both residential and non-residential projects, although the latter are by far the largest component.



Head Offices

A final issue that we want to address briefly in this review of the economic context for the 2007 budget is the worrisome loss of corporate head office jobs in BC generally, and Greater Vancouver in particular.

In July 2006, Statistics Canada published a study of trends in head office location and employment.⁴ The study counted 3,784 “head offices” in Canada as of 2005 (up slightly from 3,633 in 1999). Of these, 443 (11.8%) were located in British Columbia (in 1999, BC’s share of the Canada-wide total stood at 13.1%). Ontario ranks first in head offices (39% of the total in 2005), followed by Quebec (22%), Alberta (15%), and then BC.

Of greater interest, and also concern, is the trend in head office employment. Between 1999 and 2005, employment at the BC-based head offices included in the Statistics Canada study tumbled by 29% – falling from 18,817 jobs to just 13,441. Greater Vancouver, which is home to almost 90% of the BC head office jobs counted in the Statistics Canada study, also saw a 29% decline in head office employment over the same period. Other than Manitoba (which experienced a modest 7.6% decrease), BC was the only province to see a fall-off in head office jobs. And Greater Vancouver stands out as by far the worst performer among major Canadian metropolitan regions in head office employment.

We can only speculate here as to the reasons for BC’s and Greater Vancouver’s poor track record on this important indicator of economic vitality. Consolidation in the forest and mining industries has certainly played a role. In a small number of cases, corporate head offices have been lost following acquisitions of BC-based firms by foreign or other Canadian enterprises. High costs for land and commercial office space in Greater Vancouver, coupled with a paucity of available industrial land, may have discouraged some firms from investing in the region. Finally, the failure of the plethora of municipalities that make up Greater Vancouver to engage in any kind of region-wide collaboration in areas such as economic development, business attraction, investment marketing, or regulatory coordination and

⁴ Desmond Beckstead and W. Mark Brown, Head Office Employment in Canada, 1999 to 2005, Statistics Canada, Catalogue No. 11-624-MIE (July 2006).



streamlining is a particularly glaring weakness of the Vancouver “city-region” that, arguably, has hindered the development of a strong head office sector.

Research shows that a robust head office sector provides substantial economic and social benefits for any region. The loss of head office jobs in BC, and more especially in Greater Vancouver, is alarming. *We recommend that the provincial government take the lead in working with local governments and the private sector to determine the reasons behind the erosion of the head office base, and to consider what options might be available to turn the situation around.*

BC Economic Outlook: Summary

The British Columbia economy looks set to continue expanding at an above average pace over the next two years, although given some of the risks on the horizon this threshold may be tested in 2007. *We see the current consensus outlook⁵ for a 3.7% advance in real GDP in 2007 as on the high side, and thus recommend that the Ministry of Finance stick with its more conservative 3.1% growth forecast.* A slightly stronger economic performance is likely in 2008, as lower US and Canadian interest rates buoy interest-sensitive spending. Uncertainty around the US outlook and its potential impact on the global and Canadian economies poses a challenge for BC budget planners. But in spite of concerns over a softening American economy and the easing of a few domestic economic indicators, record levels of construction, strong investment in the energy, mining and transportation sectors, an improved domestic business climate, rising incomes, sustained consumer optimism, and the run-up to the 2010 Olympics are among the factors that should keep BC’s economy on a solid growth path over the next two years.

⁵ Average of 2007 forecasts from BMO, CIBC, RBC, Scotiabank, TD and CUCBC.



II. FISCAL POLICY

The government has done an excellent job managing the province's finances. Most importantly, it has either met or exceeded all of its annual fiscal targets, a record which has contributed to the turnaround in BC's economic fortunes and paved the way for successive upgrades of the province's credit-rating. The latest positive news on this front came earlier this month, when Moody's Investor Services boosted the province's debt rating from Aa1 to Aaa. As Moody's news release commented, "the rating upgrade reflects the implementation, in recent years, of a well-structured fiscal framework, leading to a reduced debt burden and [supporting] Moody's expectation that further improvements in debt ratios will be realized over the medium-term."

Apart from Alberta, British Columbia is in the strongest financial position in the country, with a meaningful budget surplus and a comparatively low ratio of taxpayer-supported debt to GDP. Based on the September 2006 quarterly update, the government is again on course to beat the targets set in last February's budget. An overall operating surplus of \$1.75 billion (including a \$550 million forecast allowance) is now planned for 2006-07, up from the \$1.45 billion assumed in the 2006 budget. Surpluses in the vicinity of \$1.8 billion are predicted for the following two fiscal years.⁶ These projections are based on a prudent economic forecast, with real GDP growth pegged at 3.6% this year and 3.1% in 2007 - a view that is more cautious than the current private sector consensus.

The level of public sector debt relative to the size of the economy is the main indicator of the province's long-term fiscal health. British Columbia's net or taxpayer-supported debt has been slowly falling as a share of GDP since 2002-03, when it reached 21.3% of GDP (it stood at just 12% of GDP at the beginning of the 1990s). By the end of this fiscal year, the net debt will amount to 15.7% of the province's GDP, the second lowest debt/GDP ratio in Canada. Looking ahead, the government's revised three-year fiscal plan sees the net debt dropping to 14.5% of GDP by the end of 2008-09.

⁶ The out-year surplus figures include forecast allowances of \$550 million in 2007-08 and \$400 million in 2008-09. First Quarterly Report, Fiscal Year 2006/07 (September 2006), p. 3.



Given escalating health care costs and the fiscal pressures that will come with the retirement of the front-end of the massive baby-boom generation, the Business Council recommends that the government continue to focus on reducing the net debt/GDP ratio gradually over time. Because British Columbia's economy should keep growing and the government has committed not to run operating deficits, lowering the net debt/GDP ratio is consistent with continued significant provincial borrowing to pay for capital spending to develop new and refurbish existing infrastructure and other long-lived capital assets.

Expenditure Management

Total provincial government spending in the current fiscal year (2006-07) will reach \$34.6 billion, up from \$32.9 billion the year before, for a 5.3% spending increase. In a period of budget surpluses, it is doubly important that the province maintain a disciplined approach to managing expenditures. Government needs to have the capacity to address new priorities and issues. This calls for an ongoing commitment to expenditure review, and a willingness to reallocate funding from low to higher-priority programs and objectives. *The provincial government should set a goal to control spending such that total program outlays do not increase by more than inflation plus population growth (approximately 4% per year). It should also institute a policy of continuing expenditure review to ensure that existing programs are meeting their objectives and delivering value for each taxpayer dollar.*

The province continues to face spending pressures, notably in health care. Over the current three-year fiscal plan, government outlays will also be rising due to the recently concluded public sector collective agreements. We recognize the need for modest expenditure increases in selected program areas, including family and community supports. The Business Council would highlight post-secondary education and research and workforce skills development as priorities. We note that the BC Competition Council recently drew attention to the benefits of an enhanced provincial commitment to support graduate studies and research at BC's universities, particularly given that Alberta, Ontario and some other provinces have



stepped up investments in this area.⁷ The Business Council believes that strong universities, colleges and technical institutes, coupled with excellence in university research, are critical to driving innovation and the development of a globally competitive knowledge-based BC economy.

A Note on Capital Spending

The government's revised capital plan calls for almost \$5 billion in expenditures this year, followed by \$4.8 billion in 2007-08 and \$4.6 billion in 2008-09. More than two-thirds of capital spending is taxpayer-supported, while the rest reflects outlays by self-supporting Crown corporations like BC Hydro and the BC Transmission Corporation.

As noted above, the Major Projects Inventory indicates a record level of construction underway or planned across the province. There is concern in some quarters that these high levels of building and related project development activity are contributing to an overheated construction market and pushing up construction costs. The Business Council recognizes the need for taxpayer-supported capital expenditures to meet the demands being placed on BC's aging and overburdened infrastructure by a growing population and economy. Continued investment in transportation infrastructure is especially important to the province's economic future. *However, careful management of the government's capital plan is essential in the present environment of rising construction costs and skilled labour shortages. The Business Council recommends that the government review the provincial capital plan and determine whether any modifications are warranted given today's red-hot construction marketplace.*

We also believe the government should continue to look to public-private partnerships (P3s) as a means to tap private sources of capital and expertise to build, finance and operate projects in areas where P3 models make business sense. British Columbia is now recognized as a leader in Canada in using P3s to develop new infrastructure. The

⁷ Enhancing the Competitiveness of British Columbia, Report of the BC Competition Council (June 2006), pp. 8-9.



establishment of Partnerships BC as an arm's-length commercial agency with a mandate to promote and help implement P3s was a key step in this policy evolution. There is a large body of international evidence suggesting that well-structured P3s can yield positive economic benefits, including speedier completion of projects, reduced government borrowing requirements, and the transfer of project risk from taxpayers to private parties. P3s and other kinds of out-sourcing agreements can also assist in building successful, locally-based businesses that are able to leverage the skills and experience developed within BC to sell into the global marketplace, thereby generating future exports and employment for the province.



III. TAXATION ISSUES

To become one of the best places in North America to invest and do business, British Columbia needs competitive taxes. This doesn't necessitate having the lowest taxes, but it does mean keeping tax burdens on investment, highly skilled labour, and other "mobile" factors of production within the range of those imposed by major competing jurisdictions.

Since 2001, the provincial government has reduced personal and business taxes and made the tax system more conducive to investment, productivity growth, and entrepreneurship. Some progress on this front has also been made at the federal level. By Canadian standards, British Columbia today has reasonably competitive income tax rates for both small and large companies; no general capital tax;⁸ favourable tax provisions for venture capital, film production, and mineral exploration; the second lowest top personal marginal tax rate in Canada; and the lowest personal income tax burden in the country for individuals with annual incomes below approximately \$80,000. Still, BC continues to face strong competitive tax pressure from Alberta, the western US states, and some offshore jurisdictions. Further policy changes will be necessary to align BC's tax system with the goals of sustainable prosperity and improved competitiveness.

The aggregate tax burden is one factor shaping the business climate. Currently, provincial government own-source revenues exceed \$30 billion per year, equivalent to slightly more than 18% of gross domestic product.⁹ This adds up to a fairly steep tax burden, particularly since own-source provincial revenues represent less than half of the total taxes paid by BC residents and businesses (the rest consists of federal and local government taxation).

Apart from the overall tax burden, the nature of the tax structure and mix also exerts a powerful influence on capital formation, business growth, work incentives, and many other aspects of economic behaviour. There is a consensus among leading public finance economists that taxes on labour, capital and savings are more damaging to productivity and

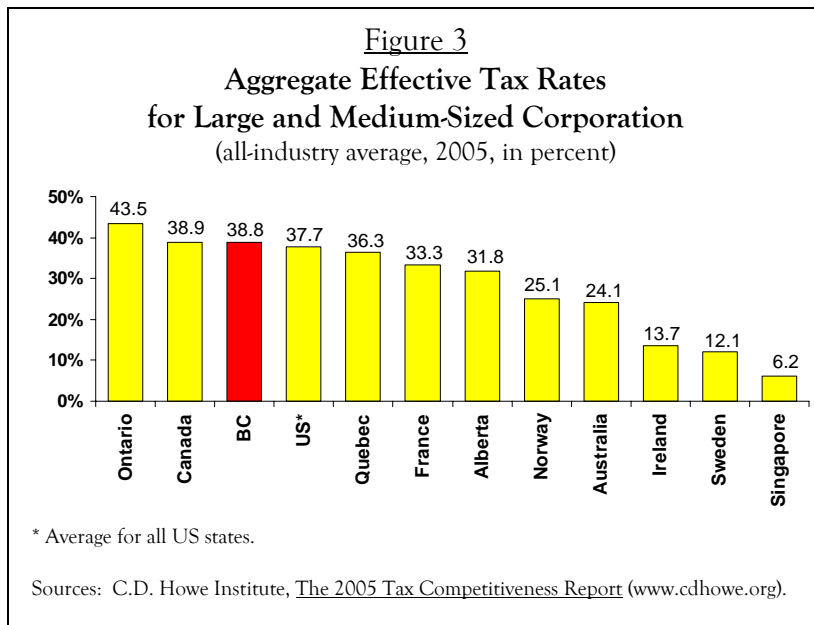
⁸ Except on large and medium-sized financial institutions, which continue to face a tax on capital

⁹ "Own-source" provincial revenues exclude cash transfers received from the federal government, but include the net income of commercial Crown corporations as well as all other provincial revenue sources.



long-term economic growth than taxes on consumption-related activities.¹⁰ In addition, taxes levied in relation to the cost of providing services are often fairer and more efficient than taxes set at a fixed rate. Over time, shifting the tax system toward greater reliance on consumption taxes and user charges would foster a more dynamic and competitive economy, by creating fiscal room to reduce taxes that are more harmful to capital formation, productivity growth, exports, and competitiveness.

On the subject of business taxes, policy-makers need to pay close attention to marginal effective tax rates (METRs), which have a significant impact on capital formation and productivity.¹¹ Unlike statutory tax rates, METRs measure the true tax burden on new business investment in capital assets – equipment, plant, and engineering structures. They take into account not just income taxes, but also capital taxes, sales taxes on business inputs, capital cost allowances, and a host of other tax provisions that affect the



after-tax returns on capital investment. There is a growing body of evidence that METRs influence firms’ investment and location decisions. Unfortunately, Canada maintains among the highest effective tax rates on business investment of all industrial nations.¹² And while average METRs in British Columbia are slightly lower than in Canada as a whole (Figure 3),

¹⁰ See Jack Mintz, *The 2006 Tax Competitiveness Report: Proposals for Pro-Growth Tax Reform*, C.D. Howe Institute (September 2006), and the sources cited therein. Also see the OECD’s latest report on Canada: Organization for Economic Cooperation and Development, *OECD Economic Surveys: Canada* (June 2006), chapter 2.

¹¹ *Ibid.*, pp. 48-50; Jon Kesselman, *Tax Design for a Northern Tiger*, Institute for Research on Public Policy (March 2004), pp. 30-34; J. Mintz, D. Chen, Y. Guillemette, and F. Poschmann, *The 2005 Tax Competitiveness Report*, C. D. Howe Institute Commentary (September 2005).

¹² Jack Mintz, *The 2006 Tax Competitiveness Report: Proposals for Pro-Growth Tax Reform*, C.D. Howe Institute (September 2006), p. 12.



the tax burden on new capital investment by medium-sized and large enterprises is still high by both North American and OECD standards. In part this reflects the imposition of provincial sales tax on business inputs, an issue that is discussed below.

Tax Reduction Priorities for the Short- and Medium-Term

As it reviews possible tax changes, the Business Council recommends that the government carefully consider the proposals outlined below.

i) Business Taxes

BC's current statutory corporate income tax rates are 4.5% for small businesses and 12% for all other businesses. The provincial government's September 2005 decision to trim the corporate income tax rate from 13.5% to 12.0% was a welcome step. We do not recommend further corporate tax cuts in the 2007 budget. However, as Alberta brings its corporate tax rate down to 8.0% in the coming years, BC should be prepared to make further adjustments so that the gap with Alberta does not widen. The Business Council endorses the BC Competition Council's recommendation that the government ensure that BC's corporate income tax rate does not exceed 125% of Alberta's rate.¹³

Another important tax policy issue emphasized by the BC Competition Council is business property taxation.¹⁴ Province-wide, the average property tax ratio (the tax rate on business properties relative to the residential class rate) has risen from 2.5 to 3.7 since 1990. In some municipalities, the ratio of industrial to residential property taxes is much higher – more than 10 to 1 in a few cases. Most property tax is collected by municipalities, but regional authorities and the provincial government¹⁵ also levy property taxes. Among the various classes of business in BC, the steepest property tax burdens are imposed on Major Industry, Light Industry and Utilities. Academic studies show that BC's business property tax system discourages investment and acts as a competitive handicap, particularly for capital-intensive

¹³ Enhancing the Competitiveness of British Columbia, Report of the BC Competition Council (June 2006), p. 17.

¹⁴ *Ibid*, pp. 18-20.

¹⁵ The provincial government levies property tax on residential and business properties for school purposes.



industries like pulp and paper, lumber manufacturing, chemicals, and other types of manufacturing.¹⁶ In fact, from a broad competitiveness perspective, BC arguably has the worst business property tax regime in Canada, for three reasons: 1) there are an unusually large number of discrete property classes; 2) municipal governments have an unfettered ability to set tax rates and ratios, leaving them free to shift the property tax burden onto certain types of business; and 3) no municipal board or other appeal mechanism exists to ensure fairness.

According to a recent study, approximately one-quarter of BC municipalities impose property tax burdens on certain categories of businesses (especially Major Industry) that are punitive and far in excess of the cost of providing services to such enterprises.¹⁷ In numerous instances over the past 15 years, as assessment values for industrial properties have declined, municipalities have responded by hiking tax rates to maintain or even increase the revenues collected from such properties. This has served to exacerbate the problem of high industrial property taxes.

*The Business Council believes that change in this area depends on the province showing leadership. As suggested by the BC Competition Council, the government should legislate maximum ratios between municipal property taxes on residential as compared to different classes of business property.*¹⁸ The goals should be to improve tax fairness for businesses and reduce average property taxes for the most heavily taxed sectors, especially Major Industry, in municipalities where such taxes are now excessive. On a transitional basis, the government could consider establishing a fund to assist smaller municipalities that are required to reduce industrial property taxes as a result of the adoption of the proposed provincial policy.

¹⁶ Robert Bish, "Property Tax on Business and Industrial Property in British Columbia: Comparisons and Business Climate Observations," University of Victoria School of Public Administration, Working Paper #11 (October 2003).

¹⁷ Ibid.

¹⁸ Since 1997, the province has limited the tax rate that may be applied to the Utilities class to the greater of \$40 per \$1,000 of assessed value, or a rate 2.5 times that charged to the Business and Other tax class.



A third business tax issue is the levying of provincial sales tax on business inputs. Taxing production inputs undermines competitiveness, especially in the case of industries that produce tradable goods and services. At present, BC imposes a 7% sales tax on a diverse mix of business inputs. Indeed, in some 40% of total provincial sales tax revenue is derived from the taxation of goods and services purchased by businesses as part of their production activity. Taxing business inputs adds to the cost base of all BC industries and discourages new investment. The province does provide an exemption for business purchases of machinery and equipment used in manufacturing and resource processing. *Beginning with the 2007 budget, and then continuing as fiscal circumstances allow, the Business Council recommends that the government extend this limited PST exemption to additional categories of business inputs, including machinery and equipment used in non-manufacturing industries, business purchases of information and communications technology products, and energy.*¹⁹

Unfortunately, adding more exemptions to the PST brings its own problems, notably the further complication of an already complex BC sales tax system. *From a longer-term perspective, the province should look at replacing the current sales tax with one based on a value-added model.* This could be done either by adopting a BC-specific value-added-tax or by harmonizing the province's sales tax with the federal Goods and Services Tax. A value-added tax would reduce tax evasion, simplify the sales tax system, yield administrative savings for government, and enhance the province's competitiveness by removing all sales tax from the cost base of businesses.

A final area where reform of BC's current business tax policy is needed relates to the imposition of the capital tax on financial institutions. As noted by the BC Competition Council, "any form of capital tax is unfriendly to investment and an inhibitor to growth."²⁰

¹⁹ According to a recent OECD study, reducing/removing provincial sales tax on capital inputs is the most important step that provinces which maintain their own sales tax regimes can take to lower METRs. See Organization for Economic Cooperation and Development, *OECD Economic Surveys: Canada* (June 2006), chapter 2.

²⁰ *Enhancing the Competitiveness of British Columbia*, Report of the BC Competition Council (June 2006), p. 21.



The financial services industry is both a large employer and a dynamic economic sector that is rapidly evolving on a global scale. *The Business Council recommends a three-year phase-out of the capital tax on financial enterprises.* Eliminating the capital tax would foster the growth of high-paying jobs in BC's financial services industry, encourage exports of high-value financial services, and support the efforts of the International Financial Centre to build a stronger financial services sector in British Columbia.²¹

ii) Personal Taxes

Personal income taxes in British Columbia are not unreasonable by Canadian standards. BC has the second-lowest top marginal tax rate in Canada (after Alberta) and the lowest PIT rate in the country on low- and middle-income earners. However, the province faces stiff competition to attract and retain skilled knowledge workers in many technical, professional, and managerial occupations. And as highlighted by the BC Competition Council, the PIT burden in BC is appreciably higher than in Alberta for skilled workers earning more than approximately \$88,000 per year. *We support the Competition Council's recommendation that the government reduce PIT rates for taxable incomes between \$67,000 and \$150,000, such that BC has the lowest rates in Canada for everyone with incomes below \$150,000.* The estimated cost of this proposal is \$200 million per year.

In November 2005, the federal government announced that it would introduce an enhanced personal income tax credit to help equalize the tax treatment of dividends and other types of investment income. This federal proposal requires that the provinces participate in order to deliver parallel enhanced dividend tax credits. *The Business Council recommends that the provincial government proceed with its recently announced plan to make BC's approach to dividend taxation consistent with that of the federal government.*²²

²¹ The estimated cost of eliminating the capital tax on financial institutions is \$100 million.

²² Ministry of Finance, Information Bulletin (October 10, 2006).



iii) Other Taxes

Finally, the Business Council also recommends that the government commit to two additional tax policy changes in the 2007 provincial budget:

- *Extension of the existing provincial Scientific Research and Experimental Development tax credit program to all companies that carry out qualifying R&D in British Columbia;* at present, the program is restricted to Canadian-controlled private corporations, which makes little sense if government's objective is to encourage private sector R&D.²³
- *Reduction of aviation fuel taxes.* At present BC has among the highest aviation fuel taxes in North America. This puts our airports at a competitive disadvantage and runs counter to the government's strategy to fortify BC's position as a Pacific Gateway. The province previously lowered fuel taxes for international and US flights, and eliminated the tax on the international cargo payload portion of mixed passenger/cargo flights. As a result, YVR and some other BC airports were able to attract additional international business. Eliminating aviation fuel taxes for international and US flights, coupled with a reduction in the tax to the 1.5 cents/litre rate now charged in Alberta for domestic services, would generate substantial benefits for the transportation and tourism sectors.²⁴

²³ This recommendation would likely cost the government no more than \$10 million per year.

²⁴ The estimated cost of this measure is less than \$30 million per year, and this assumes (unrealistically) that the province would gain no additional aviation business.



V. CONCLUSION

With 2006 drawing to a close and the date of the 2007 budget fast approaching, British Columbia is in an enviable economic position. Along with Alberta, it is leading the country on many economic indicators and benefiting from still solid global demand for energy and some other industrial raw materials. The unemployment rate is near a three-decade low, job vacancies are plentiful in many regions, and aggregate disposable income has been increasing at an impressive pace.

Looking ahead, a number of factors point to a generally positive economic outlook for the province, notwithstanding a scenario of slower US growth:

- Record levels of current and planned non-residential construction activity.
- The continued expansion of BC's diverse energy sector – oil and gas, related services and infrastructure, plus the development of new independent power projects as a result of BC Hydro's recent successful call for power – coupled with the ongoing growth of mineral exploration and the prospect of developing several new mines.
- Strong economic growth in Asia, including the recovery in Japan, BC's second biggest export market.
- A steadily increasing population, which is supporting housing demand, retail sales, and other domestically-focused service industries.
- A more attractive business climate due to previous provincial tax reductions, regulatory reform initiatives, sound fiscal policy, and a significant improvement in the government's underlying financial position.
- The economic stimulus associated with the 2010 Olympic and Paralympic Winter Games.

All of this creates an encouraging backdrop for the 2007 BC budget. We urge the government to use the forthcoming budget to unveil additional policy measures to stimulate long-term investment and business growth, boost productivity, accelerate the development of



an increasingly skilled and well-educated work force, and reinforce British Columbia's emerging position as one of Canada's economic pacesetters

The Business Council appreciates the opportunity to appear before the Legislative Standing Committee on Finance and Government Services.

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