



Business Council *of*
British Columbia

**Submission
in Advance of the
2007 Federal Budget**

January 22, 2007



Business Council of British Columbia

The Business Council of British Columbia is pleased to provide our views on the upcoming federal budget. Established in 1966, the Business Council is an association representing more than 200 large and medium-sized enterprises engaged in business in British Columbia. Our members are drawn from all major sectors of the provincial economy, including forest products, mining, manufacturing, transportation, agri-food, telecommunications, information technology, financial services, energy, utilities, tourism, retail, construction, biotechnology and life sciences, engineering, healthcare, education and the professions. Taken together, the corporate members and the associations affiliated with the Business Council are responsible for one-quarter of all jobs in British Columbia.

1. Economic Setting and Outlook

From the vantage point of January 2007, the prevailing outlook among forecasters is for the global economy to post solid growth through 2008, albeit at a slower pace than the impressive 5.1% expansion recorded last year. Global output should increase by around 4% in 2007, led by a moderation in economic activity in most industrialized economies. In North America, real GDP is projected to advance by a subdued 2.5%, before climbing to 3% or more in 2008. Growth in Japan is likely to edge below 2% this year. The overall Eurozone economy is expected to follow a similar path. Even the frenzied expansion in Asia should ease a bit, with China's growth rate expected to dip slightly below 10% over the next two years. At the same time, growth in the other Asian emerging economies taken as a whole will likely downshift from 5% plus last year to the 3.5%-4.0% range in 2007.

With many exporting countries still dependent on the American market, the slowdown south of the border is an important factor shaping the global outlook. US economic growth came in at a modest 2.0% (annualized) in the third quarter, and may have slowed further in



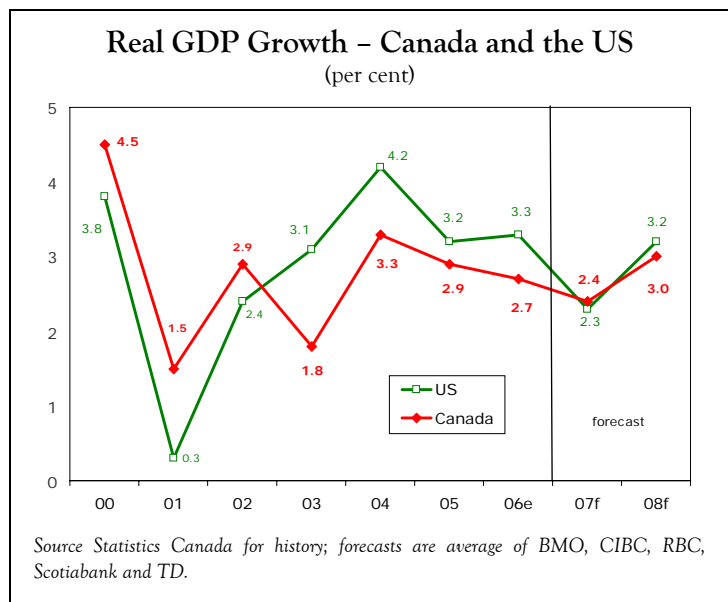
Q4. Although some recent data hint at a near-term upturn, there was little economic momentum heading into 2007. This sets the stage for below-trend US growth in the vicinity of 2.2%-2.4% for the coming year.

Part of the US deceleration reflects the maturing of the business cycle, as the world's largest economy moves from a recovery phase to a mid-cycle expansion. Weaker housing markets, the lagged effect of past energy price hikes, and tighter monetary conditions are all taking a toll. Faced with heightened global competition and rising inventories, the US manufacturing sector is also struggling. These developments, and in particular lingering worries about a further deterioration in the housing sector, present a downside risk for the US in 2007.

There is also some good news, however. Employment in the US has held up remarkably well and the unemployment rate remains low (4.5%). Business investment is robust and corporate balance sheets are healthy. US exports are also on the rise. By the second half of 2007, a lower US dollar, the effects of retreating energy prices, and the likelihood of a cut in interest rates should underpin a gradual improvement in economic conditions.

Mirroring developments in its primary trading partner, Canada's economy has lost momentum over the past two quarters, and appears on track for real GDP growth of 2.3%-2.5% this year, down from an estimated 2.7% in 2006. A key

difference vis-à-vis the US is that the economic softness in Canada is concentrated in the export sector. Many Canadian manufacturers are weighed down by factors such as a still strong dollar, declining North American automobile production, intense offshore competition, and sagging lumber prices caused by slumping US housing starts.





On the other hand, bolstered by ongoing job and income gains, domestic demand has stayed buoyant. Business investment in both machinery and equipment and structures has become a major growth driver. The higher dollar has been encouraging Canadian firms to invest in (mainly imported) machinery and equipment, thus laying the foundations for improved productivity going forward. The extended economic upswing in the western provinces is now being propelled by exceptionally brisk investment in non-residential structures.

While the residential sector is finally slowing, Canada's housing industry is on course for a soft landing. In contrast to the US, housing starts are down only moderately and home prices are stable – and in some regions still climbing. There is also less speculative activity than in the US, where mortgage defaults are climbing.

In fact, in broad macroeconomic terms, Canada is in better shape than the US. Our consumers are less stretched, the housing market poses fewer risks, inflation is lower, the current account is in surplus, and the public sector is not burdened with a large deficit.

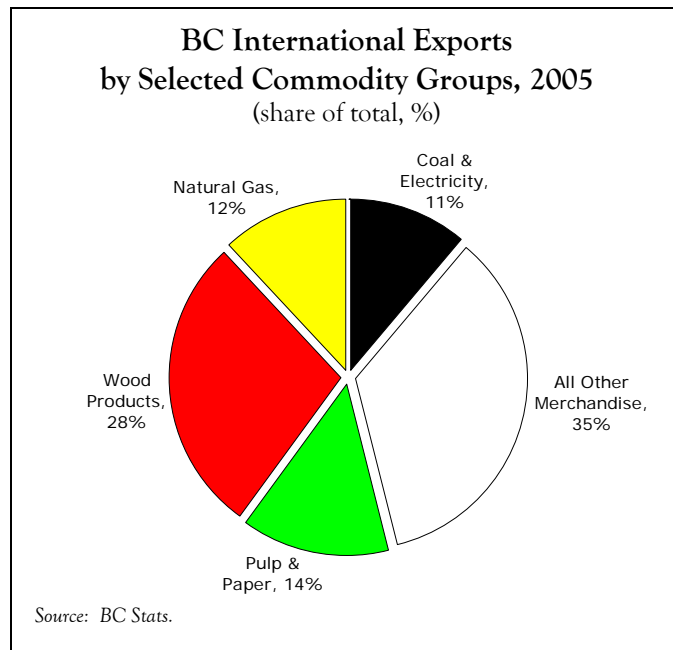
The Business Council recommends that the government adopt a cautious economic outlook in developing the 2007 federal budget. Even though there are signs that the shaky US housing market is stabilizing, another down-leg is a possibility, creating the prospect of more pronounced spillover effects on consumer confidence and spending than have been evident to date.

2. Focus on British Columbia

In the wake of the strongest multi-year expansion since the late 1980s, economic growth in BC is set to moderate in 2007 but will remain comfortably above the long-term average. The Business Council forecasts 3.4% growth in 2007, followed by slightly bigger gains in 2008 and 2009. Although these projections are down from an estimated 4.3% increase in real GDP last year, they should be enough to keep British Columbia near the top of the provincial growth rankings for the next few years.

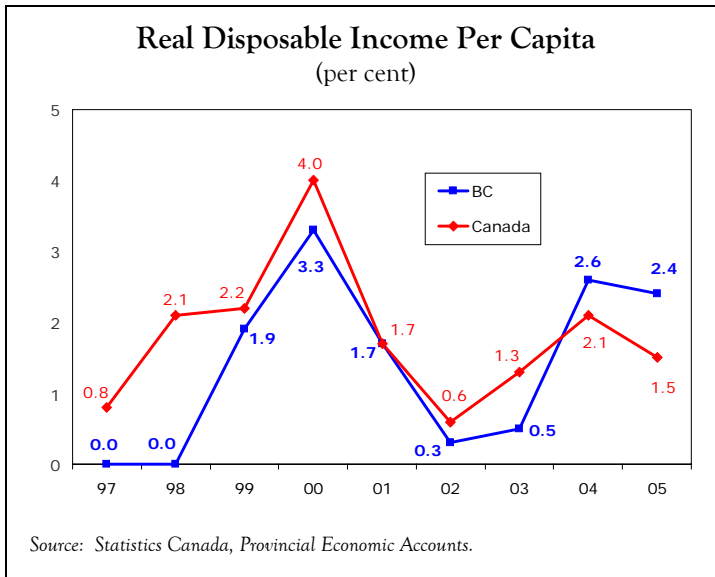


In spite of robust domestic demand, BC is not immune from the economic slowdown unfolding across North America. As with Canada, exports are the main weak spot. Lumber and other wood products account for almost 30% of the province's international merchandise exports, so the US housing downturn is a significant negative factor. Falling energy prices mean that BC's natural gas exports are also likely to be weak in 2007.



That said, BC's increasing exposure to the Asia-Pacific region augurs favourably for its economic prospects. China's booming economy continues to fuel demand for a wide range of resource products. The rising volume of Chinese and other Asian manufactured goods being shipped to North America is giving a lift to transportation, logistics and other Gateway-related industries in British Columbia. Japan's improved economic fortunes are another positive, with BC's exports to Japan increasing for three consecutive years after a decade of steady decline.

On the domestic side of the economy, a few soft spots are contributing to the economic easing. New home construction is set to slip, following several years of robust growth. Non-residential investment, however, is expected to continue at or near record levels. In addition, the labour market is strong and personal consumption is growing at a healthy clip. Incomes have also been on an upward trend, mainly thanks to higher wages. Over the past two years, BC has enjoyed faster growth in per capita incomes than most other provinces.



This is a welcome change from the 1990s and the early part of the current decade, when British Columbians saw little increase in real after-tax incomes.

A critical issue for both BC as well as Canada is taking full advantage of the dramatic growth in trade and commerce in the Asia-Pacific region. Led by

China, Asia has become the most dynamic and fastest growing region in the world, accounting for half of the overall increase in global output in recent years. And there is nothing on the horizon to suggest that this pattern is about to change. The combined two-way trade of BC and the rest of Canada with the Asia-Pacific region is almost certain to increase more rapidly than trade with other significant external markets in the coming decade. This marks a departure from the 1990s, when the Canada-US and NAFTA trade agreements triggered a re-alignment of trade toward the United States.

Canada's trade with China has risen sharply. Between 1999 and 2005 the value of Canadian exports to China jumped 135%, compared to a 17% increase in exports to all countries. China is also an increasingly important source of foreign goods entering Canada. The value of merchandise imported from China surged by 230% from 1999 to 2005, whereas the value of total Canadian imports rose just 18%.

Looking ahead, the emergence of China as a major global economic power, coupled with continued strong growth in India and other Asia-Pacific markets, promises to benefit Canada by bolstering Asian countries' demand for many Canadian-produced materials, goods and services and by boosting both Canadian imports from Asia and the numbers of Asian tourists entering Canada. In this context, it is imperative that the infrastructure is in



place to allow Canada's Pacific Gateway to be a competitive and efficient facilitator of the burgeoning two-way trade and commerce between North America and Asia. The Business Council recognizes the significant financial commitment which the federal government has already made to expand transportation infrastructure linked to the development of the Pacific Gateway. However, we believe that further federal commitments of funding as well as political and policy leadership will be necessary if Canada is to realize the economic potential of the Pacific Gateway and Corridor Strategy announced by the Minister for International Trade in 2006.

3. Federal Spending and Debt Management

Within the OECD, Canada boasts an enviable record of almost a decade of federal budget surpluses and a sharply falling debt/GDP ratio. Notwithstanding this, it is important that the federal government stay focused on prudent fiscal management. The November 2006 Economic and Fiscal Update forecasts a modest \$4.2 billion "planning surplus" for 2006-07, with smaller annual surpluses pencilled in through the end of the decade. The Update also projects a further drop in the federal debt/GDP ratio, from 33.3% this year to below 30% by 2008-09 and 25.6% in five years' time. The Business Council is comfortable with the government's debt management targets. However, the estimated planning surpluses are very small relative to the size of the budget and are likely to leave little room for significant new spending initiatives or broad tax cuts beyond those outlined in last year's budget.

The Economic and Fiscal Update predicts that federal program outlays will reach \$187 billion this year, up almost 30% from the level four years ago. This underscores the continued need for disciplined expenditure management. The Business Council suggests the following spending rule: limit future increases in federal program outlays to no more than population growth plus inflation. We also favour the continuing review of program expenditures to ensure that the government has the resources to meet new needs by reallocating money from lower priority areas and scaling back ineffective and outdated programs.



4. Comments on the Advantage Canada Plan

The Business Council applauds the government for setting forth a bold agenda to strengthen the foundations of national prosperity in the Advantage Canada plan released along with the November 2006 Economic and Fiscal Update. The plan outlines the elements of a forward looking strategy to address Canada's lagging productivity and eroding global competitiveness. The task is urgent. Despite a solid showing in overall GDP growth, job creation, and public sector fiscal management, Canada continues to suffer from a sub-par productivity performance and a widening productivity gap with our key trading partner, the United States. Canada has also been steadily losing ground, both within the OECD and on a North American basis, in attracting inward foreign investment, including investment by leading global enterprises in fast-growing industries like pharmaceuticals, medical devices, scientific instruments, machinery and equipment, and information and communications technologies. If these trends continue, Canada risks falling progressively further behind the United States in living standards and becoming an increasingly more marginal presence in the global economy.

The Business Council endorses the broad policy directions charted in Advantage Canada: controlling the growth of federal spending; providing further tax relief for individuals and businesses; modernizing federal regulation and cooperating with the United States in areas where greater regulatory convergence would serve Canada's interests; strengthening incentives for Canadians to work; investing more in skills development, research and infrastructure; and reviewing existing policy frameworks in areas such as competition policy and foreign investment.

Two specific tax proposals outlined in Advantage Canada that would benefit individual taxpayers are to use the fiscal savings arising from falling interest costs on a shrinking federal debt to decrease personal income tax rates, and to develop a new working income tax credit for lower-income earners. Both of these are sound policy suggestions. The Business Council recommends that Budget 2007 also include a multi-year plan to reduce capital gains and withholding taxes.



As for business taxation, Advantage Canada pledges to establish the lowest effective marginal tax rate on new business investment in the G7 by revising capital cost allowances, removing distortions from the tax system, and working to integrate remaining provincial sales tax systems with the federal GST. There is broad support for these proposals within the BC business community. They build on previous federal tax reforms, including reductions in corporate income tax rates and the elimination, in Budget 2006, of the Large Corporation Capital Tax.¹ Smart tax policy must be a central part of any strategy to strengthen Canada's competitiveness and prosperity. Over the medium-term, the Business Council recommends that the government also accelerate the timeframe for achieving the announced reduction in the corporate income tax rate to 18.5% and phase out the capital tax that is still levied on financial enterprises.

The affordability of tax cuts must be considered when weighing the merits of any tax reduction package. We note that the government remains committed to trimming the GST by one point, following the earlier one-point drop implemented in 2006. While many Canadians undoubtedly would like to see a lower GST rate, the tax measures discussed in the two preceding paragraphs would have a bigger positive impact on Canada's productivity and competitiveness than another one-point reduction in the GST. Thus, we recommend that the government re-evaluate its priorities for tax relief to ensure that additional GST cuts will not compromise its ability to proceed with other tax changes that would deliver significant economic benefits over the long haul.

Canada's economic prosperity increasingly will depend on the quality of human capital. The Advantage Canada plan touches on a number of aspects of the human capital challenge, including commitments to provide stable funding to the provinces for post-secondary education, to modernize the current system of student financial assistance, to invest more in graduate student education and support, and to improve the labour market performance of immigrants. The Business Council endorses these policy directions and looks forward to

¹ Capital tax continues to be levied on financial enterprises.



seeing more details on how the government intends to proceed. We suggest that the government move quickly to modify current immigration policies by making it easier to recruit temporary foreign workers, allowing more foreign students attending Canadian post-secondary institutions to stay in the country after graduating, and ensuring that federal immigrant selection criteria are aligned with job market realities, including the pressing need to recruit immigrants with qualifications in the skilled trades and technical occupations.

Regulatory reform is another important focus of the Advantage Canada plan. The government promises to “finalize a new approach to smart regulation” and work with Canada’s NAFTA partners to strengthen regulatory cooperation and coordination. The Business Council fully supports these policy objectives, as well as the specific pledge to reduce the administrative paper burden stemming from federal regulation by 20%. In addition, we urge the government to apply its stated commitment to efficient and streamlined regulation to all spheres of federal activity. This includes, *inter alia*, the new Fisheries Act tabled in December, as well as the proposed Clean Air Act unveiled in the fall. We are concerned that the latter Act, in particular, may lead to an expanded federal regulatory presence in a field where provincial governments traditionally have exercised predominant jurisdictional authority. More generally, as the External Advisory Committee on Smart Regulation noted in its landmark 2004 report, the Business Council believes a concerted effort is required to achieve greater cooperation and reduce duplication and inconsistency between federal and provincial ministries and agencies with similar or overlapping regulatory responsibilities in areas such as environmental assessment, environmental protection, major project development, and fisheries management.

The Business Council appreciates the opportunity to provide our advice and recommendations on the 2007 federal budget.