



Business Council *of*
British Columbia

**Submission
to the
Select Standing
Committee
on Finance and
Government Services
in advance of the
2008 Provincial Budget**

October 11, 2007



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**SUBMISSION TO THE SELECT STANDING COMMITTEE
ON FINANCE AND GOVERNMENT SERVICES
IN ADVANCE OF THE 2008 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 2008 provincial budget that will be presented next February.

By way of background, the Business Council, established in 1966, is an association representing approximately 210 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 one quarter of all jobs in British Columbia.

1. ECONOMIC OUTLOOK AND KEY CHALLENGES

British Columbia's economy continues to grow at a healthy pace. While most current indicators point to a still buoyant domestic economy, near term prospects are somewhat diminished due to a noticeable softening in the export sector. The sharp downturn in the US housing market has sent a chill through forestry ~ the province's largest export industry. While there appears to be enough momentum on the domestic side to keep the overall BC economy on a solid expansion track, the likelihood of protracted weakness in US home building, combined with a Canadian dollar now trading above par relative to the American greenback, has prompted us to adopt a somewhat more cautious stance on the province's outlook.



In fact, some easing in economic conditions is already evident, as most forecasters have trimmed their growth projections for BC to around 3.0% for 2007. This represents a downshift from the 3.6% gain recorded in 2006. We expect similar domestic and external conditions to carry through next year, keeping GDP growth close to 3.0% again in 2008.

External Conditions

At the top of the list of factors shaping the economic climate is the slowdown underway in the United States. While most prognosticators believe the US will avoid a recession, deteriorating credit market conditions, pronounced weakness in the housing market, and preliminary signs that employment has softened are causing forecasters to downgrade their projections. Most recent forecasts see US real GDP growth in the range of 2% this year, down from 3% in 2006, with the outlook for 2008 not much better. One leading forecaster, Global Insight, pegs the odds of a technical recession stateside at one-third. Although the recent 50 basis point cut in short-term interest rates by the US Federal Reserve is a positive development, it is also a sign that American policy-makers are concerned about the economy. History shows that a shift to lower interest rates in the US frequently coincides closely with the onset of a recession.

With wood products accounting for one quarter of BC's merchandise exports, the plight of the US home-building sector is a major worry. Although US home-building activity has already shriveled in response to poor market conditions, housing starts are likely to continue falling for some time. Inventories of new and existing homes remain high, with eight to nine months' supply based on recent sales rates in both segments. Leading forecasters, including Goldman Sachs, anticipate that US housing starts will dwindle through the second quarter of 2008, with the number of homes built next year slipping to 1.1-1.2 million, down from 1.4 million this year and 2 million plus in 2005. Moody's has warned that the housing slump could persist through 2009.

Until recently, reasonably strong job growth, rising business investment, and healthy corporate balance sheets suggested that America's housing difficulties were not spilling over



to other sectors of the economy. But there is some evidence that the US job market may be weakening. On top of this, the re-pricing of risk under way in many segments of the credit market is making it harder for some businesses to secure financing.

Apart from the US housing downturn, the other key external factor clouding the outlook for BC is the currency. Although the move to an even footing with the US dollar made headlines, it is the rise in the Canadian dollar vis-à-vis the US greenback since the start of the year (on top of big gains in earlier years) that is further challenging the competitiveness of many Canadian export sectors - including pulp and paper, tourism, lumber, and film production, all of which are important industries in BC. After retreating to the US 85 cent mark at the end of 2006, the Loonie has climbed nearly 20% so far this year, recently reaching parity with the US dollar. Currency appreciation increases the cost of BC goods shipped to the US, a cost that is typically absorbed by exporters in the form of shrinking margins. If the dollar stays high, over time some Canadian exporters will see an erosion of market share as lower cost competitors take business away from them in the huge American market - still the destination for two-thirds of BC's exports.

Tourism is another sector directly affected by the currency. In addition to border security issues, passport requirements, and higher gasoline prices, the steady rise in the Canadian dollar continues to chip away at the number of US visitors coming to the province. Not surprisingly, same day US visits have fallen off significantly, but the number of US visitors coming for longer trips has also dropped in the first half of the year.

The good news is that the softening US economy may not take a major toll on global economic growth (although the jury is still out at this point). From 2004 through the first half of 2007, the US accounted for just 12% of the total cumulative increase in global output. China alone accounted for 30%, the rest of "developing" Asia contributed another 17%, and emerging market oil exporters added 10%.¹ Having said that, the slowdown in

¹ CIBC World Markets (August 16, 2007).



the US is bound to have knock off effects since it absorbs 21% of China's exports, 17% of South Korea's, and a similar proportion from the rest of developing Asia.²

In the face of a faltering US, Japan's growth rate is likely to be around 2% next year. The EU is expected to post a similar performance. Although Chinese exports will be affected by developments in the US, most analysts expect China's 10% plus growth run to be sustained. Continued solid expansion in many other emerging markets should help to buoy global demand for Western Canadian industrial raw materials, energy and agricultural products.

While dismal lumber markets and low natural gas prices will drag down BC's merchandise exports over the next 12 months, the province's rebounding mining sector and growing role as a Pacific Gateway are helping to offset some of the weakness on the trade side. In addition to building the infrastructure necessary to move goods more efficiently through BC ports (e.g., Prince Rupert container terminal, Deltaport, South Fraser Perimeter Road, plus highway and border infrastructure improvements), BC's booming transportation services and logistics industries are becoming important sources of economic and job growth in their own right.

A Strong Domestic Economy

Last year's impressive economic performance was driven by domestic demand. Non-residential construction is playing a pivotal role in sustaining the province's economic upswing. The most recent Major Projects Inventory finds a record high level of planned investment in significant projects³ across the province. Employment in the broadly defined construction industry has soared by more than 60% since 2001. And Business Council research reveals that six of the ten fastest growing BC industries from 2003 to 2006 were in construction-related sectors.⁴ Residential construction also remains a positive factor, even though housing starts have leveled off after several years of 20% plus annual gains earlier in

² Asia Development Bank, Asian Development Outlook 2007.

³ Defined as projects with a capital cost of \$15 million or higher (\$20 million or higher in the Lower Mainland).

⁴ Measured by real GDP growth from 2003 to 2006.



the decade. With the average price of a home still edging higher, the value of building permits continues to increase, despite little change in the number of starts. To some extent rising permit values reflect a pick up in renovation activity, as more homeowners invest in improvements. In 2006, renovation spending hit \$4.5 billion, an 11% increase from 2005 and the third consecutive year of double digit gains. Recent figures suggest this trend is continuing with renovation spending in BC during the second quarter up 17% over the same period a year earlier.

Personal consumption is the other element underpinning robust provincial growth. BC's economic upswing is translating into sizable job and income gains, which in turn are fuelling additional consumer spending. Following several years of healthy growth, BC retail sales powered ahead another 7.4% in the first half of the year compared to the same six month period in 2006. Spending on consumer services is also advancing briskly.

<u>Table 1</u> Current BC Economic Indicators		
Indicator	2007 year-to-date % change from same period in 2006	2006 % change from previous year
Total Employment	3.2% (Jan-Sept)	3.0%
Construction employment.	9.2% (Jan-Sept)	6.7%
Housing starts	-6.9% (Jan-Aug)	4.3%
Retail sales	7.4% (Jan-June)	6.8%
Non-residential building permits	14.2% (Jan-July)	22.1%
Total Manufacturing shipments (\$)	-0.6% (Jan-June)	2.5%
Manufacturing shipments Wood products (\$)	-17.9% (Jan-June)	-12.3%
Lumber production (cubic metres)	-7.2% (Jan-June)	0.1%
International merchandise exports	-3.3% (Jan-July)	-3.6%
Total International travelers to BC	-5.8% (Jan-July)	-5.2%
US overnight visitors	-1.1% (Jan-July)	0.0%
US same day visitors	-9.1% (Jan-July)	-16.0%
Sources: Statistics Canada, BC Stats, CMHC.		



Structural Factors Cloud Medium Term Prospects

As we move through 2008 and beyond, a number of structural factors will begin to impinge on the province’s economic performance. Although their impacts will unfold gradually and may be hard to quantify, a rising trade deficit, mounting labour shortages, the pine beetle infestation, and a chronically poor productivity record will all curtail economic growth in varying degrees over the next several years.

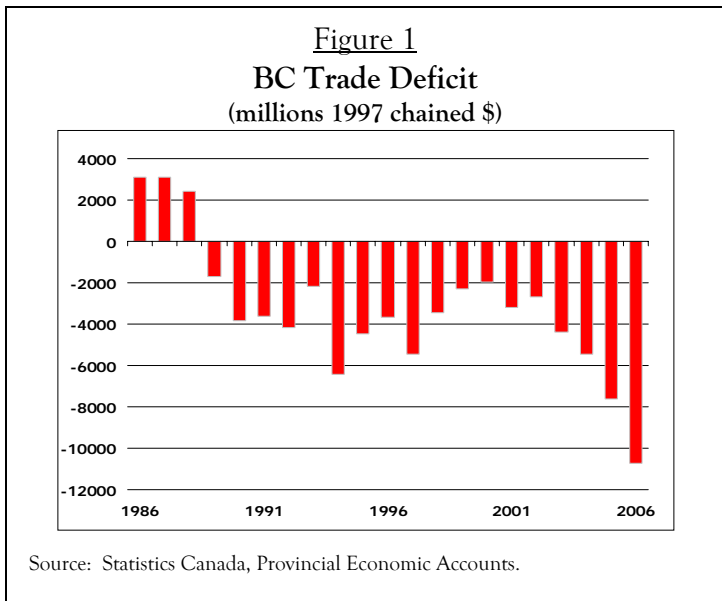
Export Performance and the Trade Deficit

BC has run a deficit in its trade with the rest of the world (including other provinces) since 1989. While the size of the deficit has fluctuated, the past four years have seen a steep increase, with the aggregate trade deficit hitting \$10.7 billion in 2006 (in inflation adjusted dollars). This amounts to a record high 7.1% of real provincial GDP.

A trade deficit acts as a drag on economic growth because imports represent an outflow of domestic income and are therefore subtracted from the value of domestic production. Total economic growth is diminished

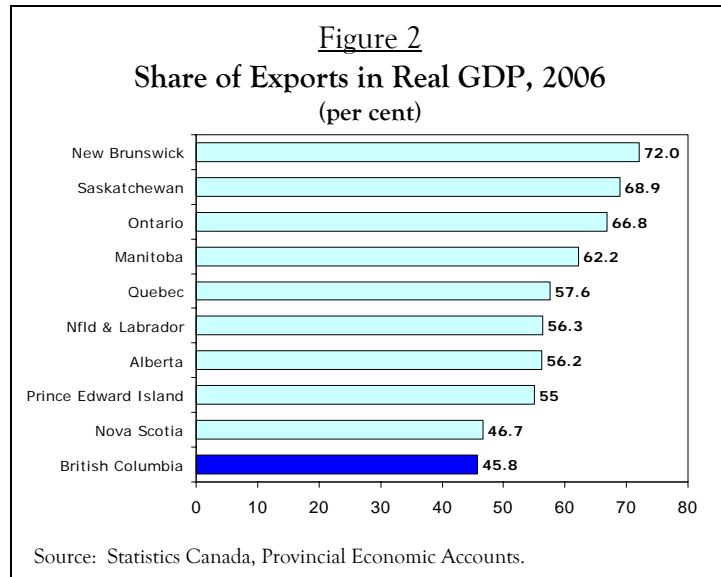
when a jurisdiction imports more than it exports. When a trade deficit arises, it is “financed” by an inflow of funds from external sources (either capital investment or transfers of income).

Opinion is mixed about the implications of a persistent large trade deficit. But many economists see it as a sign that GDP growth is tilted towards an excess of borrowing to fund consumption, and that the affected jurisdiction may suffer from a relatively weak economic base (export sector) that cannot sustain the same pace of growth and consumption in the long term.





Unfortunately, this well describes British Columbia's situation. Our growing trade deficit stems in part from the fact that the province has both a comparatively small export base, and one that is poorly diversified in terms of its product composition (resource goods supply 75% of BC's international merchandise exports) Total exports (international and interprovincial goods and services) make up just 45.8% of GDP. This is the smallest proportion in Canada and well below the export/GDP shares in the other large provinces.



Another point is that export growth has not kept pace with the rise in imports. Between 2001 and 2006 the value of BC's exports increased by 17% (in inflation adjusted dollars), whereas higher consumption and strong investment in machinery and equipment drove imports up by 28% over the same period. While differing growth rates for imports and exports are normal and perhaps even expected in light of the appreciating currency, BC's under-sized export base magnifies the problem and tends to entrench trade deficits.

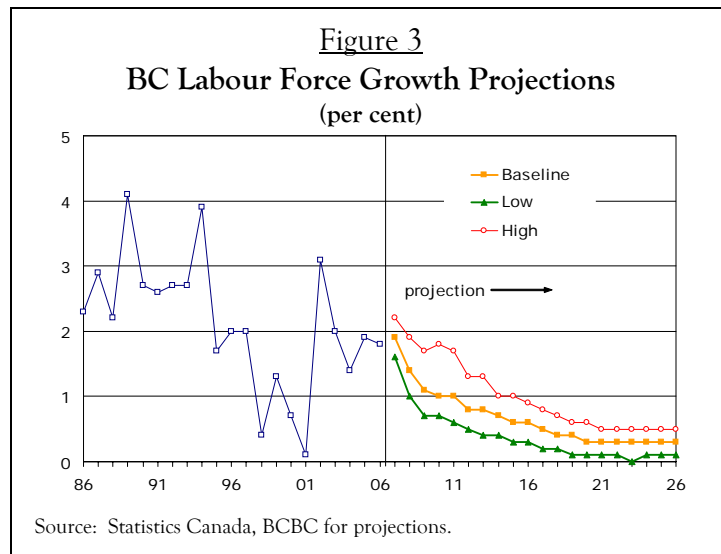
With most factors lining up to support import growth (the dollar, strong consumption and more business investment) and dampen export growth (the dollar, weak US lumber demand, soft natural gas prices), BC's trade deficit is likely to take a bite out of economic growth in the next few years.



Labour and Skill Shortages

While labour and skill shortages have been acute in the construction, oil and gas and health care industries, more sectors are now reporting difficulties finding workers. Sectors such as retail, hospitality and foodservices, transportation, some professional services, high technology, and law enforcement are all having trouble filling vacancies. Most of these shortages reflect an economy growing well above long-term potential as well as cyclical factors such as the ongoing construction boom. But looking ahead, population aging, a sharp rise in the number of retiring workers, and smaller cohorts of young people entering the labour force promise to create an even more challenging environment for BC employers seeking to expand business or replace departing workers.

The hard demographic reality is that the rate at which the province's workforce grows is inevitably going to diminish over the next decade. Another, less talked about dimension of an aging population and more slowly growing labour force is the effect on the broader economy. Smaller increases in the size of the workforce will dampen economic



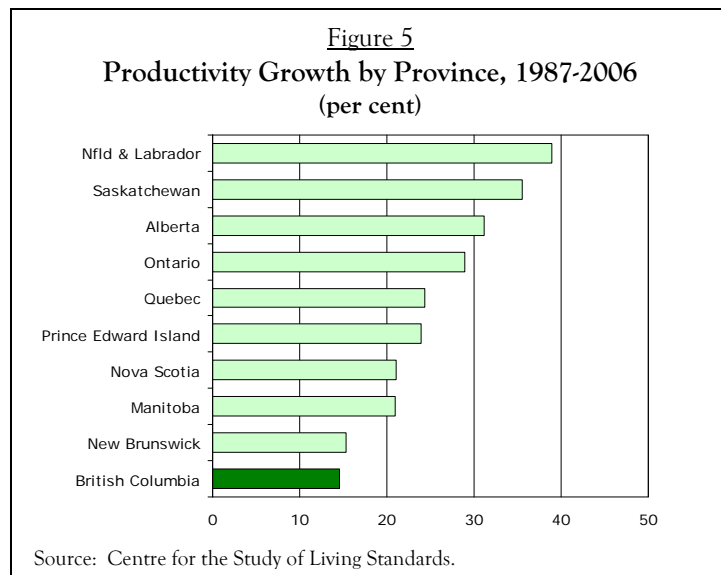
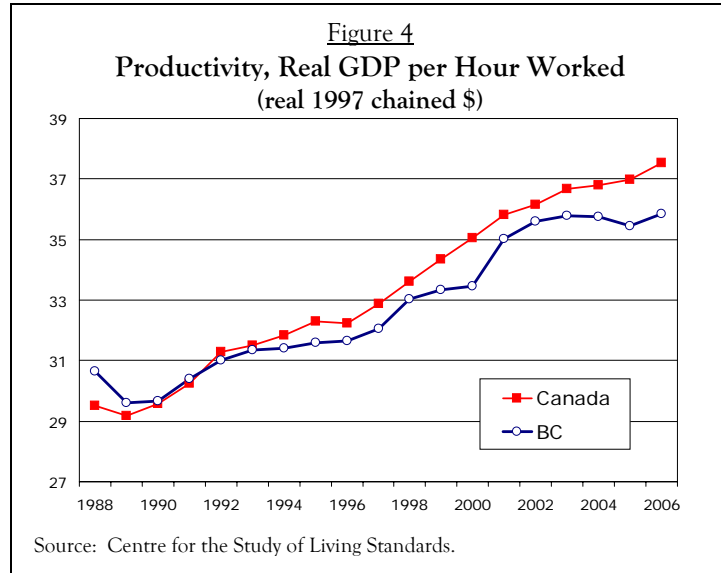
growth. Business Council projections show that between now and 2015, annual labour force growth in BC is set to slide from approximately 1.5% to 0.5% or less. Barring a miraculous increase in productivity, this shift will limit gains in real economic output (GDP) within just a few years' time. For governments and businesses accustomed to operating in an economy where the labour force expands by 2% per year and real GDP by 2.5% to 3.5%, this structural downshifting in potential growth will present difficulties, not least because an aging population will be putting more pressure on the province's already stressed health care system.



Productivity

There is no doubt that the province's economy has been faring well, especially over the past three years. Employment growth has been strong, the unemployment rate has fallen to record lows, business investment is high, a great deal of new infrastructure is being built, and real incomes are rising after stagnating or falling over most of the 1990-2002 period. But in one crucial area the province is losing ground: productivity. Despite better economic times, productivity growth averaged just 0.5% over the past five years, well below the 1.4% annual increase recorded over the preceding decade.

BC has also lagged behind the Canadian benchmark, resulting in a widening productivity gap. And because Canada has badly underperformed the US in raising productivity, the productivity gap between BC and the United States has grown even faster. Sub-par productivity gains have become the norm for BC - the province has failed to match Canada in 14 of the past 19 years.



Indeed, BC's ranks last in the country in cumulative productivity growth since 1987. That we have continued to fall short during a period when BC's economy has been stronger than Canada's underscores the structural nature of our productivity woes.



It is also consistent with another stylized fact: most of BC's economic growth over the past several years is due to higher levels of employment rather than gains in productivity. With the unemployment rate near 4% and labour force growth set to slow, the scope for future employment-driven increases in output and real incomes is dwindling. Looking ahead, improvements in real wages and economic prosperity increasingly will depend on attaining higher levels of productivity. Developing a "productivity agenda" should be a central focus of future provincial budgets.

Pine Beetle

The mountain pine beetle epidemic spreading rapidly throughout the interior is the largest in recorded history. The volume of standing dead trees is estimated at 530 million cubic metres, approximately 40% of the merchantable pine inventory.⁵ If the patterns exhibited over the past eight years continue, close to four-fifths of all merchantable pine will be killed by 2015.⁶ Pine is BC's most important commercial tree species. The projected volume of beetle infested wood represents close to one quarter of the provincial forest land base.

In the early stages of the infestation, government focused on controlling the outbreak. Now policy has shifted to salvaging beetle-killed wood to minimize the timber loss and encouraging community planning for the day when most of the pine forest is gone. The potential to mitigate losses is complicated by the relatively short and uncertain shelf life of beetle killed wood. Shelf life depends on moisture content, checking (cracking), decay rates as well as changes in mill technology and lumber market prices. Current indications are that most trees are useful as saw logs up to two years after being killed, but after that their commercial value deteriorates steadily. In the third year after death, perhaps only half of the trees can be used as saw logs. Beyond this, the expectation is that most beetle-infested trees will no longer be viable as saw logs, but may have alternative uses such as chips or pellets.

⁵ BC Ministry of Forests and Range, "Timber Supply and Mountain Pine Beetle Infestation in British Columbia 2007 Update."

⁶ Ibid.



Once economically valuable beetle killed wood has been harvested, cut levels are projected to fall sharply. In one scenario, the annual allowable cut in affected areas falls from 45.9 million cubic metres in 2006 to 25.1 million cubic metres a decade later. This is 20.8 million cubic metres below the stepped up 2006 harvest level and 12.1 million (or 33% lower) than harvest levels prior to the acceleration of the cut rate.

Reductions of this magnitude will pose major economic and social challenges for the affected communities, workers, and companies – and indeed for the province as a whole. The Business Council applauds the efforts being made by the province and communities in the Interior to develop mitigation and diversification strategies. While there is potential to develop alternative uses for infected pine, such as certain types of construction materials and biofuels, the highly efficient interior wood industry is heavily oriented to production of lumber and other higher-value building products. Finding alternative uses will require restructuring and substantial capital investment. At this stage, it is not clear to what extent such expenditures will be economic.

The fallout from the pine beetle is limited at this stage because harvest rates have actually risen. Significant negative impacts will materialize when harvest levels fall somewhere around 2015. But in anticipation of this, out-migration, uncertainty about the future, and a reluctance to invest may adversely affect some communities well before 2015.

Summary and Risks

Overall, the BC economy should remain near the top of the provincial rankings in 2008 and 2009. Amid difficulties in forestry and a weak export sector, real GDP growth both this year and in 2008 will be held to perhaps 3%. With the fallout from the US housing slump still unfolding and a general re-pricing of risk under way in global financial markets, the risks are on the downside. Beyond next year, growth in BC may pick up slightly with a boost from the run up to the 2010 Olympics. However, a number of the structural challenges discussed above will soon start to bite into growth – something that policy-makers need to plan for as they consider new budget initiatives and update the government's current three year fiscal plan.



2. PRIORITIES FOR BUDGET 2008

The government deserves high marks for its effective stewardship of British Columbia's public finances. By meeting or exceeding all of the fiscal targets set since 2001, it has helped to revive consumer and business confidence and presided over a substantial decline in the province's debt/GDP burden. Credit rating agencies have responded by repeatedly upgrading the province's rating. After posting a record operating surplus of \$4 billion in 2006-07, the province is on track for a \$1.6 billion surplus this year, with smaller surpluses projected over the remaining two years of the fiscal plan.⁷ Taxpayer-supported debt, which is the best metric for gauging long-term fiscal sustainability, continues to shrink as a share of GDP: it is now expected to reach 13.8% GDP by the end of 2007-08, down from a peak peaked at 21.3% of GDP just a few years ago. Surplus budgets and a falling debt/GDP ratio are contributing to a positive climate for economic and business growth.

On the spending side, the Business Council has been impressed with the government's disciplined approach to managing outlays. The current fiscal plan calls for a modest (2.8%) rise in overall Ministry spending in 2008-09. We are comfortable with the government's broad spending targets, but we do recommend increased funding in two specific areas of the operating budget:

- Post-secondary education, research and training. The province is expanding capacity in the post-secondary system and has boosted research support. But the shift to a knowledge-based economy, the need to strengthen further BC's research infrastructure, and widespread shortages of skilled workers in the trades and various technical occupations all suggest that the government should be using a portion of its fiscal dividend to direct additional funding to high-priority initiatives in the areas of post-secondary education, research and training.
- Social supports, particularly to deal with homelessness, substance abuse, and mental health programs. The social challenges evident in downtown Vancouver, Victoria and a number of other communities are a concern for many British Columbians.

⁷ If the \$500 million "forecast allowance" isn't needed, the surplus rises to \$2.1 billion in 2007-08.



The government has already stepped up funding in these areas, but we believe additional targeted resources can be put to good use.

Turning to taxation, in recent years the government has trimmed both personal and business taxes and made the tax system more conducive to investment, job creation, and entrepreneurship. Today, British Columbia has reasonably competitive statutory income tax rates for both small and large companies; no general capital tax;⁸ targeted tax provisions to support 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 incomes up to \$108,000. All of these are positive features of the current provincial tax system.

Still, British Columbia faces fierce competition for both talent and new business from Alberta, the western US states, and some offshore jurisdictions. Additional tax policy changes will be necessary to align BC's tax system with the goals of enhanced competitiveness and business growth. There is a consensus among economists that taxes on labour, capital and savings are more damaging to productivity and long-term economic growth than taxes on consumption-related activities. Shifting the tax system toward greater reliance on consumption taxes would help to foster capital formation and higher productivity.

In the coming budget, the government should be looking beyond the current economic upswing to assess how best to position BC as an attractive location for high-value investment and high-quality jobs over the medium term. Among other things, more must be done to encourage economic diversification and accelerate the development of emerging, export-capable industries in areas like advanced technology, health-related products, secondary manufacturing, financial services, and other tradable services. In addition, the government should be acting to further reduce effective tax rates on new business investment, which remain higher here than in a number of other provinces as well as in many OECD

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



jurisdictions.⁹ Effective tax rates on capital differ from statutory business income tax rates because they take into account the impacts of sales taxes on production inputs, capital taxes, capital cost allowances, and other provisions that affect the after-tax returns on incremental private sector investments in fixed capital. As a result, effective tax rates provide a better picture of how taxes can affect investment decisions.

In terms of the 2008 budget, the Business Council has several specific tax recommendations.

- In its 2006 report, the BC Competition Council¹⁰ argued that lowering personal income tax rates for individuals earning between roughly \$70,000 and \$150,000 per year would make it easier to attract and retain the skilled knowledge workers on which BC employers increasingly depend. The Business Council shares this view. We recommend that the government implement measures to give BC the lowest PIT rates in Canada for all taxpayers with annual incomes below \$150,000. The annual cost of this proposal is estimated at \$200-\$220 million.
- The 2006 federal budget introduced an Employment Tax Credit to recognize work-related costs and improve incentives to work. In its 2007 budget, the federal government announced a new Working Income Tax Credit of up to \$500 per year for low-income workers, also with a view to strengthening incentives for labour force attachment. We strongly support fiscal initiatives to raise the after-tax incomes of individuals holding low- and modest-paid jobs. British Columbia has already made progress on this front by reducing personal income tax rates and by removing many low-income workers from the tax rolls. But it is worth asking whether more can be done. One intriguing model is the US Earned Income Tax Credit (EITC), which is widely recognized as a successful policy for assisting low-income working

⁹ Jack Mintz, 2007 Tax Competitiveness Report, C.D. Howe Institute, Commentary (September 2007); Duane Chen, Jack Mintz and Andrey Tarasov, Federal and Provincial Tax Reforms: Let's Get Back on Track, C.D. Howe Institute, Backgrounder (July 2007).

¹⁰ Report of the BC Competition Council (June 2006).



households.¹¹ What sets the EITC apart from many other tax-delivered programs is its refundability – the amount of the credit for which a working individual is eligible is independent of how much income tax is owed. This means that lower-income workers who receive few if any benefits from most tax credits and deductions are able to take full advantage of the incentives provided by the EITC.¹² Although it may make more sense to implement this type of program on a national scale, we urge the province to explore whether a version of the EITC might be adopted in BC.

- As for business taxes, in 2006 the BC Competition Council¹³ advised the government that the province's statutory corporate income tax rate should not exceed 125% of the applicable Alberta rate. At 12%, BC's present corporate rate is 20% greater than Alberta's basic 10% rate. If Alberta trims its business tax rate, we recommend that BC respond in accordance with the Competition Council's suggestion.
- A few years ago the province phased out its job-destroying capital tax for all businesses except large and medium-sized financial institutions. As the Competition Council observed, the argument for removing the capital tax from businesses in general applies with equal force to businesses involved in the financial services industry. We believe British Columbia has the potential to become a significant international financial centre serving the rapidly growing Pacific Rim. However, taxing the capital of financial institutions works directly against this objective. Moreover, other provinces have signaled that they plan to do away with capital taxes on financial institutions. Accordingly, the Business Council recommends that the government phase out the capital tax on financial businesses over the next three years.¹⁴

¹¹ For an excellent recent review, see Steve Holt, "The Earned Income Tax Credit at Age 30," Brookings Institution (February 2006).

¹² *Ibid.*, pp. 2-3.

¹³ Report of the BC Competition Council (June 2006).

¹⁴ The annual revenue impact of this recommendation is slightly more than \$100 million.



- Another tax issue of longstanding concern to the business community is property tax. 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. Most property tax is collected by municipalities, although regional authorities and the provincial government¹⁵ also levy property taxes. Among the various classes of business, 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 industries like pulp and paper, lumber manufacturing, chemicals, and mining.¹⁶ The Business Council submits that, from a competitiveness perspective, BC has the worst business property tax regime in Canada, for three reasons: 1) there is an unusually large number of property classes; 2) municipal governments are completely free to set their own tax rates and ratios and to arbitrarily shift the overall property tax burden onto specific types of business; and 3) there is no appeal mechanism to review the fairness of local decisions. Many municipalities presently impose property tax burdens on some categories of businesses that are both punitive and far in excess of the cost of providing services to such enterprises. The Competition Council flagged this as a key issue in its 2006 report. As an initial step, we recommend that the province move to legislate maximum ratios between municipal property taxes on residential as compared to various classes of business property. Legislating maximum ratios would put some limits on the ability of local governments to "tax-shift" onto industry. Over the medium-term, the government should be looking at a more sweeping overhaul of the property tax regime affecting business.

Beyond next year's budget, the province will need to re-visit the existing sales tax system and consider options for reform. Today, two-fifths of the \$5 billion which the province raises in

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

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).



annual sales tax revenue comes from inputs purchased by businesses large and small to produce goods and services and to run their operations. Taxing production inputs undermines competitiveness, especially in the case industries that produce tradable goods and services. Studies show that removing taxes on business inputs would significantly lower the effective tax burden on capital and stimulate investment in new plant, equipment and technologies.¹⁷

There are different options for easing the fiscal burden that arises from taxing business inputs. One is to expand the existing exemptions from provincial sales tax for business purchases of machinery and equipment used in manufacturing and resource processing, to cover a wider range of intermediate inputs – for example, purchases of energy, legal services, and machinery and equipment used in non-manufacturing. Another option is to replace the current provincial sales tax with a BC-designed value-added-tax, with the definition of the tax base determined by the province. Still another approach would be to harmonize the province's sales tax with the federal Goods and Services Tax. The Business Council is not recommending a specific reform option at this time. However, we believe the issue should be on the government's future tax policy agenda.

3. CLIMATE CHANGE AND ENERGY POLICY

Since the beginning of 2007, the government has laid out an ambitious environmental agenda by pledging to slash BC's emissions of greenhouse gases (GHGs) by one-third between 2007 and 2020, mandating that half of future increases in electricity demand be met through (unspecified) conservation measures, and prohibiting the development of coal-fired electricity generation at a time when the province intends to develop significant additional generating capacity. The pre-budget consultation document produced by the Ministry of Finance asks for suggestions on how to create a "greener future" for British Columbia. The primary purpose of the annual budget is to allocate overall public spending and set the fiscal climate, not to tinker with environmental policy. Nonetheless, the Business

¹⁷ Jack Mintz, 2007 Tax Competitiveness Report, C.D. Howe Institute, Commentary (September 2007)



Council has a number of comments on the matters raised in the Ministry of Finance's pre-budget consultation paper and on the government's revised Energy Policy.

Climate change arguably is the most vexing challenge facing the world today. It is fair to say that Canada has been slow to come to grips with the problem. All industrialized countries, including Canada, have a responsibility to take steps toward developing a less carbon-intensive economy. The Business Council strongly favours a national approach to tackling climate change - in our view, the country will not be well served by a proliferation of separate provincial strategies featuring differing, and perhaps conflicting, goals, targets and policies. Moreover, because climate change is a global problem, international cooperation and coordination are essential to making progress. No international agreement can possibly be credible or effective unless the biggest emitters are involved. After all, Canada produces just 2% of global GHG emissions, of which BC contributes less than one-tenth.

That said, British Columbia has made its own far-reaching commitments to tackle greenhouse gas emissions and established a Climate Action Secretariat to develop a plan. In September, the government announced that it intends to establish hard caps on GHG emissions from major industry sectors (such as pulp and paper, cement and oil and gas), a proposal that is linked to its plan to participate in a future "carbon-trading" market involving a number of Western US states and Manitoba under the auspices of the Western Climate Initiative (WCI). British Columbia's strategy differs from that of the federal government, which has announced intensity-based GHG reduction targets on eight industry sectors responsible for roughly half of Canada's emissions.

Thus, it now appears that BC's emission caps will be more stringent than those adopted nationally. This raises the question of how the reporting requirements, sector definitions, compliance mechanisms, and other rules flowing from BC's regulatory regime for industrial greenhouse gas emissions will mesh with the emerging national system, since both will capture some of the same industries and companies. To date the government has provided no clear answer to this important question.



In any case, once it has legislated hard caps, BC will have taken a big step toward setting a price on GHG emissions from major industry. Clearly, it will take time to establish the proposed WCI cap and trade regime, and to assess the economic impact of that scheme as well as the absolute emission reductions which the province intends to demand of various BC industries. During this period, the government should steer clear of other new policies that would further increase costs for the industries facing GHG caps. As we move to a carbon-constrained economy, policy-makers need to ensure that BC energy producers and manufacturing firms are not placed at a competitive disadvantage, particularly in a North American context.

As part of its climate change plan, the province may wish to consider additional incentives to stimulate the development and deployment of low-carbon technologies. It could also look at boosting the \$25 million Clean Energy Fund through a one-time budget allocation.¹⁸ At the same time, the government should be taking steps to streamline the environmental review and permitting processes for new power projects, in support of its goal of relying heavily on “green energy” to help meet BC’s growing demand for electricity. In part, this requires more cooperation between provincial and federal agencies. But it also depends on provincial agencies having enough staff in place to handle a growing volume of work flowing from increased activity in the power sector, the revival of mining, and a record level of major project investment in many areas of British Columbia. Finally, the *International Financial Centre* has mooted the idea of establishing BC as a market leader in carbon trading by modifying the International Financial Activities Act.¹⁹ Including profits earned on trading emissions credits as a qualifying activity under the Act would make BC an attractive location to transaction this type of international business. The Business Council believes this proposal merits the government’s consideration.

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

¹⁸ We do not support increasing the Clean Energy Fund by levying additional charges on BC Hydro customers.

¹⁹ International Financial Centre British Columbia, [Newsletter](#) (September 2007).