Business Council of British Columbia

A Decade By Decade Review of British Columbia's Economic Performance

November 2012

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A DECADE BY DECADE REVIEW OF BRITISH COLUMBIA'S ECONOMIC PERFORMANCE

By Peter Severinson[1],
Jock Finlayson and Ken Peacock[2]

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Introduction

By historical accident, the last two new governments to take power in British Columbia did so at the start of new decades: the NDP in 1991, and the Liberals in 2001. Not surprisingly, it's become popular to argue that one party's ability to manage the economy was shown to be better than another's, based on which decade apparently produced the best overall economic outcomes.

This exercise can sometimes cause confusion. For one thing – as we all know – statistics can tell quite different stories, depending on which data are used and how they're presented. For example, using different points of reference, the same data can be used to say that either the 1990s or the 2000s were the economically superior decade. Moreover, focusing on selected economic indicators, and ignoring others, can lead to different conclusions on which period generated the best results.

It can also be misleading to look at BC in isolation when assessing the province's economy. After all, in global terms, BC is a very small market, representing less than 1% of total North American gross domestic product (GDP). The province's economic well-

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being is influenced as much or more by external factors (such as world prices for our natural resource exports or the value of the Canadian dollar) as by domestic public policies or other "internal" developments. To take one example, consider the most commonly cited measure of economic performance, "real" (or inflation-adjusted) gross domestic product. When GDP increases, this might be for a variety of reasons: a growing population, robust external demand for our exports, improved terms of trade, a lower Canadian dollar (which tends to enhance the competitiveness of local trade-exposed industry sectors), a booming housing market, or the development of more efficient and productive local businesses. Looking at the raw numbers, it may be hard to tell which is doing the heavy lifting.

That being said, the fiscal and economic policies and conditions within the province do affect our ability to take advantage of opportunities presented by the global marketplace. Provincial and local government tax and regulatory policies, the processes used to review and advance resource and infrastructure projects, the quality of transportation and communications networks, and the capacity of our education and training systems to produce skilled and qualified people are all important in shaping the domestic environment for investment, consumer spending, and economic growth. At times these "internal" factors can be significant in driving investment and job creation decisions.

While focusing on top-line GDP growth is inadequate as a way to gauge macro-economic performance, there are a few simple steps that can allow us to get a clearer picture of how BC's economy has fared over time. To start with, in this paper we include the decade of the 1980s to add more data and gain greater insights into longer-term trends. Also, and of particular importance, in some cases we examine per-capita measures of economic activity, which take account of changes in population. Lastly, in this report we compare BC's economic record to that of Canada as a whole. Because world economic conditions tend to affect BC and Canada similarly, determining how BC did relative to the rest of the country can provide a better sense of the extent to which the province capitalized on the global economic conditions of the day.

By using these kinds of straightforward techniques, we are in a better position to comment on economic outcomes in the 1980s, the 1990s and the 2000s.[3] In this paper, we explore the province's track record over this three-decade period by summarizing how BC did in the areas of GDP, personal income, employment, business investment, fiscal management and exports. We find that the first decade of the 2000s produced somewhat better results than the two earlier decades on two critical performance measures: real GDP per person and real income person. The decade-by-decade results are mixed on a number of other economic performance metrics considered in the study. It should be noted that even by 2010, BC still had a less productive economy than the country, based on comparing the level of output or real GDP per person.

No claim is made here that the policies of one provincial government directly led to better or worse economic results than the policies of another government. Particularly for a small jurisdiction like BC, such cause-and-effect assertions can be difficult to prove. In any case, the focus of this paper is on summarizing and comparing overall economic outcomes, not on explaining the differences from one decade to another with reference to government policies. Nor does this analysis examine intra-decade trends that may provide some insights into the effects of government policies over time. Still, we believe there is value in presenting a fact-based, high-level summary of how BC's economy has performed over the past thirty years. In many ways, it's a good news story about an economy that has grown at a solid pace and, in a few areas, done better than Canada as a whole.

GDP Growth

The most common way to capture economic performance is to look at the evolution of real gross domestic product – the total value of goods and services produced each year, adjusted to remove the effects of inflation. On this measure, British Columbia has enjoyed

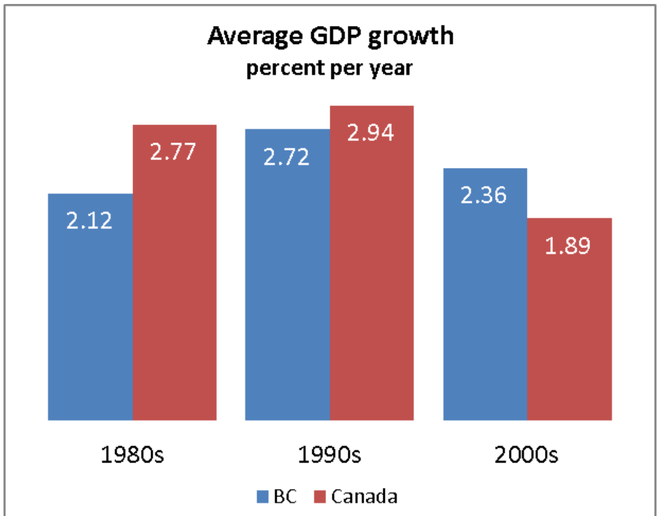
[3] In this report, the 1980s refer to the years 1981-1990; the 1990s refer to the years 1991-2000; and the 2000s refer to the years 2001-2010.

reasonably steady economic growth over the last three decades[4], with annual real GDP increasing on average by:

- 2.12% in the 1980s,
- 2.72% in the 1990s, and
- 2.36% in the 2000s.

In absolute terms, the 1990s stand out as the decade with the higher average aggregate GDP growth rate. However, by including a few other measures in our analysis, we are able to get a more complete picture of how the economy performed.

As discussed above, GDP growth has at least as much to do with what's happening outside of BC as within the province. By comparing BC's economic growth rate to Canada's, we can get a better sense of how well the province capitalized on the global economic conditions each decade had to offer. Compared to the Canadian average, BC's annual GDP growth rate was:



Source: Statistics Canada, Provincial Economic Accounts
GDP in chained 2002 dollars

- 0.65 percentage points slower in the 1980s,
- 0.22 percentage points slower in the 1990s, and
- 0.47 percentage points faster in the 2000s.

[4] There were occasional recession periods, when real GDP declined. Two examples are 1982 and 2009.

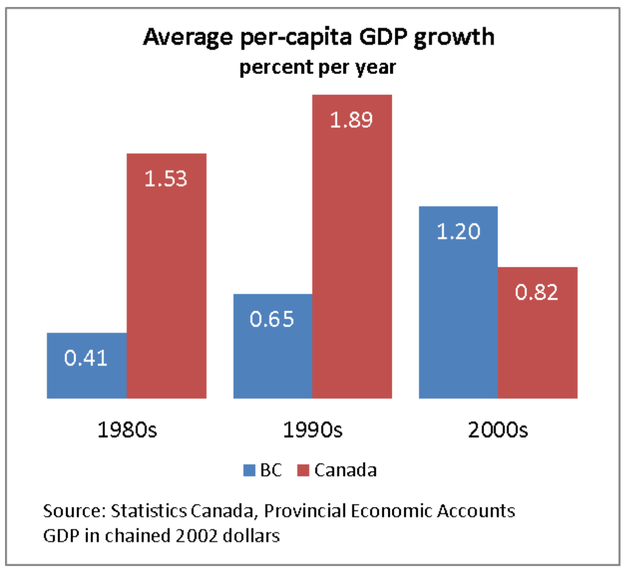
These results should give us pause. BC posted its highest overall economic growth rate in the 1990s, but relative to the Canadian benchmark, the 1990s were a weaker decade than 2001-10.

When looking at what drives GDP, an important factor to consider is population change. When the population increases, this usually delivers a boost to GDP as new residents add their consumption, labour and savings to the economy. But the economic well-being of a jurisdiction only improves if the "economic pie" grows faster than the population. This is why economists generally concentrate on <u>per-capita GDP</u>, which accounts for changes in population. The good news is that this has been rising over time in British Columbia.

On an annual basis, real GDP per capita in BC increased, on average, by:

- 0.41% in the 1980s,
- 0.65% in the 1990s, and
- 1.20% in the 2000s.

Based on this widely-used economic indicator, the 2000s were BC's best decade, while the 1980s saw the smallest gains in living standards.



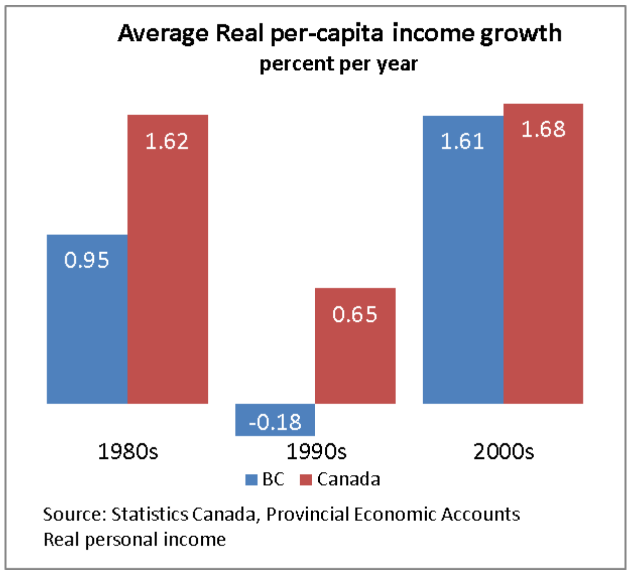
Moreover, when comparing BC to Canada, we see the same trend as before: the province underperformed the country in the 1980s and the 1990s, but did better than the Canadian average in the 2000s.

<u>Incomes</u>

Per-capita income is another often-cited measure of living standards that conveys vital information on whether (and to what extent) people are actually benefitting from a growing economy. In BC's case, it tells an interesting story. On an average annual basis, real per-capita income[5] in the province:

- increased by 0.95% in the 1980s,
- decreased by 0.18% in the 1990s, and
- increased by 1.61% in the 2000s.

Again, real income per person rose more quickly in the 2000s than in the previous decades, with a sizable gap between the 2000s and the 1990s. The 1990s actually saw a downward trend in real income per person. Of interest, BC did less well on this economic measure than Canada in each of the decades examined in this study, although the gap was smaller in the 2000s (when real per capita income growth in BC came close to matching the national average).



Curiously, then, the 1990s saw the greatest overall GDP growth, yet at the same time it was the only decade when real per capita income actually declined. Although we don't probe the issue further here, this finding is partly explained by high levels of population growth in the 1990s, fuelled to some extent by a recession in Ontario in the early part of the decade and the reunification of Hong Kong and mainland China in 1997. The resulting surge of newcomers made British Columbia's economy "bigger" in terms of total GDP, but the growth of output per person did not keep pace, with the result that income per person fell. Yet as noted in the next section, the province also experienced a significant

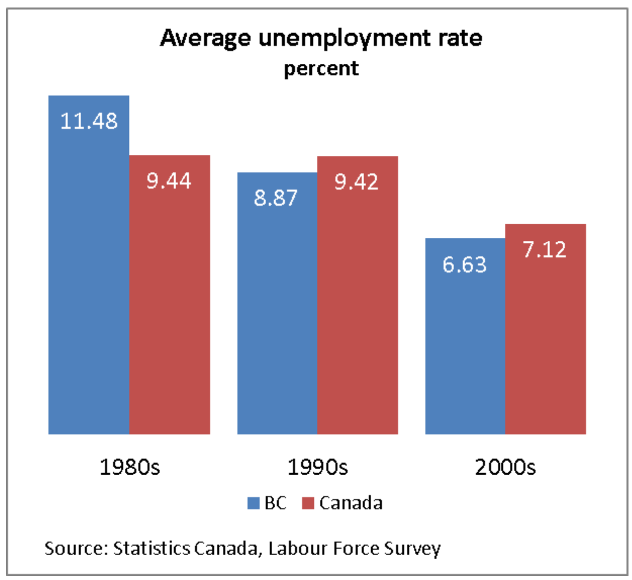
[5] Our focus here is on pre-tax income adjusted for inflation.

increase in total employment in the 1990s. This suggests that the decline in real per capita income over the 1990s may be linked to the quality (rather than the quantity) of jobs, and to other aspects of the broader economic environment that impinge on incomes – such as investment, entrepreneurial activity, and business location/expansion decisions.

Employment

One of the benefits we expect from an expanding economy is the creation of jobs – and employment is a critical element in economic well-being for most people, not least because more than two-thirds of total household income comes from employment. The unemployment rate is often used a shorthand way to tell whether an economy is providing jobs for those who wish to work. Again, in BC's case, the story is largely positive, with unemployment rates falling from troublingly high levels in the 1980s to near record lows in the period immediately preceding the 2008-09 global financial crisis and recession. By decade, the unemployment rates in BC were, on average:

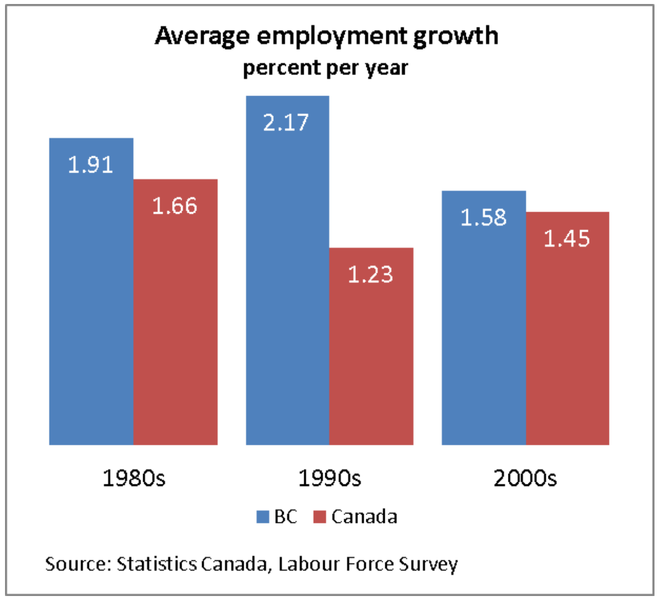
- 11.48% in the 1980s,
- 8.87% in the 1990s, and
- 6.63% in the 2000s.



On unemployment, BC did better than Canada as a whole in both the 1990s and the 2000s, and by very similar margins.

But for assessing the health of the labour market, the unemployment rate doesn't tell the whole story. Just as we saw with GDP, population growth plays a role in shaping the job market. When the population grows quickly, as it did in BC in the 1990s, job creation has to be equally brisk in order for the unemployment rate to stay the same. So it's important to track the number of people who actually have jobs, in addition to the unemployment rate. On a decade-by-decade basis, average annual employment growth in BC was:

- 1.91% in the 1980s,
- 2.17% in the 1990s, and
- 1.58% in the 2000s.



On this measure, BC outpaced Canada in every decade, but especially in the 1990s, when job creation exceeded the national benchmark by almost a full percentage point.[6]

So while the 2000s had a lower unemployment rate, the 1990s featured the strongest job growth. This, again, is partly related to contemporaneous changes in the population. As BC's population rocketed higher in the 1990s, the job numbers climbed even faster, reducing the unemployment rate even as more people moved to the province and searched for work. By the 2000s, population growth had eased. The rate of job creation slowed, too, but only slightly, resulting by 2006-07 in a significantly lower unemployment rate than the province had enjoyed in decades past.

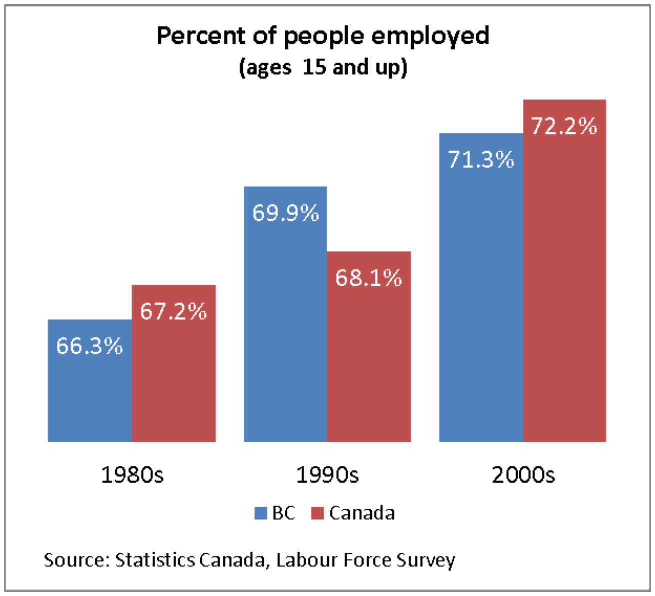
These trends can be seen clearly when using a third method for assessing the labour market: the percentage of the population aged 15 and older holding a job.[7] A high percentage indicates a generally healthy economy and job market, where more people

[6] When assessing the strength of the job market, another helpful delineation is growth in the number of public sector employees versus private sector employees. In BC, the average annual growth in public sector employment was 0.52%, 2.25% and 1.84% over the 1980s, the 1990s and the 2001-2010 period, respectively. For Canada the corresponding public sector employee growth rates were 1.05%, 0.18% and 2.30%. Here the 1990s stand out as a time when public sector jobs in BC grew significantly faster than in the country as a whole. For the 1980s, the 1990s and the 2001-10 period, private sector employment in BC grew on average by 1.97%, 1.71% and 1.40%, while for Canada the comparable growth rates were 1.63%, 1.24% and 1.27%.

[7] Statistics Canada, CANSIM 282-0087.

are able to find work. An advantage of this measure is that it captures people who are not actively seeking employment as well as those holding or actively looking for jobs, something that the official unemployment rate doesn't include. On average, the percentage of people aged 15+ in BC who were employed was:

- 66.3% in the 1980s,
- 69.9% in the 1990s, and
- 71.3% in the 2000s.



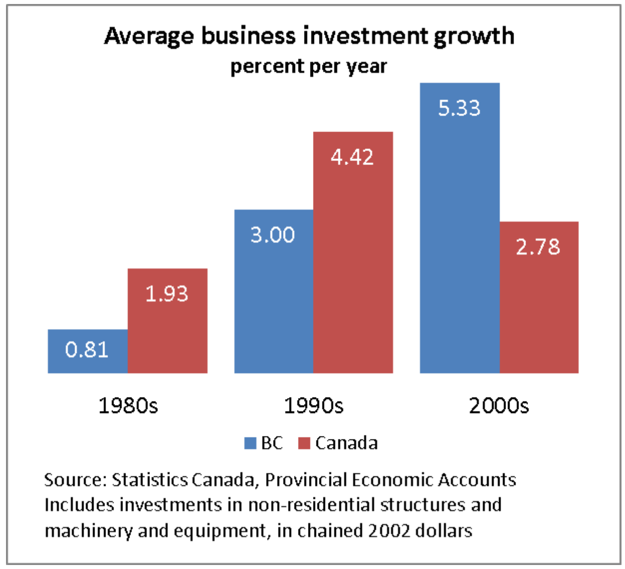
These results generally confirm what the other figures suggest. The most impressive employment score in terms of the employment rate was in the 2000s, but the strongest job creation occurred in the 1990s – which was also the decade with the fastest population growth. As noted above, a rising population tends to boost GDP and to be accompanied by additional demand for goods, services and housing, which in turn helps to spawn a greater demand for workers and thus more jobs.

Business Investment

With the statistics available, we can also evaluate the state of the overall business climate by looking at investment trends in each decade. Statistics Canada tracks investments in residential structures, non-residential structures, and machinery and equipment. Here, we are mainly interested in capital investments that are directly associated with business expansion, new business formation, and productivity growth, so this section excludes residential construction.

The general trend in non-residential business investment in BC is a story of a marked decade-by-decade turnaround. The average yearly growth rate for non-residential business investment (after adjusting for inflation) in the province was:

- 0.81% in the 1980s,
- 3.00% in the 1990s, and
- 5.33% in the 2000s.



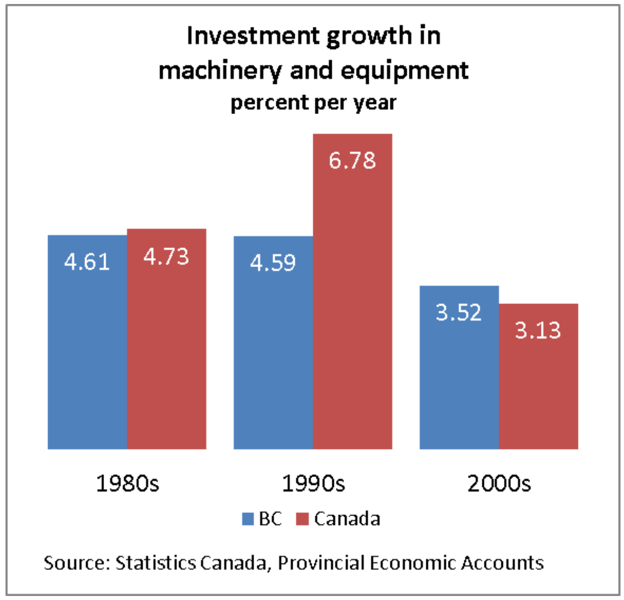
These numbers show strong investment growth, and comparing them with the Canadian average reinforces the picture of steady improvement. Canada's business investment growth rate was more than twice that of BC in the 1980s; it was almost half again as large as BC's in the 1990s; but by the 2000s the relationship had flipped, with business investment in BC rising almost twice as fast as in Canada.

The investment story is not all positive, however. A key reason why we want to see robust non-residential investment is that it is expected to foster higher productivity. But historically, BC has fallen behind the rest of the country in the growth of labour productivity, which is a measure of the value of real GDP (or economic output) per hour worked. British Columbia's inability to boost productivity is worrisome. Between 2005 and 2010, labour productivity advanced by 2.2% per year in Canada, but by only 1% in BC.[8] Research points to feeble productivity gains as a factor contributing to stagnant or slow-growing real wages. In the long run, an economy that can't generate sustained productivity growth will find it difficult to improve living standards for many households.

Investments in machinery and equipment (M&E) are a crucial part of boosting economy-wide productivity, and here BC's performance has also been unimpressive. By decade, the average annual growth of investment in machinery and equipment in BC was:

[8] The figures cited refer to productivity in the "business sector" and thus exclude the "non-market" sector of the economy. Source: Statistics Canada, CANSIM 383-0026.

- 4.61% in the 1980s,
- 4.59% in the 1990s, and
- 3.52% in the 2000s.



Slower growth in M&E investment may be partially explained by the diminishing importance of sectors such as manufacturing and natural resource extraction, which tend to utilize more physical capital, and the expanding role of service industries, most of which require relatively little "physical" but lots of "human" capital. Similar structural changes may be affecting investment at the national level (M&E investment in Canada also eased over the last decade). One positive outcome for BC is that M&E investment growth was actually higher in BC than it was in Canada in the first decade of the 2000s, although the overall trend is not particularly comforting from the standpoint of productivity.

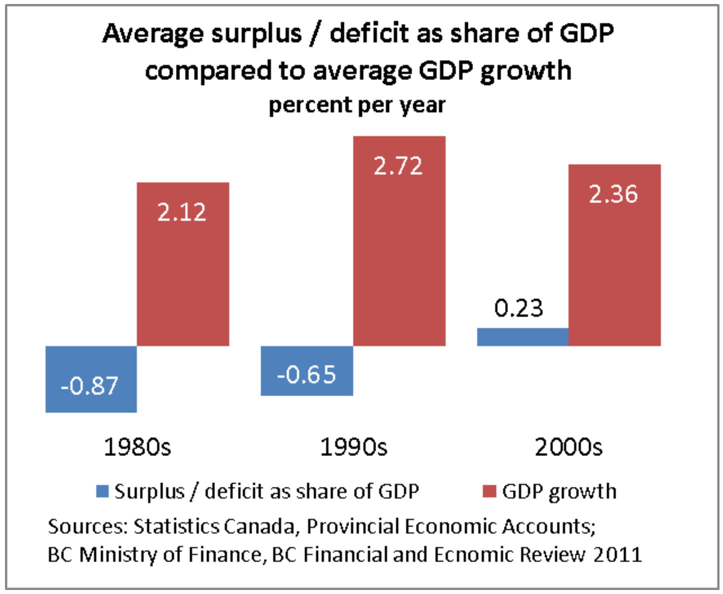
Fiscal Management

One expectation citizens have of governments is that they will prudently manage the public finances. Perhaps the most basic way to assess fiscal policy is to look at the extent to which a government runs deficits or surpluses in its annual operating budget. We can give these numbers a proper sense of scale by displaying them as a percentage of GDP (where a negative number indicates deficits, and a positive number means surpluses).

Over the three decades covered in this paper, average provincial government operating surpluses and deficits, measured as a share of GDP, were:

- -0.87% in the 1980s,
- -0.65% in the 1990s, and

- +0.23% in the first decade of the 2000s.



On this indicator, the results point to fairly similar proportionate deficits in the 1980s and 1990s, followed by a shift to government operating surpluses, on average (but not every year), in the first decade of the 2000s.

These numbers are a good starting point, but they don't quite tell us enough. After all, governments aren't always wrong to run deficits, and in some circumstances aiming for budget surpluses arguably may be a mistake. There's no scientific method for determining when governments ought to run either deficits or surpluses – or of what magnitude – but there are some principles that can serve as useful guides.

The first is to compare surpluses and deficits to economic growth. The general idea is that deficits are more appropriate in periods when the economy is growing slowly (or not at all) and private sector spending is depressed. In contrast, periods of brisk economic growth are typically good times to run budget surpluses that can be used to pay down part of the accumulated public debt or to build up "rainy day" funds to be tapped when economic conditions are less favourable.

To compare one decade to another, we can use the same figures as above (surplus/deficit as share of GDP), and then compare them to the average GDP growth rate of the province during each decade. Using this technique, a narrow gap or a smaller number suggests that government finances were well-aligned with the pattern of economic growth over the decade, while a larger difference provides evidence that the two were divergent. The differences for BC were:

- 2.99 in the 1980s,
- 3.37 in the 1990s, and
- 2.13 in the 2000s.

While the 1980s and 1990s saw similar levels of deficit spending relative to the size of the provincial economy, these results suggest that the deficits of the 1990s were less appropriate when judged against the macroeconomic conditions and growth rates prevailing at the time. The first decade of the 2000s, on the other hand, showed the smallest difference between the trend of economic growth and the government's fiscal balance, suggesting a period of more prudent fiscal management.[9]

A second principle we can use to assess government finances is that policy-makers should not allow the public debt to get out of hand – for example, by countenancing a steadily increasing ratio of debt-to-GDP. In this area, BC has generally done quite well, having long maintained one of the lowest debt-to-GDP ratios among the ten provinces. In fact, this key ratio has (very) slowly decreased over the last 30 years. BC's average provincial government debt,[10] as a share of GDP, was:

- 27.20% in the 1980s,
- 26.85% in the 1990s, and
- 22.20% in the first decade of the 2000s.

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[9] In the adjacent chart, the data measure deficits/surpluses as a share of GDP and the average annual growth of real GDP. For each decade, the relevant computation is the economic growth rate **minus** the deficit/surplus stated as a share of GDP. For the 1980s, this is 2.12 minus negative 0.87, which produces the figure of 2.99.

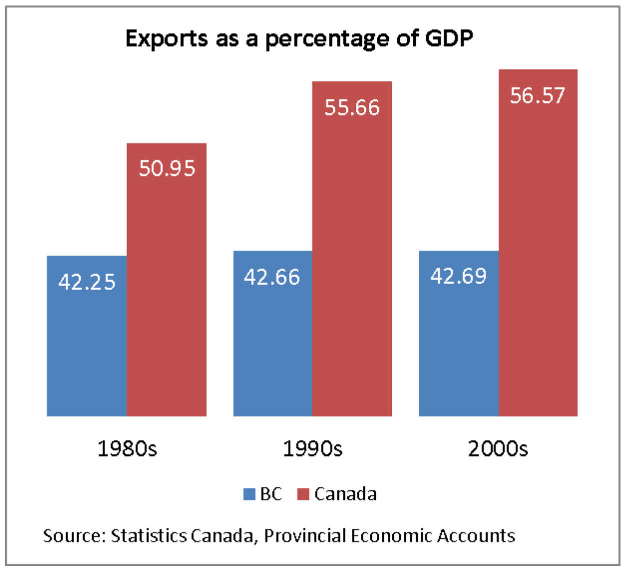
[10] The data reported here measure total provincial debts, which differ from (and are larger than) the "taxpayer-supported" debts often highlighted in provincial government budgets.

While the debt shrank relative to the size of the province's economy in both the 1990s and the 2001-2010 period, the latter decade saw more significant progress, with the average debt-to-GDP ratio declining by almost four percentage points compared to the 1990s.

Exports

While on most indicators BC's economic performance improved over the last three decades, this is not true across-the-board. Exports have been one area of notable economic weakness. Despite boasting tremendous resource wealth and being home to two of Canada's most important ports, British Columbia has lagged behind the rest of the country in overall export performance. One way to show this is to look at the scale of exports within the context of the wider economy. BC's total exports of goods and services, stated as a share of GDP, varied as follows:[11]

- 42.25% in the 1980s,
- 42.66% in the 1990s, and
- 42.69% in the 2000s



These statistics describe a province stuck in a rut of mediocre export performance, particularly considering that the Canadian export/GDP ratio has increased over the last three decades, and by significant margins. Indeed, by the 2000s, the percentage of GDP made up by exports in the country was almost 14 points higher than in BC.[12]

[11] The figures cited include exports of goods and services to other countries and other provinces, combined.
[12] A better measure of export performance is obtained by examining the "value-added" component of exports (exports net of the import content). Because BC's exports are heavily resource-based, the province's export shipments have a lower import content than is the case for some other parts of Canada. After adjusting for import content, BC's comparative export performance vis-à-vis other provinces looks somewhat better.

The growth in exports over each of the decades in question underscores British Columbia's underwhelming export performance. In constant dollars, the average annual growth of the province's total exports was as follows:

- 3.8% in the 1980s,
- 4.7% in the 1990s, and
- 1.2% in the 2000s.

Most of the slowdown in growth over time is attributable to international exports, which declined slightly on average (-0.2%) in the 2000s. In this regard, however, BC is not alone, as Canadian international exports also fell (on average by -0.7% per year) in the most recent decade. BC's record is better with respect to exports of goods and services to other provinces.

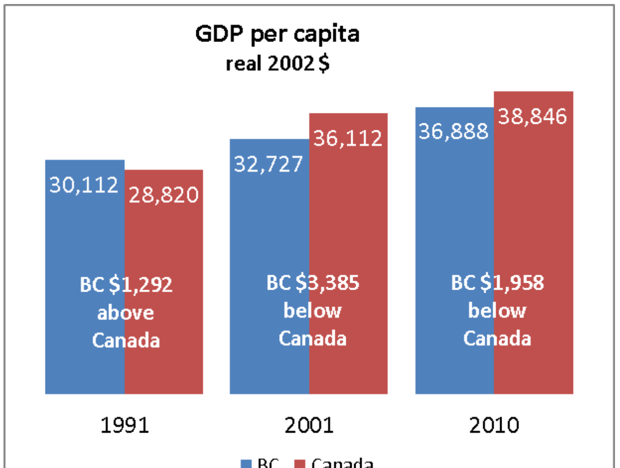
Conclusion

With an election due in May 2013, we should expect to hear more about how the province's economy fared in the 1990s vis-à-vis the first decade of the 2000s. Hopefully, this short review will bring a bit more clarity to that discussion. The overarching story is that British Columbia experienced positive economic growth and development in both decades, particularly compared to the 1980s. On the other hand, exports and productivity stand out as areas where we have continued to lag for 20 years or longer.

The evidence shows that, while the 1990s were a time of substantial economic growth, this was fuelled in large part by a concurrent population boom and a favourable external environment (notably a strong US economy). BC's economic expansion in the 1990s was weaker than that experienced in Canada as a whole. During the 1990s employment grew faster than the population, paving the way for a lower unemployment rate and enabling BC to outpace the country in job creation. However, these employment gains were not accompanied by higher incomes – indeed, real income per capita fell over the 1990s, an unusual development in BC's economic history.

The first decade of the 2000s brought further declines in the unemployment rate, as well as a solid pace of job creation. Real GDP per person rose more quickly over 2001-10 than in the previous two decades, as did real income per person – arguably these are the two most important comparative metrics for evaluation overall economic performance. The province also posted stronger growth in business non-residential investment in 2001-2010 than in the previous decade (although this did not extend to investment in machinery and equipment).

As a small jurisdiction, BC can't do much to affect global economic conditions (or even national economic variables like interest rates), but it does have influence over how it reacts to those conditions. Comparing BC's performance to Canada's on different economic indicators is a useful way of capturing that effort, and it is here that BC registered some appreciable gains in the 2000s.



Source: Statistics Canada, Provincial Economic Accounts
GDP in chained 2002 dollars

The data reported above only extend through 2010, and so far we have said nothing about how the province's economy performed in the most recent calendar year, 2011. As it happens, BC did relatively well in 2011, with the province's real GDP increasing by 2.9%, compared to 2.4% for Canada. Real GDP per capita rose by approximately 1.3%, while in Canada the average gain was less than 1%. In addition, real per capita income grew faster in BC than in the country as a whole. However, BC trailed Canada in employment growth (0.8% compared to 1.5% nationally) in calendar 2011.

Finally, we close with a brief comment on the trend in the level of economic output or real GDP per person over the past three decades. As shown in the adjacent figure, two decades ago British Columbia boasted a higher level of real GDP per person than Canada. This advantage diminished and then disappeared over the 1990s, and by 2001 BC had fallen behind the national average by almost $3,400. The gap in per capita GDP narrowed over the first decade of the 2000s, but by 2010 we still stood below the national benchmark by $1,958. So based on this core measure of economic success, it is fair to say that British Columbia has no grounds for complacency.

In the coming months, the Business Council plans to undertake further work on the determinants of prosperity for a small open market economy like British Columbia.

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