

POLICY PERSPECTIVES



Business Council of
British Columbia
Est. 1966

VOLUME 29, ISSUE 2, JULY 2022

STUCK IN THE SLOW LANE: A CLOSER LOOK AT CAPITAL INVESTMENT TRENDS IN CANADA AND BRITISH COLUMBIA

HIGHLIGHTS

- The OECD projects that Canada will be the worst performing economy out of 38 advanced countries over 2020-30 and 2030-60, with the lowest growth in real GDP per capita. The principal reason is Canada's serial inability to generate meaningful gains in labour productivity (real output per hour worked) and real market incomes. Low and declining investment per available worker is an important contributor to this.
- Alberta businesses consistently invest significantly more per available worker than firms elsewhere in Canada. Canadian investment per available worker is low and falling compared to other countries – but it would be even lower if not for Alberta.
- British Columbia's total investment (residential and non-residential) per available worker is slightly higher than the "Rest of Canada" (i.e., Canada excluding B.C. and Alberta). This reflects relatively high investment per available worker in residential structures and non-residential structures (the latter reflects several major capital projects), partly offset by relatively low investment in machinery and equipment (M&E) and intellectual property products (IPP).
- In 2020, B.C.'s real investment per available worker by asset type was \$9,700 in residential structures, \$8,200 in non-residential structures (\$4,500 excluding major capital projects), \$2,700 in M&E, and \$1,500 in IPP. All figures are measured in 2012 constant prices.
- B.C. firms have a modest advantage over the Rest of Canada (but not Alberta) in non-residential investment per available worker. This is because there are currently several major capital projects underway that are lifting *structures* investment.
- B.C. firms' investment per available worker in M&E and IPP, respectively, have been declining since about 2007. Investments per available worker in both asset types are consistently lower than the Rest of Canada.
- B.C. has an unusually large share of its economy focused on constructing, renovating, and trading residential structures compared to other regions (and other countries). On average over 1981-2020, British Columbians invested around \$1,400 more per available worker (\$900 more per capita) in residential structures than the Rest of Canada. Since 1987, B.C. has consistently invested more in residential structures than any other asset type.
- Possible reasons for Canada and B.C.'s serially poor business non-residential investment performance compared to other countries include: antiquated federal and provincial tax systems; inefficient regulatory approval processes at all levels of government; punitive corporate income tax rates on businesses that grow net income beyond \$0.5 million; lack of relief for energy-intensive, trade-exposed industries in B.C.'s carbon tax regime, unlike the backstop federal carbon tax regime; B.C.'s inefficient provincial sales tax (PST) regime; high internal barriers to trade across provinces; and Canada and B.C.'s retreat from international trade since 2000.
- Canadian and B.C. policymakers are unwittingly pursuing labour-intensive economic growth strategies during the digital fourth industrial revolution. As other countries shift their economies toward higher value-added, capital- and technology-intensive activities suited to the digital age, the data indicates Canada is instead gravitating toward lower value-added, labour-intensive activities. This will likely perpetuate serially low growth in labour productivity and real market incomes, consistent with the OECD's projections for real GDP per capita in Canada and, by extension, B.C.

INTRODUCTION

The OECD projects that Canada will be the worst performing economy out of 38 advanced countries over 2020-30 and 2030-60, with the lowest growth in real GDP per capita ([Williams 2021](#)). The principal reason is our serial inability to make meaningful gains in labour productivity (real output per hour worked). The OECD predicts Canada will generate the lowest rate of annual productivity growth of any advanced country over 2030-60.

Low and falling levels of capital investment per worker (except in residential structures), along with comparatively low levels of innovation and business scaling, help explain Canada's poor productivity growth performance. This paper delves into capital investment trends from 1981-2020, with particular attention on British Columbia compared to Alberta, the "Rest of Canada" (i.e., Canada excluding B.C. and Alberta), and Canada as a whole.

HOW DOES CANADA COMPARE TO OTHER COUNTRIES?

Before comparing B.C.'s investment performance with its domestic peers, it is important to recognise that international comparisons show Canada's investment track record is poor. This means Canada is a weak benchmark for B.C., and the Rest of Canada is an even weaker one. In a landmark paper, [Robson and Wu \(2021\)](#) found that the average Canadian firm invests far less per available worker than average firms in other advanced countries – and the gap is increasing. The authors

found that, on average, Canadian firms invest around \$7,000 less per available worker per annum than the OECD average. **To put it another way, for every dollar spent on capital investment by an average firm across the OECD, the average Canadian firm invests only 60 cents. For every dollar spent on capital investment by an average U.S. firm, the average Canadian firm invests even less, just 50 cents** ([Robson and Wu, 2021](#)).

[Robson and Wu \(2021\)](#) conclude that as other countries shift their economies toward high value-added, capital- and technology-intensive activities, ours appears to be transitioning toward lower value-added, labour-intensive activities. This will almost certainly doom Canadians to anemic growth in their real market incomes. These findings are consistent with the OECD's projections for real GDP per capita, cited earlier.

METHODOLOGY AND DATA

The analysis largely follows the methodology of [Robson and Wu \(2021\)](#). Specifically:

- Economic theory, such as in the seminal paper by [Solow \(1956\)](#), predicts that workers in an economy are more productive – that is, they generate higher value-added (output) per hour worked – when they have larger stocks of capital, tools and technology to work with. Therefore, capital accumulation contributes to higher labour productivity, real GDP per capita, and real market incomes.
- Although governments undertake capital investment, particularly in

infrastructure, the analysis focuses on private sector investment because it has met a market test. It is therefore presumed to increase labour productivity and real market incomes.

- The main metric for the analysis here is *capital investment per available worker*. The denominator, "available worker," is the labour force (number of persons). The labour force is a better denominator than employment, because the former abstracts from business cycle changes in the unemployment rate. The labour force will, however, still be affected by cyclical changes in the participation rate. For comparison, some investment series are also presented as a percent of GDP and on a per capita basis.

This paper departs from [Robson and Wu \(2021\)](#) in several respects:

- There is no international analysis. That can be found in [Robson and Wu \(2021\)](#).
- British Columbia's investment performance is compared to Canada, the Rest of Canada (i.e., Canada excluding B.C. and Alberta), and Alberta.
- The analysis examines long-term trends using *annual* investment data since 1981, from [Statistics Canada Table 36-10-0222-01](#). In contrast, [Robson and Wu's \(2021\)](#) study looked at quarterly investment data since 1991. Labour force data used here is also annual, from [Statistics Canada Table 14-10-0327-01](#).
- The unit of analysis for investment is real (price-adjusted) volumes in constant 2012 prices.¹ The series are additive and allow for comparisons between B.C. and the Rest of Canada.

¹ The chained volume approach uses the Fisher method to convert nominal investment dollars to real volumes. However, Fisher-based series are not additive. The advantage of the constant price approach used here, which is based on the Laspeyres method, is that series are additive.

- The analysis includes residential structures investment, defined in the national accounts as expenditure on new and renovation residential construction, plus expenses to transfer ownership of existing and new real estate (i.e., realtor commissions, land transfer taxes, and conveyancing, inspection and survey fees). Like business investment, residential structures investment has met a market test, albeit one set (mostly) by households. Residential structures investment does not necessarily raise the economy's long-term productive capacity, other than through the expansion of consumption (specifically, shelter services for households). Nonetheless, residential structures absorb scarce capital and labour resources to produce and trade, and are therefore an important part of Canada and B.C.'s overall capital investment story.
- The analysis in this paper focuses on business gross fixed capital formation (i.e., total investment, including residential and non-residential investment); residential structures investment (defined above); and business non-residential investment. The latter is calculated as total investment less residential structures investment. The sub-components of business non-residential investment are: structures (engineering structures and non-residential buildings); machinery and equipment (M&E); and intellectual property products (IPP, including software, research and development, and mineral exploration). Note that Statistics Canada applies "adjusting entries" to these sub-components when summing to business gross fixed capital formation.

HOW DOES CAPITAL INVESTMENT IN B.C. COMPARE WITH OTHER PROVINCES?

Figure 1 shows total capital investment (including residential and non-residential investment) per available worker. The first feature to note that is that Alberta attracts significantly more investment per available worker than other provinces. Alberta's total investment (measured in 2012 constant prices) peaked at \$51,000 per available worker in 2014. Even after several years of decline, Alberta still saw real investment of \$24,400 in 2020. Alberta has *always* exceeded Canada and the Rest of Canada (i.e., Canada excluding B.C. and Alberta) in total capital investment per available worker – and always by a sizable margin.

In 2020, B.C. saw real total investment of around \$22,100 per available worker, modestly surpassing the previous high of \$19,300 at the end of the 2000-08 business cycle. B.C.'s total investment per available worker lags Alberta but exceeds Canada and Rest of Canada. B.C. consistently lags Alberta, but the gap is the smallest since the 1980s. As will be discussed, B.C.'s recent investment trends are heavily influenced by a long boom in residential structures investment, and by several major engineering projects in the province since 2011.

COMPOSITION OF CAPITAL INVESTMENT IN B.C.

Figure 2 shows B.C. real investment by major asset type, as a percent of GDP. Since 1987, the province

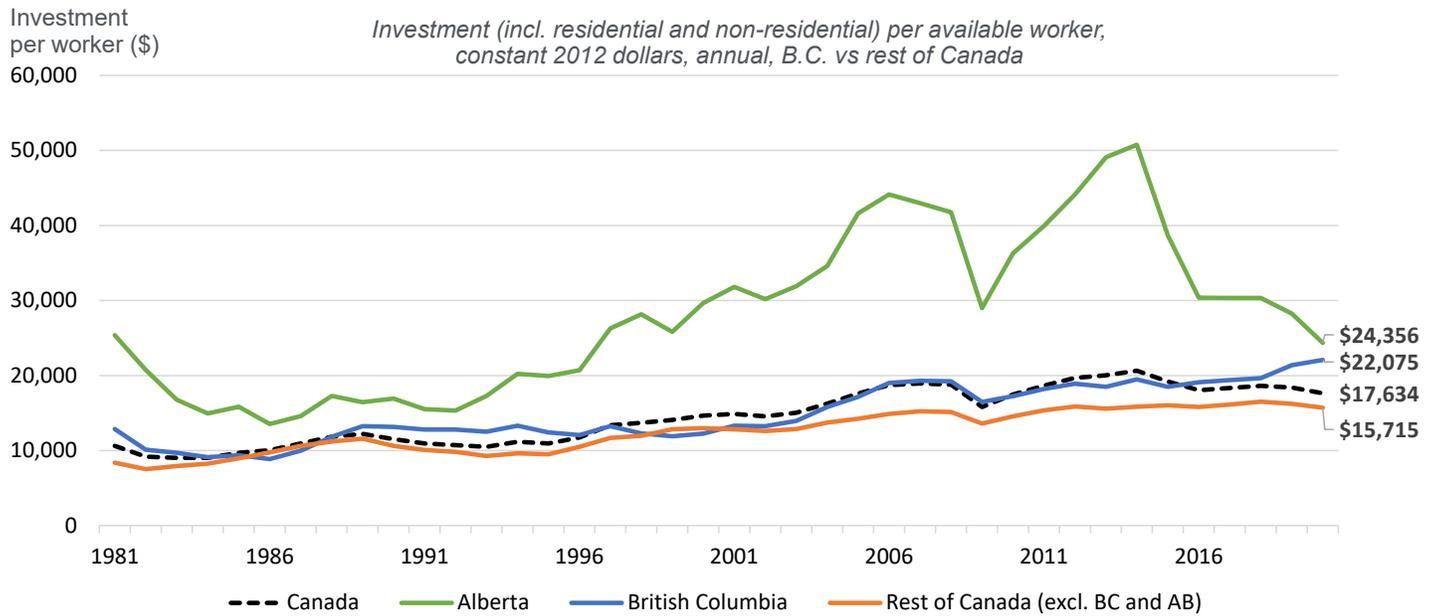
Low and falling levels of capital investment per worker, along with comparatively low levels of innovation and business scaling, help explain Canada's poor productivity growth performance.

has attracted more investment in residential structures than any other asset type. **Over 2016-2020, around 10% of B.C.'s GDP was devoted to building, renovating and trading residential structures, a level not seen since 1992.** The share of GDP directed toward residential structures has boomed since 2000 when investment in this asset type was only 6% of B.C.'s economy.

B.C. attracted \$9,700 of residential structures investment per available worker in 2020, compared to only \$8,200 in non-residential structures (\$4,500 excluding major capital projects), \$2,700 in M&E, and just \$1,500 in IPP (**Figure 3**). After rising from 1981-2008, investments in M&E and IPP have been falling since the Global Financial Crisis (i.e., the end of the 2000-08 business cycle).

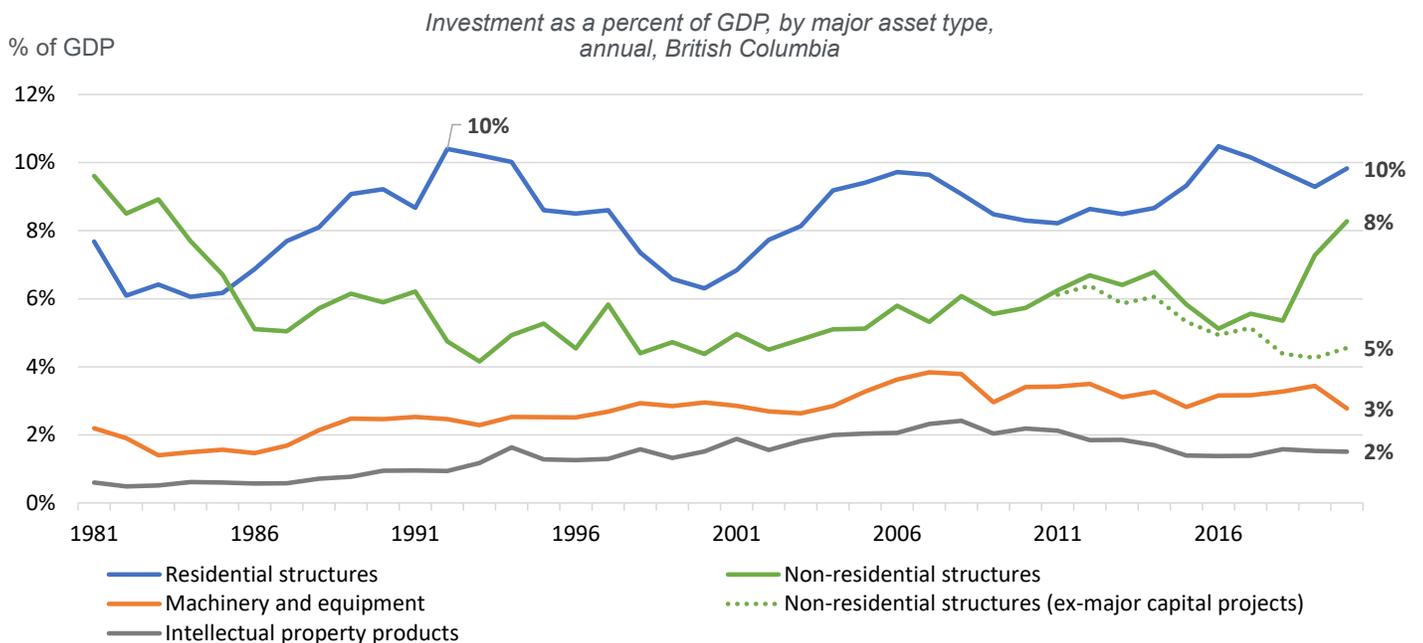
After residential structures, non-residential structures are B.C.'s second largest investment type. To show the impact of major capital projects since 2011, we exclude the estimated impact of the Rio Tinto smelter upgrade in Kitimat, the Trans Mountain pipeline expansion, the Coastal GasLink project and the LNG Canada project. All else being equal, our estimates suggest that these projects drove just over half of B.C.'s

FIGURE 1: B.C.'S TOTAL CAPITAL INVESTMENT PER WORKER EXCEEDS REST OF CANADA — DUE TO MAJOR PROJECTS AND RESIDENTIAL STRUCTURES



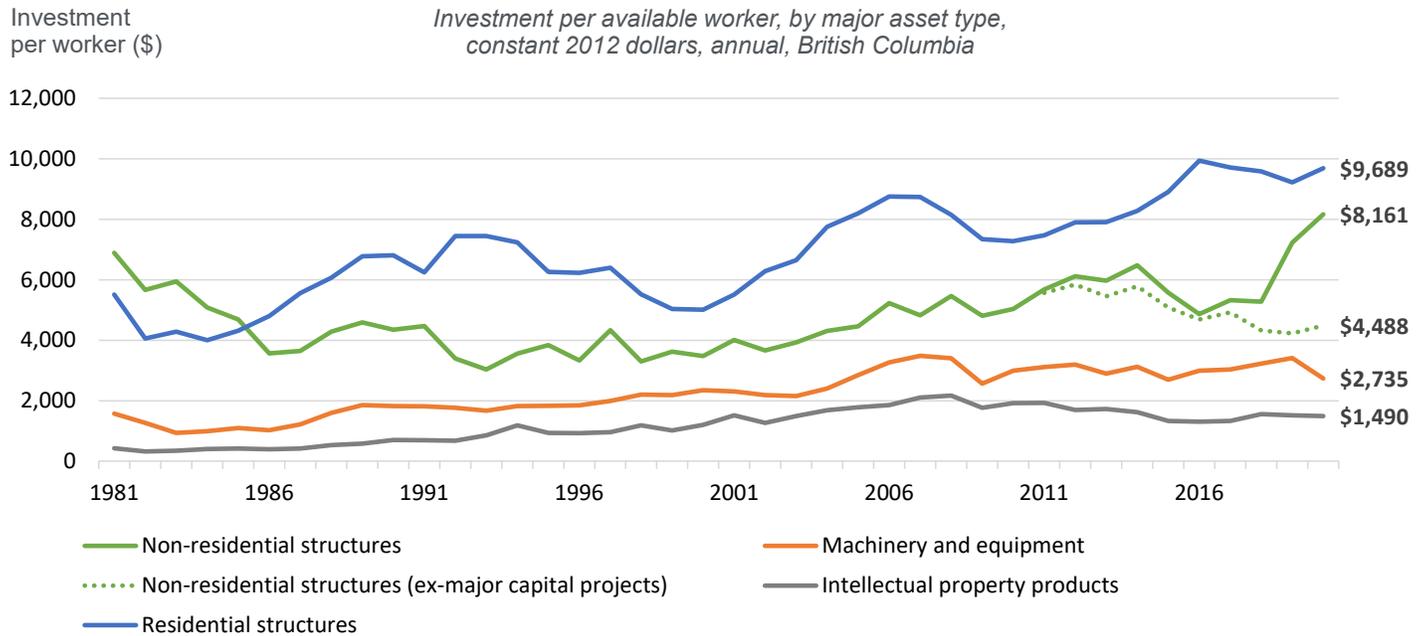
Source: Statistics Canada, BCBC.

FIGURE 2: B.C.'S ECONOMY IS UNUSUALLY FOCUSED ON INVESTMENT IN CONSTRUCTING, RENOVATING & TRADING RESIDENTIAL STRUCTURES



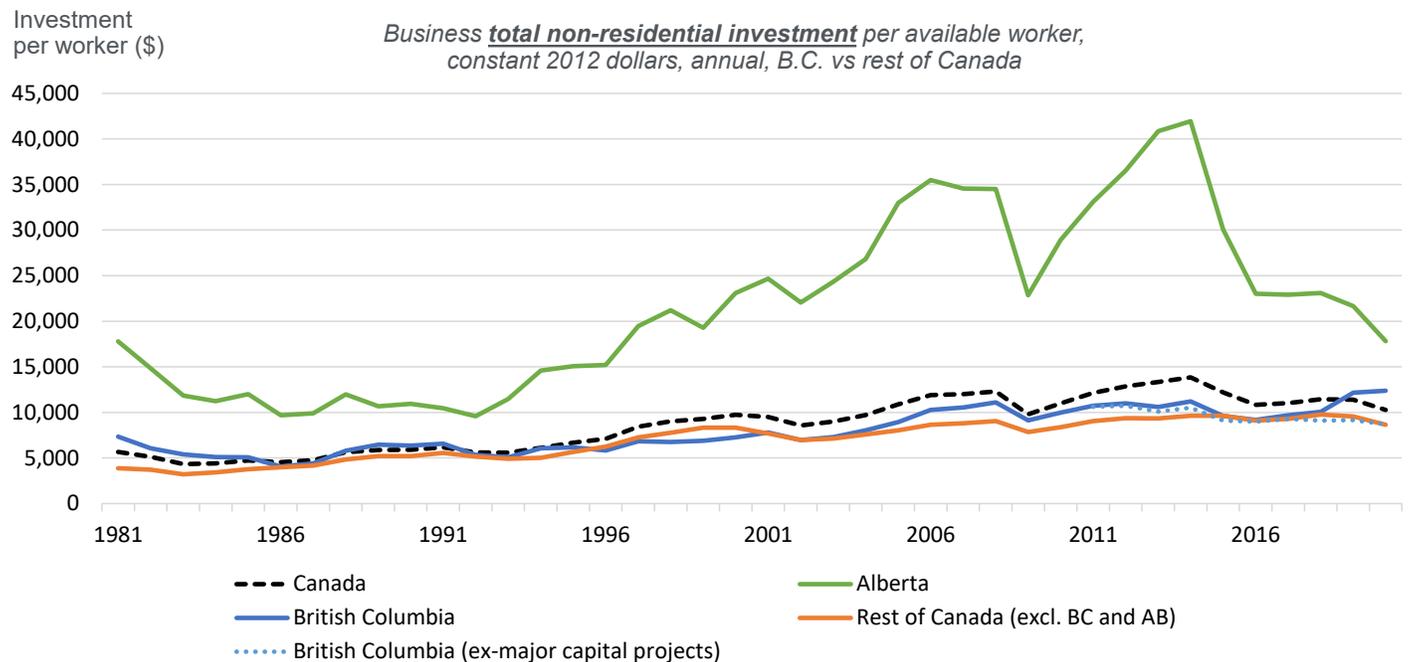
Source: Statistics Canada, BCBC.

FIGURE 3: **B.C. INVESTS MORE IN CONSTRUCTING, RENOVATING & TRADING RESIDENTIAL STRUCTURES THAN IN ANY OTHER ASSET**



Source: Statistics Canada, BCBC.

FIGURE 4: **BUSINESS TOTAL NON-RESIDENTIAL INVESTMENT PER WORKER IS CURRENTLY ABOVE REST OF CANADA**



Source: Statistics Canada, BCBC.

structures investment in 2020.² As these projects are completed over the next few years, other investment will need to pick up the slack – or else total non-residential investment in the province could fall.

HOW DOES BUSINESS NON-RESIDENTIAL INVESTMENT IN B.C. COMPARE TO OTHER PARTS OF CANADA?

Total non-residential investment

Figure 4 shows business total non-residential investment (calculated as total investment less residential structures investment) per available worker. Businesses in Alberta invest significantly more than businesses anywhere else in Canada. Alberta leads the country in investment per available worker in structures, M&E, and IPP.

Business total non-residential investment in B.C. is typically below that in Canada but only because Alberta lifts the national average. B.C. has slightly higher investment per available worker than the Rest of Canada. In 2020, total non-residential investment per available worker was \$17,800 for Alberta, \$12,400 for B.C. (\$8,700 excluding major projects), \$10,300 for Canada, and just \$8,700 for the Rest of Canada. However, absent major capital projects, the level of business investment per available worker in B.C. tends to be similar to the Rest of Canada – which is lower than Canada – and is therefore relatively low by international standards.

B.C. firms typically lag the Rest of Canada on M&E and IPP investment per worker.

Structures investment (non-residential)

B.C. business investment in non-residential structures was \$8,200 per available worker in 2020 (**Figure 5**). Structures investment has surged in recent years due to a handful of major capital projects. Excluding B.C.'s major projects, structures investment per available worker was \$4,500 in 2020 – less than Canada (because Alberta lifts the national average) but on par with the Rest of Canada. Alberta consistently leads the country by a wide margin. Structures investment there fell from a peak of \$28,800 per available worker in 2014 to around \$10,800 in 2020, but it is still more than double the national average (\$5,300) and the Rest of Canada (\$3,900).

Machinery and equipment (M&E) investment

Alberta also leads the country in M&E investment (**Figure 6**). The gap since the mid-1990s has been enormous. In 2020, M&E investment was \$4,900 per available worker – about where it stood in the early 2000s – but down from highs of almost \$10,000 during the 2006-14 period. Still, Alberta's M&E investment per available worker in 2020 was almost double the Rest of Canada.

B.C. typically lags Alberta, Canada, and the Rest of Canada on M&E

investment. Nonetheless, B.C. saw steadily *rising* real M&E investment per available worker from the early 1980s until 2007. B.C.'s M&E investment per available worker has gradually edging down since about 2007 and was \$2,700 in 2020.

Intellectual property products (IPP) investment

Alberta has also consistently led the country in investment in IPP (software, research and development, and mineral exploration). In 2020, Alberta's IPP investment was \$2,100 per available worker, while investment in the Rest of Canada was \$2,000. This was the narrowest gap since the 1980s (**Figure 7**).

B.C. typically lags the Rest of Canada on IPP investment and the gap is the widest it has been in decades. Real investment per available worker in B.C. rose from \$300-400 in the early 1980s to a peak of \$2,200 in 2008. It has since declined to \$1,500 in 2020, well below the Rest of Canada.

HOW DOES NON-RESIDENTIAL INVESTMENT IN B.C. COMPARE WITH OTHER PARTS OF CANADA?

Figure 8 shows side-by-side charts of business total non-residential investment and residential structures investment *as a share of GDP*. To reiterate, business total non-residential investment includes non-residential structures, M&E and IPP. Residential structures investment includes expenditures on constructing and renovating

² The Trudeau Government nationalised the Kinder Morgan pipeline expansion project on August 31, 2018. What had been *private sector* investment became public sector investment and thus should be beyond the scope of this paper. Unfortunately, it is not possible to disentangle investment spending concerning the (public sector) Trans Mountain pipeline project from the (private sector) Coastal Gas pipeline project, as both projects boost all-industries transport investment and are underway concurrently. Our estimate of "major projects" investment is therefore slightly overestimated (because the Trans Mountain project is still included after August 2018 even though it is public sector investment). Consequently, our estimates of various investment series "excluding major projects" are slightly underestimated for 2018-20.

residential structures, plus expenditures to transfer ownership of existing and new real estate between owners.

Alberta leads the country in business total non-residential investment (Figure 8, left panel). B.C.'s non-residential investment as a share of GDP in 2020 was almost on par with Alberta at 13% of GDP. For B.C. this was a record share of GDP and reflected capital spending on a small number of major capital projects.

B.C. leads in the country in residential structures investment (Figure 8, right panel). **In 2020, around 10% of B.C.'s economy was focused on constructing, renovating, and trading residential structures, compared to 7% for Canada and Rest of Canada, and just 5% for Alberta.**

Figure 9 shows residential structures investment per capita (left panel) and per available worker (right panel). Regardless of metric, B.C. consistently invests more in residential structures than the Rest of Canada and the national average. B.C. usually invests more than Alberta too. In 2020, B.C. invested \$9,700 per available worker in residential structures, about 37% more than the Rest of Canada (\$7,100). Adjusting for population size, B.C. residential structures investment was \$6,200 per head of population in 2020, compared to around \$4,500 per head in the Rest of Canada and Alberta.

UNDERSTANDING B.C.'S INVESTMENT GAP

B.C.'s investment gap with Canada

B.C. non-residential investment lagged Canada by about \$700 per

In 2020, around 10% of B.C.'s economy was focused on constructing, renovating, and trading residential structures, compared to 7% for Canada and Rest of Canada, and just 5% for Alberta.

available worker on average over 1981-2010 (Figure 10). However, this is mainly because Alberta lifts the national average. Due to a few ongoing large projects, B.C. currently has a positive investment gap with Canada. This has not happened since the 1980s.

Figure 11 shows the investment gap with Canada by asset type. B.C. consistently invests less than Canada on M&E and IPP. It has also typically had a negative gap with Canada on non-residential structures, except during the 1980s and in 2019-20.

Residential structures investment in B.C. in 2020 was \$2,300 per available worker above the national average for Canada (Figure 10). On average over 1981-2020, British Columbians spent around \$1,100 more per available worker (\$700 more per capita) on constructing, renovating and trading residential structures than Canada.

B.C.'s investment gap with the Rest of Canada (i.e., Canada excluding B.C. and Alberta)

Figure 12 shows the investment gaps between B.C. and the Rest of Canada. In 2020, B.C. spent \$2,600 more per available worker (\$1,700 per capita) on constructing, renovating and trading residential structures than the Rest of Canada. On average over 1981-2020, British Columbians spent

around \$1,400 more per available worker (\$900 more per capita) on residential structures investment than the Rest of Canada.

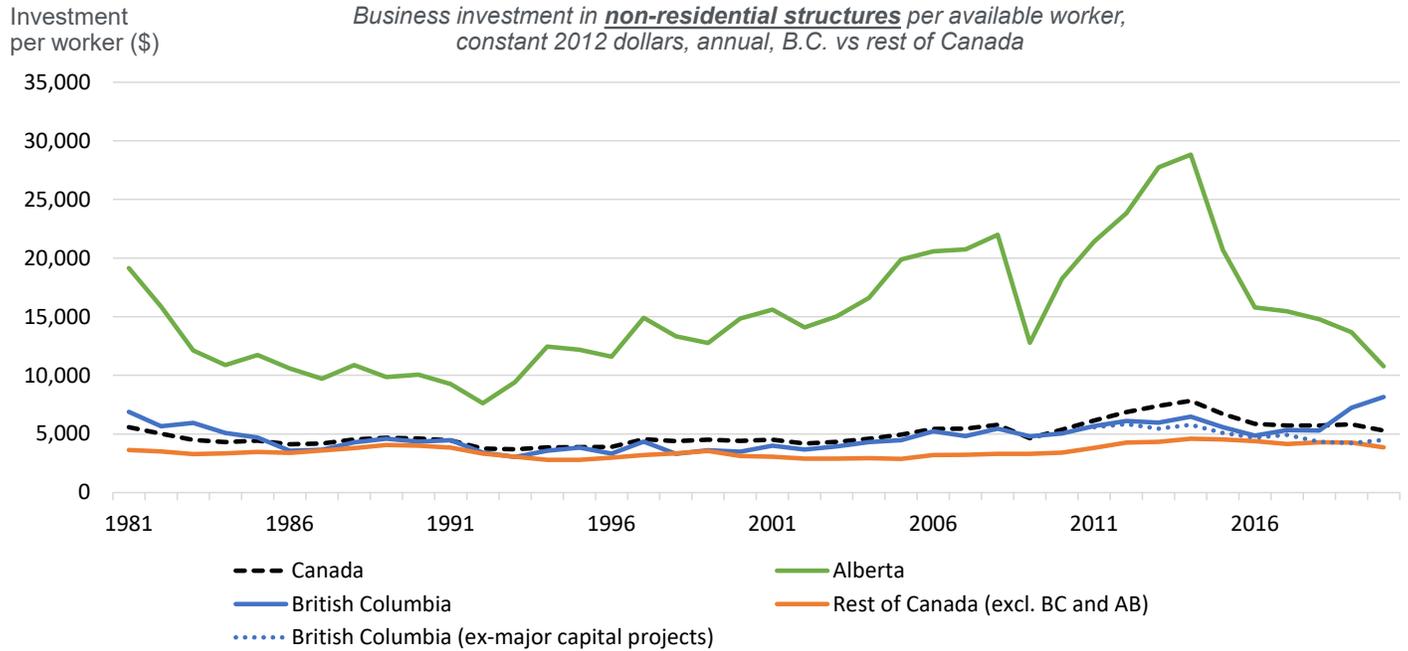
B.C. non-residential investment exceeded the Rest of Canada by an average of \$800 per available worker over 1981-2010. As shown above (Figure 10), this compares to an average gap of -\$700 with respect to Canada as a whole. Due to a few major capital projects since 2011, B.C. currently has a large positive business non-residential investment gap of around \$3,700 per available worker compared to the Rest of Canada. The gap is concentrated in non-residential structures (Figure 13). B.C. consistently invests less than the Rest of Canada on M&E and IPP.

DISCUSSION

When considering Canada's investment performance, Alberta truly is in a different league. Businesses in Alberta consistently invest significantly more than other businesses in non-residential structures, M&E and IPP. This reflects the large role played by the capital-intensive and export-oriented oil and gas industry in Alberta's economy. Canada's business investment performance may be poor compared to other countries (Robson and Wu, 2021), but it would be far bleaker without Alberta.

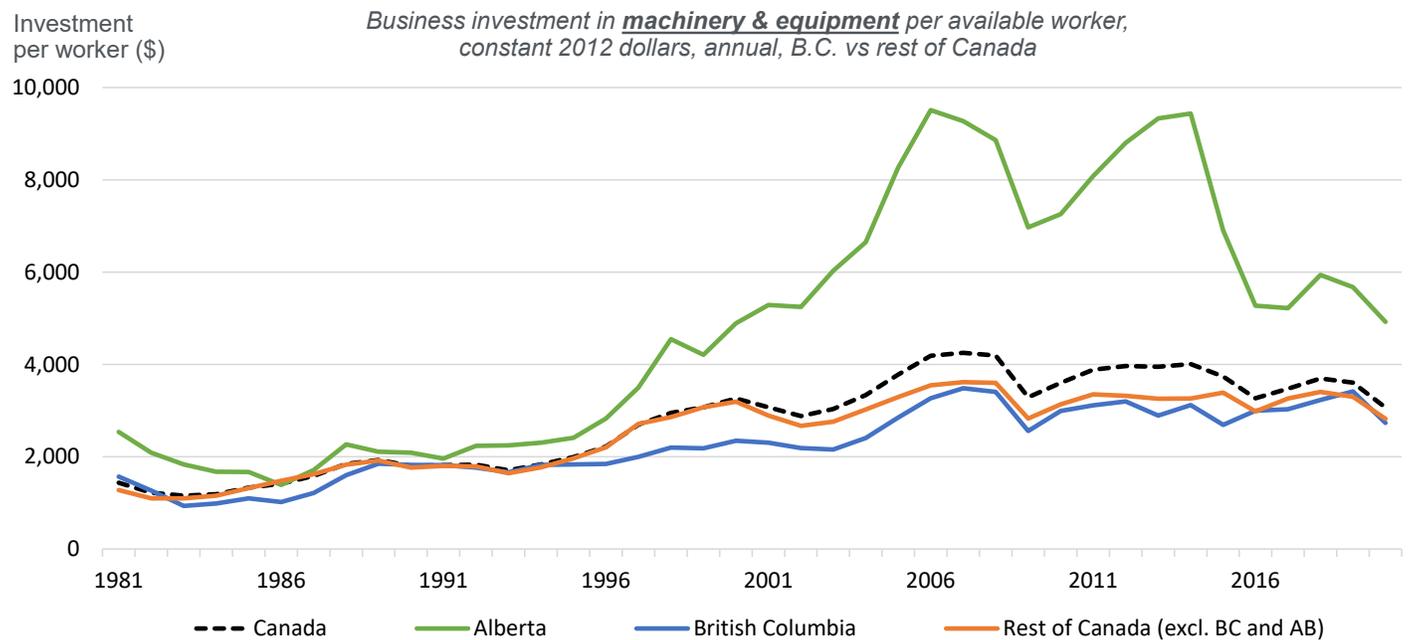
Since 1987, B.C. has attracted more investment in residential structures than any other asset type (Figures 2 and 3). In 2020, B.C. saw about \$9,700 of residential structures investment per available worker, compared to \$12,400 of total non-residential investment (\$8,700 excluding major capital projects). After rising from 1981 until

FIGURE 5: MAJOR PROJECTS HAVE LIFTED B.C. FIRMS' INVESTMENT PER WORKER IN NON-RESIDENTIAL STRUCTURES



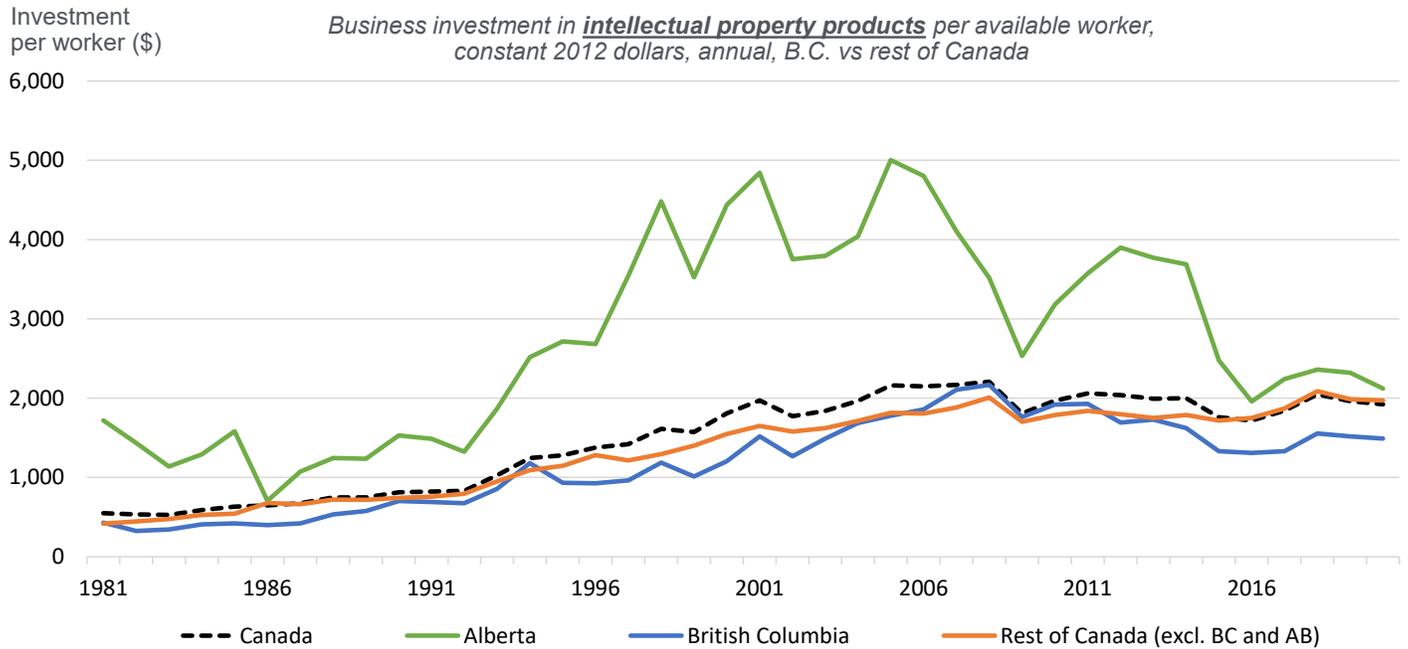
Source: Statistics Canada, B.C.

FIGURE 6: B.C. FIRMS' INVESTMENT PER WORKER IN MACHINERY & EQUIPMENT HAS DECLINED SINCE 2007



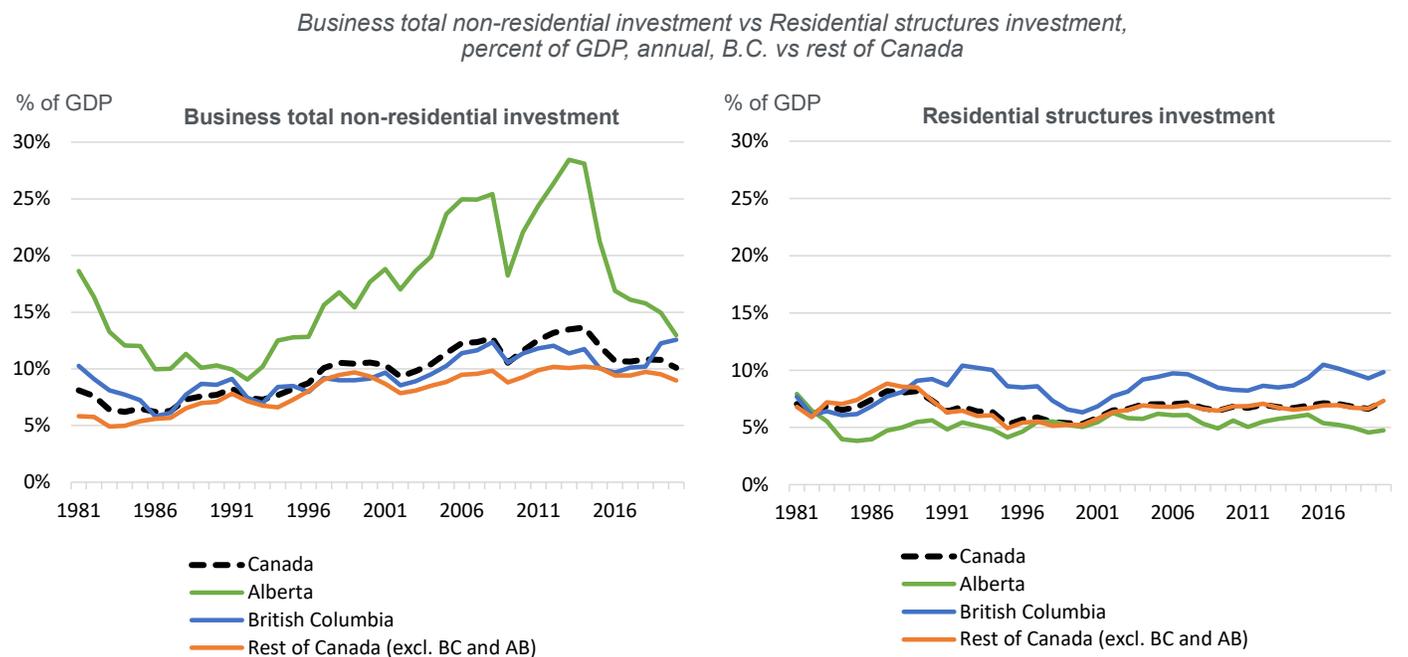
Source: Statistics Canada, BCBC.

FIGURE 7: B.C. FIRMS' INVESTMENT PER WORKER IN INTELLECTUAL PROPERTY PRODUCTS HAS DECLINED SINCE 2007



Source: Statistics Canada, BCBC.

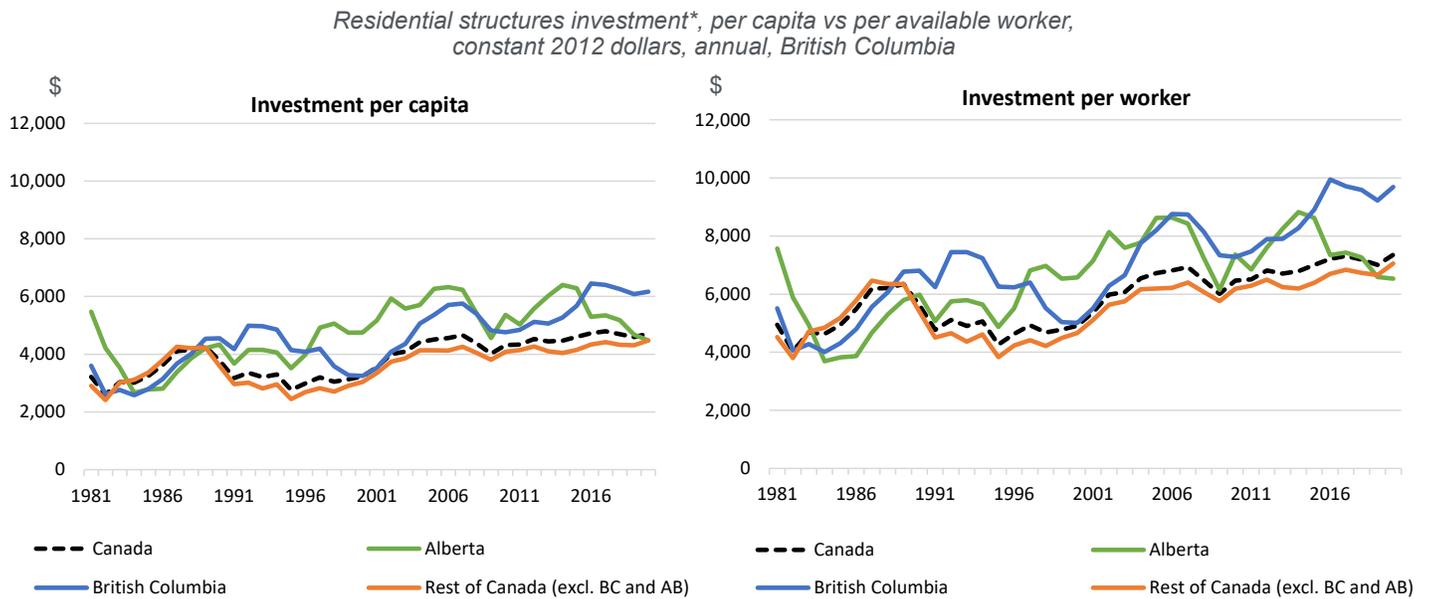
FIGURE 8: B.C.'S ECONOMY HAS BEEN UNUSUALLY TIED TO RESIDENTIAL STRUCTURES INVESTMENT SINCE ABOUT 1990



Source: Statistics Canada, BCBC.

*Expenditure on new and renovation residential construction, and costs to transfer ownership of existing and new real estate.

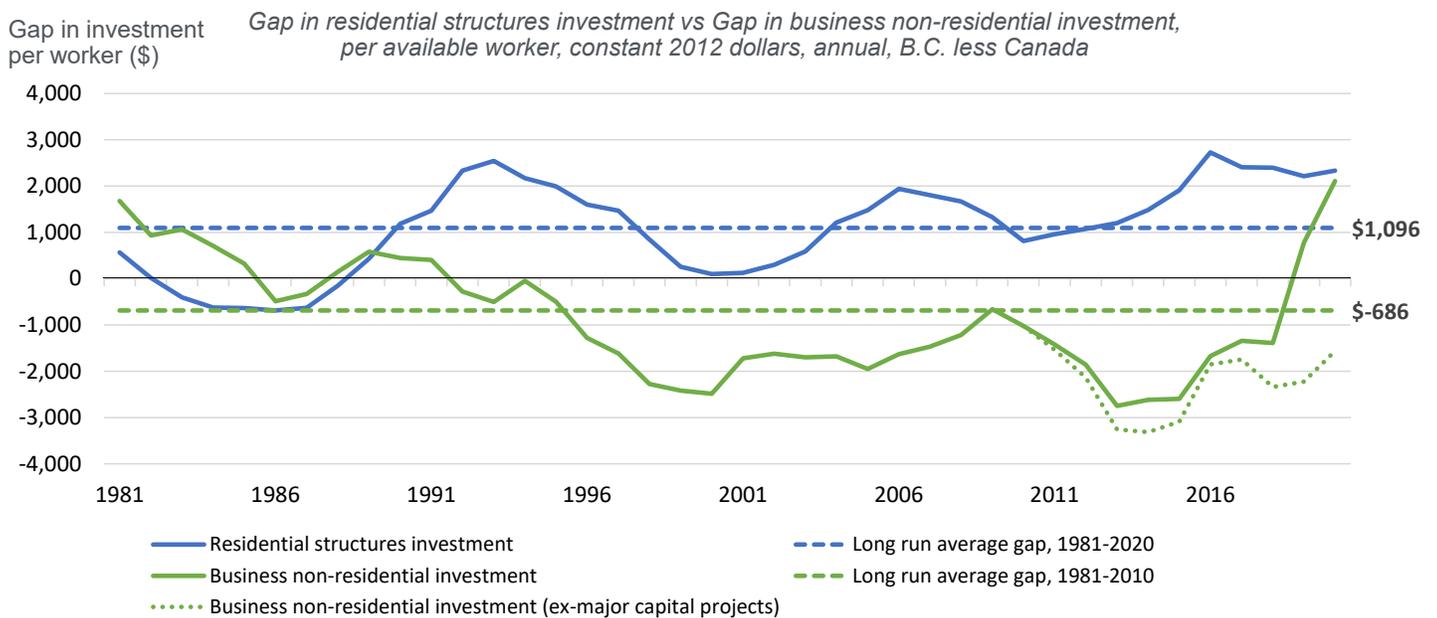
FIGURE 9: B.C. INVESTS FAR MORE THAN CANADA IN CONSTRUCTING, RENOVATING AND TRADING RESIDENTIAL STRUCTURES



Source: Statistics Canada, BCBC.

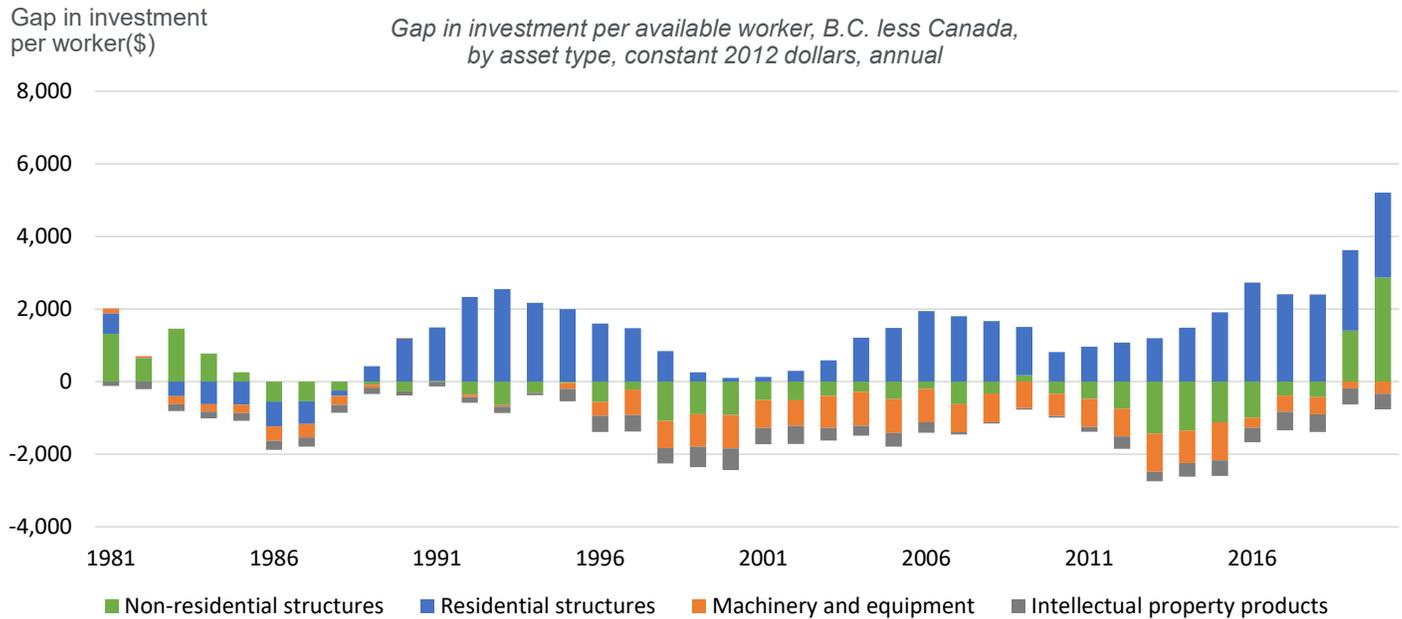
*Expenditure on new and renovation residential construction, and costs to transfer ownership of existing and new real estate.

FIGURE 10: MIND THE GAP! COMPARED TO CANADA, B.C. TYPICALLY INVESTS \$1,100 MORE PER WORKER IN RESIDENTIAL STRUCTURES AND \$700 LESS IN BUSINESS NON-RESIDENTIAL CAPITAL



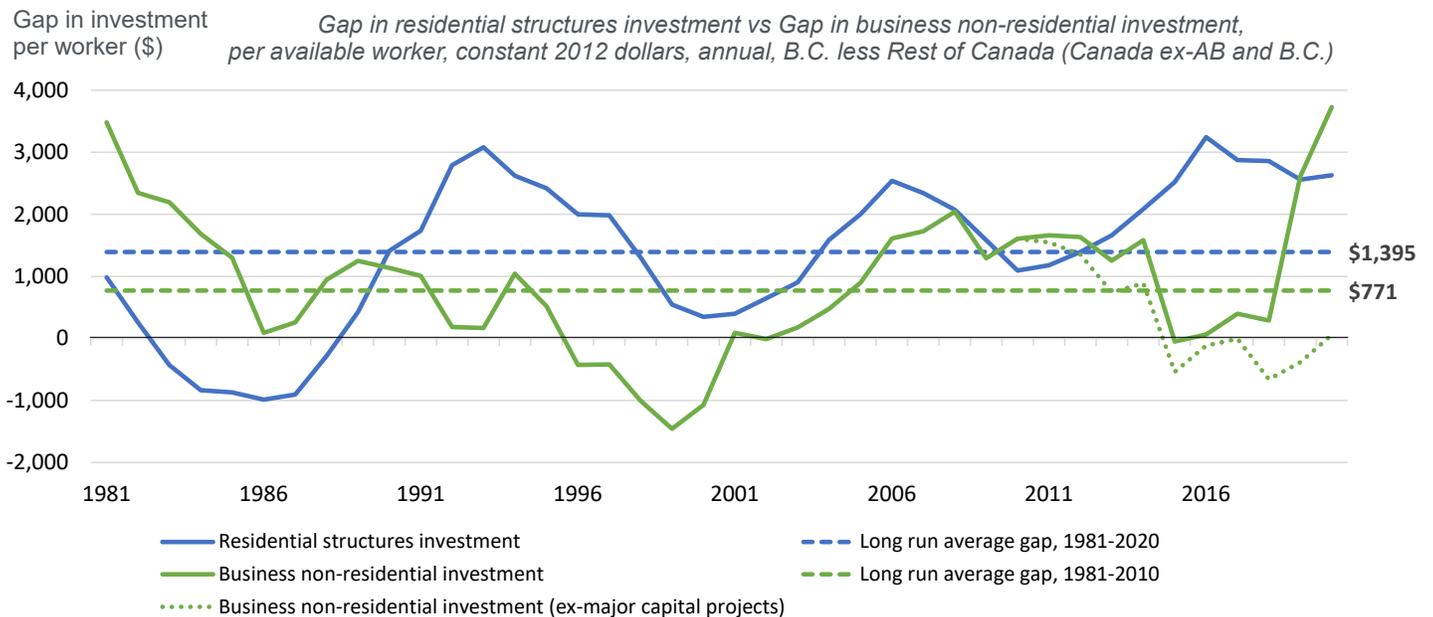
Source: Statistics Canada, BCBC.

FIGURE 11: B.C. LAGS CANADA IN INVESTMENT PER WORKER ACROSS MOST ASSETS (EXCEPT RESIDENTIAL STRUCTURES)



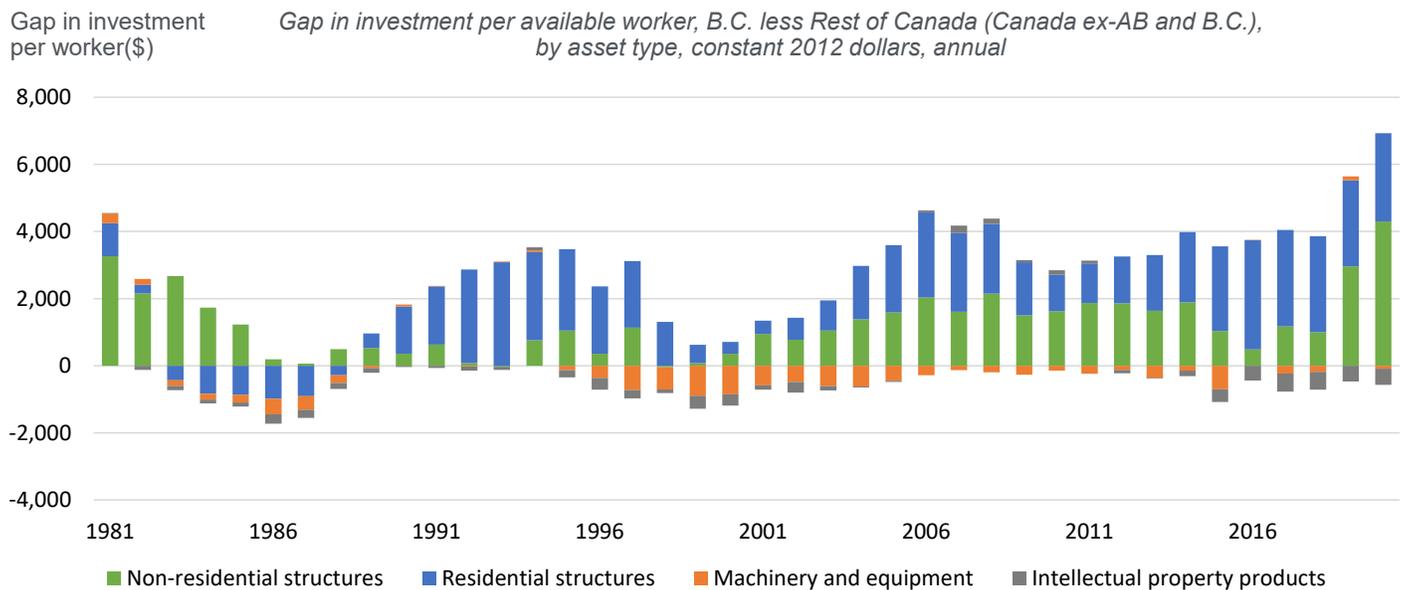
Source: Statistics Canada, BCBC.

FIGURE 12: COMPARED TO REST OF CANADA, B.C. TYPICALLY INVESTS \$1,400 MORE PER WORKER IN RESIDENTIAL STRUCTURES AND \$800 MORE IN BUSINESS NON-RESIDENTIAL CAPITAL



Source: Statistics Canada, BCBC.

FIGURE 13: B.C. HAS A POSITIVE INVESTMENT PER WORKER GAP WITH REST OF CANADA, CONCENTRATED IN RESIDENTIAL AND NON-RESIDENTIAL STRUCTURES



Source: Statistics Canada, BCBC.

2008, investments in M&E and IPP have been falling since the Global Financial Crisis (i.e., the end of the 2000-08 business cycle). As B.C.'s major capital projects wind down over the next few years, it will be important for new projects to pick up the slack – otherwise non-residential structures investment per available worker could fall too.

B.C. has a rising and an unusually large share of its economy focused on constructing, renovating, and trading residential structures compared to other regions. B.C. exceeds Canada, the Rest of Canada, and Alberta regardless of whether residential structures investment is measured as a share of GDP, per available worker, or per capita. All three metrics are currently around record levels and could fall in coming

years as central banks raise interest rates rise and shrink their balance sheets to rein in runaway inflation.

B.C. lags Canada on business total non-residential investment per available worker. However, this is mostly because Alberta lifts the national average. Compared to the Rest of Canada, B.C. has a slight advantage in non-residential investment per available worker which is entirely concentrated in structures. B.C. consistently invests less than the Rest of Canada in M&E and IPP.

POSSIBLE REASONS WHY CANADIAN INVESTMENT IS POOR AND POLICY AREAS TO ADDRESS

B.C.'s investment performance is not particularly impressive except in

residential structures and, in recent years, non-residential structures due to a handful of major capital projects. The same international criticisms levelled at Canada regarding its low capital investment per available worker are mostly applicable to B.C. too.

What structural factors could be contributing to Canada (except Alberta) and B.C.'s declining business investment performance compared to other countries?

- **Outdated and unwieldy tax systems** – the last comprehensive review of the Canadian tax system was the Royal Commission of the 1960s chaired by Kenneth Carter. Calls for B.C. to holistically review and modernise the provincial tax system have similarly gone unheeded. Many other countries have reviewed,

modernised, and streamlined their tax systems during in the past 60 years. Canada has not done this. The likely result is that it costs Canada and B.C. more – in terms of forgone output (i.e., real income) – to raise each dollar of tax revenue to fund public services and income supports.

- **Inefficient regulatory processes** – Canada and B.C.’s regulatory approval processes are widely regarded as excessively long, bureaucratic, complex, inefficient, uncertain, and politicised compared to other countries, while being no more effective in achieving desired environmental and social outcomes than in other advanced countries.
- **Punitive corporate income taxes on business scaling** – the corporate income tax more than doubles when Canadian companies grow their net income above \$0.5 million. By its design, the corporate tax system discourages capital accumulation and business scaling around and beyond that point.³
- **Disappearance of Canada’s traditional corporate tax advantage over the United States** – Canada no longer has a material advantage over the United States with respect to the corporate income tax rate and the overall income tax burden on large businesses.

Decreasing openness to trade and waning international competitiveness are contributors to low labour productivity growth in Canada and B.C.

- **High business property taxes** – business property owners are generally required to pay an outsized share of municipal property taxes compared to residential property owners. This is certainly the case in B.C.

- **Canadian policymakers like to “pick winners” with taxpayers’ dollars, with few demonstrated successes** – Canada’s political class over the past 20 years has arguably had a more than occasional predilection for introducing pet tax and subsidy programmes that try to “pick winners” and benefit narrow constituencies, rather than attempting holistic (but politically and technically challenging) reforms where economic gains are widely shared.

- **B.C.’s carbon tax regime differs from the backstop federal carbon tax** – it offers limited relief for energy-intensive, trade-exposed (EITE) industries. Relief for average-income households is also less than under the federal scheme. Also, although introduced in 2008 on a revenue-neutral basis, B.C.’s carbon tax (the first in North America) has long since been used as a net revenue source for the provincial treasury.

- **B.C.’s provincial sales tax (PST) system unduly penalises capital investment** – most other advanced countries replaced arcane PST-style sales tax regimes decades ago. Under the PST, sales taxes cascade through the value-chain as, at each stage of production, sales taxes are charged on tax-inclusive prices (“taxes-on-taxes”). The PST is

therefore distortionary and inefficient (costly) compared to modern value-added taxes like the GST/HST. GST-style taxes provide input tax credits and, as a result, sales taxes are effectively levied *once* at the *final* point-of-sale. The PST contributes to B.C. having the highest marginal effective tax rate (METR) on new capital investment in Canada. On average, B.C.’s treasury claims about one-quarter (25.6%) of the pre-tax returns on new capital investment in B.C., compared to an average METR of 15.6% across Canada ([Bazel and Mintz, 2021](#)). In addition, the absence of input tax credits means the PST encourages hidden and unreported transactions. Statistics Canada data shows B.C.’s underground economy is booming and is the largest in Canada ([Williams, 2019](#)). Other taxpayers unfairly bear the costs of hidden and unreported transactions.

- **Canada and B.C.’s retreat from international trade** – the economies of Canada and B.C. are becoming more insular. Exports have steadily declined as a share of GDP since 2000 ([Peacock and Finlayson, 2022](#)). In contrast, virtually all other advanced countries in the OECD have become more *open* to international trade with a rising share of exports to GDP since 2000. Decreasing openness to trade and waning international competitiveness are likely contributors to low labour productivity growth in Canada and B.C.
- **Internal barriers stifle cross-Canada trade** – Canadian provinces are highly protective of certain product markets, industries, and occupations,

³ Even for firms with less than \$0.5 million of net revenue, the corporate tax rate more than doubles when either capital in the business exceeds \$10-15 million or the firm’s passive investment income exceeds \$50,000-150,000 per annum. The 2022 Federal Budget relaxed the capital test slightly so that the small business tax rate phases out more gradually for firms operating with \$10-50 million of capital.

preventing the free flow of economic resources within Canada. [Bemrose and Brown \(2020\)](#) estimate that domestic trade regulations, on average, impose an effective tariff of around 6.9% on goods crossing provincial borders. [Deloitte \(2021\)](#) estimates that the removal of intra-Canada trade barriers would raise Canadian wages by 5.5%, household incomes by 5%, corporate profits by 2%, and real GDP per capita by \$2,100.

CONCLUSION

The OECD projects that Canada will be the worst performing economy out of 38 advanced countries over 2020-30 and 2030-60, with the lowest growth in real GDP per capita. The main reason is Canada's persistently low growth in labour productivity. Low and falling rates of real capital investment per available worker are a key contributor to this.

B.C. firms have gradually reduced their investments per available worker in machinery and equipment and intellectual property products since around 2007. Non-residential structures investment has been rising and is slightly above the Rest of Canada (i.e., Canada excluding B.C. and Alberta) but could slip by the mid-2020s as major capital projects in the province wind down. B.C. consistently invests significantly more than any other region in Canada in constructing, renovating and trading residential structures. This holds true regardless of whether residential structures investment is measured per available worker, per capita, or as a percent of GDP.

Canada and B.C.'s economic growth model relies heavily on credit-dependent industries and record high levels of immigration to drive topline GDP economic growth and demand for new housing. In our view, policymakers are paying scant attention to expanding the economy's long-term productive capacity by fostering higher business non-residential investment per worker and increasing exports as a share of GDP ([Williams and Finlayson, 2022](#)). Demonstrably, current policies are yielding scant growth in real GDP per capita and real market incomes. Canada's total capital investment per available worker is declining, except with respect to residential structures. Exports as a share of GDP have fallen in Canada and B.C. over the past two decades while they have risen as a share of GDP in most other advanced countries ([Peacock and Finlayson, 2022](#)).

Canada and B.C. appear to be pursuing unusually *labour*-intensive economic growth strategies during the digital fourth industrial revolution. As other countries shift their economies toward high value-added, capital- and technology-intensive activities, ours appears to be transitioning toward lower value-added, labour-intensive activities. This will likely perpetuate serially slow growth in real market incomes for Canadians and British Columbians.

AUTHORED BY

[David Williams, DPhil](#)
Vice President of Policy

References

- Bazel, P. and J. Mintz. 2021. "[2020 Tax competitive report: Canada's investment challenge.](#)" University of Calgary School of Public Policy, SPP Research Paper 14:21, September.
- Bemrose, R.K. and W. M Brown. 2020. "[Going the distance: Estimating the effect of provincial borders on trade when geography \(and everything else\) matters.](#)" *Canadian Journal of Economics* 53(3): 1098-1131.
- Deloitte. 2021. "[The case for liberalizing trade barriers in Canada.](#)" Report prepared for the Working Group on Interprovincial Trade Barriers, November.
- Peacock, K. and J. Finlayson. 2022. "[Long-term export underperformance underscores the need to address Canada's and B.C.'s competitiveness problems.](#)" Business Council of British Columbia, *Policy Perspectives* 29(1), February.
- Robson, W. B. P. and M. Wu. 2021. "[From chronic to acute: Canada's investment crisis.](#)" C.D. Howe Institute E-brief 312.
- Solow, R.M. 1956. "[A contribution to the theory of economic growth.](#)" *The Quarterly Journal of Economics* 70(1): 65-94.
- Williams, D. 2021a. "[OECD predicts Canada will be the worst performing advanced economy over the next decade...and the three decades after that.](#)" Business Council of British Columbia, *Insights*, December 14.
- Williams, D. 2021b. "[Pay and productivity growth in Canada: Growing together, only slower than ever.](#)" *International Productivity Monitor* 40, Spring.
- Williams, D. 2019. "[The east of doing hidden business in Canada and B.C.](#)" Business Council of British Columbia, *Policy Perspectives* 26(1), April.
- Williams, D. and Finlayson, J. 2022. "[Why Canada's economic growth is expected to be dead last among advanced countries.](#)" *Globe and Mail*, Report on Business, February 24.