Business Council *of* British Columbia

Submission to the Select Standing Committee on Finance and Government Services in Advance of the 2015 Provincial Budget

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SUBMISSION TO THE SELECT STANDING COMMITTEE ON FINANCE AND GOVERNMENT SERVICES IN ADVANCE OF THE 2015 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 and advice concerning the 2015 provincial budget.

By way of background, the Business Council, established in 1966, is an association representing more than 260 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, renewable energy, chemicals, utilities, financial services, transportation, construction, telecommunications, information technology, hospitality and tourism, wholesale/retail, communications, agri-food, life sciences, film production, healthcare, education and the professions (including legal, accounting and engineering). Taken together, the corporate members and associations affiliated with the Business Council account for approximately one quarter of all payroll jobs in British Columbia.

1. ECONOMIC OUTLOOK

Although the global economic expansion continues, it remains uneven and on the whole disappointing. Over the past few years economic forecasts for world growth have routinely been downgraded. Consistent with this trend, the IMF's just-released World Economic Outlook trimmed projections for 2014 and 2015. This follows earlier downward revisions in the summer, such that global output growth in 2014 is now expected to be 0.4 percentage points lower than the IMF predicted in April. In short, a pattern of growth coming in below earlier expectations persists, with a widening divergence in performance across countries also becoming evident. The IMF currently sees the world economy expanding by 3.3% (after inflation) in 2014, with growth increasing to 3.8% in 2015. The latter projection, in particular, should be viewed with caution given the experience of the last few years.

Table 1
Global Growth Outlook
(annual % change in real GDP)

	2013	2014 (projections)	2015 (projections)
US	2.2	2.2	3.1
Euro area	-0.4	0.8	1.3
Japan	1.5	0.9	0.8
China	7.7	7.4	7.1
UK	1.7	3.2	2.7
India	5.0	5.6	6.4
World Output	**3.3**	**3.3**	**3.8**

Source: IMF, World Economic Outlook, October 2014.

In the advanced economies, the legacy of excessive debt, both private and public, continues to dampen the recovery. Despite relatively buoyant equity markets, business investment remains subdued. Medium-term structural problems, including aging populations and weaker trend productivity growth, are weighing on potential growth and impeding the recovery process. Modest economic prospects best describes the outlook for the advanced economies, which collectively are on course for real GDP growth of 1.8% this year and 2.3% in 2015. In emerging markets, economic activity has slowed and is well shy of the pace registered in the pre-crisis boom. Real GDP for the emerging market and developing economies as a group is pegged by the IMF to rise by 4.4% in 2014, before picking up to 5.0% in 2015.

For Canada, including BC, the most significant development on the external front is the long-awaited acceleration of the giant American economy. After a temporary setback in the first quarter of 2014, the US has rebounded. The IMF, the OECD and other forecasting agencies now see US output increasing by 2.2-2.3% for 2014, despite the negative first quarter. Real GDP grew at a 4.6% annualized rate in the second quarter, and labour market and other indicators suggest that the forward momentum continues. The strength of the US economy is underpinned by an improving labour market, healthier household balance sheets, favourable financial conditions for borrowers, a rapidly growing energy sector, and reduced fiscal drag from the government sector. The positive turn in America's labour market is especially welcome: current forecasts suggest that job growth in 2014 will be the strongest since 1999. Next year, the US economy should be expanding in the vicinity of 3% on an after-inflation basis.

The US Federal Reserve recently released data showing that the household sector's debt service ratio has fallen to a near record low, as millions of Americans have paid down debt (due in part to foreclosures) and interest rates have stayed low. US households are now in better shape financially to support future growth in consumer outlays and housing market activity. (This contrasts with the situation in Canada, where household debt metrics have reached record highs and the housing market is poised to cool.) US residential investment will gather speed as depressed household formation rates gradually return to levels more consistent with demographic trends – a prospect that bodes well for BC's forest products and building materials industries over the next few years. Another positive development in the US is the sharp increase in oil and gas production. This is adding to the gains in GDP and employment while also putting downward pressure on energy prices, which is benefitting US consumers as well as non-energy firms.

Despite the economic pick-up, price pressures remain contained in the US, with consumer price inflation reaching 1.7% y/y in August.[1] Real wages have been flat, reflecting the fact that slack still exists in some segments of the labour market. With limited inflationary pressure in sight, the Federal Reserve will not be in a hurry to tighten monetary policy. It is expected to start increasing its short-term policy rate in the second half of 2015. As for unconventional monetary policy, the US central bank has just finished winding down its multi-year government bond and mortgage security buying program ("quantitative easing").

Advanced Europe has fallen back into stagnation, with some large economies (Germany and Italy) in or on the cusp of technical recessions. Legacies of the financial crisis – weak demand, escalating public debt, and painfully high unemployment rates – continue to pose challenges

[1] The core personal consumption expenditure measure of inflation preferred by the US Federal Reserve is running at 1.5% on an annualized basis.

to more robust and sustained growth. Across the 18-member Eurozone,[2] per capita output, overall employment and business investment all remain well below pre-2008 levels. Eurozone GDP growth is expected to hover near 0.8% in 2014 and 1.3% in 2015. But with indications that Germany may be tipping into recession and that France's economy has stalled, the risks are clearly on the downside. Growth projections have been revised down for all of the major European economies except Spain and the UK.

In China, the economic outlook has been downgraded slightly for both 2014 and 2015 relative to the IMF's spring forecast. Following a weaker-than-expected first quarter, the Chinese authorities implemented policy measures to bolster economic activity, including tax relief for small and medium enterprises and increased fiscal and infrastructure spending. The Chinese economy is expected to grow by 7.4% in 2014, close to what the government is targeting. For 2015, growth is projected to moderate to 7.1% as residential investment downshifts and the world's second largest economy continues the bumpy transition to a more sustainable growth path.

A significant development affecting the world economy is a general softening in commodity prices over the past 18 months or so. After tripling from 2000 to 2011, the commodity price index published by The Economist magazine has declined by almost one-third from the peak, with further weakness likely in the coming months. Crude oil prices have recently slipped below US$90 per barrel owing to increased North American supply and slowing demand in China and other emerging markets. With little oil production in British Columbia, lower oil prices are a net economic plus for the province, inasmuch as consumers and firms here stand to benefit from lower gasoline and heating oil costs. Less welcome news for BC is that natural gas prices have fallen because of soft demand and ample supplies. Coal prices have also slumped amid shifting global supply-demand balances. Some metal prices have stabilized after earlier declines; however, there is no expectation of a broadly based price

[2] The 18 Eurozone member countries have adopted a common currency and operate with a single central bank. Ten other countries that are part of the European Union (EU) do not belong to the Eurozone, including the UK, Sweden, Poland, Denmark and the Czech Republic.

rebound in the near-term. The one area of the commodity complex with a favourable pricing outlook from BC's perspective is lumber (and, to a lesser extent, pulp), with rising US demand for wood products offsetting less buoyant market conditions in Asia.

The Canadian Economy

Canada's economy lost a step in the first quarter of 2014 but has since staged a modest rebound on the back of accelerating activity in the United States. The IMF expects the Canadian economy to grow at 2.3-2.4% (after inflation) in 2014 and 2015. Some domestic forecasters anticipate a slightly better outcome. Essentially, Canada is following the US growth profile as the export sector rides the coattails of a stronger American economy and a lower Canadian dollar. Exports of goods and services should be a primary driver of Canadian economic growth over the next two years. As more exporters expand production, they will also need to step up investments in facilities, machinery, equipment and technology – a scenario that should finally produce some gains in non-energy business capital spending in Canada.

An important shift in the domestic economy is a moderation in the pace of household debt accumulation after many years of heavy borrowing. Household credit growth has eased from double-digit rates in 2006-07. Supported by rock-bottom borrowing costs, housing market activity has strengthened in recent months, and auto sales have surged to record levels. Spending in these areas tends to be predominantly debt-financed. Yet as noted, household credit growth has downshifted to roughly 4% year-over-year. A trend towards higher down payments on home purchases and fewer high-ratio mortgages appears to be part of the explanation.

Employment gains in Canada have been underwhelming over the past year, reflecting caution by firms about hiring new personnel. Between December 2013 and August 2014, job creation was subpar, averaging just 10,000 per month, with most of the hiring being part-time and a large share of it concentrated in Alberta. September brought a surprising

74,000 jump in employment. We see the September result as an anomaly, and look for the job market to remain relatively subdued over the next 6-12 months, with employment growth nationally running near 1% y/y.

Continued slack in the economy, well-anchored inflation expectations, and downside risks to the global economic outlook imply that the accommodative monetary policy stance adopted by the Bank of Canada remains appropriate. We do not believe the Bank will begin raising its short-term policy rate until the second half of 2015. However, market-driven interest rates, such as prime borrowing and posted mortgage rates, may edge higher in advance of any move by the central bank to alter its policy rate, as financial market participants anticipate and respond to the tightening of US monetary policy.

BC Mirrors the National Performance

In British Columbia, economic conditions broadly match the national picture. As with Canada, economic indicators have been mixed, with employment being especially soft. External conditions are also varied for the province's trade exposed industries. The upturn in the US economy is a positive development. Offsetting this is the moderation of activity in emerging economies, particularly China, and downward pressure on most non-oil commodity prices.

Table 2
BC Economic Forecast
(% change unless noted)

	2013	2014 (forecasts)	2015 (forecasts)
Real GDP	2.0	2.2	2.6
Employment	-0.2	0.9	1.5
Retail sales	1.6	6.0	4.0
Housing starts (000s)	27.1	27.0	27.0

Source: Business Council, Statistics Canada for history.

Over the January to August period, BC's international merchandise exports rose by approximately 8%, compared to the same period in 2013. The slowdown in emerging market economies and the improvement in the US are evident in the province's export numbers. In dollar terms, goods exports to the US have climbed 14.4% year-to-date. In contrast, sales to China have made no headway relative to

2013, which differs from the string of double-digit annual increases seen over the past two decades. British Columbia's merchandise exports to Japan are down 6.5% year-to-date.

Chart 1

Source: BC Stats; seasonally adjusted; latest August 2014.

Chart 2

Source: Statistics Canada; latest: September 2014.

Service exports play an increasingly important role in the provincial economy. Transportation services are a growth area thanks in part to buoyant Gateway-related trade and tourism activity, including record volumes of cargo being handled by Port Metro Vancouver. The weaker Canadian dollar and a pick-up in US economic growth have boosted international tourism in BC and we expect this trend to continue. Exports of professional, business and technology services should all benefit from the US upswing.

On the domestic side, economic conditions are still mixed. Of particular concern is the underperforming BC job market. While we expect hiring to revive in 2015, the pace of job creation has surprised to the downside for the last two years, for reasons that aren't entirely clear. Following essentially zero net employment growth in 2013, total employment is up just 0.6% this year, shy of the national benchmark (0.7%) and a poor showing compared to the other western provinces. The September jobs report from Statistics Canada pointed to

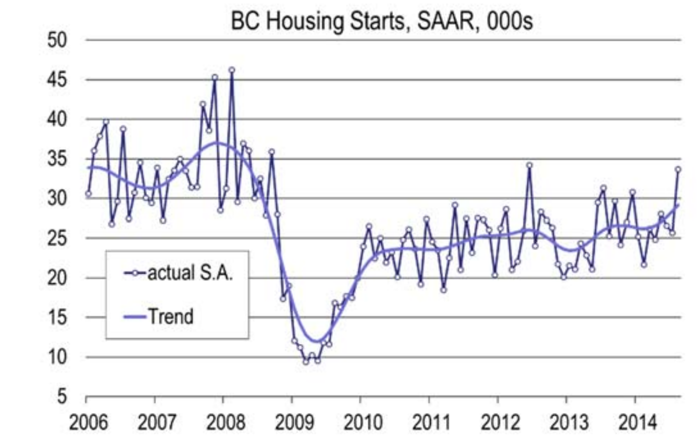
10,000 net new jobs in BC, but we are not prepared to attach much significance to a single month's number in a data series that seems to have become increasingly unreliable of late.

Business investment is another area where improvement is needed if the province is to move to a healthier economic footing. As with the rest of Canada, businesses in BC have been somewhat hesitant to deploy capital. The recent deterioration in BC's business tax competitiveness – discussed below – is one factor tempering capital spending in many sectors. To achieve a solid economic expansion, BC needs to make progress in advancing large development projects and raise the level of private sector capital spending more generally. Non-residential building permits are up 5.5% year-to-date, pointing to some strength in construction investment in the commercial sector. But overall the permit data depict a sideways trend, which is consistent with the results of Statistics Canada's investment intentions survey released earlier this year.

While it is true that there are many major engineering and other significant capital projects on the books in BC, as updated regularly in the government's Major Projects Inventory, we are concerned that the "conversion rate" from proposed to actual investment spending is faltering. A year ago we expected a significant number of these projects to come online and begin to make a contribution to growth in 2014-15. Some have, particularly in the commercial (office and retail) sector, but as of the final quarter of 2014 it is clear that our earlier optimism about the pace and extent of project development needs to be scaled back. Large resource, infrastructure and industrial projects are complex and have proven difficult to advance in BC (and in Canada for that matter). In the mining sector, numerous projects are being postponed due to unfavourable commodity and capital market conditions. In the energy transportation segment, proposed oil pipelines are meeting stiff opposition and face regulatory and other challenges. Our earlier forecast included some early stage activity for the development of two LNG facilities by the latter part of 2015. We now believe that any ramping up of construction work on LNG facilities and related gas pipelines is likely to be pushed into the post-2015 period.

A surprising recent development is the strength of retail sales. Annual growth of spending in BC stores is running near 7%, up from 3% earlier in the year. Part of the reason is robust auto sales, but retail spending more broadly has also risen. Some of this may be attributable to diminished enthusiasm for cross-border shopping now that the Canadian dollar has lost value relative to the US currency.

Chart 3



Source: Statistics Canada, seasonally adjusted annual rate; latest Aug. 2013

BC's large housing and real estate development sector is contributing to economic growth to a greater degree than we anticipated a few months ago. Home sales have perked up and are now 17% higher than last year. In tandem with the stronger sales environment, housing starts are up 6.5% year-to-date. The Business Council forecasts that housing starts will be essentially flat over the next two years. But relatively low interest rates will continue to support housing market activity – including renovations – through 2015.

The shift to positive net interprovincial migration has helped to nudge overall population growth up to 1.1% per year. This will provide support to retail spending, housing and consumer services purchased in the province. Public sector fiscal restraint – seen in flat to slightly declining real BC government spending on a per person basis, coupled with some paring back of capital spending – will have a small dampening effect on economic growth over the next year or two.

Summary and Risks

Reflecting the still sluggish global economy, a deteriorating outlook for mining, weak business investment at home, and the delay of early stage construction work on proposed LNG facilities, the Business Council has downgraded our BC economic forecast for 2015. We now expect the economy to grow by 2.6% (in real terms) next year, down from our earlier 2.9% projection. For 2014 we are keeping our growth outlook at 2.2%. The BC government's latest forecast, as reported in the September 2014 First Quarterly Report, adopts a more conservative view, with real GDP predicted to increase by 1.9% this year, rising to 2.3% in 2015.

There are risks to the outlook. The global economic backdrop remains unsettled, particularly in Europe. There is a chance that the US recovery could lose momentum, although the US might just surprise on the upside. Finally, central bank policy and the pathway to the gradual "normalization" of interest rates create some uncertainty. Although the Bank of Canada is unlikely to hike its overnight rate until the latter part of 2015, developments in the US could cause Canadian market interest rates to jump, with negative implications for housing activity and auto sales.

2. BUDGET 2015: ADDRESSING COMPETITIVENESS AND OTHER MEDIUM-TERM PRIORITIES

The government is on course to balance the operating budget. The First Quarterly Report points to a modest surplus of $466 million for 2014-15. As we have observed in previous submissions, the government has managed to keep the province's finances on a sound footing at a time of marked global economic uncertainty. This included containing the size of the deficit during the 2008-09 downturn, and following through with a commitment to balance the operating budget once economic growth had resumed. The Business Council acknowledges the government's sound fiscal stewardship and the hard work necessary to eliminate the operating deficit, although as argued above the current policy of fiscal restraint is one of the factors weighing on the economy in the near-term.

Evaluating BC's Competitiveness

While balancing the budget and managing the debt are important to BC's long-term prosperity, the province has other near- and medium-term challenges that also must be addressed. Over the past year, the Business Council has closely examined BC's evolving competitive position within a North American context. Based on a survey of our member companies, one-on-one discussions with CEOs and other industry leaders, and a review of the work done by the BC Jobs and Investment Board, we have concluded that the province has lost ground on competitiveness. The impact has been greatest in "traded industry"[3] sectors that are critical to the province's long-term economic success. Our high level assessment of BC's competitive position is summarized in Exhibit 1.

Competitiveness is a complex topic, and not all sectors face the same issues and challenges. That said, a number of cross-cutting themes emerged from our work. Below we outline a number of these and identify steps that could be taken to strengthen BC's competitiveness. We recognize that the current fiscal situation limits the options available to policy-makers for next year's budget.

One message that came out during our research is that the attractiveness of the overall business tax environment has deteriorated. The picture is not uniform across all industries, and BC does benefit from relatively low statutory corporate and small business income tax rates. But there are areas where the overall tax structure/burden acts as a disincentive to investment and hinders the expansion of businesses already operating in the province. This concern is especially relevant for key traded industry clusters – i.e., the natural resource, manufacturing, high technology, infrastructure, and tradable services sectors.

[3] Traded industries are those that sell a substantial portion of their output beyond BC's borders, as well as those which compete with imported goods and services in the domestic market.

Exhibit 1: Overall Assessment of BC Competitiveness

Business tax policy	• competitive statutory business tax rates • but offset by high METRs in many sectors, mainly due to PST • carbon tax and property tax are concerns for some industries
Personal tax burden	• generally competitive within Canada (but a widening gap in top tax rates vis-a-vis Alberta)
Regulatory frameworks	• reputation as a complex and costly jurisdiction to do business and pursue project development, especially for land-based industries and infrastructure service suppliers
Energy costs	• high fossil fuel costs by US/Canadian standards • relatively low power costs (but our advantage is eroding)
Workforce supply	• some spare capacity remains in the labour market • modest labour force growth projected in next decade • skill shortages emerging in some areas, aggravated by Alberta competition
Workforce skills	• fairly strong overall, but some evidence of skill mismatches • recent provincial overhaul of PSE/training should help • but BC needs to ensure sufficient resources are available for PSE and advanced skills development going forward
Infrastructure	• significant public and private investments in transportation and communications infrastructure in recent years • need to build on BC's existing gateway advantage • specific transportation challenges in lower mainland • BC is a difficult place in which to develop new energy infrastructure
Local government	• a growing obstacle to economic development and BC's overall competitiveness • municipalities increasingly are impeding projects that advance the wider provincial and Canadian interest • municipalities are outliers in terms of spending increases and the management of payroll costs • the province has failed to exercise leadership and direction vis-à-vis local government issues affecting the BC economy
Quality of life	• generally an area of strength for BC • temperate climate, superb amenities, natural beauty • high housing costs in lower mainland are a growing problem

As we have observed in the past, the re-establishment of the PST raised the cost of producing goods and services in the province by more than $1.5 billion per year, while adding a further $150 million in annual tax compliance costs for the business community as a whole. With the PST restored, BC now has the highest average marginal effective tax rate on new business investment among the ten provinces.[4] This constitutes a significant competitive disadvantage. The federal government's capital consumption allowance rules also make it less attractive to invest in BC relative to US jurisdictions where capital depreciation write-offs are more generous.

Table 3
Average (All-Industry) Marginal Effective Tax Rates, Selected Jurisdictions, 2013

US (national average)*	35.3%
British Columbia (Note – it was 17.8% in 2012)	27.5%
Manitoba	26.2%
Australia	25.9%
UK	25.9%
Germany	24.4%
Saskatchewan	24.3%
Canada (national average)	18.6%
Ontario	18.2%
Alberta	17.0%
Quebec	15.2%

* actual METRs vary by state
Source: J. Mintz and D. Chen, School of Public Policy, University of Calgary, November 2013.

Marginal effective tax rates [METRs] provide a useful summary indicator of a jurisdiction's tax-related competitiveness from an overall business perspective. Table 3 reports the average business sector METRs for 2013 for the ten provinces, Canada and a few other countries, based on the model developed by Canadian economist Jack Mintz – a leading expert in the field of public finance. Using this methodology, British Columbia has seen a sharp erosion of business tax competitiveness vis-à-vis other Canadian and US jurisdictions in the past few years. Indeed, BC now has the least competitive business tax regime in Canada, according to an all-in METR calculation. The erosion of tax competitiveness since 2011-12 is almost wholly due to the return of the PST, which has boosted the sales taxes that companies pay on a wide range of capital and other intermediate inputs. The three Canadian provinces with the highest average METRs are BC, Manitoba and Saskatchewan. The tax systems of all of these provinces share one attribute: "The common feature…is having a conventional retail

[4] As estimated by the federal Department of Finance. The marginal effective tax rate is a comprehensive measure of the tax burden on capital investment and takes into account corporate tax rates, capital taxes, other asset-based taxes, sales and other consumption-related taxes on business inputs, and depreciation rules. For further details, see Duanjie Chen and Jack Mintz, 2013 Annual Global Tax Competitiveness Ranking – Corporate Tax Policy at a Crossroads, University of Calgary School of Public Policy, SPP Research Papers, November, 2013.

sales tax, which is not based on value added and, hence, is not refundable when it is applicable to [business purchases of] capital inputs such as building materials, machinery and equipment as well as intermediate goods…"[5]

The BC carbon tax continues to put some local exporters at a competitive disadvantage vis-a-vis the rest of North America. We support the government's decision to freeze the carbon tax, but the reality is that in its current form the tax increases the cost of producing and shipping goods for thousands of BC companies. At $30 per tonne, the carbon tax has left BC with the highest fossil fuel energy costs in North America. While the revenues generated by the carbon tax have financed lower personal income taxes and a small reduction in the corporate and small business income tax rates, the net impact of the "tax shift" policy embodied in the province's carbon tax regime has been negative for many industries, including those responsible for most of BC's merchandise exports.

Access to incentives also affects the competition for new capital investment in North America. Financial incentives, such as tax holidays and direct payments to firms undertaking new investments, are widely used by American states as well as many local governments as part of their economic development toolkit. One recent estimate is that US state and local governments are spending $80 billion per year on such firm-specific incentives, which typically take the form of property and income tax breaks, cash payments for jobs created, generous loan terms, and discounted public services.[6] While we are not proposing that the province get into the business of luring companies with these kinds of targeted incentives, policy-makers in BC need to be aware that tax and other inducements are influencing capital allocation and facility location decisions across North America – particularly in the manufacturing and advanced technology sectors. Because BC generally eschews firm-specific "subsidies" or other similar incentives, it is vitally important that all aspects of the

[5] Ibid., p. 20.
[6] Council on Foreign Relations, "Curtailing the Subsidy War Within the United States," May 2014.

business tax regime are aligned with the objective of attracting high-value business investment and the jobs that go with it. That is not the case currently.

Relatively low cost electricity is one area where BC has long enjoyed a competitive advantage. But this is changing as power rates rise here at the same time as some US states enjoy lower electricity prices due to greater reliance on low-cost gas-fired generation. As such, the government needs to do what it can to retain BC's position as a jurisdiction with relatively low electricity rates and continue with its recent initiatives to address rising power costs.

The competitiveness/investment climate in the province is complicated by significant regulatory and permitting issues as well as unresolved First Nations rights and title interests on the land base. While much good work has been done to deal with these matters and BC has become a leader within Canada in many areas of aboriginal relations, regulatory, permitting and First Nations issues tend to drive up costs and increase project development risks for resource and other land-based industries. In particular, we note that the province will need to work diligently in the coming months and years to ensure that the Supreme Court of Canada's recent decision in the William case does not result in additional uncertainty and delays for resource development sectors, including important potential linear infrastructure projects.

The Business Council has prepared a series of short reports and opinion pieces that seek to highlight both recent progress in building new relationships between government, First Nations and industry as well as the challenges that remain to be addressed. The overall message from this work is clear: collaborative models of economic development are necessary and useful, but more must be done to enhance their effectiveness and to deal with outstanding issues that impede investment and project development. We also believe the provincial government needs to be proactive in communicating a constructive message to the capital markets and to potential investors about the legal and regulatory landscape for resource and economic development in BC in the post-William context. Based on our research, including working with our front-line member companies and their lead staff, we have become convinced that First Nations engagement is an area where additional government financial and human resources should be deployed – both within the public service and to improve capacity for the majority of First Nations in BC that are interested in moving forward with mutually beneficial economic development.[7]

Municipal operating costs and the taxes necessary to discharge local governments' responsibilities have become a focus of concern for business and industry. Although a portion of the additional operating costs facing municipalities is attributable to population growth and the delivery of public safety services, when examined on a per capita basis (to adjust for population growth) municipal operating costs have run well ahead of the expenditure increases seen at the provincial or federal levels. As documented in an earlier Business Council study, measured in real per capita terms, provincial operating spending rose by 10% between 2000 and 2010.[8] By comparison, collectively the municipalities in Metro Vancouver boosted real per capita spending by 32%. An increase of this magnitude seems out of line, particularly in the absence of a significant expansion (or visible improvements in the quality) of locally provided services. Rapid growth in spending has not been limited to Metro Vancouver; outsized increases in real per capita expenditures have also been seen in some other BC municipalities over the past decade or so.[9]

To help finance higher expenditures and limit the economic impact on households, some municipalities have shifted a disproportionate share of the aggregate property tax burden on to certain categories of business, particularly heavy industry (class 4) and utilities (class

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[7] Interested readers are invited to visit the Business Council's web site (www.bcbc.com) to review our published papers and opinion pieces dealing with this broad topic.
[8] Business Council of British Columbia, "Up and Away: The Growth of Municipal Spending in Metro Vancouver," Policy Perspectives, May 2012.
[9] CFIB, "BC Municipal Spending Watch," November 2013.

6), while keeping rates low for residential property owners. There are dramatic differences across BC municipalities in the property tax rates levied on utilities, industry and the commercial sector. Ratios can be as high as 12:1 or even 15:1 between industrial property (class 4) and residential property. While the industry-to-residential ratios are lower than this in most municipalities, the concern in the business community is that tax rates and ratios can be changed at any time at the discretion of local councils, with no oversight from the province or any commitment to fairness or fiscal discipline. This is a source of ongoing uncertainty for businesses that have invested in some local communities. It is worth noting that the BC government, in its own property tax regime, has established maximum ratios between property classes to ensure consistency and fairness in the system. Since the late 1990s, the province has also legislated tax caps that apply to municipal taxation of port property and railway property. Municipal taxes, including development charges and fees, are increasingly cited by Business Council members as a deterrent to investing in British Columbia.

Education and Training

A number of trends will shape the environment for education and training over the next decade. An aging and more slowly growing workforce is one. Increased demand for skilled tradespeople is another. BC must continue to develop a high-skill workforce to fill vacant positions, support economic growth, and enable the province to compete for increasingly mobile capital. In this regard, the Business Council welcomes the government's new Skills for Jobs Blueprint. In particular, the planned re-orientation towards a data-driven system in which training dollars and education programs are better aligned with jobs in high demand fields makes sense. We also support the move to a more outcome focused PSE and training system, which means monitoring enrolment patterns, completion rates and other performance indicators and adjusting funding and program capacity accordingly.

The Business Council is pleased that the government has adopted the recommendations contained in the Industry Training Authority (ITA) review, conducted by Jessica McDonald.

Ensuring that the province has a demand-driven system that meets the needs of workers and employers for trades training is essential given anticipated skill shortages. Unifying cross-government decision-making, with funding allocated based on labour market information and workforce targets, should produce better results over time. We also applaud the government's promise to invest more in the collection of labour market information and data; this is now recognized as an area of weakness all across Canada. Finally, we would emphasize that more employers need to step up their game with respect to workforce skills development, especially smaller and medium-sized firms. Many firms in Canada have long been content to poach trained employees from other organizations. In a world of greater labour scarcity and growing demands for advanced skills, that approach won't work.

As a final comment, the Business Council believes it is important for the province to ensure that the overall post-secondary education and training system is adequately funded to meet the demand for educated and skilled workers and to help British Columbia become a more innovative and competitive economy. As the government's fiscal circumstances improve, additional funding should be allocated to the PSE system after several years of flat/declining real resources.

Infrastructure

British Columbia has long been an export-oriented economy whose prosperity is intimately linked to our capacity to trade goods and -- increasingly -- services with other jurisdictions. Globalization, advances in technology and the restructuring of international production have altered the nature of infrastructure and the types of assets necessary to support economic activity. Globalization and the accompanying proliferation of trade agreements have increased capital flows and the movement of goods, services and knowledge across borders. Over the past three decades the growth of global trade has significantly outpaced the growth of production or output. For BC, between 1981 and 2012 the value of goods and services exports, measured in inflation-adjusted dollars, rose by 170%, while imports of goods/services increased by 230%. In comparison, the provincial economy expanded by a more modest 110% over the same period.

Public infrastructure investment must be strategic. While most infrastructure investments are positive and contribute to growth and productivity gains, developing the right infrastructure in the right place and at the right time should be the goal. Infrastructure pricing is also a key issue. In BC, infrastructure policies have largely been determined separately from broader strategic economic development planning. On occasion, infrastructure projects have been framed around short-term goals, and in the lower mainland in particular, they are often influenced by local municipal political concerns rather than a coherent regional vision that recognizes and respects the wider provincial interest.

Although BC has made substantial investments in public infrastructure over the past 15 years, a more systematic and strategic approach to building and maintaining these high cost, long-lived assets would be beneficial. Given Asia's growing impact on the global economy and world-wide consumption patterns, the BC and federal governments must continue to focus on Pacific Gateway initiatives. Previous investments to strengthen the Pacific Gateway have paid dividends, and now is the time for further planning and investment. Without an ongoing commitment of funding and political leadership to build out the Pacific Gateway, both BC and Canada will lose out on future opportunities to expand trade and commerce with many of the world's fastest-growing markets. In addition, policy-makers also need to be thinking about more consolidated governance and priority setting processes involving all levels of government to help ensure the highest and best use of scarce infrastructure dollars.

Deficits and Debt

The First Quarterly Report indicates the province will again meet its plan of balancing the provincial budget and actually post a surplus of $466 million (assuming the $200 million forecast allowance is not needed). Overall this is a relatively small cushion on a $45 billion annual budget (about 1% of expenditures). Considering that the economic picture is still unsettled, it is prudent to retain some degree of flexibility on the budget targets. While a balanced budget is desirable, if revenues are dampened by weaker-than-anticipated economic conditions then incurring a small deficit may be advisable – and have little effect on the province's financial health or credit rating. Further fiscal restraint, to deal with unanticipated or temporary revenue shortfalls in an already fragile economic environment, would work against economic growth and further strain government resources and capacity.

According to the First Quarterly Report, the province is ahead of its debt reduction plan as outlined in the 2014 budget. BC's taxpayer-supported debt remains manageable, with a net debt/GDP ratio that is the third lowest among the provinces and an AAA credit rating. As we noted in last year's pre-budget submission, operating deficits are not the main contributor to the rise in public sector debt. The vast majority of the debt accumulated in the past decade is attributable to capital spending to acquire, build and maintain long-lived physical assets. While balancing the operating budget contributes to keeping debt levels manageable, small operating deficits would have little impact on BC's debt burden given the scale of planned capital spending and the associated borrowing.

Having said that, because BC has a comparatively low net debt-to-GDP ratio, there is a case for accelerating capital spending on high priority provincial infrastructure projects. Doing so can enhance efficiency and competiveness and also improve quality of life for residents.

3. RECOMMENDATIONS FOR BUDGET 2015

Recognizing that in the near-term the government has limited fiscal manoeuvring room, most of our recommendations look mainly to the medium-term, with some consideration given to a handful of recommendations with small fiscal impacts or that are urgent in nature.

Beginning with taxation:

- In the 2015 budget, we recommend that BC introduce a new, refundable tax credit on the PST paid on machinery, equipment and information and communications technology products and services applicable to the entire business sector. This measure, which was proposed by the Expert Panel on Business Tax Competitiveness in its 2012 report to the Minister of Finance, can be gradually phased in over a three-year period to manage the fiscal impact.
- As a medium-term objective, the province should explore more fundamental sales tax reform options, as suggested by the Expert Panel, with a view to strengthening BC's competitiveness from a capital investment/cost-of-doing business perspective.
- The government made an election campaign commitment to return the corporate income tax rate to 10% by 2017-18. Rather than taking this step, the Business Council suggests using the fiscal room linked to this proposal to offset some of the damage that has been done to export-oriented and other trade-exposed industries as a result of the shift back to the PST and the made-in-BC carbon tax.
- We endorse the decision to freeze the BC carbon tax at $30/t through 2017. In the event that other provinces/states fail to introduce carbon taxes in their own jurisdictions, we propose that BC consider rolling back the tax to $25/t once the five-year freeze has expired. In the meantime, the province should consider measures to address the negative impact of the carbon tax on energy-intensive and trade-exposed industry sectors. Most other jurisdictions that have put a price on carbon

have also acted to protect the competitiveness of domestic industries that are particularly disadvantaged by this policy. BC stands out for having failed to do so.[10]

- We recommend that the province develop and implement legislation setting out prescribed "fairness ranges" or "maximum caps" for property tax ratios across different property classes that would mandatorily apply at the municipal level, starting in 2016. Municipalities with tax ratios that exceed those consistent with the defined "fairness ranges" or "maximum caps" would be given 3-5 years to comply.

With respect to the regulatory environment and First Nations engagement:

- We propose that the province work towards a 'Smart Regulation' philosophy and model across all domains of regulatory activity. This means a transition to models that systematically shift regulatory frameworks to clear, outcome-defined metrics. Relatedly, the government should move away from the "number count" approach to reviewing regulations and instead direct its efforts to defining and implementing regulatory regimes that include specific timelines for decisions – preferably spelled out by statute – and clear expected outcomes and deliverables from proponents and businesses looking to expand.
- Consideration should be given to establishing a high-level advisory body of experienced public servants and business and First Nations leaders to examine broad fields of government regulatory activity with a mandate to consult and develop proposals to modernize and improve existing legal frameworks, procedures and practices.
- We recommend a broad review of permitting-related costs relative to peer jurisdictions, to ensure that the full costs of the permitting and project lifecycles are understood and quantified. In our experience, frequent additional information requirements, outside of actual permit costs, are significant cost drivers for many firms operating on the land base. This work should be undertaken outside of the

[10] Except for the greenhouse industry.

public service, drawing on global expertise in the area of regulatory system costs and design.

- The government should increase frontline capacity and staff retention/training programs in all of the key Ministries and agencies dealing with land, resource and infrastructure development matters.
- For First Nations, we recommend dedicating more resources to proactively promote and assist with coordinating tripartite pathways for industry-First Nation-government economic engagement. This requires ongoing refinement of policy toolkits and working with First Nations to build collaborative decision-making frameworks that are backed by reliable data and reinforced by deeper (staff) expertise. The Business Council notes that this is an area where the federal government urgently needs to increase its presence, funding and political commitment.
- Over time, and in close collaboration with First Nations and industry, consideration should be given to establishing a central office that would be charged with coordinating all aspects of the First Nations consultation process – working directly with key statutory decision-makers in line Ministries. This would build on the success BC has already had with engagement agreements and leverage the data sharing and IT modernization processes currently underway in the Natural Resource Transformation Secretariat.
- The province needs to build stronger programs of direct (community level) engagement with First Nations and resource sector associations to collectively address skills shortages, information gaps and capacity deficits.
- Finally, we recommend that the province develop the capacity to fully inform and address corporations looking at investing in the province and help businesses which are new to BC to successfully work with First Nations to partner for business development.

On infrastructure, while the province has made significant headway, more needs to be done over the next few years.

- As a first step, we recommend that the province develop a long-term and comprehensive infrastructure strategy. This would require the government to regularly table an updated long-term infrastructure plan in the Legislature, covering a period of at least 10 years. The plan should include principles to align planning with demographic and economic trends to maximize the value of infrastructure investments and promote innovation, competitiveness, and job creation. Such a strategy could also facilitate the coordination of infrastructure needs and planning across different levels of government. A longer-term strategy would also be beneficial in ensuring that First Nations' interests are more effectively integrated into provincial infrastructure policy-making and planning.
- BC needs to constructively engage with the federal government to leverage federal funding for major infrastructure projects. In this regard, infrastructure should be elevated to a top priority in all discussions between the province and the federal government. Partnerships BC's mandate could be expanded to set targets for federal involvement and support and to report regularly on progress in meeting these targets.
- Given its critical importance to the national economy, we believe it is essential that BC continue to advocate for ongoing investments and expansion of infrastructure assets and services associated with the Pacific Gateway.
- At the regional level, we recommend that the province and municipalities jointly explore options for better transit and transportation planning in the lower mainland. Enhanced regional coordination, effective and accountable governance, and a shared commitment to leverage funding and economic development opportunities offered by land-value capture and densification along key transit corridors should be priorities. We support a continued significant role for the province in the governance structure for regional transportation in the lower mainland.

- In light of the constrained fiscal environment at the provincial level, additional options for financing large-scale infrastructure projects should be explored and more fully developed. Pension funds, for example, have large pools of capital available and increasingly are looking for stable mid-single digit returns on investments in certain "hard" asset classes. In a world of low interest rates, more infrastructure projects may serve as attractive investment opportunities for non-governmental pools of capital.

- Finally, given the low borrowing cost environment, the province should consider the option of taking on more debt to finance the development of new infrastructure. Arguably, this is a favourable time for governments to step up investments in infrastructure assets that generate long-term economic benefits. The Business Council is currently engaged in a project on infrastructure policy and financing that will take up this topic in more detail.

4. SUMMARY

In summary, the Business Council wishes to highlight the following points from this pre-budget submission.

- Our base case forecast for the provincial economy sees real GDP increasing by 2.2% this year and by 2.6% in 2015. We have scaled back our 2015 outlook because of delayed investment in large projects and weaker global commodity markets.

- We support a balanced budget and applaud the government's commitment to disciplined fiscal management. But there should be some flexibility to respond to revenue shortfalls and weaker-than-expected economic conditions. At a time of record low borrowing costs, the province should consider taking on additional debt to finance high priority infrastructure projects.

- Budget 2015 should introduce a refundable tax credit for PST paid on the acquisition of machinery, equipment (including computers and software) and advanced technologies for use in all types of business, to be phased in over a period of three years

- Finally, the government needs to focus more attention on BC's competitive position in North America. All policy and regulatory decisions made by government Ministries, Crown agencies and other provincial bodies should be examined through a competitiveness lens to assess their expected impact on the investment climate, the cost of doing business, and the effort to build a more innovative BC economy.

The Business Council appreciates the opportunity to share our advice on the 2015 budget with the Legislative Standing Committee on Finance and Government Services.

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