SUBMISSION TO THE SELECT STANDING COMMITTEE ON FINANCE AND GOVERNMENT SERVICES IN ADVANCE OF THE 2023 PROVINCIAL BUDGET

JUNE 24, 2022

Business Council of British Columbia
Est. 1966

TABLE OF CONTENTS

SUBMISSION TO THE SELECT STANDING COMMITTEE ON FINANCE AND GOVERNMENT SERVICES IN ADVANCE OF THE 2023 B.C. 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 on the 2023 provincial budget due to be tabled next February. We note that financial results for fiscal 2021-22 are not yet complete as we near the end of the first quarter of fiscal 2022-23. Reporting of Q1 financial results is several months away. With limited information about the current fiscal situation, it is therefore difficult to offer a full suite of up-to-date recommendations for the 2023 budget, especially considering the rapidly changing economic backdrop. Later in the year, the Business Council will offer supplementary input when the government is finalizing its next three-year fiscal plan.

The Business Council, established in 1966, is an association representing more than 200 large and medium-sized enterprises with assets and operations in B.C. 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 professional services(including legal, accounting/advisory, scientific, and engineering). Taken together, the corporate members and the associations affiliated with the Business Council account for approximately one quarter of all private sector payroll jobs in British Columbia.

Recent budgets were preoccupied with fighting the pandemic and providing necessary supports for households and businesses. Even this year's budget, presented just a few months back, included inordinate amounts of unallocated contingency funding in case additional pandemic-related supports were deemed necessary. But with the economy now operating at (if not beyond) full capacity, and serious COVID cases waning, the justification for loose fiscal policy has passed. Instead, near-record low unemployment rates and runaway inflation – 8.1% y/y as at May 2022 – means it is past time for the government to scale back fiscal stimulus and reduce the operating deficit. It is also time to focus on expanding the B.C. economy's long-term productivity capacity.

In this preliminary submission, we focus our comments and recommendations on the shifting economic landscape and a few key policy areas of particular concern to the business community.

The Economic Outlook is Shifting Quickly

The global and North American economic landscape is changing quickly and merits close attention as the government turns its attention to framing next year's budget. The top-line message from the OECD in its June 2022 global forecast update is that "projections for economic growth in 2022 have been slashed since December 2021, as countries grapple with fresh supply shocks in energy and commodities following Russia's invasion of Ukraine."[1] The OECD now expects world real GDP to grow by 3.0% in 2022 (down significantly from the 4.5% pace anticipated in December 2021) and to then downshift further to 2.8% in 2023 (3.2% was projected in December).

Growth across advanced economies is forecast at 2.7% in 2022 (down from December's 3.9% forecast). More concerning is that real GDP growth across OECD countries is expected to slow to an anemic 1.6% pace in 2023 (much slower than the 2.5% expansion projected just six months back). Relevant for B.C., U.S. growth is expected to fall to just 1.2% in 2023, half the pace projected last December. In the months ahead, the U.S. Administration will be forced to abandon its hitherto expansionary monetary and fiscal policy and flip to sharply tighter settings to try to rein in runaway consumer inflation. U.S. CPI inflation was 8.6% y/y in May 2022 – more than quadruple the Federal Reserve's target.

The Canadian economy is also losing steam but has benefitted from near-record prices for energy and other commodities. Favourable export prices will help keep Canada's economy somewhat resilient, growing at 3.8% in 2022 and by 2.6% in 2023 (not much different from December's outlook) according to the OECD. But forecasters closer to home see dark storm clouds on the horizon for Canada given the expected slowing in the U.S. economy. This reflects, in part, slower export volume growth and the impact of sharply higher borrowing costs on housing-related activities and consumer spending. The most recent Canadian growth forecasts are shown in the table below. Note the consensus view contained in the 2022 provincial budget was for Canadian real GDP growth of 3.0% (with the Ministry of Finance wisely choosing to assume a more conservative 2.6% rate for budgeting purposes). Every bank now expects slower growth for Canada, with four projecting sharply slower growth than the figure used in B.C.'s budget produced earlier this year. Risks to the inflation outlook continue to be weighted to the upside.

[1] OECD Economic Outlook, June 2022.

Canada Economic Outlook				
	Real GDP growth, %		CPI inflation, y/y%	
	2022	2023	2022	2023
BMO	3.5	1.5	6.7	4.0
CIBC	3.4	1.5	6.4	1.9
RBC	4.2	1.9	6.3	2.7
Scotia	3.8	2.6	6.5	3.3
TD	3.7	1.7	6.7	3.5

Sources: most recent forecasts published on websites of each bank as of June 24, 2022.

Consistent with the national picture, the B.C. economy is set to gear down in 2023. Economic growth will remain strong at around 3.5% in 2022. But as the lift from high commodity prices wanes and domestic activity softens, provincial real GDP growth in 2023 is set to soften to around 1.6%, in line with more recent forecasts for Canada.[2]

Given the unsettled external backdrop and mounting fears that the slowdown will tip into outright recession in North America, the Business Council believes it is prudent to build next year's provincial budget around lower *real* GDP growth expectations. We note that high inflation could still see strong rates of *nominal* GDP growth that will boost government net revenues.

Spending and Fiscal Setting

Economic and fiscal circumstances have changed. Budget 2022 was crafted amid an environment of massive inflation-driven upside revenue surprises that likely resulted in a small surplus for fiscal 2021/22 (we won't know for several more months), rather than the initially anticipated deficit of nearly $10 billion. Just a few months ago, most economists believed that the strong growth seen in 2021 would carry through 2022, with the economy then downshifting towards its long-term average growth potential of around 2% per year. February's budget assumed real GDP growth of 4.0% this year, followed by a 2.5% expansion in 2023. This projection reflected the average of 15 private sector forecasts back in November/December 2021 and refined in the first weeks of January. But the economic outlook has clearly deteriorated since the 2022 B.C. budget was tabled, while inflation has increased.

[2] In BCBC's June 2022 Outlook we forecast growth of 2.4% for 2023. Recent global growth downgrades, inflation developments, and interest rates/policy responses from the Bank of Canada are prompting us to significantly downgrade our provincial growth outlook.

The Business Council believes government needs to incorporate a much weaker real growth profile into its 2023 budget. Real GDP growth in the range of 3.5-3.8% for 2022 is likely to be followed by a sub-2% expansion in 2023. The outlook should probably also embody additional downside risk, given the possibility of an outright economic contraction in the U.S. and even Canada in 2023.

British Columbians are grappling with high inflation. B.C.'s CPI inflation rate was 8.1% y/y in May, the highest since November 1982. At the same time, B.C.'s unemployment rate was 4.6% in May, one of the lowest readings in 50 years. There is simply no justification for running operating deficits when the unemployment rate is near record lows and inflation is spiralling higher. Public consumption should not be adding to demand in the economy. BCBC recommends the budget move to structural balance, at a minimum. There may even be a case for contractionary fiscal policy – i.e., budget surpluses – to slow the economy and bring inflation back to the 2% target forthwith, rather than leaving the entirety of the task to monetary policy and the Bank of Canada.

Policy Priorities: Background

With inflation climbing above 8%, gas prices surging more than 40% and food prices up around 10% y/y, many households are struggling. Many will come under increasing financial strain as interest rates climb. Hardest-hit are low- and middle-income households, notably those with sizable debts (mortgage and other) as well as those where high rents take up disproportionate amounts of household incomes. The challenge for government is to deliver financial relief while not further stoking demand and worsening already high inflation. It may be time to address a structural issue in that Metro Vancouver has the highest petrol prices in North America. The government should ensure petrol prices are aligned with comparable major cities across Canada: Vancouverites do not earn higher incomes than their fellow Canadians.

The unanticipated surge in living costs means the province will also need to recalibrate social and financial supports for persons and households. Having made significant headway in reducing poverty over the past decade, policymakers need to be alive to the regressive effects of surging energy, transportation, and food costs.

We recognize the government's desire to continue to advance its agendas on childcare, "clean growth," infrastructure development, and housing. In health care, there is a pressing need for more doctors and front-line health care workers, <u>not</u> administrative staff. This points to a need for additional health care funding beyond growth in baseline funding with the caveat that it should be directed to hiring actual front-line health care workers.

The Business Council believes resources should continue to be prioritized towards reconciliation as the government works to implement UNDRIP. Community development, training, and advancing First Nations' role in economic and project development should be high priority areas.

At the same time, government should carefully review spending in all areas to ensure available funding flows to priority areas. It is important to protect B.C.'s longstanding advantages in terms of sound fiscal management and comparatively low debt levels. This is attainable but will require disciplined financial management. As the government outlines its budget for the upcoming three years, it should also recognize that B.C. benefits from stronger business investment per worker, an expansion of exports as a share of GDP, local firms that are not unduly disincentivized from scaling and growing, and higher productivity – all of which can deliver additional resources for government over time.

Strengthening the foundations of prosperity

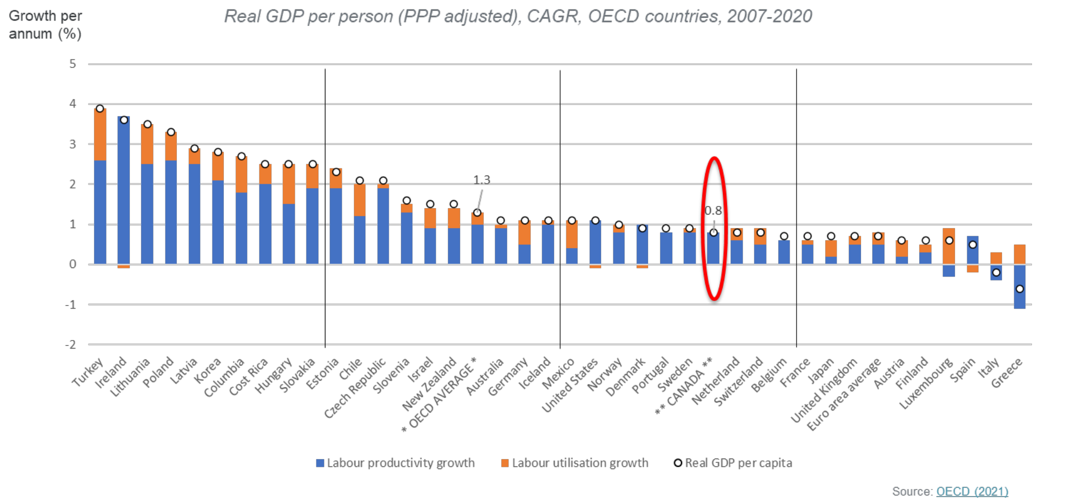
As the COVID-19 virus retreats and the related spending falls, it is time for the province to step up its focus on strengthening the foundations for prosperity and well-being. Ultimately, this means prioritizing the growth of real GDP per person – the single most important measure of living standards.

Based on BCBC research published in December 2021 and a subsequent column in the Globe and Mail in February 2022, the 2022 Federal Budget recognized the importance of growing per capita GDP. It acknowledged that Canada has lagged other advanced countries in growing prosperity and well being: ***"The stakes are high. Most Canadian businesses have not invested at the same rate as their U.S. counterparts. Unless this changes, the OECD projects that Canada will have the lowest per-capita GDP growth among its member countries."*** (2022 Federal Budget, p.26).

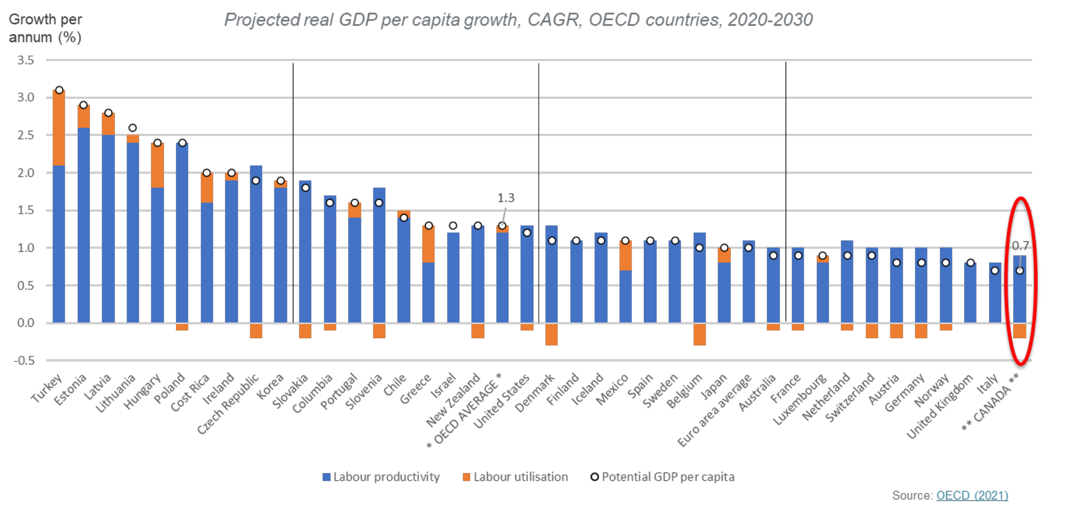
The OECD found that, over the 2007-2020 business cycle, Canada's real per capita GDP grew at a very modest average annual rate of 0.8%, a pace well down the growth rankings (26th of 39 OECD countries). More concerning, for the decade 2020-2030 the OECD predicts Canada (and by extension B.C.) will rank dead last among all advanced countries in real per capita GDP growth. The OECD also expects Canada will be the worst performing economy among 38 advanced countries over 2030-60, with the lowest growth in GDP per capita and labour productivity growth. This augurs badly for future real market income growth for Canadians and British Columbians.

The first figure below shows the OECD's summary of real per capita GDP growth by country over the 2007-2020 period. The second figure displays the organization's projections for average annual real per capita GDP growth going forward.

CANADA'S ECONOMIC POLICIES YIELDED LITTLE GROWTH IN REAL GDP *PER CAPITA* OVER 2007-2020



OECD PREDICTS CANADA WILL BE THE WORST PERFORMING ADVANCED ECONOMY OVER 2020-2030...



For some time, the Business Council has been concerned about slowing real GDP per capita growth, slow labour productivity growth, and Canada and B.C.'s retreat from international trade (despite a favourable export price environment). The impact on business investment and growth from inefficient taxes, byzantine project assessments and environmental permitting processes, abrupt changes to policies and legislation in the areas of labour and employment standards and rising relative carbon emission costs are all driving business operating costs higher, often without producing much in the way of offsetting benefits for the province. Worse, these structural impediments are shifting the economy away from high value-added, capital- and technology-intensive activities toward low value-added, labour-intensive activities. To unwittingly adopt a labour-intensive economic growth strategy as the world moves into the digital fourth industrial revolution will bring to reality the bleak income per capita growth projections of the OECD for Canada and B.C.

To sustain social programs and enhance support for health care and education, support First Nations reconciliation, and maintain high quality public infrastructure, the province must focus on raising economic output on a per capita basis. This generally occurs through higher labour productivity growth, which comes from investments in new machinery, equipment, and advanced-process technologies; a more educated and skilled workforce; efficient, well-functioning regulatory regimes; better transportation and communications infrastructure; and the scaling-up of more local firms. These are the areas that legislators and policymakers need to concentrate on if the goal is to build a more productive and prosperous British Columbia.

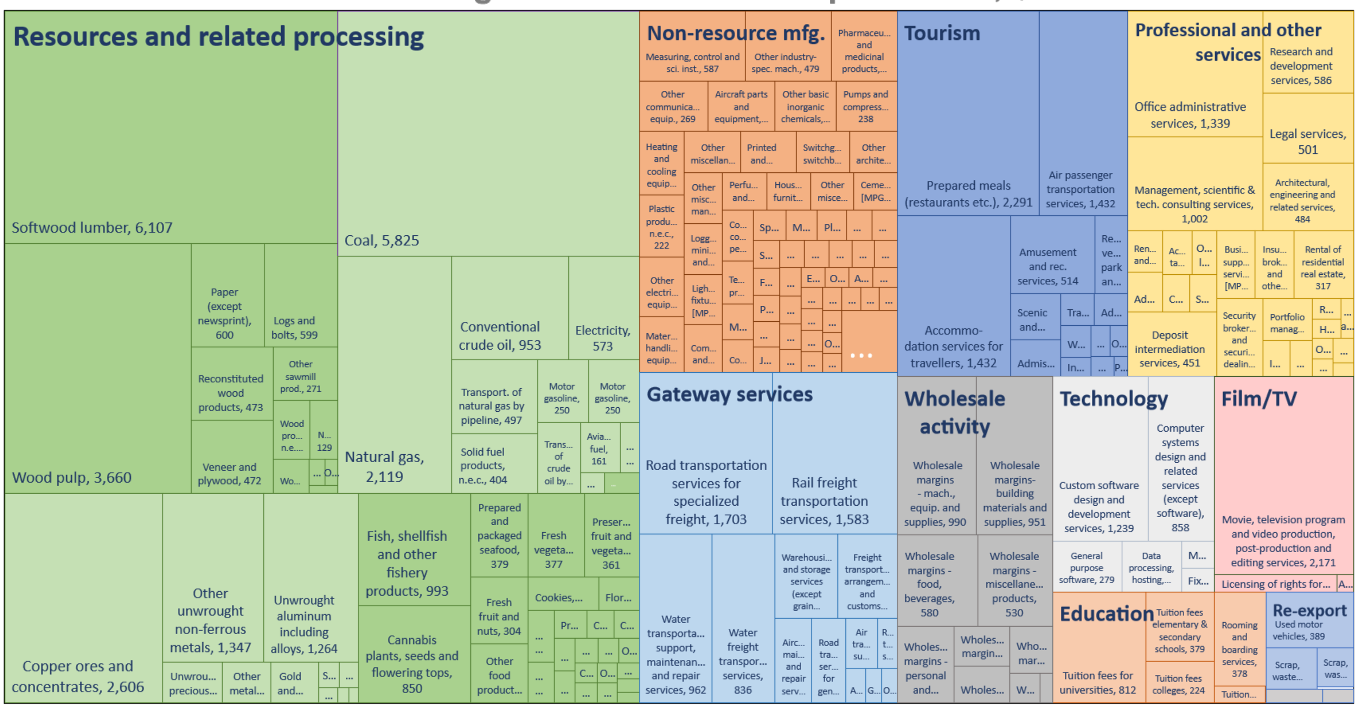
Exports underpin stronger per capita growth and prosperity

For a small trade dependant economy like B.C., growing exports is central to fostering stronger real per capita GDP growth. It is very difficult for a small market jurisdiction to sustain economic growth at a rate higher than labour force growth without accessing and trading with external markets. To an extent, the Business Council supports the government's current initiative to develop an Export Trade and Diversification strategy, although we also favour "just growing" exports writ large as a share of GDP. The renewed focus on Gateway infrastructure and the intent to promote and expand "clean technology" exports in the B.C. Economic Plan released earlier in the year are especially welcome.

From our perspective, however, as currently outlined the scope of the strategy is too narrow. Efforts to support the export sector should be much bolder. The government should focus on nurturing investment and scaling up exporting businesses right across the province's industrial landscape. B.C. is fortunate to have a diversified export base, including a greater orientation towards services than other provinces. It is a pity that Canada and B.C. have retreated from international trade over the past 20 years as most other advanced countries have expanded exports as a share of GDP. Indeed, the share of exports in GDP for Canada and B.C. has retreated to about where it was in 1980. That forty-year regression from the international market must be turned around. Our economy should be more open to international trade, not more insular.

The figure below provides a visual summary of key sectors (and industries within these sectors) comprising B.C.'s export base. If the aim is to grow exports (and prosperity) generally, then policymakers need to recognize the size and contribution of all the province's key export sectors, especially the resource sector. For B.C. to prosper, we require a policy environment that supports the export sector broadly, including the province's massive resource sector that is the leading source of export earnings and the source of thousands of high paying, family-supporting jobs.

B.C. international goods and services exports 2018, $ millions



Some High-Level Strategic Level Recommendations for the 2023 Budget

Recognizing the economic setting is deteriorating, below we offer several high-level recommendations to inform budget 2023.

Establish a credible plan to return to structural budgetary balance. Government should aim to avoid running operating deficits in an environment of low unemployment and runaway consumer inflation. As part of a sound fiscal plan, B.C. should:

- set an upper limit for the provincial debt-to-GDP ratio, even as capital spending ramps up;
- avoid baking-in billions of dollars of new permanent program costs across government;

- ensure that any new cost-of-living relief measures for households are targeted;
- adopt a general cost containment mindset in the budgeting process to help ensure available funding flows to a small number of priority areas.

Recognize the importance of growing real per capita GDP and the challenges B.C. faces in this regard, as the federal government did in its recent budget.

- Establish a **B.C. Prosperity and Productivity Commission** as an independent agency that consults and advises on structural reforms that could increase real per capita GDP growth and lead to higher productivity-based real market wages for more B.C. workers. The agency would help ensure that policies and new regulatory provisions are viewed through a productivity/prosperity lens. It would advise on changes that support scaling up businesses, growing the export sector, increasing productivity growth, and nurturing stronger real wage growth.

Take steps to mitigate the punitive effect of the rising B.C. carbon tax on energy-intensive export industries – which comprise upwards of half of B.C.'s export base – relative to other jurisdictions. B.C. exporters pay hundreds of millions of dollars in annual carbon tax while competitors in other North American jurisdictions pay little to nothing for their emissions. This does nothing to reduce global emissions as production shifts to other jurisdictions.

- The Business Council supports carbon pricing but is concerned that B.C.'s manufacturers and natural resource producers are being left to bear the full cost of the rising carbon tax, unlike competitors in other regions. B.C. firms in these sectors, despite producing lower carbon goods than competing firms elsewhere, are at an ever-growing economic disadvantage.
- We therefore recommend that the government align the B.C. carbon tax with the backstop federal carbon tax with respect to treatment of trade-exposed industries.

Avoid adding capital-related costs to business operations and introduce modest tax changes in budget 2023 to support stronger per capita economic growth. With careful management, the government should also have sufficient fiscal room to introduce a few modest phased-in tax changes that align with the goal of strengthening per capita growth and prosperity. Some near-term suggestions of growth-supporting tax changes with limited fiscal impact include:

- Reduce the penalty for business scaling by graduating the CIT rate between small/large companies. B.C. has two rates of corporate income tax – the general rate and the lower small business rate. The small business rate is 2% and applies to businesses with net income up to $500,000. As net income increases above that arbitrary limit it is abruptly taxed at six times that rate - at the general 12% provincial CIT rate. The threshold is a strong disincentive to firm growth. Rather than jumping from 2% to 12% after $500,000, the climb to 12% should be phased in over several increments.

- Broaden PST exemptions for business investment in machinery/equipment. In keeping with a productivity-enhancing growth agenda, the government should be looking to encourage and support capital investment, particularly in new technology and equipment. To support capital investment and improve competitiveness, the province long ago eliminated PST on machinery and equipment in the resource and manufacturing sectors. The government should broaden the current suite of machinery and equipment PST exemptions to other industries.

The government should continue efforts to advance reconciliation and implementation of the Declaration on the Rights of Indigenous Peoples Act that was passed into law in 2019. The Business Council encourages building frameworks that support the rights of Indigenous Peoples and enable new approaches to decision-making, leading to more predictability and transparency in project development.

Finally, talent, skill, and qualified workers are critical for our economy. It is paramount that the government ensure B.C.'s post secondary education regime is aligned with labour market needs. In addition, the government can support work-integrated-learning across the education system and supporting micro-credentialing to facilitate re-skilling and upgrading.

Conclusion

The B.C. economy has largely recovered from the pandemic and unemployment is around 50-year lows. Runaway inflation of 8.1% per annum – more than quadruple the Bank of Canada's target – is helping to restore the province's finances. The outlook for real GDP growth has darkened as central banks scramble to reduce monetary stimulus by hiking borrowing costs.

The overriding challenge for policymakers is to focus on stronger per capita GDP growth and advancing prosperity. British Columbians would benefit from a policy environment that is geared toward expanding the economy's productivity capacity. This means B.C. attracts more investment, encourages entrepreneurship, and reduces disincentives to business growth.

We urge the B.C. government to view policy and regulatory changes through the lens of improving labour productivity growth, real per capita GDP growth, and real market incomes for British Columbians as it frames the 2023 budget.