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Returning British Columbia to Prosperity

by Jason Clemens and Joel Emes
with a Foreword by Jock Finlayson, Business Council of BC

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Foreword

In many ways, the 1990s qualify as a “lost decade” for the British Columbia economy. As documented in this important and timely new study from The Fraser Institute, since the early 1990s the province has fared poorly on most measures of economic success. BC has been a laggard within Canada when it comes to increasing not just gross domestic product per capita, but also disposable incomes, business investment, and productivity. From 1992 to 2000, it posted virtually no gains in real GDP per person, ranking last in the country on this basic indicator of prosperity. Even more telling, by 1999 British Columbia had slipped below the national average in real after-tax income per person. On this score, BC has descended, even if only temporarily, to the status of a “have-not” province.

Facts are one thing, but how do we account for this disturbing trend? Broadly speaking, two sorts of explanations for BC’s sub-par economy have been offered by analysts, commentators, and politicians. The first points to external forces and how they have long shaped the province’s economic fortunes. According to this view, feeble growth in per capita output and income in BC can be traced to the Asian crisis of 1997-98, high Canadian interest rates earlier in the decade, the protracted economic slump in Japan, shifts in global commodity markets, and constraints on access to the American market under the managed trade scheme enshrined in the Canada-US Softwood Lumber Agreement.

Explanations of the second type put the analytical spotlight on internal factors. This perspective, which is reflected in the current study, links British Columbia’s economic decline to the actions and policies of the NDP government that took office in late 1991 and then won a second electoral mandate in 1996. Of course, in reality, external and internal forces both weigh on the economy.

However, since British Columbians cannot influence what happens in the outside world, it makes sense to direct attention to the domestic policy and institutional environment.

The main policy directions charted by the BC government in the decade from 1991 to 2000 may be summarized as follows:

- A bias toward interventionist approaches to economic management. This was achieved using not only the familiar instruments of taxation and regulation, but also through bail-outs of troubled businesses, the creation of new government entities such as Forest Renewal BC, the Jobs for Power Act, egregious political manipulation of large-scale capital projects (e.g., Skytrain and “Fast Ferries”), and the largely unfettered control exercised by the BC government over both Crown Corporations and the public sector quasi-monopolies that have become entrenched in the fields of education, social services, and health care.
- The emergence of an ever-growing number of restrictions on the ability of companies and individuals to make use of private and public lands and natural resources for economic and industrial development (i.e., wealth- and job-creation) purposes.
- The creation of a labour and employment law regime designed to promote the interests and bolster the economic and legal powers of trade unions.
- Adoption of sharply higher timber-harvesting levies (stumpage), and the implementation of a plethora of cumbersome and costly new regulations on the forest industry—still BC’s biggest economic engine and

the source of more than half of its exports and manufacturing shipments.

- A marked reluctance by BC policy-makers to match the tax cuts instituted in Alberta and Ontario, or to follow other provinces (or indeed the federal government) in paring back the size of the public sector.

Of particular significance has been the expanding presence of government in the BC economy. There has been a divergence across Canada in the growth and intrusiveness of what might be called the “provincial state.” Over the past 10 to 15 years, several other provinces chose to sell off some of their state-owned enterprises and other public assets; BC has shown little initiative on this front—indeed, Crown Corporations arguably play a larger role in the economy today than they did 10 or 12 years ago. Other provinces have taken steps to introduce more competition into areas previously dominated by heavily regulated and/or government-owned monopolies; BC has resisted pressure to move in this direction. Finally, in British Columbia, real provincial government spending has surged almost 30 percent since 1991, compared to increases of less than 7 percent for Ontario and for all provinces collectively, and a small decline in next-door Alberta. A longer-term perspective confirms the above picture. Expenditures by the provincial public sector rose by the equivalent of six percentage points of GDP in BC between 1975 and 2000. In contrast, neither Alberta nor Ontario recorded any meaningful increase in the size of their provincial public sectors over this 25-year period. Not

coincidentally, the economic performance gap between BC and these other two “have” provinces has widened over time.

The authors of *Returning British Columbia to Prosperity* believe that British Columbia has been punching well below its economic weight—a sentiment widely shared across the province—and that it can do better. To that end, they propose a series of policy and institutional changes intended to marshal British Columbia’s impressive natural and human assets in the quest for enhanced prosperity. These recommendations touch on fiscal and taxation policy, labour matters, regulatory reform, natural resource development, land use, the manner in which public services are provided, state-owned enterprises, and the management of the provincially-regulated education, health care, and social service systems.

Not all readers will agree with all of the individual recommendations put forward in this study, but they will profit by reviewing it closely and with an open mind. The overall thrust of the analyses and prescriptions outlined here will appeal to those who, like this writer, believe that an overweening state and a failure to understand the unrivalled wealth-creating power of markets have contributed to the economic malaise that has befallen British Columbia in recent years.

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* The views expressed by this author are his own and do not necessarily express the opinions or views of the Board or members of the Business Council of BC.

Executive Summary

Economic Performance

Over the last decade, British Columbia's economic performance stands in sharp contrast to its historical performance. Given the province's natural resources, access to foreign markets, educated workforce, and traditional level of economic performance, the last decade has been disastrous and unacceptable for British Columbians.

Income Performance

British Columbia began the decade with real per capita GDP \$367 greater than the national average, and ended the decade \$3,471 lower. While Ontario and Alberta experienced tremendous growth in real per capita GDP, 16.7 percent and 26.7 percent respectively, British Columbia languished with a mere 2.1 percent increase in real per capita GDP over the 1990s. In fact, the average annual growth rate in real per capita GDP in British Columbia of 0.1 percent over the last decade stands in sharp contrast to the 1.2 percent and 2.2 percent experienced in Ontario and Alberta, respectively.

British Columbia's performance is even worse when disposable income is assessed. The province began the decade with real per capita disposable income \$743 above the national average, within close range of both Ontario and Alberta. It ended the decade with real per capita disposable income \$768 below the national average, substantially below Ontario's and Alberta's levels. In fact, while Ontario and Alberta experienced moderate growth in real per capita disposable income of 1.0 percent and 3.8 percent respectively, over the decade, BC actually experienced a contraction of 5.9 percent. In other words, average British Columbians had less real disposable income in 2000 than they did in 1990.

In terms of per capita income, whether measured by GDP or disposable income, British Columbia, over the course of a mere decade, has gone from a position of economic leadership and prosperity in Canada to a position of mediocrity.

Employment: A Bright Spot?

Employment Growth

Given British Columbia's poor economic performance, its ability to increase employment and maintain reasonably competitive unemployment rates is quite surprising. Between 1975 and 2000, total employment growth in British Columbia (96.3 percent) exceeded employment growth in Ontario (64.2 percent) and Canada as a whole (61.0 percent) and trailed Alberta (102.2 percent) only slightly.

Equally surprisingly, given British Columbia's poor income performance over the 1990s, is its strong employment growth over the 1990s. Between 1990 and 2000, British Columbia achieved employment growth of 25.6 percent, outperforming Canada as a whole, Ontario, and Alberta, which achieved growth of 14.2 percent, 13.1 percent, and 24.6 percent respectively. It is not surprising that British Columbia's unemployment rate has been competitive, given its employment performance. Unfortunately, the employment picture is not as positive as it first looks.

Public Sector Employment: Part of the Story

One explanation for the province's strong employment performance is its population growth. An increasing population helps employment by creating an increased demand for a wide range of goods and services. Both immigration and Cana-

dian migration to British Columbia clearly helped the province post positive employment gains during the 1990s.

An equally potent explanation for the province's strong employment performance is the expansion in its public sector over the period. British Columbia, unlike Ontario and Alberta, has increased the number of public sector employees in the province. Since 1983, the number of public sector employees in BC has increased 22.2 percent, from 283,000 in 1983 to 345,000 in 2000. More strikingly, between 1990 and 2000, British Columbia expanded the public sector by 8.2 percent while Ontario and Alberta reduced their public sectors by 11.8 percent and 14.2 percent respectively. It is highly likely that both the absolute number of public sector employees as well as the percentage of total employment represented by the public sector will need to be curtailed in the future as part of a rationalization of government spending.

Business Investment

Business investment in BC is facing a serious crisis. Over the last four years, the province has been rated consistently as having the worst investment climate in the country. In a recent survey of money managers, British Columbia received the highest negative ratings for maintaining the appropriate mix of public policies required to foster investment.

This lack of business confidence has translated into dismal levels of business investment. Real net fixed business investment (that is, investment in fixed assets beyond simply replacing worn out and depreciated assets) has continued to fall in British Columbia after the last Canadian recession. It fell by negative 13.3 percent between 1991 and 1999. Canada as a whole achieved a rate of 46.7 percent while Alberta experienced a business investment boom, recording growth of 800.7 percent.

Equally telling, between 1991 and 1999, British Columbia experienced an average contraction in net fixed business investment of 1.4 percent. This means that the average growth in real net fixed business investment in British Columbia failed to keep pace with the depreciation of previous investments. This occurred while Ontario experienced an average net increase of 7.2 percent, Alberta a whopping 75.7 percent, and Canada as a whole 6.0 percent.

The lack of business investment and the contraction in the stock of fixed business assets will continue to act as a drag on BC's economy, even with a rebound in capital investment, since it will take time for these new investments to be completed and available. A stagnant or depleting stock of assets will constrain productivity growth and ultimately hamper increases in individual and family income.

Red Herrings

Two of the common explanations for British Columbia's poor performance, namely, the Asian currency crisis (commonly referred to as the "Asian Flu") and the decline in commodity prices, cannot fully explain the decline in British Columbia's economic performance. The Asian currency crisis, which began in 1997, cannot explain a structural decline in economic performance that started in 1990/91. The deterioration in Asian countries made an already bad situation worse. Similarly, the decline in commodity prices over the decade cannot fully explain the economic difficulties facing the province since commodity price increases did not result in improved economic performance. The underlying cause of the economic malaise currently facing British Columbia is poor public policy.

Government Spending and Taxes: The Root of the Problems

The root of the economic problems in British Columbia is poor public policy founded on a belief in the efficacy of a more activist and interventionist government. Over the last decade, real per capita government expenditures in British Columbia have increased 7.5 percent, compared to declining expenditures of 0.6 percent in Ontario and 19.7 percent in Alberta. Government spending as a percent of GDP increased by 13.3 percent in British Columbia over the 1990s while it decreased 2.8 percent and 27.0 percent in Ontario and Alberta, respectively.

Government spending ultimately drives government taxation and revenue collection. Provincial government revenue now consumes 20.2 percent of GDP in British Columbia but only 16.4 percent in Ontario and 17.3 percent in Alberta. British Columbia has used deferred taxes or debt throughout the decade to finance much of the expansion in government. In other words, rather than fully financing the expansion in government spending with current taxes, the provincial government chose to borrow or defer taxes, thus putting the burden of today's spending on tomorrow's taxpayers. British Columbia has seen its debt position relative to the other provinces deteriorate and the cost of debt servicing increase over the last decade.

The road to recovery requires a smaller, more focused government. It requires the provincial government to limit itself to doing those, and only those things, we actually need it to do.

General Policy Recommendations

The main prescription for economic recovery in British Columbia is for government to reduce spending and lower taxes. This will mean reductions in core areas of government spending, in-

cluding health care, education, and social welfare. However, as the specific policy sections in the main body of the report demonstrate, by reforming the *way* services are delivered, using methods that have already been tested in other jurisdictions, services can be maintained and indeed improved, while spending is cut. The reduction in government spending must be paired with major reductions in personal and business taxes. The reductions should aim to make the province's tax system more efficient and competitive with competing jurisdictions. Finally, the province should privatize Crown Corporations, with the proceeds earmarked for provincial debt reduction, which in turn would allow for greater tax relief.

The rest of this summary outlines the key policy recommendations from each of this study's eight policy sections.

(I) Fiscal Policy: Government Spending and Taxation

Government Spending

- Decrease the percentage of the economy accounted for by government

British Columbia must implement fiscal policies that reduce the proportion of the economy consumed by government, in order to move the province towards the optimal level of government—a level which maximizes social and economic progress while minimizing economic distortions.

- Reduce the public service and allow the private sector to provide more services

Unlike other provinces, particularly Ontario and Alberta, British Columbia's public service has not been curtailed. Through privatization and a greater reliance on the private

sector for the delivery of goods and services, the civil service must be reduced, both in absolute numbers and as a percent of total employment.

- Introduce strong tax and expenditure limitation laws

Strong tax and expenditure limitation laws (referred to as TELs) have proven successful in stemming the growth of government and ensuring fiscal responsibility in the United States. TELs effectively constrain a government from increasing either taxes or spending without popular approval. For instance, expenditure limitation laws require any spending increase in excess of inflation and population growth to be specifically approved by referendum.

Taxation

- Introduce a *minimum* 20 percent across-the-board reduction in personal income tax-rates
- Eliminate the top two statutory tax rates, formerly the high-income surtaxes
- Reduce business income tax rates with a target rate for corporations of 8.00 percent
- Immediately eliminate capital taxes
- Harmonize the Provincial Sales Tax with the GST

There are serious problems in the current provincial sales tax, chief of which is that business inputs are taxed. Harmonizing the provincial sales tax with the federal GST and collecting it as a value-added tax would eliminate this problem.

- Over the longer-term, the province should implement a broad-based flat tax

A flat tax should fully integrate personal and business taxes and ensure that all sources of income are taxed uniformly at one rate, one time. A flat tax would move the tax system away from the taxation of income towards a system based on consumption, which is inherently more efficient. Such a system would encourage economic growth and achieve the basic tenets of prudent tax policy (efficiency, simplicity, and equity). A flat tax could be implemented in British Columbia on a revenue neutral basis, so it could be implemented without jeopardizing the current amount of revenue raised, yet stimulate and encourage entrepreneurship, risk-taking, investment, and diligence.

Debt

- Implement a legislated program of debt reduction

British Columbia should legislatively require any unused portion of the contingency fund to be applied each year to the province's debt. In addition, all unexpected surpluses, whether garnered from higher than expected revenues, lower than expected interest costs, or lower than expected expenditures, should be exclusively restricted to reducing the province's debt.

(2) Regulation

- Implement a three-year moratorium on all new regulations in conjunction with a review of existing regulations
- Apply cost/benefit tests, with results made public

British Columbia should require a reliable and comprehensive cost/benefit analysis of proposed regulations before they are enacted. The results should be made public.

- Prioritize regulations

Since not all risks are of equal magnitude, regulatory bodies in BC should be required to prioritize all regulations. Emphasis and priority should be placed on regulations that address the most serious risks.

- Redirect government focus to results

New regulations should focus on achieving specific and measurable goals.

- Introduce a regulatory budget along with the annual fiscal budget

The government should submit annually, along with the normal budget, a comprehensive, detailed budget delineating the costs of regulation, including costs for both government and those affected by regulations, i.e. businesses and individuals.

- Enact a sunset clause for all regulations

Regulatory bodies should include a sunset clause in all new regulations to ensure that they are reviewed regularly and eliminated when no longer relevant.

(3) Labour Market

- Repeal amendments made to the Industrial Relations Act, the Employment Standards Act, and the Fair Wage Act over the last decade

There is mounting evidence that the amendments made to the first two pieces of legislation have led to a dramatic deterioration in labour-management relations in BC and contributed to a negative business climate. Furthermore, the amendments have increased the cost of doing business in the province by increasing the cost of labour. A return to market-determined compensation and

greater flexibility must underlie labour market reform.

- Rescind announced increases to the minimum wage and ensure that minimum wages maintain an appropriate relationship with per capita GDP, assuming they remain at all

Minimum-wage laws have a detrimental effect on employment, particularly for young and unskilled workers. Governments need to stop interfering in the process of real wage determination in response to changes in labour supply and demand. Assuming that minimum wages continue to be a fact of life, they should be set at an appropriate level relative to per capita GDP—a proxy for per capita productivity.

- Enact right-to-work legislation

British Columbia should enact right-to-work legislation, which precludes closed-shop unions and makes union membership voluntary. As a result, workers would no longer be forced to join unions and would be given more flexibility to negotiate contracts with employers based on their own particular economic and personal circumstances. Unions, in turn, would be forced to become more responsive to the interests of their members, who have chosen to join.

(4) Natural Resources—Forestry Focus

- Create a pro-development natural resource investment and business climate

British Columbia must make a real effort to reverse the current negative business climate and create an environment conducive to investment. In the natural resource sector, part of this effort should include streamlining

regulations with an emphasis on intended results rather than mandated processes.

- Privatize forests that are currently owned and managed by the Crown

One of the biggest problems with state ownership of forests is that neither government nor private companies logging on Crown lands have any incentive to operate efficiently, to replant, or to harvest prudently. Government has little incentive to replant since the main beneficiary of this initiative will be some other government in power later on when the trees mature. Since private companies harvest on land that they themselves do not own, they see no direct benefit or economic incentive to invest in costly long-term “forest enhancement.” Both see the short-term benefits of harvesting, but not the long-term value of replanting and forest enhancement programs. The presence of possible native land claims, although an immediate barrier to privatization, does not negate the long-term efficacy of privatization.

- Repeal the Forest Practices Code and the Forest Renewal Act

Both acts have more to do with increasing the regulatory burden on the forest industry than enhancing the environment. A results- and performance-based forest code that establishes key performance targets and objectives and provides business operators flexibility to meet the targets in the most efficient manner should be enacted to replace the Forest Practices Code.

- Eliminate the minimum stumpage fee and link stumpage fees to world prices for timber.

Since coming to power in 1991, the NDP government has increased stumpage fees by nearly 200 percent. These payments are now

part of the cost of production for forestry companies. As a result, British Columbia forest companies have become costly producers of lumber and other forest products, a situation that has led to lower levels of output and reduced employment. Given that world lumber prices fluctuate constantly, the provincial government should put in place a mechanism for linking stumpage fees to the price of lumber in order to allow companies to remain profitable and viable well into the future. Note that as this study went to print, the provincial government indicated that they were going to move towards a market-determined stumpage fee process (Hamilton, 2001).

- Eliminate the British Columbia Environmental Assessment Act

British Columbia’s Environmental Assessment Act is a cumbersome and time-consuming process that leads to allocation inefficiencies. The government should repeal this act and rely on common-law remedies to ensure environmental protection. Its one-size-fits-all process of assessing the environmental impact of projects around the province fails to take into account each project’s uniqueness and the possible negative externalities arising from each.

- Subject the setting aside of Crown land for parks and heritage sites to cost/benefit analyses.
- Co-ordinate land claim settlements with forest privatization

(5) Health Policy

This section is broken into two separate parts: intermediate policies and long-term policies. The delineation is a result of the Canada Health Act. As long as the federal government prevents provinces from enacting broad-based

institutional reform, many of the most necessary and productive reforms cannot begin.

Intermediate Health Policy Recommendations

- Use private health contractors, both non-profit and for-profit, to deliver health services more efficiently

If private contractors are allowed to provide health services, it will clearly improve the health care sector's incentive structure. Additionally, it will provide greater accessibility to health care by increasing the sector's productive capacity. Perhaps most importantly, private contractors could provide health services at reduced costs with no adverse effects.

- Negotiate a renewed Labour Accord

British Columbia should immediately move to implement market wages for all medical and non-medical hospital staff.

- Eliminate reference-based pricing

Evidence shows that restrictive drug programs can have adverse effects on patient health and create unanticipated incentives, which may actually drive *up* net costs.

Longer-Term Health Policy Recommendations

- Adopt a system of medical savings accounts

Under a system of medical savings accounts (MSAs) the province would channel health care spending through individuals rather than service providers. Each individual's MSA would be divided into two parts: one to pay for regular expenses, such as routine doctors' visits and prescription drugs, and the second to fund a catastrophic insurance plan.

Any surplus in the fixed annual amount could be carried forward or applied to an RRSP, but individuals would be required to make up any deficit from personal funds. The government-funded catastrophic illness plan would ensure that no individual would be left bankrupt as a result of a major illness.

- Allow and encourage the privatization of health care service delivery

British Columbia should acknowledge and promote private alternatives to the public provision of health care. Health care service provision should be privatized over a pre-determined period so that a pricing system could be introduced that would improve health care resource allocation, and improve service delivery by creating and promoting patient-caregiver accountability.

(6) Education—Elementary and Secondary

Intermediate Policy Recommendations for Education

- Eliminate funding discrimination for independent schools

The discriminatory funding structure for independent schools in British Columbia not only affects the nearly 60,000 students enrolled in them, but also impedes the development of and access to independent schools for potential students. The funding structure should be adjusted immediately to eliminate provincial discrimination.

- Introduce flexible regulations for independent schools

The province should immediately overhaul regulations governing both existing and new independent schools to give them greater

flexibility and the opportunity to experiment within the education system.

- Eliminate catchment areas

Allowing parents to transfer their children to different schools within the current public system would introduce an important element of competition within the public system and at least partially re-direct education incentives back towards the delivery of education for students.

- Enact strong charter school legislation

British Columbia should move to introduce strong charter school legislation based on experience from international models that have successfully encouraged the creation and maintenance of charter schools.

- Direct the focus of the Ministry of Education on communications

With greater parental choice will come a greater need for the Ministry to provide information to parents. The Ministry should develop a system for collecting information about all education providers, and giving it to parents, citizens, and the media.

- Continue to focus on delivering resources to the classroom

British Columbia needs to be vigilant about rationalizing administrative functions to ensure that as many resources as possible flow through to the classroom. Although the situation has improved in recent years, more administrative functions need to be streamlined, outsourced, or contracted out.

- Give students more learning opportunities by permitting non-certified teachers to teach

their area of expertise to classes on a part-time or instructional basis.

- Re-negotiate collective agreements so that they reflect market-based compensation and maximize classroom resources.

Education remuneration, particularly for non-teachers, should be market-tested, given British Columbia's already skewed focus on non-educator expenditures. That is, non-teacher compensation should be compared to similar positions in the general labour market in order to calculate compensation levels. Any savings from adjustments to compensation levels should be re-directed to the classroom.

- Foster a private voucher system to augment the current public system

British Columbia should encourage charities, foundations, business organizations, and those interested in education to develop private initiatives, such as private vouchers. Specifically, a private voucher system could be established to provide low and middle-income families with additional educational resources to cover tuition not covered by the limited public voucher program and incidental expenses such as uniforms and textbooks.

Long-Term Policy Recommendations for Education

- Implement a broad public voucher system for education

Provincial education reform ultimately rests in the creation of a broad-based public voucher system in which parents, rather than schools, would receive education resources.

(7) Welfare Policy

- Introduce strong sanctions and immediate work requirements

British Columbia should immediately institute work requirements for eligible welfare recipients, coupled with strong financial penalties for non-compliance. Those willing, but currently unable to enter the workforce should be helped to do so.

- Implement time limits for the receipt of benefits

A specific time limit, similar to the ones introduced in the US reform initiative of 1996, should be included as part of a broad-based reform of welfare in British Columbia. Specifically, individuals should be precluded from receiving welfare benefits for more than two years in any given five-year period. A flexible cap on the receipt of public assistance would reduce the number of people who rationally choose welfare over work. People with disabilities that prevent them from working should be excluded from such restrictions.

- Adopt a diversion strategy prior to providing welfare

Implement a program that helps divert potential recipients away from welfare by focusing on familial sources of support, charitable organizations, lump-sum payment programs, and/or employment opportunities.

- Introduce full-check sanctions

Tougher sanctions against welfare abusers, including the reduction and/or elimination of benefits, should be introduced along with other reforms.

- Monitor the relationship between total welfare benefits and the amount of after-tax income a recipient could earn in the labour market
- Adopt a comprehensive measure of welfare benefits

All cash and in-kind benefits and tax credits available to welfare recipients should be considered when the resources available to a welfare recipient are compared to what that person could reasonably expect to earn in the labour force.

- Promote and encourage experimentation

Every province, including British Columbia, should pursue initiatives proven to be successful in the United States. British Columbia must aim to deal quickly, precisely, and compassionately with welfare recipients and their problems.

- Continue to reduce administrative costs
- Adopt a basic needs definition of poverty

(8) Industrial Development and Privatization

- Purposefully move away from activist and interventionist industrial policies towards a market-based approach to economic development
- End all direct and indirect subsidies to business
- Immediately designate several Crown corporations as candidates for privatization

Given the international and Canadian experience with privatization, several BC Crown corporations could be immediately designated for privatization. They include BC Hydro and Power Authority, BC Ferry Cor-

poration, BC Liquor Distribution Branches, Insurance Corporation of BC, and BC Railway Corporation.

- Review all remaining Crown corporations

The government should immediately undertake a thorough, unbiased review of all remaining Crown corporations with a clear mandate to rationalize. Crown corporations that operate in sectors where private firms already deliver similar goods and services should be immediately identi-

fied for privatization. The operations of Crown corporations not so designated should be thoroughly reviewed to determine the feasibility of contracting out the services they now offer.

- Legislatively require all proceeds from asset sales to be used exclusively for debt reduction

Specific legislation needs to be enacted to ensure that one-time asset sales are not used to help balance the government's accounts or undertake new spending initiatives.

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Economic Performance

This first section of *Returning British Columbia to Prosperity* assesses the economic performance of BC over the last quarter-century. It places particular emphasis on British Columbia's relative performance with Ontario and Alberta and also with Canada as a whole. This section is meant to provide readers with an understanding of the province's past and current economic performance.

Three core areas of the economy have been selected for analysis: income, employment, and investment. These three core areas provide readers with an adequate picture of British Columbia's economic performance over the last 25 years. Some of the areas assessed in this first section are also examined in later policy sections.

Income Performance: Signs of Deterioration—The Lost Decade

This study uses two principal measures to assess British Columbia's performance in expanding the income of the province's residents: the gross domestic product (GDP) and disposable income. Gross domestic product (GDP) refers to the total value of goods and services produced. Disposable income is a measure similar to GDP except that it only includes the amount of income available to citizens after deductions for direct taxes, such as income taxes and payroll taxes. This study will examine both income measures in a number of different ways to provide multiple

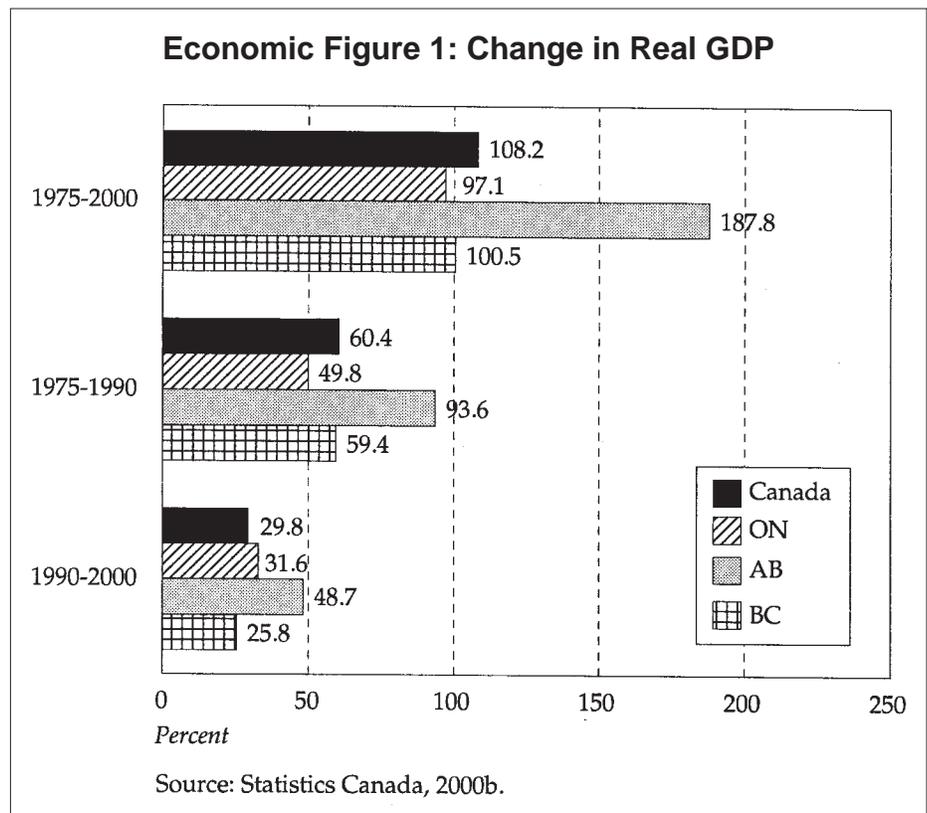
views of income performance for both GDP and disposable income.

Gross Domestic Product: Lagging Performance

Aggregate Real GDP

The simplest way to view GDP is in aggregate. That is, to inquire as to what changes occurred in the total, or aggregate, value of goods and services. Economic Figure 1 depicts the changes in real GDP between 1975 and 2000 for British Columbia, Alberta, Ontario, and Canada as a whole.

As Economic Figure 1 indicates, British Columbia fared well compared with Ontario and Canada as a whole for the entire period from 1975 to 2000 in terms of growth in the total real value of goods and services (GDP). British Columbia's real GDP



growth in the period exceeded that of Ontario by 3.4 percentage points, and was only 7.7 percentage points lower than Canada as a whole. Alberta far and away outperformed all of the jurisdictions over this period, recording growth in GDP 79.6 percentage points greater than the next highest jurisdiction, Canada as a whole. Alberta's growth was so strong that it actually overtook British Columbia in terms of the total size of its economy in 2000.

British Columbia performed particularly well between 1975 and 1990. Total real GDP growth in British Columbia exceeded that of Ontario, and was only 1 percentage point lower than in Canada as a whole. Again, Alberta's GDP growth far exceeded that of any other jurisdiction during this time.

As Economic Figure 1 depicts, all jurisdictions experienced a slowdown in GDP growth during the 1990s. British Columbia, unfortunately, experienced a more pronounced decline in its real GDP growth. Between 1990 and 2000, British Columbia's GDP growth lagged behind all three other jurisdictions. In fact, in an analysis of real GDP growth between 1992 and 1999, the Business Council of BC concluded that British Columbia ranked second last among all the provinces in its ability to increase economic output (Business Council of BC, 2000b).

Real Per Capita GDP

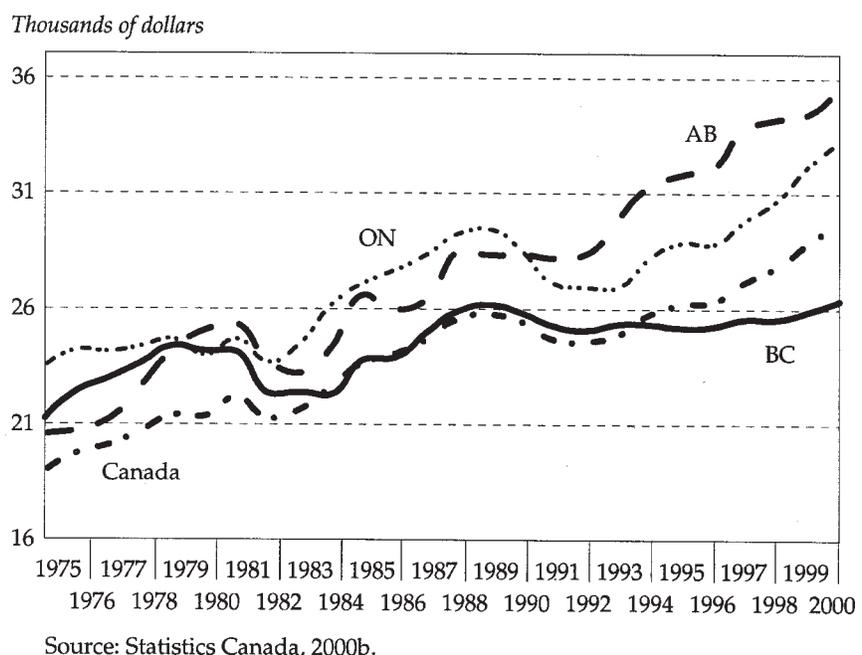
Examining changes in total GDP can be overly simplistic. For instance, it ignores changes in population. It is entirely possible that GDP could be increasing while the residents of a particular re-

gion are becoming poorer. This would occur when growth in GDP was insufficient to account for growth in population. Per capita GDP figures and per capita disposable income data will provide evidence that that is exactly what has occurred in British Columbia over the last decade.

Economic Figure 2 illustrates the real per capita GDP values for Canada as a whole, Ontario, Alberta, and British Columbia between 1975 and 2000. Like the previous figure, the tremendous growth in per capita GDP in Alberta stands out. From 1975 to 2000, real per capita GDP grew 74.6 percent in Alberta, which was significantly greater than in Canada as a whole, Ontario, or British Columbia, which experienced 57.5 percent, 41.6 percent, and 24.2 percent growth, respectively. Put differently, the growth in real per capita GDP in British Columbia between 1975 and 2000 was roughly one-third that of Alberta and less than half that of Canada.

In 1975, the real per capita GDP values for the four jurisdictions were relatively similar: Canada (\$18,949), Ontario (\$23,521), Alberta (\$20,597),

Economic Figure 2: Real Per Capita GDP (1975-2000)



and British Columbia (\$21,246). British Columbia's real per capita GDP was \$2,297 greater than the national average, and \$649 greater than Alberta's real per capita GDP. Like most regions, British Columbia lagged behind Ontario in its real per capita GDP in 1975. Nonetheless, there was a relatively small disparity (\$2,275) between these two "have" provinces.

In 1990, British Columbia's real per capita GDP (\$25,834) remained above the national average, although by only \$367. The spread between the real per capita GDP values for British Columbia and Ontario had widened, and Alberta now surpassed BC. Nevertheless, British Columbia remained competitive. Specifically, Ontario's real per capita GDP (\$28,530) exceeded British Columbia's by \$2,696 while Alberta's real per capita GDP (\$28,383) exceeded British Columbia's by \$2,549.

The serious under-performance of British Columbia in expanding real per capita GDP occurred between 1990 and 2000 (see also Economic Figure 3). While Canada as a whole, Ontario, and Alberta posted respectable rates of growth in real per capita GDP, namely, 17.2 percent, 16.7 percent, and 26.7 percent respectively over the ten-year period, British Columbia lagged with a growth rate in real per capita GDP of 2.1 percent.

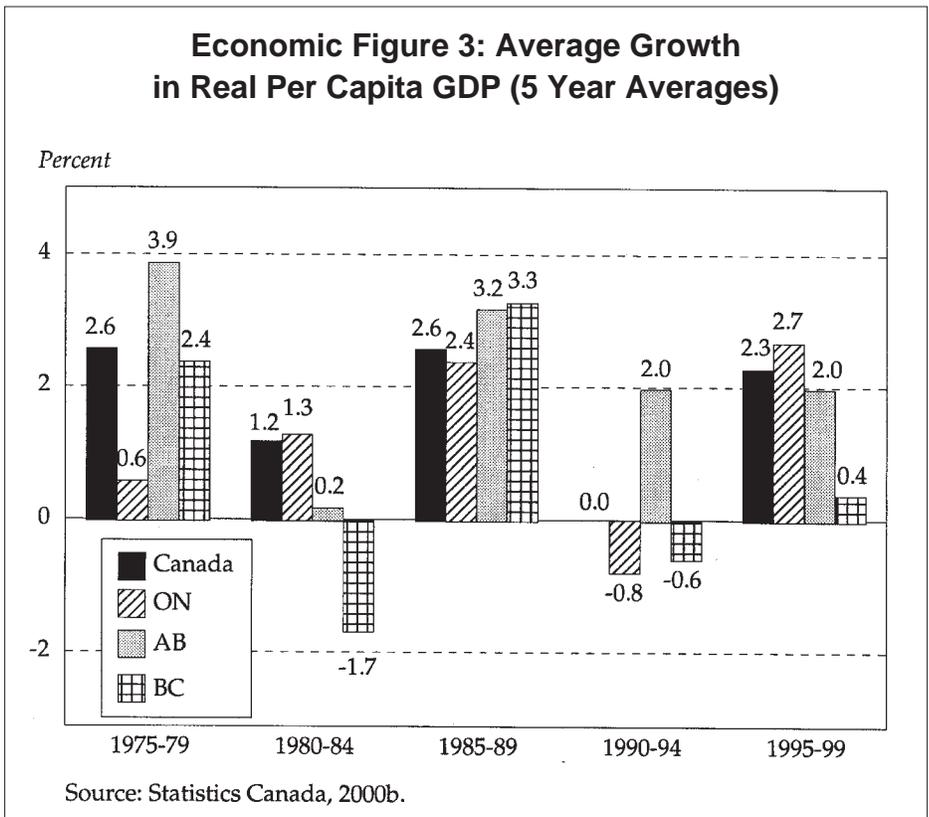
This lacklustre growth rate has resulted in serious gaps in real per capita GDP values between jurisdictions. For instance, British Columbia's real per capita GDP of \$26,383 in 2000 is \$3,471 less than the national average, and considerably less than the comparable values for Ontario and Alberta—\$33,295

and \$35,969, respectively. In fact, British Columbia now maintains real per capita GDP values at 79.2 percent and 73.3 percent of Ontario and Alberta, respectively.

As Economic Figure 3 illustrates, British Columbia posted moderate but nonetheless competitive rates of real per capita GDP growth between 1975 and 1979 and between 1985 and 1989. Growth in real per capita GDP in British Columbia between 1975 and 1990 totalled 21.6 percent, slightly more than in Ontario (21.3%) but less than in Alberta (37.8%) and Canada as a whole (34.4%).

British Columbia suffered major declines in real per capita GDP between 1980 and 1984 while other provinces experienced increases. However, the most significant divergence in growth in real per capita GDP values between the jurisdictions occurred over the last decade. British Columbia posted the second worst growth rate between 1990 and 1994 and experienced the worst growth rate between 1995 and 1999. BC's dismal performance in the 1990s in growing the real value of per

Economic Figure 3: Average Growth in Real Per Capita GDP (5 Year Averages)



capita GDP has been disappointing given the province's enormous potential.

What the Future Holds: Conference Board and CIBC Estimates

According to Conference Board of Canada estimates, British Columbia will continue to lag Canada as a whole as well as Ontario and Alberta for 2000 and 2001. British Columbia is expected to post gains in real GDP of 2.8 percent and 2.9 percent respectively, for 2000 and 2001, well below the rates expected for Canada (4.2% and 3.0%), Ontario (4.6% and 3.2%), and Alberta (5.8% and 3.4%) (Conference Board of Canada, 2000).

Recent projections by the Canadian Imperial Bank of Commerce (CIBC) support the Conference Board of Canada estimates. CIBC expects GDP growth in British Columbia to lag behind Canada as a whole and both Ontario and Alberta in 2001 and 2002 (CIBC, 2000c). The consensus view for GDP growth in British Columbia is positive but still significantly below that of both of the

other "have" provinces as well as Canada as a whole. In other words, British Columbia is not expected to regain its position as one of Canada's leading economic jurisdictions.

Disposable Income: From Bad to Worse

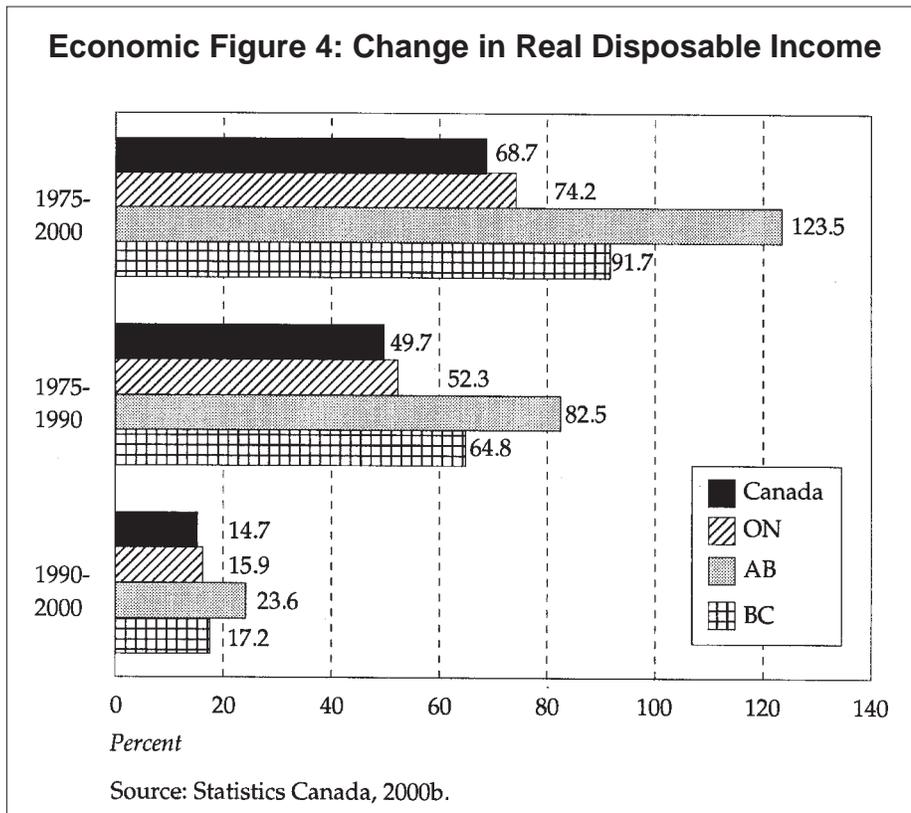
Aggregate Real Personal Disposable Income

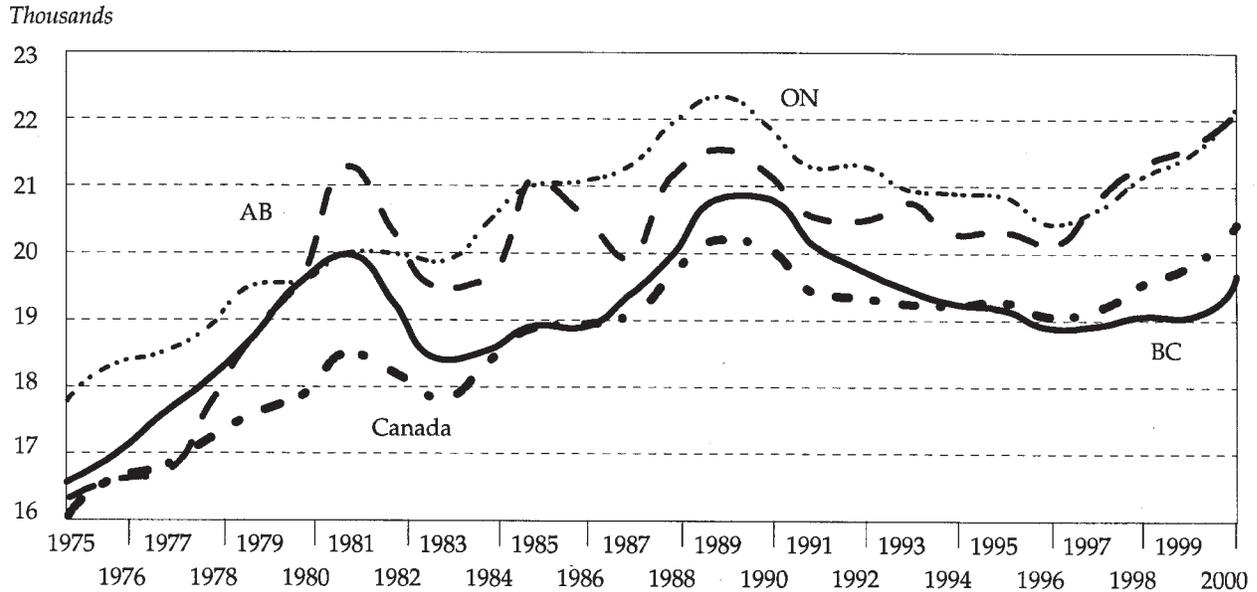
Recall that personal disposable income measures personal income adjusted for direct personal taxes to provide a measure of income available to residents. Economic Figure 4 presents the growth in real personal disposable income between 1975 and 2000. British Columbia performs better using this measure than using real GDP growth (Economic Figure 1). Although Alberta significantly outperforms all other jurisdictions over this period, British Columbia consistently outperforms both Ontario and Canada as a whole. For instance, over the entire period (1975-2000), real personal disposable income in British Columbia grew 91.7

percent whereas it grew 68.7 percent in Canada as a whole and 74.2 percent in Ontario. Alberta outperformed all jurisdictions in growth in real personal disposable income with a rate of 123.5 percent.

Real Per Capita Disposable Income

Like aggregate GDP, viewing aggregate disposable personal income can be too simplistic as it ignores important factors such as population growth. As was the case for aggregate GDP, once disposable personal income is adjusted to account for population changes, BC's performance seriously



Economic Figure 5: Real Per Capita Personal Disposable Income (1975-2000)

Source: Statistics Canada, 2000b.

deteriorates. Economic Figure 5 depicts real per capita personal disposable income for the four jurisdictions between 1975 and 2000.

Economic Figure 5 contains two noticeable details. First, Canada as a whole, Alberta, and British Columbia begin the period with nearly identical levels of per capita personal disposable income. In fact, the difference in real per capita personal disposable income between the three jurisdictions is a mere \$560, with British Columbia maintaining the highest level (\$16,563) of the three jurisdictions and Canada as a whole the lowest (\$16,003). In 1975, Ontario maintained a real per capita personal disposable income of \$17,759, materially above all three jurisdictions.

The second observation is the tremendous growth experienced by both Alberta and Ontario compared with BC's abysmal performance. British Columbia ends the period with the lowest real per capita disposable income (\$19,666) of the four jurisdictions, \$768 below the national average of \$20,434, and significantly below the levels achieved in either Ontario (\$22,211) or Alberta

(\$22,119). In fact, British Columbia's real per capita disposable income is now 88.5 percent of Ontario's and 88.9 percent of Alberta's.

The major difference in per capita disposable income growth occurs largely over the 1990s, as Economic Figure 6 shows. British Columbia performs relatively well between 1975 and 1990, excluding 1980 to 1984. In fact, the relative total growth rates for this 15-year period are much closer to each other than those achieved in the last decade. For example, while Ontario and Alberta posted growth rates in per capita disposable income between 1975 and 1990 of 23.3 percent and 29.9 percent, respectively, British Columbia experienced growth of 25.7 percent. Unfortunately, this competitive performance was not continued in the 1990s.

British Columbia's performance in expanding real per capita personal disposable income between 1990 and 2000 was disastrous (Economic Figure 6). From 1990 to 2000, only BC experienced a net reduction in real per capita personal disposable income—a decline of 5.9 percent.

The three other jurisdictions all posted positive gains between 1995 and 2000, enabling them to end the decade with a net gain in real per capita personal disposable income. A 2000 report by the Business Council of BC examining economic performance concluded that BC's performance in disposable income for most of the 1990s ranked dead last among the Canadian provinces (Business Council of BC, 2000b).

What the Future Holds: Conference Board Estimates

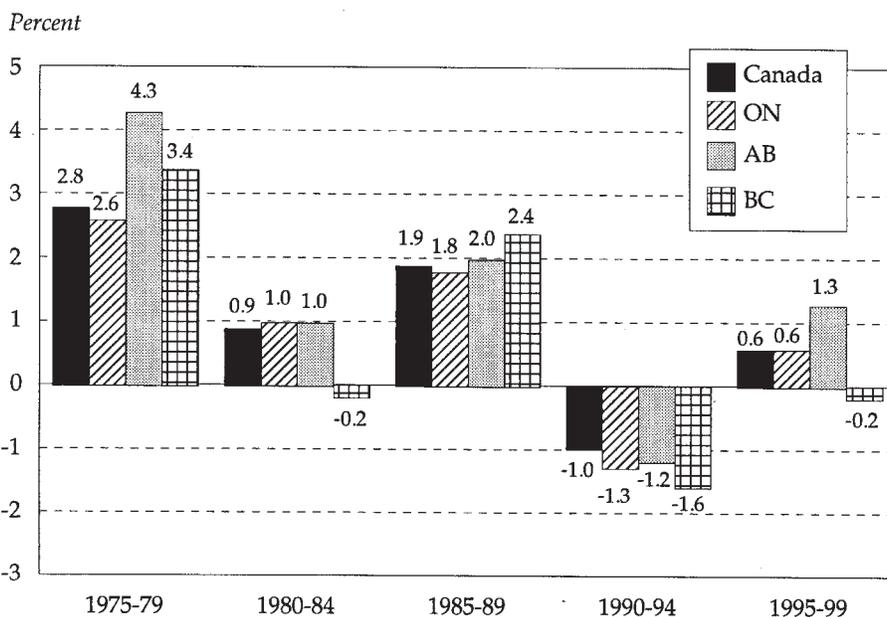
According to the Conference Board of Canada, British Columbia will continue to lag all three jurisdictions in personal disposable income growth in 2000 and 2001. The Conference Board expects personal disposable income in BC to grow by 5.4 percent and 4.6 percent in 2000 and 2001, respectively. This is generally below the levels estimated for the three other jurisdictions: Canada (6.1% and 4.6%), Ontario (6.8% and 4.8%), and Alberta (6.5% and 5.4%) (Conference Board of Canada, 2000).

Income Performance Conclusion

Two observations emerge from the GDP and disposable income data presented above. The first is that British Columbia competed relatively well with both of the other "have" provinces, namely Alberta and Ontario as well as with Canada as a whole between 1975 and 1990 in increasing the income of its citizens. For instance, British Columbia consistently maintained per capita incomes above the national average and its growth rate was generally competitive.

The second observation is that British Columbia's performance in increasing its residents' incomes over the last decade has been appalling. British Columbia now maintains income levels below the national average, and well below those achieved in the two other "have" provinces. In fact, BC's income growth ranked near the bottom of the provinces. Given the province's economic potential and its historical income levels, the performance of the last decade has been unacceptable.

Economic Figure 6: Average Growth in Real Per Capita Disposable Income (5 Year Averages)



Source: Statistics Canada, 2000b.

II. Employment Performance: A Bright Spot?

Another important measure of economic performance is a jurisdiction's ability to generate employment growth and, thus, to minimize unemployment. Given British Columbia's disastrous performance in income growth, some of the province's employment statistics are surprising.

Employment and Unemployment

Employment Growth

Economic Figure 7 depicts average employment growth for the five five-year periods between 1975 and 1999. British Columbia was competitive with the other jurisdictions over the five periods. In fact, BC recorded the highest growth rates in employment for both the 1985-1989 and the 1990-1994 periods.

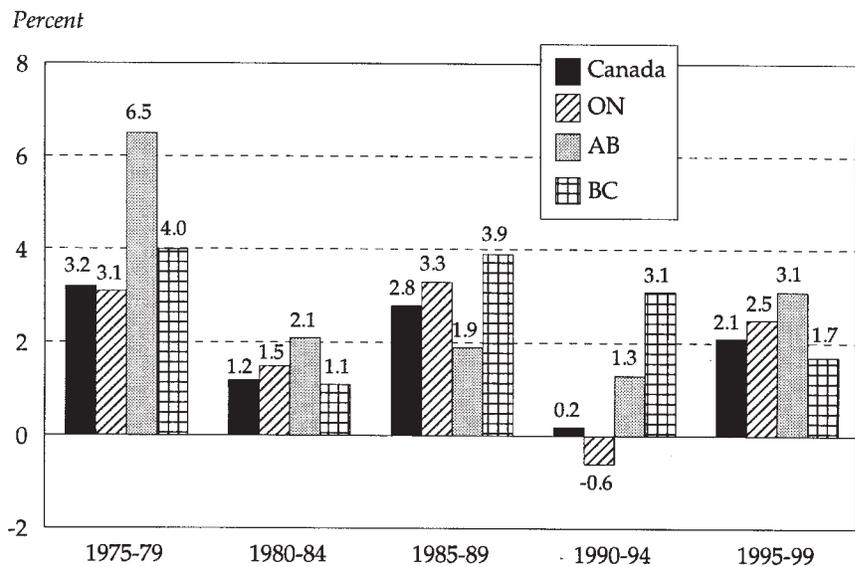
Total employment growth between 1975 and 2000 in British Columbia (96.3 percent) exceeded employment growth in either Ontario (64.2 percent) or Canada as a whole (61.0 percent). It trailed Alberta only slightly, which led all jurisdictions in employment growth with a 102.2 percent increase between 1975 and 2000.

Equally surprising, given British Columbia's poor income performance over the 1990s, is its strong employment growth over the same decade. As noted, British Columbia led all jurisdictions over the 1990-1994 period and fared reasonably well between 1995 and 1999. In fact, British Columbia led all four jurisdictions over the entire 1990 to 2000 period with employment growth of 25.6 percent, compared with 14.2 percent in Canada as a whole, 13.1 percent in Ontario, and 24.6 percent in Alberta.

Unemployment Rates

Given the employment figures above, it is not surprising that British Columbia's unemployment rate has been competitive with that of other jurisdictions. Economic Figure 8 depicts the av-

Economic Figure 7: Average Growth in Employment (5 Year Averages)



Source: Statistics Canada, 2000b.

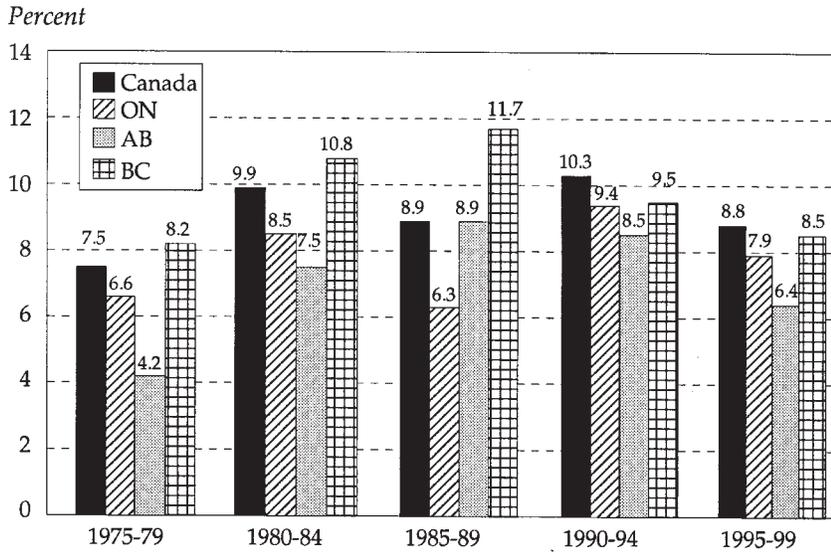
erage unemployment rates for the five five-year periods between 1975 and 1999. Between 1975 and 1989, BC had a higher unemployment rate than the national average. The province's unemployment rate then dropped below the national average for both the 1990-94 and 1995-1999 periods.

Public Sector Employment: Part of the Story

Given British Columbia's poor income and growth performance, its employment performance is quite surprising. How can the province's strong performance in generating employment be reconciled with its poor income and growth performance? Several mitigating factors at least partially explain this paradoxical outcome.

One explanation is British Columbia's strong population growth. The Business Council of BC concluded that "much of the job growth in BC in the 1990s has been directly tied to the province's expanding population" (Business Council of BC, 2000b, p. 3). An increasing population helps em-

Economic Figure 8: Average Unemployment Rates (5 Year Averages)



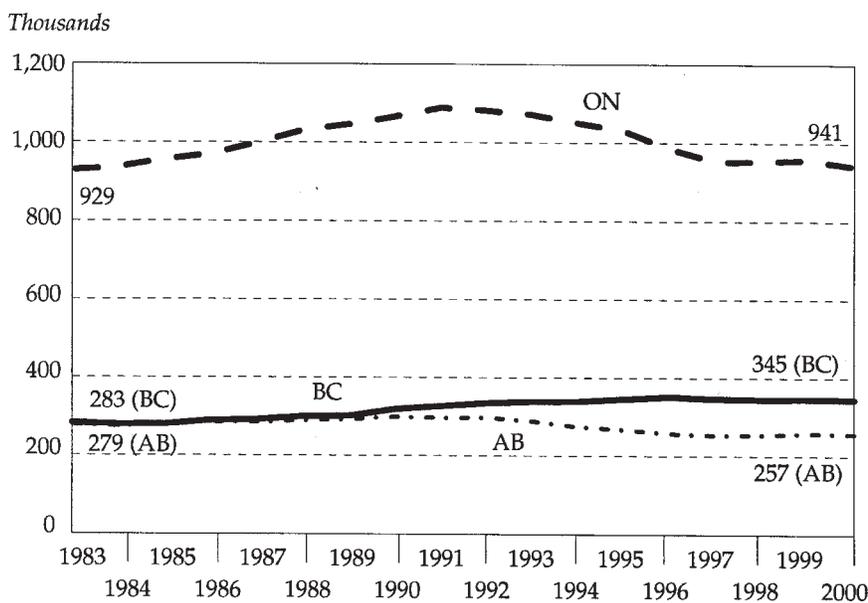
Source: Statistics Canada, 2000b.

ployment because it creates an increased demand for a wide range of goods and services. As the income section explains, over the 1990s British Columbia experienced increasing aggregate GDP and disposable income largely due to increases

in population. Clearly, immigration and Canadian migration to British Columbia helped the province post positive employment gains during the 1990s. Another explanation for this phenomenon is public sector employment growth. Economic Figure 9 shows the number of public sector employees for Ontario, Alberta, and British Columbia from 1983 to 2000. The decline in the number of public sector employees in Alberta and Ontario is evident. Although the current number of public sector employees in Ontario (941,000) is still above the

929,000 employed in 1983, it is significantly down from its peak in 1991 of 1.09 million. Similarly, Alberta has actually reduced the number of public sector employees from 279,000 in 1983 to 257,000 currently.

Economic Figure 9: Public Sector Employment (1983-2000)



Source: Statistics Canada, 2000b.

941,000) is still above the 929,000 employed in 1983, it is significantly down from its peak in 1991 of 1.09 million. Similarly, Alberta has actually reduced the number of public sector employees from 279,000 in 1983 to 257,000 currently. British Columbia, on the other hand, has increased the number of public sector employees in the province. Since 1983, the number of public sector employees in BC has increased by 22.2 percent, from 283,000 in 1983 to 345,000 in 2000. The Business Council of BC concluded that the bulk of new jobs created in the province between 1996 and 1999 were in the broadly defined public sector (Business Council of BC, 2000b). In fact, it cautioned that “comparatively few BC companies have been adding to their

full-time payrolls" (Business Council of BC, 2000b, p. 3).

Economic Figure 10 illustrates the percentage of total employment represented by the public sector. For all four jurisdictions, the percentage of the labour force comprised by the public sector has been decreasing since its peak in the early 1990s. Unfortunately, British Columbia still has a relatively high proportion of its labour force in the public sector. BC begins the period with the second highest proportion of its labour market in the public sector relative to the other two "have" provinces, and ends the period with the highest proportion. Specifically, while in Ontario and Alberta public sector employment declined as a percentage of total employment (from 20.5 percent and 22.0 percent, respectively, in 1981, to 16.0 percent and 16.1 percent, respectively, in 2000), in British Columbia public sector employment dropped (as a percentage of total employment) to a much lesser extent. As a percentage of total employment, British Columbia's public sector has declined from 21.5 percent in 1981 to 17.7 percent

in 2000, which is nearly 2 full percentage points greater than either Ontario or Alberta.

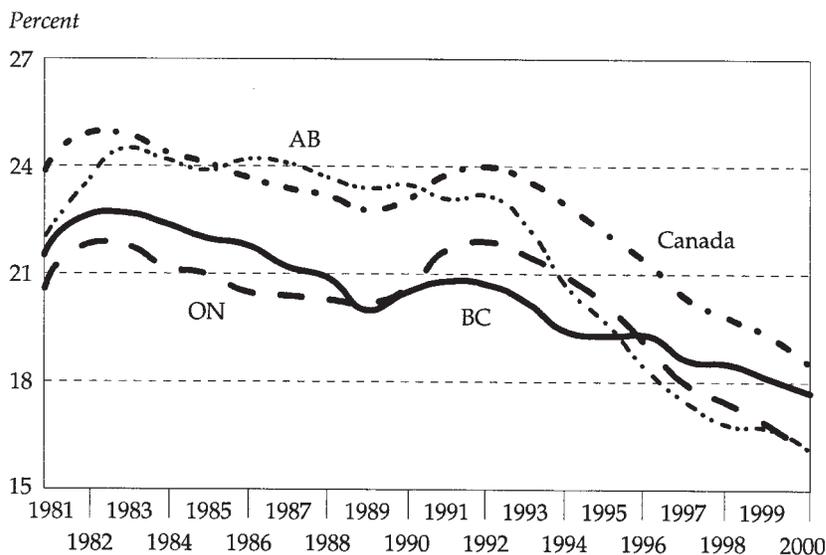
It is questionable whether such an expansion in the number of employees and the muted reduction in the percentage of total employment in the public sector is sustainable. As the spending section will discuss, the BC government currently faces a serious crisis in its spending levels. The absolute number of public sector employees as well as the percentage of total employment represented by the public sector will have to be curtailed further as part of a rationalization of government spending.

What the Future Holds: Conference Board and CIBC Estimates

According to Conference Board of Canada estimates, British Columbia will continue to lag Canada as a whole and both Ontario and Alberta in employment growth and unemployment for 2000 and 2001. The Conference Board expects employment growth in BC of 2.4 percent in 2000 and 1.9 percent in 2001. This is near or below the levels of employment growth expected in Canada (2.9% and 1.8%), Ontario (3.2% and 2.1%), and Alberta (2.5% and 1.8%).

Estimates for employment growth by CIBC for the four jurisdictions for 2000, 2001, and 2002 are similar to the Conference Board's. It expects employment growth as follows: Canada (2.6%, 2.0%, and 2.5%), Ontario (3.0%, 2.0%, and 2.6%), Alberta (2.3%, 2.4%, and 2.3%), and British Columbia (2.2%, 2.0%, and 2.0%). CIBC expects that at best, employment growth

Economic Figure 10: Public Sector Employment, as a Percent of Total employment (1981-2000)



Source: Statistics Canada, 2000b.

in British Columbia will match the levels in other jurisdictions in 2001, but will return to lower levels in 2002 (CIBC 2000c).

Equally troubling, the Conference Board of Canada expects BC to maintain higher rates of unemployment than all three other jurisdictions for 2000 and 2001. CIBC's unemployment estimates echo the view that under-performance is expected in British Columbia for 2000, 2001, and 2002. The Conference Board expects British Columbia's unemployment rate to increase from 7.1 percent in 2000 to 7.3 percent in 2001 while all three other jurisdictions are expected to have stable or lower rates of unemployment. Specifically, both Canada and Ontario's unemployment rates are expected to remain constant at 6.6 percent and 5.3 percent, respectively. Alberta's unemployment rate is expected to decline from 4.9 percent in 2000 to 4.8 percent in 2001 (Conference Board of Canada, 2000). Again, CIBC's unemployment estimates support the Conference Board's estimates. CIBC expects British Columbia's unemployment rate to exceed the rates of Canada, Ontario, and Alberta for 2000, 2001, and 2002 (CIBC, 2000c).

III. Investment Performance: Lack of Confidence

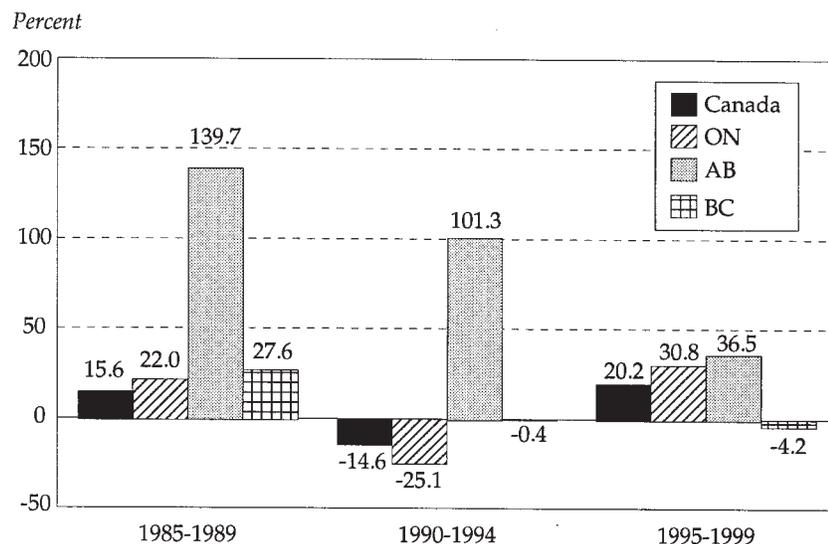
Another critical area of economic performance is business investment. Investment in plants, equipment, and new technologies offers the potential to increase worker productivity and thus, ultimately, real wages. It is also a barometer of future economic prosperity since such investments provide the foundation for future production.

Economic Figure 11 depicts the growth in real net business investment between 1985 and 1999. The data presented are net of depreciation. That is, the data represent the real growth in investment after accounting for the replacement of current fixed assets such as plant and equipment.

British Columbia performs quite well in expanding real net business investment between 1985 and 1989. Although well below the average growth in the level of investment recorded in Alberta, British Columbia nonetheless experienced a 27.6 percent average increase in the amount of real net business investment over the period—higher than both Ontario and Canada as a whole.

Unfortunately, the last decade has seen a net reduction in the amount of business investment in the province. That is, the level of investment in BC has not kept pace with the depreciation of past business investment. On average, net business investment shrank by 0.4 percent between 1990 and 1994, and decreased another 4.2 percent between 1995 and 1999. Both Ontario and Canada as a

Economic Figure 11: Growth in Real Net Fixed Business Investment (1985-1999)



Source: Statistics Canada, 2000b.

whole experienced more pronounced declines between 1990 and 1994 but both recovered in the 1995-1999 period. Alberta alone posted strong and consistent growth in net business investment over the entire period. The Business Council of BC, in its 2000 report on economic performance in British Columbia, concluded that the “weakness in private sector investment over the past number of years lies at the heart of BC’s economic malaise” (Business Council of BC, 2000b, p. 4).

Part of the poor performance in business investment is due to the harsh business climate that currently exists in the province. Economic Figure 12 depicts the 2000 results for the investment climate survey of investment managers. The survey, which asks senior pension and investment fund managers to rank the investment climates of the various provinces, indicated a continued negative view of British Columbia. BC ranked last among the ten provinces for the second year in a row (Clemens and The Fraser Institute, 2000).

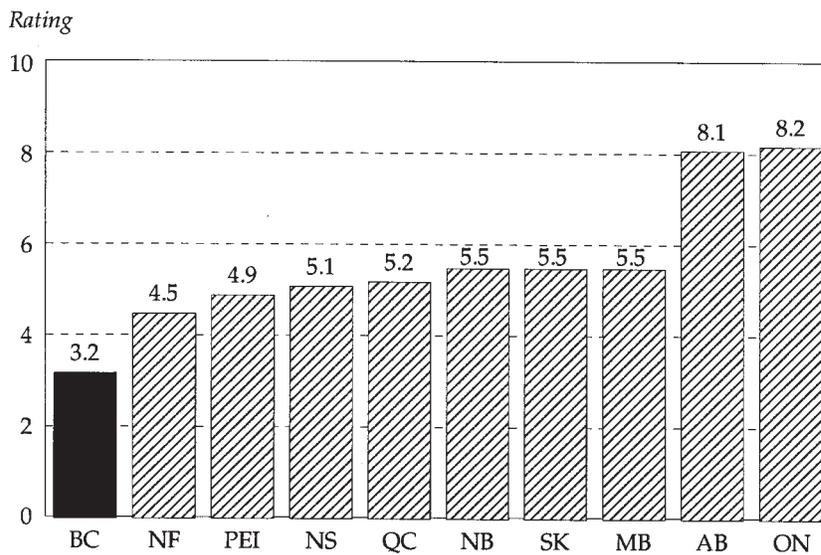
One of the side-effects of this anti-business climate has been a serious deterioration in the prov-

ince’s corporate development, particularly in Vancouver as a location for corporate headquarters. Calgary—not Vancouver—has become the business choice for corporate headquarters in Western Canada (Clemens and Emes, 2001). This has occurred despite Vancouver’s better access to the US and Asia, a well-developed port, and a more temperate climate. It is clear that part of the reason for Calgary’s attractiveness must be rooted in public policies. It will require a concerted effort to return Vancouver to a position of favour for corporate headquarters.

Asian Flu and Commodity Prices: Red-Herrings

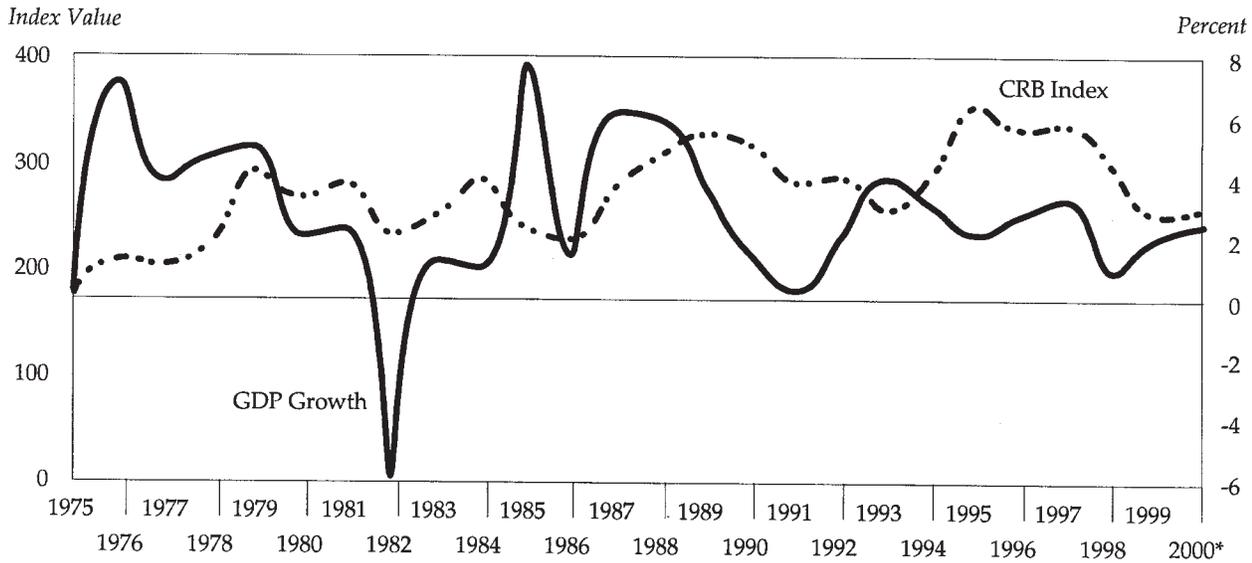
Many people have attributed BC’s poor economic performance to two external events: the downturn in Asian economies and the decline in commodity prices. The collapse of some Asian economies coupled with the decrease in commodity prices may have worsened the economic situation in British Columbia, but they cannot explain the last decade’s long-term, downward trend in economic performance.

Economic Figure 12: Provincial Investment Climate Ratings (2000)



Source: Clemens and The Fraser Institute, 2000.

It is popular to explain away British Columbia’s lacklustre economic performance over the last decade by blaming the downturn in the Asian economies. There is little disagreement among economists that BC’s economy is more dependent on trade with the Asian economies than any other Canadian province. However, this is not the sole explanation for BC’s poor performance, as the deterioration in the Asian economies occurred well after the decline in BC’s economy began.

Economic Figure 13: Commodity Prices and BC's GDP Growth* (1975-2000)

*The GDP growth scale is on the right-hand side.

Sources: Bridge CRB (Chicago); Statistics Canada, 2000b.

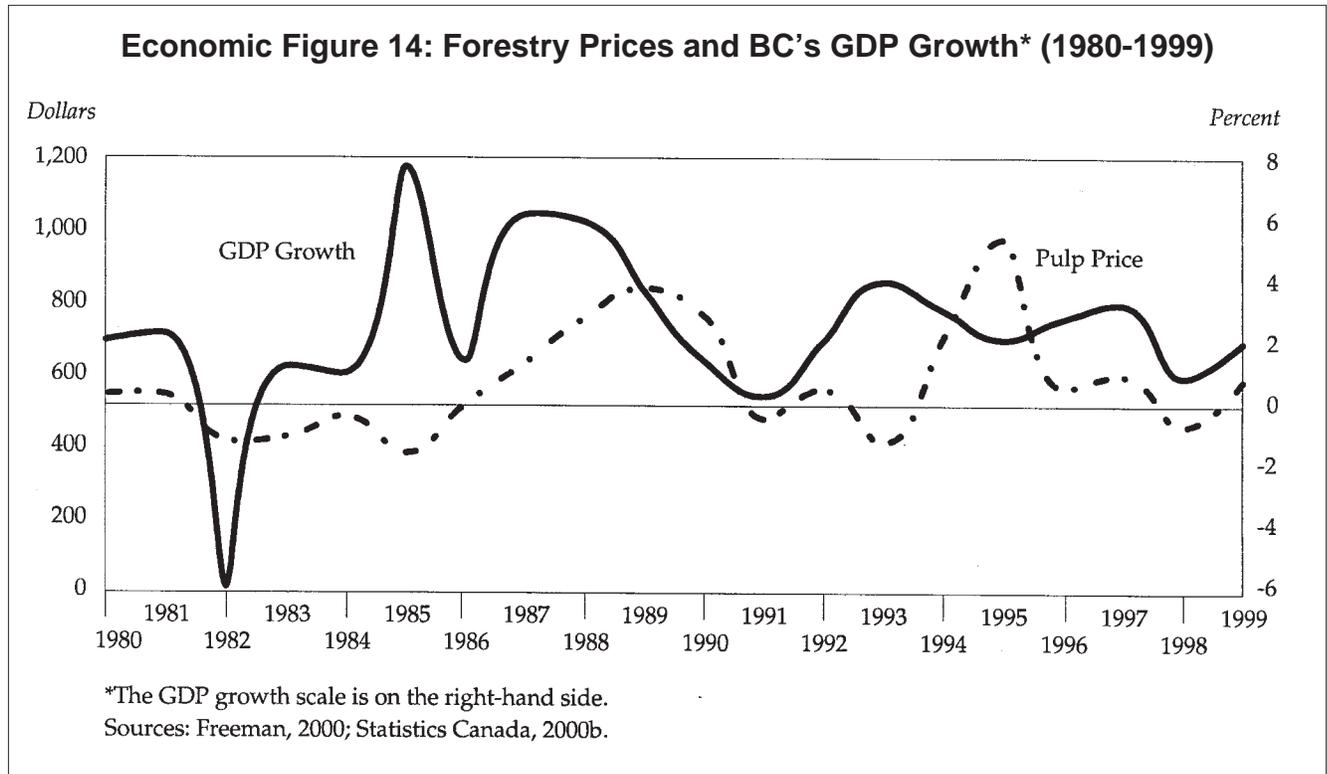
The full collapse of the Asian economies did not occur until the second quarter of 1997, with initial signs of the collapse emerging earlier that same year. For example, Sammi and Hanbo Steel (a Korean chaebol and conglomerate respectively) collapsed in January and March of 1997, respectively. Thailand first felt the effects of a looming financial crisis with the failure of Finance One, the country's largest finance company in May 1997 (Shahabi-Azad, 2000). It is, therefore, difficult to explain an economic decline which began in the early 1990s with a crisis in the Asian economies that occurred in 1997 and 1998. Nonetheless, the downturn in the Asian economies did exacerbate an already difficult economic environment in British Columbia.

Another popular explanation for BC's economic downturn is the dramatic drop in commodity prices, particularly prices for pulp and paper in the 1990s. However, just as the downturn in the Asian economies exacerbated but did not create a bad economic environment in British Columbia,

the decrease in commodity prices is not solely responsible for the province's poor economic performance.

Economic Figure 13 presents a broad measure of commodity prices, expressed as an index value, and GDP growth rates over the last 25 years. The commodity price index includes all raw material inputs such as oil, gas, minerals, and other natural resource products. As Economic Figure 13 shows, there is little relationship between rates of GDP growth in British Columbia and aggregate commodity prices. The correlation value for the two series over the time period was 0.0394, which indicates no correlation. In fact, between 1993 and 1997 the two series were negatively related. That is, as GDP declined over the period, commodity prices actually increased.

Economic Figure 14 presents a similar analysis of pulp prices, specifically northern bleached softwood pulp and GDP growth rates between 1980 and 1999. There is a weak relationship between BC's economic growth rate and pulp prices be-



tween 1980 and 1999.¹ It is important to recognize, however, that there are periods when the two series move in opposite directions. For instance, between 1993 and 1995, pulp prices increased dramatically while the province's economic growth declined. Similarly, between 1995 and 1997, pulp prices decreased while the rates of economic growth in the province increased.

Although the downturn in the Asian economies and the decline in commodity prices clearly aggravated an already difficult economic environment in British Columbia (particularly in regards to forestry products), they cannot explain the larger downward trend in economic performance which began in the early 1990s.

Conclusion

Whether assessed according to GDP, disposable income, private sector employment, or business investment, British Columbia has clearly experienced a difficult decade. Far from being external to the public policies enacted in the province, the decline in economic performance is directly attributable to poor public policies, as later sections will illustrate. The path back to prosperity will be difficult and will likely result in painful displacements. However, the gains from such reforms will be significant.

¹ Statistically, the two series had a correlation value of 0.2216, indicating a weak but positive correlation.

Government Spending: The Root of BC's Economic Problem

A government's fiscal policy includes both its spending and the taxation required to finance it. The British Columbia government's single greatest failure over the past decade has been its fiscal policy. The government has increased spending dramatically, and this has led to increased provincial taxes and debt levels. In a single decade, the province has gone from having a frugal, focused government that emphasised fiscal conservatism to an activist, interventionist government that undertook the expansion of the state.

This section begins with a brief summary of the economics of government spending. It then presents an empirical analysis of government spending in British Columbia, along with comparative data from other Canadian jurisdictions, both historic and current. Finally, it offers a series of policy recommendations.

Economics of Government Spending: Achieving the Optimal Size of Government

Government spends money to accomplish specific goals: to ensure the health of its citizens, to provide military protection, to supply a justice system, or to educate citizens. Nearly all economists agree that there are a number of functions and services that the government must provide, finance, and/or regulate. Thus, for most economists, the optimal size of government is a value greater than zero. Similarly, most people do not want government to use all of society's resources. Thus, somewhere between 0 and 100 percent, there is an optimal size of government. The debate over fiscal policy is most often rooted in determining what constitutes that optimal size.

Government expenditures come at a price: taxes. Taxes, as the Taxation section illustrates, create economic distortions (Browning, 1976). They do this by changing the relative prices of certain activities, goods, or services, while at the same time altering economic incentives (Aaron and Pechman, 1981).

Size of Government and Economic Growth

A great deal of research has examined the relationship between the size of government and economic growth. Both Daniel Landau (1983) and Robert Barro (1991) investigated the relationship between the size of government and economic growth in a number of countries over a number of time periods. Both studies concluded that countries with smaller governments, that is, with less government spending, experienced higher rates of economic growth.

Similarly, research by Keith Marsden (1983) and William Easterly and Sergio Rebelo (1993) found that countries with lower marginal tax rates experience faster economic growth than countries with higher marginal tax rates. In fact, a 1990 study by Robert King and Sergio Rebelo found that increasing a country's taxes by 10 percent reduced its economic growth (measured as the annual change in GDP) by nearly 2 percent.

A number of studies completed by The Fraser Institute corroborate these findings. For instance, the Economic Freedom of the World project, which has now published four international reports along with one provincial report, provides overwhelming empirical evidence of the relationship between increasing levels of economic freedom (usually implying smaller government) and

increased rates of economic growth and income (Gwartney, Lawson, and Block, 1996; Gwartney and Lawson, 1997, 1998, 2000; Arman, Samida, and Walker, 1998). Similarly, research by Johnny Chao and Herbert Grubel concluded that historically, economic growth was maximized when government taxes and spending equalled 34 percent of national income, 5 percentage points lower than the roughly 39.0 percent we have today (Chao and Grubel, 1998).

To reiterate: smaller governments impose fewer distortions on economic activity because they are able to levy much lower and much less distortionary taxes. As a result, economies with smaller governments are likely to be more efficient, and this is reflected in higher rates of economic growth (Easterly, 1993).

Size of Government and Social Progress

The argument that larger government impedes economic growth is not unusual. In fact, it is quite intuitive and well-accepted. Less well known is the growing field of research that suggests that larger government also fails to achieve greater social progress than smaller government. For example, a series of studies completed by International Monetary Fund (IMF) economists Vito Tanzi and Ludger Schuknecht concluded that countries with governments whose expenditures exceed 50 percent of GDP do not materially (statistically significantly) outperform countries with smaller governments—those whose expenditures are less than 40 percent of GDP. In fact, Tanzi and Schuknecht have found that not only do large-government countries fail to outperform smaller-government countries, but that countries with medium-sized governments (those with expenditures between 40 and 50 percent of GDP) also fail to materially outperform smaller government countries (Tanzi and Schuknecht, 1995, 1997a and 1997b, and 1998).

Another important study recently completed by Professor Gerald Scully of the University of Texas (Dallas) supports the findings of Tanzi and Schuknecht. Professor Scully examined 1995 data for 16 indicators of social progress, including literacy, infant mortality, life expectancy, caloric consumption, access to health care, infrastructure, political freedom, civil liberties, and economic freedom, across 112 countries. He concluded that there was little or no difference in social outcomes among countries in which governments spent less than 40 percent of GDP and those that spent in excess of 50 percent of GDP (Scully, 2000).

Another striking conclusion contained in the Scully research is that government spending ceases to yield any further social progress, as measured by the 16 social indicators, at 18.6 percent of GDP for advanced countries (Scully, 2000). There is some variance among countries; for instance, the rate at which government spending ceases to provide any marginal benefits in Canada is 19.5 percent of GDP. This is particularly striking as the Organisation for Economic Co-operation and Development (OECD) in its June 2000 Outlook estimated that total government spending in Canada would be 39.0 percent in 2001, significantly exceeding the estimates of optimality provided above (OECD, 2000).

Government spending produces economic distortions that impede economic growth because of the taxes associated with government spending. Furthermore, as mentioned, mounting research indicates that larger governments do not necessarily achieve increased social progress. Clearly, there is some optimal size of government where social progress is maximized while the level of economic distortions and impediments to economic growth are minimized. This optimal level is clearly below the current level of government spending in British Columbia.

Where Are We Today?

Government Spending in British Columbia

This study will employ three primary sources, as well as supplementary supporting documents, to assess government spending: Statistics Canada's Financial Management System, Statistics Canada's Provincial Economic Accounts, and the Province of British Columbia's 2000 Budget.

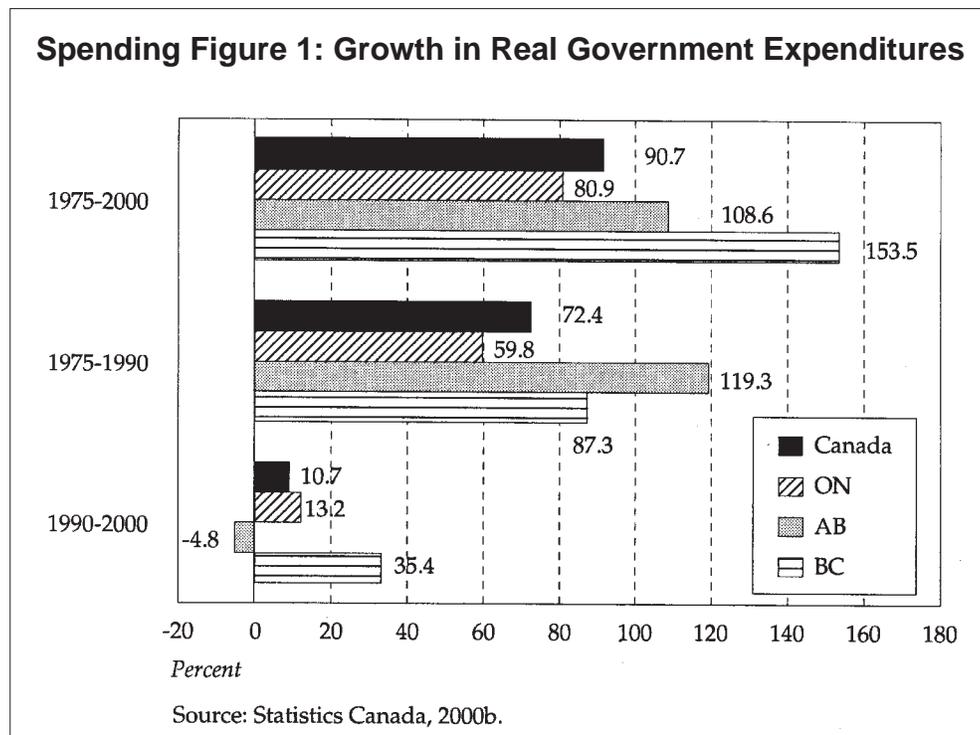
Statistics Canada's Financial Management System is the best source for inter-governmental comparisons because it is standardized across jurisdictions. The Financial Management System (FMS) coupled with the Provincial Economic Accounts will be the basis for all historical analysis. The study will use budget information to provide some insight into the government's plans.

Spending Figure 1 illustrates the real (inflation-adjusted) growth in provincial government expenditures between 1975 and 2000 for BC, Alberta, Ontario, and Canada as a whole. Government expenditures increased significantly over the pe-

riod in British Columbia. In fact, the increase in government expenditures in British Columbia outpaced the increase in the next highest-spending province, Alberta, by nearly 50 percentage points.

More startling, however, is the significant difference in expenditure growth over the last decade (Spending Figure 1). While Canada as a whole and Ontario recorded increases of 10.7 and 13.2 percent, respectively, over the period, and expenditures in Alberta actually declined 4.8 percent, government expenditures in British Columbia increased an astounding 35.4 percent.

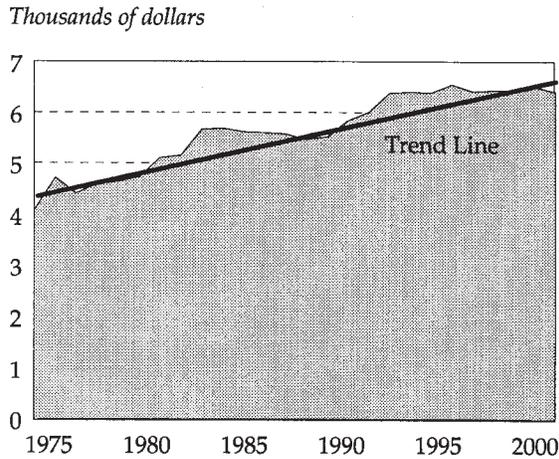
Examining aggregate increases in government expenditures alone can be too simplistic. For instance, they ignore population growth. A jurisdiction could, for instance, experience shrinking government in both per capita terms and as a share of the economy while total aggregate expenditures increased. In order to effectively gauge government spending, it should be measured either on a per capita basis, or as a share of the economy.



Real Per Capita Spending

Spending Figure 2 depicts real per capita government spending in British Columbia between 1975 and 2000. Except for a brief period in the early to mid 1980s, the BC government's increase in real per capita expenditures has been unrelenting, rising from \$4,188 in 1975 to \$6,465 in 2000—a real increase of 54.4 percent.

Spending Figure 2: Real Per Capita BC Government Expenditure (1975-2000)



Source: Statistics Canada, 2000b.

British Columbia has also, unfortunately, resisted the last decade's trend of restrained government spending. Between 1990 and 2000, real per capita government expenditures in British Columbia increased 7.5 percent. Real per capita government expenditures in Alberta, Ontario, and Canada as

a whole decreased 19.7 percent, 0.6 percent, and 1.0 percent, respectively. These declines were a central part of the initiatives undertaken to balance the books of these various jurisdictions.

Government Spending as a Percent of GDP

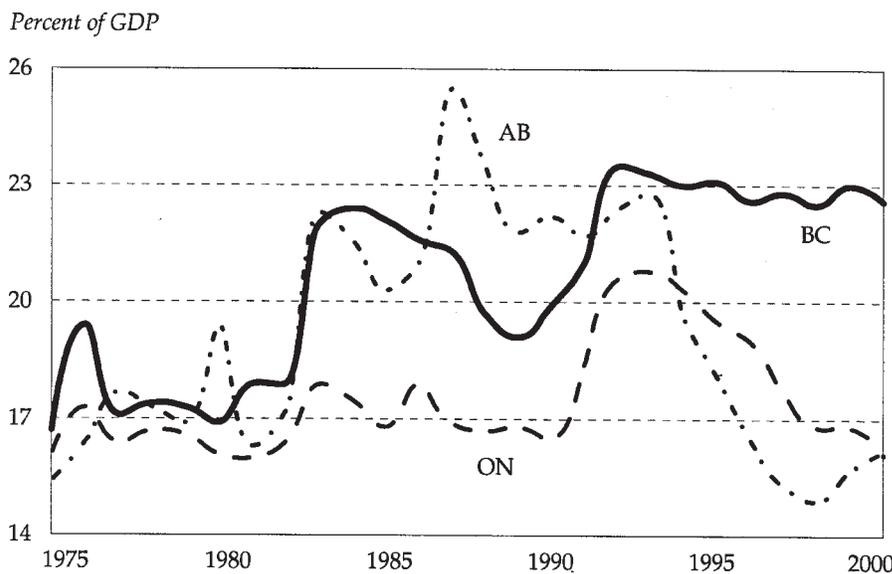
An alternative way to examine government spending is by comparing it to the size of the economy. Spending Figure 3 depicts government spending as a percent of the economy (GDP) between 1975 and 2000 for Ontario, Alberta, and British Columbia. The figure illustrates two important details.

First, all three provinces began the period (1975) with similar levels of government spending relative to GDP: Ontario (16.1%), Alberta (15.4%), and British Columbia (16.7%).

Second, while Alberta and Ontario ended the period (2000) with nearly the same levels of spending as a percent of the economy as they started, 16.2 percent and 16.1 percent, respectively, British

Columbia diverges significantly. Government spending as a percentage of the economy increased 5.9 percentage points in British Columbia, from 16.7 percent in 1975 to 22.6 percent in 2000.

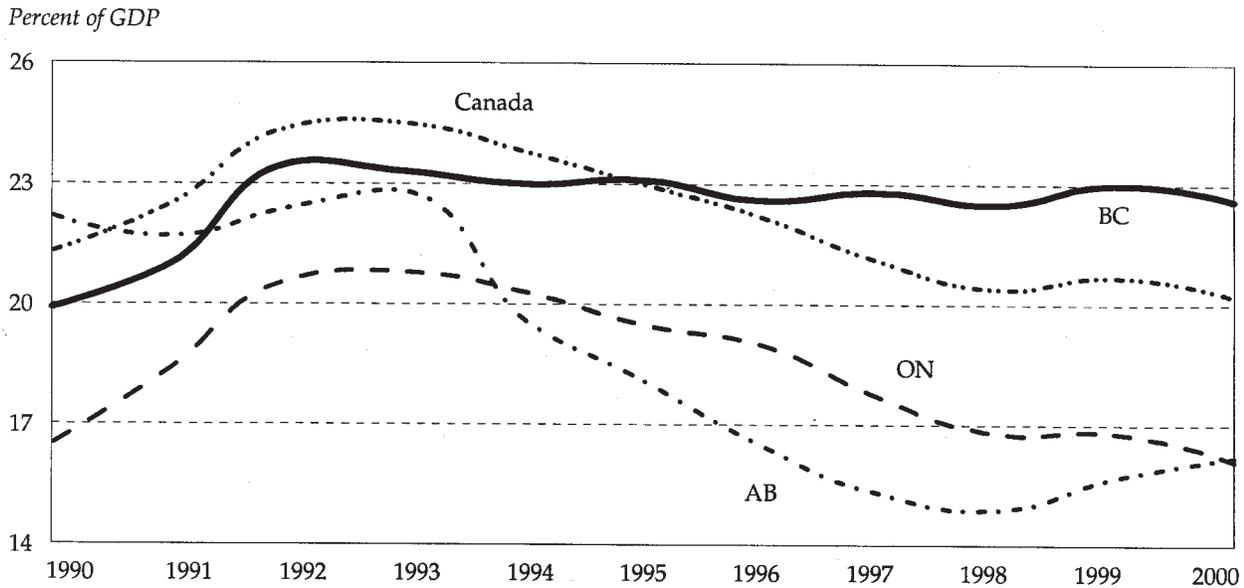
Spending Figure 3: Real Provincial Government Expenditures as a Percent of GDP (1975-2000)



Source: Statistics Canada, 2000b.

Of further interest is the relative performance of all three provinces compared to Canada as a whole over the last decade. Spending Figure 4 shows government spending as a percent of GDP for all four jurisdictions in the 1990s. In the early 1990's recession, all four

Spending Figure 4: Real Provincial Government Expenditures as a Percent of GDP (1990-2000)



Source: Statistics Canada, 2000b.

jurisdictions experienced an increase in government spending as a percent of the economy. However, as the economy improved, Canada as a whole, Alberta, and Ontario experienced a marked decline in the percentage of their economies consumed by government spending. Specifically, government spending as a percent of the economy declined from its peak in Ontario, Alberta, and Canada as a whole by 22.7 percent, 28.9 percent, and 17.4 percent, respectively over the course of the 1990s.

On the other hand, British Columbia's government spending as measured against the size of the economy declined from its peak, but by only 3.8 percent over the period. Unfortunately, British Columbia started the 1990s with the second lowest level of government spending (as a percent of GDP) of the four jurisdictions, but ended with the highest.

Overall, real provincial expenditures in British Columbia increased, according to the Financial Management System (FMS) by 19.4 percent between 1991/92 and 1999/00. In inflation-adjusted

or real terms, health care expenditures increased by 40.5 percent, education by 18.6 percent, and social services by 16.3 percent. Together, these three areas of provincial expenditure account for 71.4 percent of total provincial expenditures.

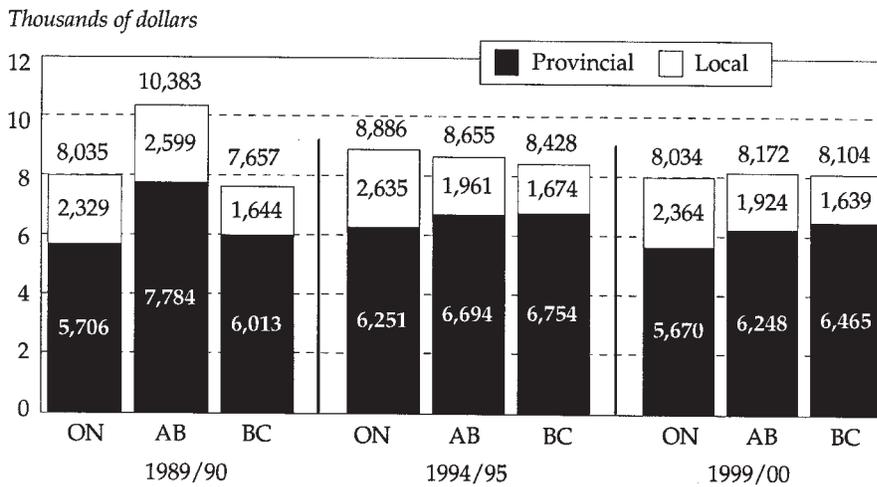
Consolidated FMS Data: A Comprehensive View

[Note: Due to a limited time series, we were not able to provide an analysis prior to 1989/90.]

In addition to the provincial-only data, Statistics Canada also publishes information on provincial spending, which is consolidated to include local (municipal) activities. Therefore, it provides a more comprehensive view of government spending differences among provinces.

This is an important addition to the provincial-only data since it adjusts for differences in municipal responsibility among provinces. In other words, it eliminates any advantage or disadvantage a province may have by spending more or less at the local rather than the provincial level.

Spending Figure 5: Consolidated Government Real Per Capita Spending for Select Years



Source: Statistics Canada, 2000a.

Note: Local values are calculated as the remainder of consolidated spending after provincial spending has been accounted for.

Unfortunately, making adjustments for local expenditures does not reverse the trend of larger government in British Columbia over the last decade. Consolidated real per capita spending remained constant in Ontario over the decade, recording a zero growth rate. Alberta actually reduced real per capita spending, on a consolidated basis over the 1990s, by 21.3 percent (Spending Figure 5). British Columbia, on the other hand, increased consolidated real per capita spending by 5.8 percent.

Per Capita Analysis

In 1999/00, there was a nearly 10-percentage point difference in the ratio of local to consolidated provincial² spending among the “have” provinces (see Spending Figure 5). Ontario had the highest proportion of spending at the local level with 29.4 percent of consolidated provincial spending undertaken at the local level. British Columbia maintained the lowest proportion of local spending with 20.2 percent of consolidated provincial spending done at the local level. Put differently, of the \$8,105 in consolidated real per capita government spending in British Columbia in 1999/00, \$6,465, or 79.8 percent, was spent by the provincial government with the remainder consisting of local expenditures (Spending Figure 5).

Population growth is an important dynamic influencing per capita analyses. Over the 1990s, Ontario experienced the lowest population growth rate of the three provinces, with an increase of 12.7 percent. Real consolidated expenditures increased 13.9 percent over this period, close to the increase in population. The increase in real consolidated provincial spending did not result in higher per capita consolidated spending.

On the other hand, Alberta actually reduced real consolidated expenditures by 6.7 percent while its population increased by 17.3 percent, resulting in a real per capita decrease in government consolidated expenditures of 21.3 percent. British Columbia recorded the largest increase in population of 23.1 percent and, not surprisingly, the largest increase in real consolidated expenditures of 33.3 percent. The increase in real consolidated

² Consolidated provincial/local spending is referred to as consolidated provincial.

expenditures more than compensated for the increase in population, and resulted in a net increase in real consolidated per capita government expenditures of 5.8 percent over the decade.

Percent of GDP Analysis

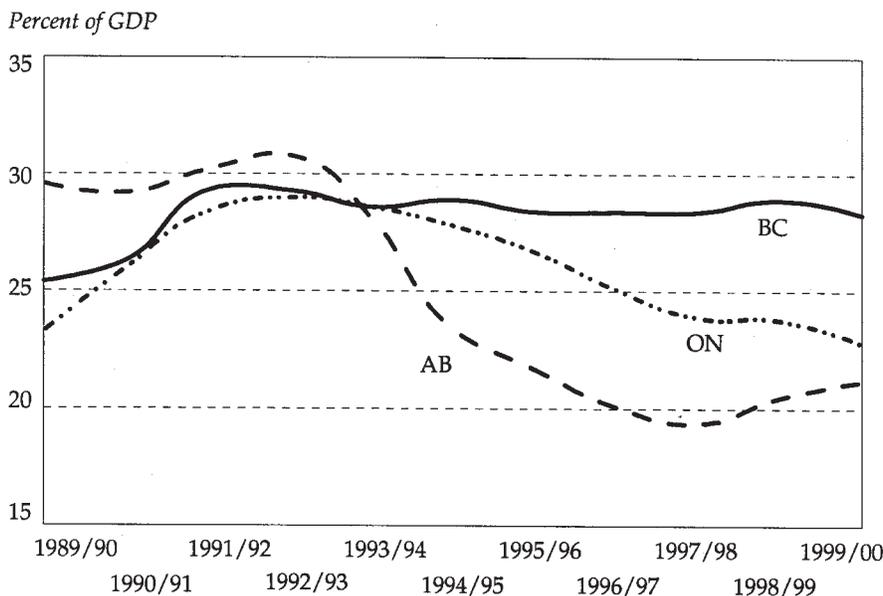
An alternative way to view consolidated expenditures is by comparing them to the size of the economy. Spending Figure 6 illustrates consolidated real provincial expenditures as a percent of provincial GDP between 1989/90 and 1999/00. Again, British Columbia stands out in resisting the trend towards smaller government exhibited by the two other "have" provinces. Ontario reduced consolidated provincial government spending as a share of GDP over the decade by 2.2 percent. Alberta more dramatically reduced the size of government, decreasing consolidated provincial expenditures as a share of the economy by 28.4 percent. British Columbia, however, increased the share of the economy consumed by consolidated provincial expenditures by 11.5 percent.

Although consolidated provincial expenditures present a more comprehensive view of government spending, they do not alter the conclusion that British Columbia, unlike the other "have" provinces, embarked on a path of increased government expenditures and thus bigger government over the course of the last decade. Regardless of whether consolidated or provincial-only data is examined, it is clear that government spending has increased in BC over the 1990s.

Budget & Fiscal Performance Index: Jurisdictional Comparisons

The Fraser Institute produces two studies that compare performance in fiscal policy: the Fiscal Performance Index (2001) and the Budget Performance Index (2000). The Fiscal Performance Index compares tax and spending performance among Canadian provinces and US states, while the Budget Performance Index compares spending, tax revenues, and debts and deficits among Canadian governments.

Spending Figure 6: Consolidated Provincial Expenditures as a Percent of GDP (1989/90-1999/00)



Source: Statistics Canada, 2000a.

In the recently-released 2001 Fiscal Performance Index, British Columbia ranked 32nd out of 54 US states and Canadian provinces in spending control with a score of 56.3 out of a possible 100. British Columbia ranked lower than any other Canadian province (Emes, 2001).

In the Budget Performance Index (2000), British Columbia ranked 8th out of 10 for spending control with a score of 28.2 out of a possible 100 (Emes, 2000). British Columbia's performance in both indi-

ces presents a serious indictment of government spending in the province relative to both other Canadian governments and US states.

Where Are We Going?

Unfortunately, the government of British Columbia seems to have failed to comprehend the severity of its current spending problem. The 2000 Budget called for a 6.0 percent increase in total government spending relative to the original 1999/00 estimates, representing a nominal increase of \$1.255 billion. In addition, the government of British Columbia just announced a new, \$400 million day care program (BC Ministry of Social Development and Economic Security, 2001).

A full 86.4 percent of the planned increases in government spending occur in the core areas of health, education (both K-12 and post-secondary), and social services. These four spending envelopes are expected to increase 7.1 percent, 4.4 percent, 6.1 percent, and 3.2 percent, respectively (BC Ministry of Finance & Corporate Relations, 2000 Budget). Each of these spending areas is dealt with in later sections of the study.

Conclusion

The dramatic increases in government spending across a number of areas should be cause for concern. Recall that current increases in government spending usually result in increases in taxation either now, or in the future. Tax increases subsequently imply lower rates of economic growth with little or no social progress, assuming government is spending beyond the optimal level. It seems clear that the experiment with larger government, as measured by government spending over the last decade, has yielded only small social gains, if any, while dramatically affecting the province's economic growth rate. British Columbia desperately needs a rational and prudent plan

for reducing the level of government spending, both in terms of per capita spending and as a share of the economy.

Policy Recommendations

- (1) **Decrease the percentage of the economy accounted for by government.**

Provincial government spending in British Columbia represented 28.3 percent of total provincial GDP, 33.3 percent more than Alberta and 24.3 percent more than Ontario. British Columbia must forcefully implement fiscal policies aimed at reducing the size of the economy consumed by government so as to move the province towards the optimal level of government, one which maximizes social and economic progress while minimizing economic distortions. The size of reductions required implies cuts in core areas, including health care, education, and welfare. However, as the subsequent policy sections discuss, reform of the delivery systems and the introduction of competition can result in cost-savings with no adverse program affects.

- (2) **Broadly restructure government to focus on outcomes.**

The government of British Columbia must be fundamentally overhauled so that it focuses on outcomes rather than simply continuing on a path which leads to ever increasing government spending without commensurate increases in economic well-being or social progress.

- (3) **Reduce the public service and have the private sector provide more services.**

As discussed in the Economic Performance and Regulation sections, the public service in British Columbia has not been curtailed to the extent that it has in other jurisdictions.

Through privatization and a greater reliance on the private sector for the delivery of goods and services, the civil service must be reduced, both in absolute numbers and as a percent of total employment. Part of this process should include greater competitive bidding for the provision of government goods and services by both private and public providers.³

(4) Introduce a strong Expenditure Limitation law.

Strong Tax and Expenditure Limitation laws (referred to as TELs) have proven successful in stemming the growth of government and ensuring fiscal responsibility in the United States (Krol, 1996 and 1997; Stansel, 1994; Matsusaka, 1995). Both tax and expenditure limitation laws effectively constrain the ability of governments to increase either taxes or spending without popular approval. For instance, expenditure limitation laws require any spending increase in excess of inflation and population growth to be specifically approved by referendum. Such a system has caused re-prioritizing in the US as states are forced to focus on the goods and services actually required of them as opposed to special-interest driven projects.

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Recommended Readings

[Note: For complete publication data, please see the list of references.]

Robert J. Barro (1990). "The Neoclassical Approach to Fiscal Policy. In Robert J. Barro, *Modern Business Cycle Theory*.

William Easterly and Sergio Rebelo (1993). *Fiscal Policy and Economic Growth: An Empirical Investigation*.

Joel Emes (2001). "Fiscal Performance Index."

Joel Emes (2000). *Budget Performance Index 2000: Comparing the Recent Fiscal Conduct of Canadian Governments*.

Robert Krol (1997). *A Survey of the Impact of Budget Rules on State Taxation, Spending, and Debt*.

Gerald W. Scully (2000). *Public Spending and Social Progress*.

Vito Tanzi and Ludger Schuknecht (1997). *Reconsidering the Fiscal Role of Government: The International Perspective*.

Vito Tanzi and Ludger Schuknecht (1998). "Can Small Governments Secure Economic and Social Well-Being?"

³ The September 1998 *Fraser Forum* includes a discussion of competitive bidding at the local level as implemented by former Indianapolis Mayor Stephen Goldsmith.

Government Tax and Revenue Policy: Aggravating BC's Lack of Competitiveness

Tax policy is often viewed in isolation from related policy issues such as government spending and deficits. However, taxation is ultimately driven by government spending. It is important to assess government deficits and the accumulation of debt in the context of taxation since debt is simply the accumulation of deferred taxes. Thus, deficits and debt should also be considered part of tax policy.

This section analyzes both tax policy and the use of deficits in British Columbia. First, it assesses debts and deficits, then presents the economics of tax policy. A detailed empirical analysis of taxation in British Columbia follows, along with inter-provincial comparisons. Finally, it provides tax and debt policy recommendations.

I. Balancing the Books: A Government Failure

Over time, all economic participants, whether they are individuals, firms, or governments, must balance their budgets. In other words, over time, the present value of expenditures must equal the present value of revenues for all economic actors (Blanchard and Fischer, 1993; Romer, 1996; Good, 1995; Law and Clemens, 1998).

For government, this principle implies that a current deficit will translate into a future tax. Put differently, if a government runs a deficit today, it must run a surplus tomorrow to generate the financial resources required to pay the principal and interest accumulated on today's deficit.

Tax Smoothing: Optimal Public Finance

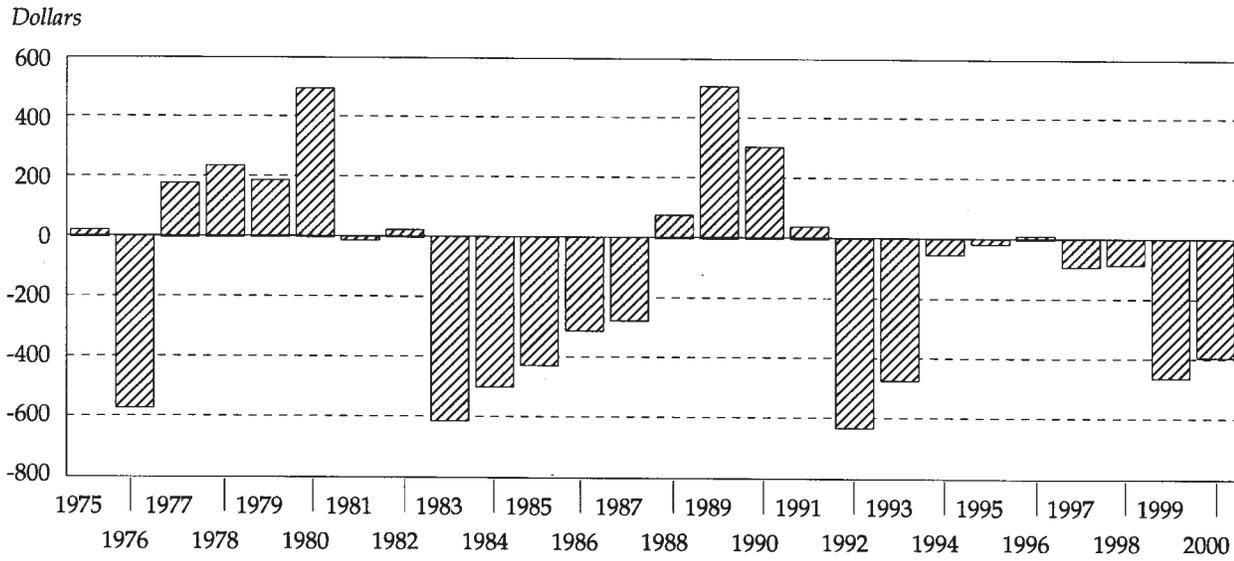
Given the general principle that governments, like all other economic participants, must balance their books, the pertinent question becomes: what

is the most efficient (i.e. best) way for the government to finance spending over time? According to economist Robert Barro, governments should choose the mix of deficits and surpluses that minimize the "excess burden" of taxation (Barro, 1979). The foundation of this argument is that government spending must ultimately be financed by taxation, which causes economic distortions by altering relative prices and economic incentives (Aaron and Pechman, 1981).

A fiscal rule requiring the government to balance its budget every year would not be optimal. Tax collections and government spending fluctuate according to cyclical patterns, but such a rule would require tax rates to fluctuate in unison with cyclical fluctuations, implying higher tax rates in periods of slow economic growth or recession, and vice versa. The economic costs of tax collection would increase because tax rates and spending would have to increase and decrease according to the cyclical behaviour of the economy. A far better strategy would be to run deficits during economic downturns and pay these deficits later with surpluses when economic conditions improve. This would enable government to smooth tax rates over time and minimize the inefficiencies caused by distortionary taxes (Aiyagari, 1989). In other words, government budgets should be balanced over the business cycle.

British Columbia's Debt Record: Recent Failure

Unfortunately, the simplicity of this concept has been completely lost over the last decade in British Columbia. During a period of slow but positive growth both in the economy and in revenue, the government of British Columbia has nearly consistently failed to balance its books.

Tax Figure 1: Real Per Capita Annual Surpluses and Deficits (1975-2000)

Source: Statistics Canada, 2000b.

Tax Figure 1 illustrates the real per capita deficits posted by the government of British Columbia between 1975 and 2000. It is based on the Financial Management System published by Statistics Canada rather than the budgets used by government because the FMS is a more consistent and broad measure of fiscal performance than that provided by budget information.

Although it is not unusual for a government to operate in deficit during a recession, Tax Figure 1 clearly shows that British Columbia failed to post surpluses during ensuing expansionary periods.⁴ In its analysis of BC's 2000 Budget, the Royal Bank of Canada's Economics Department characterized the province's fiscal performance as having an "exceedingly long timetable for deficit elimination, particularly in light of BC's improved economic outlook" (Royal Bank Economics, 2000).

Tax Figure 2 provides further evidence of the difficulty the BC government has had in balancing

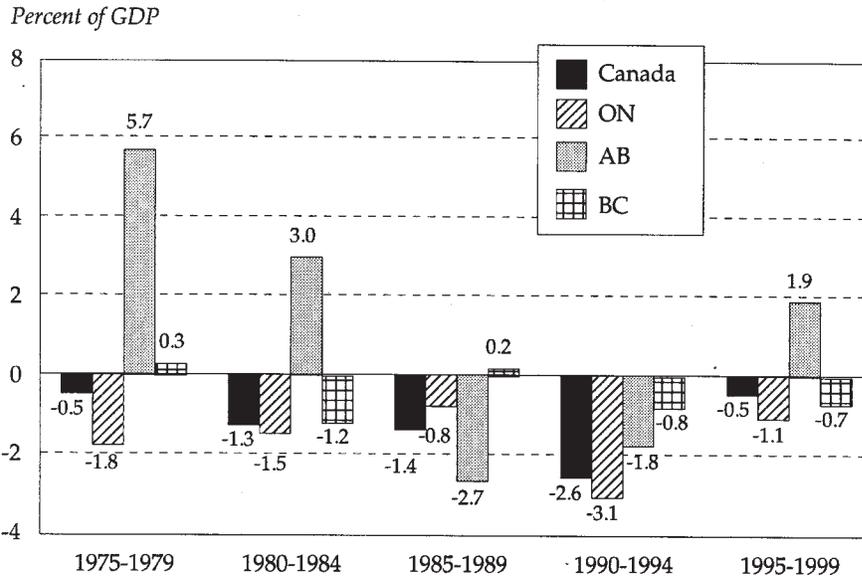
its books. It depicts the five-year average deficit or surplus as a percent of GDP for the five periods between 1975 and 1999. British Columbia fares quite well relative to Canada as a whole and Alberta and Ontario for the three five-year periods 1975-1979, 1980-1984, and 1985-1989. In fact, British Columbia led the nation with a five-year average surplus of 0.2 percent between 1985 and 1989 while nearly all other jurisdictions experienced deficits.

Unfortunately, this performance did not continue in the 1990s. Although British Columbia posted the smallest deficit (as a percent of GDP) of the three "have" provinces for the period 1990-1994, it did so during a period in which the country as a whole, and in particular Ontario, were experiencing either sharp declines in economic growth or outright recession. British Columbia did not experience nearly as difficult an economic period.

The last five-year period illustrates the fiscal challenge facing the province. Although Ontario con-

⁴ For information on GDP growth, see the Economic Performance section, specifically Economic Figures 1, 2, and 3.

Tax Figure 2: Average 5 Year Deficit/Surplus as a Percent of GDP



Source: Statistics Canada, 2000b.

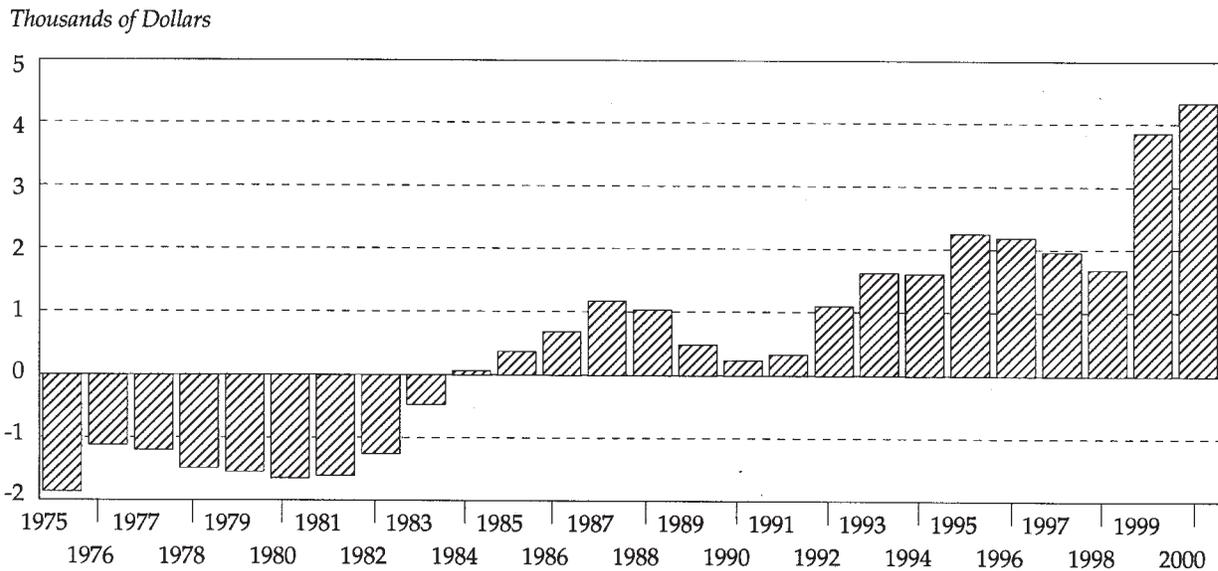
province has used those surpluses to eliminate its net debt and place it in the unique and enviable position of being able to cut taxes further without compromising government spending.

The British Columbia government's deficit spending has resulted in a vast increase in the province's debt. As Tax Figure 3 illustrates, the amount of real per capita debt has increased significantly since 1984. In fact, prior to 1984, British Columbians actually had a negative per capita net debt position. That is, the

province's financial assets exceeded its financial obligations. In its analysis of British Columbia's 2000 Provincial Budget, Nesbitt Burns noted that the debt load of the province was rising "inexora-

tinued to incur deficits larger than British Columbia's, it did so in a period of tax reduction. Alberta, on the other hand, was able to post large budget surpluses even as it reduced taxes. The

Tax Figure 3: Real Per Capita Net Debt (1975-2000)



Source: Statistics Canada, 2000b.

bly,” and that it had squandered its position as the province with the lowest level of tax-supported debt (Nesbitt Burns Economics, 2000).

Statistics measuring debt as a percentage of GDP present a similar picture of fiscal mismanagement over the last decade. In 1975, debt represented -7.6 percent of GDP (i.e. financial assets exceeded liabilities). By 1990, this advantage had deteriorated such that debt represented 0.8 percent of GDP. Debt now stands at 15.3 percent of GDP. This accumulation of debt means that increasing levels of budgetary resources must be allocated to servicing the debt rather than providing for goods and services. In fact, debt-servicing costs are expected to increase by 7.3 percent between 1999/00 and 2000/01, according to recent budget figures (BC Ministry of Finance & Corporate Relations, 2000a).

Budget Performance Index: Jurisdictional Comparisons

The Budget Performance Index provides some inter-jurisdictional performance data for debts and deficits. British Columbia ranked 8th out of 10 provinces in debts and deficits with a score of 38.0 out of a possible 100 (Emes, 2000). Unfortunately, the Fiscal Performance Index, which includes US states, does not include debt and deficit data. Nonetheless, it is clear that British Columbia's performance in the area of deficits and debts has not been competitive with other Canadian jurisdictions.

II. Tax Policy: Part of BC's Lack of Competitiveness

Introduction

Tax policy should focus on raising adequate revenue to cover government expenditures in the least distortionary manner. That is, tax policy should aim to supply enough monies for government to provide necessary and demanded goods

and services while at the same time minimizing the amount of economic distortion.

Economics of Taxation

The traditional criteria for assessing and guiding tax policy are: equity (fairness), efficiency, and simplicity (Technical Committee on Business Taxation, 1997; Kesselman, 2000; Clemens and Emes, 2001). Efficiency refers to the minimization of economic distortions created by the introduction of a new tax or the expansion of an existing tax. Simplicity refers to whether the system can be generally understood by those it affects. Equity, or fairness as it is often now called, relates to two distinct concepts: vertical equity and horizontal equity. Vertical equity requires that the amount of taxes paid increases as the amount of income earned increases. Horizontal equity requires that individuals with similar incomes face similar levels of taxation. Vertical equity has more recently come to mean that people should pay a greater percentage of their incomes in taxes as their income increases.

The Cost of Taxes

Taxes create economic distortions by altering incentives and changing the relative prices of certain activities, goods, and services (Aaron and Feckman, 1981). A large body of research illustrates the negative effects of taxation. A number of the more high-profile studies investigating the negative effects of taxation are summarized below.

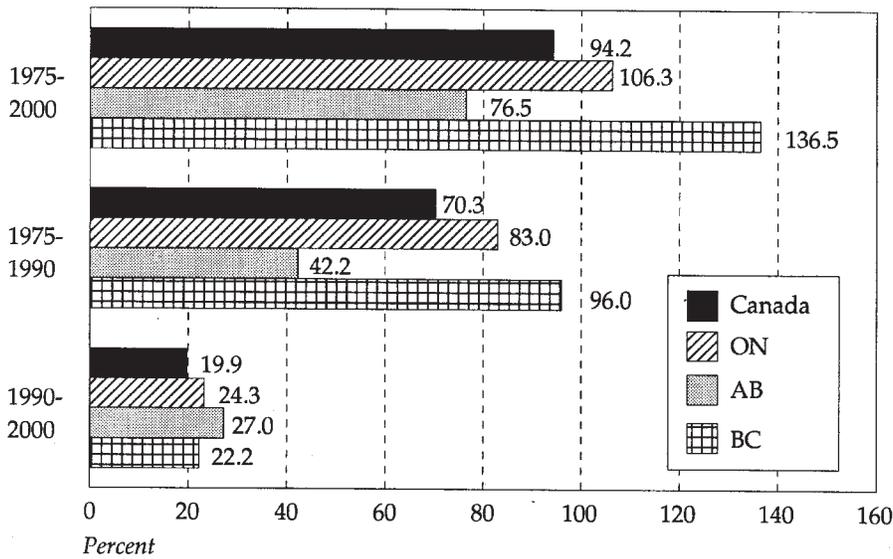
- High marginal tax rates on labour reduce labour supply. By lowering the cost of leisure, high marginal income tax rates encourage people to substitute leisure for work (Heckman, 1993; Triest, 1990).
- Payroll taxes increase the cost of labour, both absolutely and, more importantly, relative to capital. An increase in payroll taxes will cause firms to change the mix of labour and capital,

moving away from labour towards capital so as to minimize their costs. Payroll taxes can, therefore, be seen as a tax on employment. Empirical evidence supports the assertion that payroll taxes have a negative impact on employment (OECD, 1994c; De Matteo and Shannon, 1995). For instance, De Matteo and Shannon found that a 1 percent increase in average payroll taxes increases the employers' real wage costs by 0.56 percent, reduces workers' real wages by 0.55 percent, and reduces employment by 0.32 percent (De Matteo and Shannon, 1995).

- Taxes on capital gains and dividends reduce both savings and total investment. Taxes on capital gains and investment income reduce the net rate of return and, thus, result in lower overall levels of investment since what investors care about is the rate of return net of taxes, as opposed to gross, pre-tax returns (Summers, 1984; Ture and Sanden, 1977). Since productivity improvements are often embodied in new capital investment, the impact of such taxes in the long run is to slow down the rate of capital accumulation and the rate of economic growth (Marsden, 1983).
- Punitive taxation levels encourage the growth of an underground economy. When faced with high tax rates, individuals will tend to engage in untaxed activities and avoid taxed activities (Feige, 1989; Lippert and Walker, 1997). For instance, provincial sales taxes, in some cases, have been shown to promote tax evasion and the growth of a black market "underground" economy (Starobin, 1994). Empirical estimates suggest that the size of the underground economy in Canada could be anywhere from 4.5 percent to 20 percent of GDP (Mirus, Smith, and Karoleff, 1994; Drummond, Ethier, Fourgere, Girard, and Rudin, 1994).
- The deadweight costs of taxation are particularly high in Canada. It has been estimated that each additional dollar of taxes collected through the Canadian federal personal income tax system reduces output by \$1.38; a dollar increase in taxes collected through the provincial income tax reduces output by \$1.66. Surtaxes in certain provinces impose extremely large deadweight losses and may even result in diminished tax collections (Dahlby, 1994).

One of the critical issues in tax policy is the mix of taxes particular jurisdictions use to raise the revenue they require. The list of taxes that government can use to raise revenue is almost endless: income (both personal and business), payroll, property, sales, licenses, fees, capital, etc. A key aspect of tax policy is selecting the appropriate mix of taxes in order to satisfy the traditional criteria for taxes (efficiency, simplicity, and equity).

Different taxes introduce different types of distortions with varying costs. A number of studies have attempted to document these costs. For example, a study by Dale Jorgensen and Kun-Young Yun calculated the marginal efficiency cost of an additional dollar of tax revenue raised by different types of taxes. They calculated the marginal efficiency cost of certain taxes as: consumption taxes (\$0.26), labour taxes (\$0.38), capital income taxes at the business level (\$0.45), and capital income taxes at the individual level (\$1.02) (Jorgensen and Yun, 1991). Put differently, it costs the economy \$0.26 to raise one dollar of tax revenue using consumption taxes. At the other end, it costs the economy \$1.02 to raise one dollar of tax revenue using capital taxes assessed on the individual. In order to achieve the principle of efficiency, one of the three tenets of tax policy, taxes which minimize the amount of economic distortions in the economy (i.e. consumption taxes) should be employed to the greatest extent possible.

Tax Figure 4: Growth in Real Government Revenue

Source: Statistics Canada 2000b.

Government Revenue in British Columbia

As was the case in the analysis of government spending, Statistics Canada's Financial Management System and Provincial Economic Accounts along with the province of British Columbia's 2000 Budget will form the basis for the analysis of BC revenues.

Tax Figure 4 shows the real (inflation-adjusted) growth in provincial government revenues between 1975 and 2000 for BC, Alberta, Ontario, and Canada as a whole. Government revenue growth in British Columbia significantly outpaced that in all the other jurisdictions over this period. In fact, the increase in government revenues in British Columbia over the entire period outpaced that in the province with the next highest increase, Ontario, by 30.2 percent.

During the last decade, while BC government revenues did increase, they did not do so nearly to the extent necessary to cover government spending increases. The difference was reflected

in large increases in provincial debt. Thus, increased government revenues or future spending restraint will have to pay for the use of deferred taxes and the resultant accumulation of debt during the 1990s.

Examining aggregate increases in government revenues, similar to simply examining aggregate increases in government spending, can be too simplistic. To effectively estimate government revenues, two measures should be used: per capita

government revenues and government revenues as a share of the economy.

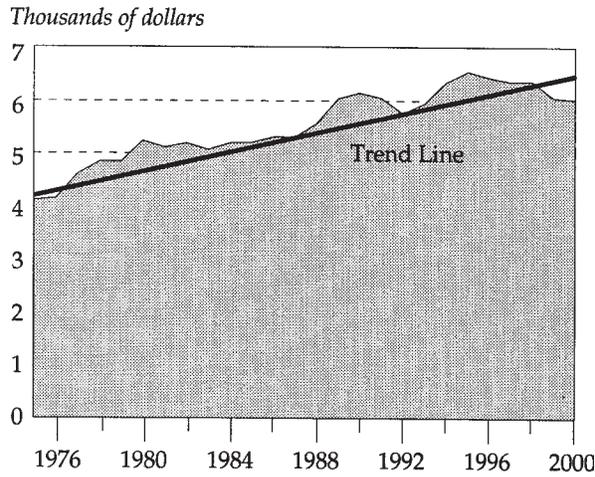
Per Capita Government Revenue

Tax Figure 5 presents real per capita government revenues for British Columbia between 1975 and 2000. Real per capita revenues in British Columbia rose steadily up to and including 1994/95. Specifically, they increased in real terms from \$4,212 in 1975 to \$6,066 in 2000, an increase of 44.0 percent. Since peaking in 1994/95 at \$6,734, real per capita government revenue has declined to \$6,066 in 1999/00, a decrease of 7.2 percent.

Interestingly, both Canada as a whole and Alberta now extract more government revenue per capita than British Columbia in dollar terms, but take less as a percent of GDP. Specifically, Canada now receives \$6,455 in real government revenue per capita, while Alberta extracts \$7,078.

Unfortunately, a large part of the explanation for this difference rests on the fact the British Columbia has a lagging economy. That is, both per cap-

Tax Policy 5: Real Per Capita BC Government Revenue (1975-2000)



Source: Statistics Canada, 2000b.

its GDP and disposable income growth have been dismal in British Columbia over the last decade. The tremendous economic growth experienced by Alberta has enabled it to take less of the economy in revenue while actually taking more in dollar terms. Simply put, when economic growth

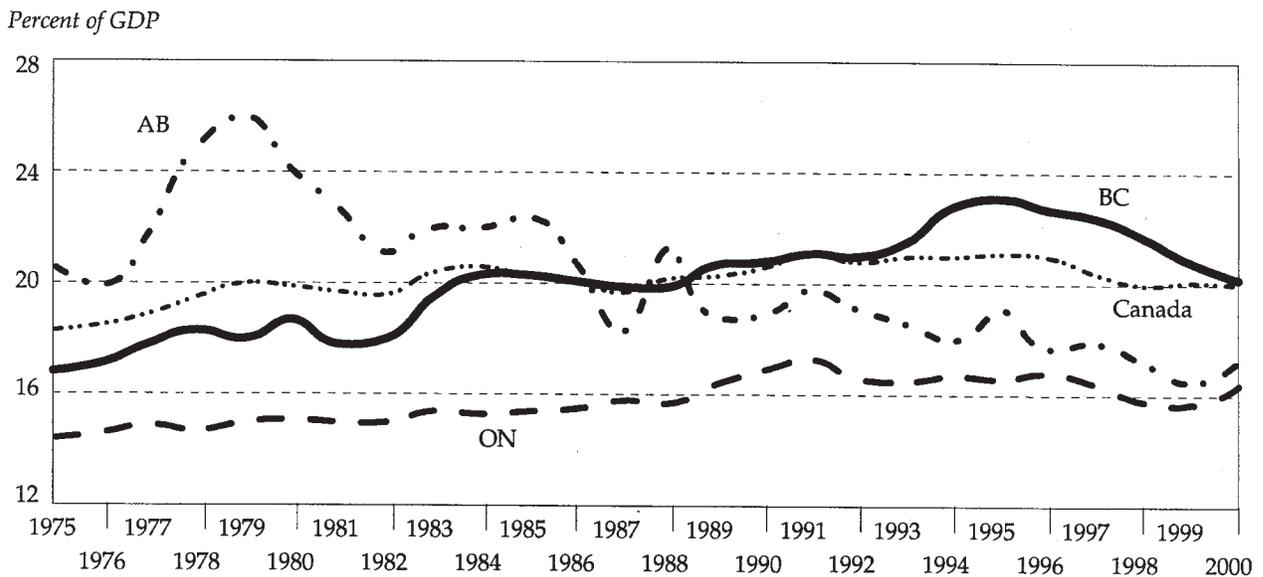
translates into income growth it is possible for the government to take less (as a percent of the economy) but generate more revenue (measured in dollars). This effect is illustrated by viewing government revenue relative to the size of the economy.

Government Revenue as a Percent of GDP

Tax Figure 6 presents government revenue as a percent of GDP for all three "have" provinces and for Canada as a whole. Government revenue in Ontario and Alberta now accounts for significantly less of their provincial economies than it does in British Columbia. Government revenue in British Columbia now accounts for 20.2 percent of GDP while in Ontario and Alberta it accounts for 16.4 percent and 17.3 percent, respectively.

Interestingly, British Columbia previously maintained a tax advantage over both Alberta and Canada as a whole. In 1975, Ontario consumed the smallest portion of the economy in government revenue at 14.4 percent, followed by British

Tax Figure 6: Real Government Revenue as a Percent of GDP (1975-2000)



Source: Statistics Canada, 2000b.

Columbia (16.8%), Canada as a whole (18.3%), and Alberta (20.6%). While Alberta has experienced a dramatic decline in the amount of the economy consumed by government revenue, British Columbia has, unfortunately, experienced the opposite. In fact, between 1975 and 2000, the portion of the economy consumed by government revenues increased by 20.3 percent in British Columbia while it declined 16.1 percent in Alberta.

Tax Freedom Day for British Columbia

Another way to assess the tax burden for British Columbians is Tax Freedom Day, which was pioneered by The Fraser Institute. Tax Freedom Day measures the burden of all taxes levied by all levels of government on the average family. This burden is then translated into the number of work days required in a year to pay the tax bill. Tax Figure 7 gives the Tax Freedom Days for British Columbia, Alberta, and Ontario for the years 1981, 1985, 1992, and 2000.

Two trends are evident from Tax Figure 7. One, the burden of taxes on the average family in all three jurisdictions has been increasing since 1981. Two, the tax burden for the average family, as measured by Tax Freedom Day, was higher in British Columbia than in other provinces in each year for which data is available.

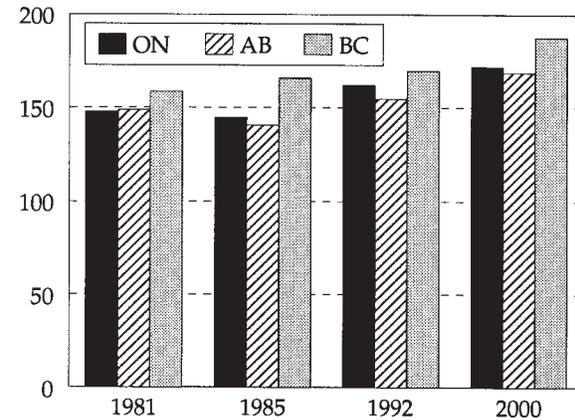
Consolidated FMS Data: A Comprehensive View

[Note: Due to a limited time series, we were not able to provide an analysis prior to 1989/90.]

In addition to the provincial-only data, Statistics Canada also publishes information on provincial government revenue which is consolidated to include local activities. It, therefore, provides a more comprehensive view of government revenue differences among provinces.

Tax Figure 7: Provincial Tax Freedom Days

*Number of Days a Family With an Average Income
Must Work to Pay their Total Tax Bill*



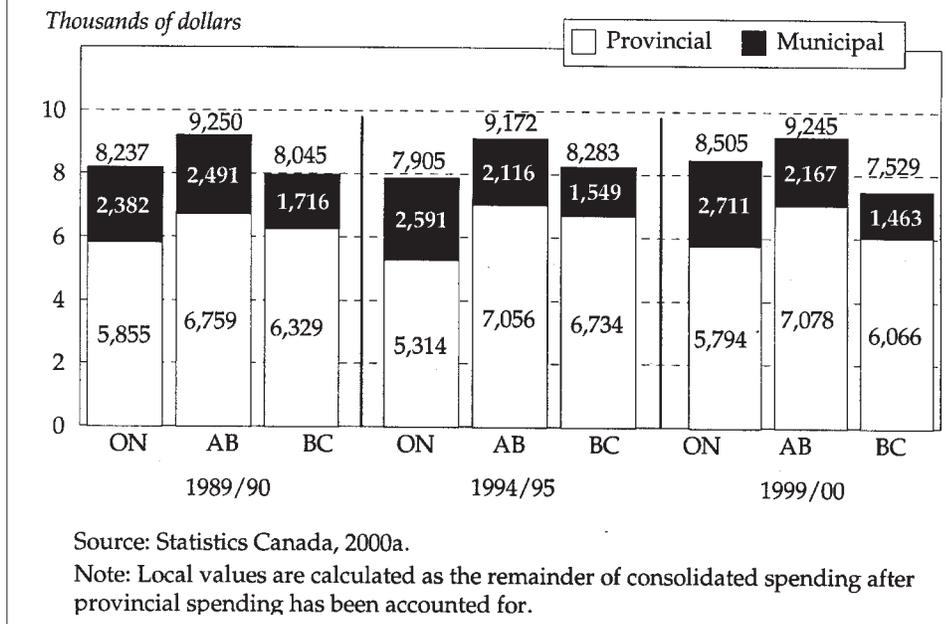
Source: Emes and Walker, 2000.

This is an important addition to the provincial-only data since it adjusts for differences in local revenue collection authority among provinces. In other words, it eliminates any advantage or disadvantage a province may have when more or less revenues are collected at the local rather than at the provincial level.

Per Capita Analysis

In 1999/00, there was over a 10-percentage point difference in the ratio of local to consolidated provincial revenues among the three “have” provinces (see Tax Figure 8). Ontario had the highest proportion of consolidated revenues at the local level of government, with 31.9 percent of consolidated revenues generated at the local level. British Columbia had the lowest proportion of consolidated revenues at the local level, with only 19.4 percent. Put differently, of the \$7,529 in consolidated per capita government revenues generated in British Columbia in 1999/00, \$6,066, or 80.6 percent, was collected by the provincial government with the remainder generated by local revenues (Tax Figure 8).

Tax Figure 8: Consolidated Government Real Per Capita Revenues for Select Years



crease in government consolidated revenues of 0.1 percent (Tax Figure 8).

British Columbia recorded the largest increase in population, 23.1 percent and the second largest increase in real government consolidated revenues of 17.8 percent, just outpacing Ontario by 0.2 percentage points. Real consolidated per capita government revenues fell by 6.4 percent in British Columbia over the decade (Tax Figure 8).

An important aspect of per capita analysis is population growth. Over the 1990s, Ontario experienced the lowest population growth rate of the three provinces, with an increase in population of 12.7 percent. It similarly recorded the lowest growth rate in real consolidated government revenues (17.6 percent) over the decade, due to a combination of factors including lower population growth and, more importantly, large-scale reductions in taxes. It is important to recognize, however, that the large-scale tax reductions implemented in Ontario have not resulted in accordant large-scale reductions in government revenues. Government revenues have actually increased over the decade while tax rates have been reduced. Real per capita government consolidated revenues increased by 3.2 percent in Ontario.

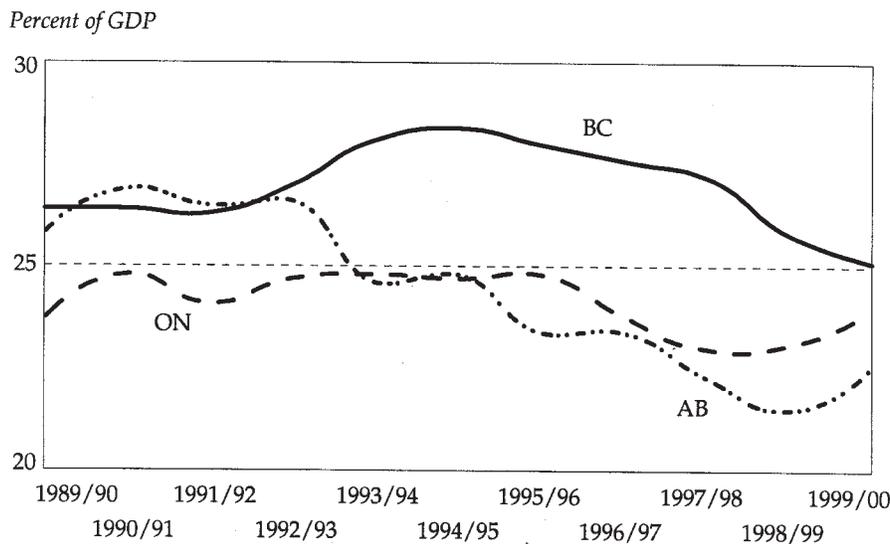
Alberta experienced the largest expansion in real consolidated government revenues (18.5 percent) over the decade, while its population increased 17.3 percent, resulting in a real per capita de-

Percent of GDP Analysis

An alternative way to view consolidated government revenues is by comparing them to the size of the economy. Tax Figure 9 depicts the consolidated real provincial revenues as a percent of provincial GDP between 1989/90 and 1999/00. British Columbia recorded a 1.3 percentage point reduction in the amount of GDP consumed by government revenues over the 1990s. Ontario's consolidated revenues actually increased as a share of the economy by 0.3 percentage points. Alberta more dramatically reduced the size of government, decreasing consolidated provincial and local revenues as a share of the economy by 3.2 percentage points, representing a decline of 12.4 percent.

The government revenue figures underestimate the size of government since the provincial governments in British Columbia and Ontario consistently operated in deficit over the decade. That is, the governments used deferred taxes in the form of borrowings to finance current operations. The

Tax Figure 9: Consolidated Government Revenues as a Percent of GDP (1989/90-1999/00)



Source: Statistics Canada, 2000a.

differences between British Columbia and Ontario and Alberta in terms of the prominence of government revenues would have been more pronounced had British Columbia and Ontario been using current taxes to finance current operations, as opposed to borrowing funds to pay for current outlays.

Budget & Fiscal Performance Index: Jurisdictional Comparisons

The Fraser Institute produces two studies that compare jurisdictional performance in fiscal policy: the Fiscal Performance Index (2001) and the Budget Performance Index (2000). The Fiscal Performance Index compares government revenue and spending performance among Canadian provinces and US states while the Budget Performance Index compares spending, revenues, and debts and deficits among Canadian governments.

British Columbia ranked 53rd out of 54 in the Fiscal Performance Index (2001) for tax policy with a score of 40.8 out of a possible 100 (Emes 2001). Overall, the province ranked second last for tax

policy among the participating Canadian provinces and US states.

British Columbia fared somewhat better in the Budget Performance Index (2000) as different variables were measured and the index only includes Canadian provinces and the federal government. In this ranking, British Columbia ranked 5th out of 11 jurisdictions in tax rates and revenue with a score of 58.9 out of a possible 100 (Emes, 2000).

Composition of Taxes in British Columbia

Overall, according to the Financial Management System (FMS), real provincial own-source revenues increased from \$16,862.3 million in 1991/92 to \$21,312.6 million in 1999/00, an increase of 26.4 percent. Tax Table 1 contains the specific contributions made by each type of government revenue in 1999/00 according to FMS data. The largest components of provincial revenues are personal income taxes, sales taxes, property and related taxes, and government transfers.

Using data from the FMS, let us examine the specific revenue areas in which real increases occurred between 1991/92 and 1999/00. In inflation-adjusted or real terms, personal income taxes, representing 22.6 percent of total government revenue in 1999/00, increased in real dollar terms by 12.5 percent between 1991/92 and 2000/00. Consumption taxes, another major category of revenue, increased in real dollar terms, by 35.2 percent over the same period. Revenue gar-

Tax Table 1: Composition of Government Revenue (Select Years)			
	1991/92	1995/96	1999/00
Own Source Revenue	87.4%	89.6%	88.8%
Income Taxes	28.2%	27.2%	26.2%
PIT	25.0%	21.2%	22.6%
CIT	3.3%	5.1%	3.5%
Mining & Logging	-0.1%	0.9%	0.2%
Consumption Taxes	21.9%	21.9%	23.8%
General Sales Tax	11.7%	12.6%	13.4%
Alcohol & Tobacco	2.5%	2.0%	2.0%
Amusement	0.1%	0.1%	0.1%
Gasoline and Motive Fuel	3.4%	3.4%	3.7%
Liquor Profits	2.6%	2.4%	2.6%
Remitted Gaming Profits	1.3%	1.0%	1.7%
Other	0.3%	0.3%	0.4%
Property and Related Taxes	7.6%	8.2%	8.7%
General Property Taxes	5.9%	5.5%	5.8%
Capital Taxes	0.1%	1.6%	1.8%
Other	1.6%	1.1%	1.0%
Other Taxes	2.7%	2.4%	2.6%
Payroll	0.0%	0.0%	0.0%
Motor Vehicle	1.3%	1.3%	1.4%
Natural Resource Taxes & Licenses	0.0%	0.0%	0.0%
Miscellaneous	1.4%	1.1%	1.2%
Health Insurance Premiums	4.3%	3.4%	3.7%
Contributions to Social Insurance Plans	3.5%	4.2%	3.9%
Sales of Goods and Services	2.7%	2.5%	2.4%
Investment Income	16.0%	19.3%	16.8%
Other Revenue from Own Sources	0.5%	0.5%	0.6%
General Purpose Transfers from other Gov't	0.1%	0.1%	9.9%
Specific Purpose Transfers from other Gov't	12.5%	10.4%	1.3%
Total Revenue	100.0%	100.0%	100.0%
Source: Public Institutions Division, Statistics Canada, 2000.			

Tax Table 2: Personal Income Tax Rates, Thresholds, and Exemptions (2001)

Brackets/ Exemption	Canada		Ontario*		Alberta		British Columbia	
	Income Range	Tax Rate	Income Range	Tax Rate	Income Range	Tax Rate	Income Range	Tax Rate
1st Bracket	\$7,368- \$30,754	16.0%	\$7,368- \$30,004	6.2%	\$12,900 & over	10.0%	\$8,000- \$30,335	8.4%
2nd Bracket	\$30,754- \$61,509	22.0%	\$30,004- \$60,009	9.24%			\$30,335- \$60,670	11.9%
3rd Bracket	\$61,509- \$100,000	26.0%	\$60,009 & over	11.16%			\$60,670- \$70,000	16.7%
4th Bracket	\$100,000 & over	29.0%					\$70,000- \$85,000	18.7%
5th Bracket							\$85,000 & over	19.7%
Basic Exemption	\$7,368		\$7,368		\$12,900		\$8,000	
Spousal Exemption	\$6,257		\$6,257		\$12,900		\$6,980	

*Ontario has two income tax surtaxes: 20% on provincial income tax over \$3,466 and 36% on provincial income tax in excess of \$4,373. The income thresholds at which these surtaxes apply are not fixed but can be as little as approximately \$52,000 (20% surtax) and \$62,000 (36% surtax).
Source: Ontario Ministry of Finance (2000); Alberta Treasury (2000a); BC Ministry of Finance & Corporate Relations (2000a); Federal Department of Finance (2000a and 2000b); Karin Treff and David B. Perry (2000).

nered from the provincial sales tax increased 42.7 percent in real terms over the period. Property and related taxes, yet another important category of government revenue, increased 41.7 percent in real dollar terms. The largest increase—and one that should be particularly worrisome for British Columbians concerned with economic efficiency—occurred in capital taxes, which increased from a mere \$15 million in 1991/92 to \$441.0 million in 1999/00, an increase of 2,833.7 percent.

Personal Income Tax (PIT)

Personal income taxes remain a challenge for British Columbia. The province maintains relatively high statutory tax rates across the board, with one of the highest top marginal tax rates in the country. Tax Table 2 summarizes the rates, thresholds, and exemptions for the three “have” provinces and the federal government for 2001.

In assessing the effective tax rate for low-income earners, it is critical to combine the exemption value with the applicable rate. A higher applicable rate combined with a higher exemption, as is the case in Alberta, often results in a lower effective tax rate for low-income earners. Put differently, the value of the exemption or the amount of money individuals are able to earn tax-free, has a much greater affect on low-income earners than the applicable rate. Low-income earners are generally better off with a higher exemption and rate than with a lower exemption and rate.

More critical for British Columbia is the lack of personal income tax rate competitiveness at higher income levels. In both the middle- and high-income tax brackets, British Columbia maintains the highest applicable tax rates of the three “have” provinces. In addition, British Columbia introduced two new high-income statutory rates applicable at \$70,000 and \$85,000, respectively.

Tax Table 3: Canadian Provincial Income Taxes, Top Marginal Tax Rates, 2000

Province	Top MTR (%)	Comments
Quebec	25.0%	Effective top MTR after adjusting for abatement is 20.2%
British Columbia	20.9%	Includes high income surtax; top MTR for 2001 at 49.9%
Newfoundland	20.9%	
Saskatchewan	19.3%	
New Brunswick	18.4%	
PEI	18.3%	
Nova Scotia	18.3%	
Manitoba	17.6%	Includes flat tax and surtax
Ontario	17.4%	
Alberta	13.3%	Move to flat tax in 2001 decreases top MTR to 10.5%*
*Alberta Treasury has since announced the rate will be further reduced to 10.0%. Source: Kesselman, 2000.		

British Columbia has also consistently maintained one of the highest top marginal tax rates in the country. For instance, prior to the 2000 round of provincial budgets, British Columbia had the third highest top combined federal and provincial marginal tax rate (51.26%), just narrowly behind Newfoundland (51.31%) and Quebec (51.66%) (Alberta Tax Review Commission, 2000). Unfortunately, as illustrated in Tax Table 3, after the tax reductions contained in the 2000 round of provincial budgets, British Columbia still had one of the highest top provincial marginal tax rates. In fact, the province's top marginal tax rate in 2000 (20.9%), based on the new tax-on-income structure, tied BC with Newfoundland for the second highest top marginal tax rate, behind only Quebec (Kesselman 2000).⁵

British Columbia clearly has a challenge in making its personal income tax system more competitive. Not only will the rates have to be reduced, but thresholds will also have to be increased. Further, greater attention must be paid to the top marginal rates in order to make British Columbia's tax system more competitive and indeed, to make the economy as a whole more competitive. Eliminating the top two statutory personal income tax rates, formerly assessed as surtaxes, would be a good beginning.

Business Income Taxes⁶

Although business income taxes represent a small portion of provincial revenue, only 4.3 per cent in 2000, they are nonetheless an important

5 For an excellent discussion of top marginal tax rates in both the US and Canada, see Kesselman, 2000.

6 It is important to note that the seminal Carter Commission on Taxation (1966) concluded, in agreement with most economists, that businesses do not in and of themselves pay taxes. Rather, the customers, shareholders, and employees of business ultimately pay the price of business taxes in the form of higher prices, reduced service and/or quality, lower dividends and/or appreciation of equity, and lower remuneration. Business taxes should only be employed when they meet the objectives of traditional tax policy: efficiency, equity (fairness), and simplicity.

Tax Table 4: Summary of Provincial Business Income Tax Rates

	BC	AB	SK	MB	ON	QC	NB	NS	PEI	NF
Small Business Income Tax Rate	4.75	5.00 ^a	8.00	7.00	6.50 ^c	9.01	4.50	5.00	7.50	5.00
Threshold ^f	200,000 ^e	400,000	200,000 ^e	200,000 ^e	400,000	—	200,000 ^e	200,000 ^e	200,000 ^e	200,000 ^e
General Corporate Income Tax Rate	16.50	15.50 ^b	17.00	17.00	14.00 ^d	9.01/ 16.46 ^g	17.00	16.00	16.00	14.00
M&P Income Tax Rate	16.50	14.50 ^b	10.00 to 17.00	17.00	12.00 ^d	9.01	17.00	16.00	7.50	5.00

^aAlberta's Small Business Income Tax Rate will be reduced to 3.00% by 2003.
^bAlberta's corporate income tax for all corporations will be reduced to 8.00% by 2005.
^cOntario's Small Business Income Tax Rate will be reduced to 4.00% by 2006.
^dOntario's corporate income tax for all corporations will be reduced to 8.00% by 2006.
^eSystem is based on the federal corporate income tax system.
^fLargely based on the federal thresholds for small business taxation.
^gThe higher rate applies to passive (investment) income of a corporation.
Sources: *Alberta Business Tax Review: Report & Recommendations 2000*; Ontario Ministry of Finance; Canadian Tax Foundation (2000), *Finances of the Nation*; Finlayson, 2001; Ontario Budget, 2000; specific inquiries to provincial Ministries of Finance.

driver or deterrent to economic activity. It is, therefore, essential that British Columbia maintain a competitive business tax regime.

Tax Table 4 contains business income tax rates for all of the provinces. The differences between British Columbia's business income taxes and those of the other Canadian provinces, particularly Alberta and Ontario, make business tax reform and reduction a high priority. For instance, British Columbia's general corporate income tax rate, as well as its manufacturing and processing corporate income tax rates, will be more than double the rates of Alberta and Ontario once reductions in these provinces are fully implemented. Although British Columbia made a great deal of noise regarding its planned reduction in the income tax rate for small business, it remains above the applicable rate in Alberta.

The announcements of business income tax reductions by Alberta and Ontario will clearly force other provinces to make similar cuts in their upcoming budgets. Alberta's and Ontario's an-

nounced cuts will not be fully implemented until 2005 and 2006, respectively. This gives provinces like British Columbia time to announce their own equal, or better yet, more aggressive business income tax reductions.

Tax Table 4 provides evidence that British Columbia's business income tax rates are currently uncompetitive; this situation will deteriorate further as reductions announced by other provinces are implemented. It is imperative that British Columbia move quickly to reduce its business income tax rates to levels found in other major Canadian provinces.

Capital Tax: A Particularly Damaging Tax

Capital taxes are another tax problem facing British Columbia. Businesses face capital taxes whether they generate a profit or not. Increasingly in recent years, governments have relied on profit insensitive taxes, such as capital and property taxes, to avoid or at least mitigate the cyclical

Tax Table 5: Provincial Capital Taxes										
Capital Tax	BC	AB	SK	MB	ON	QC	NB	NS	PEI	NF
Non-Financial	0.3	0.0	0.6	0.3/ 0.5	0.3	0.64	0.3	0.25	0.0	0.0
Financial	1.0/ 3.0	0.0*	0.7/ 3.25	3.0	3.0	0.6/ 0.99	1.28	3.0	3.0	4.0
*Effective April 1, 2001. Source: BC Ministry of Finance, 2000a; Ort and Perry, 2000; and Alberta Business Tax Review Commission, 2000.										

nature of government revenue, which is a result of the close relationship between business income tax collections and business profits, both of which rise and fall with the business cycle.

The quest for stabilization in government revenue has come at a cost. As discussed previously in this section, by their very nature, taxes distort economic activity. The greater the distortion, the greater the cost to the economy. A number of studies have examined this phenomenon and concluded that some types of taxes are more efficient than others (Jorgensen and Yun, 1991; Kesselman, 1997; Kneller, Bleaney, and Gemmell, 1999). As the Jorgensen and Yun study (1991) notes, capital taxes are a particularly poor way to raise revenue as the economic distortions associated with them are quite high. In other words, it costs a great deal to raise revenue using capital taxes as opposed to other, more efficient taxes, such as payroll or consumption taxes.

Tax Table 5 gives the capital taxes for both non-financial and financial companies in each Canadian province. Only three provinces—Alberta, PEI, and Newfoundland and Labrador—do not assess a capital tax on non-financial companies. Effective April 1 of this year, Alberta became the only province not to assess financial companies a capital tax. British Columbia could excel in one area of tax policy by immediately eliminating capital taxes for both financial and non-financial companies.

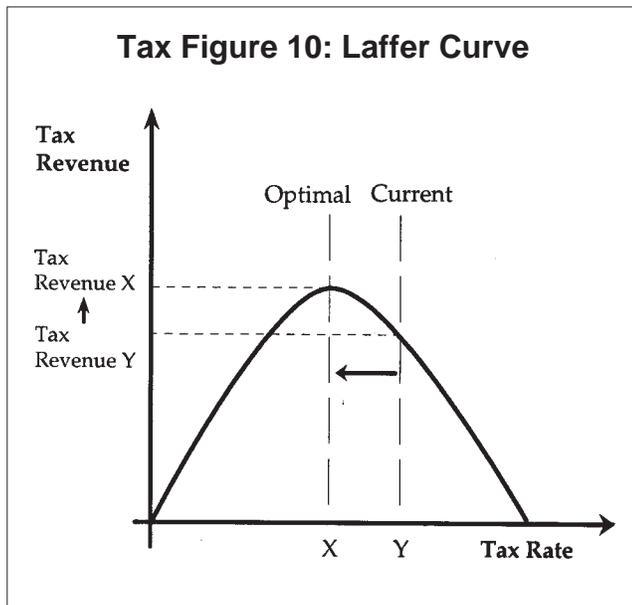
The Laffer Curve and BC Taxes

In an important paper for the BC Business Council, Professor Maurice D. Levi of the University of British Columbia's Faculty of Commerce and Business Administration assessed fiscal policy, taxation, and the potential for future prosperity in British Columbia.

The study's most interesting and relevant finding is that British Columbia's tax rate is beyond the optimal rate. Professor Levi specifically discusses the concept of the Laffer Curve, a theoretical construct illustrating the relationship between tax rates and tax revenue (Tax Figure 10). Simply put, having a non-optimal tax rate, one that is either too low or too high, fails to yield the maximum amount of revenue.

Professor Levi concluded that British Columbia's tax rates are beyond the peak point of the curve, and thus result in less, not more, tax revenue than could be generated with lower tax rates (Levi, 2000). Tax Figure 10 shows that British Columbia's current tax rates (Y) are to the right of the optimal (X). Thus, according to the Laffer Curve, a shift in tax rates to the left (reduction) would result in greater tax revenues. Lower tax rates would yield greater tax revenues because people would have more of an incentive to work and save.

Professor Levi included a number of specific tax recommendations, including:



- reduce both personal and business income tax rates to bring them in line with other major Canadian provinces;
- eliminate capital taxes;
- ultimately introduce a low, flat tax, offset by higher sales taxes (if required for revenue generation) (Levi, 2000).

Professor Levi's conclusion is clear: British Columbia must reduce its tax burden. When it has done so, it will actually be in a position to generate more tax revenue.

Obstacle or Opportunity?

Instead of viewing the tremendous tax challenge facing the province as an overwhelming obstacle, British Columbia should see this as an opportunity to fundamentally change the province's tax system.

Flat Tax: A Real and Effective Tax Advantage

Much was made of the notion of a flat tax in the most recent federal election. Unfortunately, a full and frank debate regarding the efficacy of a flat

tax—distinctly different from the Canadian Alliance's proposal—was not undertaken during the election. A flat tax based on the work of Professors Robert Hall and Alvin Rabushka would revolutionize the tax system in British Columbia.

Hall and Rubushka's flat tax proposal represents a coherent integration of the personal and business tax systems. It ensures that all three tenets of tax policy—efficiency, simplicity, and equity—are achieved. Further, it would create an enormous tax-based advantage for British Columbia over other jurisdictions, both in Canada and abroad.

In summary, the Hall-Rabushka tax system contains no tax credits, deductions, or exemptions, except personal, spousal, and child exemptions. The myriad tax credits and deductions present in the current system and the attendant complicated and time-consuming paperwork are eliminated. Business income and personal income are taxed in an integrated manner in order to ensure that income is taxed uniformly and only once.

A flat tax system would move the tax system away from one based on income towards one based on consumption. Economists generally agree that the taxation of consumption is one of the most efficient ways to raise tax revenue. The net economic effect of flat tax reforms include improved incentives for work, increased entrepreneurial activity, and greater capital formation leading to a substantially higher level of national output and standard of living.

The Fraser Institute's upcoming study on flat tax systems contains a section calculating various different flat tax rates for each province. The following table summarizes the rates and specifics from the various proposals in the study. Note that the flat tax reforms presented in Tax Table 6 are revenue neutral compared to the current, existing tax systems.

Tax Table 6: Flat Tax Rates for British Columbia						
Case	Value of Exemption	\$2,000 Child Exemption	Current RRSP/RPP	Current Charitable Donation Tax Credit	Provincial Only Flat Tax Rate	Combined Federal-Provincial Flat Tax Rate
1	—	No	No	No	7.0	19.7
2	7,231	No	No	No	9.2	25.9
3	8,766	No	No	No	9.8	27.6
4	8,766	Yes	No	No	10.0	28.3
5	8,766	Yes	Yes	No	10.9	30.8
6	8,766	Yes	Yes	Yes	11.0	31.1
7	11,834	Yes	Yes	No	12.5	29.0

Source: Clemens and Emes (2001, forthcoming).

As the results in Tax Table 6 reveal, there are a number of possibilities for an integrated flat tax system in British Columbia. Rates would vary according to the number and extent of tax deductions included in the flat tax. For instance, if RRSP and RPP deductions were permitted, the applicable provincial flat tax rate would increase by roughly 1 percentage point. Regardless, however, of the particular flat tax system implemented, the economic benefits accorded the province from simplifying the tax system and focusing on economic efficiency would be overwhelming.

Conclusion

British Columbia is clearly faced with a taxation problem based on competitiveness and economic efficiency. Reduction and reform of British Columbia's tax system is nearly as important as the overhaul of government spending. British Columbia must act decisively and immediately to re-focus its tax policy on achieving the traditional measures of tax success (efficiency, simplicity, and equity) while at the same time focusing on jurisdictional competitiveness.

Policy Recommendations

British Columbia must act immediately to eradicate its tax-based disadvantage by reducing some taxes and eliminating others. However, more fundamentally, the province must begin implementing longer-term, broad-based tax reform.

We have included several static revenue loss estimates for the tax reduction/elimination we have proposed. These estimates do not account for supply-side effects which will likely increase government revenues. As summarized in Professor Levi's paper, British Columbia's tax rates and total take of the economy are well beyond their optimal level. Thus, reducing the tax rates and size of government will likely actually boost government revenue by encouraging entrepreneurial activity, risk-taking, innovation, and diligence. Therefore, the estimates provided should be taken as the worst-case scenario of the potential revenue losses. Actual losses will likely be considerably smaller than projected and the attendant improvements in the tax system may increase tax revenues.

Intermediate Policy Recommendations

(1) Reduce personal income tax-rates by a *minimum* across-the-board 20 percent.

A rate reduction of this magnitude will bring British Columbia's statutory personal income tax rates in line with those of other major Canadian jurisdictions. The maximum revenue effect of such a reduction, based on the Social Policy Simulator Database/Model produced by Statistics Canada for 1999/00, is \$1.2 billion. That is, without considering the dynamic effects of tax reduction, such as supply-side efficiency gains, the amount of revenue lost through across-the-board personal income tax rate reductions would be \$1.2 billion.

(2) Eliminate high-income surtaxes, now constituted by the two new top statutory tax rates.

British Columbia should immediately eliminate the high-income surtax, now present in the form of the top two personal income tax rates, in order to stimulate entrepreneurial activity, greater work effort, increased risk-taking, and innovation. Eliminating the high-income surtaxes would also make British Columbia's top marginal tax rates more competitive with those in other jurisdictions in Canada. This change could cost a maximum of \$228 million in foregone revenue, based on Statistics Canada's estimates derived from the Social Policy Simulator Database/Model.

(3) Reduce business income tax rates.

In accordance with other Canadian provinces, particularly Ontario and Alberta, British Columbia should immediately announce corporate tax rate reductions for the province, aiming for a target rate of 8.00 percent. The BC Ministry of Finance and Corporate Relations estimates a static revenue loss of \$74 million

per percentage-point decline in corporate business income tax rates.

(4) Immediately eliminate capital taxes.

As discussed, capital taxes are a particularly inefficient way to raise revenue. Also, their elimination would create a tax-based advantage for British Columbia given only Alberta does not assess capital taxes currently. The maximum revenue effect of such a reduction, based on FMS data for 1999/00, is \$441.0 million. That is, without considering the dynamic effects of tax reduction, such as supply-side efficiency gains, the amount of revenue lost through the elimination of capital taxes would be \$441.0 million.

(5) Harmonize the provincial sales tax with the GST

Although not specifically discussed in this section, there are serious problems inherent in the current provincial sales tax, chief of which is that business inputs are taxed. Harmonizing the provincial system with the federal GST and collecting it as a value-added tax would alleviate this problem and may reduce collection costs for both business and government.

(6) Introduce a strong Tax Limitation Law.

Strong Tax and Expenditure Limitation laws (referred to as TELs), as discussed in the Spending section, have proven successful in the US in stemming the growth of government and ensuring fiscal responsibility (Krol, 1996 and 1997; Stansel, 1994; Matsusaka, 1995). Both tax and expenditure limitation laws effectively constrain the ability of governments to increase either taxes or spending without popular approval. For instance, successful tax limitation laws require any tax increase to be specifically approved by

referendum. Such a system has caused re-prioritizing in the US as states are forced to focus on the goods and services actually required of them, as opposed to programs driven by special-interests.

(7) Introduce a legislated program of debt reduction.

British Columbia should immediately move towards legislatively requiring that any unused portion of the contingency fund be applied each year to the province's debt. In addition, all unexpected surpluses, whether garnered from higher than expected revenues, lower than expected interest costs, or lower than expected expenditures, should be exclusively restricted to reducing the province's debt. This would mean that last minute, year-end spending of unexpected surpluses, as the federal government has been disposed to engage in (Clemens and Emes, 2000) would be precluded.

Long-Term Policy Recommendation

(1) Implement a broad-based flat tax.

British Columbia should immediately undertake to implement a flat tax based on the work of Professors Hall and Rabushka (See Clemens and Emes, 2001). The flat tax system should fully integrate personal and business taxes, and ensure that all sources of income are taxed uniformly at one rate, one time. A flat tax would also move the tax system in general away from the taxation of income towards the taxation of consumption, which is inherently more efficient. Such a system would facilitate economic growth and achieve the basic tenets of prudent tax policy (efficiency, simplicity, and equity). Finally, as

Tax Table 6 illustrates, a flat tax could be implemented in British Columbia on a revenue neutral basis; it could be implemented without jeopardizing the amount of revenue BC currently raises, and would, in all likelihood, increase the amount of revenue raised by stimulating and encouraging entrepreneurship, risk-taking, investment, and diligence.

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Recommended Readings

[Note: For complete publication data, please see the list of references.]

Herbert G. Grubel (2000). *Unlocking Canadian Capital: The Case for Capital Gains Tax Reform.*

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Jason Clemens and Joel Emes (2001, forthcoming). *Flat Tax: Issues and Principles.*

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W. Michael Cox and Richard Alm (1999). *Myths of Rich & Poor. Why We're Better Off Than We Think.*

Regulatory Policy: The Hidden Tax

The expanding regulation of economic activity, in health and safety, labour markets, and countless other sectors, is increasingly drawing the attention of economists, policymakers, and concerned citizens. The reason for this increasing attention is that regulations represent a cost to both individuals and businesses. Although there are many important areas affected by regulation, including transit, energy, and the operation of Crown Corporations, this study covers two of the more important areas of regulatory activity: labour and natural resources, specifically, forestry.

This chapter presents a general analysis of regulation, including the economics of regulation, an overview of regulation in British Columbia, and some cost estimates. Some general recommendations for regulatory reform follow, along with a specific analysis of labour market regulation in British Columbia. The study also includes a section on natural resource regulation, specifically the regulation of the forestry industry. The chapter concludes with relevant policy recommendations.

I. Regulation in British Columbia

[The main section on regulation relies heavily on previous work completed by Fazil Mihar, the former Director of Regulatory Studies at The Fraser Institute; most of the recommendations for regulatory reform are taken from policy sections in previous works.]

Regulation as a Hidden Tax

Governments at all levels now regularly compel both businesses and individuals to act in certain ways, or preclude them from undertaking certain activities through regulation, in order to protect the “public interest.” Regulation covers myriad economic sectors. For instance, governments in Canada regulate such activities as radio and cable

television, packaging and labelling of consumer products, financial institutions, airlines, taxicabs, Canadian content in culture, energy, liquor, minimum wages, and occupational licensing and certification.

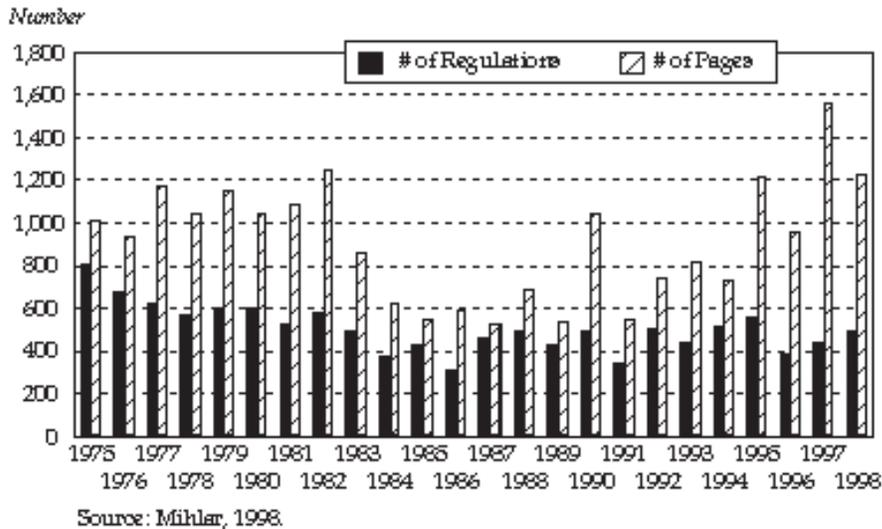
Regulation involves both direct costs and indirect costs. The direct costs of regulation are compliance costs, such as administration required of individuals and businesses based on regulation, in addition to monitoring costs incurred by government in the enforcement of regulation.

The indirect costs of regulation are a result of the behaviour-changing effect regulation can have. Like taxes, regulations change the relative price of certain activities, resulting in either more or less economic activity in the regulated areas. Regulations can also impose indirect costs when they stifle innovation and experimentation by individuals and businesses, or where they increase the level of uncertainty as to how businesses will be treated.

Although both direct and indirect costs constitute a hidden tax on individuals, it is the direct cost of regulation, namely compliance and administration, that is readily measurable. Thus, when the cost of regulation is referred to in the rest of this section, the term is referring only to the compliance cost of regulation, or the direct cost of regulatory activities.

As discussed, regulations force businesses and individuals to act in certain ways, or avoid particular behaviours. The idea that the direct cost of regulation is a hidden tax is most easily seen in business regulation. When governments require businesses to undertake certain activities, or preclude them from doing so, the requirements impose subsequent compliance costs, such as monitoring and reporting costs. These costs are

Regulatory Figure 1: Number of Regulations and Pages of Regulations in British Columbia (1975-1999)



inevitably paid by the business's customers through higher prices, by the owners through lower profits, and/or by the employees through lower compensation.

In addition to the costs that businesses and individuals incur, government also incurs costs to monitor and assess regulatory compliance. Economist Murray Wiedenbaum of the Center for the Study of American Business estimated that for each \$1 the government spends on regulations, business typically spends roughly \$20 in compliance costs (Defina and Wiedenbaum, 1978). For Canada, Mihlar (1996b) estimated that in the fiscal year 1993/94 alone, regulations cost Canadians roughly \$85 billion in total compliance costs, including both government costs and business and individual costs.

Economics of Regulation

As with most other economic analyses, the economic evaluation of regulation uses a cost/benefit approach: does the associated benefit of a particular regulation exceed its costs? Unfortu-

nately, all too often the decision to enact regulation ignores this fundamental principle.

Since the early 1970s, Canada has experienced a decline in productivity growth (OECD, 1994; OECD, 1997; Sharpe, 1998; and Law, 2000). This decline in both total factor and labour productivity has resulted in slower real income growth. In fact, after-tax real incomes have actually declined in the last decade. Empirical analyses have concluded that

increasing government regulations account for between 12 and 30 percent of the productivity decline (Wienert, 1997). Worse still, other analyses have suggested that in many cases, the cost of regulations have exceeded their benefits (Hahn and Hird, 1991). Not only has the regulatory burden dampened productivity and income growth, but in many cases, the benefits from regulation were outweighed, in some cases significantly, by their costs.

Regulation in British Columbia

British Columbia has experienced a significant expansion in its regulatory burden over the last quarter century. As Regulatory Figure 1 illustrates, between 1975 and 1998 British Columbia passed 12,133 regulations totalling 21,891 pages.⁷ The last decade alone has witnessed the addition of 3,675 regulations, or a little over 30 percent (30.3%) of the total number of regulations added since 1975. Further, 7,788 pages of regulation have been added since 1991, or 35.6 percent of the total number of regulatory pages added since 1975 (Mihlar, 1998; with calculations by author).

The average number of pages per regulation is a proxy for the complexity of the regulations. As Regulatory Figure 2 depicts, the average number of pages per regulation has been increasing since the late 1980s. For example, the average number of pages per regulation for the last 25 years was 1.8, while the average number of pages for regulations passed between 1991 and 1998 was 2.1, an increase of 16.7 percent (Mihlar, 1998; with calculations by author). The trend is evident: not only has the number of regulations been increasing in British Columbia, but so have their complexity.

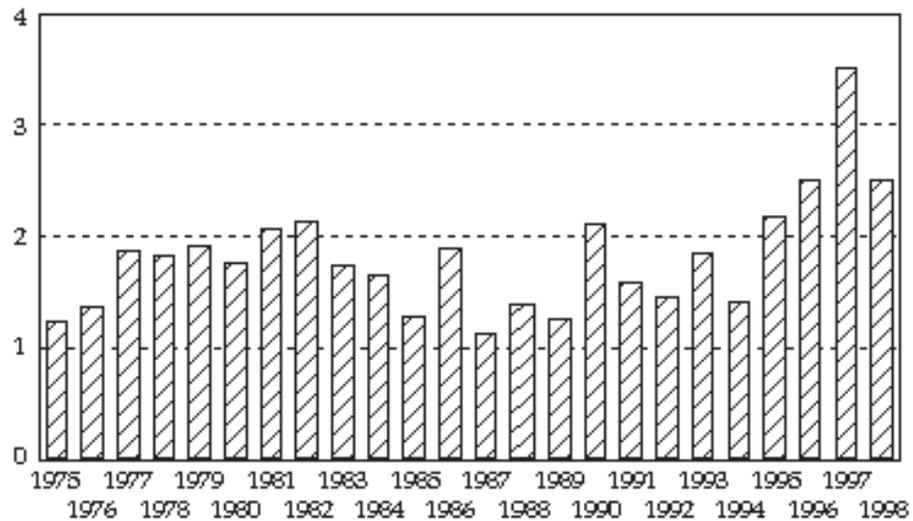
Cost of Regulation

*[For a detailed explanation of the methodology used to calculate compliance costs, please see: Fazil Mihlar (1996). **Regulatory Overkill: The Cost of Regulation in Canada.**]*

Not surprisingly then, the cost of regulatory compliance has also been increasing in British Columbia. Regulatory Table 1 presents the cost of regulatory compliance for British Columbia for selected years between 1973-74 and 1995-96, the latest year for which data is available. The data presented in Regulatory Table 1 and depicted in Regulatory Figure 3 clearly illustrate that British

Regulatory Figure 2: Regulatory Complexity (1975-1998)

Number of Pages Per Regulation



Sources: Mihlar, 1998; Jones, 2001 (forthcoming).

Columbia, far more than either Alberta or Ontario, has experienced a consistent upwards trend in the cost of regulation. In fact, the growth in the total cost of regulation in BC between 1973-74 and 1995-96 (194.9%) far exceeded the cost growth incurred in either Ontario (123.6%) or Alberta (48.4%) (Mihlar, 1998; with calculations by author). In fact, Mihlar (1996b) estimated that the direct cost of administering regulations in British Columbia increased by nearly 800 percent between 1973/74 and 1993/94.

Total regulatory compliance costs⁸ do not illustrate the full extent of the regulatory burden since they do not account for the different sizes of the relative economies or populations. Regulatory Table 1 also includes per capita regulatory costs between 1973-74 and 1995-96. The per capita data show a similar trend to the data for the total regu-

7 This measure includes regulations that contain rules not intended to change economic behaviour and excludes statutes containing rules designed to alter economic behaviour.

8 As discussed earlier, the cost of regulation calculations only include compliance costs and not calculations of the total dead-weight loss associated with regulation.

Regulatory Table 1: Total and Per Capita Regulatory Costs						
	1973/74	1980/81	1987/88	1993/94	1995/96	Growth
Total Regulatory Costs (Thousands of 1993-94 Dollars)						
BC	77,546	151,469	148,035	202,821	228,707	194.9%
AB	90,464	158,725	128,301	153,490	134,217	48.4%
ON	273,369	452,679	593,751	720,368	611,161	123.6%
Per Capita Regulatory Costs (Thousands of 1993-94 Dollars)						
BC	31.61	53.41	47.33	55.08	58.91	86.4%
AB	51.40	68.89	52.09	56.74	48.26	-6.1%
ON	33.24	51.21	60.07	66.53	55.05	65.6%
Source: Mihlar, 1998; and calculations by the author.						

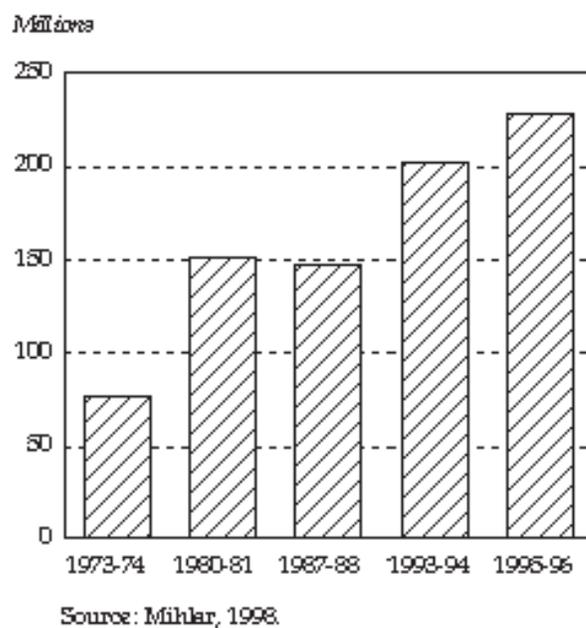
latory cost. The growth in the total per capita cost of regulation in British Columbia between 1973-74 and 1995-96 (86.4%) exceeded the growth in per capita regulatory costs in either Ontario (65.6%) or Alberta (-6.1%) (Mihlar, 1998; with calculations by author).

BC's Attempt at Reform

The NDP government of British Columbia announced a review of regulations in its 1998/99 budget. The Business Task Force on Regulatory Impact was formed and some areas of regulation are under review. The task force's mandate is to recommend ways to reduce the cost of doing business in British Columbia by streamlining regulations and eliminating red tape as well as devising institutional processes to prevent unnecessary regulation. The streamlining initiative, particularly, indicates that the provincial government has apparently taken the need for regulatory reform seriously.

In addition to creating the task force, the provincial government also passed the Regulatory Impact Statement Act (RISA) in 1999. Under RISA, government ministries and agencies must scrutinize proposed regulation based on an OECD

Regulatory Figure 3: Cost of Regulation in British Columbia for Select Years (Real 1993-94 Dollars)



checklist. Over time, RISA should lead to better and more carefully considered regulatory decisions. In addition, spurred by the task force, reviews of several existing areas of provincial regulation are now under way. Unfortunately, recent changes to labour laws indicate a weak

commitment to these principles as most were ignored.

Some changes to regulation have already been enacted. For instance, outmoded rules governing the number and size of television screens permitted in licensed establishments serving alcohol have been streamlined. Some changes have also been made to ease the burden of the Forest Practices Code whereby the government has agreed in principle to the need for a simplified results-based code in place of the current process-driven code. The government appears to be increasingly open to some kinds of regulatory reform. However, the status of some extremely costly environmental measures, such as the phase-in of the zero emission standards for pulp mills, is still uncertain. Some isolated progress has been achieved, but British Columbia still lacks a broad, coherent system for managing regulation.

General Regulatory Policy Recommendations

(1) Implement a three-year moratorium on all new regulations in conjunction with a review of existing regulations.

The province should place a three-year moratorium on all new regulations, except in special circumstances. It should concurrently complete a thorough review of all existing regulations, emphasizing outcomes and streamlining the regulatory process.

(2) Apply cost/benefit tests, and make the results public.

British Columbia should require reliable and comprehensive cost/benefit analyses of proposed regulations before they are enacted.

Further, the results of such analysis should be made public.

(3) Prioritize regulations.

Regulatory bodies in British Columbia should prioritize all regulations. Since not all risks are of equal magnitude, emphasis and priority should be given to the most serious risks facing British Columbians.

(4) Change the regulatory focus to outcomes.

Any new regulations should focus on achieving specific and measurable goals. They should also be written clearly and concisely to ensure that they are readily understood.

(5) Introduce a regulatory budget along with the annual fiscal budget.

The government should submit a comprehensive budget annually, along with the normal budget, that details the costs of regulation, including costs for both government and those affected by regulations, i.e. business and individuals.

(6) Enact a sunset clause for all regulations.

Regulatory bodies should include a sunset clause in all new regulations to ensure that they are reviewed regularly. This would assure relevance, accountability, and adaptability for the province's regulatory framework.

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Recommended Readings

[Note: For complete publication data, please see the list of references.]

Peter L. Bernstein (1996). *Against the Gods: The Remarkable Story of Risk*.

Laura Jones, ed. (2000). *Safe Enough? Managing Risk and Regulation*. Fazil Mihlar (1998). *The Cost of Regulation in Canada, 1998 edition*.

Milloy, Steven and Michael Gough (1999). *Silencing Science*.

II. Labour Market Policy

The labour market is perhaps the most important example of how regulation can affect markets. Specifically, by implementing regulations, whether they target health and safety, unionization, or mandatory benefits, government changes the way the labour market functions by changing the costs associated with labour.

Economics of Labour Policy

One peculiarity of the labour market is the way in which regulatory costs manifest themselves. The cost of regulation incurred by individuals—and collectively by society—comes in the form of higher than normal unemployment, and lower than normal productivity growth. Mounting research indicates that an inflexible labour market may have been a major contributor to the unemployment and the productivity growth slowdown that most countries experienced during the 1970s and 1980s (Grubel, 1988; Daly and MacCharles, 1986; OECD, 1994b).

These barriers, or rigidities, are the direct and indirect result of legislation. For instance, minimum wage laws or certain mandatory benefits create a regulatory barrier for firms hiring new employees (Stigler, 1946; Gramlich, 1976; Rottemburg, 1981; Linneman, 1981; Neumark and Wascher, 1992). Similarly, labour market rigidi-

ties are created when legislation permits some employees to exact higher compensation from their employers than they would otherwise receive by restricting the hiring of others, as in the case of closed-shop union contracts (Hirsch, 1997; Mihlar, 1997). Another labour regulation that can cause rigidity relates to workplace laws limiting employer flexibility, such as workplace jurisdictional rules, seniority, and other practices that prevent an employer from using incentives to promote productivity and innovation (Hirsch, 1997).

How do labour market rigidities caused by regulation translate into higher unemployment and lower productivity growth? The answer is rooted in the costs necessitated by such regulation. For instance, minimum wage laws and mandated benefits increase the cost of labour, at least initially. When labour becomes more expensive without a corresponding rise in productivity, there is an obvious incentive for the employer to reduce, or at least control costs, by substituting capital for labour.

Another example of labour regulations translating into higher unemployment and lower productivity growth relates to workplace rules, particularly those that limit flexibility. By limiting a firm's ability to react to market conditions, experiment with new production models, or introduce new products, labour regulations prevent, or at least impede, the business's ability to remain competitive. The end result of such legislation is often industrial stagnation and a loss of competitiveness which eventually results in less employment.

A final example of this deleterious relationship rests on organized labour's ability to extract higher compensation for its members through closed-shop union contracts. These contracts preclude non-union workers from joining a firm or sector's workforce, depending on the nature of the contract (Mihlar, 1997). Such preferential

treatment allows a union to negotiate significant benefits for its members, but in many cases, these higher labour costs and restrictive hiring and workplace practices also reduce employment levels and productivity. For instance, studies show that unionized firms are about 10 to 20 percent less profitable than non-unionized firms (Mihlar, 1997). A study of 510 Canadian firms between 1980 and 1985 found a median growth rate for employment in non-unionized firms of 27 percent, compared with 0 percent for their unionized counterparts (Mihlar, 1997). A series of international studies have also shown that unionization reduces rates of employment growth (Cote and Hostland, 1996; Mihlar and Peacock, 1997).

British Columbia's Labour Policies

Unfortunately for British Columbia, the last decade has seen significant increases in labour market regulation, and subsequently a serious decline in the level of labour market flexibility. For example, 1991 changes to the Industrial Relations Act banned the use of replacement workers during strikes and lockouts, allowed secondary picketing, and eliminated the right of workers to a secret ballot for union certification.

Another example is the Fair Wages Act, introduced in 1992. It imposed a minimum standard of pay and benefits on successful bidders for government contracts (Mihlar, 1996a). Since the standards imposed are above market wages, the taxpayer is, in effect, subsidizing union wages on government projects. Estimated cost increases due to this policy approach 4 percent, with annual costs to the taxpayer totalling nearly \$166 million. One study found the act was responsible for the disappearance of almost 10,600 construction jobs alone in the province between 1994 and 1995 (Mihlar, 1996a). The clear intent of the Act is to promote unionization within the private sector by making it more difficult for non-union suppliers to obtain government contracts.

Changes to the Employment Standards Act introduced in 1994 provide yet another example of labour market regulation. The Act attempted to establish minimum working conditions for part-time employees. Issues such as vacations, statutory holidays, termination of employment, and layoffs were all proposed for coverage under the Act. The government effectively denied the covered workers the opportunity to negotiate their own terms of employment with their employers (Mihlar, 1996a) as well as reduced the efficiency of firms employing part-time workers. Also, the Act clearly increased the cost of employment and thus once more raised the cost of doing business in British Columbia.

In spite of clear evidence of the harm associated with increasing minimum wages (Law, 1998), the British Columbia government has continued increasing the minimum wage. In fact, it just recently announced a two-stage increase to bring the minimum wage up to \$8.00 per hour. This announcement means British Columbia will have by far the highest minimum wage in the country.

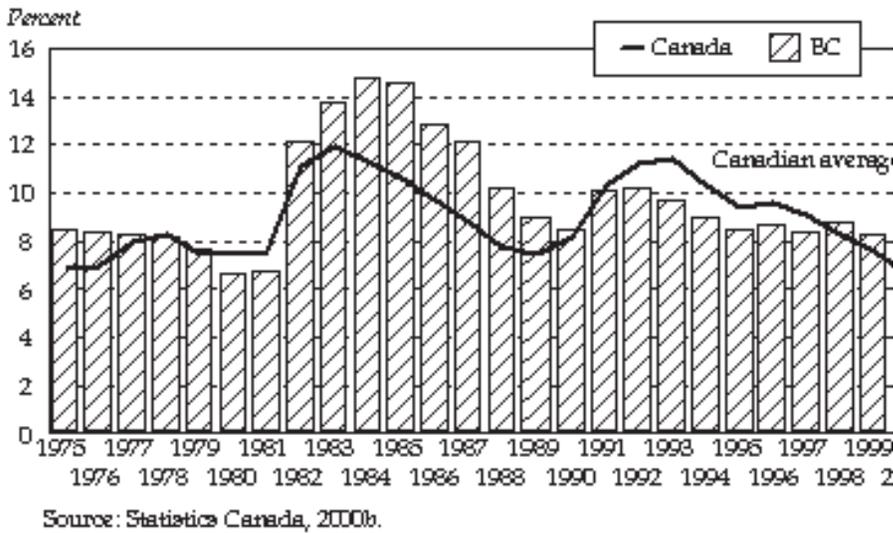
The State of BC's Labour Market: The Cost of Rigidity

[A more expansive assessment of labour market performance is found in the Economic Performance section.]

Given the economic research into the relationship between labour market flexibility and employment, one would expect British Columbia's labour market performance to be relatively muted. Regulation Figure 4 shows the average unemployment rates for British Columbia and Canada as a whole between 1975 and 2000 (see also Economic Figure 8).

Two periods shown in Regulation Figure 4 are striking: 1982-1990 and 1991-1997. First, between 1982 and roughly 1990, British Columbia's unemployment rate was significantly above the na-

Regulation Figure 4: Average Unemployment (1975-2000)



tional average. Second and more importantly, between roughly 1991 and 1997, British Columbia's unemployment rate was lower than the national average. Unfortunately, since 1997, BC's unemployment record has reverted to its previous trend of being above the Canadian average. For instance, British Columbia's average annual unemployment rate of 7.1 percent for the year 2000 is above the national average for the year of 6.6 percent.

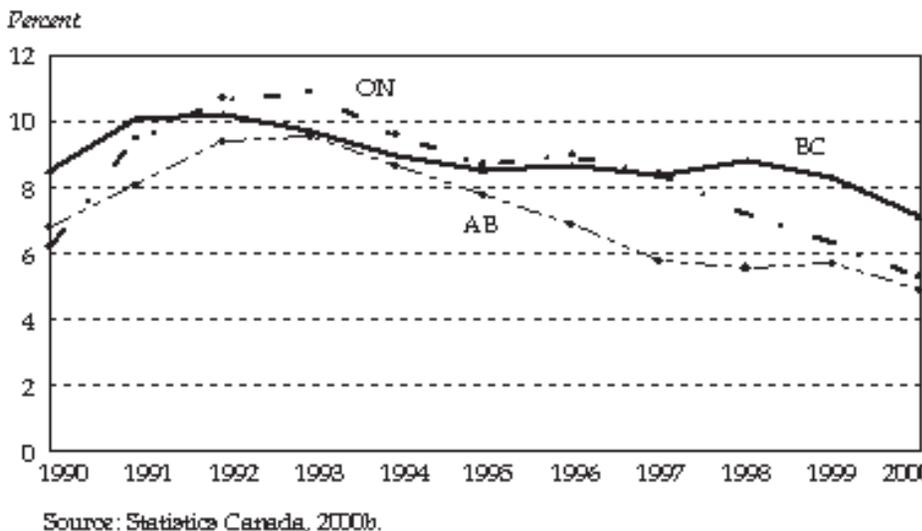
ment rates in Ontario (5.3%) and Alberta (4.9%) were well below that in British Columbia (7.1%).

As discussed in the Economic Performance section, British Columbia's relatively positive performance in employment during the 1990s must be taken in context. Although the province performed relatively well in generating employment growth between 1990 and 1994, it has done so largely by expanding the public sector. That is,

while private sector employment growth has been next to stagnant, the public sector has grown. Specifically, employment in the provincial public sector increased from 319,000 in 1990 to over 345,000 in 2000, an increase of 8.2 percent.

As the Economic Performance section discussed, it is unclear how dramatic the curtailment will be in the public sector once the necessary structural re-

Regulation Figure 5: Provincial Unemployment Rates



ductions are made to the level of spending and taxes. What is clear, however, is public sector growth cannot continue to offset lacklustre performance in private sector employment.

Equally importantly is the continued negative business and investment climate. Part of this negative environment is driven by anti-business labour legislation enacted over the last decade and partially enumerated above. There is little disagreement that one of the main priorities for reform must be labour market reform aimed at re-instituting labour market flexibility.

Policy Recommendations

*[The policy recommendations included in the labour policy section are largely based on those made in the 1998 report by Satinder Chera and Fazil Mihlar, *The Government of British Columbia, 1991-1998: An Assessment of Performance and a Blueprint for Economic Recovery*.]*

(1) Repeal the amendments made to the Industrial Relations Act, the Employment Standards Act, and the Fair Wage Act over the last decade.

Mounting evidence reveals that amendments made to the first two pieces of legislation have led to a dramatic deterioration in labour-management relations and contributed to a negative business climate in BC. Similarly, the amendments to all three labour bills have increased the cost of doing business in the province by altering the cost of labour. A return to market-determined compensation and greater flexibility must underlie labour market reform. A first step in this process is to undo the damaging labour legislation implemented over the last decade.

(2) Rescind announced increases to the minimum wage and ensure that minimum wages

maintain an appropriate relationship with per capita GDP, assuming they remain at all.

Mounting research indicates that minimum-wage laws have a negative effect on employment, particularly for young and unskilled workers (Law, 1998). In fact, the evidence shows that minimum wage laws may be to blame for high rates of unemployment among young British Columbians (Law, 1998; Mihlar, 1996a). While jobs continue to be created in the rest of the country, employment growth in British Columbia is expected to remain relatively weak (Conference Board of Canada, 2000). Governments in general need to stop interfering in the process of real wage determination in response to changes in labour supply and demand. Assuming the ongoing presence of minimum wages, they should be set at an appropriate level relative to per capita GDP—a proxy for per capita productivity (Arman, Samida, and Walker, 1998).

(3) Enact Right-to-Work (RTW) legislation.

The government of British Columbia should repeal the existing Labour Relations Code and enact Right-to-Work legislation. Right-to-Work laws preclude closed-shop unions and thus make union membership voluntary. As a result, workers are no longer forced to join unions and have more flexibility to negotiate contracts with employers based on their own particular economic and personal circumstances. Unions, in turn, would be forced to become more responsive to the interests of their members, who have chosen to join. Indeed, a large body of evidence shows that jurisdictions where RTW laws have been implemented successfully have lower rates of unemployment and stronger economic growth (Mihlar, 1995; Holmes, 1995). For instance, in the United States between 1988 and 1993, 77 percent of all new high-paying jobs in manufacturing were created in states with

Right-to-Work laws (Mihlar, 1995). Further, a study by Thomas Holmes of the Federal Reserve Bank of Minneapolis found that employment grew by 170 percent in Right-to-Work states between 1947 and 1995, compared with employment growth of just 54 percent in states which authorized union monopoly hiring (Holmes, 1995). RTW legislation would allow British Columbia's labour market to become more competitive, improve labour productivity, and increase employment. This legislation should be modelled on the Employment Contracts Act enacted in New Zealand.

(4) Implement a more balanced approach to the issue of union certification and decertification.

Government legislation should neither favour the creation of, nor unduly impede the introduction of a union, assuming the presence of Right-to-Work legislation which prevents closed-shop unions. The question of unionization should be left to the workers affected by such a decision. The province should, therefore, move to reinstate secret balloting for union certification and decertification and ensure equal access for all employees for certification and decertification.

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Recommended Readings

[Note: For complete publication data, please see the list of references.]

Walter E. Block and Michael A. Walker (1981). *Discrimination, Affirmative Action, and Equal Opportunity*.

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III. Natural Resources: A Sector in Decline?

Natural resource industries have historically been central to the economic development of British Columbia, and they continue to play an important role in determining the economic well-being of the province (Finlayson, 1998). Unfortunately, due to space and resource constraints, a broad analysis of the natural resource sector was not possible for this study. The following analysis of the natural resource sector is limited to forestry, as it remains one of the largest sectors of the BC economy (PriceWaterhouseCoopers, 2000b). This does not, however, in any way diminish the importance of other natural resource industries, such as mining, oil and gas, agriculture, and fishing, or the regulatory problems facing them.

This subsection, like all policy sections, presents the general economics associated with natural resources. It assesses the state of natural resource policy in British Columbia and offers policy recommendations for forestry. Many of the regulatory problems affecting forestry are equally applicable to other natural resource industries. Thus, the policy recommendations offered for forestry can, in many cases, be applied to other industries in the natural resource sector.

Importance of Natural Resources to BC: A Lifeline

Logging and forestry activities represented 2.7 percent of GDP in 1999, with mining accounting for another 2.5 percent of GDP in the same year. The production of paper and allied products represented an additional 1.2 percent of GDP in 1999,

the latest year for which industrial GDP statistics are available (Statistics Canada, 2000c).

According to the BC Ministry of Finance and Corporate Relations, (2000b), forestry directly accounted for 1.6 percent of total employment in the province in 1999, roughly 30,200 people (BC Ministry of Finance and Corporate Relations, 2000b). According to a 2000 PriceWaterhouseCoopers' (PWC) study, in 1999, the forestry industry, broadly speaking, employed 90,600 people directly, with another 181,200 people employed indirectly (PWC, 2000b). Further, PWC estimates that the forestry industry in BC alone accounts for 49 percent of manufacturing shipments, 16 percent of GDP, and 14 percent of the provincial workforce (PWC, 2000b). The same study characterized the forestry industry in British Columbia as the "largest industrial and most geographically dispersed employer," upon which "British Columbia's economic prosperity is dependent" (PWC 2000b).

It is clear that BC's economy, whether viewed in terms of GDP or by employment, is still reliant on the natural resource sector, particularly the forestry industry. Public policy within the natural resource sector influences an important aspect of the provincial economy that cannot be neglected.

Economics of Natural Resources

Public policy analysis of natural resources should use cost/benefit techniques. However, the natural resource sector is unique in that governments in Canada own most of the resource. That is, private property rights, and thus functioning markets for vast quantities of natural resources, are either absent or significantly muted by government ownership. For instance, the BC Ministry of Finance and Corporate Relations noted in its 2000 review that the government of British Columbia "has a higher degree of responsibility for forest management than most other jurisdictions in the world because it owns more than 90 percent of the province's land" (BC Ministry of Finance,

2000b, p. 95). In fact, 88.8 percent of all forestry products billed in 1997/98 were from Crown lands (BC Ministry of Forests, 1999).

One of the problems inherent in situations where the state owns the resource is what is referred to as the "tragedy of the commons." This term means that the lack of private property rights results in an incentive to overuse the natural resource. The traditional example of the "tragedy of the commons" is the field designated for grazing. When private property rights do not exist, there is an incentive for those using the field to allow their animals to overgraze on it, since they do not directly incur the cost of doing so. If one farmer stops his animals from overfeeding on the common property, there is no incentive for others to do the same; in fact, his restraint may prompt them to expand their own use of the field. Thus, the incentive is for everyone to overuse the natural resource.

Elizabeth Brubaker, executive director of Environment Probe, has researched the different incentive structures present in governments and markets. She has specifically argued that one of the main reasons governments continue to prove unable to manage natural resources efficiently and effectively is because of defective incentives. Using the case of overfishing, Brubaker identified four problems associated with government and its incentive structure (Brubaker, 1998):

(1) *Short-Termism*

Governments are generally unable to implement policies with time horizons that exceed the election cycle. Thus, governments often select public policies that have immediate returns, even if they result in long-term negative consequences.

(2) *Agency*

Participants in the political process are required to compromise between vying or competing interests in order to maximize votes.

This compromise process often leads to legislation that fails to increase the welfare of the general population; thus, governments are ineffective agents for the general public.

(3) *Special Interests*

Special interest groups armed with the ability to influence specific voters can exert enormous pressures, which can force government to implement legislation that may ultimately have negative effects on all except for the particular group exerting pressure.

(4) *Government Accountability*

The link between the outcome of specific decisions and the rewards or punishments experienced by government policymakers are extremely weak, if not absent altogether. Most often governments are not held accountable for each specific decision, but rather for their aggregate performance every four or five years.

A final economic consideration is the nature of the products the natural resource sector produces. By and large, this sector's products face internationally-determined prices. Firms must, therefore, focus more intensely on cost control since it is extremely difficult, if not impossible, to create premium-priced products based on marketing, distribution, or product differentiation. Currency exchange rates are also that much more crucial than in other sectors since much of this sector's production is exported.

The natural resource sector poses specific challenges that are not generally present in other areas of public policy, due to the government's ownership position. Also, the government faces specific incentive problems in making decisions, both within natural resource policy and in general. Finally, the general economics of regulation apply equally to the field of natural

resource regulation and, as will be demonstrated, one of the main challenges to the natural resource sector in British Columbia is the heavy hand of regulation.

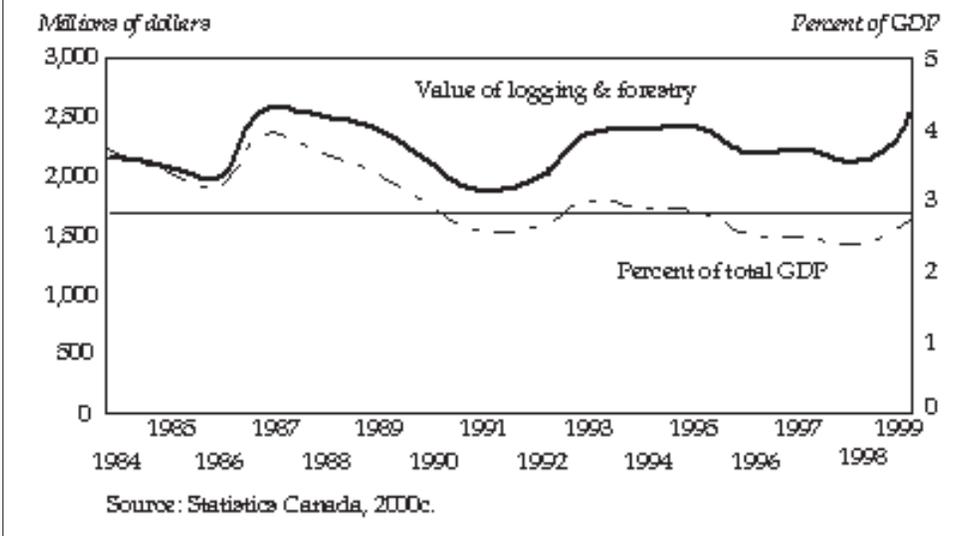
The State of Forestry in BC

Unfortunately for British Columbia, the forestry industry shows serious signs of decline. The sector's employment is well below levels previously maintained, its rates of return are lagging badly behind those in other jurisdictions, and capital expenditures are well below replacement values.

Before assessing current specific deficiencies in the forestry industry, let us examine some aggregate industrial data. Regulation Figure 6 depicts the real value of forestry and logging activities in British Columbia between 1984 and 1999, in both dollar terms and as a percentage of total GDP. Since peaking in 1987 at \$2.6 billion, representing 3.9 percent of GDP, logging and forestry activities have declined in dollar value and as a percent of GDP. In 1998, they totalled \$2.1 billion, or 2.4 percent of GDP. Logging and forestry activities recovered slightly in 1999, fuelled by a moderate increase in paper prices, increasing to \$2.5 billion, or 2.7 percent of GDP.

The provincial timber harvest remains well below the allowable annual cut (AAC)—the amount of timber available for harvesting each year as determined by the provincial government. Regulation Figure 7 shows the annual provincial timber harvest measured in millions of cubic metres along with the allowable annual cut. Except for 1993, each year's harvest has been below the permitted level. Even with a 26 percent increase in coastal harvesting, and a 13 percent increase in interior harvesting in 1999, the actual timber harvest remained 5.2 percent below the allowable actual cut (PWC, 2000b).

Regulation Figure 6: Logging & Forestry in British Columbia (1984-1999)



does not, exist in a vacuum. Any deterioration in the international market will affect the provincial industry.

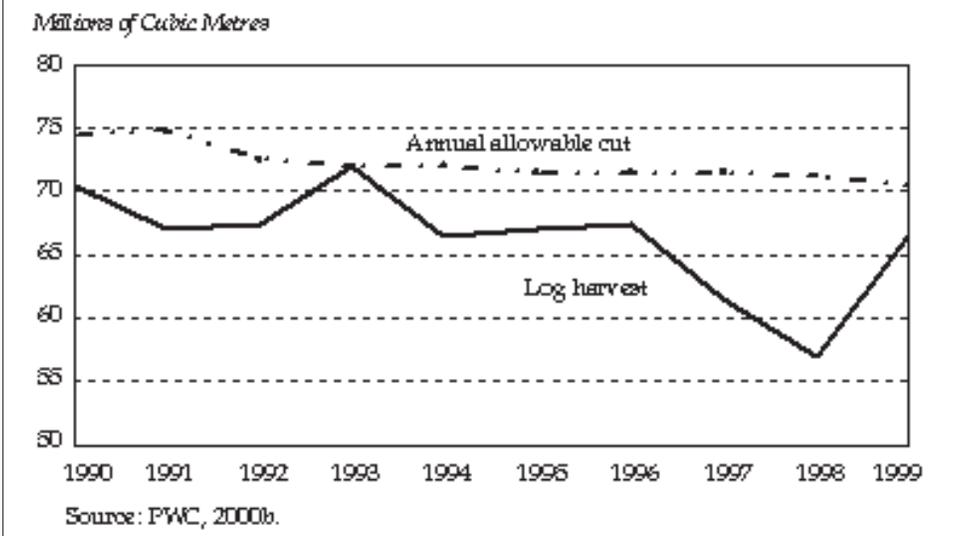
PWC, in its analysis of the BC forestry industry, concluded that over the last decade or so, British Columbia has implemented a number of policies that have impeded the development and operations of the forestry industry. For instance, the government implemented large-scale increases to stumpage fees, withdrew large

Effect of BC Regulation: Purposeful Decline of Forestry

The question for policy makers is whether the decline in British Columbia is simply part of a larger global decline in the industry or whether it is due to poor public policies. As discussed previously, British Columbia's forestry industry cannot, and

amounts of timber supply by doubling the acreage of parks and ecological reserves (from 6 to 12 percent of the province's land area), reduced the permitted harvest (annual allowable cut), and imposed a complex, process-based Forest Practices Code. The net result of these various initiatives has been to substantially increase the cost of operating in the forestry industry in BC while stifling the investment climate.

Regulatory Figure 7: Provincial Timber Harvest and the Allowable Annual Cut (AAC)



Increasing the Cost of Forestry

The Forest Practices Code, which includes restrictions and requirements aimed at preserving biological diversity and non-timber values, including wildlife and fish habitat, water quality, and even the visual quality of forests (Haley, 1996), is attributed with almost the entire increase in provincial-based log-

ging costs. Between 1989 and 1998, the average provincial logging cost increased from \$37 per cubic metre to \$57 per cubic metre. Inflation accounted for \$8, or 40 percent, of the increase. The entire remaining amount, \$12 per cubic metre, is explained by regulation costs associated with the Forest Practices Code (PWC, 2000a). The \$12 per cubic metre increase in average provincial logging costs is estimated to be roughly \$680 million per year in additional regulatory costs (PWC, 2000a). Another study estimated these additional costs to be roughly \$400 million per year with little or no significant social benefit (Van Kooten and Wang, 1998).

An additional cost increase imposed on the forestry industry that has had negative effects is the increase in stumpage fees—a cost charged to loggers by the province to harvest timber on Crown lands. The average stumpage fee increased from \$9 in 1991 to \$24 in 1998 (PWC, 2000a).

Both the Forest Practices Code and the “super-stumpage” fees were predicated on the government’s belief that the lumber market had fundamentally changed. The government believed that a floor had been reached in lumber prices. This meant that the increased costs imposed by government on forestry in British Columbia were deemed affordable, given the new price floor. The subsequent decline in lumber prices, which caught the government by surprise, significantly affected the performance of BC forest companies.

The above-mentioned additional costs (both government-imposed costs and the actual operational costs) have resulted in a significant increase in the average total cost of logging and forestry in BC. The average total cost of logging on Crown lands increased from \$45 per cubic metre in 1989 to \$81 per cubic metre in 1998, an 80.0 percent increase over 8 years (PWC, 2000a).

Another deleterious initiative undertaken by the government of British Columbia is the reduction

of allowable cuts in the province. While forestry companies have invested substantial sums in reforestation and reduced the backlog of unsatisfactorily reforested sites, the government has nonetheless reduced the allowable cut. This effectively reduces the potential supply of timber. It is not surprising, then, that a 1996 analysis incorporating the supply reduction anticipated massive employment reductions, roughly 45,000 jobs over a future 5- to 10-year period (MacCallum, 1996). In fact, in its analysis of the forestry industry in 2000, PWC concluded that total employment (direct and indirect) in the sector would have been 26,000 positions greater had production just met the allowable annual cut (PWC, 2000a).

Unionization and the corresponding increase in wages has also affected the forestry industry. The relatively high concentration of ownership in the sector has permitted large-scale union wage increases. In 1999, the average compensation per forest industry employee in BC, excluding benefits, was \$49,633—a premium above the average provincial wage of 52.7 percent (PWC, 2000a).

Much more than reducing stumpage fees must be done to decrease the costs of forestry in British Columbia. The tremendous cost increases, doubling between 1992 and 1997 alone (PWC, 2000a), must be reversed if British Columbia is to return to a position of prominence in the forestry industry. Another example of the decline in BC’s cost competitiveness is that ten years ago, British Columbia represented one of the low-cost producers in Canada; now is well below other jurisdictions, such as Ontario and Quebec, in its cost competitiveness.

Investment and Capital Deficiency

Apart from significant cost increases, the BC forestry industry also faces serious investment concerns because of uncertainty arising from

the ongoing negotiations with aboriginal groups to settle land claims. The as-yet-unknown results of these negotiations could have serious effects on natural resource rights in the province. This uncertainty is a major barrier to investment in the province (PWC, 2000a; and PWC, 2000b).

Cost increases coupled with investment uncertainty have resulted in a decline in the forestry industry's performance in British Columbia. PWC estimates that a minimum threshold for return on capital to ensure reinvestment in the forest industry is roughly 12 percent. Rates of return on capital employed (ROCE) have lagged in British Columbia relative to rates achieved in the rest of Canada. PWC calculated the 1999 five-year average rate of return on capital employed in British Columbia at 2.9 percent compared with an average rate of return of 8.1 percent in the rest of Canada (PWC, 2000b). The rate of return gap in 1998 for the BC interior relative to the rest of Canada was 12.4 percent while the rate of return gap for the BC coast was 14.4 percent for the same year (PWC, 2000a). Across the board, British Columbia has been unable to compete with its Canadian counterparts, largely due to poor government policy, increasing costs, and constrained supply.

A serious concern for the future of BC's forestry industry is the poor record of capital investments made by forestry companies in recent years. This should not be surprising, given the forestry sector's poor performance in generating positive and competitive rates of return. Gross capital expenditures fell below depreciation values in both 1998 and 1999 by \$306 million and \$255 million respectively (PWC, 2000b). The deficiency in capital expenditures has led to serious fears of dis-investment, since new capital is not replacing depreciated capital. If this trend continues, the assets, and thus the productive capacity of the forestry industry in British Columbia, will continue to decline.

Attempts at Improvement

There have been a number of recent improvements in government policy aimed at revitalising the forestry industry. For instance, the government has accepted, at least in principle, the need to move from the process-based Forest Practices Code to a simpler, results-based code; it has asked industry to assist in developing new guidelines, and has enacted some pilot projects.

The government has also attempted to mitigate the difficulties it created when it increased stumpage fees. It has introduced modest reductions in stumpage and Forest Practice Code costs since 1998. Average total logging costs on Crown land (including stumpage) were estimated by PWC to have declined to \$75 per cubic metre in 1999 from \$81 per cubic metre in 1998, a reduction of 7.4 percent. However, average total logging costs are still 66.7 percent higher than they were in 1991 (PWC, 2000a).

Just as this study was going to print, the provincial government announced an agreement with coastal forestry companies to phase out the stumpage fee system and replace it with a market-based stumpage system (Hamilton, 2001). BC Forests Minister Gordon Wilson stated that the ministry could reduce forestry costs by as much as \$400 million per year. The Minister specifically stated that a new policy regime would be implemented by March 1st of this year (Hamilton, 2001).

Increasingly, small businesses and community forestry initiatives are joining the forestry sector. In an effort to diversify the industry, the provincial government has been allocating an increasing volume of timber to small businesses, value-added projects, and community forest initiatives (referred to as tenures). Although these initiatives are a step in the right direction, they are piecemeal attempts to compensate for a top-heavy regulatory regime—an inferior approach to pursuing greater private ownership and competitive markets.

Conclusion

The potential for increased employment, greater capital investment, and profitability in the industry remain the purview of government, since most of the difficulties currently facing the industry are government-driven. A responsible and balanced approach to forestry must emerge involving outcome-focused regulation, based on cost-benefit analyses. If British Columbia is to return to a position of economic leadership and prominence, the forestry industry and its rebirth must be a central part of the process.

Policy Recommendations

*[The policy recommendations included for the natural resource sector are largely based on those made in the 1998 report by Satinder Chera and Fazil Mihar, **The Government of British Columbia, 1991-1998: An Assessment of Performance and a Blueprint for Economic Recovery.**]*

Most, if not all of the recommendations listed below, are equally applicable to other natural resource sectors not covered in this study. For instance, mining, which has enormous potential in the province, has been plagued by many of the same problems discussed above and would, therefore, benefit from some of the same types of policy changes recommended below.

(1) Create a pro-development natural resource investment and business climate.

The last decade has been characterized by a generally anti-business climate in BC, which has had disastrous effects on business investment. The government of British Columbia must make real efforts to reverse the business climate and create conditions conducive to investment. Part of these efforts in the natural resource sector will include streamlining regulations with emphasis on outcomes rather than process, and taking a more pro-

development stance. It is interesting that the results of The Fraser Institute's most recent *Mining Survey* corroborate the need for an improved investment climate. For instance, of the nine policy factors examined, British Columbia scored the worst on 8 of any of the 35 jurisdictions (Fredricksen and Jones, 2000). Clearly, British Columbia needs to adopt a more pro-development view of natural resources, and indeed of the economy as a whole.

(2) Privatize forests that are currently owned and managed by the Crown.

Given the evidence presented on the adverse impact government policies have had on forestry in British Columbia, the best solution for managing the industry efficiently would be to privatize Crown-owned forests in British Columbia. One of the biggest problems with state ownership of forests is that neither government nor private companies logging on Crown lands have any incentive to operate efficiently, to replant, or to harvest prudently.

Governments have little incentive to replant since the main beneficiary of this initiative will be some other government in power later, when the trees mature. Since private companies harvest on land that they themselves do not own, they see no direct benefit or economic incentive to invest in costly long-term "forest enhancement." In short, both see short-term benefits in harvesting, but no long-term value in replanting and forest enhancement programs.

Rather, as Lawrence Solomon, executive director of Environment Probe pointed out: "Private owners don't cut at a loss, they don't cut for employment reasons, and they manage their forests not as an undifferentiated commodity but as multi-purpose properties with timber being but one asset" (Solomon,

1989). Since “the long-term value of an asset is the present value of the long-term stream of income from it, a private owner with secure property rights will act to preserve that long-term income stream” (Robson, 1992, p. 39). Hence, private ownership would put an end to lumber disputes between Canada and the United States and provide economic incentives for implementing replanting programs and for harvesting at sustainable yields.

For instance, in 1991, Abitibi Price began cleaning up its half-million acres of land near Thunder Bay, Ontario. Three years later, it turned one section of the land into a money-making park and made plans to lease cottages around some remote lakes. The company stated: “We can market our products—our forest and lakes—better and get more value from them” (Brubaker, 1997). Canadian Pacific made a similar decision with its game reserve near Montebello, Quebec. The company manages the property for forestry and tourism purposes. In the process, it has not only created jobs, but has also succeeded in preserving the natural beauty of the region. Private owners have financial incentives to protect the long-term value of their property because to do otherwise would have an adverse impact upon the long-term profitability of their enterprises.

Serious questions have, however, been raised regarding the possibility of forestry privatization given unresolved aboriginal land claims. This is particularly true in the wake of the Supreme Court of Canada’s *Delgamuukw* decision, which effectively ruled that the province has no capacity to extinguish native rights and that aboriginal title may well hold in many areas of the province. The presence of possible native land claims, although an immediate barrier to privatization, does not negate its long-term efficacy.

(3) Repeal the Forest Practices Code and the Forest Renewal Act.

Both the Forest Practices Code and the Forest Renewal Act have more to do with increasing the regulatory burden on the forest industry than generating positive environmental outcomes. Haley estimated that the Forest Practices Code will cost the provincial economy \$1.4 billion per year in lost economic activity, but will fail to reach even its own objective of sustainable forest resources development (Haley, 1996). Like the Forest Practices Code, the Forest Renewal Act is also more oriented towards process than towards outcomes. The government should repeal these bills and rely on common-law remedies and private ownership of the forests to protect the environment. Further, a results- and performance-based forest code that establishes key performance targets and objectives, and provides business operators flexibility to meet the targets in the most efficient manner should be enacted to replace the Forest Practices Code.

(4) Eliminate the minimum stumpage fee and link stumpage fees to world prices.

Since coming to power in 1991, the NDP government has increased stumpage fees by nearly 200 percent. These payments are now part of the cost of production. As a result, British Columbia forest companies have become costly producers of lumber and other forest products, a situation that has led to lower levels of output and reduced employment. Given that world lumber prices fluctuate constantly, the provincial government should put in place a mechanism for linking stumpage fees to the price of lumber in order to allow companies to remain profitable and viable well into the future. As this study went to print, the provincial government had indicated that they were indeed going to move to

wards a market-determined stumpage fee process (Hamilton, 2001).

(5) Eliminate the British Columbia Environmental Assessment Act.

British Columbia's Environmental Assessment Act results in cumbersome and time-consuming processes that lead to allocative inefficiencies. The government should repeal this act and rely on common-law remedies to ensure protection of the environment. Its one-size-fits-all process of assessing the environmental impact of projects around the province fails to take into account the uniqueness of each project and the possible negative externalities arising from each. The assessment mechanism overestimates the impact of certain projects and so deprives the provincial economy of higher levels of economic activity when these projects are not undertaken.

(6) Subject the setting aside of Crown land for parks and heritage sites to cost/benefit analysis.

The government must immediately stop the practice of turning Crown lands into provincial parks or heritage sites without a cost-benefit analysis. This move would ease the uncertainty over land use in the province and lead to a more stable investment climate and would ensure that land is devoted to its highest-value use.

(7) Co-ordinate land claim settlements with forest privatization.

Future development in the resource sector requires final settlement of native claims and conversion of settlement resource values into marketable private property rights. This will ensure a secure and level playing field is established for all current and future investors.

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Recommended Readings

[*Note: For complete publication data, please see the list of references.*]

Elizabeth Brubaker (1997). *No Expropriation Without Full Compensation.*

Elizabeth Brubaker (1998). *Property Rights: Creating Incentives and Tools for Sustainable Fisheries Management.*

Harry Nelson (1998). *Seeing the Forest as well as the Trees.*

PriceWaterhouseCoopers (2000). *The B.C. Forest Industry: Unrealized Potential.*

PriceWaterhouseCoopers (2000). *The Forest Industry in British Columbia, 1999.*

PriceWaterhouseCoopers (2000). *The Mining Industry in British Columbia, 1999.*

Health Care: Getting British Columbia Healthy Again

In a short 35 years, socialized health care has become one of Canada's defining characteristics. Unfortunately, as the following analysis will illustrate, Canadian health care is in a self-imposed crisis due to a poorly formulated institutional structure.

This section begins with the general economics associated with health care as well as a discussion of the implications of the Canada Health Act. It then presents health care results, such as access to technology and waiting times for both Canada and British Columbia. It summarizes the reforms undertaken in a number of countries in order to catalogue some of the alternatives available, and also summarizes the RAND study on health premiums and consumption. As with all policy sections, this one concludes with a series of policy recommendations for British Columbia; included in this are measures that assume the repeal of the Canada Health Act, or at least a failure on BC's part to comply.

Economics of Health Care

Like the provision of welfare, health care is affected by the economics of moral hazard. Moral hazard exists when individual behaviour changes following the introduction of an insurance program. In other words, by its very presence, an insurance scheme or similar program, such as health care, reduces the costs of certain behaviour and thus alters the actions of individuals accordingly.

This can be seen quite clearly in how health care is "purchased" in Canada. Decisions that have adverse health consequences, such as smoking, do not influence the "purchase" price of health care for individuals, as they do life insurance, since health care is financed by various taxes, not purchased directly. There is no direct penalty in

terms of the cost of health insurance for those who choose unhealthy lifestyles since the full cost of smoking is not fully borne by the individual.

Impeding the Use of Markets: the Canada Health Act

To a large extent, the Canada Health Act prevents the use of market mechanisms to allocate resources within the socialized portion of the Canadian health care system. By legislative dictum, the federal government has precluded voluntary choices and forced a command-and-control system of resource allocation in health care.

Health care delivery, although largely a provincial responsibility, is nonetheless constrained by the federal government through its financing and associated regulatory power. The federal government effectively oversees the health care system in Canada under the auspices of the Canada Health Act and its accordant ability to withhold transfer payments as a means of disciplining provinces that contravene the act.

Canada Health Act (1984)

In 1984, the federal government, in spite of opposition from organized medicine and some provincial governments, passed the Canada Health Act, which reaffirmed the principles of the Medical Care Act of 1966 and added an additional principle: accessibility. By adding accessibility as a principal of Canadian health care, post-1984 the federal government could assess dollar-for-dollar penalties by reducing provincial transfers for any user fees or extra billing that the provinces permitted.

Although the original intent of socialized health care was a 50-50 federal-provincial split in health care funding, the last 30 years has seen a dramatic

decrease in the amount of health care funded by the federal government. For instance, in 1970, the provincial government of Saskatchewan, the birthplace of Canadian socialized medicine, contributed 36 percent of that province's total health care funding. By 1990, its contribution had increased to 73 percent, a 103 percent increase in the proportion funded by the province (McArthur, Ramsay, and Walker, 1996).

Five Principles of the Canada Health Act

It is worth discussing briefly the five principles of the Canada Health Act—universality, accessibility, portability, comprehensiveness, and public administration—to understand the constraints it places on health care delivery.

Universality requires that 100 percent of a province's residents receive health insurance. In other words, universality requires that every Canadian receive medical care. However, it is quite clear that universality does not exist. For instance, even though low-income households in British Columbia are exempt from paying medical premiums, the BC Ministry of Health concluded that only 97 percent of BC residents were actually covered by the Medical Services Plan. In other words, nearly 100,000 British Columbians were without public health insurance (McArthur, Ramsay, and Walker, 1996).

Accessibility refers to the principle that financial and other barriers should not preclude access to health care services. Put differently, one of the goals of socialized medicine is to prevent wealthy Canadians from purchasing higher quality, or faster, better, health care service. The data, however, shows quite clearly that Canada's health system is not equally accessible to all. For example, BC Workers' Compensation uses private clinics to jump queues in order to reduce their own costs by more speedily returning workers to work. Similarly, research in British Columbia

concluded that queue-jumping was mainly undertaken for non-medical reasons, and those most likely to queue jump were those in positions of prominence, such as politicians, health professionals, celebrities, and others of high influence (Alter, Basinski, and Naylor, 1998; and Amoko, Modrow, and Tan, 1992). In fact, a number of studies, including one completed in 2000, concluded that the poor had less access to medical specialists than wealthier Canadians (Alter et al., 1999; Dunlop, Coyte, and McIsaac, 2000). In addition, long and worsening waiting lists for medical procedures and access to medical specialists have become the norm in the Canadian health system rather than the exception.

Portability refers to the ability of Canadians to travel out-of-province or abroad without fearing loss or lack of applicability of health care coverage. In reality, portability is limited, even within Canada. For instance, Quebecers travelling to other provinces must pay all medical expenses out-of-pocket, then request reimbursement from their government. The province will only reimburse the equivalent costs in Quebec. Any cost difference is borne by the resident.

The fourth principle, *comprehensiveness*, implies that the Canadian public health care system will cover all, or at least the most necessary health care services. However, the list of services covered by the various provincial health plans is by no means exhaustive. In fact, in 1999, public expenditures on health care covered only 69.5 percent of total health care expenditures in Canada. Thus, a little over 30 percent, or nearly one-third of all health care expenditures were made privately (OECD, 2000).

The Canada Health Act's fifth principle is *public administration*. There is nothing about the principles of universality, accessibility, portability, or comprehensiveness that require health insurance to be publicly administered (McArthur, Ramsay, and Walker, 1996). However, the Canada Health

Act does require that health care be publicly administered. The rationale for public administration has been cost minimization. It was believed that a single provincial insurer providing first-dollar coverage of all insured services (meaning zero deductibles) would minimize administrative costs. This belief overlooked the fact that creating a monopoly brings about its own set of costs: higher prices, lower quality service, lagged innovation, and poor customer satisfaction (McArthur, Ramsay, and Walker, 1996). Additionally, recent work by economists at the University of Chicago suggests that theoretical savings from risk-pooling in life insurance markets do not, in fact, exist, implying that the monopoly provision of health insurance in Canada may be largely ill-founded (Cawley and Philipson, 1999). Thus, public administration and the subsequent monopolization of health care in Canada may come at a very high cost and with very little benefit.

Markets Versus Government

The net effect of the Canada Health Act is to significantly tilt the provision and financing of health care in Canada away from markets and towards government command and control. Under the act, health care in Canada is a single-payer, fee-per-service system. Since the single payer is the state, consumers are not charged for their consumption of most health care services. Physicians who supply medical services bill the government for each service rendered at a rate collectively negotiated with the government. Hence, market prices do not emerge as a mechanism for resource allocation.

Economics 101: Demand Curves Slope Downwards

The emergence of waiting lists should not surprise anyone familiar with basic economics. A central principle of economics is the “law of demand,” which tells us that, all other things being

equal, the quantity demanded of a particular good rises as the price of that good falls. This well-established law of economics applies forcefully to the market for health care: as the relative price of health care falls, people consume more of it. Hence, if the price of health care is negligible, we would expect the demand for it to be very high.

That the “law of demand” should apply to health care is not only intuitively obvious; it also receives a great deal of empirical support. Perhaps the most decisive empirical test of this proposition was provided by the RAND Corporation in its Health Insurance Experiment (Newhouse and the Health Insurance Group, 1993). Researchers at RAND observed the behaviour of families who were assigned to different health insurance plans and tracked over 10 years. Some families received complete insurance (zero price for health care) while other families received only partial coverage for their health care expenses. Researchers confirmed that families with more health insurance consumed more health care. In other words, as the price for routine medical expenses rises, people consume less health care. Moving households from full insurance to co-insurance has the effect of reducing consumption of health care services. More importantly, the study did not observe negative health effects on non-low-income households that used less health care due to the presence of deductibles and other user fees.

State of Canadian Health Care

Health Care Table 1 contains information on health care expenditures for OECD countries. It strongly suggests that Canada’s health care difficulties are not rooted in the level of health care spending. For instance, in 1998, Canada ranked 5th among OECD nations in health care expenditures relative to the size of the economy. Only the US (13.6%), Germany (10.6%), Switzerland (10.4%), and France (9.6%) spent more on health care as a percentage of the economy than Canada

Health Care Table 1: OECD Health Statistics (1998)								
	Total Per Capita Health Expenditures (PPP\$)*	OECD Rank	Total Health Expenditures as a % of GDP	OECD Rank	Public Health Expenditures as a % of GDP	Public Health Expenditures as a % of Total Health Expenditures	Private Health Expenditures as a % of GDP	Private Health Expenditures as a % of Total Health Expenditures
USA	4,178	1	13.6	1	6.1	44.9%	7.5	55.1%
Switzerland	2,794	2	10.4	3	7.7	74.0%	2.7	26.0%
Norway	2,425	3	8.9	6	7.4	83.1%	1.5	16.9%
Germany	2,424	4	10.6	2	7.9	74.5%	2.7	25.5%
Canada	2,312	5	9.5	5	6.6	69.5%	2.9	30.5%
Luxembourg	2,215	6	5.9	26	5.4	91.5%	0.5	8.5%
Denmark	2,133	7	8.3	12	6.8	81.9%	1.5	18.1%
Iceland	2,103	8	8.3	12	7.0	84.3%	1.3	15.7%
Belgium	2,081	9	8.8	7	7.9	89.8%	0.9	10.2%
France	2,077	10	9.6	4	7.3	76.0%	2.3	24.0%
Netherlands	2,070	11	8.6	8	6.0	69.8%	2.6	30.2%
Australia	2,043	12	8.5	9	5.9	69.4%	2.6	30.6%
Austria	1,968	13	8.2	15	5.8	70.7%	2.4	29.3%
Japan	1,822	14	7.6	18	6.0	78.9%	1.6	21.1%
Italy	1,783	15	8.4	10	5.7	67.9%	2.7	32.1%
Sweden	1,746	16	8.4	10	7.0	83.3%	1.4	16.7%
Finland	1,502	17	6.9	21	5.3	76.8%	1.6	23.2%
U.K.	1,461	18	6.7	23	5.6	83.6%	1.1	16.4%
Ireland	1,436	19	6.4	24	4.8	75.0%	1.6	25.0%
New Zealand	1,424	20	8.1	16	6.2	76.5%	1.9	23.5%
Portugal	1,237	21	7.8	17	5.2	66.7%	2.6	33.3%
Spain	1,218	22	7.1	20	5.4	76.1%	1.7	23.9%
Greece	1,167	23	8.3	12	4.7	56.6%	3.6	43.4%
Czech Rep.	930	24	7.2	19	6.6	91.7%	0.6	8.3%
Korea	730	25	5.0	27	2.3	46.0%	2.7	54.0%
Hungary	705	26	6.8	22	5.2	76.5%	1.6	23.5%
Poland	496	27	6.4	24	4.7	73.4%	1.7	26.6%
Average		1,795.6	8.2		6.0		2.1	

*Purchasing Power Parities (PPPs) are the rates of currency conversion that eliminate the differences in price levels between countries. Source: OECD 2000; calculations by the author.

Health Care Table 2: Medical Technology in the OECD (1997)

Technology	Number per Million People	OECD Average	Canada's Rank	Number of OECD Countries*
CT Scanners	8.1	12.9	21	28
Radiation Equipment	5.3	4.2	6	17
Lithotriptors	0.4	1.4	19	22
MRIs	1.7	3.9	19	27

*Data was not available for some OECD countries.
Sources: Harriman, McArthur, and Zelder (1999), and OECD Health Data (1998).

Even in radiation equipment, the one area where Canada performs well, early warning signs are now emerging that Canada faces problems. For instance, in October of 2000, the Canadian Association of Radiologists warned that up to half of all radiology services, ranging from ultrasounds to CAT scans, could be shut down unless updated or replaced (Arnold, 2000).

(9.5%) (OECD, 2000). Canada also ranked 5th in the dollar value of health expenditures, as measured by purchasing power parity (OECD, 2000).

While Canada spends more than most OECD countries on health care, given our high level of government intervention in its provision, one would expect the health care system to show the traditional outcomes of such intervention: higher prices, lower quality service, and lagged innovation. In addition, given the absence of a functioning price system, we would also expect to see rationing as an alternative mechanism for allocating medical resources. Unfortunately for Canadian health care consumers, that is exactly what we observe.

Health Care Table 2 gives information on select medical technologies and their availability in the OECD countries. Despite spending 28.8 percent more than the OECD average on health care, Canada performs quite poorly with respect to access to medical technologies. For instance, Canada ranks 21st of 28 OECD countries with respect to access to CT Scanners (Harriman, McArthur, and Zelder, 1999). In fact, of the four technologies examined, Canada is only competitive in access to radiation equipment.

The lack of a functioning price system in health care has necessitated the use of rationing as a means of allocating health care resources. The result of rationing is that people must wait for medical procedures and treatment. In fact, waiting times have significantly increased over the last 7 years—the longest period for which comprehensive and comparable data are available. For instance, between 1993 and 1999, the median wait between referral by a general practitioner and seeing a specialist increased from 3.7 weeks to 5.6 weeks (Zelder, 2000d). Similarly, the median wait time between an appointment with a specialist and receiving treatment increased from 5.6 weeks in 1993 to 8.4 weeks in 1999.

In 11 of 12 specialty categories (e.g., neurosurgery, orthopaedic surgery, and medical oncology) the median wait times between both the referral and specialist appointment, and between the specialist appointment and treatment increased between 1993 and 1999. In some cases, the increases were quite large. For instance, the total median wait time for neurosurgery increased from 12.9 weeks in 1993 to 18.2 weeks in 1999, an increase of 41.1 percent. Canadians are clearly waiting longer for medical treatment (Zelder, 2000d).

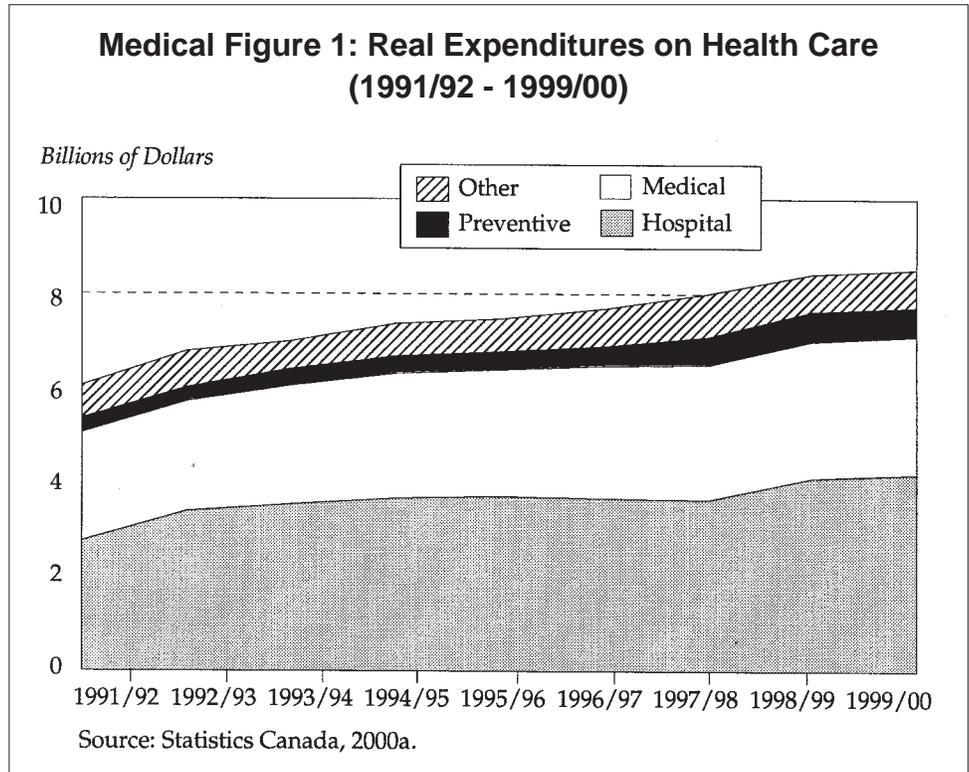
The State of British Columbia's Health Care

Cost of Health Care

Unfortunately for British Columbians, the state of the health care system in BC mirrors the state of Canada's overall health care system. According to budget estimates, British Columbia will spend \$8.3 billion on health care in fiscal 2000/01, representing 37.1 percent of total budgeted provincial expenditures (BC Ministry of Finance & Corporate Relations, 2000a). This figure does not include an additional \$500 million in health care spending announced in December 2000. Excluding the extra \$500 million, the BC Government expected health care expenditures to increase 7.1 percent over last year. British Columbia, like Canada as a whole, devotes a great deal of resources to health care without achieving corresponding results.

A more precise method by which to assess expenditure data is through Statistics Canada's Financial Management System (FMS). The FMS is a standardized system of accounting that allows for easy inter-provincial comparisons.

According to the most recent FMS information, British Columbia spent \$8.5 billion on health care in the fiscal year 1999/00. The FMS divides health care spending into four major categories: hospital care (\$4.2 billion), medical care (\$2.9 billion), preventive care (\$582.0 million), and other (\$800.5 million) (Statistics Canada, 2000a). As Health Care Figure 1 depicts, total real expenditures on health care have increased an astounding 40.5 percent since 1991/92.



According to FMS data, expenditures on health care represent 33.2 percent of total provincial expenditures, the single largest envelope of provincial expenditures. In fact, expenditures on hospital care (16.4%) represent the single largest area of expenditure, with K-12 education following closely at 16.0 percent of total expenditures (Statistics Canada, 2000a).

Medical Technology

The state of medical technology in BC is as troubling as Canada's ranking in the OECD for access to medical technology. A 1999 case study investigating access to a variety of medical technologies in British Columbia, Washington State, and Oregon concluded that British Columbia lacked, both in relative and absolute terms, access to a host of medical technologies (Harriman, McArthur, and Zelder, 1999). Health Care Table 3 summarizes the results from the case study for a variety of medical technologies.

Health Care Table 3: Case Study on Technology (1997/98)

Technology	Percent of Hospitals with Technology		
	Washington State	Oregon	British Columbia
Ultrasound	100	100	100
CT Scanner	100	100	90
Nuclear Medicine	100	90	80
MRI	100	80	20
Lithotripsy	70	90	0
PET Scanner	10	0	0
Spectroscopy	60	40	60

Source: Harriman, McArthur, and Zelder, 1999.

Except for ultrasound, CT scanners, and spectroscopy, British Columbia maintains substantially lower levels of access to technology than either Washington State or Oregon. For example, the percentage of hospitals with MRI technology in British Columbia was a pale 20

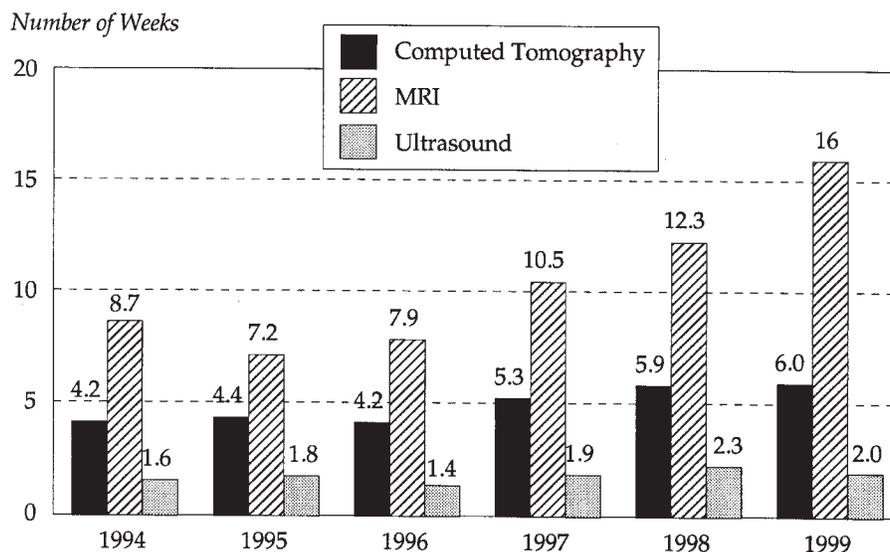
percent, while Washington State and Oregon maintained significantly higher levels of access, namely, 100 percent and 80 percent, respectively.

In fact, the wait times for access to the available technologies have been increasing. Health Care Figure 2 illustrates the median wait times for computed tomography, MRIs, and ultrasound in British Columbia from 1994 through 1999. The largest increase in waiting time occurred for MRIs, which increased from 8.7 weeks in 1994 to 16.0 weeks in 1999.

Rationing in British Columbia

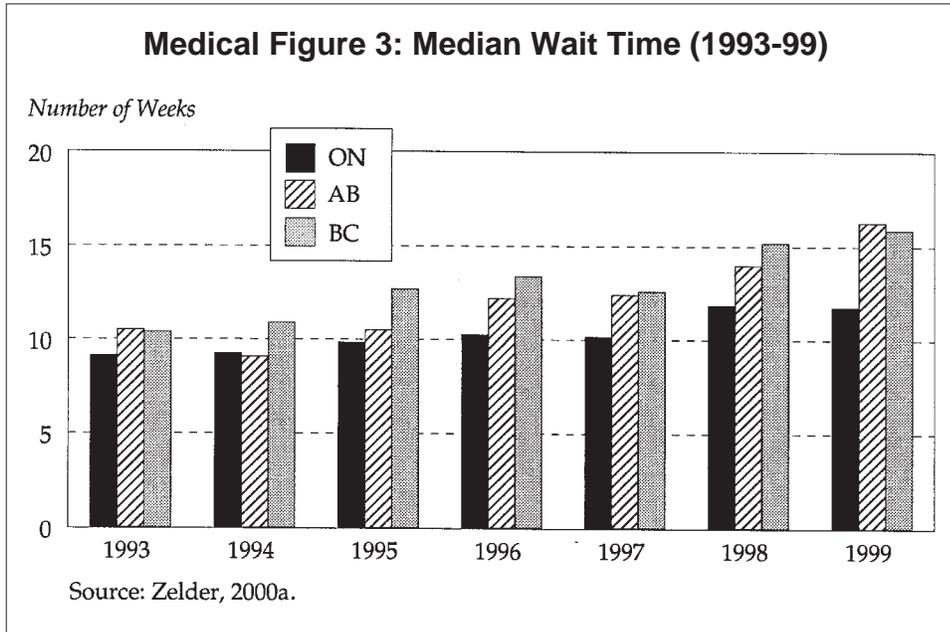
British Columbia's performance in reducing, or at least maintaining waiting times, is equally as disturbing. As Health Care

Figure 3 depicts, the total median wait time in British Columbia has increased from 10.4 weeks in 1993 to 15.8 weeks in 1999, an increase of 51.9 percent. It is also substantially above the median wait time maintained by Ontario (11.8 weeks) and only marginally below Alberta's wait time (16.3 weeks).

Medical Figure 2: Waiting Time for Technology (1994-1999)

Sources: Zelder, 2000a; and Harriman, McArthur, and Zelder, 1999.

British Columbia fared even worse with respect to total wait times for specialists. Health Care Figure 4 shows the wait times for three select specialties: orthopaedic surgery, cardiovascular surgery (urgent), and radiation oncology. In all three categories, British Columbia's waiting times exceeded those of Alberta, Ontario, and the Canadian weighted average. In cardiovascular surgery (urgent), for instance, British



Columbia's wait time exceeded Alberta's, Ontario's, and the Canadian average by 4.8 weeks, 4.7 weeks, and 4.2 weeks, respectively.

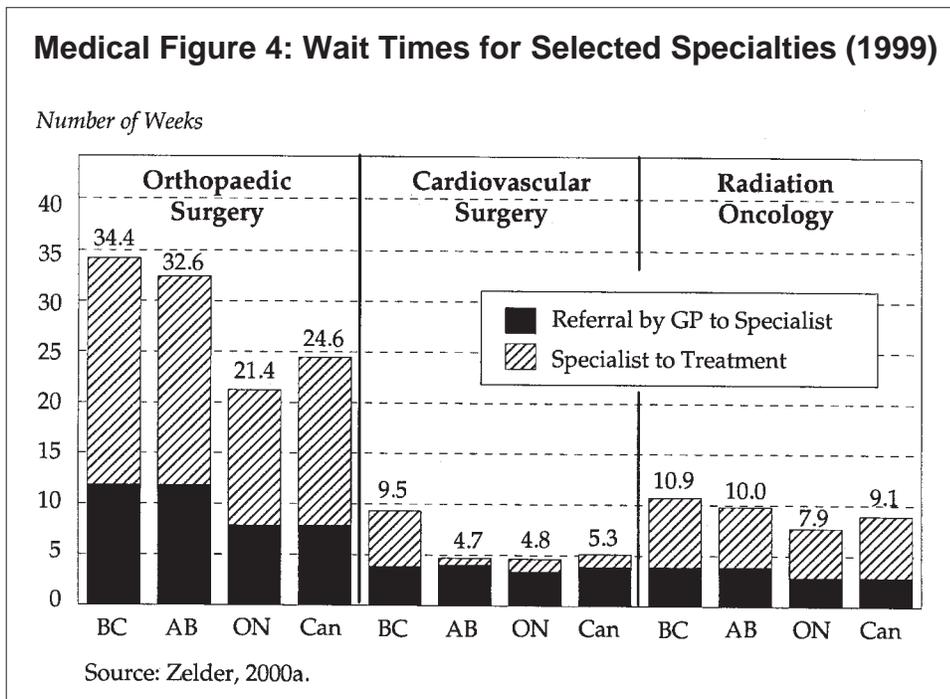
The trend with respect to wait times for specialists (appointments and treatment) has generally been worsening. Health Care Figure 5 depicts the trend for orthopaedic surgery and radiation oncology between 1993 and 1999. The wait time for orthopaedic surgery has increased by 12.2 weeks,

wherein resources are not always used most productively. For example, a study completed by Martin Zelder of The Fraser Institute examining health spending and waiting times concluded that between 1993 and 1998, additional health spending did not result in reduced waiting times or increased rates of treatment by specialists, implying that funds were not used productively (Zelder, 2000e).

representing a 55.0 per cent increase, while the wait time for radiation oncology experienced a marginal decrease.

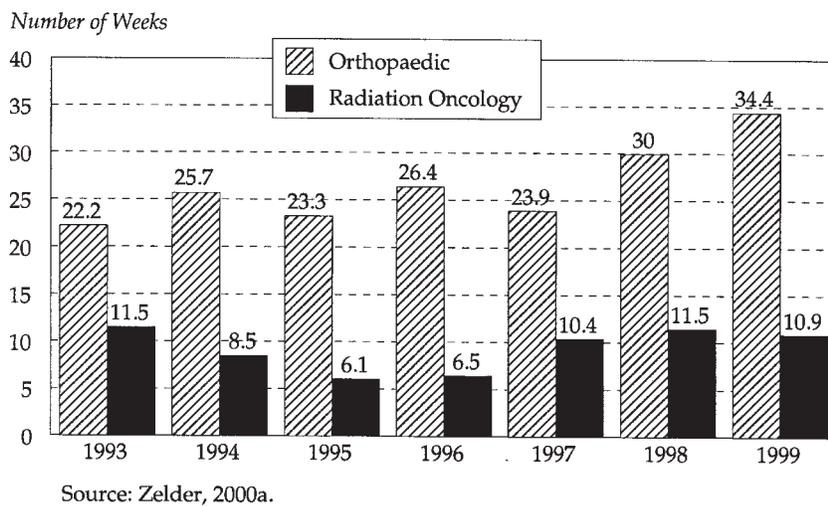
Other Problems Plaguing Health Care

Several factors apart from rationing are contributing to waiting times not just in British Columbia, but in Canada. For instance, the lack of a health care pricing mechanism has resulted in a situation



High unionization rates in the health care sector have created another challenge to its effective and efficient delivery: high labour costs. Health economist Cynthia Ramsay investigated the cost of wages and salaries in health care in 1995 and concluded that roughly 4.0 percent of the entire health care budget could be saved if the wages and salaries paid to non-medical staff were market-based, as opposed to union-imposed.

Medical Figure 5: Selected Specialties Total Wait Time (1993-99)



waiting times increased from 9.7 weeks in 1993 to 15.8 weeks in 1999 (Zelder, 2000a).

Two International Examples of Health Care Alternatives

It is clear that health care in this province—and this country—is in need of a serious solution to the many problems currently facing it. Fortunately, there are myriad available alternatives. The following section briefly presents such two alternatives based on the experiences of Germany and its two-tier health care system, and Singapore, which uses a system of mandatory savings to finance health care.

For example, an analysis of 18 employment categories at the Royal Columbian Hospital revealed a wage premium of \$3.94 per hour relative to comparable private sector positions. For instance, purchasing clerks employed in the health care sector received a 50 percent wage premium over their market counterparts; laundry workers garnered a 34 percent wage premium. The range of wage premiums in the health care sector relative to comparable market-determined wages ranged between 25 percent for store attendants and 63 percent for painters (Ramsay, 1995). In fact, had it paid market wages for non-medical services the savings for the Royal Columbian Hospital in 1995 alone would have amounted to some \$5.4 million, the equivalent of 3.3 percent of its annual budget (Ramsay, 1995).

Germany: Two-Tier Health Care in Action

[This section on German health care is based largely on the work of Dr. William McArthur, Cynthia Ramsay, and Michael Walker in their 1996 book, *Healthy Incentives: Canadian Health Reform in an International Context*. The book is available on the Internet at www.fraserinstitute.ca/publications/books/health_reform/.]

Another problem affecting British Columbia's waiting times, and which is generated by hospital employees' high unionization rates, is work stoppages. Recent analysis by The Fraser Institute's Martin Zelder has concluded that work stoppages aggravate waiting times. For instance, the number of strike days (per capita) lost in the health care sector in British Columbia increased from 4.1 days in 1993 to 27.9 days in 1999, while

Germany has been described as a "midpoint in the spectrum of systems that countries have adopted to protect their populations against the financial consequences of illness" (McArthur, Ramsay, and Walker, 1996, p. 63). Germany maintains a two-tier health care system: one tier is private and the other public. In 1992, 87.9 percent of German citizens were covered by the public system, referred to as Statutory Health Insurance

(SHI). A little over ten percent (10.3%) were covered by private health insurers. The remaining citizens were split evenly (1.6 percent each) between a state program covering civil employees and welfare recipients, and citizens voluntarily choosing no insurance (McArthur, Ramsay, and Walker, 1996).

Citizens may only opt out of the public system if their income reaches a certain pre-determined threshold, or they are self-employed. In 1995, the threshold was DM 5,850 per month (roughly \$4,300 Canadian). All others, including students, the unemployed, farmers, and workers earning less than the threshold, are automatically covered by the public system.

As one would expect, the two systems operate quite differently. The public system is financed through a dedicated payroll tax of 13.2 percent (as of 1995) up to a threshold income of DM70,200 per year (roughly \$52,000 Canadian). The payroll taxes are unrelated to usage, risk, or demographics. Further, user fees and co-payments are limited. Thus, there is very little connection between health care costs and individual payment. The public system is also characterized by heavy regulation, the aim of which is to control costs.

The private system, on the other hand, is characterized by heavier reliance on market mechanisms for the allocation of health care resources. For instance, contribution rates vary according to usage and risk, largely based on sex and age. Contribution rates also reflect the medical history or risk of the insured.

Germany's two-tier health care system has permitted greater diffusion and use of technology—Germany ranks 9th in CT Scanners, 8th in radiation equipment, 8th in lithotriptors, and 6th in MRIs (Harriman, McArthur, and Zelder, 1999).

The incorporation of some of Germany's health care policies, particularly the ability to opt out of

the public system and the subsequent development of a private, parallel system, would inevitably ease the pressures currently daunting Canada's public health care.

Singapore: Mandatory Savings

*[This section on the Singaporean health care system is based largely on the work of Dr. Thomas A. Massaro and Yu-Ning Wong in their study **Medical Savings Accounts: The Singapore Experience**, and to a lesser extent on the work of Mukul G. Asher and his study, **Compulsory Savings in Singapore: An Alternative to the Welfare State**. Both are available electronically on the Internet at www.ncpa.org.]*

Rather than provide social welfare services such as welfare and health care directly, the government of Singapore uses forced savings, through which individuals accumulate funds to expend on these programs. The Central Provident Fund (CPF) is a government-required system of individual savings that is used for everything from retirement to home purchases, health care expenditures, education, and investing.

Singapore maintains three separate health care programs under the auspices of the CPF: Medisave, Medishield, and Medifund. Medisave was enacted in 1984 to help citizens meet their individual health care responsibilities. Contributions are graduated according to income and age. They begin at 6 percent of total wages and rise to 7 percent at age 35 up to a maximum contribution of S\$360 per month (roughly \$412 Canadian). Contributions increase to 8 percent at age 45 up to a maximum of S\$450 per month (about \$515 Canadian).

Once an individual's Medisave account reaches S\$16,000 (roughly \$18,300 Canadian), all future contributions are redirected to their Ordinary account, also part of the CPF. Medisave funds can be used at all public and private hospitals. In fact, in 1992, 83 percent of hospitalized patients

used at least a portion of their Medisave accounts to pay for their hospital bills (Massaro and Wong, 1996).

The second health care account, Medishield, was established in 1990 after it was determined that low-income workers were unable to accumulate sufficient funds in their Medisave accounts to pay for their own medical care. Medishield is a catastrophic insurance program that pays extraordinary hospital expenses for those under 70 years of age. Premiums range from S\$12 to S\$132 per annum (roughly between \$14 and \$151 Canadian), depending on age, and are automatically deducted from the Medisave account. Medishield coverage begins when the length of a hospital stay exceeds 1.5 times the average stay, which results in only between 20 and 25 percent of hospitalizations receiving Medishield coverage (Massaro and Wong, 1996).

The third form of health care savings in Singapore is the Medifund program. Medifund is a government-funded program established in 1993 to provide financial assistance to the poor whose Medisave accounts are low and who have limited resources to pay for expenses out of pocket. The Medifund program receives in excess of S\$100 million per annum in government subsidy.

In addition to forced savings, Singapore also directly subsidizes roughly 19 percent of all health care expenditures (as of 1992). A central component of the subsidy program is a tiered structure of payments to health care providers. There are five classes of wards available in hospitals, each with different subsidies and varying amenities. For instance, Ward Class B1, the second highest ward class available, receives a total government subsidy equal to 20 percent of the total cost. Alternatively, the lowest ward class, Class C, receives an 80 percent subsidy (Massaro and Wong, 1996).

Access to health care facilities and treatment, medical technology, and health outcomes in gen-

eral in Singapore are more than competitive with in neighbouring Asian countries. In fact, many of the indicators of health outcomes in Singapore are comparable with those of managed care providers in the United States (Massaro and Wong, 1996). The Singaporean model of individual savings provides strong evidence of the efficacy of an individual-based system of health care allocation.

Research Breakthrough: RAND Study

[This section on the RAND health experiment is based largely on the work of Martin Zelder (2000), "Canadian Health Reformers Should Understand RAND" Fraser Forum (February). Digital document available on the Internet at www.fraserinstitute.ca.]

The RAND Experiment was conducted by the California-based RAND Corporation over an 11-year period from 1971 to 1982. The study included about 2,000 non-elderly families in a variety of different insurance plans. The set of families was randomly selected and were randomly assigned to insurance plans that varied both in their coinsurance rates and deductibles.

The coinsurance rate, the fraction of expenses paid out of pocket by the families, varied from 0 to 95 percent. The deductible amounts, the level of annual health spending at which the insurance company pays all subsequent charges, were percentages of family income (5, 10, or 15 percent), up to a maximum of \$1,000 (US).

Outcomes within the assigned plans for about 1,400 of the families were followed for 3 years; the other 600 were tracked for 5 years. This enabled the researchers to measure the effects of different plans accurately. The effects fell into two categories: health spending and health outcomes.

Those families who paid 25 percent out of pocket (up to a total of \$1,000 US maximum per year) incurred annual health care costs, on average, of

US\$826. By comparison, those in the “Canadian” group (0 percent co-insurance) incurred annual costs of US\$1,019. In other words, a 25 percent co-insurance rate led to a reduction in annual costs of US\$193, or 19 percent. Cost savings estimates for British Columbia based on the introduction of a 25 percent premium (as indicated by the RAND study) would be approximately \$1.6 billion (Zelder, 2000f).

The truly remarkable finding contained in the RAND analysis, however, relates to the change in health status among the families studied. Before-and-after measures of health status were collected to determine any health effect associated with changes in health consumption due to the varying insurance schemes. This permitted researchers to determine whether members of the “Canadian” type of plan, who received more health care, were better at improving and maintaining their health than those who paid 25 percent or more out of pocket. Extraordinarily, access to “free” health care did not benefit the “Canadians,” with very minor exceptions. “For the average person there were no substantial benefits from free care” (Newhouse et al., 1993, p. 201).

Reform Attempts in BC

The BC government’s cost containment initiative with respect to prescription drugs, referred to as reference-based pricing, in theory reduces costs by paying only for the least costly drug in a therapeutic group of pharmaceutical drugs, unless the physician specifically requests an exception. However, a US study of 12,900 patients in Health Maintenance Organizations (HMOs) found that restrictive prescription programs have adverse health effects and produce other unintended negative consequences, which end up defeating the intentions of the programs. In HMOs with restrictive drug payment programs, there were 83 percent more doctors visits, and 160 percent more prescriptions written, with drug costs actually increasing by 161 percent compared to HMOs

which honoured physicians’ discretion in selecting pharmaceutical treatment (McArthur, 1997).

The BC government Columbia recently announced a series of initiatives, referred to as *BC’s Health Action Plan: Putting Patients First* (available on the Internet at www.bchealthaction.org/index.html), aimed at improving health care in the province. Unfortunately, the plan is largely based on simply spending more money, as opposed to fundamentally altering the manner in which health care is delivered in the province (Zelder, 2000e). For instance, the plan calls for 400 new nurses, resources for nurses to upgrade current skills, increased medical residencies for doctors, additional resources for ambulatory and emergency services, and new money for medical technologies and specialized services (BC Ministry of Health, 2000).

Policy Recommendations

This section is broken into two separate parts: intermediate policies and long-term policies. The reason for the delineation is the presence of the Canada Health Act. As long as the federal government prevents provinces from enacting broad-based institutional reform, many of the most necessary and productive reforms cannot be implemented. Thus, we include policy recommendations that could improve health care delivery under the constraints of the Canada Health Act, as well as longer-term reforms.

Intermediate Policy Recommendations

- (1) Use private (both non-profit and for-profit) health contractors to more efficiently deliver health services.**

Contracting out the delivery of health services does not contradict the Canada Health Act as long as the clinics are prevented from charging user fees and the costs are covered by the provincial health insurance plan. If pri-

vate contractors were to provide health services, it would clearly improve the health care sector's incentive structure. Additionally, it would provide greater accessibility by increasing the sector's productive capacity. Perhaps most importantly, if private contractors were to provide health services, it would reduce costs, yet result in no negative service affects (Zelder, 1999).

(2) Negotiate a renewed Labour Accord.

British Columbia should immediately implement market wages for all hospital staff, including both medical and non-medical employees. This would inevitably entail a reduction in non-medical staff remuneration with commensurate increases in medical staff remuneration.

(3) Eliminate Reference-Based Pricing.

Evidence shows that restrictive drug programs can have adverse effects on patient health and create unanticipated incentives, which may actually drive *up* net costs.

Longer-Term Policy Recommendations

(1) Adopt a system of Medical Savings Accounts.

Under a system of Medical Service Accounts (MSAs), the province would channel health care spending through individuals rather than service providers. Each individual's MSA would be divided into two parts: one for regular expenses, such as regular doctors' visits and prescription drugs; the second to fund a catastrophic insurance plan. Any surplus in the fixed annual amount could be carried forward, or applied to an RRSP, but individuals would be required to make up any deficit from personal funds. The government-funded catastrophic illness plan would ensure that no individual would be left bank-

rupt as a result of a major illness (Goodman and Musgrave, 1992; Ferrera, 1995; Massaro and Wong, 1996; Scandlen, 1998; Ramsay, 1998; and Gratzner, 1999).

(2) Allow and facilitate the privatization of health care service delivery.

British Columbia should acknowledge and promote the presence of private alternatives to the public provision of health care. Health care service providers should be privatized over a pre-determined period to introduce a pricing system that would improve health care resource allocation, create and promote patient-caregiver accountability to improve service delivery, and finally, introduce competitive pressures for health care delivery.

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Recommended Readings

[Note: For complete publication data, please see the list of references.]

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Education Policy: The Future of British Columbia

Without a doubt, one of the most important services in which governments are involved is education. Education provides the foundation for people to develop the skills not only to work but indeed to engage in civil society. Education policy must, therefore, focus on maximising the quality of children's education and not become a captive of special interests.

This section, like previous sections, first presents the basic economics underlying the provision of education. It then presents information on the cost of education and relative performance of education in British Columbia. It summarily presents a number of international educational reforms to give a flavour of the reform possibilities available for education in British Columbia. The section concludes with a series of policy recommendations.

This section focuses almost exclusively on elementary and secondary education due to both space constraints and, more importantly, the fact that elementary and secondary education consumes nearly 70 percent of education resources in British Columbia. Further, as will be shown, government has a much more important role to play in elementary and secondary education than it does in post-secondary education.

Economics of Education

Most economists would agree that government has a role to play in the provision of education. Education, particularly elementary and secondary schooling, is an activity in which social bene-

fits are likely to exceed private benefits. Certainly each of us benefits privately from being more educated. Higher levels of education normally increase an individual's skills and ability to earn a higher income.

A strong case can be made that society as a whole also benefits when individuals obtain a basic level of education. For instance, a more literate society may be a more law-abiding and civil society. Also, jurisdictions may be more competitive in attracting high-growth and high-value industries when society is more literate. Hence, because education confers benefits that accrue not only to the individual but also to society at large, society has an interest in ensuring that each individual receives at least a basic level of education.

Economists refer to such situations, where social benefits exist, as possessing "positive externalities." In the case of education, for example, society gains net positive benefits by having a more educated population. However, the presence of these net social benefits also means that individuals do not keep the full benefit of their education for themselves (i.e., some of the benefit goes to society at large). This means that a purely market-based system would tend to provide too little education, since the person paying for the education does not reap *all* of the rewards from that better education. Thus, it makes economic sense to use public resources to ensure an optimal amount of education, again particularly in primary and secondary education (Easton, 1988).

This is not likely to be the case for higher levels of education, as the returns to a university or college education are almost entirely captured by the individual who earns that education, in the form of higher future income. The rationale for government intervention in the market for higher education is much weaker than the parallel argument for primary and secondary education (Constantos and West, 1991).

Role of Government in Education

The conclusion that there is a role for government in education does not establish precisely what that role should be. In theory, there are many ways governments can participate in education (Easton, 1988). It can, for instance, simply finance education, giving money or vouchers to parents with children and allow parents to choose among private-sector suppliers. Or, it can finance and provide education through a system of schools owned and operated by the government. Or, it can allow some mix of private and public provision and financing.

State-controlled education dominates in most Canadian provinces, and the results are usually the same: government-run schools are generally expensive and do not specifically serve the interests of students and parents. There is widespread dissatisfaction across Canada with the public school system, and provincial governments across the country are under pressure to change the status quo. Before discussing the options for reform, it is critical that we understand where we are today.

The State of Education in BC

Education Costs

According to 2000 Provincial Budget figures, total expenditures on education in BC, for elementary, secondary, and post-secondary, will increase 4.0 percent, from \$6.19 billion in 1999/00 to \$6.44 bil-

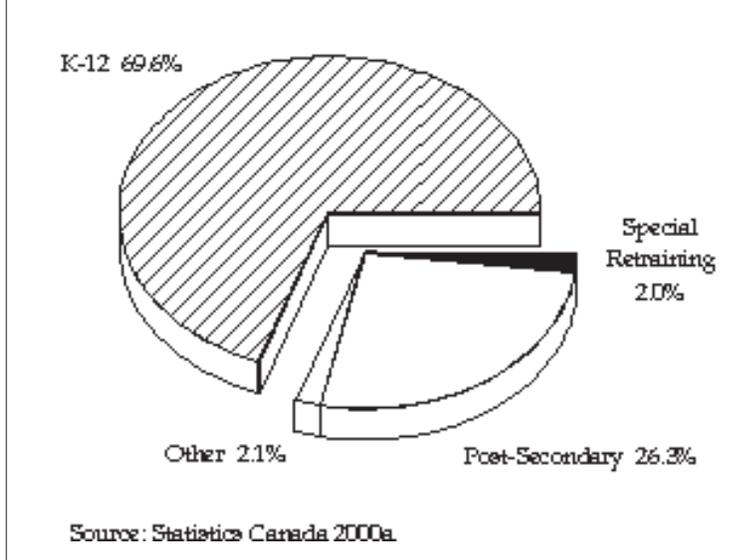
lion in 2000/01. Total expenditures for education account for 28.9 percent of total consolidated provincial budget expenditures (BC Ministry of Finance & Corporate Relations, 2000a).

The provincial budget divides education expenditures into two separate categories: 1) education (elementary and secondary) and 2) advanced education, training, and technology. The budget for the Ministry of Education (elementary and secondary schooling) for 2000/01 totals \$4.54 billion, representing a 4.4 percent increase from 1999/00. This figure also represents 20.3 percent of total consolidated provincial budget expenditures (BC Ministry of Finance & Corporate Relations, 2000a). The *Second Quarterly Report* indicated actual expenditures on primary and secondary education below budget forecasts (BC Ministry of Finance & Corporate Relations, 2000b).

The budget for the Ministry of Advanced Education, Training, and Technology is expected to increase by 6.1 percent, from \$1.81 billion in 1999/00 to \$1.90 billion in 2000/01. Expenditures in this ministry account for 8.5 percent of total consolidated provincial budget expenditures. Similar to expenditures for elementary and secondary education, the actual expenditures for post-secondary education were below budget forecasts as of June 2000 (BC Ministry of Finance & Corporate Relations, 2000b).

Some of the budgeted increase is explained by the creation of 5,025 new post-secondary positions (\$39 million), enhanced funding for post-secondary institutions including the partial cost of the tuition freeze and salary increases (\$38 million), contributions to Royal Roads University (\$3.8 million), and spending on equipment and library facilities (\$9 million). In addition, the cost of the student assistance program is expected to increase based on a projected increase in demand of 5 percent (\$14 million) and increased risk of cost-sharing programs with financial institutions and the extension of coverage to include private insti-

Education Figure 1: Composition of Education Spending (1999/00)



of accounting that allows for easy inter-provincial comparisons.

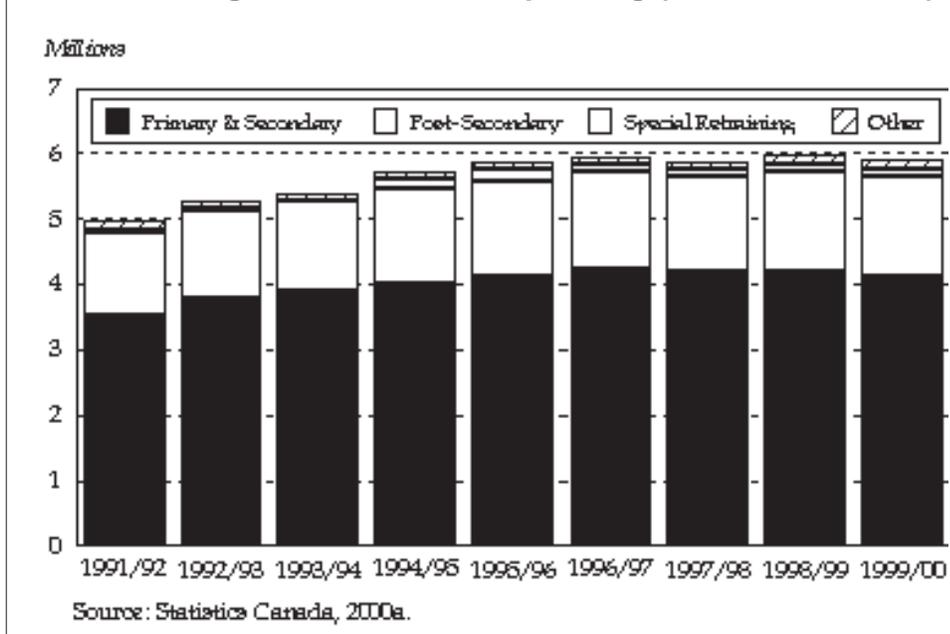
According to the most recent FMS information, British Columbia will spend \$5.89 billion in education in the fiscal year 1999/00. Of that total, \$4.10 billion is for primary and secondary education, \$1.55 billion is for post-secondary education, \$118 million is allocated for special training, and \$121 million is expended on other education programs. As Education Figure 1 shows, spending on elementary and secondary education envelops 69.6 percent of total education spending, while post-secondary expenditures account for an additional 26.3 percent. In other words, 95.9 percent of the education expenditures are allocated to elementary, secondary, and post-secondary education (Statistics Canada, 2000a).

tutions (\$5 million) (BC Ministry of Finance & Corporate Relations, 2000a).

As in previous sections, this one presents figures from Statistics Canada's Financial Management System (FMS) as it is generally regarded as a more precise method of assessing tax and expenditure information than simply using government budgets. The FMS is a standardized system

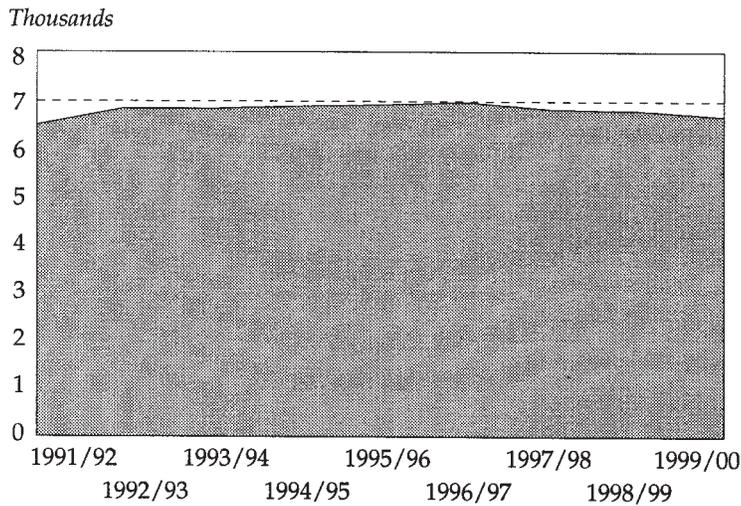
According to FMS data, total real (inflation-adjusted) education expenditures in British Columbia have increased 18.6 percent between 1991/92 and 1999/00 (Education Figure 2). Real spending on elementary and secondary education has increased 16.8 percent over the same period while expenditures

Education Figure 2: Education Spending (1991/92 - 1999/00)



on post-secondary education have increased 20.8 percent. Although spending on special training amounts to the smallest budgeted area, it experienced the largest real increase over the period, 288.1 percent, increasing from a mere \$30.4 million to \$118.0 million. Education spending categorized as "other" decreased in real terms between 1991/92 and 1999/00 by 16.6 percent (Statistics Canada, 2000a).

Education Figure 3: Real Per Pupil Expenditures



Sources: BC Ministry of Finance and Corporate Relations, 2000b; Statistics Canada, 2000a; with calculations by the author.

Although real per pupil expenditures have decreased since peaking in 1996/97, they are still 2.7 percent higher than in 1991/92, as depicted in Education Figure 3 (BC Ministry of Finance & Corporate Relations, 2000b; Statistics Canada, 2000a; with calculations by the author). Put differ-

ently, per pupil expenditures in 1999/00 amounted to \$6,684, \$175 greater than in 1991/92 measured in constant 1999/00 dollars.

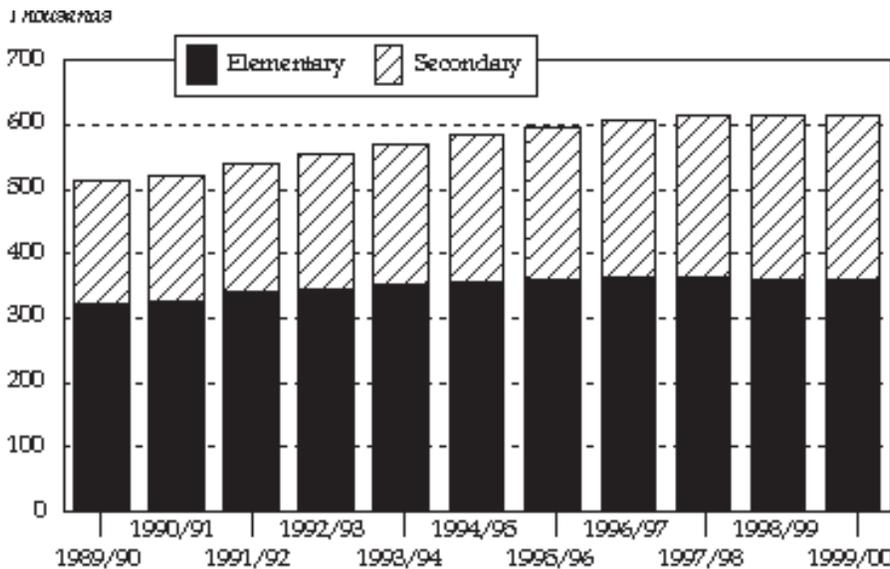
Some of the aggregate expenditure increases are a result of simply having more students in British Columbia. As Education Figure 4 depicts, the number of elementary students increased 11.1 percent between 1991/92 and 1999/00 while the number of secondary students increased 27.2 percent during the same period.

Not surprisingly, the number of schools also increased. Education Figure 5 illustrates the increase in the number of elementary, secondary, and

other schools in British Columbia between 1991/92 and 1999/00. The number of elementary schools increased 3.8 percent, the number of secondary schools increased 12.8 percent, and the number of "other" schools increased 56.8 percent for a total increase in the number of schools of

10.4 percent between 1991/92 and 1999/00 (BC Ministry of Finance & Corporate Relations, 2000b). In addition, approximately 500 new teachers were hired with requisite capital spending to create 28,886 new elementary and secondary student spaces (BC Ministry of Finance & Corporate Relations, 2000b).

Education Figure 4: Public School Enrolment (Number of Students)

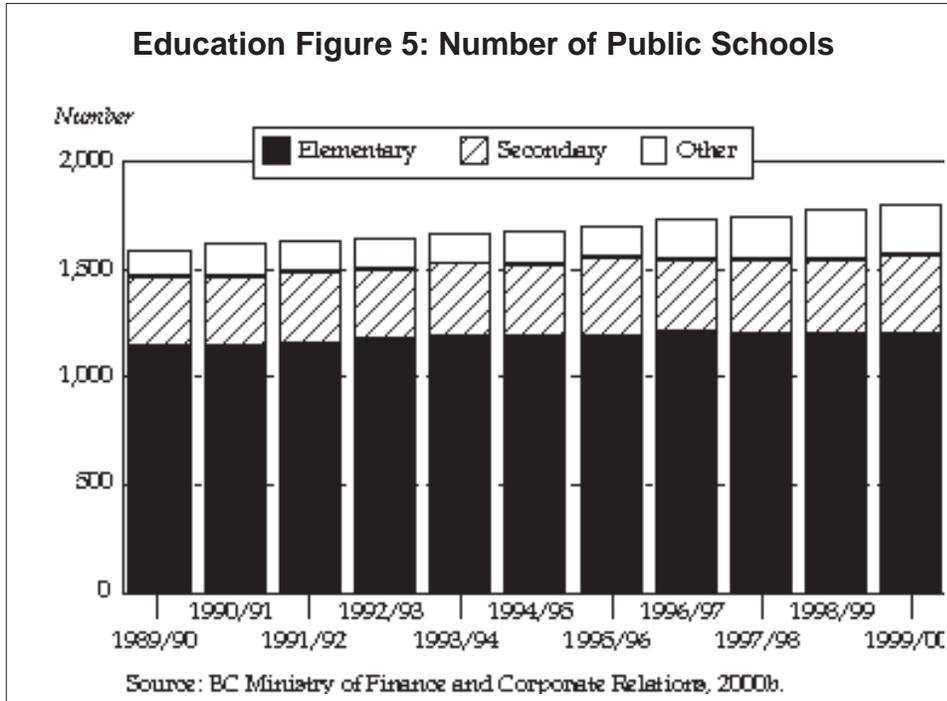


Source: BC Ministry of Finance and Corporate Relations, 2000b.

Structure of Spending

In a 1999 report, Statistics Canada compared provincial spending on edu-

Education Figure 5: Number of Public Schools



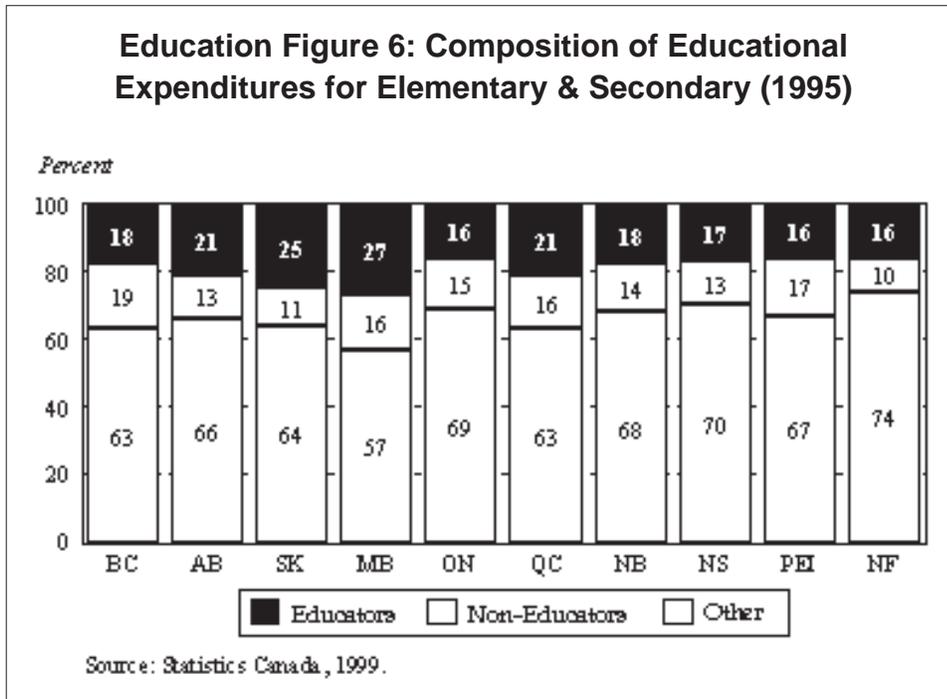
Columbia allocated the highest percentage of any province, 19 percent of education expenditures, to non-educator expenses (Statistics Canada, 1999).

Education Figure 7 shows total public school expenditures as a percent of per capita GDP for British Columbia, Alberta, and Ontario between 1992/93 and 1998/99. This measure indicates the burden placed on individuals in each of the provinces in terms of public expenditures on education. Both

Alberta and Ontario have experienced a decline in the percent of per capita GDP allotted for public education expenditures. Of the three provinces, only British Columbia has experienced an increasing percent of per capita GDP being allocated for education spending (BC Ministry of Education, 2000a).

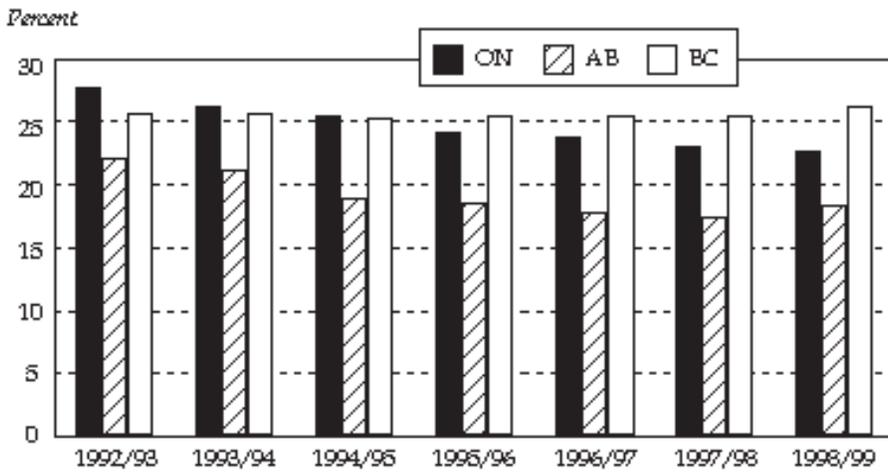
Alberta and Ontario have experienced a decline in the percent of per capita GDP allotted for public education expenditures. Of the three provinces, only British Columbia has experienced an increasing percent of per capita GDP being allocated for education spending (BC Ministry of Education, 2000a).

Education Figure 6: Composition of Educational Expenditures for Elementary & Secondary (1995)



Every province except Saskatchewan and Newfoundland experienced an increase in the ratio of students to educators between 1992/93 and 1998/99 (BC Ministry of Education, 2000a), as illustrated in Education Figure 8. British Columbia's increase in this ratio was not nearly as pronounced as that in Alberta and Ontario.

Education Figure 7: Total Public School Expenditures per Student as a Percent of GDP Per Capita



Source: BC Ministry of Education, 2000a.

cil of Ministers of Education which presents educational testing results, both inter-provincially and internationally. Education Tables 1 and 2 contain the summary results for both the School Achievement Indicators Program (SAIP) and Third International Mathematics and Science Study (TIMSS).

School Achievement Indicators Program (SAIP)

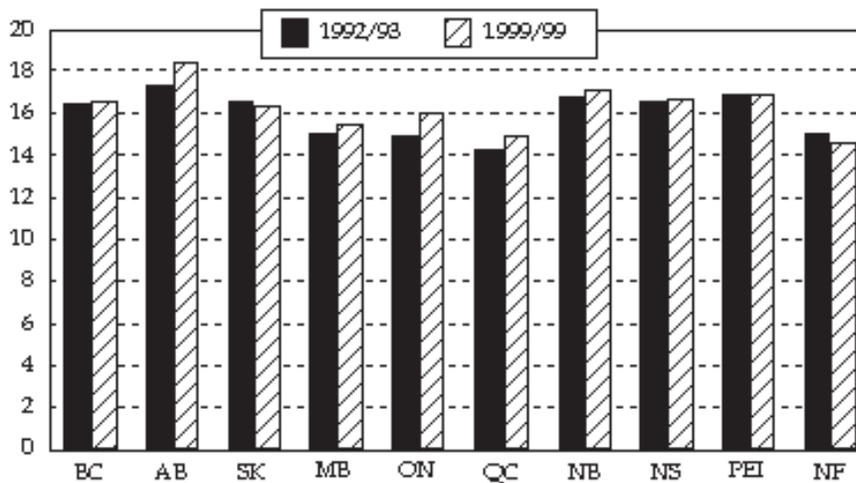
Test Score Performance

One of the important questions is whether or not British Columbia's students are excelling, or at least improving, in educational performance. Statistics Canada has compiled a report for the Coun-

The School Achievement Indicators Program (SAIP) measures the scholastic achievements of a sample of 13- and 16-year-old students across Canada in mathematics, reading, writing, and science. The results are reported according to achievement levels: level 1 being the lowest and level 5 being the highest. Education Table 1 presents the results for

13-year-olds for all subjects tested at Level 2 and 3.

Education Figure 8: Student-Educator Ratio (1992/93 and 1998/99)



Source: BC Ministry of Education 2000a.

Note: Figure for PEI for 1998/99 is data available for 1997/98.

Education Table 1 indicates whether students in each province scored at, below, or above the national average. As the table indicates, students in British Columbia generally performed at the national average. For instance, in all tests for 13-year-olds at Level 2, students in British Columbia scored at the national average in every subject test except Mathematics

Education Table 1: Provincial Performance (Relative to Canada) on SAIP Assessments**13 Year-Olds at Level 2 or Above**

	BC	AB	SK	MB*	ON*	QC**	NB	NS*	PEI	NF
Mathematics Content (1993)	0	+	n/a	-	-	+	0	n/a	-	-
Mathematics Content (1997)	0	+	-	-	-	+	-	-	-	0
Mathematics Problems (1997)	-	+	0	-	-	+	-	-	0	-
Reading (1994)	0	0	n/a	0	0	0	0	n/a	0	0
Reading (1998)	0	0	0	0	0	0	0	-	0	0
Writing (1994)	0	0	n/a	0	0	0	0	n/a	0	0
Writing (1998)	0	0	0	0	0	0	0	0	0	0
Written Science (1996)	0	+	+	0	-	0	0	0	+	0

13 Year-Olds at Level 3 or Above

	BC	AB	SK	MB*	ON*	QC**	NB	NS*	PEI	NF
Mathematics Content (1993)	0	0	n/a	-	-	+	-	n/a	-	-
Mathematics Content (1997)	-	0	-	-	-	+	-	0	-	-
Mathematics Problems (1997)	-	+	0	0	-	+	-	0	-	-
Reading (1994)	0	0	n/a	0	0	0	0	n/a	0	0
Reading (1998)	0	0	0	0	0	0	0	0	-	0
Writing (1994)	0	0	n/a	0	0	0	0	n/a	0	0
Writing (1998)	0	0	0	0	0	0	0	0	0	0
Written Science (1996)	0	+	0	0	-	0	0	0	0	-

Symbols:

+ = Significantly higher than Canada.

0 = No statistically significant difference from Canada.

- = Significantly lower than Canada.

Note: *Refers to English language schools only.

**Refers to French language schools only.

The terms “significantly higher” and “significantly lower” refer to statistically significant differences between the results of provinces and the results for Canada. Results are statistically different with 95 percent confidence if the relevant confidence intervals do not overlap.

Source: School Achievement Indicators Program (SAIP), Council of Ministers of Education, Canada, as referred to in Statistics Canada, 1999.

Education Table 2: TIMSS International, Canadian, and Provincial Achievement Scores (1994-95)

Country	Grade 4 Mathematics	Difference from International Mean	Grade 8 Mathematics	Difference from International Mean	Grade 4 Science	Difference from International Mean	Grade 8 Science	Difference from International Mean
Korea	76	17	72	17	74	15	66	10
Singapore	76	17	79	24	64	5	70	14
Japan	74	15	73	18	70	11	65	9
Hong Kong	73	14	70	15	62	3	58	2
Quebec	69	10	68	13	65	6	59	3
Czech Republic	66	7	66	11	65	6	64	8
Alberta	65	6	61	6	68	9	65	9
Ireland	63	4	59	4	61	2	58	2
United States	63	4	n/a	n/a	66	7	n/a	n/a
CANADA	60	1	59	4	64	5	59	3
British Columbia	59	0	63	8	64	5	62	6
Newfoundland	58	-1	56	1	62	3	59	3
New Brunswick*	58	-1	54	-1	61	2	57	1
Sweden	n/a	n/a	56	1	n/a	n/a	59	3
Spain	n/a	n/a	51	-4	n/a	n/a	56	0
France	n/a	n/a	61	6	n/a	n/a	54	-2
Ontario	57	-2	54	-1	62	3	56	0
Norway	53	-6	54	-1	60	1	58	2
New Zealand	53	-6	54	-1	60	1	58	2
Iceland	50	-9	50	-5	55	-4	52	-4
Portugal	48	-11	43	-12	50	-9	50	-6
International Mean	59		55		59		56	
Note: *Refers to English schools only.								

Problems (1997), in which they were below the national average.

The results were worse for Level 3 for 13-year-olds. Students in British Columbia tested below the national average in two subject areas: Mathematics Content (1997) and Mathematics Problems (1997). In all other test areas, students in British Columbia scored at the national average.

Only two provinces stand out in terms of the SAIP testing: Alberta and Quebec. Alberta students tested above the national average in 4 test areas for 13-year-olds at Level 2 and in 2 test areas for 13-year-olds at Level 3. Similarly, Quebec French-only students tested above the national average in 3 test areas for both 13-year-olds at Level 2 and Level 3.

Third International Mathematics and Science Study (TIMSS)

The TIMSS program focuses exclusively on mathematics and science due to the larger than normal returns to those educational areas. The results presented are for countries (and provinces) that met sampling requirements for the testing program. In each area, tests were conducted at the grade 4 and 8 level as well as the final year of secondary school (results not available). Education Table 2 presents the results for Quebec, Alberta, British Columbia, Newfoundland, and New Brunswick as well as various countries participating in TIMSS.

The first and most obvious observation is the dominance of Asian countries. Korea, Singapore, Japan, and Hong Kong dominate the rankings for all four test areas. Canada consistently scored above the international mean, albeit by only small margins. The range of scores for Canada were 1 percentage point above the international mean for grade 4 mathematics and 5 percentage points above the international mean for grade 4 science.

Like Canada, British Columbia consistently scored above the international mean. However, like Canada, the margins were generally small. For instance, British Columbia scored at the international mean for grade 4 mathematics and 8 percentage points above the international mean for grade 8 mathematics (Education Table 2).

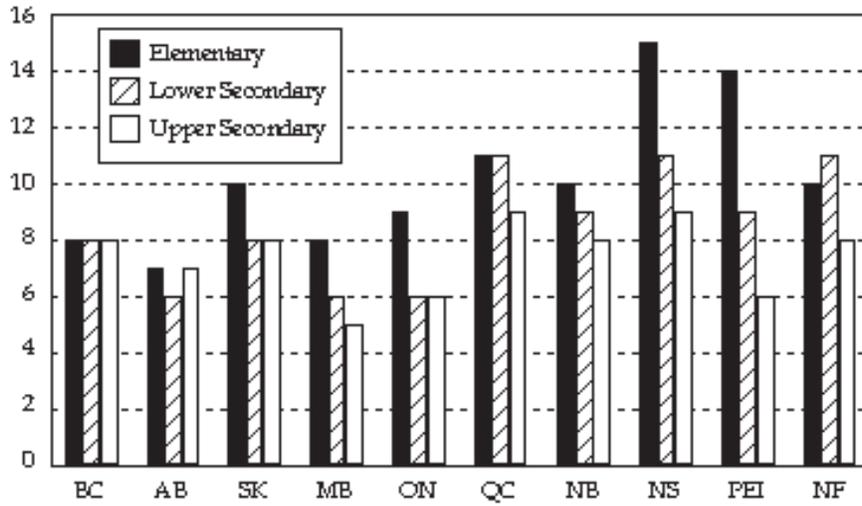
Unfortunately, both Canada as a whole and British Columbia in particular trailed their Asian counterparts by wide margins. For instance, the achievement gap between Korea, which ranked in the top three countries for all four tests, and British Columbia ranged between 17 percentage points for grade 4 mathematics and 4 percentage points for grade 8 science. There is clearly room for improvement for students in British Columbia and indeed for Canadian students in general as measured by the TIMSS.

The 1999 results of TIMSS are now available, but unfortunately, the results have not yet been analyzed sufficiently to indicate intra-Canadian differences. That is, the results only indicate national performance as opposed to indicating sub-national performance, so it is unclear whether British Columbia has improved its performance. Nonetheless, Canada did perform above the international average for both mathematics and science (US Department of Education, 2000).

Fraser Institute's Report Card Series

One of the Ministry of Education's key objectives is to ensure that all students in the province have access to equally high-quality education (Ministry of Education, 2001.) However, prior to 1998 there was no systematic way to compare the results of different schools within the province. Dr. Stephen Easton and Peter Cowley, both of The Fraser Institute, developed an objective process through which the performance of secondary schools in provinces could be readily compared. Now, through The Fraser Institute's series of pro-

Education Figure 9: Pupil-Computer Ratio in Elementary-Secondary Schools (1999)



Source: Statistics Canada, 1999.

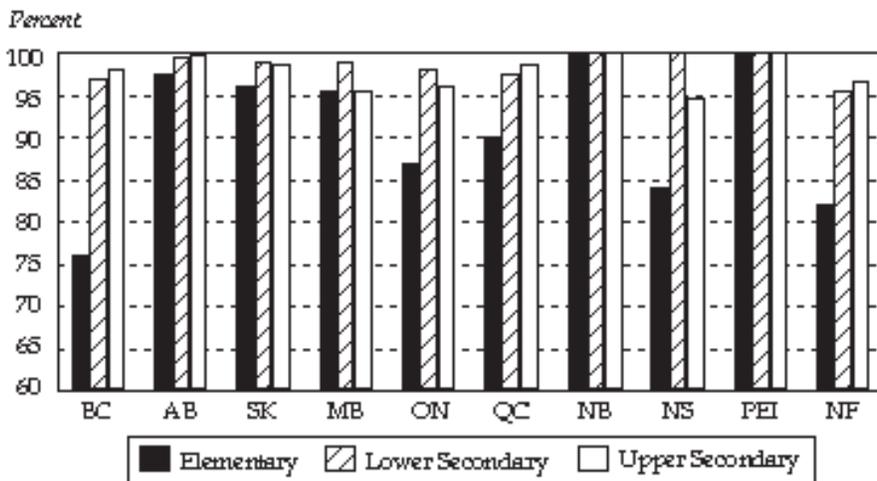
vincial secondary school report cards, parents, educators, students, and taxpayers in several provinces are able to assess secondary school performance objectively.

Each year, the results on each of the indicators of school performance measured in the report cards have varied widely among schools. Many of

those involved in education suggest that school performance is largely the result of the individual and family characteristics of the school's students. But, even when parental income, parental level of education, and a variety of other socio-economic and demographic variables are taken into account, the report card shows that some schools do better than others. Apparently, some schools are able to help students succeed regardless of their background, while others are not.

The Ministry of Education has recently instituted the Foundation Skills Assessment program. Under this testing initiative, all of the province's students in grades 4, 7, and 10 will be tested annually in reading, writing, and mathematics. These test results indicate that similar disparities in school effectiveness can also be found at the elementary school level.

Education Figure 10: Percentage of Students Connected to the Internet (1999)



Source: Statistics Canada, 1999.

Computer Access

Interestingly, the Statistics Canada report referred to previously also investigated inter-provincial differences in access to computers, measured by both the ratio of students to computers and the percentage of schools connected to the Internet. As Education Figure 9 illus-

trates, British Columbia fared well relative to the other provinces in the student-to-computer ratio for elementary schools. British Columbia's ratio of 8 students per computer ranked second, along with Manitoba, behind Alberta (with a ratio of 7 students per computer) for elementary schools (Statistics Canada, 1999). Nova Scotia recorded the worst ratio at 15 students per computer.

British Columbia's performance for lower secondary and upper secondary schools was not nearly as positive. As Education Figure 9 reveals, British Columbia ranks in the middle of the provinces with a ratio of 8 students per computer for lower secondary schools. Again, Alberta led all provinces with a ratio of 6 students per computer while Quebec, Nova Scotia, and Newfoundland ranked last with 11 students per computer (Statistics Canada, 1999).

British Columbia ranks next to last for the ratio of students to computers for upper secondary schools with a ratio of 8. Only Quebec and Nova Scotia maintain a worse ratio of 9 students per computer. Manitoba led the nation with a ratio of 5, followed closely by Ontario with 6 students per computer (Statistics Canada, 1999).

British Columbia performs considerably worse when the percentage of students in elementary and secondary schools connected to the Internet is measured (Education Figure 10). British Columbia fairs the worst of any province for elementary schools and ranks second worst for access for lower secondary schools. The province ranks considerably better for access to the Internet for upper secondary schools, although it still only achieves a middle ranking (Statistics Canada, 1999).

Monopoly: Cause of Difficulty

The difficulties facing many of British Columbia's public schools are grounded in its monopoly institutional structure (Gardner, 1996; Raham, 1996). The monopoly enjoyed by the public

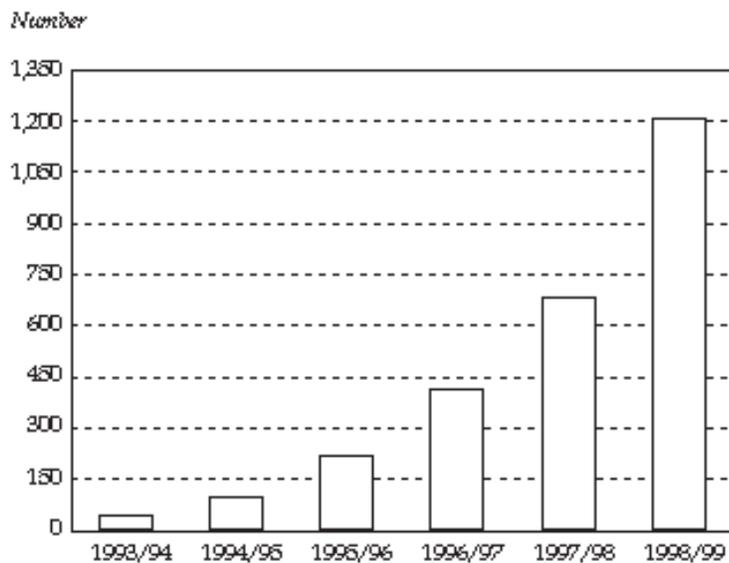
school system makes it unresponsive to change. When educational policy is standardized by public sector officials, a one-size-fits-all approach to schooling tends to emerge.

There is, however, no single approach to education that is appropriate for all students in all regions or jurisdictions, given the population's diverse talents and endowments. The result, unfortunately, is that few students will receive the type of schooling they need. A one-size-fits-all approach to schooling stifles the experimentation and diversity that would make schooling more responsive to the needs of individual students.

Furthermore, when government has a monopoly to provide education, the school system ceases to be accountable to its customers—the parents and students. In the absence of choice and competition, education policy can be set without the approval of parents. Whole programs and pedagogies can appear or disappear at the whim of administrators without the consent of parents.

It seems relatively clear that taxpayers and parents are not receiving full value for the education they are supporting. British Columbia continues to spend more money than both its international and provincial counterparts in a vain attempt to spend its way out of a problem founded in the organization of its public education spending. British Columbia has a number of educational problems facing it: average performance in testing, wide inter-provincial differences in performance, resources focused on administration rather than on the classroom, a lack of technological access, etc., none of which are based on a lack of spending. British Columbia must fundamentally assess where and how it allocates its current educational resources.

Education Figure 11: Growth in Charter Schools in the US (1993/94 - 1998/99)



Source: US Department of Education, 1998; Center for Education Reform, 1999.

International Reform Experience: A Few of the Possibilities

[Note: This section is based entirely upon the work completed by Claudia Hepburn, Education Analyst at The Fraser Institute in her 1999 study, *The Case for School Choice: Models from the United States, New Zealand, Denmark, and Sweden*. The study is available on the Internet at www.fraserinstitute.ca/publications/critical_issues/1999/school_choice/.]

Canada, and in particular British Columbia, could clearly be doing better. Education reform should not occur in a vacuum as if other nations have not struggled with the same questions that currently face reformers in British Columbia. This section provides a brief overview of some of the possibilities available for elementary and secondary education reform based on initiatives undertaken in the United States, New Zealand, Denmark, and Sweden. This section simply summarizes reforms undertaken internationally and is not meant to present a definitive description or

assessment of the reform initiatives. For such information, readers should refer to the recommended readings at the end of this section.

United States: A Laboratory for Experimentation and Innovation

Perhaps due to its unique history, its culture, or possibly simply due to its size, the United States has been the centre of education experimentation and innovation for the better part of the last decade. In fact, all four major types of education innovation are present in the United States.

US Charter Schools

Charter schools offer school choice within the existing public system. Charter schools operate independently, both financially and legally from the local school board. They are not bound by union contracts or other school board policies. Further, pupil funding is forwarded directly to the charter school, avoiding the costs associated with a school board. Charter schools are precluded from charging tuition because they are publicly funded. Their charters are also subject to periodic renewal based on performance. Like independent schools, charter schools require active parental support. This permits a great deal more flexibility in the delivery of education by charter schools.

In late 1999, there were 37 states with charter legislation, several more considering legislation, and 27 states with operating charter schools (Center for Education Reform, 1999). Arizona led the US with more than 4 percent of students in charter schools. Other states with strong charter laws include California, Michigan, Colorado, and Massachusetts. A few states, however, have such

weak legislation that no charter schools have been established at all.

Currently less than 1 percent of all US students attend charter schools (Hepburn, 1999b). Nonetheless, the number of charter schools had grown to 1,205 by 1999, serving more than 300,000 students (Education Figure 11). This represents a more than 200 percent increase in the number of schools and more than a 300 percent increase in the number of students educated in charter schools between 1993/94 and 1998/99 (US Department of Education, 1998; Center for Education Reform, 1999).

A number of the fears raised by opponents of the charter movement have been proved unfounded. For instance, a study by the US Department of Education in 1997 investigated the demographic characteristics of charter schools and concluded that:

no evidence to support the fear that charter schools as a group disproportionately serve white and economically advantaged students... Charter schools are similar to their districts on student racial/ethnic and income level characteristics, but about a third are more likely to serve students of color and low-income students. (US Department of Education, 1998, pp. 7-8)

Charter schools were also found to serve disabled and impeded children. Further, the Hudson Institute's study found that charter schools attract low-income children, children with learning and behavioral disabilities, and children at risk (Finn et al., 1996).

Parental satisfaction and support for charter schools is evidenced by waiting-lists at practically all charter schools. Further, the intention of an overwhelming majority of parents to keep their children in charter schools similarly documents parental contentment (Hepburn, 1999).

The most significant finding was that students in charter schools achieve greater academic results than do their peers in public schools. According to research by the Center for School Change, charter school students achieve markedly better academic performance, achieving gains of 1.3 to 2 years in a variety of subjects (Cheung, Murphy, and Nathan, 1998).

Charter schools have also been embraced both by teachers and, surprisingly, by teacher unions. Surveys conducted by the Hudson Institute concluded that teachers preferred the more "familial school atmosphere, sensible management decisions, dedicated colleagues, and enhanced personal and institutional accountability" present in charter schools (Finn et al., 1996, p. 4).

Also, there is growing evidence that teachers in charter schools are not subjected to lower pay across the board. For instance, a study by the Goldwater Institute found that Arizona's charter schools "set their salary schedules 5 percent higher than traditional public schools, with merit pay and pay for special skills raising the overall average to 6 percent higher" (Solomon and Gifford, 1999).

American charter schools have been appropriately called "America's educational research and development centers" (Manno et al., 1998, p. 2). The Fraser Institute's Claudia Hepburn stated that "it would be impossible to describe adequately the myriad educational innovations taking place between their walls. Many create new learning environments by organizing school time, spaces, and structures differently, in ways that meet their educational goals better than the usual timetable of 40-minute lessons, six-hour days, and nine-month years" (Hepburn, 1999b).

Public Vouchers in the US

Public vouchers move beyond reforming education within the public system. Public voucher

programs essentially involve giving parents the financial resources to purchase education. In other words, public vouchers put public funds in the hands of parents in order to allow them to choose alternative schools for their children. They represent a watershed in education reform. The first of two major public voucher programs, Milwaukee's Parental Choice Program is summarily presented below.⁹

Milwaukee

Milwaukee Parental Choice Program (MPCP) is the oldest and longest-studied public voucher program in the US. It began in 1990 in response to high drop-out rates, poor test scores, and significant disparity in education opportunity between low-income and middle-income families.

The program initially allowed 1 percent (increased to 15 percent in 1995) of Milwaukee Public School (MPS) students from low-income families to attend independent, non-sectarian schools. Students applied to the participating independent schools and, once their family incomes were verified, were selected randomly by the schools for the places available. This voucher program cost taxpayers 41 percent of the cost of sending students to a Milwaukee public school (Greene, Peterson and Du, 1997, p. 13).

In 1995, the program was expanded to include religious schools, which was critical since religious schools accounted for roughly 90 percent of Milwaukee's independent schools (Greene, Peterson and Du, 1997).

Researchers at the University of Wisconsin have concluded that "[i]n all five years, parental satisfaction with choice schools increased significantly over satisfaction with prior public schools" (Witte, Sterr and Thorn, 1995). Findings by researchers at Harvard and Princeton showed "statistically significant" efficiency gains (Greene, Peterson and Du, 1997, p. 2). Evaluation by Harvard researchers concluded that academic improvements began in the first year of attending a choice school and increased the longer they were enrolled (Greene, Peterson, and Du, 1997, p. 17). Both the Harvard and Princeton studies recommended increasing and expanding the choice programs.

Private Vouchers in the US

Private vouchers, like their public counterparts, are meant to provide parents with the resources to make decisions regarding their children's education. The difference is that private vouchers are funded by non-governmental organizations like foundations, charities, and business.

Three landmark voucher programs illustrate the growth in scope and potency of the private voucher movement over the past three years.

Giffen Memorial Elementary School

In the early 1990s, Virginia Gilder sponsored a voucher program for students at several poorly performing municipal schools in upper New York State. Each summer, a few students at each of the schools won a voucher and transferred to an independent school. Meanwhile, the government schools' dropout rates remained unaccepta-

⁹ The second major public voucher program in Cleveland, Ohio, provides yet another example of the powerful influence public vouchers can have on students, teachers, and government. For information on the Cleveland voucher program please see: Jay P. Greene, William G. Howell, and Paul E. Peterson, *An Evaluation of the Cleveland Scholarship Program* (1997) and *Lessons from the Cleveland Scholarship Program* (1997), both published by Harvard University, Cambridge, MA. See also Claudia Hepburn (1999), *The Case For School Choice: Models from the United States, New Zealand, Denmark, and Sweden*. Critical Issues Bulletin. Vancouver, BC: Fraser Institute. Digital document available on the Internet at www.fraserinstitute.ca.

bly high, their literacy and numeracy scores remained unacceptably low, and the school board made no apparent attempt to improve them.

At the Giffen School, only half of the grade 3 students could read at the minimum state standard and their results deteriorated the longer they attended. Gilder offered every child at Giffen a scholarship of up to US\$2,000 per year, or 90 percent of the cost of an independent school, for three to six years. Thirty-four percent of the low-income parents accepted her offer, even when asked to pay a share of the tuition. For the first time the school board was forced to account for and defend its use of public funds.

Children's Scholarship Fund

The Children's Scholarship Fund (CSF) has taken the private voucher movement to a new level of size and significance. Less than nine months after its establishment, the US\$100 million fund had raised an additional US\$100 million in matching grants and US\$55 million in additional donations. CSF distributed 40,000 vouchers with a total value of US\$170 million for the 1999/2000 school year: 35,000 of these vouchers were distributed through local organizations established in 43 cities and three states while another 5,000 were available to low-income children who applied from any other part of the country. CSF has made private vouchers a movement of national significance.

Long-standing research comparing government schools and independent schools indicates that the educational value added by independent schools is greater than that added by government schools (Coleman, Hoffer, and Kilgore, 1982; Powell, Farrar, and Cohen, 1985; Chubb and Moe, 1990). New research based on the academic achievements of voucher recipients in Milwaukee, Cleveland, and New York confirms these results (Greene, Howell, and Peterson, 1997a, 1997b; Greene, Peterson, and Du, 1997; Peterson,

Myers, Haimson, and Howell, 1997; Peterson, Myers, and Howell, 1998). Voucher programs facilitate the ability of parents to make school choice decisions.

Education Tax Incentives

Tax credits for education developed from the premise parents should have some power to direct their school taxes to their preferred system of education. Tax incentives can be designed either to reduce the barrier to independent schooling for middle-income and lower-income students or to provide the families at the very bottom of the socio-economic ladder with the option of independent schooling for their children.

Growing numbers of Americans are advocating tax credits as an alternative to public vouchers. In Minnesota, Iowa, and Louisiana, tax incentives have been enacted to reduce the financial barrier to independent school enrolment, making it possible for a greater proportion of the population to afford independent schooling for their children (Blum Center for Parental Freedom in Education, 1998).

New Zealand's Charter Schools

To improve "the effectiveness and efficiency of resource use in education" (NZMoE, 1994, p. 40), the Government of New Zealand shifted authority from the central Department of Education to individual schools. A board of trustees for each school replaced the existing district school boards so that "the running of the institutions [became] a partnership between the [education] professionals and the particular community" (NZDoE, 1988, p. 1). Elected parents and other community members control the schools' boards, which unite the vision and interests of each community with the educational objectives of the state.

At the same time, the government removed school zoning. This measure was designed to im-

prove equity in enrolment, to give families a choice of educational alternatives, to encourage healthy competition among schools for students, and to promote better educational practices. De-zoning has provided a majority of families with a choice of schools: 85 percent of parents surveyed said their child was attending their first choice of school (Wylie, 1997, p. 158).

These statistics reveal not only high levels of parental satisfaction but also high levels of parental involvement in their children's education. A large majority of parents are now actively involved in deciding the course of their children's schooling. Two-thirds of New Zealand parents whose children are in school had already decided which school they would like their child to attend next and the majority (63 percent) of those parents could envisage no obstacle to prevent their child from going on to that school (Wylie, 1997, p. 158). Parental mindfulness of their children's education, as common sense suggests and research has proven, is highly correlated with successful schools (Chubb and Moe, 1990, pp. 148-49).

In the original plan for the restructuring, schools were to receive direct funding for all their expenses on a per-pupil basis, with extra allocations for schools serving special-needs students and low-income communities. In 1990, 69 schools voted to take part in a three-year direct funding initiative in which the schools themselves would receive the entirety of the per pupil funding. Three years later, direct funding had proven successful at all 69 schools; every one chose to continue it at the end of the trial period. By 1997, 10 percent of schools had opted for direct funding (Wylie, 1997, p. 137) and by the end of 1998 more than 23 percent of schools had adopted it (Hepburn, 1999b).

Another proposed reform, permitting new schools to open and allowing failing, unpopular schools to close, was never implemented because of union opposition. No new schools may be

opened if there is space for students in existing schools. This means that students and teachers are sometimes stuck in failing schools because the popular schools are filled to capacity. The American charter experience suggests that by allowing schools to open and close, the government could have increased the competitiveness and accountability of the educational marketplace. It would have enabled more families to escape bad schools and fostered new charter schools of higher quality.

School Assessment: Educational Review Office

New Zealand, as part of its education reform package, established the Educational Review Office (ERO) to inspect schools and report their standards. The ERO's purpose is to keep schools accountable to an independent public body, to help improve weak schools, and to keep parents and the general public informed about the performance of their education system.

Karen Dobric, studying the effects of competition, site-based management, and accountability on New Zealand secondary schools, concludes that "retention rates are increasing, more and more non-traditional possibilities are opening up in senior secondary areas, students' needs are increasingly being met, and retention rates are increasing further" (Dobric, 1997, p. 27). Indeed, a 7-year study by the New Zealand Council on Educational Research found that principals and teachers believed that the impact of the educational reforms on children's learning, teaching content, and teaching style was overwhelmingly positive (Wylie, 1997, pp. 161-63).

Denmark

Independent education has a long tradition in Denmark. The Danish educational system developed from the belief that parental authority over education should be paramount and that a truly democratic system of government-run education

would be impossible without a range of independent, publicly funded, alternatives

Danish Voucher System

Independent schools in Denmark have provided educational choice for families throughout the country since the first half of the nineteenth century and today they educate about 13 percent of elementary and lower-secondary school students. School choice in Denmark is achieved through a system of public vouchers for independent schooling. Approximately 75 percent of municipal spending on schools follows students who enrol in independent schools. The Ministry of Education pays a sum per pupil to each independent school. The exact amount varies depending upon the size of the school, the age of the students, and the age of the teachers.

The government requires independent schools to charge tuition to all parents except those for whom it would cause undue financial hardship. If parents choose an independent school over a municipal school, they must pay tuition of at least DKr3,500 (roughly Cdn\$720) per year. The average compulsory school charges DKr7,439 (Cdn\$1,518) per annum (Olesen, 1998), while the average secondary school charges DKr8,500 (Cdn\$1,735) (Hansen, 1998). The competitive nature of the education market prevents tuition fees from escalating.

Danish municipal schools imitate successful practices pioneered in the independent sector because they risk losing pupils and popular support if they do not. Research conducted by the OECD has found that "Municipal schools are starting to replicate the model of parental involvement developed in [independent] schools" (OECD, 1994, p. 147). The number of parents choosing independent schools grew by 50 percent in the course of a few years during the 1980s. The municipal schools responded when it became clear that they were losing students.

Sweden: The Swedish Voucher System

Dissatisfaction with educational policy grew for a generation in Sweden until fundamental organizational reforms were implemented virtually overnight in 1991. That year, a new government came into power promising to end central planning in education and to replace it with decentralization and school choice (Hepburn, 1999b).

The 1991 legislation devolved power from the central government to parents, municipalities, and independent schools. Education objectives were nationally legislated but their implementation became, for the first time, the role of the municipalities. The reforms also gave parents educational choice. For the first time, parents were free to send their children to any government school within their municipality or to an independent school, with public funding following the child to the school chosen. Independent schools approved by the National Agency for Education would receive 85 percent of the cost of educating a student in the municipal school system.

As early as 1993, a poll conducted by the National Agency of Education found that "85 percent of Swedes value their new school choice rights" and "59 percent of Swedish parents think that teachers work harder when there is school choice" (Center for Governmental Research, 1997, p. 2). The changes were felt both by the children attending new independent schools and by those who remained in the government-run system, which was starting to respond to parental concerns. As one Swedish professor of education concluded, "one cannot deny that the reform has made municipal schools more efficient" (Miron, 1996, p. 79).

The supply of these schools is growing by from .5 to 1 percent per year, educating approximately 3,500 more students every year at a time when the school-aged population in Sweden is declining. In 1998 alone, the number of students in independent schools increased by 15 percent, despite

the fact that the total number of school-aged students in Sweden declined by 11 percent (Hepburn, 1999b). Independent schools are expected to be educating 10 to 15 percent of students within a decade (Hepburn, 1999b).

International Reform Conclusion

There are myriad reforms that could be imported to British Columbia in order to facilitate and motivate improvement in the delivery of education. Whether it is expanding the limited public voucher system British Columbia already maintains, introducing charter schools, or encouraging the development of private educational vouchers, the underlying premise of any educational reform should be greater parental choice, flexibility, and accountability, if success in education delivery is the ultimate goal.

Policy Recommendations

Intermediate Policy Recommendations

(1) Eliminate funding discrimination for Independent schools.

The Province of British Columbia currently only finances two of the four types of independent schools, and then only at a percentage of the base. For instance, Group 1 schools receive 50 percent of the adjusted per-student operating cost but must comply with ministerial guidelines including curriculum, employment of certified teachers, and compliance with municipal and regional district codes. The discriminatory funding structure for independent schools in British Columbia not only affects the nearly 60,000 students enrolled in independent schools but also impedes the development and access to independent schools for potential students. The funding structure should immediately be adjusted to eliminate provincial discrimination. This, above all other recommendations

in this section, would facilitate school choice and competition within the school system.

(2) Introduce flexible regulations for existing and new Independent schools.

Independent schools not only face stiff financial penalties in the form of discriminatory funding by the province but are also encumbered by a number of regulations, including curriculum and teacher certification, assuming they choose to receive government funding. The province should immediately overhaul regulations governing Independent schools, both existing and new, to permit greater flexibility and experimentation within the education system.

(3) Eliminate catchment areas.

Allowing parents to transfer their students within the current public system would introduce an important element of competition within the public system and at least partially re-organize education incentives back towards the delivery of education for students.

(4) Enact strong charter school legislation.

British Columbia should move quickly to introduce strong and supportive charter school legislation based on international models that have successfully encouraged and facilitated the creation and maintenance of charter schools. As a comprehensive survey of the US charter school movement completed by the Hudson Institute noted, US states whose legislation provides charter schools with autonomy and support have a vibrant and expanding charter movement while those with weak legislation often fail to see any charter school development.

(5) Focus the Ministry of Education on communications.

With greater parental choice will come a greater need for the Ministry to provide information to parents. The ministry will have to develop systems for both collecting information about all education providers and disseminating this information to parents, citizens and the media.

(6) Continued focus on delivering resources to the classroom.

British Columbia needs to continue to be vigilant about rationalizing administrative functions and ensuring that maximum resources flow through to the classroom. Although advances have been made in recent years, more needs to be done to streamline administrative functions, such as outsourcing and contracting, in order to deliver more resources to educators and ultimately to students.

(7) Introduce greater flexibility into the teaching profession by permitting non-certified teachers to use their expertise to teach classes on a part-time or instructional basis.

Precluding experts from contributing to the educational process serves no one; it only protects teacher positions. The goal of the education system must be to maximize educational results rather than protect those who produce education. Greater flexibility to use experts on a part-time and specialized basis should immediately be introduced legislatively.

(8) Re-negotiate collective agreements to focus on market-based compensation.

Education remuneration, particularly for non-educators, should be market-tested, given British Columbia's already skewed focus on non-educator expenditures (see Education Figure 6). That is, non-educator compensation should be compared to similar

positions in the general labour market in order to calculate compensation levels.

(9) Fostering a private voucher system to augment the public system.

British Columbia should encourage charities, foundations, business organizations, and those interested in education to develop private initiatives such as private vouchers. Specifically, a private voucher system could be established to provide low- and middle-income families with additional educational resources to cover tuition not covered by the current public voucher and incidental expenses such as uniforms and textbooks.

Long-Term Policy Recommendation

(1) Implement a broad, public voucher system for education.

The ultimate reform of education rests in the creation of a broad-based public voucher system for the province in which parents, rather than schools, would receive education resources. The province would already be close to a public voucher system assuming the end of discriminatory funding for Independent schools. The creation of a province-wide public voucher system would simply require institutional changes for the providers of education, namely the schools, and the requisite teachers, administrators, and other employees. Such a system has proved tremendously successful in a number of countries including some already discussed.

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Social Policy: Achieving Welfare Reform

Looking back, the 20th century may well be called the age of the welfare state. The century witnessed advances in the size and breadth of state activity (Peltzman, 1980; Meltzer and Richard, 1981; Higgs, 1988). Historically, the state had been concerned with such basic duties as enforcing contracts, maintaining law and order, and protecting persons and property. The twentieth century has seen this rudimentary role of government expanded to include such activities as welfare provision for the poor, unemployment assistance and job training for the unemployed, old age pensions, education for the young, and health care for everyone.

This section focuses on the specific issue of welfare provision. It provides a thumbnail sketch of the economics of welfare and an assessment of welfare provision in British Columbia. Next, it compares welfare results for both Canada and British Columbia with results achieved in the

United States. It also presents a summary of some of the constructive reforms undertaken in the US. The section concludes with policy recommendations for British Columbia.

Readers should note that the focus on welfare is not meant to minimize the numerous other social policy areas, such as child care and housing, but rather to focus on the largest single expenditure program within the area of social policy.

Economics of Welfare Provision

The economic concerns about welfare mirror many of those present in the insurance market. Moral hazard is the chief of these (Brown, 1989, Dennis and Erdos, 1992, Murray, 1984). Moral hazard refers to the change in individual behaviour when some type of insurance program is introduced. That is, the presence of an insurance scheme, such as welfare, reduces the costs or con-

sequences of certain behaviour and thus alters the actions of individuals. The effect of such programs is that “the incidence of a certain hazard is greater when its victims are insured against losses from it than when they are not” (Grubel and Walker, 1978). In *Unemployment Insurance*, Grubel and Walker illustrate how broad, state-provided unemployment insurance schemes actually aggravate unemployment rates rather than reduce them. This is because such schemes reduce the cost of unemployment to individuals and enable them to remain unemployed for longer durations without incurring financial hardship, the natural consequence the insurance relieves.

Similarly, if welfare benefits are higher than minimum-wage earnings then it creates a strong disincentive for anyone to work at the minimum wage, since they can earn more by staying on welfare. There are trade-offs between attempting to create a reasonable safety net while not destroying the incentive to work. This trade-off must be accounted for in the creation and administration of welfare, but is often ignored.

Professor Christopher Sarlo examined the incentive structure present in Canadian welfare provision and concluded that incentives for people to leave welfare in order to seek real, long-term employment are virtually non-existent (Sarlo, 1994). Ironically, attempts to keep these programs affordable to taxpayers by reducing benefits in proportion to earnings by recipients results in a nearly 100 percent effective marginal tax rate for recipients, thereby eliminating or dramatically reducing the incentive for recipients to seek work (Richards and Watson, 1994). Some have also suggested that there is a direct relationship between increases in welfare benefits and growth in welfare caseloads (Law, Markowitz, and Mihlar, 1997). Overall, the modern welfare state is frustratingly inefficient and at the very least promotes a culture of dependency (Hill and O’Neil, 1990).

British Columbia: Where Are We?

Are Welfare Benefits Adequate?

The Fraser Institute undertook to compare welfare benefit levels with the cost of acquiring basic necessities in its 1999 publication *The Adequacy of Welfare Benefits in Canada*. Table 1 contains data from the study for BC welfare benefits.

In two cases—specifically, single parents with two children and single disabled persons—the total value of benefits conferred to recipients by British Columbia exceeds the cost of acquiring basic necessities. However, in both cases, British Columbia ranks relatively low, tenth and eighth, respectively, in relation to the difference between conferred benefits and the minimum cost of basic necessities compared to other provinces.

In the remaining two cases, namely, a single unemployed person and a couple with two children, the total benefits received are less than the cost of obtaining basic necessities. Again, British Columbia ranks relatively low in both categories in comparison to other provinces. British Columbia’s low ranking in all four categories means that the main problem in welfare provision in the province relates to the structure of delivery and the incentives to enter the labour force, as opposed to benefit levels that are set too high.

The Cost of Welfare and Welfare-Related Services

There are two major expenditure areas involving social services in BC: the Ministry for Social Development and Economic Security, and the BC Benefits program. The budget for the Ministry for Social Development and Economic Security is scheduled to increase by 3.2 percent between 1999/00 and 2000/01, from \$1.96 billion to \$2.03 billion (BC Ministry of Finance & Corporate Relations, 2000b). Expenditures in this ministry account for 9.1 percent of total consolidated

Table 1: Adequacy of Welfare Benefit in British Columbia

Household	Total Value of Assistance	Cost of Basic Needs	Difference	Provincial Rank*
1) Single parent with 2 children	17,354	16,952	402	10th
2) Single employable person	6,675	9,039	(2,364)	8th
3) Single disabled person	9,938	9,039	898	8th
4) Couple with 2 children	17,846	20,898	(3,052)	10th

*Provincial rank based on descending difference between the value of assistance and the cost of basic needs.
Source: Emes and Kreptul, 1999.

expenditures at the provincial level (BC Ministry of Finance & Corporate Relations, 2000b).

The cost for the BC Benefits program and related programs is expected to reach \$1.68 billion in 2000/01, up from roughly \$1.5 billion in 1999/00 (BC Ministry of Finance & Corporate Relations, 2000b). Expenditures for the BC Benefits and related programs represent 7.4 percent of total consolidated budgeted expenditures for British Columbia.

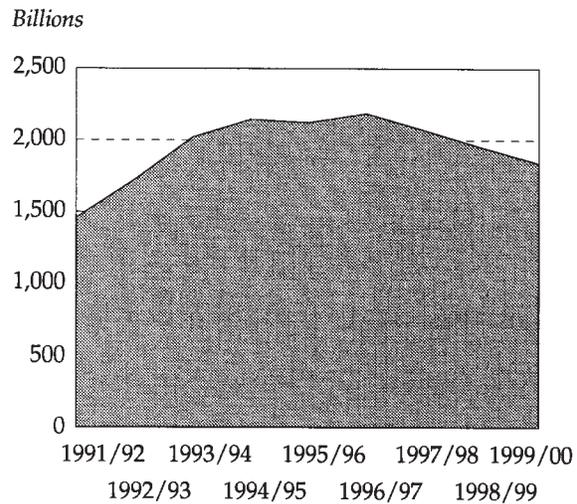
Interestingly, expenditures are expected to increase while the number of caseloads are expected to decrease by 4.2 percent (Ministry of Finance & Corporate Relations, 2000a). The overall increase is due to several initiatives, including as a 2 percent increase in income assistance rates effective July 2000 (\$23 million), the reinstatement of the flat-rate earnings exemption (\$30 million), and before-and-after school child care programs (\$14 million).

A more precise method than government budgets by which to assess government expenditure information is through Statistics Canada's Finan-

cial Management System (FMS). The FMS is a standardized system of accounting that allows for easy inter-provincial comparisons. According to the most recent FMS information, British Columbia will spend \$3.9 billion in the area of social services in the fiscal year 1999/00. Of that total, \$1.8 billion is specifically designated for social assistance programs. This represents a 26.4 percent increase in real expenditures on social assistance since 1991/92, but a 14.1 percent decline since peaking in 1994/95 (see Welfare Figure 1) (Statistics Canada, 2000a).

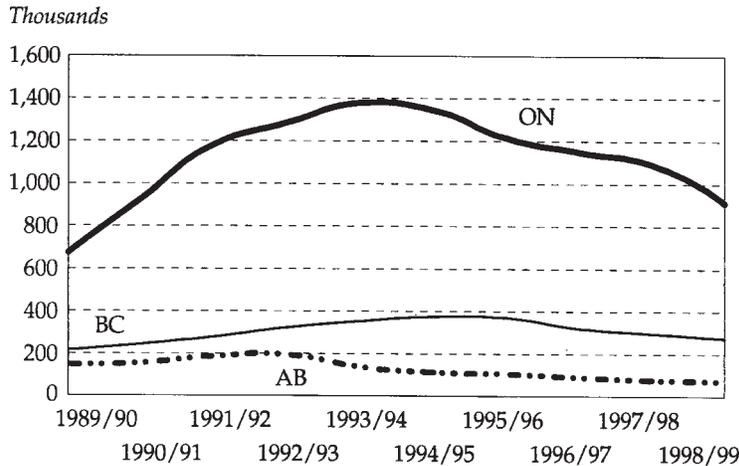
According to FMS data, expenditures on social services represent 15.2 percent of total provincial expenditures, ranking behind only health care and education. Expenditures on social assistance represent 7.2 percent of total expenditures, up from 6.8 percent in 1991/92, but down from their peak of 8.6 percent in 1993/94 (Statistics Canada, 2000a).

Welfare Figure 1: Real Expenditures on Social Services (1991/92 - 1999/00)



Source: Statistics Canada (2000).

Welfare Figure 2: Number of Welfare Beneficiaries (1989/90 - 1998/99)



Source: Joel Emes, 2000b.

ing a broader benefit program for low-income families, the government removed one disincentive for welfare recipients to move into the workforce; they can now do so without losing child benefits.

Welfare Caseloads: Are We Improving?

As depicted in Welfare Figures 2 and 3 as well as in the data presented in Welfare Table 1, of the three 'have' provinces, only Alberta has been successful in materially reducing its welfare levels over the last decade. Both Ontario and British Columbia have higher levels of welfare benefi-

ciaries, whether measured by absolute numbers (Welfare Figure 2) or as a percentage of the population (Welfare Figure 3).

Much of the reduction in the number of welfare beneficiaries has occurred because of favourable economic conditions and reductions in unemployment. In fact, a major concern for the BC government is the possibility of an economic downturn that would almost inevitably erase some or all of the gains achieved thus far in reducing welfare use (BC Ministry of Finance & Corporate Relations, 2000a).

Welfare Figure 3: Welfare Beneficiaries as a Percent of the Population, illustrates the major difference in the number of welfare beneficiaries between Alberta and both British Columbia and Ontario, as well as Canada as a whole. It also illustrates, to a certain extent, the cyclical nature of the gains achieved in all jurisdictions.

Welfare Administration

In *Retooling the Welfare State*, Professor John Richards attributed the near 110 percent increase in the number of welfare recipients between 1991 and 1996 to "poor management." In 1991, BC's newly-elected New Democratic Party (NDP) made it policy for employees of the Ministry of Social Development and Economic Security to "serve clients, not police welfare use" (Richards 1997: 160). There was a subsequent relaxation of requirements and eligibility rules that increased the number of individuals receiving welfare benefits.

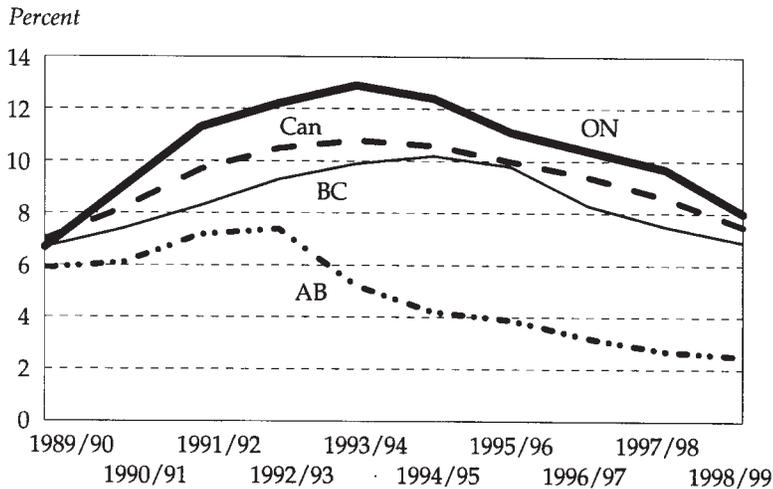
Since 1995, the NDP government has begun to tighten requirements and eligibility for welfare benefits. The ministry has hired additional staff, including investigators, eligibility officers, and verification officers, in order to facilitate this process and reduce the level of fraud (BC Ministry of Human Resources, 1998a).

In addition, in 1996, the British Columbia government introduced the BC Family Bonus Act, which extends child benefits to low-income families (BC Ministry of Human Resources, 1998b). By creat-

Workfare

One of the keys to managing the trade-off between providing benefits and maintaining work incentives is to require work in exchange for re-

Welfare Figure 3: Welfare Beneficiaries as a Percent of the Population (1989/90 - 1998/99)



Source: Joel Emes, 2000b; with calculations by the author.

States have concluded that strong work requirements for those able to work assist in moving people from welfare to work (Rector and Youssef, 1999; Shafer, Emes, and Clemens, 2001 (forthcoming)). Unfortunately, British Columbia has not implemented any type of workfare program. It is essential that those able to work be required to do so, and that those willing to work but requiring additional assistance are given that aid, in order to help move British Columbians on welfare into productive work.

Canada-US Divide: Putting Canada in Context

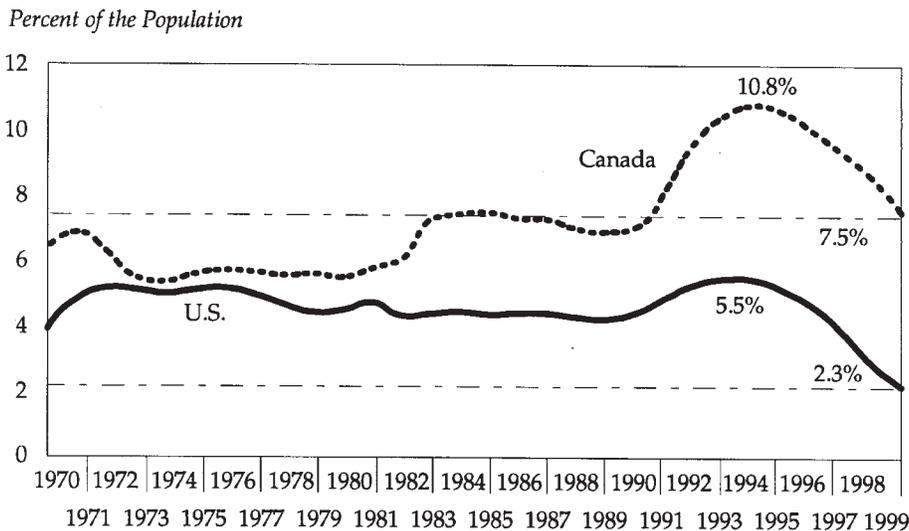
ceipt of benefits. Interestingly, much of the historical data regarding the provision of welfare-like programs prior to government provision shows that most privately-financed programs insisted that welfare recipients work if they were able to do so (Olasky, 1996). Also, a host of studies examining results in the United

It is useful to place the larger Canadian welfare experience in context, particularly with respect to the dramatic reforms enacted in the United States in 1996. The Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA) of 1996 revolutionized welfare provision by the

states. Like Canada, welfare provision in the US is decentralized such that its administration and management are carried out by the individual states. The PRWORA effectively ended welfare provision as an entitlement, and returned a great deal of autonomy and control to the states.

The results of the reforms have been positive. Buoyed by a growing economy and

Welfare Figure 4: Canadian & US Welfare Beneficiaries as a Percent of the Population (1970-1999)



Source: Joel Emes, 2000.

Table 2: Welfare Information for the 1990s

Province	Indicator	1989/90	Peak Period 1990s (Year)	1998/99	Percentage Change
Ontario	# of Beneficiaries	675,700	1,379,300 (1993/94)	910,100	+34.7%
	% of the Population	6.7	12.9	8.0	+19.4%
Alberta	# of Beneficiaries	148,800	196,000 (1992/93)	71,900	-51.7%
	% of the Population	5.9	7.4	2.5	-57.6%
British Columbia	# of Beneficiaries	216,000	374,300 (1994/95)	275,200	+27.4%
	% of the Population	6.7	10.2	6.9	+3.0%

Source: Human Resources Development Canada, Cost-Shared Programs Division, Human Resources Investment Branch; Statistics Canada, *Provincial Economic Accounts*; calculations by the author. Also available in summary form in *Fraser Forum*, October 2000. Available on the Internet at www.fraserinstitute.ca.

a robust labour market, the US has seen its welfare caseload plummet. With only 2.3 percent of the US population receiving welfare benefits in 1999, the US has achieved a reduction in welfare dependency not equalled in the last 30 years (Welfare Figure 4).

Canada, too, experienced federal reform of the welfare system in 1996, albeit indirectly. The replacement of the Canada Assistance Plan (CAP) with the Canada Health and Social Transfer (CHST) represented a step forward in allowing for flexibility and greater provincial control of social service provision. The only federally-mandated requirement under the CHST for welfare provision is that residency requirements cannot be used to determine eligibility. Thus, the CHST's implementation allowed for much greater experimentation and innovation in the delivery of welfare and related services.

Unfortunately, Canada has not experienced a similar decline in its welfare rolls. The peak rate of welfare dependency (Welfare Figure 4) in Canada (10.8%) occurred in 1993, the same year as it

did in the United States, but was nearly double the US rate (5.5%). As Welfare Figure 4 shows, Canada is still well above its low use point for the last 30 years. Also, Canada now maintains nearly three times as large a percentage of people on welfare as does the United States. Clearly, the combination of a robust economy coupled with serious welfare reforms have benefited US society, particularly those formerly on welfare. Also, the beneficial effects of those reforms are likely to continue after the strong economic growth has ended.

Innovation and Experimentation: US Experience

[Note: This section on US welfare reform is based largely on the work of Chris Shafer, Joel Emes, and Jason Clemens, contained in their forthcoming 2001 study, *Surveying US and Canadian Welfare Reform*. The study will be available on the Fraser Institute web site: www.fraserinstitute.ca.]

A plethora of innovative welfare programs have been developed across the United States in the

past decade. Due to space constraints we will focus on three of these reforms.

Private Sector Involvement

Wisconsin

This example focuses on Wisconsin's use of private companies to deliver welfare. Wisconsin contracts with private, for-profit companies for such things as determining eligibility, case management, and other related welfare services. In fact, nearly 70 percent of Wisconsin's welfare caseloads are handled by private companies (Dodenhoff, 1998). One of the many innovations of the Wisconsin Works (W-2) initiative is creating the proper incentive structure for contracted companies. Wisconsin remits a flat fee to contractors for the administration of contracted services. The companies must cut costs if they are to generate profits for themselves because the state places strict service and quality stipulations on these private companies, which prevents them from simply refusing to serve clients. In fact, contractors face severe penalties of up to \$5,000 per welfare case for a "failure to serve." As a result of innovation, the cost of administering welfare in Wisconsin has declined by at least \$10.25 million in just two years, with no adverse delivery affects (Dodenhoff, 1998).

New York City and America Works

The partnership between America Works and New York City proves that private welfare providers can actually improve the quality of service welfare recipients receive. The City of New York contracts with America Works to place long-term unemployed people into stable employment. The contract is based on performance: America Works receives 18 percent of the total per capita contract value when the person is initially placed, 70 percent after four months of stable employment, and the remaining 12 percent after an additional three months. In other words, America

Works only gets paid if it is successful in placing the hardest employment cases in stable, long-term employment.

Such contract terms have forced the company to consult with employers and innovate to create a uniquely successful orientation, job- and life-skills program. The results are striking. The Manhattan Institute estimates that 88 percent of case loads handled by America Works remained employed after three years. A further benefit is the large reduction in cost. The National Center for Policy Analysis estimates that America Works places welfare recipients in stable employment for roughly one-sixth the cost of the comparable government programs. That is, America Works is able to place people in work for roughly \$5,500 (US) per person, while comparable programs operated by the state cost roughly \$29,000 (US) per person (NCPA, 2000).

Faith-Based Provision

Faith-based welfare provision has been adopted by a variety of states including Texas, Mississippi, Michigan, Ohio, and Maryland. These states have either contracted with or decentralized to faith-based organizations for the direct delivery of welfare and welfare-related services. One example of the strength of such programs is the Family Pathfinders Program in Texas. The program uses local community volunteers such as business leaders, civic activists, and members of religious congregations to create small teams to aid specific families. The teams provide job training, housing assistance, child care, life skills training, transportation, and moral encouragement and support to help welfare families make the transition from welfare to work. The data available as of June 1999 indicate overwhelming success. Of the 527 program participants, 399 or 76 percent were off of welfare, and 287 or 55 percent were employed (Family Pathfinders Program, 1999).

Role of Private Charities

The provision of welfare by the state requires a very delicate balance between compassion and “tough love,” so that families receive the help they need to get back on their feet, but are never trapped into long-term dependence on the state. There is mounting research regarding the efficacy of private welfare provision in maintaining this balance. Much of the research investigates the level of success and breadth of coverage achieved prior to the advent of the welfare state. For instance, Dr. Marvin Olasky in his book *the Tragedy of American Compassion* (1992), documents how private charities, many of them religious, provided welfare more successfully and at lower costs than the state. In fact, Dr. Olasky argues that private charities are much more effective than the state because they are better equipped to discern need, balance the provision of assistance with dependency, and provide compassion.

Further research by Dr. David Beito has investigated the success of mutual aid societies and unions in providing social services to their members. Like the work of Olasky, Dr. Beito concludes that private organizations were able to provide social services that are comparable to those provided by the welfare state, but more effectively and more efficiently (Beito, 2000).

An article published in the October 2000 issue of *Fraser Forum* (Clemens, 2000) investigated whether Canada has the necessary charitable infrastructure for private charitable provision of welfare. After comparing like-sized religious and welfare-oriented charities with the number of welfare cases and recipients, the article concluded that the western provinces and Ontario do have a large enough charitable sector to experiment with private charitable provision of welfare.

Welfare Policy Recommendations

(1) Introduce strong sanctions and immediate work requirements.

British Columbia should immediately institute work requirements for eligible welfare recipients coupled with material financial penalties for non-compliance. Those willing but currently unable to enter the work force should be given additional resources in order to facilitate their entry to it.

(2) Implement time limits for the receipt of benefits.

A specific time limit, similar to the ones included in the US reform initiative of 1996, should be included as part of a broad-based reform of welfare in British Columbia. Specifically, individuals should be precluded from receiving welfare benefits for more than two years in any given five-year period. This type of flexible cap on receipt of public assistance would reduce the number of people who choose welfare over work as a rational decision. People with disabilities that prevent them from working should, of course, be excluded from such restrictions in recognition of their different circumstances.

(3) Adopt a diversion strategy prior to welfare provision.

Implement a program focusing on diverting potential welfare recipients away from welfare by focusing on sources of familial support, charitable organizations, lump-sum payment programs, and/or employment opportunities.

(4) Introduce full-check sanctions.

Tough sanctions, including reduction and/or elimination of benefits based on non-

compliance should be introduced along with other reforms.

(5) Monitor the relationship between total welfare benefits and the minimum wage.

One of the particularly difficult areas of welfare provision is to maintain incentives for recipients to re-enter the workforce while providing sufficient resources to prevent impoverishment. That is, as the state continues to provide welfare benefits, it must be extremely careful to maintain work incentives. Specifically, the total value of welfare benefits must be compared with the value of working full-time at minimum wage. If there is a large discrepancy that favours welfare, then there is little incentive for anyone to move back into the workforce.

(6) Adopt a comprehensive measure of welfare benefits.

In order to measure the relationship between the incentive to return to work versus remaining on welfare, the province must maintain a comprehensive view of welfare income that includes all non-cash transfers and benefits.

(7) Promote and facilitate experimentation.

British Columbia, and indeed all of the provinces, should pursue successful initiatives undertaken in the US. British Columbia must focus on providing the best outcomes for welfare recipients, that is, dealing quickly, precisely, and compassionately with the problems of welfare recipients rather than continuing to concern itself with the nature of the service provider. In other words, if for-profit companies or non-profit charities can provide better welfare programs than the government, then the province should embrace rather than preclude such experimentation.

(8) Reduce administrative costs.

The British Columbia government should establish a specific target of not less than a 10 percent reduction in the cost of administering welfare and welfare-related programs. This objective could be achieved in one of two ways: consolidate government services across the province into more comprehensive, multi-service provision centres; or, use contracts with for-profit companies and non-profit organizations for various administrative and program aspects of welfare provision.

(9) Adopt a Basic Needs definition of poverty.

In order to truly understand the problem, we must first measure it appropriately. British Columbia should, therefore, immediately adopt a basic needs assessment to define poverty and, subsequently, calculate welfare benefits. Professor Christopher Sarlo's ground-breaking work in this area provides a way to assess the cost of basic necessities.

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[Note: For complete publication data, please see the list of references.]

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John Richards and William Watson, eds., *Helping the Poor: A Qualified Case for "Workfare."*

Chris Shafer, Joel Emes and Jason Clemens, *Surveying US and Canadian Welfare Reform*. (Forthcoming)

Arthur Seldon, ed., *Re-Privatising Welfare: After the Lost Century*.

Jeffrey J. Sikkenga, *Transforming Welfare: The Revival of American Charity*.

Michael Tanner, *The End of Welfare: Fighting Poverty in the Civil Society*.

Industrial and Privatization Policy: Getting Government Out of the Business of Business

This policy section combines two policy areas under one common umbrella: industrial policy and privatization. The reason for the amalgamation is that both deal with economic development. Industrial policy broadly deals with how to expand business and economic development. It also assesses the role, if any, for government in the process.

Privatization is simply one policy alternative available under the auspices of industrial policy. It refers to the reversal of the most activist or interventionist type of industrial policy a government can pursue: outright ownership and operation of a business.

This section deals both with the proper role for government in developing industry as well as with the principles of privatization. It presents the economics of industrial policy and the particular issue of privatization. It also includes a summary presentation of the state of Crown Corporations in British Columbia along with a general assessment of the industrial climate. The section concludes with a series of policy recommendations.

Economics of Industrial Policy

There are two major schools of thought regarding industrial development: the interventionist school and the market school. The interventionist school argues that the most effective way to promote economic development is through direct ownership of business by government (Crown Corporations), the provision of subsidies and trade protection for select businesses, and the provision of incentives, such as tax holidays for new businesses to establish themselves.

Alternatively, the market approach to economic development focuses on establishing the proper environment within which competitive businesses can flourish. Rather than directly subsidizing or protecting businesses, the market approach to development calls for a hands-off approach wherein taxes are competitive, regulations focused and streamlined, and government spending prioritized.

Most countries employ an industrial policy somewhere between the two extremes by incorporating portions of both policies. Many countries "select certain industries, technologies, and/or

firms whose advancement is of critical importance for the economy as a whole, and award selective incentives, whether through subsidies, import restrictions, and/or special efforts to promote exports” (Mihlar, 1994).

Evidence suggests, however, that governments are not usually successful in picking winners and losers, and in many instances, the overall costs of such endeavours outstrip any benefits. Activist industrial policies have been found to protect inefficient firms and channel millions of dollars into political pet projects that produce very few economic benefits (Mihlar, 1994; Walker, 1984). Regional economic diversification programs, which are usually subject to political interference, have been found to generate no net benefits (Savoie, 1990). Government has been no more successful directing existing industry through regulation than it has been picking industrial winners in the marketplace. Command and control regulations, for instance, have often impeded innovation and enterprise, actually reducing economic efficiency (Wolf, 1993). In fact, the growth of a government bureaucracy with an agenda of its own has often contributed to rent-seeking behaviour that raises costs to consumers (Niskanen, 1971).

The 2000 *Summer Survey of Investment Managers in Canada*, a survey of senior pension and investment fund managers with nearly \$249 billion in assets under administration, indicated a strong preference for the market approach to economic development. In fact, of ten factors they rated important to a positive investment climate, direct subsidies to business ranked last with a score of 3.5 out of a possible 10 (Clemens and The Fraser Institute, 2000). The results from both the 2000 survey as well as previous surveys completed in 1999 and 1998 indicate overwhelming support for government to focus on the economic fundamentals to create and maintain an environment within which businesses can prosper.

Defining Privatization

Before discussing the economics of privatization, it is important to define the term. Surprisingly, among the different countries that have employed privatization, there is quite a bit of agreement about what the term means. The spectrum of privatization efforts ranges from the sale of public-sector enterprises to the private sector, to the simple contracting-out of public service provision to private contractors (Adam Smith Institute, 1986). This section takes a broad view of privatization in order to include any private sector involvement in what were formerly public sector initiatives.

Economics of Privatization

The core economic question regarding privatization is efficiency: can efficiency gains be achieved through privatization, whether by transferring assets from the public sector to the private sector outright, or by contracting out public services to private providers? Efficiency refers to the ability of producers to combine various inputs in order to produce an output. Privatization, therefore, makes sense if through the privatization process, producers are able to produce a given level of output with less input. Privatization of government enterprises, or Crown Corporations, is only worthwhile if efficiency gains can be realized.

There are a variety of reasons to believe that private producers are more efficient than public ones. One principal reason is that public sector managers face different incentives from their private sector counterparts (Hanke, 1987). Private enterprise is largely concerned with profit. Private firms are forced, by competition, to focus on a number of internal and external factors. For instance, internally, firms must constantly monitor costs, productive efficiency, and employee contentment and retention. Externally, firms must continually innovate in order to ensure that they

are delivering a high quality product at a reasonable price (Gwartney and Stroup, 1993).

The concerns for public sector enterprises are very different. Public sector firms do not have to generate a profit in order to remain viable; in fact, generating profits often results in a reduction in state subsidies, a result that creates a real disincentive for profitability. Because they have no profit motive, public sector enterprises tend to focus much less attention on cost control and productive efficiency. Also, public sector enterprises have little or no competitive pressures forcing them to innovate and improve product quality and service. Public sector enterprises increasingly stagnate because of their institutional inability to innovate and improve in a climate that values innovation and sensitivity to changes in public needs, tastes, and values. Producer concerns rather than consumer interests tend to dominate decision-making and resource allocations in the public sector (Mitchell and Simmons, 1994; Niskanen, 1971).

The mix of labour and capital also varies between the public and private sectors. Public sector enterprises generally tend to use more labour than similar private sector firms. Further, public sector enterprises tend to use capital much less efficiently than similar private sector firms (Pirie, 1988). Inefficient use of inputs is costly to the economy because it reduces the amount of labour and capital available for other uses. Public-sector enterprises also tend to have more rigid labour and workplace rules that, despite their good intentions, inevitably impede innovation and experimentation (Pirie, 1988).

Numerous studies of public sector enterprises before and after privatization have shown that, in practice, productivity gains are achieved by transferring assets from the public sector to the private sector. For instance, a 1997 CD Howe Institute review of evidence on the effects of global privatization initiatives by Carleton University

economics professor D.G. McFetridge concluded that there were generally positive outcomes associated with privatization (McFetridge, 1997).

Case Studies in How Can Privatization Yields Savings

A number of case studies corroborate the findings discussed above and provide further evidence of the benefits of privatization. A successful example of contracting out public sector services exists in Richmond, British Columbia. Significant efficiency gains were achieved when the municipality began contracting out garbage collection (McDavid, 1988). Professor McDavid estimated that after privatization, the tonnes of garbage collected per crew person per day increased from 6.2 to 10.25, while the per household cost decreased from \$52.71 to \$31.72 (McDavid, 1988).

Another example of successful privatization is the prison systems in the United States. Privately operated, for-profit prisons tend to use more sophisticated surveillance systems, which enable guards to monitor more inmates. In other words, fewer guards are needed, while the quality of supervision remains high (Thomas, 1998). Professor Stephen Easton of Simon Fraser University has estimated that Canada could save in excess of \$200 million dollars per year by employing similar privatization techniques in Canada's prisons (Easton, 1997).

A final example of a positive privatization effort is the Alberta Liquor Control Board (ALCB), which was privatized in 1993. The ALCB devolved control of liquor outlets to the private sector. Since privatization, consumers have enjoyed increased access to liquor retailing outlets, improved product choice, and better service (West, 1997).

Since the Thatcher revolution in Britain, privatization has become a major movement. According to a 1997 analysis by the Dallas-based National

Center for Policy Analysis (NCPA), privatization efforts by governments world-wide amounted to \$86 billion in 1996 alone. Between 1985 and 1997, over \$600 billion worth of public assets were sold or transferred to the private sector world-wide. The study by the NCPA quotes a World Bank study that examined 60 privatized companies in 18 different countries. The study concluded that post-privatization profitability increased 45 percent, efficiency by 11 percent, output by 27 percent, and investment in plant and equipment jumped 44 percent (NCPA, 1997). The public sector enterprises that were privatized included airports, air-traffic control, telecommunications, mining, oil and gas, banks, and postal services.

Public Sector Enterprises in British Columbia

The government of British Columbia expects to collect \$1.448 billion from government enterprises in 2000/01, representing 6.7 percent of total consolidated budget revenues (BC Ministry of Finance & Corporate Relations, 2000a). This figure is down slightly, 0.2 percent, from the revised forecast of \$1.451 billion for 1999/00.

According to the *Second Quarterly Report*, British Columbia is actually experiencing major increases in the amount of revenues received from Crown Corporations. For instance, the loss asso-

Privatization Table 1: Crown Corporations in British Columbia

Crown Corporation	Actual Net Income (First 6 Months of 2000/01) (Millions \$)	Actual Net Income (1999/00) (Millions \$)	Actual Net Income (1998/99) (Millions \$)
Taxpayer-Supported			
BC Buildings Corporation	30	45	49
BC Ferry Corporation	58	-299	-114
BC Transportation Financing Authority	8	22	-114
Forest Renewal BC	-56	1	-265
Self-Supported			
BC Hydro and Power Authority	507	416*	395
Liquor Distribution Branch	323	617	616
BC Lottery Corporation	268	532	456
BC Railway Company	19	-582	24
Insurance Corporation of BC	312	96	74
*Does not include \$129 million transferred to the rate stabilization account. Source: BC Ministry of Finance and Corporate Relations, 2000b and 2000d.			

ciated with tax-supported Crown Corporations and agencies was \$27 million better than expected (BC Ministry of Finance and Corporate Relations, 2000d). Further, the performance of self-supported Crown Corporations was \$977 million better than anticipated (BC Ministry of Finance and Corporate Relations, 2000d). In total, the net contribution by Crown Corporations for the first six months of 2000/01 was \$1.004 billion better than originally budgeted (BC Ministry of Finance and Corporate Relations, 2000d). However, the deterioration of the energy sector in California, a major customer of BC Hydro, may temper the financial results of Crown Corporations in the next two quarters. Nonetheless, Crown Corporations in British Columbia continue to provide government well in excess of budgeted revenues.

Two Types of Crown Corporations

There are two types of Crown Corporation: taxpayer-supported and self-supported. Taxpayer-supported Crown Corporations require government subsidies in order to continue operating while self-supporting Crown Corporations cover their own operating and debt-servicing costs while providing government with dividend payments. Privatization Table 1 contains information for both taxpayer-supported and self-supporting Crown Corporations in British Columbia.

According to government of British Columbia figures, the various Crown Corporations listed in Privatization Table 1 contributed a net \$406 million to the summary government accounts in 1999/00 (BC Ministry of Finance and Corporate Relations, 2000b).

A review of the various public sector enterprises and their recent financial performance reveals the scope of government enterprises in British Columbia. Estimates of market values or tax revenue savings are also presented, where possible, for each of the Crown Corporations, based on either full privatization or the implementation of competitive contracting out.

Taxpayer-Supported Crown Corporations

The BC Buildings Corporation generated a \$45 million net profit, \$30 million below budget expectations. The lower-than-expected performance was essentially due to lower property sales than expected. In 1999/00, the BC Buildings Corporation paid a \$71 million dividend to the government for profits earned in previous years (BC Ministry of Finance and Corporate Relations, 2000b). The likelihood that similar dividends could be remitted to the provincial government in the future is highly doubtful since the dividend was based on accumulated profits over a number of years.

The BC Ferry Corporation posted a net loss of \$299 million in 1999/00, \$248 million above budget and \$185 million higher than in 1998/99. The serious deterioration in the performance of the BC Ferry Corporation was largely attributable to a \$240 million write-down in the value of the newly-constructed PacifiCat ferries, the so-called fast ferries. Excluding the write-down of the fast ferries, the BC Ferry Corporation posted a net loss of \$59 million. The net loss occurred even as operating revenues increased and the provincial grant of \$24 million (1998/99) was replaced by a dedicated fuel tax totalling \$65 million (BC Ministry of Finance and Corporate Relations, 2000b). The introduction of competitive bids for the operation of BC Ferry lines combined with a rationalization of subsidies such that the government would only subsidize lines that were unprofitable was estimated to save taxpayers roughly \$17.5 million annually (Lippert, 1996).

The BC Transportation Financing Authority (BCTFA) posted a net profit of \$22 million in 1998/99, a significant improvement from the previous year's loss of \$114 million. The improvement is largely the result of a one-time adjustment of \$91 million in 1998/99 to transfer Lower Mainland highways to TransLink. Operating revenues increased 67 percent from the previous year (1997/98), largely as a result of the 1 cent a litre dedicated fuel tax while expenditures (excluding one-time items) increased 57.5 percent (BC Ministry of Finance and Corporate Relations, 2000b).

Forest Renewal BC generated net income of roughly \$1 million, significantly out-performing budgetary estimates of a \$243 million loss. The improvement was generally a result of higher than expected stumpage fees (revenues increased 49 percent) and lower than expected expenditures (expenses declined 32 percent) (BC Ministry of Finance and Corporate Relations, 2000b).

There are a host of other taxpayer-supported Crown Corporations in British Columbia, including BC Assets and Land Corporation, BC Pavilion Corporation, Pacific National Exhibition, and the BC Assessment Authority. In total, these 'other' taxpayer-supported Crown Corporations posted a net loss of \$44 million (BC Ministry of Finance and Corporate Relations, 2000b).

Self-Supported Crown Corporations

BC Hydro and Power Authority, one of British Columbia's largest corporations, posted net income of \$416 million after a \$129 million transfer to the authority's rate stabilization account. Domestic revenues rose 2.2 percent, even though a rate freeze imposed by the BC government is in its sixth year. BC Hydro and Power Authority paid a \$343 million dividend to the government in 1999/00 (BC Ministry of Finance and Corporate Relations, 2000b).

An analysis by the late Bruce Howe, former President and CEO of Atomic Energy of Canada Ltd. and Frank Klassen, former Vice-President of Finance and Administration for BC Hydro, estimated the market valuation of BC Hydro at roughly \$14 billion in 1996. The privatization of BC Hydro could, therefore, in 1996 have reduced total British Columbian debt by \$12.2 billion (net) without incurring any adverse effects in power delivery, accessibility, or overall cost (Howe and Klassen, 1996). The resultant reduction in provincial debt would yield additional annual savings of roughly \$134 million achieved through lower debt servicing costs (Lippert, 1996).

The Liquor Distribution Branch generated a net income of \$617 million, all of which is included in the government's consolidated revenue fund. In 1996, Owen Lippert, studying the experience of the Alberta government which privatized its liquor distribution, concluded that the privatization of liquor retailing outlets could yield increased an-

nual tax revenues from profitable liquor outlets totalling \$250 million (Lippert, 1996).

The BC Lottery Corporation achieved a net income of \$532 million, \$22 million higher than budgeted and 17 percent higher than in 1998/99. The increase was mainly due to increased casino and electronic bingo activity. A total of \$523 million was remitted to the provincial government of which only \$107 million was transferred to charities and local government; the remaining amount was included in the consolidated revenue fund (BC Ministry of Finance and Corporate Relations, 2000b).

The BC Railway Company incurred a net loss of \$582 million resulting from a one-time write-down of rail investments of \$617 million. Excluding one-time write-downs, operating income totalled \$34 million (BC Ministry of Finance and Corporate Relations, 2000b). An analysis of the value of the BC Railway Company by Owen Lippert in 1996 estimated that privatization of the company would yield roughly between \$600 and \$750 million. In addition, the commensurate reduction in interest costs resulting from the reduction in debt would yield an additional savings of \$54 million (Lippert, 1996).

The Insurance Corporation of BC (ICBC) generated a net profit of \$96 million for the year ending December 31, 1999. Despite a premium freeze, ICBC was able to increase revenues slightly while reducing the costs of claims by 3.7 percent (BC Ministry of Finance and Corporate Relations, 2000b). A 1996 analysis by Owen Lippert estimated that a privatized ICBC would result in annual revenues of roughly \$250 million (Lippert, 1996). This flow of tax revenue would be in addition to any revenue garnered from the privatization, that is, the sale of the corporation to public.

Conclusion

In its pre-budget submission, the BC Business Council called for a thorough review of all Crown

Corporations. It further recommended establishing a multi-year process through which to sell provincial Crown Corporations and other assets in an attempt to reduce the province's debt. The BC Business Council estimated that the sale of Crown Corporations in British Columbia could yield one-time revenues between \$7 and \$10 billion in addition to future corporate income tax revenues. The resultant reduction in debt and lowering of interest costs was estimated to garner total annual savings in excess of \$600 million (BC Business Council, 2000a).

It is important to note that in its analysis of Crown Corporations in British Columbia, the BC Business Council concluded that BC maintains several Crown Corporations in sectors in which private firms are delivering similar goods and services at similar prices and with comparable quality in other jurisdictions, thus questioning the need for government involvement. The BC Business Council followed up its 2000 pre-budget submission with another brief that echoed its earlier recommendation for large-scale privatization with a similar estimate of possible revenue realization (BC Business Council, 2000b).

British Columbia maintains a number of Crown Corporations in sectors that compete with private providers. Given British Columbia's need to reverse its dismal economic record over the last decade, it would be a mistake to continue to subsidize these expensive and unnecessary Crown Corporations. It would be far better to use the funds to reduce debt and interest costs while fostering a more positive economic environment of private-sector competition. In short, British Columbia has the opportunity to reduce costs while facilitating an improved business environment, if only it divests itself of these publicly owned assets.

Fallacy of Government Revenue & Crown Corporations

One of the most strenuously used defences for the continued use of Crown Corporations is that they provide subsidies to the government in the form of dividend payments. Indeed, Crown Corporations in British Columbia do provide net revenue to the government. For instance, the revised forecast for 1999/00 indicates that the provincial government will receive nearly \$1.5 billion in payments from Crown Corporations.

The fallacy of the argument rests in the belief that those revenues will stop if the Crown Corporations are sold to the private sector. In reality, the provincial government will continue to garner revenue from the companies in the form of corporate income tax, and a variety of other taxes levied on corporations. Thus, the privatization of Crown Corporations will not reduce the flow of revenue to government but will simply alter its nature from a dividend payment to normal corporate income tax. In fact, privatization may augment revenues. If the firms are more efficient and thus more profitable, it is entirely likely that the revenues garnered through corporate income tax would exceed those currently received as dividend payments.

Business Climate in British Columbia: In Need of a Fix

Over the last three years, the *Survey of Senior Investment Managers in Canada* has asked pension and investment fund managers with between \$140 and \$249 billion in assets under administration to rank the investment climates of the Canadian provinces. The results paint a desperate picture of the business climate in British Columbia.

The most recent survey, the 2000 *Summer Survey of Investment Managers in Canada*, which included responses from pension and investment fund managers with nearly \$249 billion in assets under

administration, ranked the investment climate in British Columbia the worst of the 10 provinces. In fact, BC received a score of 3.2 out of a possible 10 (Industrial Figure 1), well below Newfoundland's 4.5, which ranked 9th.

As illustrated in Industrial Figure 2, British Columbia also received the highest negative score (71.0%) and the third lowest positive score (19.4%) in response to whether or not the province maintained the right economic policies in order to foster globally competitive firms (Clemens and The Fraser Institute, 2000).

The results from the 2000 *Summer Survey of Investment Managers in Canada* mirror those of both the 1998 and 1999 surveys. For instance, in both 1998 and 1999, British Columbia received the lowest score and ranking for investment climates for the provinces (Industrial Figure 1). Further, in 1999, British Columbia received the highest negative response and next-to-lowest positive response regarding the presence of appropriate economic policies required to develop and foster globally

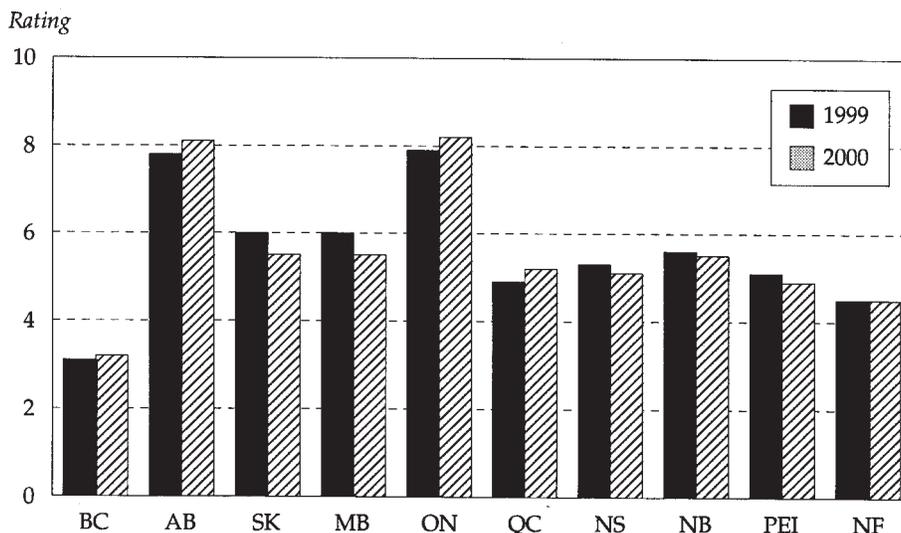
competitive firms (Clemens, Dixon, and The Fraser Institute, 1999).

Corporate Development: Attracting Corporate Headquarters

A combination of poor fiscal policy and poor industrial policy have squandered Vancouver's natural advantage as a location for corporate headquarters. Vancouver's port facilities, access to Asia and the US west coast, coupled with its temperate climate should make it the natural choice for corporate headquarters in western Canada. Unfortunately, the prolonged period of poor public policy have made Vancouver an inferior choice for corporate locations. According to data for the top 500 Canadian companies, Vancouver ranked 3rd in 1990 behind Toronto and Montreal, but fell to 4th by 1999 as Calgary moved up the rankings. Specifically, the number of corporate headquarters in Vancouver (top 500) declined by 17.8 percent between 1990 and 1999, while the number in Calgary increased by 34.1 percent (Clemens and Emes, 2001). In fact, by

1999, Vancouver was barely ahead of Mississauga (a Toronto suburb) in terms of the number of corporate headquarters. Calgary actually leads the nation in the number of corporate head offices when the figures are adjusted for population. Vancouver has clearly sacrificed an important source of business development and prestige due to the poor provincial policies.

**Industrial Figure 1: Provincial Investment Climate Ratings
(1999-2000)**



Sources: Clemens and The Fraser Institute, 2000; and Clemens, Dixon, and The Fraser Institute 1999.

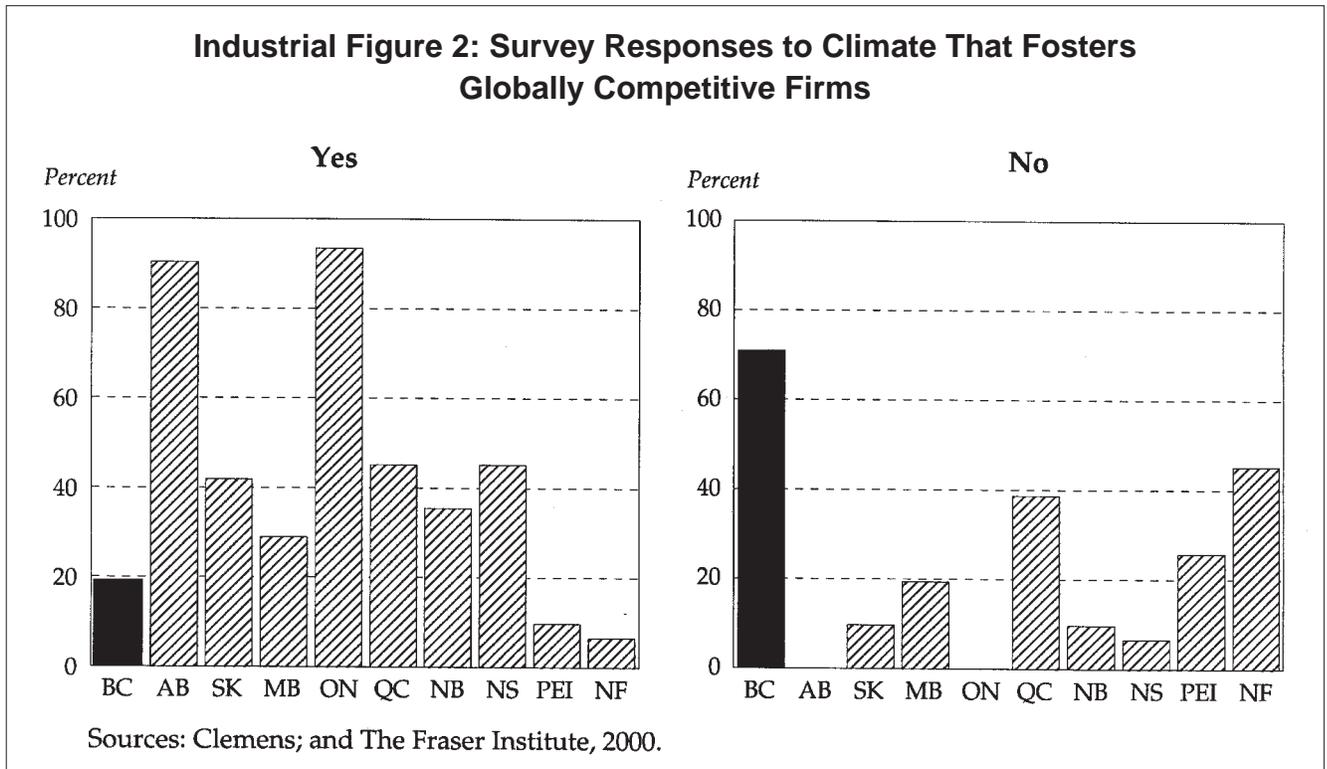
Business Investment

Not surprisingly, the poor business climate in British Columbia has translated into poor performance in the level of business investment. As depicted in Industrial Figure 3, British Columbia has not attracted real business investment in the province. British Columbia fared particularly poorly in the 1990s, especially in the last five years. While Canada as a whole and both Ontario and Alberta leapt forward with large amounts of fixed business investment, experiencing 20.2 percent, 30.8 percent, and 36.5 percent increases between 1995 and 1999, British Columbia experienced a net decline in fixed business investment of 4.2 percent. This is even more troubling when the previous five-year period is added, since net fixed business investment also declined during that period by 0.4 percent.

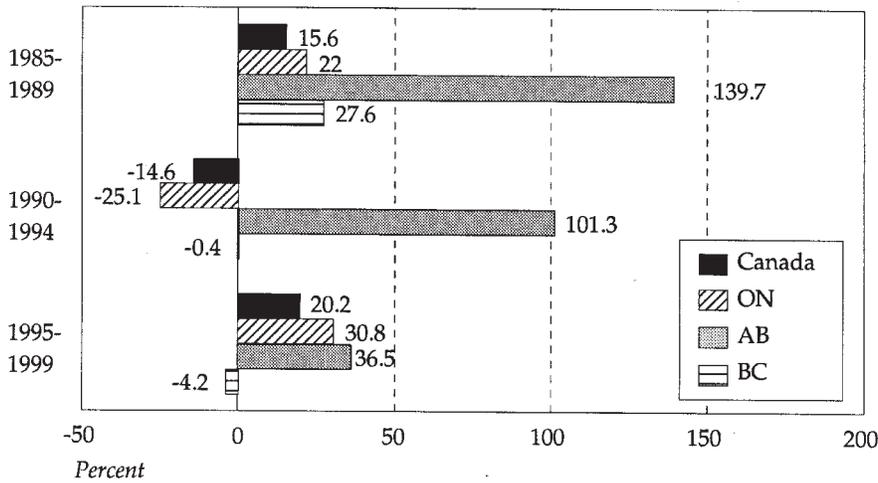
An alternative way of viewing business investment performance is contained in Industrial Figure 4. It presents the cumulative change in business investment in the Canadian provinces between 1992 and 1999. As depicted in Industrial

Figure 4, British Columbia had the worst performance of any province over this time period. This is particularly troubling as investment in new plants and equipment partially explain increases in both labour and total-factor productivity, which are the primary determinants of real income.

In its 2000 pre-budget submission, the BC Business Council explained that “A healthy level of investment in new plant, equipment and technology is a prerequisite for both higher productivity and the rising incomes that typically follow in the wake of productivity gains” (BC Business Council, 2000a). The analysis completed by the BC Business Council concluded that British Columbia had done a “poor job of attracting private sector investment” (BC Business Council, 2000a). A report stated that “companies and entrepreneurs across a range of industries do not see British Columbia as an attractive place to put new investment dollars or grow their businesses” (BC Business Council, 2000b).



Industrial Figure 3: Growth in Real Fixed Business Investment (1985-1999)



Source: Statistics Canada, 2000b.

Assessment of Industrial and Privatization Policy in BC

The British Columbia government has pursued an activist industrial policy. Since coming to power in the early 1990s, the current provincial

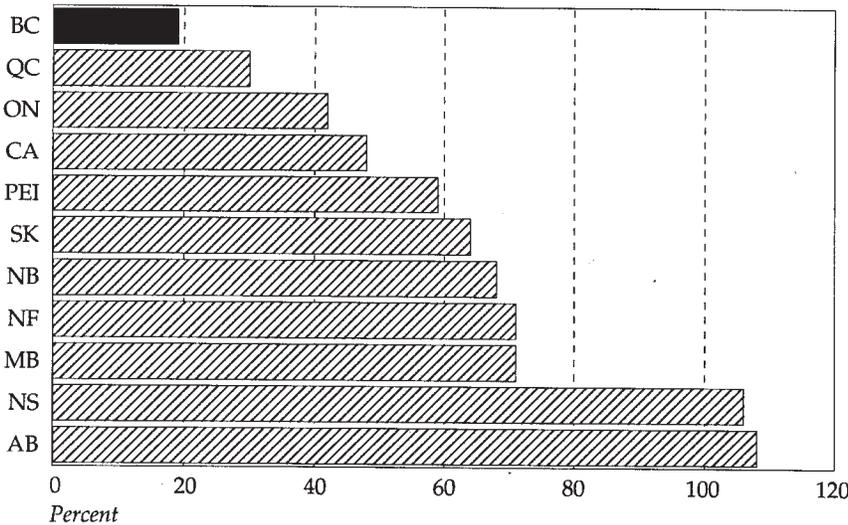
government has undertaken a number of high profile interventions, signalling a shift in industrial policy away from a market approach focusing on fundamentals towards an activist or interventionist approach.

One of the more high profile cases involved Skeena Cellulose, a pulp plant in Prince Rupert. The provincial government purchased 52.5 percent of the company even though it was close to bankruptcy. It subsequently spent

nearly \$329 million on the project, not including debt guarantees amounting to \$156 million (Beatty and Fong, 1998; BC Ministry of Finance & Corporate Relations, 2000c). Although Skeena Cellulose is now defined as self-supported, meaning it does not receive direct subsidies from the provincial government, the debt load of the company has increased from \$120 million in 1998 to \$280 million in 2000 (Beatty and Fong, 1998; BC Ministry of Finance & Corporate Relations, 2000c).

A second high profile example of an activist industrial policy is the PacifiCat fast ferries. Rather than simply purchase fast ferries for the BC Ferry Corporation, the province decided to develop a specialized industry in British Columbia for the construction of alumin-

Industrial Figure 4: Increase in Total Business Investment (1992-99)



Source: Business Council of BC, 2000c.

ium ferries. The result was a \$240 million write-down in the value of the newly constructed PacificCat ferries, little improvement in the operations that the new ferries were suppose to augment (no major reduction in passage times), and extreme difficulty by the province in selling the three ferries (BC Ministry of Finance and Corporate Relations, 2000b).

Other activist industrial endeavours have included J.S. McMillan fish processing (\$8.1 million contribution), Western Star Truck Holdings Ltd (\$62 million in debt), Pacific Racing Association (\$5 million in loans), and the Columbia Basin Power Company (\$94 million in debt), to name but a few (BC Ministry of Finance & Corporate Relations, 2000c; Chera and Mihlar, 1998). Additionally, the provincial government has enacted several programs to intervene in industrial development. These include the Jobs Protection Commission, the Ministry of Northern Development, Small Business Venture Capital Tax Credit, Mineral Exploration Tax Credit, Power for Jobs, and the Quick Response Training program (Chera and Mihlar, 1998).

It seems clear that over the last decade, the British Columbia government has implemented many interventionist policies in an effort to improve industrial development. The province has spent fewer resources to improve the environment within which business operates and more resources to influence specific industrial developments.

Unfortunately for British Columbians, the record of privatization in the province is nearly non-existent. Two examples of modest privatization efforts, namely the design of highways and BC-OnLine, were very small in scope and pale in comparison to the growth of the public sector in British Columbia. Further, it is not entirely clear that the devolvement of highway infrastructure to Translink will either be sustain-

able or, in fact, economically prudent given recent difficulties.

No reviews have been undertaken of government-sponsored private monopolies such as municipal taxi licensing or the Dairy Marketing Board. Plans to convert ICBC into a co-operative were summarily dropped under political pressure. Encouraging remarks by then-Deputy Premier Dan Miller about the desirability of forest privatization have also not materialized. A few private wine stores have continued to operate in the province, but no government stores have been privatized, and no significant expansion of competition for government liquor stores has been permitted.

There has been no comprehensive attempt to review the role of government and the potential costs and benefits of privatization. A number of Crown Corporations and related agencies have been plagued by charges of financial mismanagement, ever-increasing debt, poor customer service, managerial and staff incompetence, and occasional scandal.

Policy Recommendations

- (1) Purposefully move away from activist and interventionist industrial policies towards a market-based approach to economic development.**

This will require a broad change in both attitude and policy by the provincial government and bureaucrats.

- (2) End all direct and indirect subsidies granted to business.**

As part of the move away from activist industrial policy, the provincial government should end the practice of granting subsidies, debt guarantees, monopoly provision rights, or any other type of assistance, whether direct

or indirect. The provincial government should further undertake a review of existing subsidies and assistance programs with a view towards phasing them out within the first mandate.

(3) Several Crown Corporations should be immediately designated candidates for privatization.

Given the international and Canadian experience with privatization, there are several BC Crown Corporations that could be immediately designated for privatization, including BC Hydro and Power Authority, BC Ferry Corporation, BC Liquor Distribution Branches, the Insurance Corporation of BC, and BC Railway Corporation.

(4) Review all remaining Crown Corporations.

A thorough, unbiased review of all remaining Crown Corporations should be undertaken immediately with a clear mandate to rationalize. Those Crown Corporations operating in sectors in which private firms already deliver

similar goods and services should be immediately identified for privatization. Crown Corporations not immediately designated as candidates for privatization should have their operations thoroughly reviewed in order to determine the feasibility of contracting out services to private providers.

(5) Legislatively require all proceeds from asset sales to be used exclusively for debt reduction.

Specific legislation needs to be enacted to ensure that one-time asset sales are not used to help balance the government's accounts or undertake new spending initiatives.

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