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The Government of British Columbia, 1991–1998

An Assessment of Performance and a Blueprint for Economic Recovery

by Satinder Chera and Fazil Mihlar

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Policy recommendations

(For a more detailed explanation of these proposals, please see the relevant sections in the main text.)

Fiscal policy

- reduce government expenditures by 10 percent over the next three years
- enact a balanced budget law
- legislate a debt-reduction plan
- include the Summary Financial Statement in the Consolidated Revenue Fund as outlined in the annual budget document
- stop providing loans and loan guarantees to business
- stop guaranteeing the debts of Crown corporations

Taxation policy

- enact a 30 percent reduction in the basic provincial personal income tax over 3 years
- enact a substantial cut in the top marginal tax rate
- harmonize the provincial sales tax (PST) with the federal goods and services tax (GST)
- cut the corporate income tax rate
- eliminate the corporate capital tax
- reduce payroll taxes.

Labour policy

- repeal the amendments made to the Industrial Relations Act and to the Employment Standards Act
- implement Right-to-Work legislation
- eliminate the minimum wage
- repeal the recently introduced legislation permitting "sectoral bargaining"
- repeal the Fair Wage Act.
- reform the Workers' Compensation Board

Industrial policy

- eliminate all direct and indirect subsidies to business
- repeal the Northern Development Act
- work toward reducing interprovincial trade barriers

Regulatory policy

- implement a moratorium on new regulations
- prioritize regulations based on risk assessment
- implement a cost/benefit test
- enact a "sunset review" clause in any new regulation

Health care policy

- take control of health care
- implement a system of Medical Savings Accounts
- eliminate Reference-Based Pricing

Education policy

- implement a School Voucher system
- permit the establishment of Charter schools
- publish an annual "report card" on schools in British Columbia

Social Policy

- implement a Basic Necessities Index to guide the setting of social assistance rates
- reduce welfare benefits
- implement a mandatory "personal employment strategy" to be completed by those receiving welfare
- implement a Negative Income Tax to replace the current welfare system

Natural resources policy

- privatize forests currently owned and managed by the Crown
- repeal the Forest Practices Code and the Forest Renewal Act
- eliminate the minimum stumpage fee
- eliminate the British Columbia Environmental Assessment Act
- subject the setting aside of Crown land for parks and heritage sites to cost/benefit analysis

Privatization policy

- privatize major Crown corporations, including the Insurance Corporation of British Columbia, British Columbia Hydro, British Columbia Liquor Distribution Branch, British Columbia Railway Company, British Columbia Ferry Corporation, British Columbia Transit, the British Columbia Steamship Company, and Duke Point Development
- contract-out public sector services through a competitive bidding process

The Government of British Columbia,1991–1998

An Assessment of Performance and
a Blueprint for Economic Recovery

Introduction

Debating public policy

All too often, meaningful discussions on issues of public policy are largely derailed by politics and ideology. It should come as no surprise to most people that governments and political parties are, in most instances, more likely to be concerned with good politics rather than good public policy. Lost in this framework of public policy discussions is the economic and social well-being of the people, who are handed simplistic policies that do little to rectify existing problems and much to create new ones.

Persistent budgetary deficits and the rising debt load in British Columbia are prime examples of the adverse impact that political and ideological rhetoric have on policy. To prevent such developments in the future, we need a framework for public-policy deliberations that precludes ideological and political considerations. The focus should be placed solely upon the merits of the policy choices being contemplated by government for, as long as we are willing to accept and engage in the political and ideological rhetoric of yesterday, the public policies we choose for today and tomorrow will do little to advance British Columbia's economic well-being.

Analytical framework

The extent to which a society is able to increase its citizens' standard of living is dependent upon the degree to which the citizens enjoy economic freedom. A 1997 study conducted by The Fraser Institute found that economic freedom—consumer choice, protection of private property and freedom of exchange—were vital prerequisites for economic growth (Gwartney and Lawson 1997). The study, which reviewed the period 1975 through 1995, clearly indicated that those nations that enjoyed high levels of economic freedom also experienced the highest levels of economic growth. Conversely, nations that had less economic freedom, suffered slow and even negative economic growth. In short, the body of evidence contained within the *Economic Freedom of the World 1997: Annual Report* shows that growth and prosperity are best realized when the citizens enjoy a high level of economic freedom.

Governments that are serious about creating jobs and economic prosperity for their citizens must first act to restructure their own operations and allow the efficient use of markets. Operationally, this requires that they:

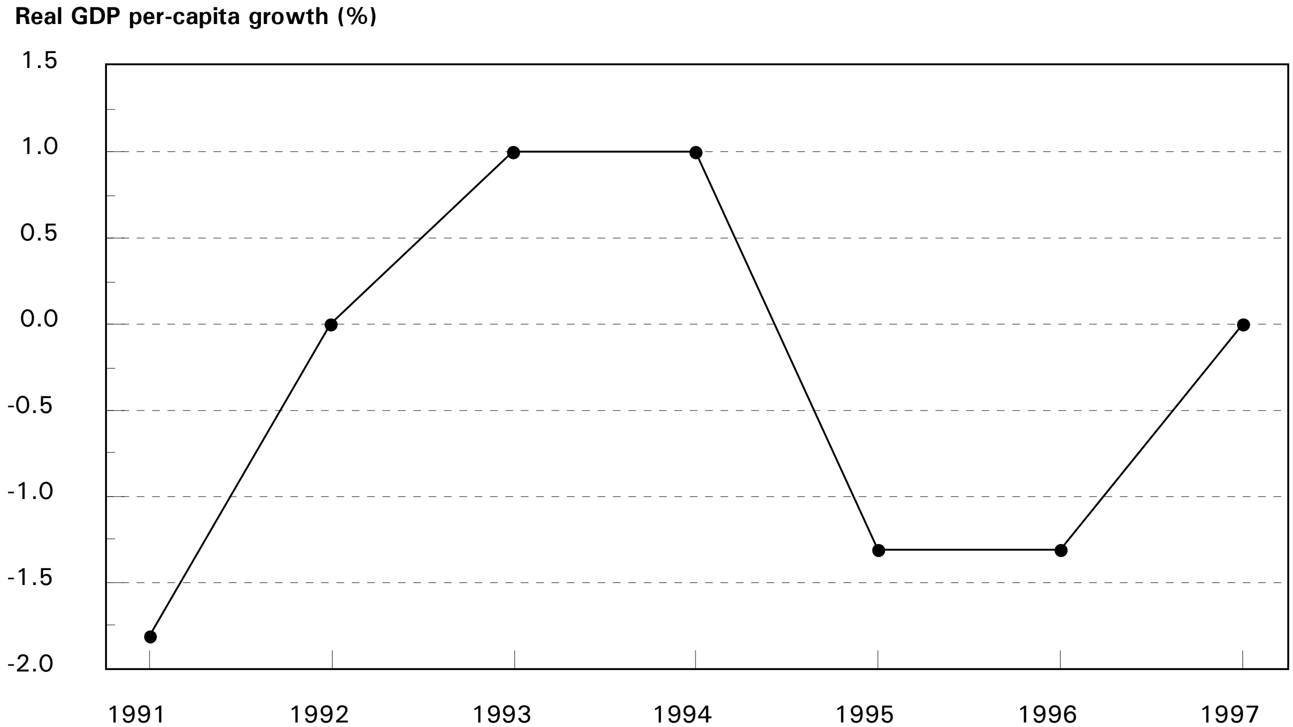
- lower levels of taxation
- balance budgets and eliminate public debts
- reduce and eliminate government regulations
- enact a labour code promoting a flexible labour market
- reduce government expenditures
- privatize government services.

The government of British Columbia

In the autumn of 1991, the New Democratic Party (NDP) came to power in the province of British Columbia. Under the leadership of Premier Mike Harcourt, the newly elected government committed itself to creating a culture of fiscal prudence, to creating employment, and to bringing economic prosperity to British Columbia. Unfortunately, the reality is that under Mike Harcourt and now Glen Clark, British Columbia has been anything but *open for business*.[1]

Over the past several years and, in particular, since the election of Premier Glen Clark, British Columbia has suffered through a period of unprecedented government intervention in the provincial economy. Government expenditures have continued to increase, the provincial debt has escalated, taxes have risen until they are among the highest in the country, the passage of government regulations has become a growth industry, and labour-market policies have introduced rigidity into the labour market, thus discouraging investment and job creation in the province. The policies that have been adopted by the NDP government during two administrations (since 1991) have restricted the economic freedom of its people and hindered economic growth and prosperity in British Columbia. While British Columbia's real gross domestic product

Figure 1: Economic growth in British Columbia



Source: Statistics Canada 1995, 1996, 1998c; calculations by authors.
Note: In 1992 and 1997, British Columbia experienced no growth in real GDP per capita.

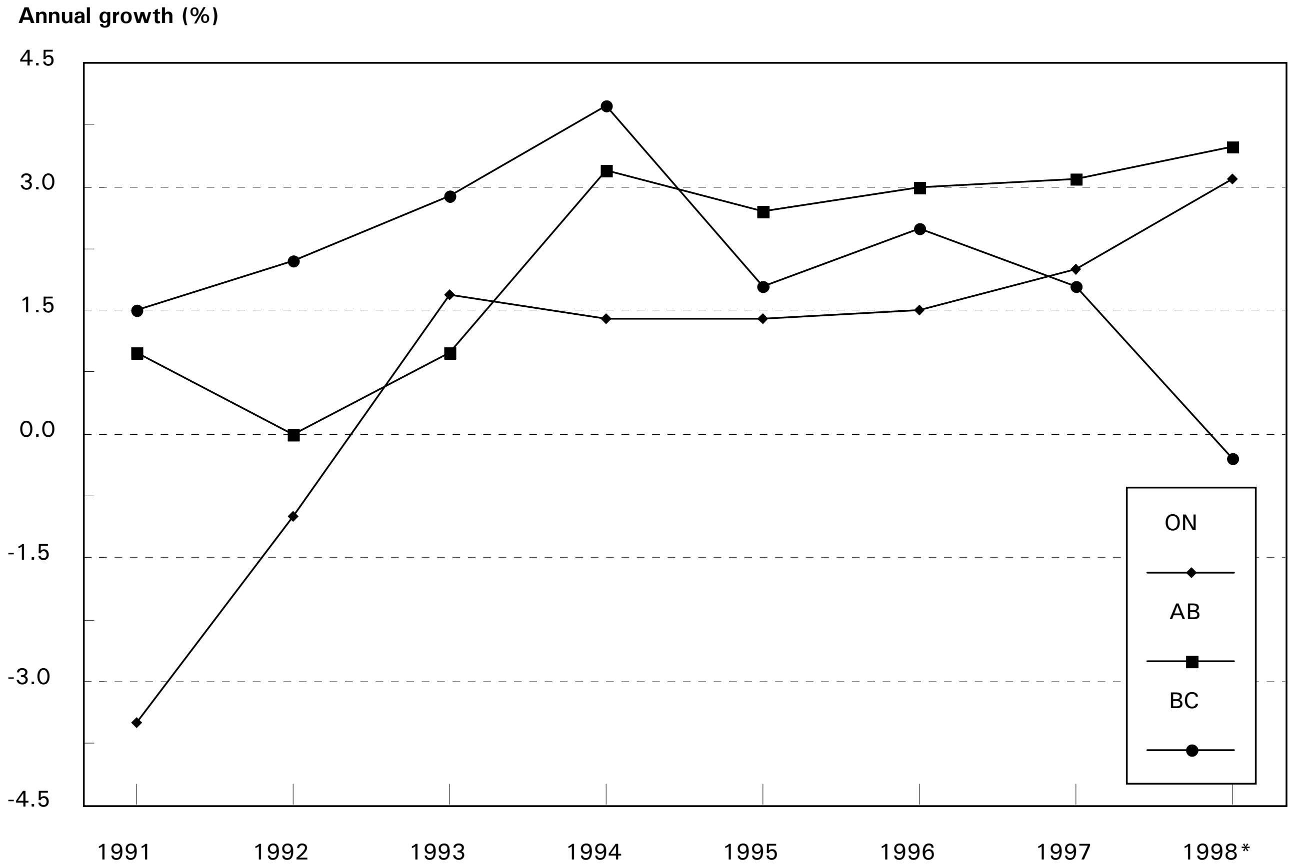
(GDP) grew at 2.6 percent per year between 1991 and 1994, in the recent period between 1995 and 1998, British Columbia has experienced an economic growth rate of only 1.1 percent, the weakest performance in the past 35 years. Moreover, in five of the past eight years, real output per person has fallen (Finlayson 1998).

In response to this weak economic performance, the Clark government has moved to shift the blame for British Columbia's faltering economy onto the Asian economic crisis. While there is no dispute that British Columbia's economy has been effected by the economic down-turn in Asia, the "Asian flu" is not the main cause of British Columbia's fundamental economic problems. First, as figure 1 clearly shows, for much of this decade, economic growth in British Columbia has been weak and, since 1994, economic growth in British Columbia has been steadily declining. British Columbia's economic decline predates the appearance of the Asian economic crises in the summer of 1997. Second, since the United States, not Asia, is British Columbia's largest trading partner,[2] we should be reaping the benefits of a booming American housing market (Schreiner 1998). Additionally, the low Canadian dollar should be encouraging increased exports from British Columbia. Third, the effect of the government's policies had been documented and the government warned as early as June, 1995 in a forecast by the Fraser Institute of the province's fiscal future (Lippert 1995). The warning sounded in that report was repeated in November, 1996 in an open letter to Premier Glen Clark. The economic distress of the province is not the product of some foreign influence; it is, as was clearly foreseen, self-inflicted by local policy (Walker 1998).

British Columbia, Alberta and Ontario: a comparative analysis

It is quite remarkable that British Columbia's economy is performing so poorly at a time when the economies of Ontario and Alberta are performing strongly. Consider for a moment the growth in employment in the three provinces as shown in figure 2. Since 1994, employment growth in British Columbia has leveled off, while both in Ontario and in Alberta employment growth has continued to increase, a trend that is expected to continue. Furthermore, as figure 3 shows, since 1994 economic growth has remained much stronger in Ontario and Alberta than it has in British Columbia. This year, real GDP per capita is projected to grow by 2.7 percent in Ontario and by

Figure 2: Employment growth in Ontario, Alberta, and British Columbia



Source: Statistics Canada 1995, 1998c; Conference Board of Canada 1998a; calculations by authors for 1991 to 1997; forecast for1998* from Conference Board of Canada.

1.5 percent in Alberta while in British Columbia it is expected to decline (The Conference Board of Canada 1998b).

British Columbia's weak economic performance in relation to both Ontario and Alberta should come as no surprise. In The Fraser Institute's *1998 Survey of Senior Investment Managers in Canada*, 37 senior investment managers, who control over $140 billion in assets, overwhelmingly agreed that both Ontario and Alberta are by far the best provinces in which to invest. Of the 37 senior investment managers surveyed, 73 percent had a positive outlook on the investment climate in Alberta, and 81 percent had a positive outlook on Ontario's prospects in the coming year. When it came to British Columbia, however, 49 percent had a negative outlook on the province's investment climate in 1998. In explaining their poor assessment of British Columbia, the majority of senior managers rated high taxes and labour policies as the main factors for their negative assessment of the province. As figure 4 shows, since 1992 British Columbia has experienced faster growth in labour costs than has the rest of Canada, a trend that is expected to continue. In comparison, a majority of the senior investment managers rated taxation and government finances as the top two reasons for their bright outlook on both Ontario and Alberta (Dixon, Mihlar, and Clemens 1998). As table 1 shows, the tax burden is much lower in Ontario and Alberta than it is in British Columbia. Given these numbers, it is not difficult to see why senior investment managers would prefer to invest in Ontario and Alberta rather than in British Columbia and, indeed, since 1995 both Ontario and Alberta have attracted more investments than has British Columbia (see figure 5).

These results are a further reflection of the policies being pursued by the three governments. In Ontario, the government of Premier Mike Harris has aggressively cut personal income taxes, reduced the size of government, is on course to eliminate the deficit by 2000/2001, has targeted over 1,500 different regulations for elimination, and repealed labour legislation and employment equity laws antagonistic towards business (Law, Markowitz, and Mihlar 1997).

Figure 3: Economic growth in Ontario, Alberta, and British Columbia

Source: Statistics Canada 1995, 1996, 1998c; calculations by authors.

Meanwhile, Alberta has already balanced its budget, put in place a plan to eliminate the province's public debt, cut back government regulation, enacted balanced labour laws, and achieved one of the lowest levels of corporate and income taxes in the country (Mihlar 1995b). In comparison, British Columbia has banned the use of replacement workers during strikes and lock-outs, made it easier for unions to form, increased public expenditures, and raised taxes until they are among the highest in the country (Mihlar 1996a; The Fraser Institute 1997c).

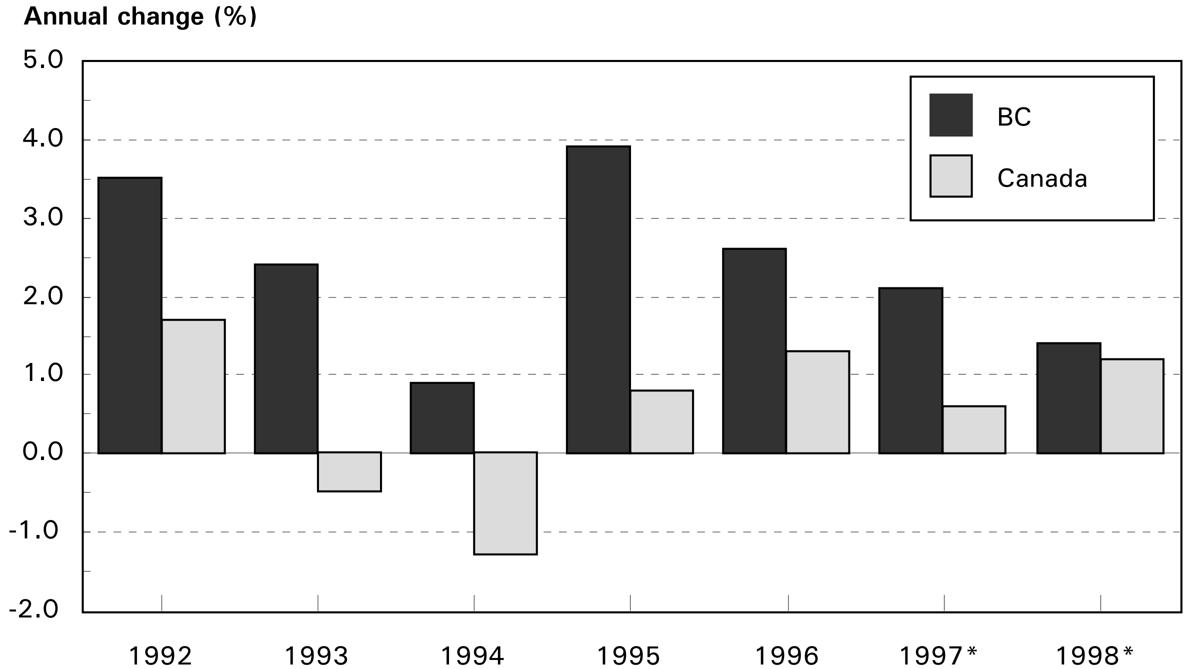
British Columbians have paid a big price for these policies (see figure 6). Since 1991, real disposable income per capita has continued to decline in British Columbia, and is also expected to post a weak recovery in relation to the rest of the country in the coming years (Chu 1998a). While Ontarians and Albertans enjoy greater economic freedom under the Harris and Klein governments, British Columbians have continued to suffer at the hands of a government that rejects the importance of economic freedom in creating wealth and prosperity (Arman, Samida and Walker forthcoming).

Table 1: Tax burden in Ontario, Alberta, and British Columbia

	Ontario	Alberta	British Columbia
Personal income tax (% of basic federal tax)	40.5%	44.0%	50.5%
Top personal marginal tax rate	50.9%	45.6%	54.17%
Basic corporate income tax rate	15.5%	15.5%	16.5%
Small business tax rate	9.0%	6.0%	9.0%
Basic capital tax	0.3%	Nil	0.3%

Source: Alberta 1998; Ontario Ministry of Finance 1998.

Figure 4: British Columbia's labour costs (% change in unit labour costs)



Source: Finlayson 1998; 1997* and 1998* are forecasts.

The structure of this report

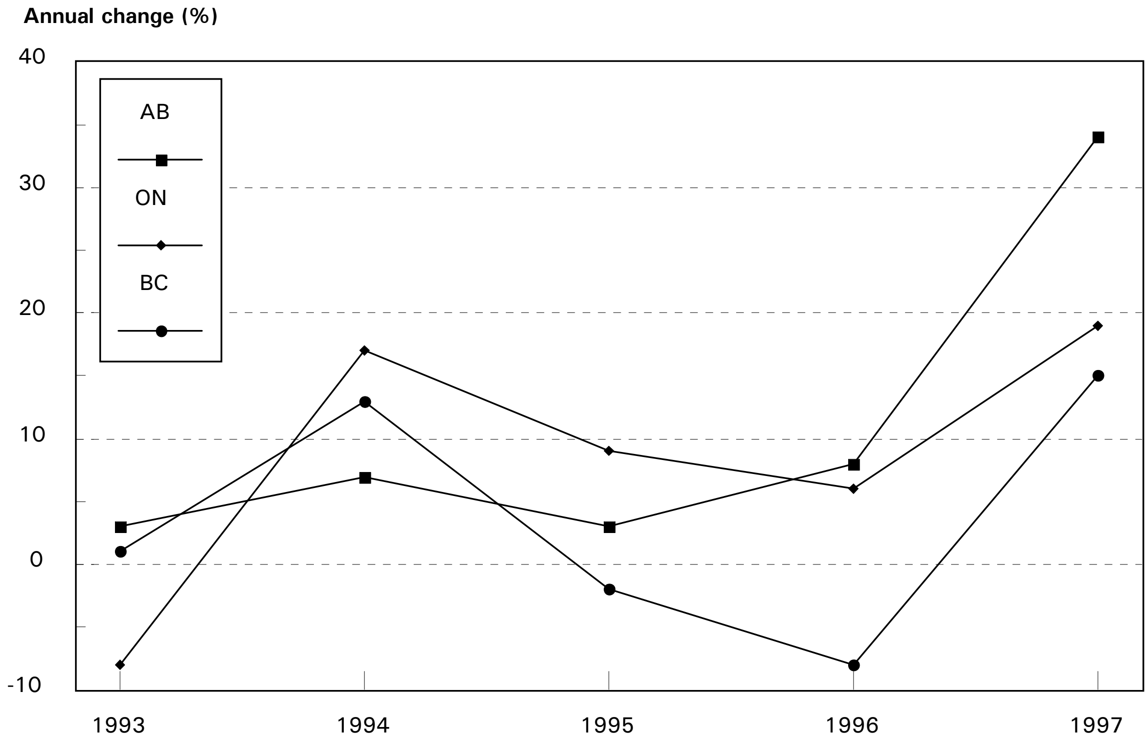
We have divided this report into 10 sections, each dealing with a different area of public policy. Each section begins with a discussion of economic theory as it pertains to the area of public policy in question and an outline of the empirical evidence supporting the theoretical proposition.[3] We then give a summaries of the policies that the British Columbian government has implemented in each policy area, and evaluate these policies in light of recent economic research in that particular field of public policy. Finally, we provide policy suggestions and assign a letter grade, reflecting how well the government has performed in each policy field.

This report is not intended merely to criticize the government and its policies but also to offer some insights on the policies that have been adopted by the BC government over the past seven years. Rather, its intent is to offer constructive criticism, with the goal of providing the public and the government with a comprehensive analysis of the impact of these policies, and to offer recommendations on how and where these policies can be improved through the use of free markets.

Notes

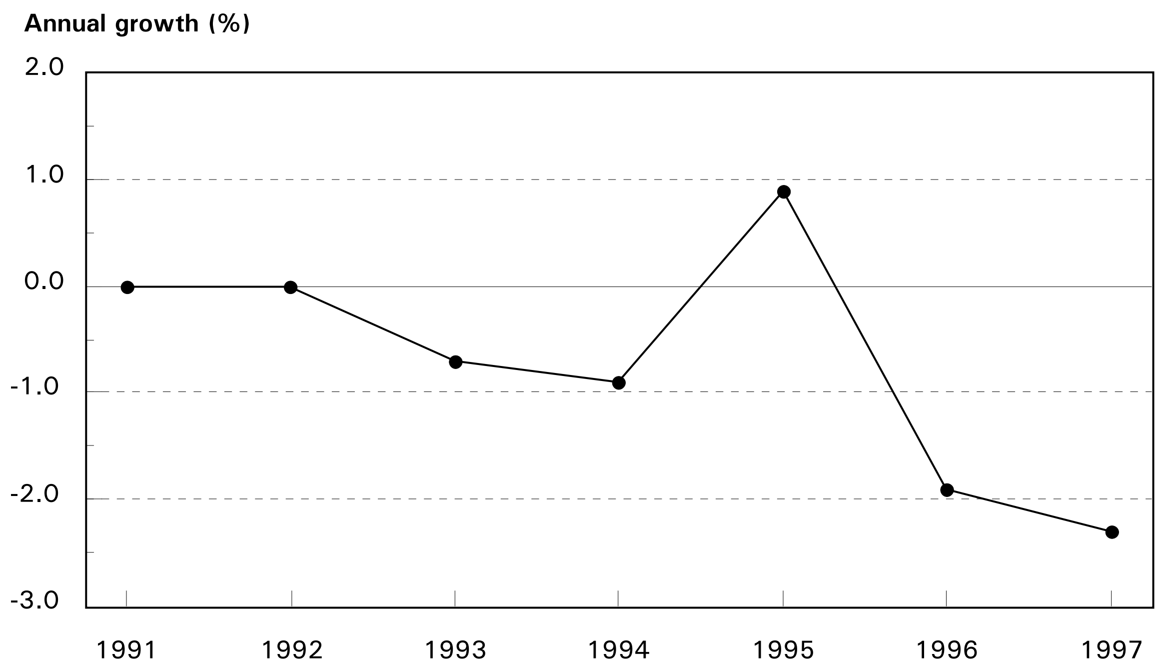
1 Please see Robson 1994.
2 For a more detailed analysis of exports from British Columbia and their destinations, please see BC Stats1998.
3 This template has been used to evaluate the federal government and the governments of Alberta and Ontario (Mihlar 1995b, Law and Mihlar 1996, and Law, Markowitz, and Mihlar 1997).

Figure 5: Real capital investments in machinery and equipment in Ontario, Alberta, and British Columbia



Source: Statistics Canada 1998c. Note: numbers have been rounded off.

Figure 6: British Columbia's real disposable income per capita, 1991–1997



Source: Kirby 1998.

Fiscal policy

Intertemporal budget balancing

Over the past few decades, governments across Canada have been accustomed to running large budgetary deficits. Faced with the choice of either raising taxes or borrowing to meet expenditure commitments, governments of the day chose the less unpopular route of borrowing to cover their costs. In doing so, both federal and provincial governments amassed large public debts. It was not until the early 1990s that provincial governments finally awoke to their unhealthy financial state. Following the lead of Saskatchewan, governments across Canada began to reverse the trend of rising deficits and debts. Most governments, including those in Ottawa, Alberta, Manitoba, Saskatchewan, Nova Scotia, and New Brunswick, have already secured balanced budgets; other provinces, such as Ontario and Quebec, are on their way to establishing balanced budgets. It would appear that the era of fiscal prudence has finally taken hold in Canada. One exception is British Columbia, which continued to run budget deficits in spite of strong growth in government revenues during the first half of the 1990s (British Columbia Ministry of Finance and Corporate Relations 1998b).

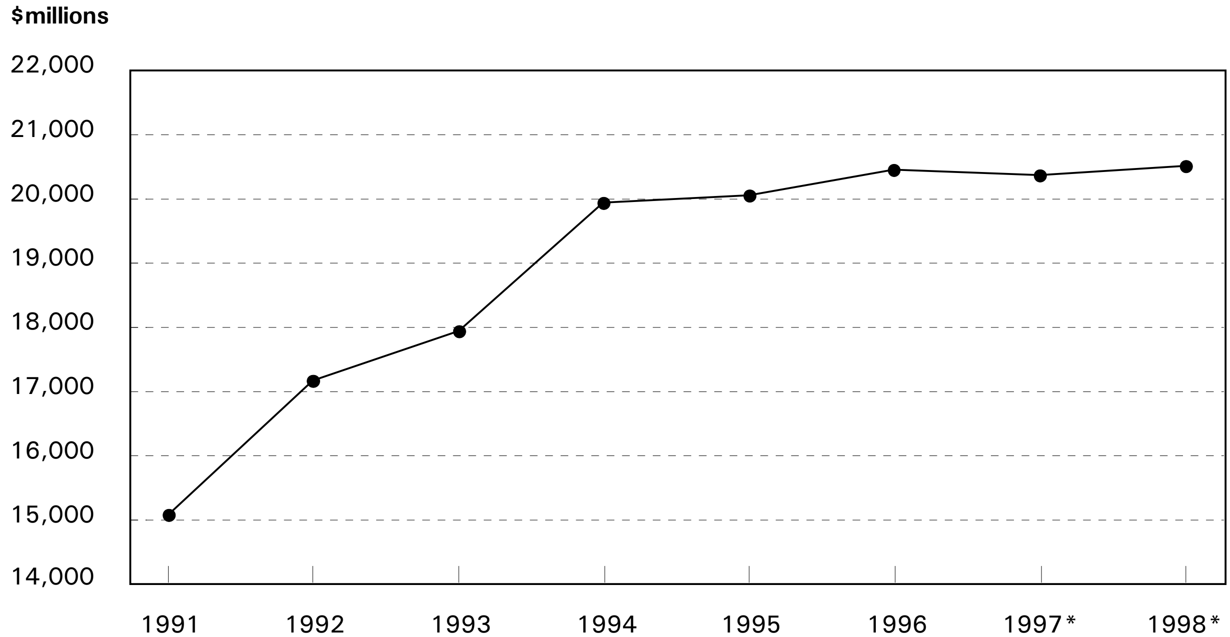
It is not difficult to understand why governments throughout Canada have been forced to reverse the trend of deficit financing: all governments must eventually balance their budgets and eventually expenditures must correspond with revenues. This is true for individuals, for businesses, and for governments (Blanchard and Fischer 1993; Romer 1996; Good 1995). If governments incur budgetary deficits during the current period, they must generate surpluses in the future in order to pay off the debt they have accumulated. Today, governments in Canada are working toward balancing their budgets in order to generate the surpluses required to pay off their accumulated deficits. In short, sooner or later the bill must be paid.[1]

The financial state of British Columbia

Premier Glen Clark once remarked "balancing a budget in BC . . . is extremely easy. Absolutely one of the easiest things I could imagine doing" (Robson 1994). However, after almost eight years in government, British Columbia's New Democrats have failed to deliver a balanced budget. Since the late 1980s, British Columbia has experienced persistent budgetary deficits. When the NDP government of Mike Harcourt came to power in the fall of 1991, the provincial deficit stood at $773.6 million (British Columbia Ministry of Finance and Corporate Relations 1998b). Both Premier Harcourt and Glen Clark, then Finance Minister, were of the opinion that deficits had no stimulative effect on the economy (Robson 1994) but, nevertheless, in their first year in office they permitted the deficit to climb to an all-time high of $2.5 billion (British Columbia Ministry of Finance and Corporate Relations 1998b). Since then, the provincial government has promised balanced budgets on a number of occasions but has failed to deliver. During the provincial election in 1996, for example, Premier Glen Clark and his government declared that British Columbia had balanced its budget. When re-elected, however, the government announced that there was a budgetary deficit instead of the much anticipated surplus.

While the government's Consolidated Revenue Fund (CRF) now projects a budgetary shortfall of $95 million in the fiscal year 1998/1999, these numbers fail to reflect the real deficit figure (British Columbia Ministry of Finance and Corporate Relations 1998a). According to the government's own 1998 Summary Financial Statement, the actual deficit for fiscal year 1998/99 is projected to be about $949 million, and not $95 million as the government continues to claim publicly. The more accurate figure of $949 million reflects the inclusion of deficits incurred by Crown corporations (British Columbia Ministry of Finance and Corporate Relations 1998a). It is important to include these deficits since the government guarantees the debt load of most Crown corporations. Hence, the government is on the hook if these corporations are unable to pay off their debts or balance their books. While the government acknowledges the deficit figures for Crown corporations on a separate table, they refuse to consolidate these numbers with the province's CRF as outlined in the annual budget document, and as recommended by George Morfitt, the province's Auditor General (BC MinFinCorpRel 1997a). The

Figure 7: Expenditures of the British Columbia government



Source: British Columbia Ministry of Finance and Corporate Relations 1998a (for years 1994 to 1998), 1998b (for years 1991 to 1993); 1997* and 1998* are forecasts.

unfortunate fact in all of the accounting gymnastics practised by the British Columbian government, is that the taxpayer cannot decipher between whether the government and their enterprises are spending more or less than their revenues. The governments' accounting methods lack transparency for both the provincial legislature and the public.

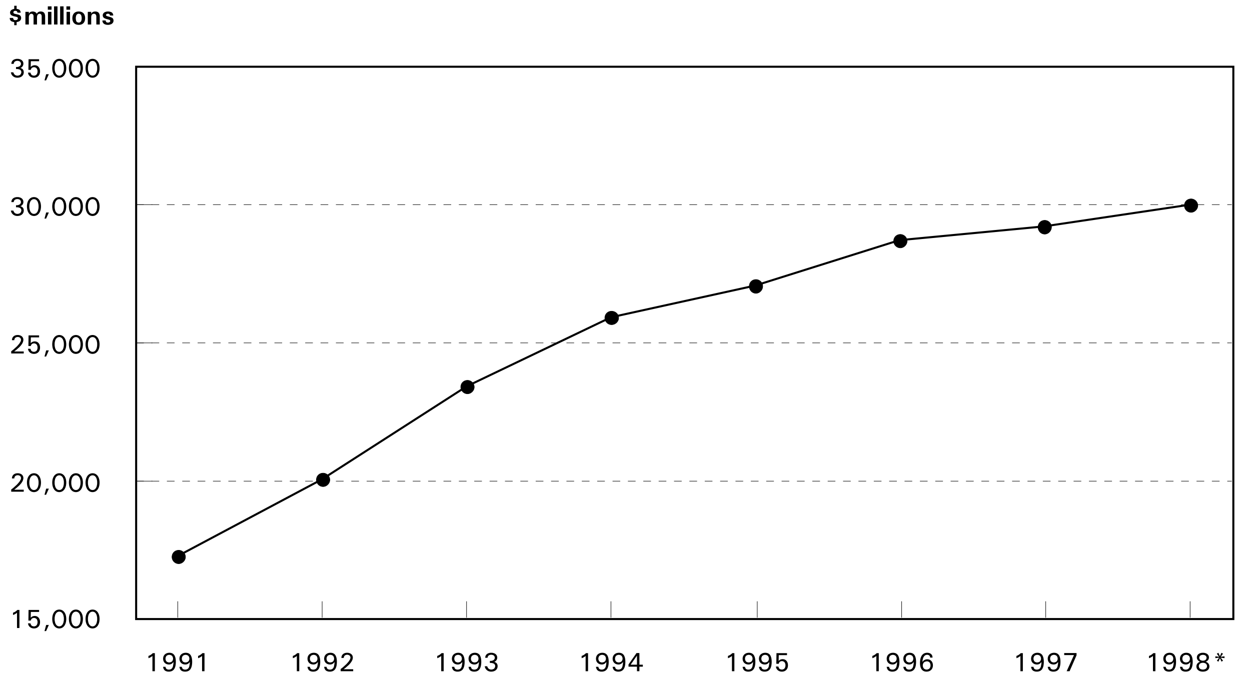
Between 1991 and 1995, government revenues in British Columbia increased by 37 percent (BCMinFinCorpRel 1998b). However, as figure 7 shows, since 1991 provincial government spending has also increased and the government is now predicting that its expenditures will be $20,536 million by fiscal 1998/99, a 36 percent increase since 1991 (BCMinFinCorpRel 1998a, b). Clearly, British Columbia has an expenditure problem, not a revenue problem. The government has opted for permanently high expenditures as opposed to making significant cuts to its programs. In doing so, total debt in the province of British Columbia has increased significantly (see figure 8). More precisely, the province's debt load is projected to hit $31.2 billion by 1999, representing an increase of 81 percent over eight years (BCMinFinCorpRel 1998a, b). The government has continually failed to meet even its own targets for debt and deficit reduction as outlined in their Debt Management Plan (Lippert 1995). As figure 9 shows, taxpayer-supported debt as a percentage of provincial GDP has also increased since the NDP government came to power, and is projected to continue its upward trend.

Optimal public financing

Since a government must balance its budget intertemporally, it is only logical to ask what is the most efficient method for a government to finance its expenditures. Should it *pay off its bills immediately or incur deficits*? Modern economic theory contends that governments should opt for a strategy of deficits and off-setting surpluses that act to lessen the burden of taxation (Barro 1979). In short, what makes government spending so costly to the economy is that it must eventually be financed by taxes, which inevitably causes economic distortions. In a free-market system, prices act to allocate resources efficiently. The introduction of taxes, however, distorts relative prices and, as a consequence, economic incentives are diminished because taxes build a barrier between marginal costs and benefits (Aaron and Pechman 1981). Economic efficiency requires governments to minimize the distortionary effect on the economy that results from changes in taxation required to finance expenditures.

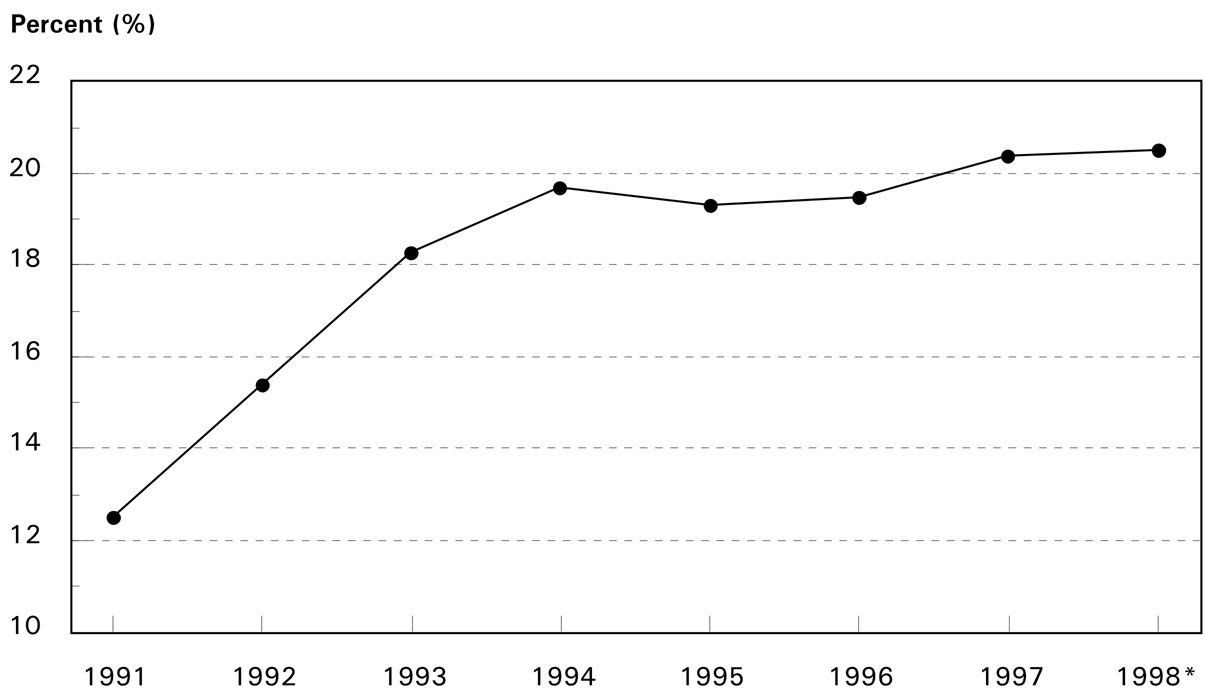
Since tax revenues and government expenditures fluctuate according to the business cycle, requiring governments to balance their books in each and every period would not be optimal. This strategy would require tax rates to fluctuate according to the business cycle, and since taxes have a distortionary effect on the economy, this option would be unwise. Also, the costs associated with collecting taxes that fluctuate

Figure 8: British Columbia's debt load



Source: British Columbia Ministry of Finance and Corporate Relations 1998a (for years 1995 to 1998), 1998b (for years 1991 to 1994); 1998* is forecast.

Figure 9: Taxpayer-supported debt as a percent of GDP in British Columbia



Source: British Columbia Ministry of Finance and Corporate Relations 1997b (for years 1991 to 1997), 1998a (for years 1998, 1999), 1998b (for years 1991 to 1993); 1998* is forecast.

with government expenditures and the business cycle would be very high. Since these fluctuations are a product of the business cycle and thus temporary, a more prudent option would be to run deficits during periods of economic downturn, and to pay back these deficits with surpluses generated when economic conditions improve. This option would permit the government to maintain stability in the tax system over time and minimize the distortionary effect of taxes (Aiyagari 1989).

If the government decides to increase its expenditures permanently, taxes must also be permanently higher as all government expenditures must eventually be paid for. It is impossible to finance ever-increasing government expenditures through the use of deficits, particularly if spending continues to rise and tax rates remain constant. Such a scenario would preclude the opportunity to accumulate the future surpluses required to pay incurred deficits and to help finance the government's increasing expenditures. Thus, the optimal policy response is a permanent increase in taxes.

While the analysis just provided is helpful in addressing the issue of how governments ought to finance their expenditures over time, it does not address adequately the issue of government expenditures. Since government's ability to finance its spending has been accounted for sufficiently, we must now ask what the optimal level of government expenditures is. How big should government be?

The optimal size of government

How much should government spend? In the previous discussion, it was noted that intertemporal budget constraints require governments eventually to pay for their expenditures through the use of tax revenues nd that what makes government debt so damaging is that it must eventually be paid for via taxes, which creates distortions in the economy (Browning 1976). Thus, since rising government expenditures require parallel increases in taxation, it would follow that larger governments are less efficient and more expensive to operate since they require higher tax rates than governments that are small and accordingly impose lower levels of taxation. Thus, bigger governments create greater distortionary effects on economic growth than smaller governments.

Empirical studies conducted by Landau and Barro concluded that nations with smaller governments experience higher levels of economic growth than those with larger governments (Landau 1983; Barro 1991). Furthermore, studies show that countries with lower marginal tax rates have levels of economic growth higher than those of countries with higher levels of taxation (Easterly and Rebelo 1993; Marsden 1983). As a result, countries with smaller governments are more likely to be efficient and to experience higher levels of economic growth than countries with large governments (Easterly 1993; Tanzi and Schuknecht 1995).

As already noted above, deficit financing may be a sensible solution to making up for temporary shortfalls in government revenue but it is not an appropriate strategy for financing permanent increases in government expenditures. Governments should opt for permanently lower levels of spending since this would lower the burden of taxation on the citizenry, impose the least amount of distortion on economic growth, and create an atmosphere suitable for generating economic wealth and increasing the standard of living.

Recommendations

In light of this evidence, we suggest that the British Columbian government adopt the following policy recommendations.

1 Reduce government expenditures by 10 percent over the next three years

Given the fact that government spending has continued to increase since 1991, we suggest that the government of British Columbia act quickly to cut expenditures by 10 percent over the next three years. The government of British Columbia should move towards a permanently smaller government, particularly given the evidence suggesting that jurisdictions with small governments experience stronger economic growth.

2 Enact a balanced budget law

This law will require the British Columbia government to balance its budget over a three year period. Evidence from the United States and Canada (particularly in Alberta and Manitoba) points to balanced-budget amendments as an effective tool for curbing the tendency of politicians to overspend (Law and Mihlar 1996).

3 Legislate a debt reduction plan

Since the government of British Columbia has been unable to meet its own targets for debt reduction as outlined in their Debt Management Plan, a legislated plan to eliminate debt over 10 to 15 years needs to be implemented.

4 Include the Summary Financial Statement in the Consolidated Revenue Fund as outlined in the annual budget document

As recommended by the provincial Auditor General, the government of British Columbia should include the Summary Financial Statement in the Consolidated Revenue Fund as outlined in the annual budget document. If the government is going to guarantee the debt of Crown corporations and provide them with financial aid when required, the public should be aware of their performance as well. This would restore some accountability to the province's accounting methods and allow the public to judge the financial performance of their government accurately.

5 Stop providing loans and loan guarantees to business

By discontinuing the practice of providing loans and loan guarantees to business, the British Columbia government will improve economic growth in the province by minimizing distortionary effects on the economy. By reducing handouts to businesses across the province, the government will be in a position to reduce the size of the state significantly and thus levels of taxation required to sustain its expenditure commitments.

6 Stop guaranteeing the debts of Crown corporations

Since these Crown entities were created to operate at arms-length from the government in the first place, the government of British Columbia should allow these self-sustaining corporations to be exactly that. Given that they were created to operate independently of the government, they should be responsible for their own financial health.[2]

Conclusion

Since governments must inevitably finance their expenditures through taxation, which is inherently distortionary, governments ultimately retard economic activity. Therefore, economic efficiency requires governments to minimize the distortionary effects on the economy that result from increases in taxes. Moreover, the evidence suggests that jurisdictions with smaller governments are best positioned to experience strong and sustained levels of economic growth. Since smaller governments require lower levels of taxation to sustain their expenditures, they create less distortion of economic growth than large governments. Unfortunately, the Clark government has failed to stop the growth of the state in British Columbia. Instead, they have chosen to follow in the footsteps of the previous Harcourt government, opting for a permanently large government. Therefore, for failing to balance the budget, increasing the provincial debt, and increasing government expenditure, the Clark government deserves an **F** for its fiscal policy.

Grade for fiscal policy: F

1 For a non-technical discussion of Ricardian Equivalence Theorem, please see Law and Clemens 1998.

2 This refers to all non-self-supporting Crown corporations.

Taxation policy

High taxes: diminishing incentives and economic growth

Economic theory suggests that by modifying the costs and benefits of a particular activity, taxes can alter the incentive structure faced by individuals and businesses and encourage outcomes that are less likely to have transpired in the absence of taxation (Gwartney and Stroup 1993; Aaron and Pechman 1981). For instance, payroll taxes impose increases in the price of labour and as a consequence persuade business to substitute capital for human resources (OECD 1994b). High marginal tax rates on employment income deprive individuals of the right to enjoy the fruits of their own labour and discourage them from working harder (Heckman 1993; Triest 1990). Taxation on capital gains tends to reduce the rate of savings and aggregate investment (Summers 1984; Ture and Sanden 1977). Moreover, provincial sales tax can promote tax evasion and encourage individuals and business into the underground economy (Starobin 1994). In short, taxes diminish incentives to work harder, place a significant drag on economic growth and the ability to increase the standard of living.

Empirical evidence on the effects of taxation

Evidence from around the world increasingly shows that jurisdictions that maintain low levels of taxation are those best positioned to experience strong economic growth. In a study by the World Bank on the effects of taxation, states with lower tax rates grew faster, experienced higher levels of investment, and higher productivity gains (Marsden 1983). Another study estimated that increasing a country's taxes by 10 percent has the effect of reducing a nation's GDP growth by almost 2 percent (King and Rebelo 1990). Likewise, Easterly and Rebelo found that there was a strong negative relationship between the rate of economic growth and tax revenue (Easterly and Rebelo 1993). High taxes impede growth in productivity and consequently economic growth.

Taxes have a distortionary effect on the economy and what is required for stronger economic growth is for governments to lower taxes. This is critically important in light of the large body of evidence suggesting that taxes have had an adverse effect on economic growth in Canada. Professor Bev Dahlby has noted that, for each additional tax dollar collected through personal income taxes, the Canadian economy is deprived of $1.38 in output (Dahlby 1994). Moreover, a study conducted by De Matteo and Shannon on the effects of payroll taxes in Canada found that a 1 percent increase in average payroll taxes results in an increase of employers' real wage costs by 0.56 percent, a decrease in real wages of 0.55 percent, and a reduction in employment of 0.32 percent (De Matteo and Shannon 1995). This finding is supported by another study conducted by Ron Parker of the Bank of Canada, who found that increasing payroll taxes from 10.6 percent of wages and salaries in 1991 to 14.1 percent in 1994 may have directly led to a reduction in employment levels in Canada by about 1 percent in 1994 (Parker 1995).

In sum, high tax rates diminish incentives, impede economic growth, and lead to a lower standard of living. Conversely, lower levels of taxation encourage firms to invest more in human and physical capital, lead to greater innovation, higher levels of productivity, and increases in disposable income, and create the climate necessary for generating strong economic growth.

Taxation in British Columbia

Despite the large body of evidence supporting the benefits of cutting taxes, the British Columbia government has been slow in reducing the mounting tax burden on its citizens and businesses. Taxes levied on businesses in the province have increased by 150 percent since 1992 while the tax bill of an average family in British Columbia has increased by $803 (Joel Emes, personal communication). In addition, British Columbia has the highest marginal (personal) income tax rate in the country at 54.17 percent of the basic federal tax, and maintains the second highest corporate income tax rate in the nation (Alberta 1998). Furthermore, between fiscal 1995/1996 and 1996/1997, individual British Columbians experienced the largest tax increase in Canada, a hike of $107 per year while, in New Brunswick, the next largest increase for the year amounted to only $42 (The Fraser Institute 1997b). These tax policies are in stark contrast to both Ontario and Alberta, where the provincial governments have worked aggressively towards cutting both personal and corporate income taxes (Law, Markowitz, and Mihlar 1997; Mihlar 1995b).

In the Fraser Institute's *1997 Fiscal Performance Index*, which rates the taxation and spending policies of provincial governments and of American state governments, British Columbia received an **F** for its performance. British Columbia had the lowest score among the 32 provinces and states on taxation policy (Fraser Institute 1997a). The Institute's 1998 Tax Freedom Day analysis, which calculates the day Canadians stop paying taxes and begin working for themselves, concluded that tax freedom day fell on June 28 this year; an advance of 16 days over the province's Tax Freedom Day in 1992, which fell on June 12. The study also found that British Columbia is the third to last province in Canada this year to experience Tax Freedom Day (Emes and Walker 1998). In short, British Columbians are having to work much harder and longer than most other Canadians before being able to enjoy the benefits of their labour and in 1997 real disposable income per capita decreased in British Columbia by almost 2.5 percent (Kirby 1998).

However, the pain of high taxes has not been confined to the taxpayers of the province. Business has also been hit hard as taxes have risen by almost 150 percent over the past five years (Sanatani 1998a). The result? In 1996, corporations paid taxes totaling 44.1 percent of their profits in British Columbia, the highest tax burden as a percentage of corporate profits in the country and more than double what corporations paid in taxes in New Brunswick and Saskatchewan. The tax burden has increased significantly from its level in 1985, when corporations in British Columbia paid direct taxes to the government totaling 31.4 percent of their profits (Arman, Samida, and Walker forthcoming).

The government announced some tax relief in its 1998 budget—just $95 million a year. Even after these tax cuts are fully implemented, however, British Columbians will still have one of the largest tax burdens in the country. For example, the government is planning to reduce the marginal income tax rate by only 1.5 percent to 52.7 percent, and the corporate income tax rate from 9 percent to 8.5 percent. Further, these changes are to take effect January 1, 1999 rather than immediately (BCMinFinCorpRel 1998a; Alberta 1998). Many of the recently announced tax measures will do little to provide relief to the taxpayers of British Columbia. According to a recent survey conducted by Angus Reid for the Vancouver Board of Trade, 85 percent of businesses in the Lower Mainland felt that the 1998 Budget did not pay enough attention to the issue of cutting business taxes. In fact, almost 35 percent believe that the budget will actually increase their taxes instead of lowering them. What is particularly disturbing is that most Lower Mainland businesses considering relocation in the near future are considering leaving the province. When asked what was the primary reason for relocating outside of British Columbia, 53 percent responded that it was due to taxes (Reid 1998). It would appear, therefore, that the government's recently announced tax cuts fall far short of what business and indeed the taxpayers of British Columbia urgently require.

Recommendations

In light of British Columbia's high and distortionary tax regime, we suggest that the provincial government adopt the following policy recommendations.

1 Enact a 30 percent reduction in the existing "basic" provincial personal income tax rate of 49.5 percent over three years

These tax cuts would help British Columbia to become more competitive with provinces such as Ontario and Alberta.

2 Enact a substantial cut in the surtax imposed upon high-income British Columbians

Currently, British Columbia has the highest marginal tax rate of any province and even in light of the recently announced rate decrease, British Columbia will still continue to have one of the highest marginal tax rates in the country. To correct this undue burden on the most productive citizens of the province, we recommend that the government reduce the top marginal tax rate to the current level in Alberta of 45.6 percent (Alberta 1998).

3 Harmonize the provincial sales tax (PST) with the federal goods and services tax (GST)

The Clark government should move towards harmonizing the provincial sales tax with the federal goods and services tax. This initiative will allow for businesses to spend more time on actually running their operations than on costly paperwork.

4 Cut the corporate income tax rate

The government announced in this year's provincial budget that it would cut the small business tax rate by .5 percent in January 1999. We recommend that the Clark government also cut the general corporate tax rate. This measure will help to restore the confidence of the business community.

5 Eliminate the corporate capital tax

If business is to thrive and have confidence in investing in British Columbia, the Clark government should eliminate the corporate capital tax. This tax is a disincentive for businesses to invest in physical capital, which is necessary for higher levels of productivity growth, strong economic activity, and job creation.

6 Reduce payroll taxes

Payroll taxes kill jobs. High payroll taxes discourage investment in human capital, reduce productivity, and ultimately induce lower levels of employment. Empirical evidence shows that reducing payroll taxes has the effect of decreasing the cost of labour and consequently increasing the level of employment (De Matteo and Shannon 1995; Dixon and Mihlar 1996). Hence, the provincial government should cut payroll taxes (including WCB premiums) in British Columbia immediately.

Conclusion

While several provincial governments across Canada have begun to make significant cuts in the taxes paid by their citizens and businesses, the government of British Columbia has been slow to move on this front. Instead, in the face of a mounting body of evidence that suggests that tax and transfer schemes have negative economic consequences, the government of British Columbia has continued to play the role of the redistributive agent. They have insisted upon maintaining high levels of personal and corporate income tax, and seem willing to provide only small amounts of tax relief. Thus, for continuing to maintain high levels of taxation and failing to provide significant tax relief to the people of British Columbia, the Clark government deserves an **F**.

Grade for tax policy: F

Labour policy

The problem: high unemployment and the productivity slowdown

For most of the past two decades, the economic landscape of Canada has been dominated by persistently high levels of unemployment. Since the early 1970s, high and rising unemployment rates have become a integral feature of most industrialized nations throughout the world (with the exception of the United States). In addition, most of these industrialized economies have also experienced slower productivity gains throughout this period (Romer 1996: ch. 1). Many of these states have responded by pursuing various economic initiatives like make-work projects and government intervention in the labour market. Despite these steps, however, high levels of unemployment continue to plague most industrialized nations, and most Canadian provinces have not been spared.

Economists have spent considerable time and effort trying to grasp the complexities and causes behind declining productivity gains and rising levels of unemployment (Romer 1987; Baily and Gordon 1988; Griliches 1988; Grey 1987; Darby 1984; Bruno 1984). While no consensus has yet emerged, there are several factors that might explain high unemployment levels. For instance, high levels of taxation and government spending habits are possible explanations. There is, however, an even more likely factor: a growing body of evidence points to labour market rigidities, laws and institutional arrangements that inhibit the labour market from operating freely, as a direct cause of declining productivity and employment (Grubel 1988; Daly and MacCharles 1986; OECD 1994b). In other words, government intervention in the labour market, through minimum wage laws, employment equity laws, and policies that strengthen the power of unions, may be to blame for this economic malaise.

The cause: government intervention in the labour market

Empirical evidence from around the world indicates that labour market rigidities, as outlined above, are a major impediment to achieving higher levels of employment and growth in productivity. For instance, empirical studies have clearly demonstrated that high real minimum wages are a cause of high unemployment, particularly among young workers (Stigler 1946; Gramlich 1976; Rottemburg 1981; Linneman 1981; Neumark and Wascher 1992; Ernst and Young 1995). Indeed, since minimum wage laws artificially increase the real wages of workers, firms are forced to substitute relatively cheap capital for expensive labour.

Further evidence has shown that employment equity laws, high payroll taxes, and laws that grant unions more power and influence in the workplace, have also had an adverse impact on labour markets. For instance, Block and Walker show that employment equity laws increase the relative price for labour as an input in the production of goods and services (Block and Walker 1982). Nobel Laureate Gary Becker, has argued that there is no need for government intervention since, in competitive markets, arbitrary discrimination on the part of employers will not last, particularly since the cost of discrimination would prove to be very high (Becker 1957). Similarly, evidence indicates that payroll taxes also have an adverse impact on growth in productivity and employment (De Matteo and Shannon 1995). For example, it is estimated that increases in payroll taxes in Canada from 1991 through 1994 may have been responsible for reducing employment by 1 percent (Parker 1995).

Empirical evidence also suggests that unionization leads to lower productivity and employment. Studies show that unionized firms are about 10 to 20 percent less profitable than non-unionized firms (Mihlar 1997). One study, which examined macroeconomic data from 902 businesses over the period from 1970 to 1980, concluded that returns on investment are 19 percent lower in unionized firms than in non-unionized firms (Mihlar and Peacock 1997). Further, evidence from around the world shows that unions have a negative impact on employment growth (Cote and Hostland 1996; Mihlar and Peacock 1997). A study conducted in 1993 by Richard Long indicated that, of 510 firms operating within Canada during the period from 1980 to 1985, the median growth rate for employment in non-unionized firms was 27 percent, compared to 0 percent for unionized firms (Mihlar 1997). In short, the majority of the evidence suggests that inflexible labour markets lead to declines in productivity and lower levels of employment.

The solution: flexible labour markets

The best labour policy is one that imposes the least number of rigidities upon the labour market. Clearly, the evidence presented above indicates that government intervention in the labour market acts to reduce labour productivity and growth in the levels of employment. Rather, what is required for improving gains in labour productivity and in employment are flexible labour markets. This entails implementing Right-to-Work Laws that allow voluntary unions. In the United States, for example, between 1988 and 1993, 77 percent of all new high-paying jobs in the manufacturing sector were created in states that have implemented Right-to-Work (RTW) legislation (Mihlar 1995a). Furthermore, a study conducted by Thomas Holmes of the Federal Reserve Bank of Minneapolis found that between 1947 and 1995 employment in the manufacturing sector grew 170 percent in RTW states, while it grew only 54 percent in non-RTW states (Holmes 1995). Surveys show that businesses who are considering relocating their operations are more likely to move to RTW states rather than to non-RTW states (Kendrick 1996). Thus, the United States, which has one of the most flexible labour markets in the world, in large part due to RTW legislation, enjoys the highest levels of productivity and the lowest rates of unemployment in the world (*The Economist* 1996). The European Union, on the other hand, which has one of the most rigid labour markets in world, has high rates of unemployment and poor productivity (Hanson 1996). In sum, the evidence points to the need for flexible labour markets to boost employment and labour productivity.

British Columbia's labour policy

British Columbia's current Labour Minister, Dale Lovick, once remarked: "It would be a grave error for any government to attempt to manipulate labour laws to favour one party or another at the bargaining table . . . Wherever that has happened, the result has been a disastrous deterioration of labour relations with severe economic consequences" (*The Financial Post* 1998b). Mr Lovick was certainly correct in his assessment of the negative implications arising from manipulating labour laws but he and his government have failed to apply this logic to their own labour-market policies. Since the NDP government came to power in the fall of 1991, they have done little to foster a labour climate that is conducive to creating jobs and increasing productivity. Rather, it has implemented labour market policies that add to unemployment, and reduce productivity and economic growth in the province. Here are some of the major labour-market policies that have been implemented by the government of British Columbia.

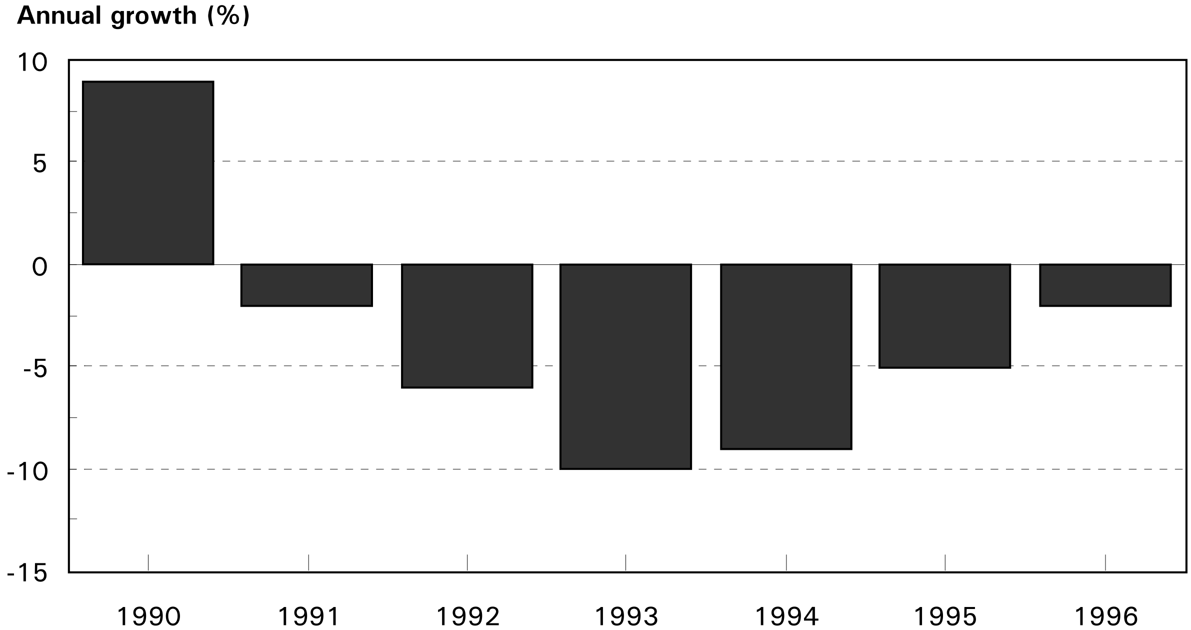
Minimum wage Between 1993 and 1998, the government increased the minimum wage from $5.50 to $7.15 per hour, a 30 percent overall increase (*Province* 1998b). A study conducted by Ernst and Young found that the government of British Columbia's initial increase in the minimum wage in 1993 from $5.50 to $6.00 per hour had the effect of decreasing employment in the restaurant industry by three percent (*Province* 1998b). Furthermore, evidence also shows that increases in the minimum wage has also led to increases in youth unemployment in British Columbia (Mihlar 1996a).

Industrial Relations Act In 1991, the government enacted changes to the 1987 Industrial Relations Act, banning the use of replacement workers during strikes and lockouts, allowing for secondary picketing, and eliminating workers' rights to use secret ballots when voting on union certification. However, evidence shows that these reforms have led to increases in work stoppages rather than decreases. In jurisdictions such as Alberta, where the labour market is more flexible and where the use of replacement workers is not banned, fewer work stoppages have occurred (Mihlar 1996a).

Employment Standards Act In 1994, the government introduced changes to the Employment Standards Act to regulate the working conditions of part-time employees. However, since these changes were all grouped into a collective agreement, covering such issues as vacations, statutory holidays, termination of employment, and layoffs, the government denied workers the freedom to determine their own working conditions (Mihlar 1996a). In short, these changes will increase the cost of doing business in British Columbia, force firms to substitute relatively cheaper capital for expensive labour, and thus reduce the number of employment opportunities available in British Columbia.

Fair Wage Act In 1992, the government introduced the Fair Wage Act. This act forces those contractors who win government contracts to pay their employees and provide them with

Figure 10: Labour productivity in British Columbia (output per person)



Source: Finlayson 1998.

benefits in accordance with a schedule dictated by the government (Mihlar 1996a). By forcing private contractors to pay their employees wages that are above the market rate, the cost of building public infrastructure projects in British Columbia has dramatically increased.[1] It is estimated that this policy has already increased the cost of projects covered by the act by almost 4 percent and that it is costing British Columbia tax-payers almost $166 million more per year. Furthermore, evidence shows that this policy is partly responsible for the disappearance of almost 10,600 construction jobs in British Columbia between 1994 and 1995 (Mihlar 1996a).

Bill 26 Recently, the government passed Bill 26 (Sectoral Bargaining), the Labour Relations Code Amendments Act, 1998. This change in the legislation will make it easier for trade unions to form in British Columbia's industrial, commercial, and institutional construction industry (*i.e.* schools, hospitals, shopping malls, and office towers). Whereas previously tradesman like electricians, plumbers, and carpenters from a non-unionized company could join a union to bargain on their behalf with their employer on working conditions related to a particular project, under the new law these workers could join a union and be covered by a master agreement covering all workers within their particular trade without having to bargain with the employer (*Vancouver Sun* 1998b; Sanatani 1998b). These changes will increase costs in British Columbia's construction industry.

These are just a few of the major labour-market initiatives that the government has enacted or is considering enacting. By all accounts, the evidence suggests that these labour reforms have had, or will have, a negative impact upon the economy. In fact, as figure 10 clearly illustrates, (labour) productivity growth has remained very weak in British Columbia since 1991 as the government has opted for a very rigid labour market despite the negative economic consequences.

Recommendations

To remedy the rigidity in the labour market, we suggest that the government of British Columbia adopt the following policy recommendations.

1 Repeal the amendments made to the Industrial Relations Act and to the Employment Standards Act

The evidence indicates that the changes made to the *Industrial Relations Act* have resulted in the deterioration of relations between labour and management, stripped workers of their right to use secret ballots, and increased the cost of doing business in British Columbia. The changes made to the *Employment Standards Act* in 1994 have denied employees the right to determine their own working conditions, increased the cost of doing business, and pushed employers to substitute relatively cheap capital for expensive labour.

2 Enact Right-to-Work legislation

The government of British Columbia should repeal the Labour Relations Code and enact Right-to-Work legislation. Under a RTW system, unions would become voluntary organizations. 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. There is, indeed, a large body of evidence showing that jurisdictions where RTW laws have successfully been implemented have lower rates of unemployment and stronger economic growth (Mihlar 1995a; Holmes 1995). In short, RTW legislation would allow British Columbia's labour market to become more competitive, improve labour productivity, and increase employment.

3 Eliminate the minimum wage

The evidence clearly shows that minimum-wage laws have a very negative impact on employment. In fact, the evidence shows that minimum wage laws may be to blame for high rates of unemployment among young British Columbians (Mihlar 1996a). While more jobs continue to be created in the rest of the country, employment growth in British Columbia is expected to remain weak in the coming year(s), a trend that began almost three years ago (Statistics Canada 1995 and 1998c; Conference Board of Canada 1998a). If the government is serious about reducing unemployment in the province, particularly unemployment among young people, it must stop interfering in the market adjustment of real wages to changes in supply and demand.

4 Repeal the recently introduced legislation respecting "sectoral bargaining"

Bill 26 (Sectoral Bargaining) will do further damage to British Columbia's already uncompetitive labour market. The provisions contained within this bill will increase the cost of doing business in British Columbia, prevent employees from negotiating their own contracts, and discourage investment. Hence, the government should repeal Bill 26.

5 Repeal the Fair Wage Act

The government of British Columbia should stop forcing private contractors to pay and offer benefits to their employees in accordance with a pre-determined schedule. This act has increased the cost of doing business and reduced employment in British Columbia's construction industry. Therefore, the government should repeal this act to allow for a more competitive bidding process, which in turn will reduce the costs incurred by taxpayers.

6 Reform the Workers' Compensation Board

British Columbia's Workers' Compensation Board is in trouble. Even as the number of claimants continues to decrease and the amount being paid out in benefits continues to climb, employers are increasingly being forced to pay higher WCB premiums to fund, in part, the cost of administering a system that is amongst the most expensive in the country (Mihlar 1996a). First, forcing employers to pay higher premiums completely ignores the vast amount of data that suggests that high payroll taxes discourage growth in employment (De Matteo and Shannon 1995). Second, the increase in the amount paid out in benefits was largely due to the government's increase in benefit levels and extension of WCB benefits to low-risk jobs (Mihlar 1996a). The WCB should be restored to its original purpose of providing workers in dangerous occupations with an alternative to litigation to recover lost earning power when they are injured on the job. The benefits paid should reflect the amount that the courts have and are prepared to award for similar injuries. Hence, the government should reduce benefits from 75 percent of gross earnings to a maximum of 75 percent of net earnings, reduce administrative costs, and repeal Bill 63, which extended WCB coverage to low-risk workers.

Conclusion

Evidence from around the world indicates that those jurisdictions that have opted for flexible labour markets, have also experienced higher productivity gains and stronger growth in employment. Furthermore, the evidence also shows that minimum wage laws, high payroll taxes, employment equity laws, and more influential unions leads to weaker economic growth and reductions in the level of employment. In spite of all this evidence, however, the government has pursued a labour-market policy of increased government intervention in the labour market. Therefore, for pursuing this misguided approach to labour market reforms, the government of British Columbia deserves an **F** for its labour policies.

Grade for labour policy: F

1 For a more detailed analysis of the potential impact of the Fair Wage Legislation on British Columbia's construction industry, see Globerman 1997.

Industrial policy

Micro-managing the economy: a failure

Since the beginning of the twentieth century, most Western industrialized nations, including Canada, began to take a more active role in the economy, primarily through aggressive industrial policies. Initially, governments invested heavily in infrastructure projects, provided tax incentives, and put in place high tariffs to protect Canadian businesses and jobs. Over time, however, governments adopted a more interventionist industrial policy. Today, the primary aim of most industrial policies is to allow governments to "select certain industries, technologies, and/or firms whose advancement is of critical importance for the economy as a whole, and accord selective incentives, whether through subsidies, import restrictions and/or special efforts to promote exports" (Mihlar 1994). The evidence, however, suggests that when the government begins to pick winners and losers in the market, the costs often outstrip the benefits.

Government intervention in the economy has not been the panacea that it was thought to be. Indeed, government intervention has not promoted efficiency but rather has encouraged inefficiency. Command-and-control regulations have often impeded innovation and enterprise (Wolf 1993). Moreover, the growth of a government bureaucracy with an agenda of its own has encouraged rent-seeking behaviour (Niskanen 1971). Activist industrial policies have protected inefficient firms and have channelled millions of dollars into politically motivated projects with very few economic benefits (Mihlar 1994; Walker 1984). In addition, regional economic diversification programs serve no efficiency objective (Savoie 1990). In light of this evidence, the optimal industrial policy for the state should be to minimize regulation; that is, the state should enforce contracts and provide the framework of laws necessary for all market participants.

Corporate welfare

In the free market, the success of firms is based on their ability to raise sufficient funds to cover the cost of production by selling goods and services at prices that consumers are willing to pay. Firms that meet the expectations of the consumer will profit and remain in business; firms that fail to do so, will inevitably be forced out of business. As Professor Walter Block wrote, the problem with governments assisting firms financially is that the "entire market process becomes short-circuited. Corporations are able to obtain from the public—through the tax-subsidy system—funds which consumers were unwilling to give to them through voluntary sales" (Block 1990). Supporting a business through government handouts (*e.g.* subsidies, loans, and tariffs), mainly for political purposes (*e.g.* employment and re-election), creates a cycle of dependency that ultimately does more damage than good.

In 1981, for instance, the automobile manufacturing industry in Canada secured Voluntary Export Restraints (VERs) on Japanese cars. The intent was to protect the three largest North American automobile manufactures, General Motors, Chrysler, and Ford, from increased competition arising from the entrance into the market of the more efficient and productive Japanese automobile manufacturers. The result? Capital investments by the North American automobile manufacturers decreased from $972 million in 1981 to $440 million by 1984. Investments in research and development declined from 0.28 percent of shipments in 1981 to 0.20 by 1984 (Mihlar 1994). Placing the protective arm of the VERs around General Motors, Chrysler and Ford removed incentives upon them to innovate or improve productivity. Furthermore, a study conducted by Mansfield and Switzer found that for each dollar of tax credit for research and development received, these firms increased their expenditures on research and development by only 30 percent to 40 percent, and pocketed the rest (Palda 1992). In Alberta, the $2.67 billion spent on economic diversification programs between 1980 and 1995 have largely been ineffective (Mihlar 1995*b*). In short, offering subsidies to businesses or putting up protective barriers (tariffs) results in disincentives to invest, creates a cycle of dependency on government handouts, and forces individuals to fund with their taxes firms that they have already freely chosen not to support.

Industrial policy in British Columbia

The government has largely pursued an interventionist industrial policy. Since coming to power in 1991, the NDP government has spent millions of dollars, mainly in the form of tax credits and subsidies to business, to encourage economic growth and employment in British Columbia. The evidence suggests that the government's industrial policy has largely failed to produce the desired (positive) outcomes. For instance, it has been noted throughout this report that job creation and economic growth in the province has continued to decline since 1994. What the government has failed to recognize is that the best prescription for economic growth and job creation is following the right macroeconomic principles: reduce taxes, eliminate restrictive labour laws, and repeal excessive government regulations on business (Gwartney and Lawson 1997). Instead, the government has continued to help corporations with the tax-payers' dollars.

For example, the government recently spent close to $329 million on the Skeena Cellulose plant in Prince Rupert, hoping to prevent the company from going bankrupt (Beatty and Fong 1998). In October 1997, it purchased 52.5 percent of the company from the Royal Bank of Canada in spite of the fact that the company continues to lose money and that, on several occasions in the past few years, it has almost been forced into bankruptcy (British Columbia Ministry of Employment and Investment 1998; Beatty and Fong 1998). Furthermore, the government's *1998 Budget* forecast that the company's debt load will increase from $120 million this year to $245 million next year, representing a 104 percent increase (BCMinFinCorpRel 1998a).

The government announced in May 1998 that, in addition to its investment in Skeena Cellulose, it would be pouring $8.1 million into the J.S. McMillan fish-processing plant also located in Prince Rupert. Like Skeena Cellulose, J.S. McMillan has remained unprofitable throughout the 1990s. Furthermore, in 1997 the government gave the company $5 million, expecting to recoup about $3 million of that money from restructuring initiatives (Beatty and Fong 1998).

These latest bailouts, however, are only a reflection of the many subsidies, tax incentives, and government agencies that are in place to protect unprofitable firms in the province. Following is a sample of these many programs and agencies.

- Job Protection Commission
- British Columbia/Alcan Northern Development Fund
- Small Business Venture Capital Tax Credit
- Mineral Exploration Tax Credit
- Quick Response Training
- Power for Jobs

In keeping with its interventionist industrial policy, the government recently passed the Northern Development Act, which will, among other things, create a new Ministry of Northern Development and provide for a northern development commissioner. The commissioner will be responsible for making recommendations to the Minister of Northern Development on job creation and economic development in northern British Columbia (Readshaw 1998).

In conclusion, in spite of empirical evidence that suggests that interventionist industrial policies are clearly the wrong strategy for promoting job creation and economic growth, the government continues to micro-manage the provincial economy.

Recommendations

So that British Columbia will be governed with a more economically sensible industrial policy, we suggest that the government of British Columbia adopt the following policy recommendations.

1 Eliminate all direct and indirect subsidies to business

Evidence suggests that providing subsidies and tax incentives to business is clearly the wrong approach to creating jobs and fostering economic growth. In fact, most economists have found evidence to suggest that business subsidies have had very little, if any, real effect on innovation and economic growth in Canada (Lippert 1994a). Hence, the government should eliminate the direct and indirect subsidies and tax incentives it provides to businesses in the province. Instead, the government should concentrate its efforts on creating the right business climate, allowing firms to create real jobs and generate economic growth.

2 Repeal the Northern Development Act

Simply creating another layer of bureaucracy will not bring more jobs and economic growth to the province of British Columbia. The government has stated that the mandate of the new northern development commissioner "will be to promote job creation and economic development in northern British Columbia" (Readshaw 1998). When governments begin to aid one region over another—picking winners and losers—often the majority of people come out on the losing side. Instead, the government should allow consumers in the north, through their own preferences for goods and services, to create the jobs and economic growth in their region without relying on government handouts.

3 Work towards reducing interprovincial trade barriers

In the past, the government of British Columbia has been reluctant to reduce interprovincial trade barriers, particularly when it concerns Crown corporations and government procurement (Lippert 1994a). Clearly, this strategy works against the government's goals of creating more jobs and economic development in the province. In fact, interprovincial trade barriers cost Canadians almost $6.5 billion a year in lost income (Palda 1994). Therefore, the government should work with the other provinces to reduce these trade barriers. Allowing more competition between firms across Canada, in the absence of trade restrictions, will force firms in British Columbia to innovate, create more jobs, and to contribute to the economic development of the province.

Conclusion

The strategy of the provincial government for creating more jobs and economic growth in British Columbia has largely been a failure. In fact, evidence shows that job creation and economic growth in British Columbia have continued to decline since the NDP government came to power in 1991. Through the use of subsidies, loans, and tax incentives to business, the government has attempted to create the right climate for such growth. However, in doing so it has ignored the large body of evidence showing that such strategies do not work. The government should be cutting taxes, reducing regulation, and allowing for a more flexible labour market rather than giving welfare to companies who fail to perform to the expectations of the consumer. Therefore, for pursuing a discredited industrial policy, the government of British Columbia deserves an **F**.

Grade for industrial policy: F

Regulatory policy

The hidden tax

Governments impose regulations on firms and individual members of society with the chief aim of protecting the public interest. The most commonly cited of these public interests include the environment, health and safety practices in the workplace, and protection from unfair labour practices. Supporters of more regulation in these areas contend that they are an important means towards securing the economic and social well-being of society. The aims are admirable but a substantial number of the regulations are nothing other than a form of taxation and, as such, impose an undue burden on the ability of businesses to operate efficiently in Canada.

From laws that restrict the ability of private firms to hire replacement workers to rules that govern the length of a wooden ladder, regulations impede economic growth by forcing firms to spend more of their time doing what the government tells them, rather than actually running their business. In 1993/94 alone, regulations cost Canadians $85 billion in compliance costs (Mihlar 1996b).

Since the 1970s, Canada has seen a sharp decline in productivity growth (OECD 1994c) which, in turn, has led to slower growth in real income and resulted in huge losses to the Canadian economy. Empirical studies suggest that between 12 percent to 30 percent of the productivity slowdown can be attributed to government regulations (Wienert 1997).

Moreover, the vast majority of regulations are exempt from a cost-benefit analysis. As such, there are many regulations where the costs exceed the benefits, impede economic growth, and fail to meet their objectives. Empirical evidence shows that in many cases the cost of regulations far exceeds the benefits experienced (Hahn and Hird 1991). Between 1973/74 and 1993/94, the direct cost of administering regulations in British Columbia increased by 800 percent (Mihlar 1996b). These increases in expenditures are inevitably paid by personal and corporate taxes. In addition, Professor Wiedenbaum at the Centre for the Study of American Business concluded that for every dollar spent on regulations by the government, it costs private firms $20 dollars in compliance costs (Mihlar 1996b). These compliance costs are indicative of the increasing transformation costs faced by businesses operating in Canada.

The cost of regulation in British Columbia

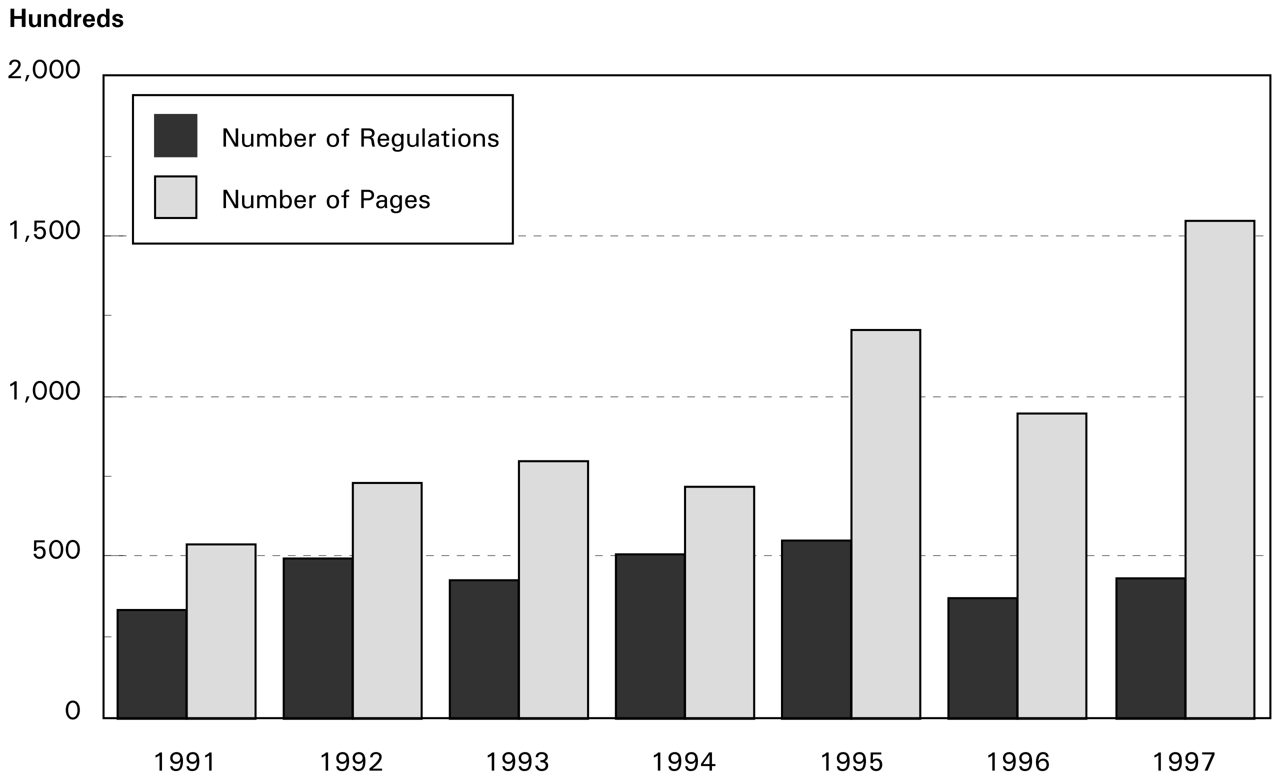
Between 1975 and 1997, British Columbia passed over 11,000 regulations amounting to almost 20,000 pages. The present government is responsible for passing almost 30 percent of these regulations since coming to power in the fall of 1991 (Mihlar 1996b). As figure 11 shows, the government has set a steady pace, passing, on average, over 400 regulations per year. Even more troubling, the number of pages it takes to log these regulations continues to grow as the increasing number of pages reflects the increasing complexity of the regulations. This is of particular concern to small businesses, which have to devote more time than they can spare to reading and complying with provincial regulations than running their operations.

What is the impact of this expansion? It has been estimated that the Forest Practices Code enacted by the government of British Columbia in 1994 has cost the forest industry about $1 billion per year in extra costs from increased red tape (*Vancouver Sun* 1998a). Moreover, evidence shows that, while the act has cost the industry hundreds of millions of dollars a year to administer, there has been little or no social benefits realized as a result of this act (Van Kooten and Wang 1998). In short, regulations do not act to increase *economic efficiency and welfare* as supporters of government regulations contend.

The response of the Clark government

In response to the adverse impact of their regulatory policies, the Clark government announced in its recent budget (1998/99) that it is initiating a review of provincial regulations. The Business Task Force has been entrusted with the responsibili-

Figure 11: Growth of regulation in British Columbia



Source: Mihlar 1996b, 1998.

ty of making recommendations on how the provincial government can cut the cost of doing business in British Columbia by streamlining regulations or eliminating red tape. The task force will also be responsible for devising ways to prevent the creation of unnecessary new regulations (Business Task Force 1998). This is indeed good news for British Columbia business, which has witnessed the cost of complying with provincial regulations rise steadily.

Recommendations

While the British Columbia government's review of all provincial regulations is a step in the right direction, there are many other initiatives that the Clark government could adopt to lower the cost of doing business in British Columbia. Specifically, we suggest that the government of British Columbia adopt the following policy recommendations.

1 Implement a moratorium on all new regulations

The Clark government should place a moratorium on all new provincial regulations for a period of three years. This step will allow the Business Task Force to complete its work without delay and stop the tide of regulations that have hurt productivity and economic growth in British Columbia. This moratorium should, of course, make exemptions for extraordinary circumstances such as earthquakes, epidemics, and other major natural disasters.

2 Prioritize all regulations

Regulatory bodies in British Columbia should use risk assessment to prioritize regulations in such areas as health, safety, and the environment. Since not all risks are of equal magnitude, the Clark government should focus on the risks that are most serious for British Columbians (Hahn 1996).

3 Implement a cost/benefit test

The Clark government should implement an assessment mechanism to analyze the costs and benefits of any future regulations. This step would prevent the passage of unnecessary regulations that impede productivity and economic growth. For instance, British Columbia should investigate Ontario's system for assessing the impact of new regulations, the Less Paper/More Jobs Test (Law, Markowitz, and Mihlar 1997).

4 Enact a "sunset review clause" in all new regulations

Regulatory bodies should include a "sunset clause" in all new regulations, which would repeal regulations on a three year cycle. This step would allow the province's regulatory regime to adapt to changing circumstances and provide for a mandatory review of all regulations for their continued relevancy and economic impact.

Conclusion

Government regulations are an implicit form of taxation. Empirical evidence has shown that regulations tend to lower productivity growth and the overall standard of living. Since the present government took power, regulations have increased at a steady pace, as have the compliance costs to business. Recently, the government announced a review of all existing regulations in an attempt to stem the escalating costs of doing business in British Columbia. While this is an important first step to cutting red tape, there is still much that needs to be done to ensure that the investment climate in British Columbia is conducive to economic activity. For finally recognizing, after six years in office, the onerous cost of regulations and initiating a task force to examine regulatory reform, the British Columbia government deserves a **D**.[1]

Grade for regulatory policy: D

1 We cautiously grant the government of British Columbia a D for its regulatory policy, since it was not known at the time this assessment was written whether or not the government would enact the recommendations suggested by the Barrett Commission. This "conditional passing" grade for regulatory policy is based on the assumption that the government will not enact the recommendations in the study that would add further to the already high regulatory burden faced by businesses in British Columbia.

Health care policy

Canada's faltering health care system

Contrary to popular belief, Canada's health-care system is anything but the best in the world. For instance, the federal government has cut billions of dollars in transfer payments to the provinces for health care services. In Ontario, hospitals have been shut down, services de-listed, and hundreds of nurses have been laid-off. In most other provinces, including British Columbia, doctors and nurses have participated in work stoppages, effectively shutting down clinics and entire hospitals for days at a time. As a result, longer waiting lists for surgical procedures have appeared, consumers have been deprived of access to pharmaceutical products of their choice, and many Canadians have been forced to go abroad to seek medical treatment.

These problems, however, are only a reflection of much deeper fundamental problems associated with the Canadian health care system. For instance, in spite of the principles embedded in the Canada Health Act (CHA), the health system in Canada is not as universal, comprehensive, accessible, or portable as most Canadians have been led to believe. Over 100,000 British Columbians, for example, are not covered by the province's health-care plan (McArthur, Ramsay, and Walker 1996). Evidence also shows that waiting lists for surgical procedures vary widely across the country, a direct violation of the principle of accessibility in the CHA that requires health-care services to be readily available to all, wherever they live (Ramsay and Walker 1998). Moreover, the health-care system in Canada is not fully portable. Residents of Quebec who require medical attention outside of Quebec are required to pay directly for medical services, and are reimbursed later, not the actual cost of the treatment, but the amount that the service would have cost in Quebec (McArthur, Ramsay and Walker 1996).

Canadians continue to cling to the belief that their system of health care is universal, accessible, and portable even though the evidence does not support this conclusion. What is becoming increasingly apparent, though, is that Canada's health-care system is failing to meet the needs of an increasingly aging population.

Not *how much* should be spent but *who* should be the one to spend!

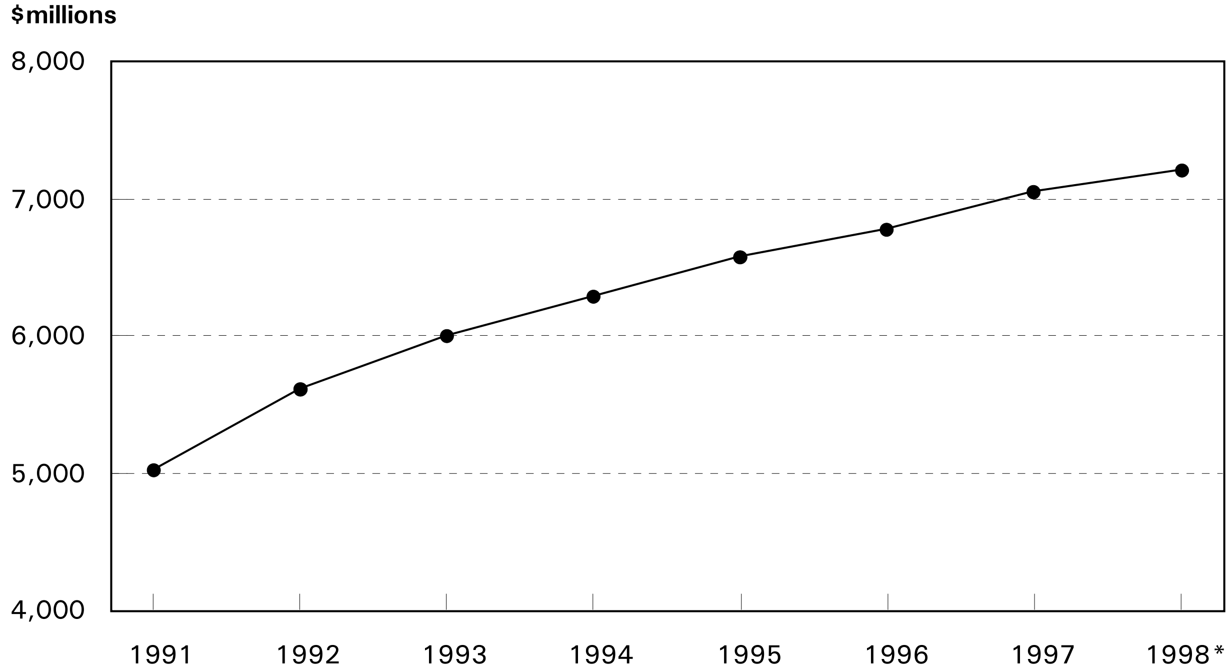
Most advocates of the Canadian health-care system would charge that the system is suffering from a lack of government funding. Most of them would argue that government cutbacks are primarily to blame for the poor state of the nation's health-care system. In reality, funding for health care services in most provinces and particularly in British Columbia has actually been increasing. As figure 12 shows, health-care spending in British Columbia has increased by almost 40 percent since 1991 although the quality of health care in British Columbia continues to decline (Ramsay and Walker 1998; McArthur, Ramsay, and Walker 1996). Table 2 shows that patients in British Columbia are having to wait much longer to receive medical treatment for various illnesses than the length of time that doctors consider to be reasonable waiting periods for each procedure. The results in British Columbia and in most other provinces suggest that putting more money into the system may not be the best option. Nevertheless, this does not mean that spending more on health care is necessarily a bad thing since Canada's health-care woes have little to do with funding levels. Rather, they reflect the flaws in the system.

Table 2: Median actual wait for treatment versus median reasonable wait for treatment in British Columbia

Treatment	Actual wait (weeks)	Reasonable wait (weeks)
Plastic surgery	7.3	5.3
Gynaecology	6.7	4.3
General surgery	4.8	3.6
Neurosurgery	4.5	2.9
Orthopaedic surgery	13.4	7.6
Cardiovascular surgery (urgent)	1.0	0.1
Radiation Oncology	5.2	2.8

Source: Ramsay and Walker 1998.

Figure 12: Spending on health care in British Columbia



Source: British Columbia Ministry of Finance and Corporate Relations 1998a, 1998b; 1998* is forecast.

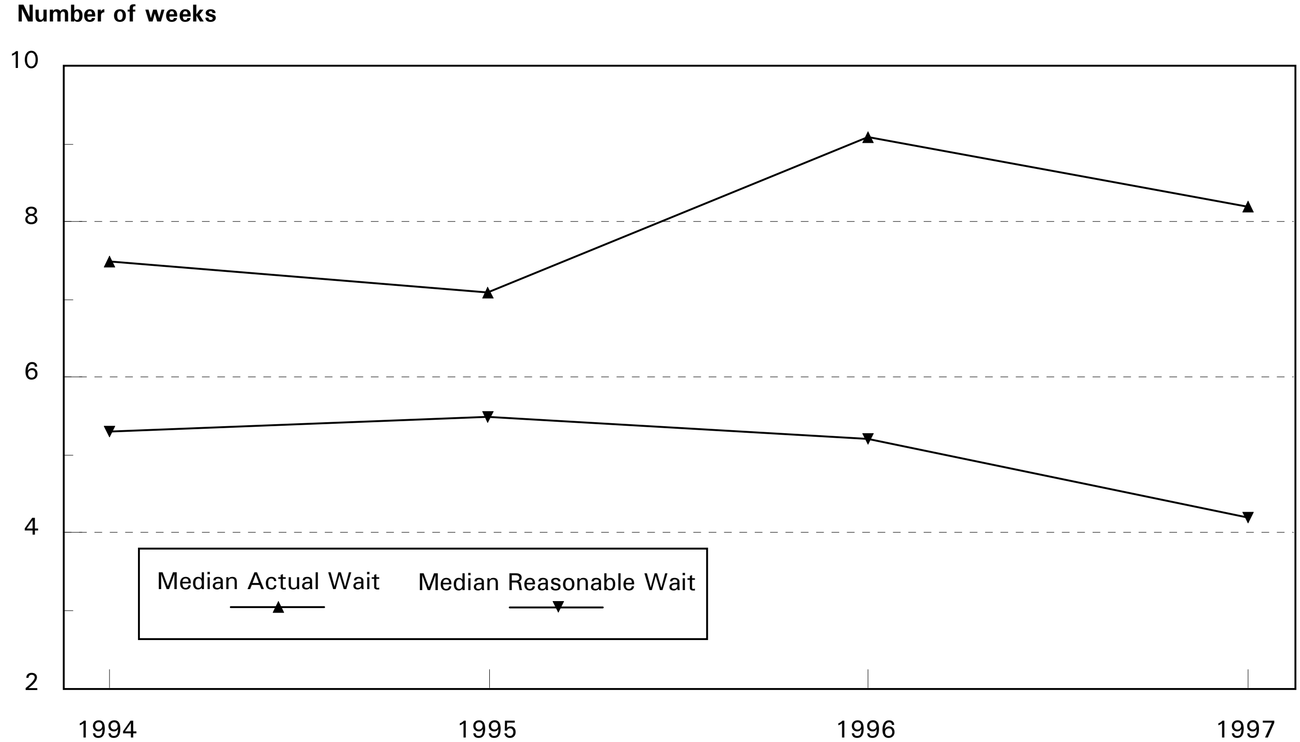
In Canada, the state rather than the consumers who receive the medical care allocates resources within the health-care system. Under the CHA, health care is based on a single-payer, fee-per-service system. Since the government is the single-payer, consumers who receive medical care are not, in general, charged directly for the specific services they receive. Hence, there are no incentives for consumers to be prudent in their use of the health system since they bear no direct costs for the medical care they receive. In addition, because governments have finite resources available to them, it is virtually impossible for the state to meet this level of demand for health care. Consequently, provincial governments have largely been left to de-list numerous medical services, ration medical services by keeping patients on waiting lists and, in some cases, force patients to seek treatment in other countries.

Governments also tend to place political considerations ahead of concerns for efficiency within the system. Although governments might be spending more on health care overall, where is the extra money actually going? For instance, a study conducted by the Fraser Institute found that hospital workers in British Columbia are paid more than their counterparts in other sectors of the economy. The evidence shows that if non-technical hospital workers (*e.g.* administrative clerks) were paid what their counterparts in the private sector are paid, the Royal Columbian Hospital in British Columbia would save over $2.6 million a year. Further, it was estimated that if all non-technical workers at the hospital were paid what their counterparts earn in the hotel industry, the hospital would be able to save over $5.4 million per year, or 4 percent of their total annual budget. The study concluded that if British Columbia could save about 4 percent on such costs, the savings would amount to about $115 million per year (McArthur, Ramsay and Walker 1996). The government monopoly in health-care services is obviously inefficient.

Market solutions

Competition among health-care suppliers would tend to reduce costs and raise the quality of health care. Indeed, in jurisdictions where competition has been introduced into the health-care sector, the quality of service has improved and waiting lists for various medical procedures have been shortened (McArthur, Ramsay and Walker 1996). Contrary to the opinion of those who claim that more competition in the health-care sector would have an adverse impact upon the health of individuals, evidence shows that a pricing system would introduce badly needed incentives for individuals to use the health system more prudently, without any adverse impact upon their health.

Figure 13: Reasonable vs. actual waiting periods from specialist to treatment in British Columbia



Source: Ramsay and Walker 1998.

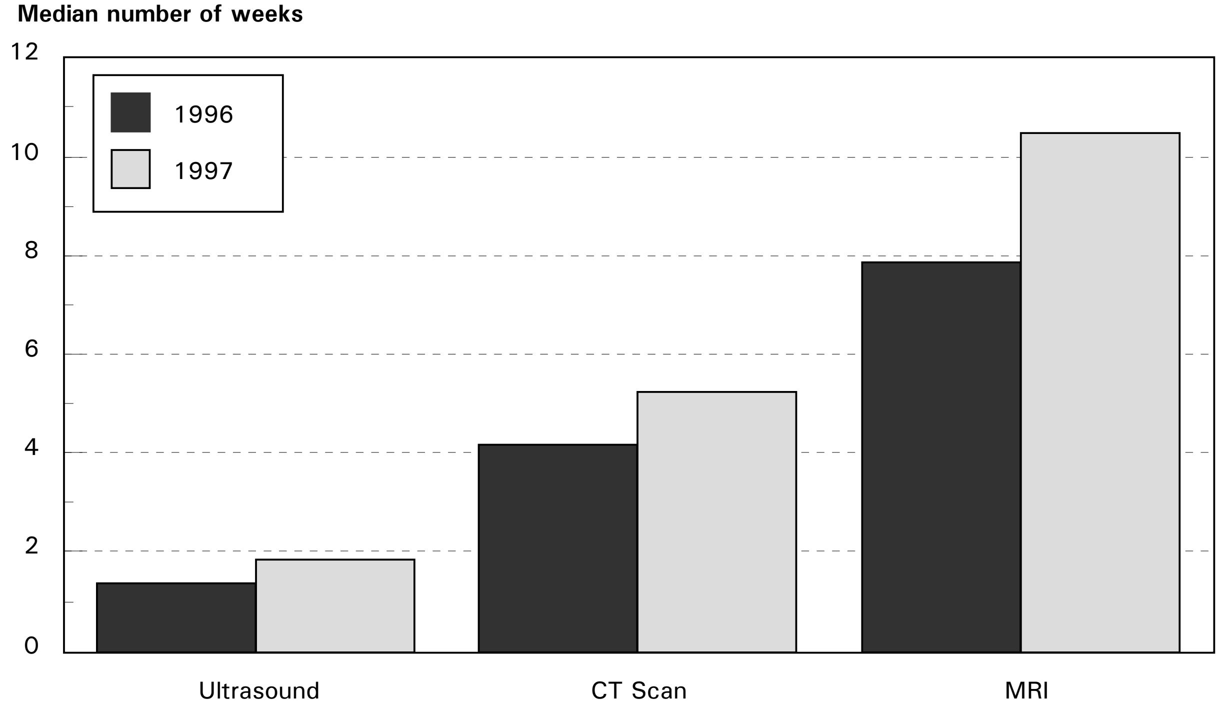
For example, the RAND Corporation studied the behaviour of families who received varying degrees of health-care coverage over several years and found that families who received full-coverage, much like the Canadian system, consumed more health care. Those families that received partial-coverage—paying a fee for their health care—consumed fewer health services. By moving those from full coverage to partial coverage, the researchers found a reduction in the overall use of the health-care system. More importantly however, the study concluded that those individuals who were charged for their health-care coverage did not feel any worse off health-wise than those families who received full coverage (Newhouse and the Health Insurance Group 1994).[1] Therefore, a competitive system could improve the quality of health care by alleviating problems such as long waiting lists.

The state of health care in British Columbia

In spite of a 40 percent increase in health-care expenditures since 1991, the state of British Columbia's health care system continues to decline. While there are countless horror stories of patients dying or falling ill due to the lengthy waiting periods for medical treatments, a report in 1997 from the government of British Columbia defended waiting lists, as long as the waiting periods for treatment were reasonable (Parker 1998). In the Fraser Institute's 1998 annual study of hospital waiting lists across Canada, however, the authors found that in British Columbia the actual waiting period for various medical treatments exceeded what was considered clinically reasonable (Ramsay and Walker 1998). Since 1994, the actual waiting period in British Columbia for patients receiving treatment after seeing a specialist has continued to exceed what is clinically accepted as a reasonable waiting period for treatment after seeing a specialist (see figure 13).

Aside from longer waiting lists, in 1995 the government, hoping to contain public-sector expenditures on pharmaceutical products, introduced a limited program of reference-based pricing (RBP). Under this program, the government categorizes drugs into various therapeutic groups and then agrees to pay for only the least expensive drug in each group (McArthur 1997). This strategy for containing costs is an unhealthy solution. For instance, a study of 12,900 patients in six health-maintenance organizations (HMOs) throughout the United States concluded that restrictive drug

Figure 14: Median number of weeks that patients in British Columbia had to wait for selected diagnostic tests in 1996 and 1997



Source: Ramsay and Walker 1998.

programs have an adverse effect upon health. The study found that, at HMO sites that employ restrictive drug programs, 160 percent more prescriptions were handed out, 83 percent more visits were made to the doctor, and drug costs were 161 percent higher than they were at sites not having restrictive drug programs. Furthermore, a study conducted by Harvard Medical School concluded that, when psychotropic drugs were restricted, visits to the doctor increased by 50 percent (McArthur 1997). Thus, not only does reference-based pricing increase costs but places the health of patients in jeopardy unnecessarily. In limiting access to various forms of medication, the government has failed to recognize that all drugs have different side effects and by limiting choice, the government may be placing patient's health in jeopardy.

Among the many changes that the government has made to the province's health-care system, the regionalization of services is by far the most significant since 1991. The purpose of the change was to "change how health is defined, to change how health services are provided, to promote better health for all British Columbians, to spend limited health dollars in a more sensible and efficient way, and to give communities and regions more control over the planning and delivery of health services (closer to home)" (McArthur, Ramsay, and Walker 1996: 156–57). While these objectives are commendable, evidence suggests that the plan has failed to meet its objectives. For instance, in recent months doctors and nurses have engaged in work stoppages, health-care expenditures have continued to rise and, rather than allowing local communities to decide their health-care needs, the changes have actually extend the government's control over health-care services into local communities (McArthur, Ramsay, and Walker 1996). And, patients are having to wait longer to receive diagnostic tests (CT Scans, MRIs, and Ultrasounds) (see figure 14).

Recommendations

In light of the evidence presented above, we suggest that the government of British Columbia adopt the following policy recommendations to improve the quality of health care in British Columbia.

1 Take control of health care

The evidence shows that the current system of health care in Canada does not work. In recent years, the federal government has been cutting back on its transfer payments to the provinces for such programs as post-secondary education, welfare, and health care. At the same time, the federal government has forced the provinces to abide by the CHA and, thus, has been forcing the provinces to provide a system of health care that is in accordance with the CHA. Hence, the provinces have been unable to experiment with other forms of delivering health care, even as the current system continues to deteriorate

British Columbians, however, should not be concerned by these threats. For instance, transfer payments to British Columbia have already decreased from about $2.2 billion in 1994/95 to $1.6 billion in 1997/98 (BCMinFinCorpRel 1998a). The federal government is making it harder for British Columbia to administer a health-care system that is already failing, by continuing to claw back the transfer payments it makes to the province to fund the system. If the federal government is under-funding health care in this country, how can they determine how the system is run? Further, under the Canadian constitution health care is a provincial matter. By taking control of health-care policy, British Columbia can begin to experiment with private-sector involvement in the health-care system as a means of improving the state of the health care in British Columbia.

2 Adopt a system of Medical Savings Accounts

Under a system of Medical Savings Accounts (MSAs), the provincial government would channel all its health-care expenditures directly to individuals through their personal MSA. Each individual's MSA would be divided into two parts: the first part would be used to pay for regular medical expenses (*e.g.* going to see the family doctor, paying for prescription drugs) and the second would be used to fund a catastrophic insurance plan. Individuals could then use their MSA (a fixed amount for the year) to pay for routine medical expenses throughout the year. Any money left over in the account at the end of year could be carried forward into the following year or be applied to an RRSP. However, an individual who exhausted the funds in his MSA for the year, would have to pay any additional expenses. The government-funded catastrophic insurance plan would ensure that no individual would be left bankrupt as a result of a major illness (Ramsay 1998; Goodman and Musgrave 1992[2]). Allowing competition and real pricing in the health-care sector would make the cost of medical care more apparent to both consumers and health-care providers and bring demand in line with supply.

3 Eliminate reference-based pricing

Evidence shows that restrictive drug programs can have an adverse effects on health and can also drive up costs. The government should realize that not all drugs have similar side-effects and that to limit the availability of pharmaceutical products is only placing the health of consumers in jeopardy. Furthermore, such a system, by impeding innovation, reduces employment and, more importantly, prevents new and improved forms of pharmaceutical products from coming to market.

Conclusion

The quality of health care in British Columbia is on the decline. In spite of recent large investments by the government, the quality of health care has continued to deteriorate. Longer waiting lists for medical procedures have developed, consumers have been deprived of access to pharmaceutical products of their choice, and some have been forced to go abroad to seek medical treatment. The province of British Columbia should, therefore, adopt a more competitive health-care system. Competition among health-care suppliers would tend to reduce costs, shorten waiting periods for medical procedures and, most of all, would allow consumers to choose how to allocate their limited resources within the health-care system. Only then can the quality of health care improve. In light of their performance in the health-care field, the government of British Columbian deserves an **F**.

Grade for health policy: F

1 The only groups that did not fair well as a result of co-insurance were the poor, mentally disabled, and the chronically ill; these groups need a separate program. For the majority of the population, co-insurance is definitely a viable option for the majority of the populace.

2 In Goodman and Musgrave 1992, Medical Savings Accounts are referred to as Medical Premium Accounts.

Education policy

Investing in the future

Most people would agree that government's role in providing a publicly funded educational system (kindergarten to grade 12) is an important investment that will secure the economic and social well-being of future generations. Educating young people today, particularly at the elementary and secondary levels of schooling, will provide them with the knowledge and tools they require to become productive citizens. Clearly, a highly educated society has a greater propensity to generate economic wealth, achieve higher levels of personal income, and attain a higher standard of living. A highly educated work force also provides social benefits as well and a more literate society has a greater tendency towards being a highly civil and law-abiding community. Thus, since education confers social as well as private benefits, society has a vested interest in ensuring that all of its citizens have at least a basic level of education.[1]

Put another way, the private rates of return on basic education are exceeded by the social rates of return (Easton 1988). Free markets encourage citizens to partake in economic activities until private marginal benefits equal private marginal costs. However, efficiency demands that social marginal benefits must equal social marginal costs. Thus, given that the social benefits of basic education exceed the private benefits, free markets might be in a position to provide only a limited degree of basic education (*i.e.* an under-investment in basic education). Therefore, an argument could be constructed to support a publicly funded educational system.

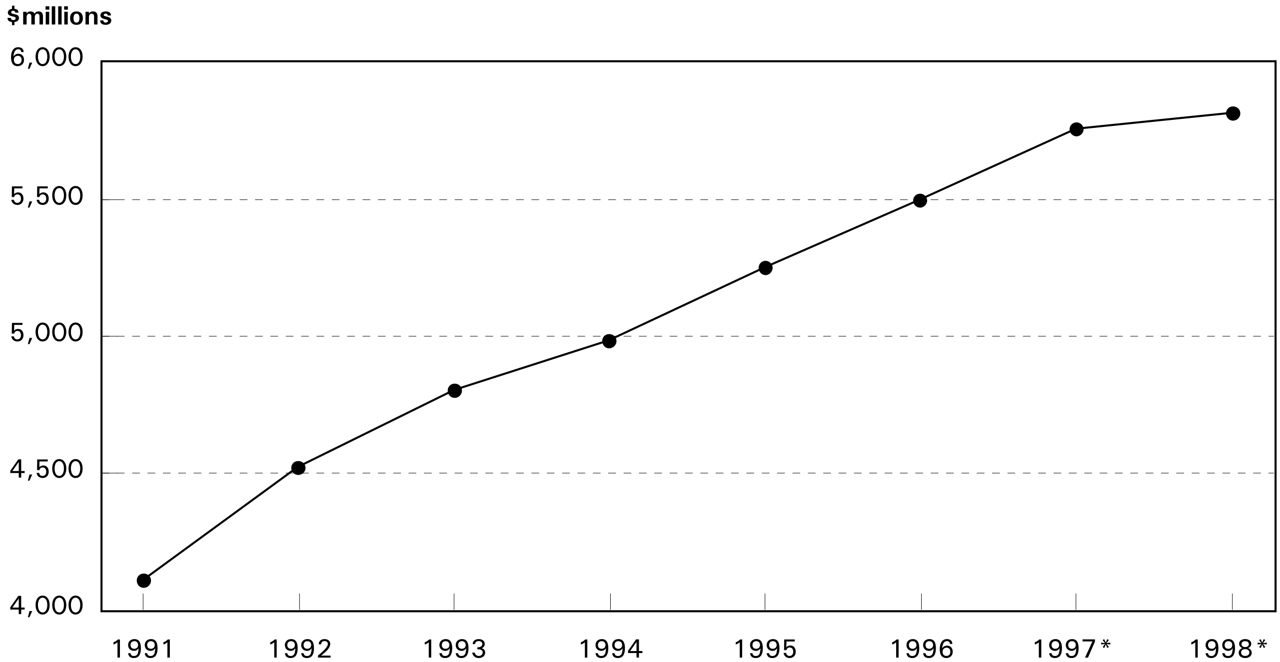
The government's role in providing education

While the government's role in providing for basic education is seen as important, it is unclear what that role should entail. Theoretically, government participation in the market for education can be expressed in a number of different ways. For instance, they can finance and provide education through schools owned and operated by the government. They could allow schools both privately and publicly owned and operated. They could allow the establishment of charter schools, where local communities have greater control over how the schools in their community ought to be managed. Or, they could provide parents with vouchers that enable them to send their children to the schools of their choice. Historically, provincial governments throughout Canada have had a monopoly over the funding and delivery of public education. However, with escalating costs, poor levels of student performance, less choice, and greater dissatisfaction with the publicly operated system, most provincial governments are striving to meet parental demand for more accountability in the system.

Currently, through a complex apparatus of bureaucratic entities at both the provincial and local level, Canadian provinces administer and direct curriculum, set out teaching methods, provide funding, and test student performance. In effect, provincial governments both direct and assess the effectiveness of their administration of the educational system. According to Dan Gardner, who conducted a study on the state of the educational system in British Columbia, this type of system is nothing more than the monopoly conflict of interest (Gardner 1996). Indeed, there is an inherent conflict of interest when the ministry of Education both delivers educational services to the public and also assesses their effectiveness. Both Gardner and Helen Raham have argued that many of the inefficiencies and the lack of accountability in the educational system stem directly from the monopolistic position of the state-run educational system (Raham 1996; Gardner 1996).

In most provinces, including British Columbia, parents are deprived of choice over what type of education they wish their children to receive. Since all children have varying degrees of talents and skills, it is difficult for a standardized system of education to meet the different demands and provide the level of education suited to each child. Furthermore, without competition in the educational system, there is no incentive to innovate, no incentive for teachers to up-grade their skills, no incentive to provide students with the education appropriate to an economy increasingly based upon knowledge. Instead, government officials control and direct educational standards without consideration of parental demands. For ex-

Figure 15: Funding for schools in British Columbia



Source: British Columbia Ministry of Finance and Corporate Relations 1998a (for 1998), 1998b (for years 1991 to 1997); *1997* and 1998* are forecasts.

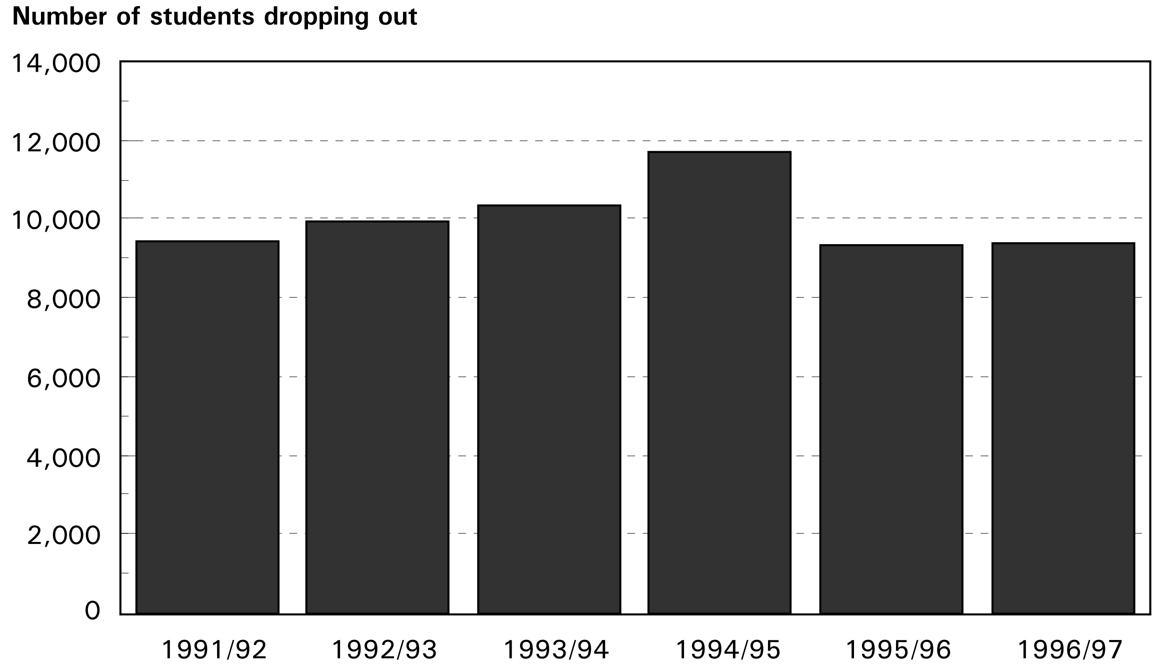
ample, a recent petition signed by over 4,000 parents in British Columbia demanded a traditional school for their children; the petition was bitterly opposed by school teachers (Luba 1998). In jurisdictions around the world where parents have greater choice over schooling and participate in how local schools operate, there is a greater degree of satisfaction with the system of education (Wylie 1997; Society for the Advancement of Excellence in Education 1997*a*). In spite of the evidence that points to the merits of providing school choice, many provinces, including British Columbia, continue to deprive parents of choice in the educational system.

The state of education in British Columbia

The educational system in British Columbia is under-performing. Surveys show that the vast majority of British Columbians, post-secondary educators and employers in British Columbia, are disappointed with the performance of the province's educational system. For instance, post-secondary educators believe that secondary school students are "horribly under-educated," only a small number of employers rate reading and writing skills of young people in British Columbia as acceptable, and satisfaction with the educational system is the lowest in the country (Gardner 1996). In response, the government has attempted to improve the educational system by pouring more money into it. As figure 15 illustrates, the government has increased overall spending on education by 45 percent since 1991. Moreover, spending per pupil in the province increased by almost $600 between 1991/92 and 1996/97 (Kubisheski 1998). However, last year an independent study conducted by British Columbia's Comptroller General found that the educational system failed to link the level of spending to student performance (Society for the Advancement of Excellence in Education 1997b).

Indeed, national test scores show that students 13 and 16 years old in British Columbia have poor mathematical and problem-solving skills compared to students in other provinces. For instance, 1997 results show that 13-year-olds in British Columbia performed at the national average in math knowledge and below the national average for problem-solving skills. Sixteen-year-olds fared even worse, scoring below the national average for both math knowledge and problem-solving skills (Raham 1998). Moreover, as figure 16 shows, the drop-out rate of students in both elementary and secondary schools has remained consistently high throughout much of this decade. What is even more troubling is that the number

Figure 16: Drop-out rates for elementary and secondary schools in British Columbia



Source: Kubisheski 1998.

of drop-outs at the elementary level is increasing (Kubisheski 1998). These results show that putting more money into the educational system in British Columbia is not helping children gain the basic skills they require in an increasingly knowledge-based economy.

If money is not the problem, then there might be something wrong with the educational system. In the Fraser Institute's 1998 study of secondary schooling in British Columbia, on a scale of one to 10, nearly half of all high schools in the province received below-average rating on their performance in several areas of education. Nearly 23 percent of high schools in the province received a failing grade for the quality of education they provided. Furthermore, in 1996/97 grade-12 students failed nearly 16,000 provincial exams (Cowley, Easton, and Walker 1998). The only examinable subject that is required of a student for graduation is grade-12 English/Communications (Easton 1998). As Professor Stephen Easton points out, since it costs about $90,000 to educate a child in British Columbia from kindergarten to grade 12, it would be "useful to know if that investment has at least met the guidelines of curriculum for each and every course our students take toward the end of their studies in high school" (Easton 1998). Clearly, the educational system in British Columbia fails to provide accountability either to parents or to the students themselves and falls far short of producing high levels of academic excellence.

Recommendations

The solution lies in replacing the structure and process of delivering education in the province of British Columbia with a system that is accountable and meets the demands and needs of individual students. We suggest that the government adopt the following policy recommendations.

1 Implement a school voucher system

The provincial government should provide school vouchers for educational services at institutions of their choice to the parents or guardians of every student in British Columbia. If the government opens up the educational system to private suppliers, parents will have the choice of sending their children to the school that best meets the individual needs of each child. Private educators would provide educational services in exchange for the school vouchers, which they would redeem for cash from the government of British Columbia. Competition among public and private schools would force innovation, higher standards of accountability, and a higher quality of education. Parents would then be able to compare results and make informed choices. Furthermore, a private system need not be too expensive and out of reach for financially disadvantaged families. Empirical evidence shows that the average cost of private education is far less than the average cost of public education.[2] In addition, competition among private suppliers would not only result in higher standards of education but would also act to lower the price of education over time.

2 Permit the establishment of charter schools

Charter schools are another means of offering parents more choice and control over the education their children receive (Raham 1996; Freedman 1996). A group of interested parents could apply for a government charter to establish a school based on the type of education they wish their child to receive. Parents would have control over curriculum, transportation, the hiring of teachers, and the general management of the school. These schools would receive funding from the province based on enrollment but the schools would be run by local communities and not by provincial bureaucrats. Empirical evidence suggests that charter schools greatly improve the accountability and performance of the educational system. The experience with charter schools in the United States and New Zealand has been very positive in terms of the academic progress of the students and overall satisfaction with the system of education (Wylie 1997; Society for the Advancement of Excellence in Education 1997a). Studies show that charter schools have lower drop-out rates, revitalize schooling in poor regions, and reduce the costs of providing quality education (Raham 1996; Freedman 1996).

3 Publish an annual "report card" on schools in British Columbia

In 1997 the Fraser Institute published a comprehensive study on the performance of each high school in the province of British Columbia. The study graded each school on various components related to the delivery of education; these included rates of failure, average marks on provincial exams, and graduation rates. The purpose of the study was to provide parents with children in school with information on how their child's school was performing and to provide parents about to send a child to school with an idea of which schools would provide a good education. The study stressed the importance of assessing how schools perform their *duties*, not simply on how the children perform (Cowley, Easton, and Walker 1998). We recommend that the government of British Columbia publish annual report cards, modelled on the criteria used in the Fraser Institute's, *A Secondary Schools Report Card for British Columbia,* on the performance of elementary and secondary schools in British Columbia. This annual report should be conducted by an independent authority, perhaps by the province's auditor general. This kind of evaluation would help to restore accountability and confidence in British Columbia's educational system.

Conclusion

The educational system in British Columbia is failing those whom it is supposed to educate. In response, the government continues to pour more money into a broken system. It has allowed education costs to spiral but the system continues to falter and produce poor results. The government of British Columbia should, therefore, introduce more competition in the market for education through either a voucher system or charter schools. This would encourage more innovation, more accountability in the system, and provide higher academic results. For continuing to increase funding of a system that yields poor results and for failing to provide parents with more choice and accountability in the educational system, the British Columbia government deserves an **F** for its education policy.

Grade for education policy: F

1 However, this is not the case for post-secondary education. The returns from a university or college-level education are almost entirely personal as the earning potential of university and college graduates is higher than that of those without post-secondary education. Therefore, arguments in favour of government intervention in the market for post-secondary education is without merit. See Constantos and West 1991.

2 Evidence from the United States shows that the average cost of a private education is cheaper than a public school education. In fact, a recent study conducted by the Cato Institute found that the total average tuition fee at private elementary and secondary schools in the United States was US$3,116 per year while a the education of a student in public school cost US$6,857 per year (Boaz and Barrett 1996).

Social policy

The welfare state . . .

The proliferation in the size and scope of the state has become an increasingly dominate feature of many Western democracies in the twentieth century (Nutter 1978; Higgs 1988). Today, state intervention both in the private lives of individuals and in their economic affairs is rampant. This was not always the case.

Only a century ago, governments in the industrial world were primarily concerned with enforcing private contracts, maintaining law and order, and protecting individual liberties and private property. Gradually, the state began to take over responsibilities for matters previously left to the care of families and private charities. This massive intrusion into the private activities of individual citizens and families has come to symbolize the modern welfare state. Today, governments provide a wide range of social services ranging from welfare assistance and employment insurance to universal Medicare and old age benefits. To appreciate the huge growth in the welfare state, consider that in Canada the number of people collecting Canada Assistance Plan benefits increased by over 200 percent between 1970 and 1995. In British Columbia, however, the increase amounted to 329 percent (Walker and Emes 1996).

. . . and the unromantic side

There is little doubt that much of the growth in the state's activities was primarily encouraged by a real desire to assist the financially disadvantaged. What is at issue, however, is not so much the intentions, which for the most part can be seen as laudable, but rather the results. Indeed, the body of evidence suggests that good intentions alone are not sufficient to develop good public policy. Empirical evidence shows that despite the growth of state intervention, many of the social problems are still present today. For instance, high unemployment is still a major concern in most Western industrialized nations (OECD 1994a). More importantly, however, those responsible for the modern welfare state have, in their quest to change the world, failed to appreciate the effect that incentives have on human behaviour.

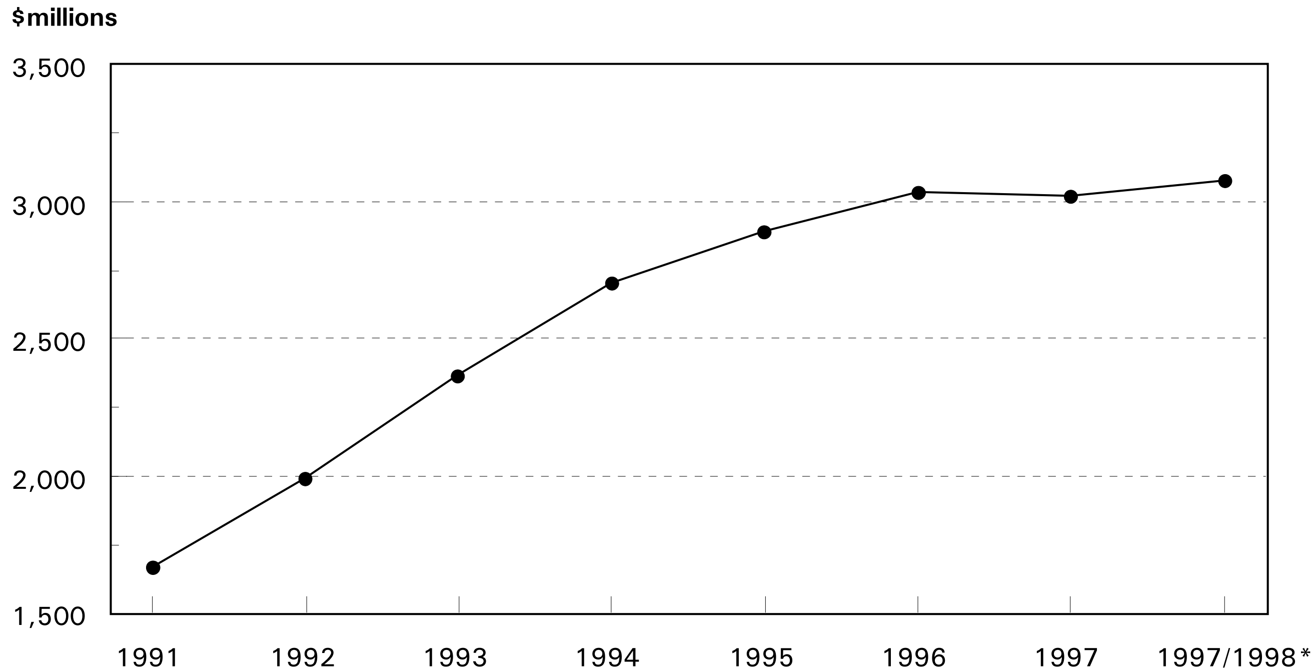
The evidence shows that the welfare system creates dependency on the system; incentives to leave the welfare rolls in search of real employment are virtually non-existent (Sarlo 1994). Currently, welfare benefits are reduced proportionately to increases in the level of income. Thus, welfare recipients face an effective marginal tax rate of almost 100 percent and, therefore, have little incentive to seek employment (Richards and Watson 1994). Moreover, there appears to be a direct correlation between increases in welfare benefits and growth in the number of social assistance caseloads (Law, Markowitz, and Mihlar 1997). In short, the present welfare state is inefficient and outdated and fosters a culture of dependency (Rector 1994; Hill and O'Neil 1990).

British Columbia's social policy

During the this government's first term in office, 1991 through 1996, the number of individuals receiving welfare benefits in the province increased by almost 110 percent (British Columbia Ministry of Human Resources 1998c). According to John Richards in *Retooling the Welfare State*, the single most important reason for the dramatic increase can be attributed to "poor management" of the system. Incoming Social Services Minister, Joan Smallwood, made it clear to ministry staff that it was their responsibility to "serve clients, not police welfare use" (Richards 1997: 160). Consequently, aside from the huge rise in the number of welfare recipients, benefits for single employable recipients and couples with two children increased by almost 4 percent and 8.5 percent, respectively, between 1991 and 1995 (National Council of Welfare 1997/98). This increase, in part, also increased the number of employable singles and couples on social assistance, between autumn 1991 and winter 1995, by almost 73 percent (British Columbia Ministry of Human Resources 1998a).

Overall spending on social services in British Columbia has continued to increase. As figure 17 shows, overall spending has increased by almost $1.6 billion, or 84 percent, since

Figure 17: Growth in spending on social services in British Columbia



Source: British Columbia Ministry of Finance and Corporate Relations 1998a (for 1997/1998), 1998b (for years 1991 to 1997); 1997/1998* is forecast.

1991. From figure 18, it is not difficult to see that welfare benefits are relatively higher in British Columbia than in the rest of the country, both for single individuals and for single parents with one child. There were still 50,000 more social assistance recipients as of January of this year than when the government came to power in 1991 (British Columbia Ministry of Human Resources 1998a). In short, putting more money in the system has, in part, increased the welfare rolls in British Columbia.

Since 1995, the government has moved toward tightening eligibility requirements and strengthening enforcement mechanisms in an effort to correct past mistakes. More investigators, eligibility officers, and verification officers have been hired in an effort to prevent further abuse of the welfare system (British Columbia Ministry of Social Services 1995/96). In July 1996, the provincial government implemented the British Columbia Family Bonus Act, which directs child benefits to low-income families and not just to those on welfare (British Columbia Ministry of Human Resources 1998b). This is an important first step toward providing an incentive for those on welfare to enter the labour market. Whereas before, only those on welfare could receive child benefits, the introduction of the family bonus ensures that leaving the welfare rolls will not preclude eligible recipients from continuing to receive these benefits. Furthermore, we cautiously point to a study conducted on the effects that the Family Bonus Act has had on welfare caseloads in British Columbia, which suggests that the number of recipients have decreased as a result of the legislation.[1] Nevertheless, while the Clark government seems to have grasped the magnitude of the problems plaguing the system, there is still much to be done.

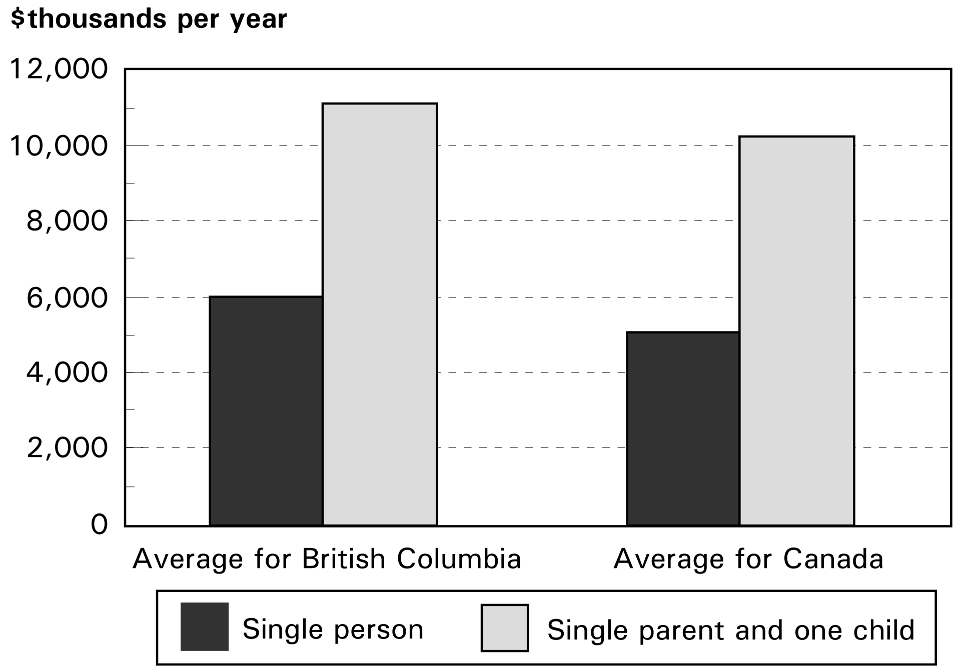
Recommendations

We suggest that the Clark government implement the following policy recommendations to stem the escalating costs of social assistance in British Columbia and to reduce the dependency on social assistance programs:

1 Implement a Basic Necessities Index to guide the setting of social assistance rates

The best solution for stemming the escalating costs of social assistance in British Columbia would be to provide social assistance to those who truly need it. Professor Christopher Sarlo has found that the current measure of poverty, Statistics Canada's Low Income Cutoff (LICO), is not an indication of actual poverty but rather a measure of inequality. In fact,

Figure 18: British Columbia's welfare benefit rates



Source: National Council of Welfare (Winter 1997/98).

Statistics Canada, who use LICO, have stated very clearly that it is *not* a measure of poverty. Therefore, we recommend that the government of British Columbia adopt Sarlo's Basic Necessities Index, which calculates the cost of food, shelter, and clothing, as a means of determining the level of welfare assistance (Sarlo 1996).

2 Reduce welfare benefits

Reducing welfare benefits would represent the second best solution towards reducing dependency on the system and reducing the costs of welfare in British Columbia. Reducing welfare payments provides incentives for those on social assistance to enter the labour market. However, as figure 18 shows, British Columbia's welfare benefits continue to exceed the national average. Once taxes and benefits are accounted for, individuals receiving welfare assistance are paid an implied minimum wage of $9.21 per hour in British Columbia, or $2.36 in excess of the provincial minimum wage (Walker and Emes 1996). Therefore, there are still many disincentives within the welfare system that discourage recipients from seeking employment. We recommend that the government of British Columbia reduce welfare benefits to bring them in line with the national average and to ensure that social assistance benefits do not act as a disincentive to returning to the workforce.

3 Implement a mandatory "personal employment strategy" to be completed by those receiving welfare

Within a month of receiving welfare benefits from the province, recipients who are "employable" should be required to submit a personal employment strategy (Lippert 1994b). This strategy should outline what action the recipient intends to take in trying to get off welfare and (re)enter the workforce. Thereafter, monthly reports should be submitted to the Ministry of Human Resources to update caseworkers on the progress made in finding employment. Non-compliance would result in benefits being withheld.

4 Implement a Negative Income Tax (NIT) to replace the current welfare system

It was noted earlier, welfare recipients face an effective marginal tax rate of almost 100 percent, since benefits are reduced proportionately to each dollar of earned income. To remove this disincentive, we suggest that the government replace the current welfare system with a Negative Income Tax (Friedman 1962). Such a system will reduce the high marginal tax rate faced by welfare recipients and thereby increase the incentives to find work. The British Columbia Family Bonus Act incorporates some aspects of a NIT, since benefits are reduced (not one-for-one) as income rises (British Columbia Ministry of Human Resources 1998b; Richards 1997). However, the entire system should be reconfigured along the lines of a NIT system. Then, the system would offer more incentives to leave the welfare rolls and to (re)enter the workforce.

Conclusion

During the NDP government's first term in office, the number of individuals receiving welfare benefits in the province increased by almost 200,000. Recently, efforts towards correcting these and other past mistakes have been met by some modest success. The number of welfare recipients is down and some incentives have been introduced to reduce dependency upon the welfare system. However, many problems remain. Spending on social services has increased by 84 percent since 1991, there are 50,000 more welfare recipients than when the government first came to power, and welfare rates are still among the highest in the country. In short, there is still much work to be done. Therefore, the British Columbia government deserves a **D** for its social policies.

Grade for social policy: D

1 While providing incentives for welfare recipients to enter the workforce is a positive step, it is important to keep a number of things in mind. First, the study conducted on the impact of the Family Bonus Act on welfare caseloads in the province is far too simplistic. It could be that more welfare recipients are leaving the rolls in favour of more economically prosperous regions of the country such as Ontario and Alberta. Or, it could be that the recent downward trend in the number of welfare recipients might be due to the government's placing individuals receiving various forms of social assistance into different categories. Finally, since the study examined a relatively short period of time (five months), it is difficult to make an accurate assessment of what the long term impact of the program will be (British Columbia Ministry of Human Resources 1998b).

Natural resources policy

The importance of natural resources

In Canada, the natural resources sector is an important contributor to economic output and consequently to employment growth. The natural resources sector contributed close to $33.2 billion to GDP in 1997, and provided direct employment to almost 470,000 individuals.[1] These figures, however, underestimate the sector's real economic importance because they fail to account for its large indirect contributions. A 1997 study conducted by Price Waterhouse on the economic impact of the forest industry in British Columbia found, for example, that while the industry directly employs close to 100,000 workers, as the largest industrial employer in the province it generates an additional 195,000 indirect jobs.[2] The average forestry worker earns $46,130, $14,180 more than the average wage in British Columbia. In 1996, the forest industry as a whole accounted for 19.8 percent of the provincial GDP (Chancellor Partners 1997). In 1997, industry exports totaling $14.5 billion accounted for 55 percent of provincial exports. In the last five years, the industry's capital expenditures totaled almost $6 billion, while payments (*i.e.* taxes and stumpage fees) to all levels of government amounted to more than $20 billion (Price Waterhouse 1998a).

Despite these impressive figures, there is evidence to suggest that the forest industry along with the mining industry, both major contributors to the British Columbia economy (see figure 19)3, are in trouble. For instance, during the past two years the forest industry has incurred over 4,500 job losses. In 1995, the industry posted net earnings of $1.2 billion. In 1997, however, the industry reported a net loss of $132 million. The rate of return on capital investments has steadily declined from 10.3 percent in 1994 to 1.4 percent in 1997. Furthermore, capital expenditures made by the industry declined by almost 17 percent between 1996 and 1997 (Price Waterhouse 1998a). The mining industry in British Columbia, which accounts for thousands of jobs and directly accounts for about 3 percent of provincial GDP (BCMinFinCorpRel 1998b), is also in decline. A 1997 survey of almost 20 mines and one smelter plant in British Columbia reported that employment declined by 4 percent and profits decreased by 26 percent. Capital expenditures by the industry have also declined as have after-tax returns on shareholders' investments (Price Waterhouse 1998b). So what are the reasons for the lackluster performance of these important industries? Part of the answer is government mismanagement.[4]

Through hundreds of regulations, command and control environmental policies, a rigid labour code, and a high levels of taxation, the government has seriously eroded the economic performance of the natural resources sector.

Managing natural resources: Why the state is incapable of meeting the challenge

Governments tend to place political considerations ahead of good public-policy decisions. They do so by discounting the negative economic consequences that might arise from their actions, and rarely rely on empirical evidence to support their policy decisions. Elizabeth Brubaker, executive director of Environment Probe, once suggested that the "perverse incentive" structure in government might explain why the state is incapable of managing natural resources efficiently and so as to maintain sustainable yields. Using over-fishing in Canada as an example, Brubaker outlined four problems associated with the system of government that renders it incapable of making sound policy choices (Brubaker 1998).

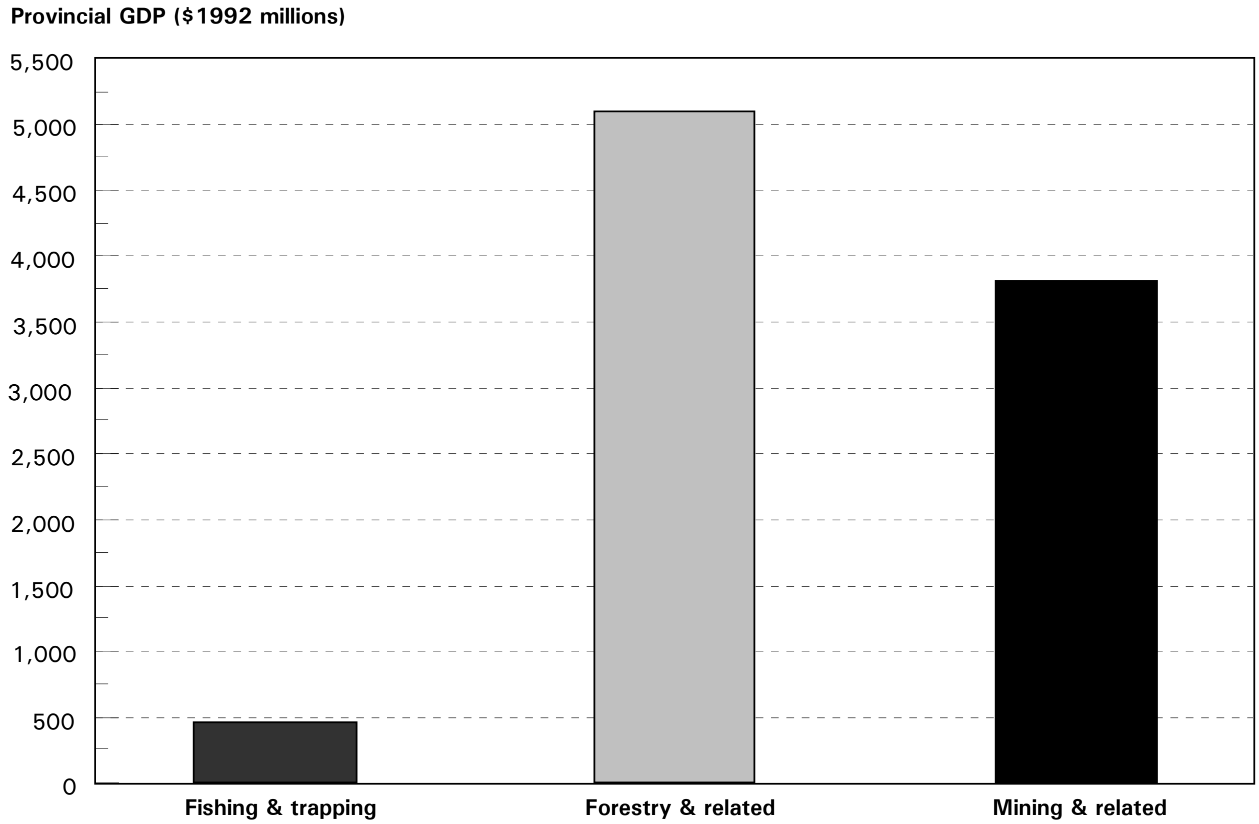
Problem 1: "short-termism"

Politicians suffer from "short-termism." Governments tend to look only far enough into the future to see the next election campaign. They tend to choose policy options that will result in immediate political pay-offs, even if they result in negative long term economic consequences.

Problem 2: agency

Often times, politicians are forced to make compromises between competing interests in order to maximize their vote

Figure 19: The importance of forestry and mining to British Columbia's economy (1996)



Source: Statistics Canada, May 14, 1988.

potential. The compromises that are reached rarely serve the majority of the population's welfare.

Problem 3: special interests
Special interest groups often exert enough political pressure to force the government to back, for political considerations, a policy choice that might ultimately prove to be the wrong one.

Problem 4: government accountability
Governments are not held accountable for the decisions they make. Since they gain no financial benefits from making good policy decisions, they do not pay the costs of the bad decisions that they make. Hence, no rewards, punishments, or incentives exist to encourage good public-policy decisions.

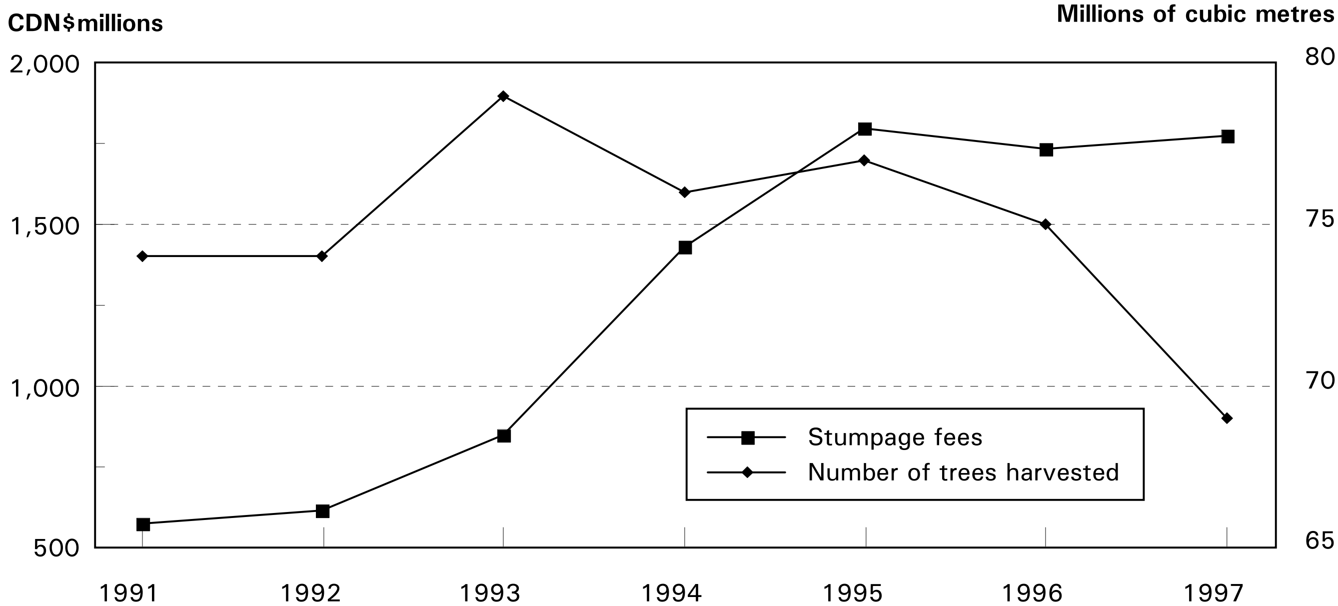
In short, Brubaker argues that all of these problems have contributed to the progressive deterioration of the East-coast fishing industry, and now threaten the West-coast industry as well.

The state of the natural resources sector in British Columbia

Since coming to power in 1991, the NDP government has pursued a natural resource policy that has largely been guided by environmental concerns that have very little to do with facts.[5] As a result, the province's two largest employers in the natural resources sector, the forest and mining industries, have suffered big losses. In forestry, for example, an almost 200 percent increase in stumpage fees since 1992, arising partly from the government's introduction of the Forest Renewal Act, has contributed to an 83 percent increase in the cost of logging on Crown land (Smyth 1998; Price Waterhouse 1998a). Instead of creating the 40,000 new jobs that Premier Glen Clark promised in his 1996 Jobs and Timber Accord, the forest industry has suffered 4,500 job losses since the accord was first announced (Price Waterhouse 1998a).

Increases in environmental regulations, due in large part to the government's 1995 Forest Practices Code, have increased the cost of production in the industry by 50 percent

Figure 20: Stumpage fees* paid and number of trees harvested in British Columbia



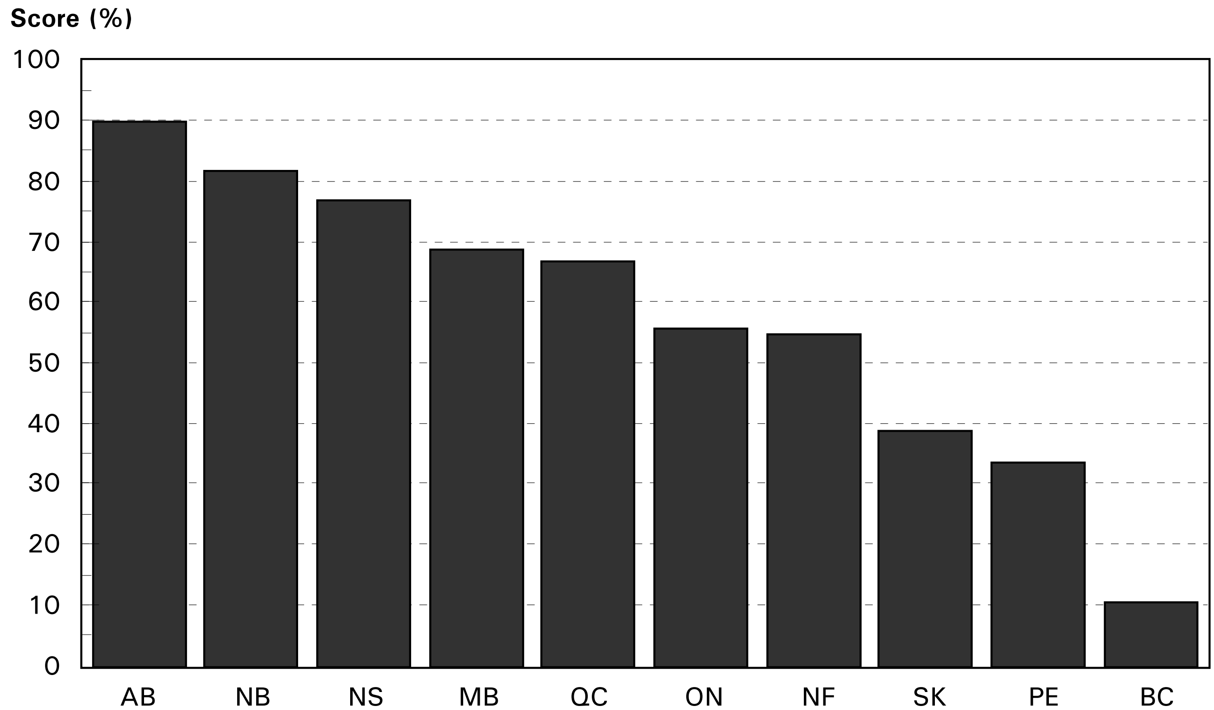
Source: Price Waterhouse 1998a. *Stumpage fees include stumpage, royalties, and rents.

(Smyth 1998). The Code unfairly places restrictions even on Crown land that is not listed as a designated park or protected area. Through complex harvesting rules, private firms are required to "maintain certain structural features of the forest in order to ensure the maintenance of biological diversity and a sustained flow of non-timber values such as wildlife and fish habitat, visual quality, water quality, and recreation" (Haley 1996). This policy is costing the industry over $400 million a year to implement with little or no social benefits in return (Van Kooten and Wang 1998). In addition, future cuts to the Allowable Annual Cut (AAC), an annual limit set by the province on the number of trees individual forest companies are permitted to harvest, are expected to result in the loss of thousands of jobs in the industry (Haley 1996).

These measures have been taken in spite of the fact that the industry continues to harvest efficiently and maintain sustainable yields. As figure 20 suggests, even as stumpage fees have dramatically risen since 1991, the number of trees that has been harvested by the industry has remained constant throughout the period. Moreover, as stumpage fees and the regulatory burden on the industry have continued to increase, evidence shows that the forest industry in British Columbia has continued to make large investments in protecting the environment. For example, the industry has increased spending on environmental maintenance of the province's forests by almost $100 million since 1994 (Price Waterhouse 1998a). Instead of acknowledging the responsible practices of the forest companies, the provincial government has been quick to accept the argument from special interest groups that British Columbia's forests are recklessly being depleted by the forest companies. The facts show that in designated replanting areas of the province, there are now three trees planted for every one harvested. This increases the survival rate to maturity for these trees to 87 percent, compared with 60 percent 10 years ago (Francis 1996). In spite of all this evidence, the government is expected to lower the AAC by 17 percent sometime between year 2000 and 2005, a move that is expected to cost around 45,000 jobs in the industry over the next 5 to 10 years (MacCallum 1996). Indeed, even a study commissioned by the government concluded that a 11.2 percent harvest reduction would have the effect of closing one pulp mill, one plywood mill, between three and five sawmills and seven shingle mills, resulting in some 4,000 direct job losses in the logging and manufacturing sectors of the provincial economy (MacCallum 1996).

Like the forest industry, the mining industry in British Columbia has also suffered big losses. For instance, while direct employment in the mining industry has declined by 35 percent since 1988, the industry reported net earnings of $154 million in 1997, a 70 percent decline since 1995. Furthermore, during the same period, expenditures on environmental initiatives increased by 14 percent (Price Waterhouse 1998*b*). According to *The Fraser Institute Survey of Mining Companies Operating in Canada: Fall 1997*, British Columbia was rat-

Figure 21: British Columbia's ability to attract new exploration investments in mining



Source: Jones and Arman 1997.
Note: The score reflects investors' preferences for investing in one province rather than another; the higher the score, the more attractive the province for investment, given government policies.

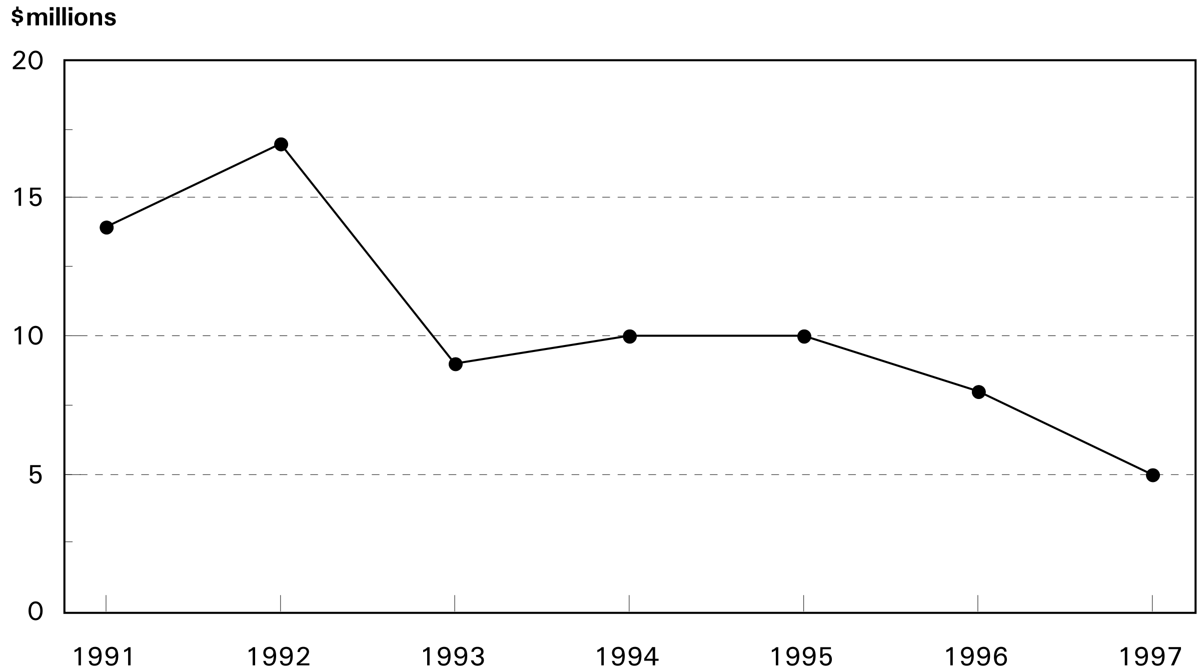
ed by mining companies as the least attractive province in Canada in which to invest (Jones and Arman 1997). As figure 21 shows, policies adopted by the government of British Columbia have significantly contributed to the poor investment climate for mining exploration in British Columbia. A coal mine operating in British Columbia pays almost $14.7 million more in taxes than it would if it were operating in Alberta. A gold mine operating in British Columbia pays almost $7.6 million more in taxes than it would if it were operating a similar mine in the Yukon (Mining Association of British Columbia 1998). Therefore, it is not difficult to understand why investments in primary mining exploration in British Columbia have continued to decline since 1992 (see figure 22).

The practice of the government of turning Crown land into provincial parks or heritage sites without any consultation or a cost-benefit analysis, is also partly to blame for this poor investment climate. For instance, after Geology Geddes Resources Limited had invested almost $50 million to discover one of the biggest mineral finds ever found in North America, the government turned the location of the discovery, commonly called Windy Craggy, into a "World Heritage Site" without any public consultation or legislative hearings. Geology Geddes was not compensated for their loss. Few benefits have been realized from the creation of the park: no one lives in the area and those wishing to visit the site can do so only by helicopter and only after applying for a permit. The costs have been almost $550 million in capital investments, and 2,000 direct and indirect jobs. In short, "This taking without fair process and without good reason has led mining company managers, who are responsible to their shareholders, to shift the bulk of their exploration planning and budgets out of British Columbia" (Webster 1998).

The Clark government's response

In response, the Clark government has rethought its policy on natural resources management. For example, the government recently announced it was cutting stumpage fees by $639 million over the next three years. Early indications from the industry suggest that the government is finally on the right track (Hunter and Hogben 1998). With regard to the mining industry, the province recently passed the Mining Rights Amendment Act, which clarifies the right of access to

Figure 22: Mining investments in primary exploration in British Columbia



Source: Price Waterhouse 1998b.

prospective lands. Claim holders, according to the new law, can expect to be compensated if their claims are expropriated by the government. Furthermore, the government has promised to introduce a more efficient permitting process (*Financial Post* 1998a). In addition, the oil and gas industry recently received good news from the government when it announced that it was cutting royalty payments between 20 and 40 percent on all new oil wells and moving to reduce the regulatory burden on the industry (Nutt 1998). While these are important first steps toward revitalizing the natural resources sector in British Columbia, there is still much to be done.

Recommendations

In light of the earlier discussion on the government's inability to manage the natural resources sector efficiently, we suggest that the government of British Columbia adopt the following policy recommendations.

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

Given the evidence presented on the negative impact government policies have had on the British Columbia forest industry, the best solution to managing the industry efficiently and so as to maintain sustainable yields 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 the government in power in 40 or 80 years 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" through advanced silviculture. In short, both see short-term benefits in harvesting but no long-term value in replanting and forest enhancement programs.[6]

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: 39) Hence, private ownership would put an end to lumber disputes between Canada and the United States,[7] and provide economic incentives for implementing replanting programs and harvesting for sustainable yield while also providing economic benefits (*i.e*. employment) to the rest of society.

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 for the leasing of 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. In short, 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.

2 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. Professor David Haley from the Department of Forest Resources Management at the University of British Columbia, has 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. Its operations are paid for by a special stumpage fee called the "super stumpage" that is levied on the industry (Haley 1996). The government should repeal these bills and rely on common-law remedies and private ownership of the forests to protect the environment.

3 Eliminate the minimum stumpage fee

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 economic output and reduced employment. Given that world lumber prices fluctuate constantly, in order to allow companies to remain profitable and viable well into the future, the provincial government should put in place a mechanism for linking stumpage fees to the price of lumber.

4 Eliminate the British Columbia Environmental Assessment Act

British Columbia's Environmental Assessment Act is a cumbersome and time-consuming process that leads 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 over-estimates the impact of certain projects and, thereby, deprives the provincial economy of higher levels of economic activity.

5 Subject the setting aside of Crown land for parks and heritage sites to cost/benefit analysis

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

Conclusion

The British Columbia government's natural resources policy has hurt the province's forest and mining industries by increasing red tape, penalizing innovation, discouraging investment, and reducing employment. By attempting to micromanage the environment, the government has hurt a vital sector of the provincial economy. Recently, however, the government has changed course. By reducing stumpage fees and the uncertainty over land use and implementing reductions in royalty payments to boost the oil and gas industry in the province, the government has finally recognized the importance of the natural resources sector. There is still much to do. Therefore, for taking these important first steps towards revitalizing British Columbia's natural resources sector, the British Columbia government deserves a **D**.

Grade for natural resources policy: D

1 See Statistics Canada 1998b. Please note that the figures on GDP contributions are taken from the following columns in table 4: Fishing, trapping, logging, and forestry; Mining (include contributions from quarrying and oil wells). Figures on employment are taken from the

following columns in table 8: Other primary; Mining, quarrying, and oil wells.

2 Please see Horne, Riley, Ransom, and Kosempel 1996 for a more detailed analysis of the large indirect contributions that the forest industry makes to the British Columbia economy.

3 Note that the figures in this chart do not reflect the large indirect contributions that the forest and mining industries make to the British Columbia economy.

4 While financial problems in Asia have had an impact on British Columbia's forestry industry, it is important to note that the majority of the problems associated with the industry resulted from the provincial government's policies and materialized well before the appearance of the "Asian Flu."

5 Evidence shows that environmental conditions are already fairly good and improving in Canada, including British Columbia. Please see Hayward and Jones 1998.

6 Private ownership would eliminate the need for the Forest Renewal Board, established under the Forest Renewal Act, since private owners would have a vested interest in establishing their own forest enhancement programs without direction from the government. Moreover, since the operations of the Board are funded by the "super stumpage fee" placed on the industry, the elimination of the Board would eliminate the super stumpage fee and allow the industry to spend these scarce dollars on forest renewal and employment. For an analysis in more depth of the debate surrounding public versus private ownership of forests, please see Deacon and Johnson 1985.

7 Currently, the United States views any reductions in stumpage fees as a form of subsidy to the forest industry. This is because the trees that are cut down by the forest companies are from lands owned by the government. As a result, the United States usually places countervailing duties on any lumber imports from Canada, particularly from British Columbia, if stumpage fees are reduced. If the land was privatized, however, both stumpage fees and trade wars with the United States over lumber exports might come to a halt.

Privatization policy

Curtailing the size of the state

For the most of the past half century, governments allowed the size of the state to grow unchecked. In the face of an increasingly competitive global market and the vast body of evidence supporting the benefits of smaller government, most provincial governments in Canada have begun to cut back on their expenditures. One means of cutting expenditures is through privatization. Broadly speaking, privatization results in the transfer of ownership and control of state services and enterprises to private interests (Adam Smith Institute 1986). In doing so, government is able to free scarce resources and allow free markets to influence the allocation of economic resources.

The benefits of privatization

Theoretically, the desirability of privatization is rooted in the efficiency gains that result in transferring control of a publicly owned and operated enterprise or public service to the private sector. Research suggests that in most areas the private sector is more capable of delivering goods and services to the public efficiently than the public sector is. For instance, private operators face incentives distinctly different from those influencing public-sector bureaucrats (Hanke 1987). While private managers are concerned with maximizing profits in order to remain in business, the bottom line is of little consequence to government officials, who are far less concerned with ensuring profitable operations than they are in conforming to the wishes of their political masters. In fact, government-run services and enterprises are likely to receive grants and subsidies from the state if they are incapable of supporting themselves. Whereas private entities face competition for the delivery of a particular good or service, government enterprises and services maintain a monopoly over their operations. As a consequence, there is no incentive for public-sector bureaucrats to improve the quality of service. Gwartney and Stroup correctly suggest that private entities must continuously innovate and provide quality services at reasonable prices to consumers in order to remain competitive and in business (Gwartney and Stroup 1993).

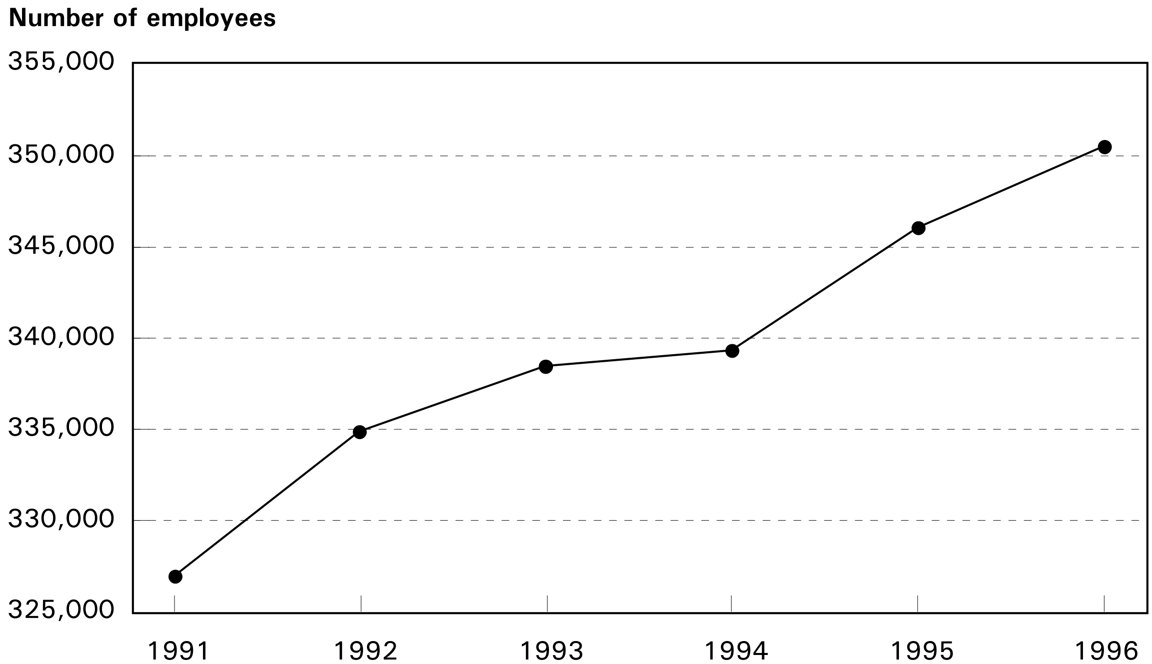
Madsen Pirie found that public-sector entities employ capital far less efficiently than do private firms in the same industry. Pirie concluded that given the inflexibility of workplace rules in the public sector, public firms are hindered in their ability to innovate and test new methods of production (Pirie 1988). In addition, numerous studies conducted on public enterprises before and after privatization conclude that privatization is successful in enhancing productivity. For instance, a study conducted by Professor D.G. McFetridge of the department of Economics, Carlton University, concluded that evidence from around the world shows that the benefits of privatization are largely positive (C.D. Howe Institute 1997). For example, private garbage collection employs fewer employees per vehicle and uses each vehicle more intensively than public-sector garbage collection (McDavid 1988). Similarly, the privatization of the Alberta Liquor Control Board yielded better customer service and improved product choice (West 1997).

A study commissioned by the World Bank concluded that 60 companies from around the world showed, when privatized, efficiency gains of 11 percent, a 45 percent increase in profits, a 27 percent increase in output, and a growth in investments in plants and equipment of 44 percent. Given efficiency gains such as these, it should come as no surprise that in 1996 governments around the globe privatized almost $86 billion of state-run services (National Centre for Policy Analysis 1997). Competition leads to innovation, efficiency gains, better product quality, and superior customer service. Government-controlled services, on the other hand, impede innovation, yield fewer efficiency gains, and force consumers to bear the brunt of high costs. In short, privatization is the perfect prescription for making chronically inefficient and costly government services work better.

Maintaining the status quo in British Columbia

Despite a growing body of evidence pointing to the benefits of privatizing government services, the government has opted to continue with the expansion of government departments. Between 1991 and 1996, the number of people

Figure 23: Growth in the size of government in British Columbia



Source: Statistics Canada 1998a.

employed by the government of British Columbia increased by almost 7 percent (see figure 23) whereas, during the same period, total employment in the public sector decreased by 6 percent throughout Canada (Statistics Canada 1998a). Further, between fiscal 1994/95 and 1995/96, the cost of running the government of British Columbia increased by almost 10 percent and, according to the British Columbia government's 1998 Budget, those costs are projected to continue rising (BC-MinFinCorpRel 1998a).

The finances of Crown corporations have grown steadily worse since the NDP government came to power in 1991. Figure 24 shows how the total debt of Crown corporations in British Columbia has increased since 1995: the total debt load will increase to almost $23 billion by 1999—a 20 percent increase since 1995—*all guaranteed by the provincial government* (BCMinFinCorpRel 1998*a*).[1]

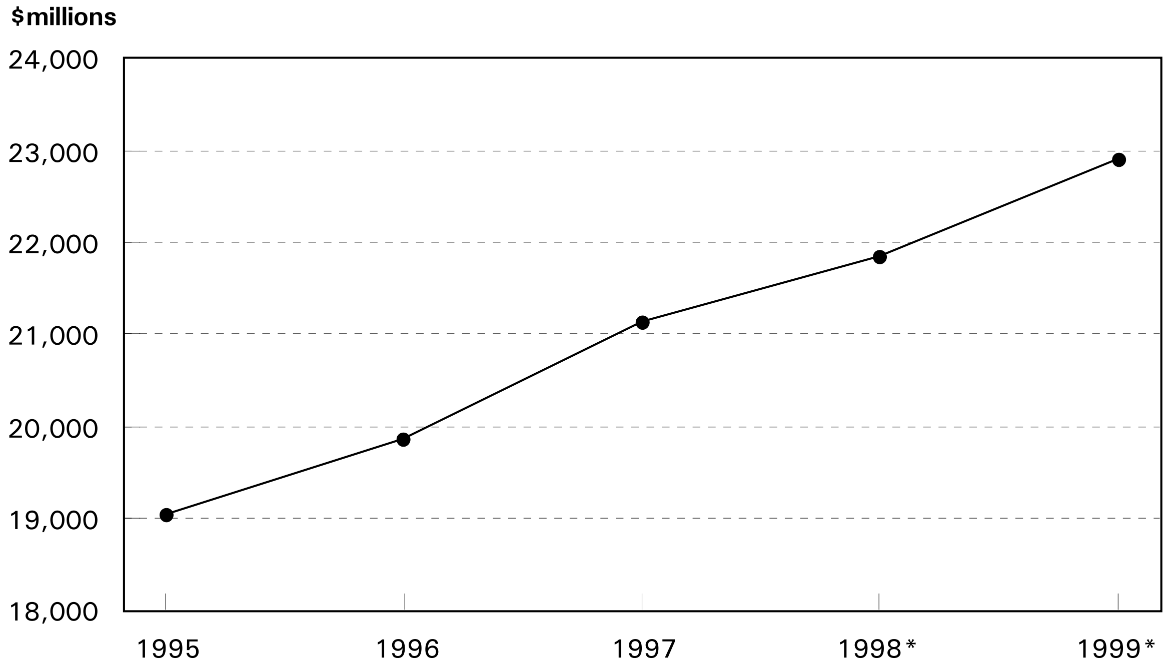
Vaughn Palmer, columnist at the *Vancouver Sun*, recently illustrated the huge inefficiencies and mismanagement that have plagued the British Columbia Ferry Corporation. The Ferry Corporation lost $137 million over the past two years and its fast ferry program has been dogged by continuous delays and increased expenses (Palmer 1998). In addition, fares during the peak season have increased by over 60 percent since 1992 (Hildebrand 1998). British Columbia Transit has fared no better. The operating cost per passenger increased by 3.2 percent while operating cost per service hour increased by 5.7 percent in 1996/1997 (British Columbia Transit Annual Report 1996/97).[2] In short, the government's maintenance of the status quo has meant a bigger, more inefficient, and costly bureaucracy.

Recommendations

The government of British Columbia should, therefore, stop increasing the size of government and begin to privatize many of the services and Crown corporations it currently controls or operates. To provide British Columbians with more choice, relatively less expensive and better services, we suggest that the British Columbia government consider privatizing the following Crown corporations:

- Insurance Corporation of British Columbia
- British Columbia Hydro[3]
- British Columbia Liquor Distribution Branch
- British Columbia Railway Company
- British Columbia Ferry Corporation
- British Columbia Transit

Figure 24: Debt load of British Columbia's Crown corporations



Source: BCMinFinCorpRel 1998a; 1998* and 1999* are forecasts.

- British Columbia Steamship Company
- Duke Point Development

This is only a start. The privatization of these highly visible Crown corporations will, at the very least, establish a clear commitment on the part of the government of British Columbia to offer its citizens more choice at lower costs for many goods and services. There are, however, numerous other services currently owned or operated by the province of British Columbia that could be contracted-out to the private sector through a competitive bidding process. For example, government publications could be produced by private firms instead of the government press.

Conclusion

The desirability of privatization is based on the efficiency gains from turning over to the private sector control of a publicly owned and operated government enterprise or service. There is a great deal of evidence to suggest that the private sector is more capable of delivering services to consumers efficiently. In short, competition leads to innovation, greater efficiency gains, quality products, and customer satisfaction.

However, the government of British Columbia has opted for a bigger role for the government in delivering services to the public. For failing to put a stop to the growth of the state in this province and ignoring the importance of privatizing government services and Crown corporations, the British Columbia government deserves an **F** for its privatization policies.

Grade for privatization policy: F

1 Please note that these figures refer to Crown corporations whose debt is supported by taxpayers.

2 These costs refer to the Vancouver Regional Transit System.

3 Studies show that privatizing British Columbia Hydro would result in efficiency gains, reduce the provincial debt by $12.2 billion, and give consumers more choice and access to cheaper forms of electricity, all without compromising the safety of British Columbians or adversely effecting the environment. Please see Howe and Klassen 1996.

Final comments

We noted at the outset of this assessment that the degree to which a society is capable of increasing its standard of living is largely dependent on the extent to which its citizens enjoy economic freedom. A growing body of evidence indicates that nations that enjoy high levels of economic freedom also experience the highest levels of economic growth. Conversely, those nations with low levels of economic freedom experience the lower levels of economic growth (Gwartney and Lawson 1997). Hence, if governments are serious about creating jobs and economic wealth, they must give their citizens greater economic freedom.

Greater economic freedom is achieved by lowering taxes, balancing budgets and eliminating public debts, reducing government red-tape, implementing a flexible labour code, and privatizing government services. Unfortunately, the NDP government has opted to pursue a very different strategy. This strategy has gradually curtailed the economic freedom of British Columbians. According to the Fraser Institute's *Index of Provincial Economic Freedom*, British Columbia now ranks eighth among Canadian provinces in terms of the economic freedom enjoyed by its citizens. This poor ranking is quite remarkable given that only seven-and-one-half years ago British Columbia ranked third in Canada (Arman, Samida and Walker forthcoming).

These figures, however, are only a further reflection of the effect of the policies that the NDP government has pursued since coming to power in 1991. For instance, the government has continued to increase expenditures, has permitted the public debt to rise dramatically, continues to maintain one of the highest tax rates in the country, has increased the regulatory burden on firms, and has introduced inflexible labour policies. These policy choices have led to a dramatic decline in economic growth, decreased employment levels in the province, and continued to diminish the disposable income of the average British Columbian. According to many observers, prospects for an economic recovery in the interim look bleak.

Dominion Bond Rating Service

Recently, the Dominion Bond Rating Service downgraded British Columbia's (economic) trend outlook from *stable* to *negative*. The agency reported that the downgrade reflects the province's inability to contain government expenditures and its failure (again) to balance the provincial budget (*Province* 1998a).

Toronto Dominion Bank

In its quarterly outlook (July 1998), the Toronto Dominion Bank projected that in most provinces economic growth will average between 2 and 5 percent this year while in British Columbia economic growth will remain flat (zero growth). Moreover, Toronto Dominion added that it is likely that British Columbia's economy will actually contract this year (Thomas 1998).

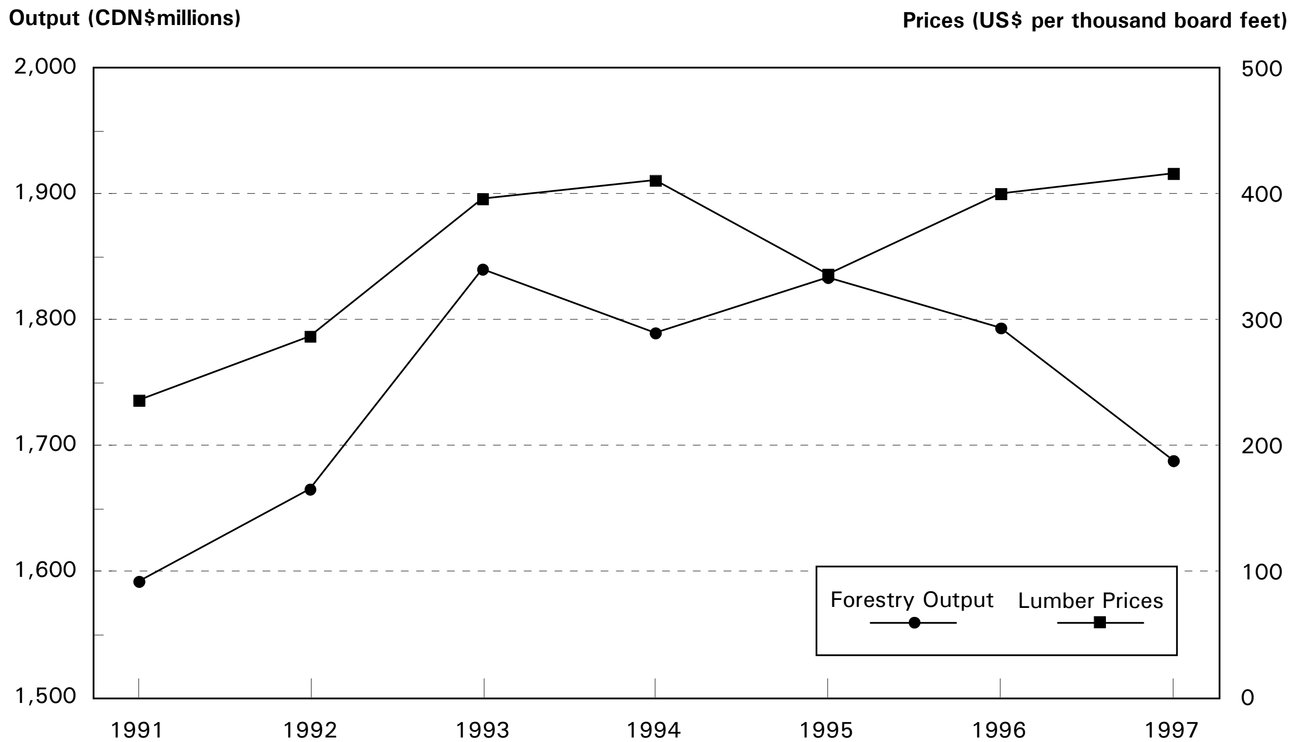
Fletcher Challenge / Spectrum Signal Processing

Hurt by high taxes and an uncompetitive labour market, firms in British Columbia are increasingly shifting their operations outside of the province. Fletcher Challenge Canada Ltd., for instance, recently sold off its assets in British Columbia and is now seeking new investment opportunities in other jurisdictions. The company announced that, unless there is a more competitive labour market, it has no plans to invest in British Columbia in the future. Barry Jinks, President and CEO of Spectrum Signal Processing Inc., recently stated that the poor business climate in British Columbia is contributing to Canada's brain drain of technical talent. Mr. Jinks said that it took his firm two years to find a marketing manager, and only after boosting the salary for the position in line with his own (Carlisle 1998).

Dun and Bradstreet

A recent survey conducted by Dun and Bradstreet Canada for *The Globe and Mail*, found that business optimism is at a 10-year high across Canada, except in British Columbia. While employers in other parts of Canada plan to hire more workers in the coming months, the survey found that employers in British Columbia are far less optimistic about hiring more workers in the near future. The survey also found that most companies expect to see their sales and profits plummet in the coming months, leaving British Columbia with the worst rating in the country in this category (MacKinnon 1998).

Figure 25: Real forestry output versus lumber prices in British Columbia



Source: Hajdu 1998; Chu 1998b.

BC Stats

A study recently published by British Columbia's statistics agency, BC Stats, concluded that the "rate of population growth [in BC] is set for a long, slow decline to some of the lowest levels in a century" (BC Stats 1998: A1) and the agency is predicting that growth will decline from 2 percent this year, to 1.6 percent by the year 2000 and to 1.1 percent by the year 2026. The weak provincial economy and strong and improving economies in both Alberta and Ontario will reduce interprovincial migration to the British Columbia. Hence, British Columbia's economy in relations to the economies of most other provinces in Canada, will remain weak for the next two years at least (MacQueen 1998).

Conference Board of Canada

The Conference Board of Canada recently issued a report giving the economic outlook for eight major Canadian cities. The Board predicted strong economic growth in 1998 for all of the cities except Victoria and Vancouver, British Columbia. Moreover, the report pointed to a poll of 125 residential-property developers in British Columbia, who reported that sales have dropped by almost 60 percent since 1997. The survey also found that almost two-thirds of the developers indicated that they plan to expand their operations outside British Columbia (Matas, Sankar, and Robertson 1998).

We also noted at the beginning of this report that, in spite of the provincial government's claim that the downturn in the British Columbian economy can be attributed to the economic malaise in Asia, there is no basis to support this claim. Nevertheless, Premier Clark and his government continue to insist that Asia is to blame for British Columbia's economic downturn. In fact, most recently the Premier made the following statement on the weak British Columbia economy: "The Asian problems are kicking the stuffing out of our resource sector. Lumber prices, pulp prices . . . all those commodities are nearing record lows, and it's having a huge impact on our economy" (Matas, Sankar and Robertson 1998: A1–A4).

In spite of this belief, the fact is that British Columbia's resource sector ran into economic trouble long before the Asian crises developed. As figure 25 shows, real output from the province's forest industry has been steadily declining since 1995. Moreover, figure 25 also shows that, in spite of rising lumber prices, in the past few years growth in the forest industry has remained weak. Given that the Canadian dollar is at an all-time low and that the United States, which imports most of British Columbia's forestry products currently has a booming housing market, British Columbia's forest industry should not be doing as poorly as it is (Schreiner 1998). Hence, if we set aside political rhetoric, it is clear that British Columbia's economic troubles are the result of a home-grown virus, not a foreign one.

It is not our intention simply to criticize the government for its policies but rather to offer a dispassionate and objective analysis of the effect that their policy choices have had on the people and economy of British Columbia. Moreover, our intentions were to show, through economic theory and empirical evidence, how and where free markets could do a better job at providing for the well-being of British Columbians. Overall, we find that the performance of the government of British Columbia has been unsatisfactory. Government regulations, high taxes, inflexible labour laws, failure to balance the budget and to reduce the size of the state have all contributed to the rapid decline in British Columbia's competitive standing in Canada and around the world. If the provincial government is truly committed to "opening up the province" to job creation and investment, it must do more than offer modest policy corrections. Rather, the government should implement substantial tax cuts, repeal restrictive labour laws, eliminate government regulations, reduce spending and, most importantly, allow the free market to play a bigger role in providing for the welfare of the citizens of British Columbia. Until these changes are implemented, British Columbia's economic troubles will continue. Therefore, for failing to reduce the size of the state, and for continuing to curtail the economic freedom of British Columbian's, the government of British Columbia deserves an **F** for its performance.

Overall grade: F

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