# au courant

Economic Council of Canada
Volume 2, No1 1981

## Spring update on the economy

Reforming Regulation

Federal-provincial fiscal agreements

Reverse mortgages may help pensioners

# PUBLICATIONS

The Economic Council has recently published a major report on regulation, reflecting the viewpoint of the Council and making policy recommendations. The report is available in both official languages.

**Reforming Regulation** (EC22-93/1981E; $9.95 in Canada, $11.95 elsewhere).

## Research Studies

Research studies are published by the Economic Council in both official languages. A list of French titles is available on request. Each study clearly attributes the findings and conclusions to the individual author or authors rather than to the Council.

The following research studies have been published since the last issue of *Au Courant*.

**Empirical Testing on Newfoundland Data of a Theory of Regional Disparities**, *by Neil M. Swan and Paul J. E. Kovacs* (EC22-92/1980E, $4.95 in Canada, $5.95 elsewhere).

**The Trees behind the Shore: The Forests and Forest Industries in Newfoundland and Labrador**, *by John A. Gray* (EC22-91/1980E, $9.95 in Canada, $11.95 elsewhere).

## Discussion Papers

Discussion Papers are typically of a technical nature, and are intended for distribution in limited numbers to individuals who may have a particular interest in these or related fields of research. Of varying length and complexity, these papers are reproduced only in the language in which they are written. Each paper is the personal responsibility of the author or authors, and distribution under the auspices of the Council does not, of course, imply that the conclusions of the paper have been endorsed by the Council.

**No. 188** 'Reverse Mortgages: A New Class of Financial Instruments for the Elderly,' *by Henry Bartel and Michael J. Daly.*

**No. 189** 'The Economic Implications of Migration to Newfoundland,' *by R. W. Boadway and A. G. Green.*

**No. 190** 'Cost and Production in the Newfoundland Fish Products Industry,' *by Noel Roy, William E. Schrank and Eugene Tsoa.*

**No. 191** 'Productivity, Transfers and Employment; Government Policies and the Newfoundland Economy,' *by Frank R. Flatters, in collaboration with Robin Boadway, Russell Krelove and Patricia Smith.*

**No. 192** 'The Effect of Provincial Borrowings from Universal Pension Plans on Provincial and Municipal Government Finance,' *by Keith Patterson.*

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**No. 195** 'Simulating Some Income Supplementation Plans for Newfoundland,' *by Richard C. Zuker.*

**No. 196** 'Economic Theories for Small Marine Economies: An Interpretation for Newfoundland,' *by Lawrence W. Copithorne.*

**No. 197** 'Revenue Implications of Offshore Oil Under Different Taxation and Profit-Sharing Regimes: The Case of Hibernia,' *by Jonathan Wilby.*

**No. 198** 'An Exploration of Crude Petroleum Self-Sufficiency in Alternative Canadian Demand Environments,' *by Bobbi Cain and H. M. Saiyed, assisted by P. Nevin and M. Willis.*

**No. 201** 'Westward Shift and Interregional Adjustment: A Preliminary Assessment,' *by K. H. Norrie and M. B. Percy.*

## How to order

Both the consensus report and research studies listed above are available across Canada from bookstores where Government publications are sold. (A list is available from the Council on request.) These publications can also be ordered by mail from the Canadian Government Publishing Centre, Supply and Services Canada, Hull, P.Q., K1A 0S9. (Please be sure to include a cheque or money order made payable to the Receiver General for Canada.)

The Discussion Papers are available without charge from the Communications Division, Economic Council of Canada, P.O. Box 527, Ottawa, Ontario K1P 5V6.

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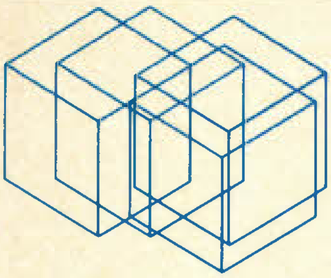
# au courant

Volume 2, No1 1981


## Regulation: the final report



Results of the Council's three-year study of government regulation of the economy are highlighted:





There have been quite a few changes in the world since the Council made some basic economic projections for the next decade in its 1980 annual review. Council economists have taken another look, and with the help of the CANDIDE econometric model, have come up with some new projections to 1990.



## Reverse mortgages

The debate on how to provide adequate incomes for Canada's senior citizens may have overlooked this possibility ...... 21



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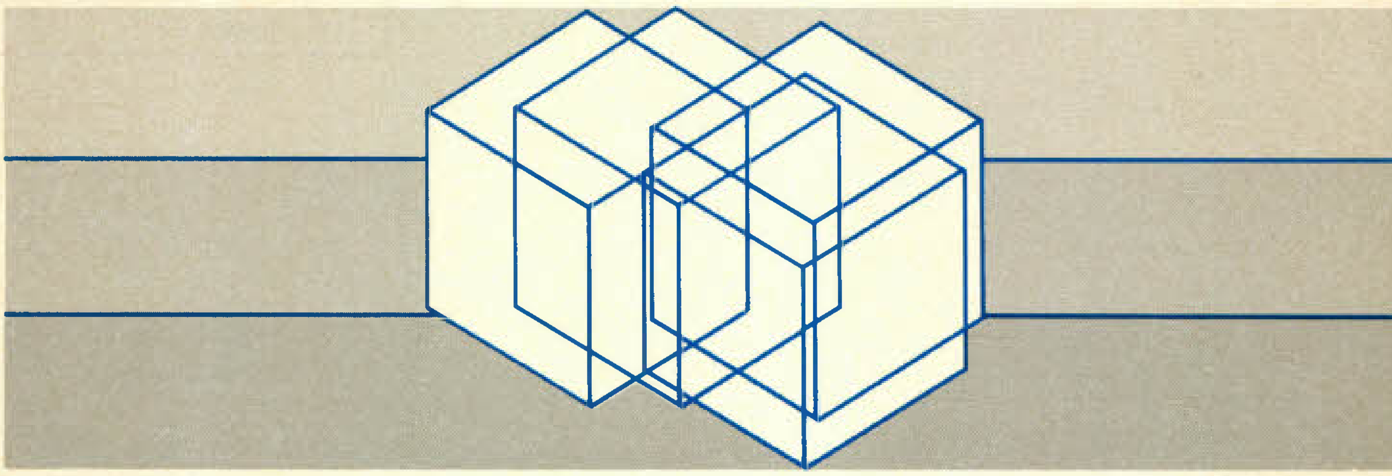
# REFORMING REGULATION



There's no doubt that government regulation of the economy has flourished of recent years. So much so that many people in the business community believe that the whole thing is now quite out of hand. It was concern about how regulation was affecting Canadian business that prompted the federal government to refer the question to the Economic Council for study.

There seems to be no simple pattern to the way the system of regulation has developed in this country, but there are some things that stand out. Government regulations, says the Economic Council, are often "responses to perceived needs that the market itself has failed to fulfil."

Sometimes, when it was felt that some generally accepted objective would not be achieved unless the government got involved, there was pressure for regulation. "Protecting the public interest" it was called. Making sure that individuals are not defrauded, that the health of workers is not threatened and that consumers are protected all fall into this category. But the perception of what the "public interest" is, has been strongly influenced by the views of specific groups in society. "The fact that the costs of many regulatory initiatives are widely diffused among consumers has no doubt softened a good deal of opposition," the Council says.

Often the pressure for regulation comes from particular groups who want their activities to be protected. The substantial influence of these narrowly based groups – trade associations, farm groups, organized labour – has contributed significantly to the way the regulatory system has developed.

Groups representing broader interests, like consumers and environmentalists, are potentially influential too. But by and large they have not been able to muster enough continuing support to remain a strong force in most public policy debates. And they are hampered because they don't have much information about the effects of regulation.

Eventually, though, many regulations tend to outlive their usefulness. The conditions that led to t' duction may no longer exis they do, there may be new pressing demands on the ec scarce resources. Clearly, s nomic Council, much regul been introduced for the exp poses of protecting an indu competition, either from within or outside its own ranks, and this may not always be in the general interest.

It's our impression, says the Council, that "the increasing complexity of the regulatory maze and the sheer physical constraints on legislators' time are overloading governments and control agencies well beyond their limits." Many highly regulated markets are probably no longer operating efficiently as a result.

Sweeping deregulation is not necessarily the answer. What needs to be done is to make regulation less attractive, or alternatively to make it much more difficult. "While we recognize the need for regulation," says the Council, "our approach is to favour individual choice and non-coercive exchanges that are part of the market process."

The Council's report on regulation is intended to raise the level of public onsciousness about regulation and to ut forward recommendations that ·flect broad as well as more immediate interests.

On the following pages, some of the ain findings and recommendations of at report are featured.

# Agricultural marketing boards

Agricultural marketing boards represent one form of regulatory activity that touches the lives of just about every Canadian. But despite considerable public criticism of the boards, the Economic Council says that most marketing boards have managed some "very positive accomplishments." They have helped to improve the overall economic lot of Canadian farmers, which is really what they set out to do. And if there is criticism against them, says the Council, it is often because they are too successful in doing exactly what they were supposed to do, that is to provide greater bargaining power and income security for their members.

Those marketing boards aimed at getting better return for farmers by strengthening their bargaining power have generally benefitted both the producers and society as a whole, because markets function better and quality is controlled. The various provincial hog boards, the fruit and vegetable boards and the Canadian Wheat Board all came under scrutiny as part of the Council's study of regulation. As with many other institutions, there are no doubt ways in which their operations could be improved, says the Council. But generally speaking, it endorses their activities and sees no need to recommend any radical changes in their mandates.

When it comes to supply management boards, though, the situation is rather different. These marketing boards, such as the ones that control the dairy industry and the marketing of eggs and chickens, have been effective in increasing the incomes of their members, but it has been "at some cost to society" the Council says.

Supply management marketing boards have the power to set prices and allocate production quotas and their activities are re-inforced by strict import controls. This particular way of redistributing incomes is one that appeals to legislators because it doesn't seem to cost the government or the taxpayers anything. The farmers' sales are guaranteed up to their quota limits and representatives of the farmers run their own boards. But these advantages are more than offset by the fact that consumers have to pay considerably higher prices and production, distribution and consumption are not as efficient as they could be.

So important are these disadvantages that the Council says it has "considerable difficulty in justifying the continued existence" of supply management marketing boards, with exclusive powers to determine prices and set production quotas for individual producers – particularly "when these powers essentially establish a cartel and are buttressed by import controls."

Although only a few commodities are subject to regulation by this type of board, they represent a big part of the food spending of Canadians. Eggs, turkeys, chickens, tobacco and milk are all subject to both import controls and supply management and they "continue to be a favoured instrument of intervention," says the Council.

Although it believes the powers of the supply management boards should be curbed, farmers who bought their quotas in good faith on the assumption that present policies would continue might suffer hardship if the powers of the boards were abolished outright. So the Council says that instead, domestic supply should be gradually expanded. Production quotas should be increased over a five-to-ten-year period so that quota values fall to more reasonable levels.

Accountability of the marketing boards is vital if they are to remain an instrument of responsible regulation in the agricultural sector. But the Council says it decided not to recommend altering the existing mandate or composition of individual commodity boards. "Farmers have fought hard to obtain a degree of control over the effects of economic conditions and a radical change might undermine their confidence in such boards," says the Council. Instead, the composition and procedures of the supervisory boards could be changed and governments should review the membership of their agricultural supervisory boards to make sure that there is an adequate balance of producer, consumer and processor representation.

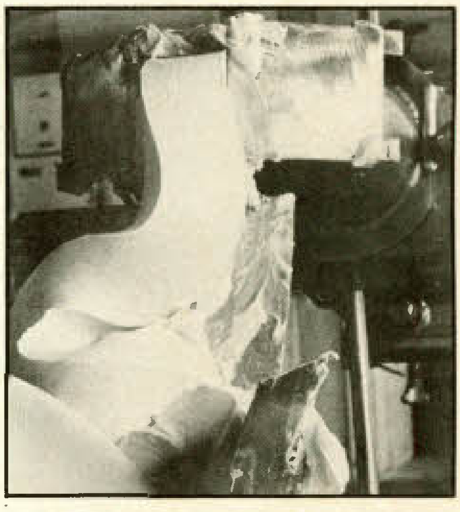
# Dairy policy expensive

There is no question that regulation of the dairy industry is expensive. Council estimates indicate that more than $200 million a year is lost because of inefficiencies in the federal government's industrial milk program. Even assuming import controls on dairy products are retained, the present dairy policy reduces national income by over $140 million a year. And these are only the measured costs of inefficiency.

There are other costs which can't be measured, but which are probably just as great – inefficient arbitrary allocation of industrial milk production, for example, the lack of energetic new talent entering the dairy industry, and the incentive farmers have to breed dairy cows to produce the maximum butterfat and the minimum milk protein, despite what good nutritional practice would dictate.

At the levels of processing, distribution and retailing there are more inefficiencies in the way milk is allocated to processing plants. Competition is reduced and there are price distortions in the processing of butter.

The income transfers inherent in the program are huge. Producers benefit by over $670 million; consumers lose by about that amount; and taxpayers incur a loss of over $300 million. If anything, the Council says, these figures probably understate the transfers and real costs of the present dairy supply management system.



Maureen O'Brien

Buttering up consumers

# Regulation of airlines should be phased out

Regulation of the air transport industry should be phased out over the next four years. The process has already begun and judging by experience in the United States, it could continue without any serious problems until direct regulation of airlines is no more.

After more than 40 years of regulation, government policy on air transportation has achieved many of its objectives, says the Economic Council, and now it's time to let the industry stand on its own. The Council's report lists a number of benefits that could result if price and entry controls on the Canadian airline industry were loosened:

- passengers would have a wider choice of fares and quality of service, which would be provided more efficiently;

- fares would probably drop on the high-volume routes because passengers would be willing to accept lower quality service;

- airlines could operate more efficiently because they would use more appropriate equipment for each route;

- new carriers entering the industry, or even the threat of them doing so, would bring fares in line with the cost of producing the services;

- carriers now have to bear the cost of regulation and delays in getting price and route authorization. Deregulation could reduce and eventually eliminate these costs.

Deregulation of airlines in the United States was greeted with some apprehension. But fears that there would be massive reductions in service and routes and that a large number of stations would close down right away proved to be groundless. There were far fewer closures than had been predicted and over many of the low-density, short-haul routes, service improved as the commuter carriers entered the market.

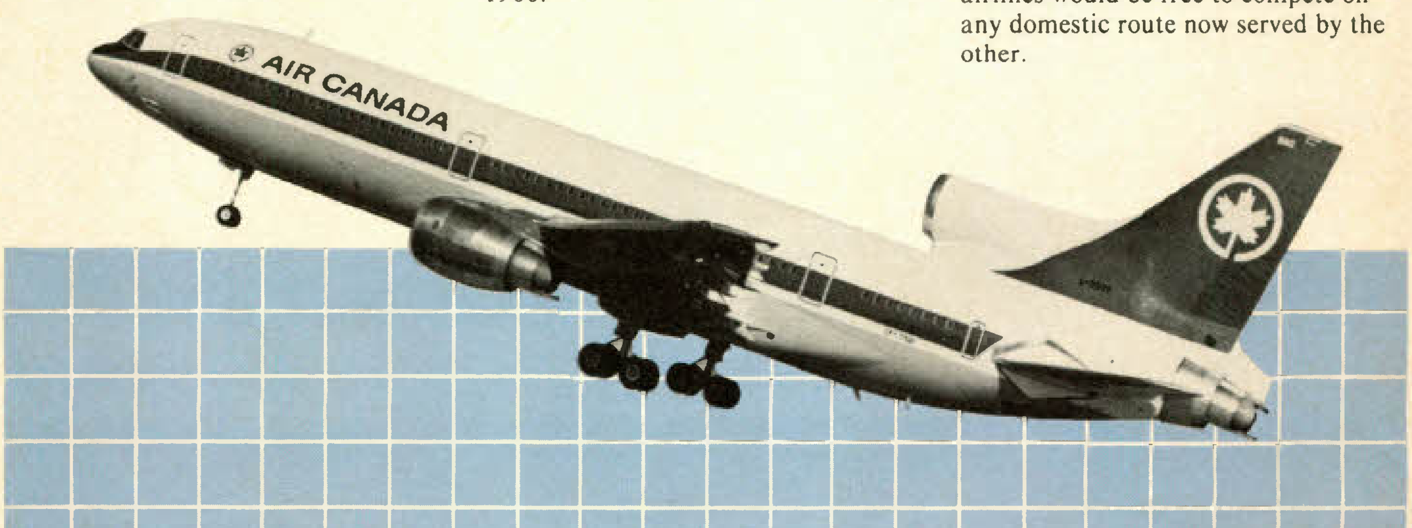
There were some adjustments to be made, though, and some communities now get a much reduced service from carriers operating slower and less advanced equipment. But two years of operating under a system in which there has been almost complete removal of entry restrictions has not brought about the predicted "destructive competition." When fares dropped, the airlines met the challenge by improving productivity. They introduced flights with higher density seating and bigger load factors, and better productivity helped them limit the general fare increases that sharply increased oil prices might have brought in 1979 and 1980.

Even though there are some significant differences in the way airlines have developed in Canada, the Council believes that deregulation of the industry here could bring many of the same benefits.

In the past, while the government protected Air Canada from competition, the publicly owned airline was expected to provide services that privately owned carriers might have been unwilling to provide. Deregulation might mean that Air Canada would drop some unprofitable runs, especially in the Atlantic region and in northern Quebec and Ontario. The question is, would the routes then be taken up by regional and local carriers operating with more appropriate aircraft and service?

If the U.S. experience is any guide, the chances are that they would. But if not, the Council says, consideration should be given to instituting direct subsidies to make sure that isolated settlements continue to receive service.

Opening up entry to the industry is the core of a less restrictive approach to regulation, according to the Economic Council. It proposes what it calls a "one-way swinging gate" approach to freer entry. Any new or existing regional or local airline could enter any market now served by CP Air or Air Canada, but the two major airlines would not be allowed to go into domestic routes now served by regional or local carriers. Each of the two national airlines would be free to compete on any domestic route now served by the other.



The Council says that more competition on transborder and international routes is just as desirable as it is on domestic routes. Where there are bilateral agreements allowing only one Canadian carrier on an international route, then all Canadian carriers should be allowed to bid for that route, it says.

On charter flights, the Council says that the regulations governing both domestic and international charter flights have been "unnecessarily restrictive." As some of the restrictions on charter flights have been removed, the regular-fare passengers have not been diverted, in fact new passengers have been attracted to air travel. It recommends that regulations on domestic and international charter operations should be eased so there is as much competition as possible between charter and scheduled carriers. In particular, minimum stay and advance-booking requirements should be reduced and the intermingling of various types of charter groups should be permitted.

The Council says that the larger and stronger airlines should not be allowed to use the power of their inherited position to limit the competitive initiatives of others. A tough stand should be taken against airline mergers and the Combines Investigation Act should include a clause to prevent predatory behaviour from airlines. Although the Council does not expect that excessive scheduling or predatory or discriminatory pricing will really be widespread, it says it's just as well to be forearmed.

The Council says its recommendations provide a "pragmatic basis" for the transition to a position of total deregulation over a period of about four years. Before the final steps are taken, however, there should be an assessment of the industry's performance under less restrictive regulations. It could be that more time will be needed to make the adjustment to greater reliance on market forces.

Removal of regulation is not going to solve all the problems of air transportation in Canada, but a more competitive and less protective environment will help the nation's air transportation system adapt to changing requirements and transportation modes of future generations.

## How business is affected

One of the main reasons for the request that the Economic Council undertake a study of regulation was the mounting concern that a proliferation of government regulations was hurting business and threatening the efficiency of Canadian firms.

Business itself tends to view regulation as part of a massive problem of government intervention. There was a feeling that legislators who dream up regulations and the bureaucrats who administer them often don't recognize the impact they are having on the private sector. Overlapping jurisdictions, both between different levels of government and between different agencies at the same level, could be adding to costs and creating uncertainty.

In an effort to see how regulation affects business costs and the ability of firms to produce efficiently and compete successfully, the Council decided to document the complaints about regulation and the regulatory process by surveying some of Canada's biggest corporations as well as small businesses. The strongest message to come out of the various case studies and interviews was that what business really objected to was not so much the regulations themselves but the way in which they were introduced, communicated and applied.

Cutting through the red tape, coping with delays and dealing with several different agencies all of which have different standards were common experiences of both small and large businesses.

There was the case of the Magnorth/Norlands/BP oil exploration consortium, for instance, which applied for permission to drill in the high Arctic. Environmental studies were followed by requests for yet more studies. Ministers and senior officials changed several times, and each time there was a change, priorities were shifted and policy changed direction.

Several different federal departments were involved and each one seemed to have its own idea of what constituted an acceptable trade-off between energy resource development and protection of the environment. After almost seven years, the issue is still not solved.

Grissol Foods said that the switch to metric and tighter net weight regulations forced it to alter its packaging installations and format at a cost of well over a million dollars over the subsequent five years.

The regulators and the regulated seem to regard each other with a good deal of suspicion. Corporate executives accused the regulatory agencies of being too stringent, of setting unrealistic precautionary standards, of dictating engineering requirements to reach those standards and of refusing to consider other ways of compliance that would not cost as much.

Regulators, for their part, often looked sceptically at the information supplied by a firm. They insisted on checking, double-checking and modifying engineering and architectural plans, adding to costs and causing delays. In one documented case, three regulatory agencies were involved and they couldn't agree on what constituted a satisfactory waste disposal system. The company had to design a totally new one to accommodate all their different requirements.

In spite of all the problems, though, the Council says that big companies, especially those in industries producing mainly for the domestic market if there is a high degree of corporate concentration, are experienced in adapting their operations to meet regulatory requirements and manage to pass on the costs either by increasing their prices or by absorbing them in their operations as part of the cost of doing business.

The biggest problems for small businesses seemed to be the amount of paperwork associated with taxation, statistics and customs and excise requirements. Most of their difficulties with regulation involved things like zoning, planning, building codes, transportation and labour standards. Here again, the conclusion was that "government regulations are not killing small business" but there is quite a bit of room for improvement in the way regulations are implemented.

*continued on page 8*

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Many business people agreed with the objectives and the need for regulations and the Council says that although it deliberately focused on the costs of regulation, it did not discount the social and other benefits that accrue from the compliance action of forms. The reason for looking specifically at costs was to get a feeling for how regulatory processes affect the competitive ability of Canadian business.

Overlapping regulatory jurisdictions, duplication and inconsistency may all have their costs—especially when there have to be long drawn-out negotiations between departments or governments, and companies are caught in the middle, bearing the brunt of the costly delays. Higher prices to consumers and poorer overall business performance may result.

But some of these problems will not be easy to solve. The biggest cause of them may be the Canadian political system itself. "If Canadians were subject only to a single government," the Council says, "many of these problems would disappear or at least be modified."

Given the realities of the Canadian federal system, however, some progress has been made in resolving some of the jurisdictional conflicts, particularly in the areas of food processing, distribution, retailing, trucking and agriculture. But in other areas like telecommunications, environment, and consumer products, it seems to be more difficult to come to some agreement. In some cases, the Council says, "difficulties in reaching an accord have been exacerbated by the quite different political positions taken by the provinces and by the federal government."

All in all, though, the Council says it is "heartened by the extent to which government departments and agencies have been successful in putting their houses in order." There are, however, two broad areas where the Council believes improvements in the regulatory process might be forthcoming. The first involves regulations that have been in effect for some time. What's needed here is a better understanding of the procedures by business. Governments should codify and publicize the major steps in the regulatory process.

The second area concerns newer regulations such as those on the environment. Companies which are developing large projects often have to deal with regulations "where the knowledge of environmental consequences is far from complete; the appropriateness of established regulations unsure; and public acceptance perhaps ill-defined." There may be several jurisdictions and departments involved and business often sees itself at the mercy of alternative regulating agencies with no clear line of responsibility and accountability to which it can appeal.

Where federal and provincial jurisdictions both have a responsibility for a single product or development project, the Council says they should explore the feasibility of designating one department as co-ordinator for all regulations relating to it.

Finally, the Council says that although it might now seem like a good idea to start dismantling some of the restrictions in the more traditional areas of direct regulation, "the cumulative evidence available to the Council does not support the view that regulation in the areas of consumer protection, environment and occupational health and safety is excessive." By and large, the cost of regulation in these fields does not seem to be out of line with the benefits that regulation brings.

The finding seems to run counter to some of the misgivings now being expressed in the U.S. about the cost of this type of social regulation. But the Council says that there are important historical, political and institutional differences between Canada and the United States and the concern of U.S. business that the private costs of many newly adopted environmental, occupational and consumer protection regulations far outweigh the benefits "is at best unproven for Canada."

Based on this perspective, the Council rejected proposals that would arbitrarily set limits on the introduction of new regulations. It does not favour the idea of a "regulatory budget" which would allocate government departments an annual limit representing the maximum regulatory costs they could impose on the economy. Besides the obvious practical difficulties of implementing such a proposal, the Council says, it could run directly counter to efficiency objectives.

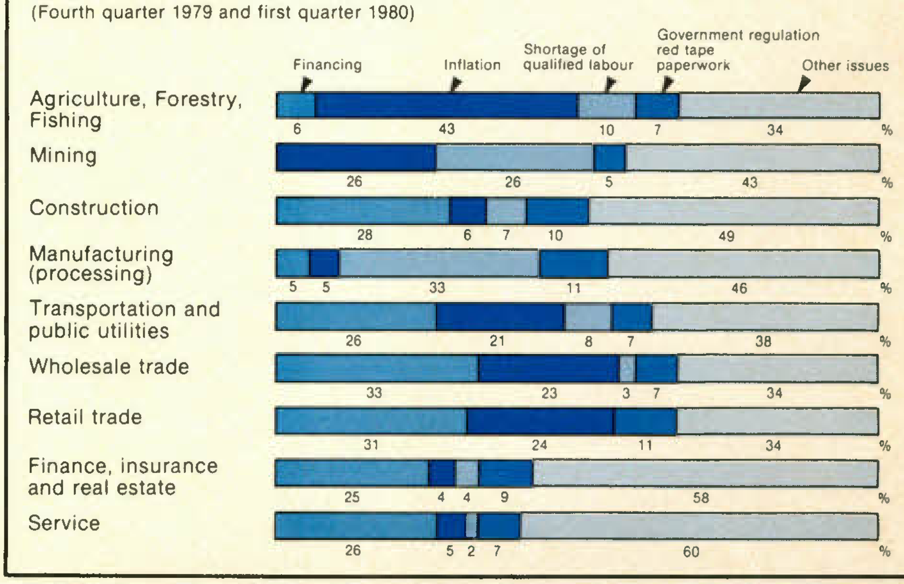
Nevertheless, the Council urged legislators to be careful, when they introduce new regulations, that the benefits will outweigh the costs they impose. And it says that "policies are certainly needed to make the compliance costs incurred by the private sector more visible and to give all concerned groups a stronger role in the regulation-making process."

### The biggest problem for small business

The Canadian Federation of Independent Businesses surveyed its members to see what they felt were the most important problems they faced.

Percentage of respondents who specified:

(Fourth quarter 1979 and first quarter 1980)



## Architects, dentists, doctors . . .

People who use the services of doctors and dentists, lawyers and pharmacists, architects and chartered accountants, are entitled to protection against incompetence or fraud. In fact protection of the public, and the maintenance of standards of quality are generally used to justify occupational regulation. But the Council says that the evidence it has gathered suggests that "a number of regulatory restrictions are imposing costs in excess of the benefits provided."

"The most restrictive form of all occupational regulation" seems to be that imposed by those who engage in trades or occupations under a specific title. These professions have drawn up their own code of rules governing a whole range of activities, from entrance qualifications to standards of members' behaviour, in order, they say, to provide the public with expert, top-quality service. And also, incidentally, to limit the use of the specific title, like chartered accountant, dentist, architect and so on, to those whom the professional association decides meet the standards.

It is true, the Council says, that when health and safety are at stake, consumers almost universally favour a high standard of performance. But professions tend to use this rationale to explain away restrictions that in no way contribute to high-quality service. Hardest to justify, in the Council's opinion, are the regulations that bar professionals from setting their own prices, advertising their services and operating at maximum efficiency.

"We are concerned with these restrictions" the Council says, "not because they can lead to higher incomes for certain groups in society – though many would find this method of redistribution highly objectionable – but because they contribute to waste and inefficiency."

Prohibitions on advertising of prices or services, and the so-called "fee-guides" put out by some associations hinder competition and keep the cost of professional services high, the Council says.

So does the refusal of many associations to allow anyone but "peak professionals" to do the work, although more use of skilled practitioners like denturists and dental assistants, law clerks, and medical and engineering technicians would increase productivity and lower costs, in the Council's opinion.

"There is considerable scope to make regulation more effective and less costly" the Council concludes. It recommends:

- tighter government control over occupational associations, through the establishment of Occupational Regulation Commissions by each province and the federal government;

- government efforts to increase the number of properly trained occupational groups that could compete in certain professional areas;

- a move by provincial governments to outlaw unnecessary restrictions on price-setting and advertising, if this can't be done through the Combines Investigation Act.

## . . . and pharmacists

Prescription drugs would be cheaper if pharmacists had to compete for the consumer's dollar, says a paper written for the Council's study on regulation.

Council economist Paul Gorecki finds that government measures to increase competition in the manufacture of prescription drugs have brought prices down considerably in most provinces.

But retail prices would drop even further, he says, if the provinces made sure that pharmacists dispensed the lowest-priced drug brands, and if they had to tell their customers how much they charge for filling a prescription – a fee that can double consumer costs.

Amendment of the Patent Act by Parliament in 1969 allowed companies without a patent, to import, manufacture and sell patented drugs under a different brand name. To give this amendment teeth at the retail level, the provinces introduced measures too – for example, one permitting pharmacists to select lower priced brands instead of more expensive ones.

As a result, prescription drugs became cheaper across the country. But not all provinces were affected equally. How much prescription drug prices fell in each province depended on the effectiveness of measures to make sure that pharmacists' savings were passed on to the consumer.

In Saskatchewan, for example, consumers have fared very well, because pharmacists there are required to buy drugs from suppliers who have to submit tenders to the provincial government.

On the other hand, they did not gain very much in Quebec, because that province has not taken a tough enough stand with the pharmacists, Gorecki says. In some cases, Quebec pharmacists are marking up prescription drugs by several hundred per cent, he found, a practice made possible by ineffective restrictions on the pharmacists' freedom to choose products and by weaknesses in the province's drug reimbursement plan. Similar mark-up problems also occurred in Ontario.

Gorecki recommends that provinces act to bring down prescription drug prices more by such measures as

- allowing consumers to know what these drugs cost, and what pharmacists are charging to fill prescriptions. This would make pharmacists themselves more competitive, leading to price cuts;

- requiring pharmacists to use the cheapest brands (unless the physician specifically directs otherwise);

- providing doctors with information on interchangeable drug brands, and the range of drug prices, so that they do not prescribe expensive brands.

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"Regulating the Price of Prescription Drugs in Canada: Compulsory Licensing, Product Selection and Government Reimbursement Programmes," by P. K. Gorecki. Technical Report No. 8.

# Communications revolution

It used to be that regulating telecommunications was relatively simple. The "telecommunications industry" meant the telephone and telegraph systems and making sure that even those in remote parts of the country got decent telephone service was an important concern of regulators.

Over the past 15 or 20 years, technological change in the industry has been nothing short of revolutionary. Now messages and information can be moved in a myriad of ways, including cable systems and satellites. Telecommunications technology, from silicone chips to fibre optics, has raised the possibility of all kinds of services – electronic funds transfers, electronic newspapers, information services like teletext, communicating word processors and electronic mail are among them.

Regulation based on the technological imperative of the telephone and telegraph systems now no longer seems appropriate and policy-makers have already started to make changes in the way telecommunications are regulated.

The main rationale for much of the regulation in the industry to date has been the belief that the economies of scale that are possible in telecommunications are so large that the industry constitutes a "natural monopoly." Although research in the area is inconclusive, it suggests that these economies are neither as large nor as pervasive as might be expected. Besides which, says the Economic Council, "The development of electronic and digital technology has opened a vast range of new opportunities and in the process, undermined the assumptions supporting the exclusive role of the telephone companies in telecommunications."

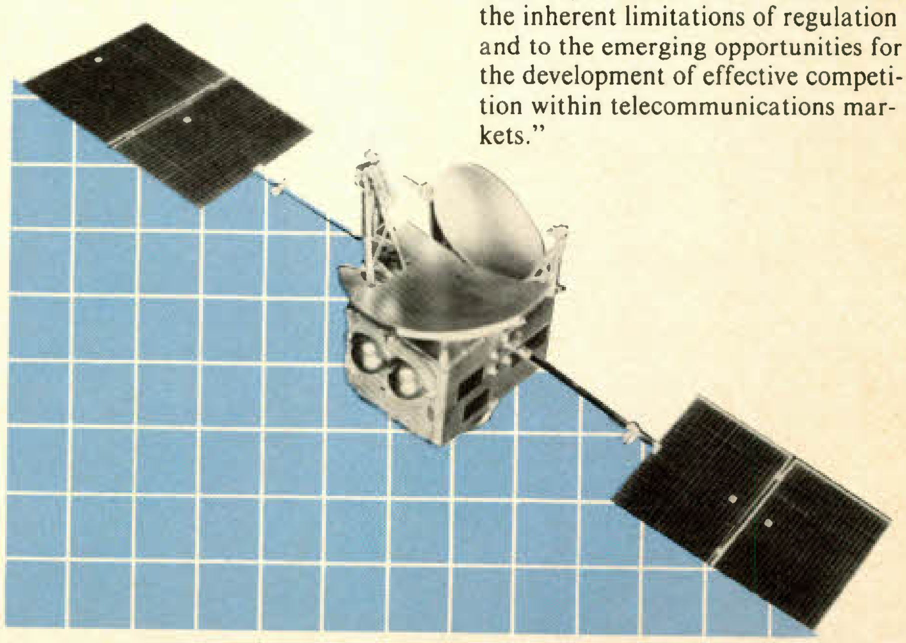
Under discussion now are a whole range of new and complex issues:

• Cable television systems, usually thought of as extensions of broadcasting and regulated under the Broadcasting Act, are becoming an increasingly important part of the telecommunications industry. But regulatory policy has not kept pace with the new developments and so it does not distinguish between the broadcast activities of the cable companies and their other functions. Non-broadcast activities have not been subject to the same obligations and controls that other carriers in the business have to face.

• Distinctions between federal and provincial jurisdiction in telecommunications are blurred and the cable sector in particular has provoked some very heated jurisdictional squabbles. There was a time, recently, when Quebec cable operators were being regulated by both the Canadian Radio-television and Telecommunications Commission (CRTC) and the Régie des services publics.

• While an argument could have been made that the telephone company was a "natural monopoly" when its business was mainly telephones, that argument is not as convincing now that telecommunications involves so much more. "In the new electronic age," says the Economic Council, "technological expertise no longer remains the exclusive province of incumbent telephone companies."

• Even in the provision of basic public telephone service, new developments could soon challenge the basis for regulation. Recent developments in the United States, for example, have already produced an alternative to the local telephone network as a link to long distance. One company is bypassing the telephone company's local service by beaming messages directly to small two-way earth stations on site at a limited number of locations. Future developments in mobile telephones, fibre optics and coaxial cables could lead to new and important sources of potential competition to local telephone loops.



Although Bell Canada claims that there are economies of technological innovation and that the monopoly firm has more incentive and more capacity for innovation than a competitive firm would, the consensus among economists now seems to be that a bit more competition would help. It could be that some of the new technology would have been introduced earlier if there had been more competition in the industry. And the CRTC has noted that services like Dataroute, Infodat, Datapac and Infoswitch "have at least in part been spurred by competition between Bell and CNCP."

In any event, the Council says that "it appears to us that outside basic telephone service a case has not been established for restrictions on competition." It recommends ways in which competition could be encouraged.

Finally, the Council says, it is not attempting to draw a "precise and rigid boundary line between the areas where competition and regulation should prevail." There has to be flexibility. "For the longer term, what is important is that decisions be made within an overall policy framework that is sensitive to the inherent limitations of regulation and to the emerging opportunities for the development of effective competition within telecommunications markets."

# Occupational health and safety

The worker's right to refuse hazardous work, without risk of reprisal, and to be informed of potential hazards should be extended across the country, says the Economic Council of Canada.

These are among the recommendations contained in the chapter on occupational health and safety of the Council's study on government regulation.

The Council concludes that federal and provincial regulations in this field serve an essential function. Its recommendations are aimed at improving existing regulation, with a view to reducing human suffering and improving economic efficiency.

Industrial accidents kill over 1,000 workers per year. About 90 per cent of the deaths are the result of injuries caused by "collisions, cave-ins, falls or moving equipment." The remainder are attributable to occupationally derived illnesses. The economic costs of disabling injuries is the loss of 12 million person-days per year.

Federal and provincial regulations should be improved to stress prevention, the Council says. Thus workers should not only be ensured of the right to refuse hazardous work but should be given all the information necessary to decide if a particular task or a substance present in the work place poses significant hazard.

The Council supports the use of joint labour-management committees "with functional authority" to guarantee the safety of workers.

The provision of information is vital, the report states, since without it workers cannot exercise their right of free choice. The report provides a grim example: "A worker cannot try black lung disease for a week or so in order to discover whether he really thinks that it is worth the risk of becoming a coal miner. Having once been contracted, the disease will be with him for the rest of his (shortened) life."

Federal responsibility for regulation of occupational health and safety is mostly covered by the Canada Labour Code. The Council supports efforts to strengthen the code and recommends the development by both the federal and provincial governments of a set of national standards for occupational health and safety that will apply across the country, as is now the case with standards for environmental matters and in the areas of food and drug administration or hazardous products.

Most regulations affecting occupational health and safety are the responsibility of provincial governments. Provincial regulations vary in meeting the Council's criteria for worker protection. The Saskatchewan system is taken as a model. It is based on the theory that "the work place, not the workers, is the central issue of health and safety and that the vast majority of accidents occur because of inherently hazardous work situations."

Ontario, Québec and New Brunswick have regulations that guarantee the right to refuse hazardous work and that ensure management-labour participation in the prevention of injury or illnesses.

Regulations in Alberta operate on the principle of "voluntary enforcement." The right of refusal to work in Alberta is conditional on "imminent danger," which must be proved by the employee.

In British Columbia workers can refuse unsafe work defined as "not normal for that occupation" but there is no formal redress against subsequent punitive action by employers.

But even the greatest attention to prevention will not stop all industrial accidents and illnesses. The Council therefore recommends that existing systems of workers' compensation be expanded in order to have universal application. There is also a need for more inspectors and stricter enforcement of regulations at both the federal and the provincial levels, the report concludes.

# Some guidelines for policy

Regulatory reform is not for the cynical or the faint-hearted, says the Economic Council of Canada. Although deregulation finds favour in some quarters, most of the pressure is in the other direction. "The momentum towards more regulation is very powerful," says the Council in the concluding chapter of its report.

Canada has an immense network of economic regulation and it has been difficult to get much support for changing it – mainly because the public hasn't understood the nature and the consequences of regulation. The Council is hoping that its report will go some way toward changing that.

Here are the Council's conclusions and guidelines for the three main areas of regulation:

- Direct regulation has resulted in "a substantial waste of economic resources and reduced the dynamism and innovation in several important sectors of the Canadian economy." The problem is that once direct regulations have been implemented people have a vested interest in continuing them.

In markets where competition can work, direct regulation is not in the public interest. Transportation, some parts of telecommunications and agriculture are all candidates for reform. The market itself is the best control mechanism and ultimately the Bureau of Competition Policy should be responsible for policing the marketplace.

- In the case of common property resources, like the environment and commercial fisheries, reform means more effective regulation rather than less regulation. Marketable rights to catch fish are recommended, and financial incentives for companies to control environmental pollution.

- Changes in the areas of social regulations, like those dealing with occupational health and professional occupations, should involve a more sensitive balancing of costs against benefits.

# SPRING U

*The material on these four pages is based on the work of the Economic Council's Performance and Outlook Group and has been published in the form of a paper "The Medium-Term Outlook: Spring 1981 Reassessment," by R. S. Preston, C. Braithwaite, B. Cain, B. L. Eyford, B. K. Lodh, P. S. Rao, H. M. Saiyed and M. Willis.*

The outlook for the Canadian economy seems to be somewhat brighter now than it was when the Economic Council published its Seventeenth Annual Review in the fall of last year. Economists with the Council's Performance and Outlook Group have taken another look at the indicators with the help of the CANDIDE econometric model. Their conclusion is that over the next three years, the performance of the economy will be a bit better than they had expected. But they are now projecting much higher inflation rates than before.

The improvement stems from a stronger recovery in the United States this year, as well as slightly higher consumer spending and a different pattern for the movement of business inventories. Gross National Expenditure (GNE) – the economy's total demand for goods and services – is now expected to increase by 2.9 per cent this year, after allowing for inflation. The increase in this major indicator is projected at 3.0 per cent next year and 4.0 per cent for 1983. Previous projections had real GNE increasing by 1.4 per cent in 1981, 3.1 per cent in 1982 and 3.5 per cent in 1983.

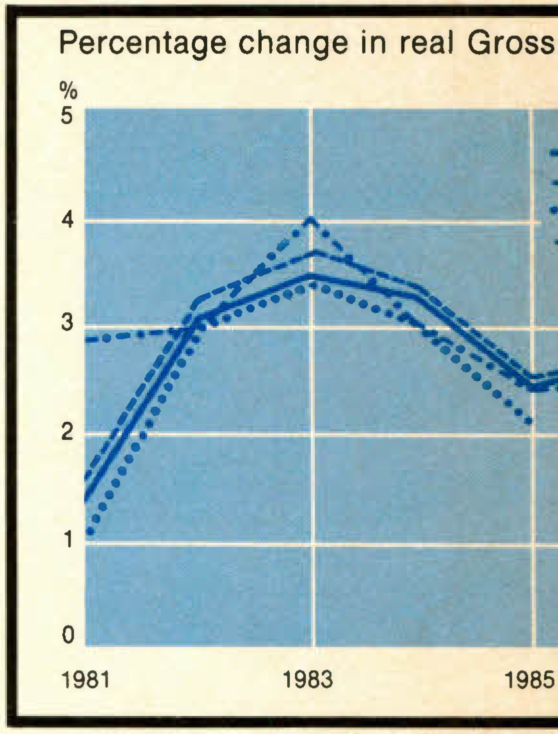
The basic projections (used as a reference point to try out various policy options and scenarios) in the Council's Seventeenth Annual Review, produced before the details of the budget were made public, were made on the expectation that policies in effect at the beginning of October, 1980 would continue. They assumed that scheduled major energy projects would go ahead, that the wellhead price of crude oil would rise by $4 a barrel each year from 1981 onwards, and that the international economic picture would be very gloomy.

Since the Review was published, quite a lot has changed. A new President has taken office in the United States with an economic program that has affected the prognosis for the U.S. economy; in Canada, the federal government has brought down a budget, and introduced the National Energy Program, prompting Alberta to react by cutting oil production; and the publication of the National Accounts data for 1980 showed that the Canadian economy finished the year on a strong note.

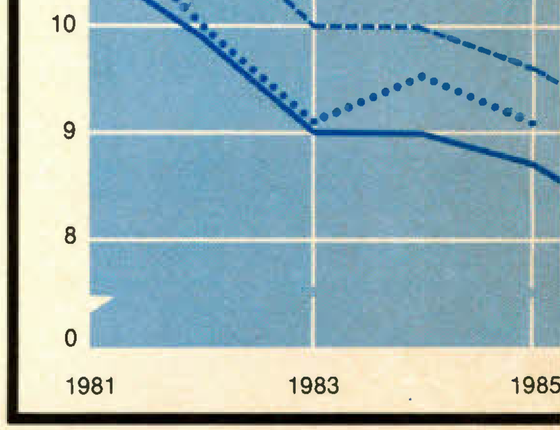
For these and other reasons, the prospects for the Canadian economy have changed since last fall. The Spring 1981 Reassessment is based on a number of assumptions:

- The U.S. economy will experience a mild recovery in 1981, with longer-term growth averaging three per cent a year, after allowing for inflation.
- Based on the National Energy Program, the domestic wellhead price for crude oil will reach $65 a barrel by 1990, with world oil prices climbing to $99 a barrel (delivered at Montreal) by then. The "blended domestic price" – the one consumers have to pay – which includes the domestic wellhead price, transportation costs, and a petroleum compensation charge, will reach $79 a barrel by the end of the decade.
- Uncertainty over the energy program and oil pricing will delay the start of the Alsands and Cold Lake oilsands projects until 1983, but pipeline projects will go ahead as envisaged in the previous projections.
- Government financing of federal-provincial established programs will increase in proportion to the growth in nominal GNE.

## Growth of t



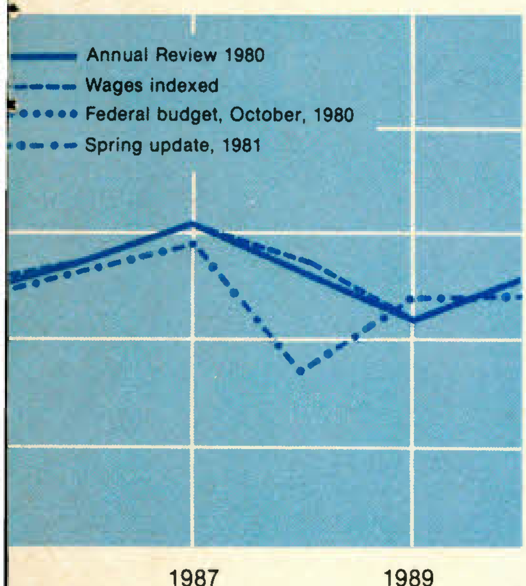

## Inflation pr



# PDATE

## he economy

National Expenditure




Council economists now project a moderate recovery for the Canadian economy over the next three years. The chart shows projections for real Gross National Expenditure (GNE), representing the total level of demand in the economy for goods and services. The projections only hold good if there is no change in existing policies and they do not take into account investment projects in the latter part of the decade now only in the planning stages.

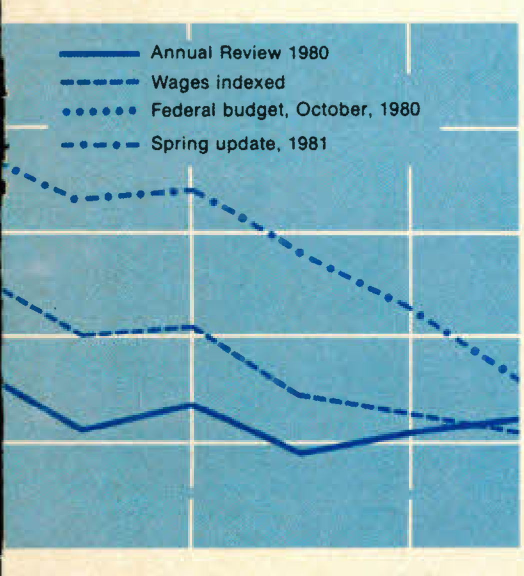
Earlier projections, made for the Seventeenth Annual Review, indicated a more modest start to the decade with real GNE increasing by 1.4 per cent in 1981, rising to a 3.5 per cent growth rate in 1983 and levelling off after that, with the lowest rate of growth showing up at 2.2 per cent in 1989.

In this Spring 1981 reassessment of the economy's medium-term prospects, the goods and services produced by the economy are shared out like this:

- Investment, after allowing for inflation, is expected to rise from about 23 per cent of GNE this year to reach a peak of 26.4 per cent of GNE in 1987, levelling off to 26 per cent by 1990. Non-residential construction should demonstrate strong growth in the next several years, especially as construction of large energy projects is resumed.
- Consumer spending is expected to maintain its present share of 63 per cent of GNE at the end of the decade after a slight dip in the mid-eighties.
- Increased investment in machinery and equipment and spending on durable goods, both of which are largely imported, may mean that imports will represent over 32 per cent of GNE by the end of the decade compared with about 27 per cent projected for 1981.

## ojections

Price Index



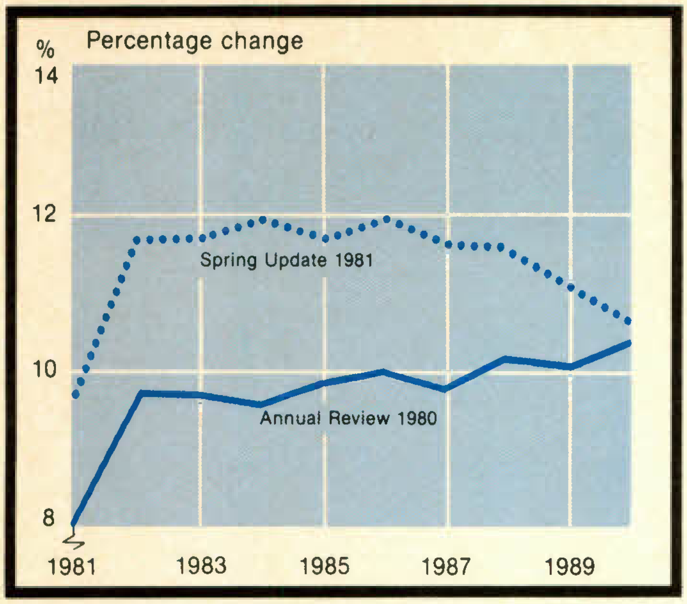

The rate of inflation is now expected to remain much higher throughout the decade than the Council projected in its Seventeenth Annual Review. This is because of slightly higher energy prices and taxes, higher prices of exports and imports, and a wide range of inflationary pressures operating in Canada.

Double digit inflation now seems likely to last almost to the end of the decade. The projections show an increase in the Consumer Price Index (CPI) of 11.4 per cent this year, rising to 11.9 per cent in 1982 and declining only gradually after that. By 1988, the inflation rate is expected to be below 10 per cent for the first time this decade, with a 9.8 per cent increase projected for the CPI in that year. By the end of the decade, inflation, according to this measure, will be running at a rate of about 8.6 per cent a year.

Projections made for the Seventeenth Annual Review last fall showed 1981 as the last year of double digit inflation – at least in this decade.

Higher inflation is likely to affect savings too. Saving incentives, such as Registered Home Ownership Savings Plans and Registered Retirement Savings Plans are not indexed to allow for inflation. So as prices rise, the value of savings in these plans is eroded. The saving rate, which was 10.2 per cent in 1980, is expected to drop off throughout the rest of the decade to reach a level of 7.7 per cent by 1990, unless the limits on incentives to savings are increased.

The Spring 1981 reassessment of wages and prices indicates wage and price inflation in the range of 11 per cent to 12 per cent over the medium term. This is more in line with one of the projections in the Seventeenth Review that assumed real wages would be maintained by indexing wage rates to the CPI.

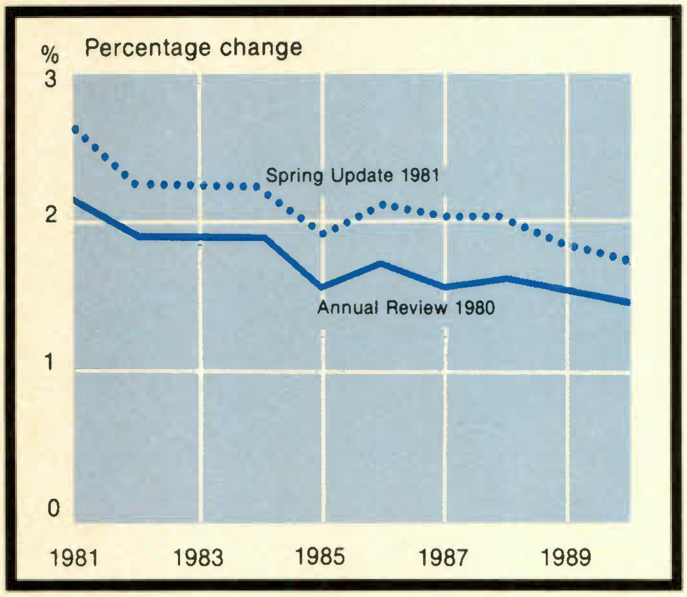



# How wages increase

Growth in nominal wage rates is now expected to be higher than before. Most econometric models over the past couple of years have tended to under-estimate wage increases.

There are other reasons for expecting wages to rise faster. Unemployment rates around the middle of the decade are now projected to be lower than they were before and this may put some upward pressure on wages.

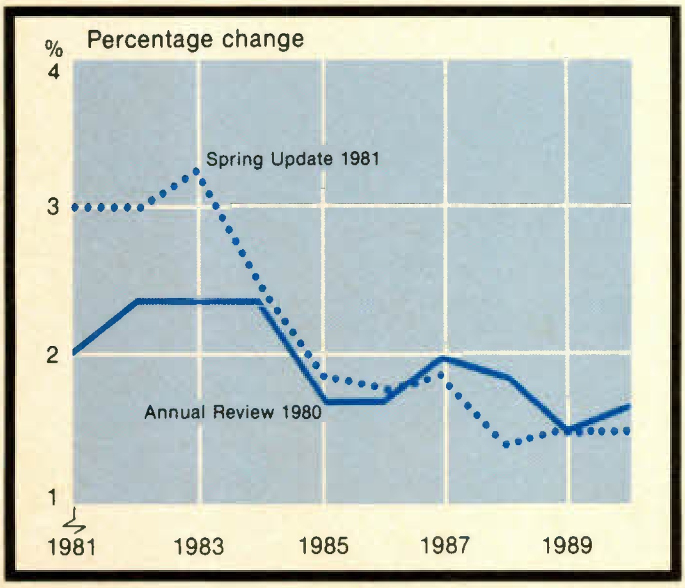
Slower growth in public sector wages will keep them more in line with inflation rates. But wages generally will not keep pace with inflation and no significant increase in the average of real wage rates is expected until the latter half of the decade. Projections of real disposable income have also been lowered. This source of spending money will probably increase by less than one per cent in 1981, averaging about two per cent a year for the rest of the decade.




# The labour force

Labour force growth is still quite strong and recent experience here indicates that previous projections may be too low. The percentage of women in the 25-to-44 year age group who are in the labour force is likely to rise faster than expected. About 60 per cent of this segment of the population is now working for pay and their participation rate is projected to reach 80 per cent by 1990.

Overall, about 63 per cent of adult Canadians are now in the paid labour force and this rate is expected to increase gradually to reach 68 per cent by 1990. Over the next ten years, labour force growth will probably average about two per cent a year. By the end of the decade, this rate should be slowing slightly.

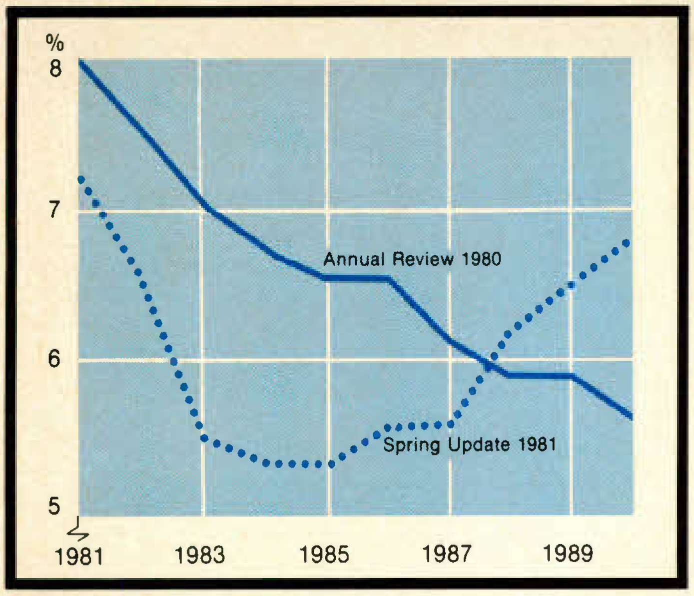



# Available jobs

Higher real economic growth, particularly in the first three years of the decade, will mean higher growth in employment. From now through 1983 the economy should be able to generate enough new jobs to increase employment by about 3.1 per cent a year instead of the 2.3 per cent projected in the Seventeenth Review.

The rate of job creation will slow down considerably towards the end of the decade, reflecting the rather depressed real growth path projected for the Canadian economy during that time.

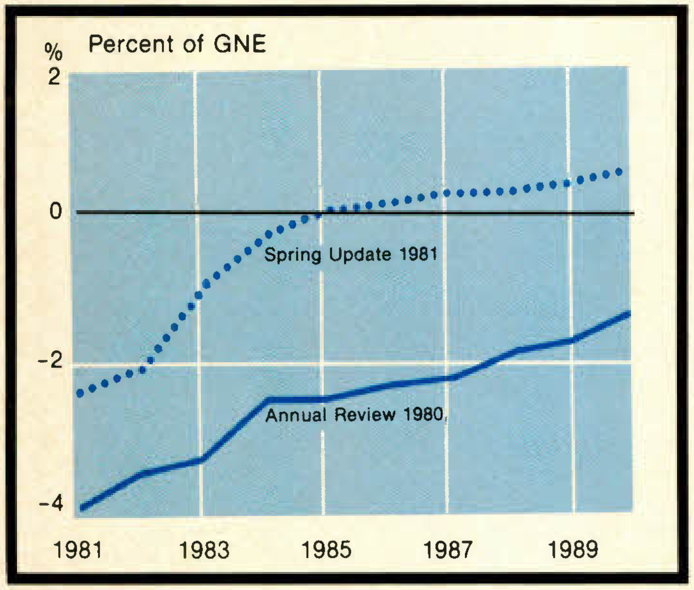
The good news is that productivity growth is likely to recover during the period 1982 to 1990, although it will remain around 1.0 per cent a year. Productivity in manufacturing will likely increase at between 2.0 per cent and 2.5 per cent a year.




# Unemployment rate

Improved economic growth and higher job creation will make it possible to bring the unemployment rate down sooner than originally projected, but the improvement may be short-lived. In the early part of the decade, the percentage of workers without jobs is expected to drop from 7.2 per cent this year to about 5.3 per cent by 1985. Earlier projections indicated a rate of 8.0 per cent for 1981 falling to 6.5 per cent in 1985.

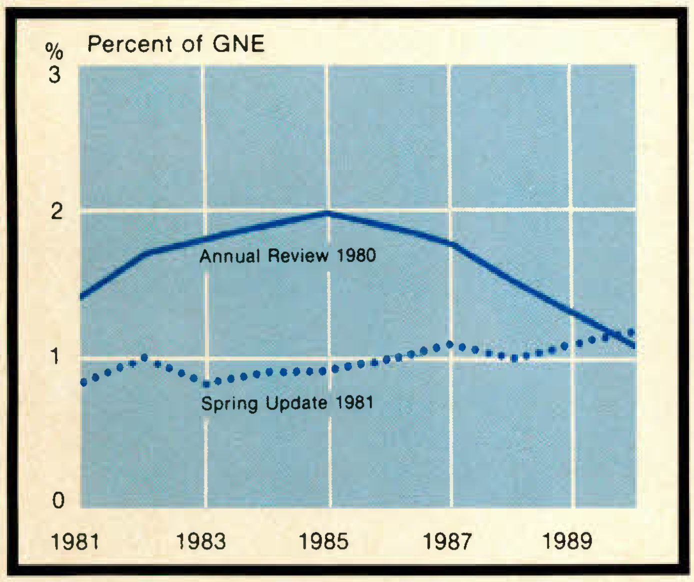
By the end of the decade, if policies do not change and investment is sluggish, economic growth will slow down and the jobless rate will be on the rise again.




# Federal deficit

Projections of the federal government's fiscal position have changed dramatically. The Seventeenth Annual Review projected a deficit amounting to 4.0 per cent of Gross National Expenditure (GNE) in 1981 and falling gradually to 1.3 per cent of GNE by 1990. Now, because of the National Energy Program (NEP), the federal government could be in a surplus position by the middle of the decade.

New revenue sharing arrangements, proposed in the NEP, shift the cost of the oil import subsidy from the federal government to the consumer and give the federal government bigger revenues. Money coming in from crude petroleum and natural gas production taxes will also help improve the federal government's budget position.




# Provincial surpluses

The position of the provincial governments is not quite as favourable as originally projected. Although these governments are expected to continue to have surpluses for the entire decade, they will be lower than expected.

Lower provincial oil and gas royalties in the early part of the decade mean that provincial surpluses will likely average about 0.9 per cent of GNE over the next five years instead of the 1.8 per cent projected in the Seventeenth Annual Review. By the end of the decade, provincial surpluses are expected to average 1.2 per cent of GNE, compared with the 0.6 per cent projected for the federal surplus.

Spending by all levels of government is expected to decline from 17.4 per cent of GNE this year to 15.6 per cent by 1990.

# Council research now in progress

Though few people are aware of it, the upcoming negotiations between the federal government and the provinces over "fiscal arrangements" may have just as much effect on Canada's future as those over the Constitution.

With this in mind the Economic Council is currently studying the key issues relating to these complex questions. The federal-provincial negotiations will centre on renewal or replacement of the Fiscal Arrangements Act, which expires in 1982. This Act of the Parliament of Canada governs the principal intergovernmental fiscal arrangements, including tax collection agreements and programs such as Equalization and Established Programs Financing – programs which account for three-quarters of all transfers from federal to provincial governments.

The intent of the Council's research in this area is to establish a context within which Canadians will be able to judge the arguments presented by the federal government and the provinces during the process of negotiation.

By stimulating informed public discussion of the issues, the Council hopes that its research will contribute to finding solutions which are equitable for all parts of the country and beneficial to the economy.

Finance Minister Allan MacEachen has already told a parliamentary committee that he is looking for a change in the arrangements and some of the provinces have also indicated their wish to alter past agreements.

At stake in the current fiscal year are nearly $11 billion in transfers from the federal government to the provinces.

The negotiations may bring into question the present goals of the equalization program and issues such as the establishment of national standards for services funded through the arrangements, including medical insurance, hospital care and post-secondary education.

The aim of the equalization program is to ensure that every provincial government has enough money to provide a reasonable level of public services to its population without any one province having to have exorbitant tax rates in relation to the others. The program has also had the effect of redistributing a portion of the nation's wealth to the poorer regions of Canada.

When equalization started in 1957, British Columbia, Alberta and Saskatchewan were among the have-not provinces. However, the rapid increase in oil and gas revenues accruing to some provinces, especially since the mid-1970s has radically altered their relative fiscal positions. This is certain to be a consideration in negotiation of the new arrangements. It clearly raises questions about the goals of the equalization program, which, it has been argued, should explicitly redistribute wealth or economic opportunities.

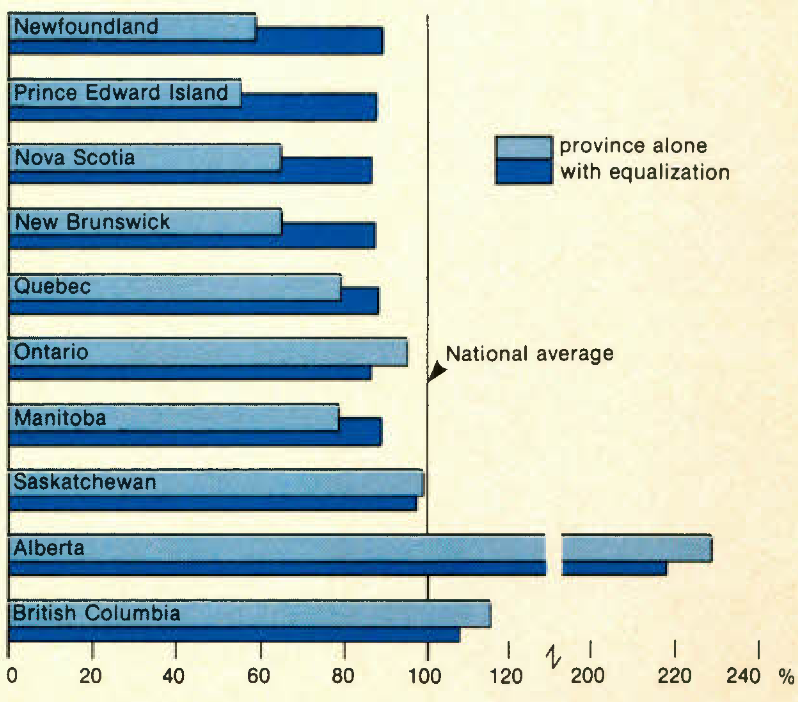
The Council's research on fiscal arrangements will include an examination of alternative forms of equalization payments; the future of federal "conditional" grants to finance provincial expenditures on health and post-secondary education; the implications of intergovernmental fiscal arrangements for stabilization policy; the effects of natural resources pricing decisions on the fiscal positions of federal and provincial governments; the movement of factors of production and efficient allocation of resources in the economy. Tax and fiscal harmonization between federal and provincial governments are being studied, as is the process of negotiating intergovernmental fiscal arrangements itself.

Finally, the research will include an examination of how other countries, including Australia, West Germany and the United States, deal with comparable questions of public finance.

### How equalization helps provinces

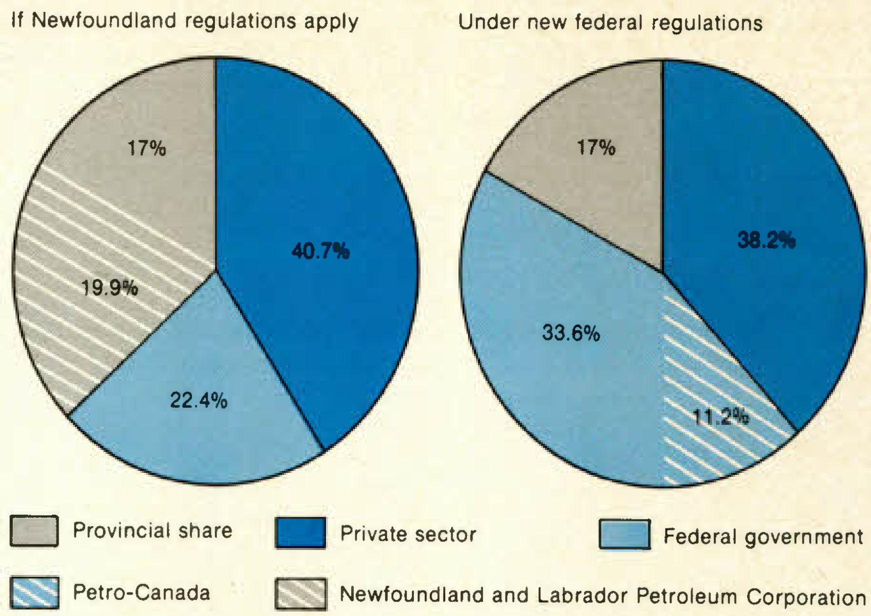
Some provinces find it more difficult than others to raise revenues. The equalization program supplements the revenues of those provinces by making unconditional transfer payments to bring their revenue capacity close to the national average.
The chart below shows how each province's revenue-raising capacity compares with the national average when provinces use only their own sources of revenue, and then how equalization payments increase the revenue capacity of each province. A representative tax system is applied to provincial revenues, which include 100 per cent of natural resource revenues and local property taxes.

Percentage of the national average, 1977-78



# Hibernia — a Pandora's box?

### How oil revenues would be distributed




The calculations above assume that oil production will total one billion dollars, that inflation will average eight per cent a year, that capital costs will increase by 12 per cent a year, and that the revenues are discounted at seven per cent a year after allowing for inflation.

The Hibernia oil field may turn out to be Canada's biggest oil discovery to date. Recent estimates put its reserves somewhere between one and two billion barrels – or considerably more oil than Canadians use in a year. Even so, Hibernia will not make Newfoundland another Alberta, says Council economist Jonathan Wilby, although discovery of other commercial fields – a distinct possibility – could transform the province's economic position.

Development of Hibernia may open a Pandora's box of problems concerning natural resource ownership. Whoever controls that billion barrels plus stands to profit substantially. The federal and Newfoundland governments are currently wrangling over that very issue, each claiming the jurisdictional right to regulate the oil field's potential revenues.

In a paper written for the Council's recently released report on Newfoundland's economy, Wilby says that Newfoundland would fare very much better under its own regulations than under those of the federal government, "but not quite to the extent that some sources have claimed."

The chart shows how different regulatory systems would affect the share of revenues going to governments, their crown corporations and the private sector. Wilby used a cash flow technique to see what would be the impact of the different proposals.

Clearly, Newfoundland gets a much bigger piece of the revenue pie when it has regulatory control. Private sector companies would get a larger share of total revenues under that system, but they would get a larger share of the expenses too.

Wilby finds, however, that these companies get a somewhat better return on their investment under a federal regime. The reason, he says, is that with provincial regulations private companies must pay all capital costs, whereas under the federal system, Petro-Canada bears many exploration and development expenses.

In dollar terms, Newfoundland stands to receive over $9 billion from Hibernia if it controls offshore oil, assuming that the oil will be priced the same as conventional oil, and that inflation averages eight per cent a year. If production continues for 20 years, Wilby calculates this income at an average of $450 million a year, or about $800 a head. In peak production years, revenues would be much higher than this.

Even under federal jurisdiction, provincial revenues over the life of the field could run as high as $4.25 billion after allowing for inflation. Would this be enough, "to wash Newfoundland's economic problems away in a sea of cash?" Probably not, says Wilby, because these figures do not allow for the fact that the equalization payments Newfoundland now gets from the federal government will dwindle as its resource revenue increases. This loss under a federally operated system and the present equalization formula would mean Newfoundland would have to give up about 49 cents in equalization payments for every dollar it gets from oil. Once it becomes a "have" province, Wilby says, "the federal government seems intent on gaining a share of mineral resource revenues from Hibernia." No one knows how big a share, but it is possible that the province would have to hand over 25 cents out of every oil revenue dollar. But Wilby's calculations indicate equalization payments will not be reduced to zero unless Newfoundland's oil revenues got up above $700 million between now and 2004 – and this does not seem to be likely.

With provincial regulations in force, equalization payments to Newfoundland could end by 1987. And over the 20-year life of the Hibernia field, Newfoundland would lose about $4 billion in these payments, eroding over half the provincial gains from oil.

The discovery and production of more fields, though, would increase the province's income and bring equalization payments to an end more quickly. Newfoundland then, under a revenue-sharing agreement, could expect a larger share in higher revenues.

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"Revenue Implications of Offshore Oil Under Different Taxation and Profit-Sharing Regimes: The Case of Hibernia," by Jonathan Wilby. Discussion Paper No. 197.

# A new look at the western boom

The notion that western Canada is prospering at the expense of all the other provinces can't be justified, claims a recent paper written for the Economic Council.

Western economies are growing rapidly right now to be sure, say University of Alberta authors Kenneth Norrie and Michael Percy. But it will be many years before the West's share in economic activity begins to rival that of Ontario and Quebec. In comparison, the shift of activity when western agricultural lands were being opened up at the beginning of this century had much more impact than the present western oil boom.

In the past, western resource booms invariably gave eastern economies a boost as well. Good markets for wheat, minerals, agricultural and forest products and oil and gas led to the development of thriving primary industries out West, but did not stimulate the growth of enough local manufacturing or services there. So eastern manufacturers and financiers were able to provide the goods and services westerners needed, and eastern industry flourished accordingly.

Today, the clamour for crude oil and natural gas means western economies are once again doing well. If this latest resource boom follows the pattern of earlier ones, eastern industry should benefit too. But some observers say it's having an entirely different effect instead – that the centre of economic gravity is shifting westward now, as provinces there attract people, investment and industry away from the East. So at a time when seven provinces must pay increasingly higher energy bills to three oil and gas-exporting provinces (British Columbia, Alberta and Saskatchewan), they are also losing their traditional dominance in the manufacturing and service industries.

What evidence is there to support the argument that the West has forsaken its dependence on the primary sector and started to industrialize? And is there any reason to suspect that the East's industrial heartland is worse off now that the West is doing well? Norrie and Percy tackle these questions from two angles: first, they use traditional economic theories to predict how rising energy prices should affect oil-producing and oil-consuming economies; and then they look at what's actually happened to the economic structure of Canada's regions so far.

Their analysis of the impact oil price increases have on two somewhat simplified regional economies, an oil-producing western region with some manufacturing, and an oil-consuming industrialized eastern region, fails to convince the authors that a resource boom of this nature changes the existing economic structure. As workers and investment in the West become increasingly tied up in the energy sector, they say, there will be little opportunity for manufacturing industries to develop there. So the West will go on relying on eastern imports, and in fact will be able to buy more of them with the larger income coming in from oil exports.


National Film Board of Canada

Eastern industry and western oil

In theory, expanding primary industries and lower taxes could attract enough people to the West to make it worthwhile for industry to settle there and avoid transportation costs. Energy sector projects could stimulate the growth of new industries too; and provincial government policies favouring local businesses, or offering subsidies and tax breaks, might also encourage firms to head west. But companies and workers are not likely to move away from the East unless there are strong incentives to do so, the authors say.

It's too early in the day to predict whether or not the westward shift will take place, but so far there's not much evidence that the West has attracted a high proportion of population and industry. Between 1961 and 1978, the increase in western Canada's share of population (1.1 percentage points), real gross domestic product (2.9 percentage points), labour force (1.3 percentage points) and new investment has been surprisingly small. Nor is there any clear indication that western manufacturing that has grown up recently is competing with eastern markets. Rather, it is closely tied to the primary sector, particularly the energy industries.

So it's hard to argue on theory or evidence that eastern Canadian economies are losing out to western ones. On the contrary, Norrie and Percy say, they're better off linked to western prosperity than they would be otherwise. Undoubtedly some of the blame for the relatively slower performance of the industrial heartland of Ontario and Quebec in the 1970s does fall on higher energy prices. But the blow would have been more severe if those provinces were paying the world oil price. Internal supplies of western oil at markedly lower costs have in fact cushioned the economic adjustment eastern provinces have to make, the authors argue.

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"Westward Shift and Interregional Adjustment: A Preliminary Assessment," by K. H. Norrie and M. B. Percy. Discussion Paper No. 201.

*Regional disparities*

# Jobless key is productivity

Why is unemployment so high in Canada east of Ontario? And why has it been that way for so long? As long as records have been kept – which is more than 30 years – "the upward march of unemployment rates going east, through Quebec, the Maritimes, and on to Newfoundland is unmistakable, in boom and recession, in big towns and little, in winter and summer" say two Council economists.

Policy-makers have tried almost everything. Equalization payments and unemployment insurance were supposed to take care of things until the normal economic adjustment process began to bite and workers moved out of the high unemployment areas or business moved in to supply them with jobs. For the past 15 or 20 years, more active attempts have been made to speed up the process through the Department of Regional Economic Expansion and other government subsidy programs. But nothing seems to have worked.

## Policy not working

Why hasn't the policy been a success? Why is it that when the number of jobs has increased so rapidly (by 85 per cent in Quebec between 1947-50 and 1976-79) unemployment remains so high? Neil Swan and Paul Kovacs argue that the theories on which current policy has been based are not the right ones. "The doctor who prescribes quinine and mineral salts for malaria will not cure a patient with influenza" they say. In a study that tests out a new theory of regional disparities, the two Council economists come to the conclusion that one key to the problem is productivity.

Traditional theories have argued that improved productivity may increase incomes but will not do much to reduce the unemployment rate. In fact some economists have said that increasing productivity may mean that fewer workers are required to do the work and so unemployment actually goes up.

Swan and Kovacs say that productivity improvement can create jobs and their research seems to bear out that proposition. If productivity is low, they say, and we assume full employment, wages will be lower than in other regions. If workers then succeed in bargaining for higher wages without improving their productivity, employers will not hire them and unemployment will increase. But if productivity increases, the demand for labour will increase and unemployment will be reduced.

Jobless in the Atlantic region


But it's no good just looking at productivity in manufacturing or the resource sectors. Productivity in the non-traded goods and services sector, which accounts for about two-thirds of any economy, is just as important. So the scope for policy is much wider than anybody thought because policy-makers have been used to thinking only in terms of boosting exports and local manufacturing.

Identifying the problem is one thing, but coming up with solutions to the disparities in eastern Canada is not going to be easy. Although unemployment could very likely be reduced by improving productivity, "there is no guarantee that government policy-makers can find cost-effective ways of improving regional productivity that have not been found by profit-seeking enterprises."

There is no single formula for improving efficiency of production in all areas of economic activity. Each industry will have to be examined individually and compared with similar industries in other regions to find the innovations in machinery, techniques or management which will make that particular industry more efficient.

"In a sense, what our study advocates is more studies" says Neil Swan. "This is not an easy way out, however, but what we see as the first step towards finally arriving at a solution to a problem that has persisted despite 30 years of efforts."

As well, "reductions in the national unemployment rate do have a very powerful effect in reducing unemployment in eastern Canada," say the authors, and their Newfoundland data confirm this. National policies towards national unemployment and inflation should take account of this, they say. And policies to promote productivity improvement, in both the service and non-service sectors, offer some hope for a permanent reduction in both unemployment and income disparities in eastern Canada, they conclude.

This study is the latest in a series conducted as part of the Economic Council's extensive examination of the Newfoundland economy. The report of that study, *Newfoundland: From Dependency to Self-Reliance*, was published in November 1980.

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*Empirical Testing on Newfoundland Data of a Theory of Regional Disparities*, by Neil M. Swan and Paul J. E. Kovacs (Catalogue No. EC22-92/1980E; $4.95 in Canada, $5.95 elsewhere).

*"Global 2000"*

# U.S. report paints gloomy picture

Population, resources and environment may soon become the number one source of contention on the international scene, replacing more traditional conflict areas such as economic competition and political and territorial differences, according to a senior U.S. government official.

Invited to Ottawa to present a seminar at the Economic Council, Thomas Pickering, Assistant Secretary of State for Oceans and International Environmental and Scientific Affairs, warned that pressure on renewable resources is "clearly greater than anyone would have expected or indeed been able to predict." Pickering headed a U.S. government effort to project and assess worldwide trends in population resources and the environment to the end of this century. The report of that study, "Global 2000," was released by the Carter administration last year.

Based on the assumption that present national policies would continue, that there would be a fairly rapid rate of technological advancement but no "miracle" breakthrough, and that there would be no major wars or disruptions of the international monetary system, the report's projections included population, climate, food supply and demand and energy developments. Despite some imperfections in the methodology, Pickering says the report's message is "clear, unequivocal and unavoidable."

- Population will increase from 4.5 billion today to more than 6 billion by the year 2000, with 90 per cent of the population growth occurring in the developing countries, much of it in huge urban areas. Thirty million people will be living in Mexico City, for example. (More recent population projections have been lower than those in the Global 2000 report.)

- The supply of natural resources probably won't keep pace with escalating demand. Although food production could grow by as much as 90 per cent between 1970 and 2000, this increase only works out to 15 per cent more a person, while food prices will nearly double.

Dwindling energy resources will continue to plague countries everywhere, particularly the developing ones. While world petroleum production should peak before the end of the century, the overall world demand for energy will increase by almost 60 per cent by 1990.

But even more alarming, Pickering said, is the rate at which forests are vanishing, with serious consequences for the world's water supply. In the tropical developing countries, he claimed, "a forested area half the size of California is disappearing each year."

Despite accusations of "gloom and doom" from some commentators, Pickering said that the overwhelming reaction to the report has been that it "correctly sets forth a series of critical, pressing global problems confronting mankind, and that we must now move beyond the analyses and consider the measures nations can take independently and co-operatively to deal with the problems." He said the report deliberately does not suggest policy responses because the study concentrated on presenting "as complete and objective a picture as possible of likely future conditions untrammelled by an effort to sell a preferred set of solutions."

# Better forest management needed in Newfoundland

Newfoundland's forests could be a better source of much-needed jobs if they were properly managed. But unless the province adopts policies to improve management and make more efficient use of its forests, timber will become a scarce resource and the number of jobs could decline, according to a study published by the Economic Council.

John A. Gray, of the University of Manitoba, says in a report prepared for the Council's study of the Newfoundland economy, that the province could be supplying more of its own lumber needs from its forests if there were proper allocation of trees between the various sectors of the forestry industry. This would in turn increase employment in Newfoundland's logging and sawmill industries.

The forestry industry in Newfoundland provides 5,000 person-years of full-time employment for islanders, ranking it third among resource employers. But, poor allocation of logs between the pulp and paper and sawmill industries means that sawmills operate below capacity and Newfoundland has to import more than half its lumber from the mainland.

Failure to improve utilization and management of forests could have dire consequences, the report concludes. In the past neither the government nor private companies have had much interest in ensuring the renewal of forests.

"With virtually no revenues from the forest, the government has little incentive to engage in forest management, as the financial benefits go to the companies. On the other hand, there is little incentive for the companies to engage in forest management, since they already have a sufficient or excess timber supply from the excess of licences allocated," says Gray.

About 75 per cent of the island's forests are now mature or overmature trees, while immature trees, the forests of the future, account for only 25 per cent. Failure to properly manage these immature stands and ensure the renewal of existing forests could bring a decline in the island's forests by the year 2000, or even earlier if the ravages of the spruce budworm infestation continue.

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*The Trees behind the Shore: The Forests and Forest Industries in Newfoundland and Labrador*, by John A. Gray (Catalogue No. EC22-91/1980E; $9.95 in Canada, $11.95 elsewhere).

*Reverse mortgages*

# A new way to help pensioners

In the current debate about how to improve the financial situation of Canada's elderly, one possibility may have been overlooked. It's a plan that would help senior citizens to help themselves. It would probably not require government involvement, and it might help to relieve the growing financial burden of supporting an aging population.

The plan is a "reverse mortgage." Not a new idea and one that seems to be flourishing in other countries like Britain and France. But an idea that is almost unknown in Canada.

Most people think of a mortgage as a way of borrowing money to buy a house – an arrangement that requires the borrower to make a monthly payment. A reverse mortgage is a way of mortgaging a home to provide a monthly income to the borrower instead.

The advantages are obvious. Having worked for 25 years or more to pay off the mortgage on a house, many senior citizens end up with a very valuable asset. But that may be small consolation if income after retirement is so low that they are living below the poverty line. They either have to suffer a very low standard of living and end up leaving the valuable asset to their heirs, or they sell the home and move into rented accommodation, leaving themselves vulnerable to the ravages of inflation. A reverse mortgage would be a way of cashing in, in their lifetime, on the wealth they have accumulated.

Economists Henry Bartel and Michael Daly, in a paper published by the Economic Council, say that reverse mortgages would give elderly homeowners much more freedom of choice and let them use their own assets to help themselves. It seems ironic, say the economists, "that, faced with the rising costs and consequent financial strain of home ownership, the very act of parting with an interest in their home, through a reverse mortgage, may generate the income to financially enable senior citizens to remain there for the rest of their lives."

There are basically two types of reverse mortgage schemes. Both are ways of borrowing against a house. The straightforward reverse mortgage does not give any ownership rights to the issuing company. The homeowner gets a periodic payment, either for a fixed period of time or for life. The debt accumulates as a mortgage loan with the house as security and is worked out so that it does not exceed, say, 75 per cent of the current market value of the house.

Because the money is only a loan, the retired person would still be able to qualify for benefits under various income-tested public assistance programs. Interest on the loan varies with prevailing market mortgage rates – an added bonus in countries like Britain and the U.S. where mortgage interest is tax deductible.

National Film Board of Canada

Homes as a source of money

At some point, of course, the mortgage loan becomes due. If the due date is the death of the owner (or surviving spouse) the house can be sold to pay off the debt. If the loan was for a fixed period, it could be renewed for another term so long as the value of the house has gone up enough in the meantime.

The second type of reverse mortgage is a reverse annuity mortgage. In this case the owner takes out a mortgage on the house and uses the money to buy a lifetime annuity. Repayment is postponed until the house is sold – either at the death of the owner or before. A variation on this plan involves the outright sale of the house in return for a life annuity from the proceeds, and the right to continue living in the house, at a nominal rent, until death.

As with all annuities, the size of the monthly payment will depend on the homeowner's life expectancy. An elderly woman would receive a smaller annuity payment than an elderly man. But the older the homeowner is when the mortgage starts, the higher the annuity will be. The authors say that a minimum age of 69 is recommended for starting the plan because the annual annuity benefit at younger ages does not seem to be worthwhile financially.

Reverse mortgage schemes are not unknown in Canada. The Nova Scotia government recently put forward a plan to improve pensions for retired homeowners, using their houses as equity. And a trust company started offering fixed term reverse mortgages about two years ago.

But Bartel and Daly say that financial institutions seem reluctant to make reverse mortgages available. In some case, government regulation may prevent them from doing so. Only life insurance companies can offer lifetime contracts under current legislation, for example. As well, tax concessions on mortgage interest encourage these schemes in both the United Kingdom and the United States, but Canada does not have these incentives. Finally, there is the difficulty of convincing elderly homeowners, "who, quite naturally, tend to be extremely cautious," that this rather complicated and unconventional scheme could be beneficial to them.

Just the same, the authors say, these new financial instruments have proved successful in Britain and France and could be particularly beneficial to elderly women who are left without any pension income when their husbands die. Reverse mortgages "would not only increase the incomes of many elderly homeowners but also allow them to remain in their homes while at the same time providing some protection against inflation." And Bartel and Daly suggest that some form of tax concession should be introduced to encourage reverse mortgage schemes.

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"Reverse Mortgages: A New Class of Financial Instruments for the Elderly," by Henry Bartel and Michael Daly. Discussion Paper No. 188.

*Language barriers*

# Francophones do better now

It is still a cherished notion of some in Quebec, both anglophone and francophone, that things haven't really changed since Wolfe met Montcalm in 1759.

This view has it that Quebec society is a ladder with the English minority holding economic power at the top while the majority of francophones languish on the bottom, blocked from rising upward.

A study by Council economist Jac-André Boulet throws a damper on a number of favorite arguments about Quebec's power structure.

This exhaustive study of the income of Montreal's male labour force clearly establishes that there are now more francophones than anglophones at the very top of the income ladder. Boulet finds that francophone workers have made steady progress in acceding to the top jobs. In 1961, anglophone workers made up 56 per cent of the upper echelon. By 1970, 56 per cent of the top jobs were held by francophones and by 1977 this figure had jumped to 70 per cent.

More startling, the study found that the problem of income disparities between individuals of equal ability doesn't really exist among the majority of Montreal workers. In fact, according to 1971 figures income gaps only begin to appear among workers earning more than $11,000 per year, and most of the disparities, Boulet found, occur among


those four per cent of Montreal workers at the very top of the corporate ladder.

Boulet suggests that these remaining disparities among the privileged of the corporate hierarchy may never disappear. He says most of the differences in income at the top of the ladder are due to the presence there of highly paid anglophones from outside Quebec.

Usually recruited by corporations to work in their Montreal head offices, these individuals are highly experienced and therefore command higher salaries than most of their Quebec-born francophone colleagues. Boulet says that the persistence of a small degree of wage disparity may be the price Montreal has to pay for its role as a head-office city.

In the past, Quebec-born anglophones may have found it easier to gain access to the upper echelon of corporations through a network of communication and contact among anglophones in Quebec. Anglophones tended, through this network, to hear first about job openings or opportunities for advancement. A similar network, however, is now being created by the presence of francophones on the corporate ladder and should help francophones to make further progress. Boulet says that the closing of the income gap between 1961 and 1977 should be looked at cautiously before drawing conclusions. On the one hand, it is the result of the massive arrival on the labour market of the francophone generation that benefited from the reform of Quebec's education system in the 1960s. But it is also the result of highly paid anglophone executives leaving Quebec. In some cases, these executives left when their jobs were shifted to other parts of the country, and they were replaced by francophones who got lower salaries because they had less experience.

The study underlines the growing economic value of bilingualism in Montreal. Bilingual anglophones were at the top of the income ladder in 1977, followed closely by bilingual francophones and bilingual people whose first language is neither English nor French. Bilingual anglophones earned incomes 22 per cent higher than unilingual anglophones. The earnings of bilingual francophones surpassed those of unilingual anglophones by 10 per cent.

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*Language and Earnings in Montreal*, by Jac-André Boulet (Catalogue No. EC22-90/1980E; $9.95 in Canada, $11.95 elsewhere).

# New appointments to the

Pierre Lortie is a senior associate with SECOR, a Montreal consulting firm, and has served as consultant to several ministers in the Quebec government. A former professor at Laval University, he is chairman of the Montreal Chamber of Commerce and president of the Montreal Stock Exchange.

Alastair Ross is president and director of Allaro Resources Ltd. of Calgary, and chairman of the Canadian Energy Research Institute. Formerly president of Decalta Petroleum Ltd., he is also a past president of the Independent Petroleum Association of Canada, and Pembina Pipeline Ltd.

# Corporate accounts need changes

The 1980s is shaping up to be a decade of investment. But will business be able to make the kind of sound investment decisions that are needed to keep the economy going? The Economic Council has some concerns that it may not, unless substantial changes are made in the way corporate accounting practices and taxation rules deal with inflation.

In its 1979 Annual Review, *Two Cheers for the Eighties*, the Council warned that under existing Canadian tax rules, inflation imposes extra burdens on many corporations. The effect was substantial during the inflationary Seventies, and may have contributed to the inadequate level of investment in that decade, said the Council. "If the tax rules and accounting practices remain unchanged," the Council said, "they may similarly inhibit the ability and willingness of firms to invest during the Eighties."

Before any business can report a net return on its capital, it has to provide out of earnings for all the costs of maintaining that capital. And inflation can affect those costs in a number of ways:

- Assets depreciate over time. Annual depreciation charges are supposed to allow for this. But both conventional accounting practice and the income tax rules say that depreciation has to be based on what the asset cost originally and not what it would cost to replace it. Chronic inflation increases the gap between historical cost and replacement cost. As a result, both reported profits and taxable profits may be overstated. Firms may also not be able to set aside enough through accumulated depreciation to replace assets and so they may delay investment.

- The inventory valuation methods accepted for tax purposes in Canada imply that a firm puts raw materials into production in the approximate sequence in which they were acquired. When prices are going up rapidly, the cost of sales will tend to be understated, because it will not reflect current costs. This means that reported profits will probably be overstated in periods of high inflation. Taxing of these so-called inventory profits may encourage businesses to reduce their inventories.

- Inflation can also affect business borrowing and lending and the use of working capital. Interest rates go up when inflation increases so that a lender can maintain a real rate of return and preserve the purchasing power of the money lent. But the inflation premium that is included in the interest rate distorts the picture. The borrower has to pay more to cover inflation, so his reported income and cash flow are lower than they would otherwise be, and the lender's reported income is higher as a result. Management, shareholders and financial markets may then get misleading pictures of the real performance and financial health of both the borrower and the lender.

Can the stock market see through these conventional financial reporting methods to get an accurate picture of the collective corporate health? One school of thought argues that the market is not deceived by profit figures distorted by inflation, and that the value of shares reflects a realistic view of profits. But others argue that, although the market does take account of the inflationary impact on depreciation and cost of sales in determining profits, the real gains that a firm may make on outstanding debt are still not reflected adequately.

In any event, "how to adjust reported profits for inflation is a highly controversial question," said the Council in its 1979 Annual Review.

On October 15 and 16 this year, the Council will sponsor a conference on the problems of financial reporting and taxation during inflation (to be held in Toronto), at which interested representatives from large and small businesses, federal and provincial governments, industry associations and professional and labour groups will be invited to express their views and exchange ideas on the subject. For further information, please contact Eugene Nyberg, Adviser, Institutional Relations, Economic Council of Canada, P. O. Box 527, Ottawa, Ontario, K1P 5V6. Telephone: (613) 993-1550.

# Economic Council of Canada

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au Courant

Spring update on the Economy

# Looking Ahead

That's the task assigned by Parliament to the Economic Council of Canada when it was created in 1963.

Since that time the Council, drawing on the expertise of its staff of economists and other specialists, has consistently provided Canadians with the analysis of economic policies, possible alternatives and their effect on the country's economic prospects. The projections, policy analysis and recommendations formulated by the Council in the past decade have played a major role in shaping public policy.

The issues the Council deals with affect each of our lives. They include inflation and the erosion of our buying power, human resources planning for future jobs, the distribution of wealth among Canada's regions, and even the cost of taking a taxi in Montreal or the effect of the lowly spruce budworm on Newfoundland's economy.

We admit the Council isn't clairvoyant but it is all in all one of the best tools Canadians have for looking into their economic future and understanding their economic past.

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