au courant

Economic Council of Canada
Volume 2, No. 3 1982

New policy options for economy

Tax breaks on retirement savings
Council studies labour markets
Productivity of doctors

PUBLICATIONS

Eighteenth Annual Review

Room for Manoeuvre (EC21-1/1981E, $4.95 in Canada, $5.95 elsewhere).

Each year the Economic Council publishes a review of the economy and makes policy recommendations. With the help of the CANDIDE econometric model, Council economists develop basic projections of key economic indicators, and they try out various policy options. The 1981 review is now available in bookstores across the country, and may also be ordered from the Canadian Government Publishing Centre (see below).

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Ex Post Aggregate Real Rates of Return in Canada: 1947-76, *by A. Tarasofsky, T. G. Roseman and H. E. Waslander* (EC22-99/1981E, $4.95 in Canada, $5.95 elsewhere).

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Volume 2, No. 3 1982

Eighteenth Annual Review

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New projections for economy from Council's 1981 annual review

Each year the Economic Council of Canada publishes a review of the economy and makes policy recommendations. With the help of the CANDIDE econometric model, the Council's Performance and Outlook Group, under the direction of Ross Preston, develops basic projections of key economic indicators and then tries out various policy options to see how these projections might change. The material on the next eight pages is based on the 1981 Annual Review, "Room for Manoeuvre."

Canada's economic problems may not be as stubborn and unmanageable as everyone has thought. It now looks as if the federal government could develop effective policies to deal with the legacy of the 1970s and get the country back on a better growth path again. And it may even be possible to make more headway in the war against inflation if monetary policy does not have to fight the good fight all on its own.

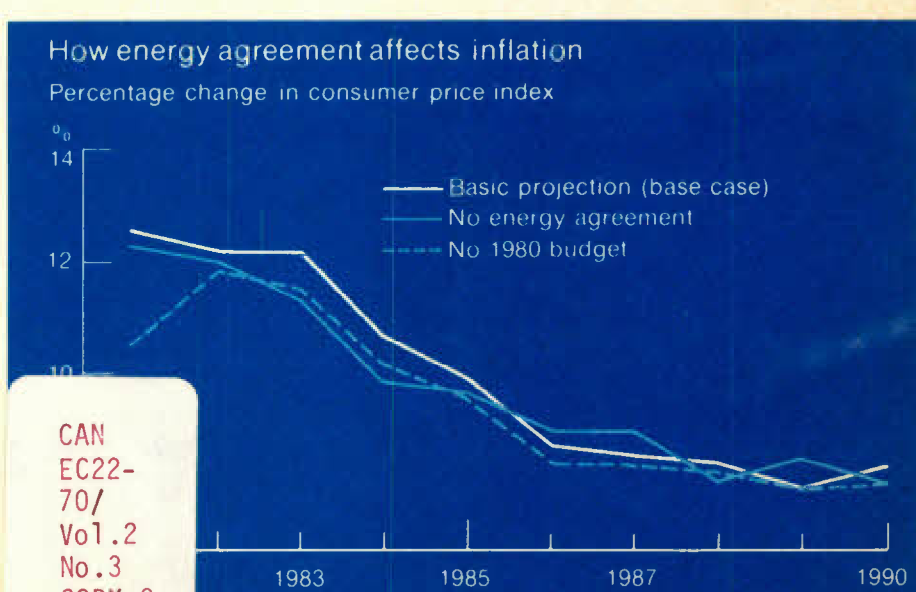
The note of optimism which is evident in the Economic Council's eighteenth annual review of the Canadian economy springs from the belief that the government now has more room for manoeuvre. And the opportunity is a direct result of the National Energy Program (NEP), launched with the October 1980 federal budget, and the signing of the Memorandum of Agreement on energy pricing and taxation between the governments of Canada and Alberta in September last year.

These two events, the Council says, changed the prospects for many key economic indicators. Although the energy agreement will increase inflation in the short term, the national energy program supported by the energy agreements will bring about a considerable improvement in the federal government's fiscal position and the problem of the federal deficit may no longer have to be the overriding policy consideration. The government should therefore be able to develop a strategy to tackle the country's two major economic ills – high rates of inflation, and an output level that is below the economy's potential.

As in previous years, the Council makes a basic projection of the key economic indicators, which it calls the "base case," founded on certain specific assumptions. It then uses this basic projection to try out various policy options to see how the economy would be affected by the different policies that might be chosen. The 1981 "base case" indicates moderate prospects for real economic growth and for employment during the 1980s; inflation getting worse for the next few years but improving somewhat by the middle of the decade; and a significant change in the outlook for the federal government's budget position compared with the previous year's assessment.

The assumptions on which these projections are based include an assessment of the impact of current monetary, fiscal and energy policies (including the September agreement between Ottawa and Edmonton), as well as the impact on Canada of many facets of the supply-side economics being implemented by the Reagan administration in the United States. It also includes an up-to-date reading (as of July 1981) of the prospects of Canada's major trading partners. Monetary policy in the U.S. is expected to remain very tight until the end of 1983, resulting in a period of unprecedented high short-term interest rates. By the end of the decade, these rates are expected to be down to the 10.5 per cent range.

The international price of oil is expected to reach \$102 a barrel (in Canadian dollars) by the end of the decade. But the Council does not share the optimistic view of the national energy program that consumers will

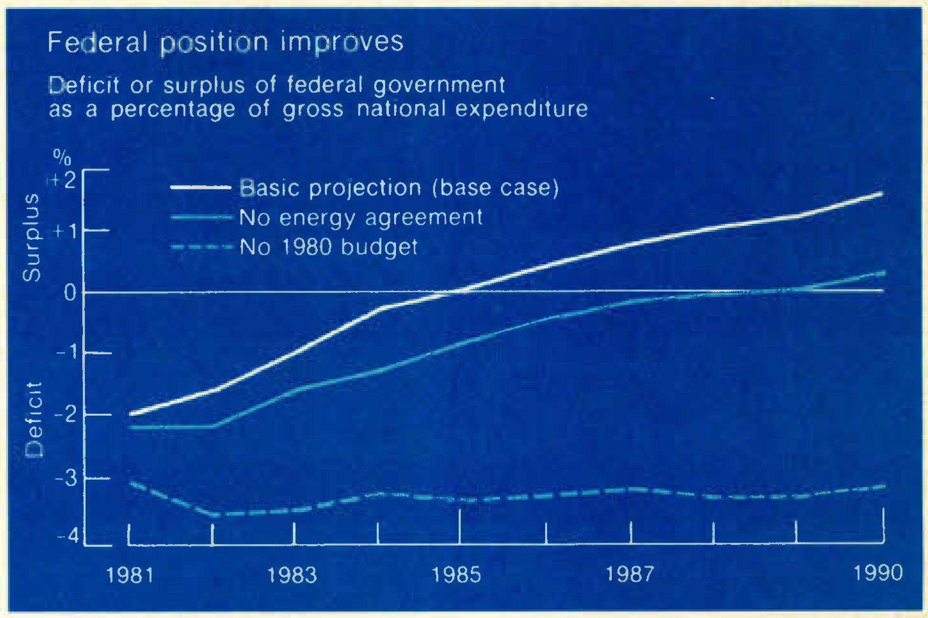


quickly switch to natural gas or electricity, thus eliminating the need for imported crude petroleum by 1990. As a result, Council economists say, the demand for oil will not decline as rapidly as expected in the National Energy Program. This, together with a slow start-up for the tar-sands projects will delay the achievement of oil self-sufficiency beyond 1990, according to the Council's calculations.

The "base case," then, reflects what lies in store for Canadians if there are no major changes in policy. The CANDIDE econometric model is then used to simulate how those prospects would change if particular policies are adopted.

Here are the highlights of the 1981 review's basic projections (what the economists call their "base case"):

- Phasing in of the large energy projects in the early years of the decade will result in higher real growth in the period from 1983 to 1986 and slower growth later. But compared with the 1960s and early 1970s, growth prospects are expected to be lower by about 1.2 percentage points. Performance could be improved if other large investment projects materialize, particularly later in the decade.
- Inflation (measured by the consumer price index) is expected to be in the double-digit range for the next three years, but will be down to about 8 per cent by the end of the decade.
- Strong real growth in the early part of the decade will make a dent in the unemployment rate, but the labour force will still be growing strongly so jobless rates could be on the rise again as Canada approaches the 1990s, unless additional projects are initiated.
- Productivity performance will not be good and will be substantially below the Canadian experience of the late 1960s and early 1970s. This is one of the more fundamental aspects of the legacy of the 1970s – although productivity growth may start to improve towards the end of the decade.
- There will not be much improvement in real wages in the first half of the decade – another legacy from the 1970s – but the situation looks better after 1985.
- Implementation of the National Energy Program and the energy agreement will contribute to a decline in the federal deficit. Provincial governments as a whole are expected to remain in surplus throughout the decade. But performance at the provincial level depends on the assumption that the renegotiated fiscal arrangements between the federal government and the provinces will not differ substantially in scope and funding levels from the existing agreements.



Federal position improves

Deficit or surplus of federal government as a percentage of gross national expenditure

Because the National Energy Program and the energy agreement between the federal government and Alberta play such a key role in giving the government more room for manoeuvre, Council economists carried out simulations to see what might have happened to the economy if these two events had not taken place. The results indicate that the September agreement on energy pricing and taxation will increase inflation, particularly in the next few years, and improve the budget position of the federal government. It will also reduce slightly the surplus of the provincial governments as a whole. The National Energy Program, which was part of the budget of October 1980, tended to reduce growth, to increase inflation and to make a dramatic improvement in the fiscal position of the federal government. The burden of financing the subsidy on imported oil for consumers in eastern Canada and the subsidy on synthetic oil was gradually switched from the federal government to consumers themselves.

But there have been other changes since the Council's 1980 review of the economy. For one thing, U.S. monetary policy has continued to be very restrictive and this has had quite a major impact. Interest rates turned out to be much higher than first expected, and the U.S. economy is now expected to put in a rather stronger performance than before. The 1980 annual review did not anticipate the weakening of world oil prices that resulted from the 1981 glut on world oil markets. The end result is a cumulative slowdown of 3.2 percentage points in real economic growth in Canada between 1981 and the end of the decade – a good deal of it associated with a reduction in investment activity.

The anatomy of inflation

The two major economic ills with which government policy must now deal are inflation and low economic growth. Council economists ran various simulations to try to identify the main reasons for the persistent high inflation that is expected for the next few years. They concluded that while there may be many reasons for the current high inflation rate in Canada, the most important influences in the coming decade will be inflation rates in other countries, wage and price expectations at home, productivity performance and the direction of energy prices.

The economists estimated the impact of seven possible scenarios on their basic projections for the economy and asked the question: What would happen to the inflation rate if:

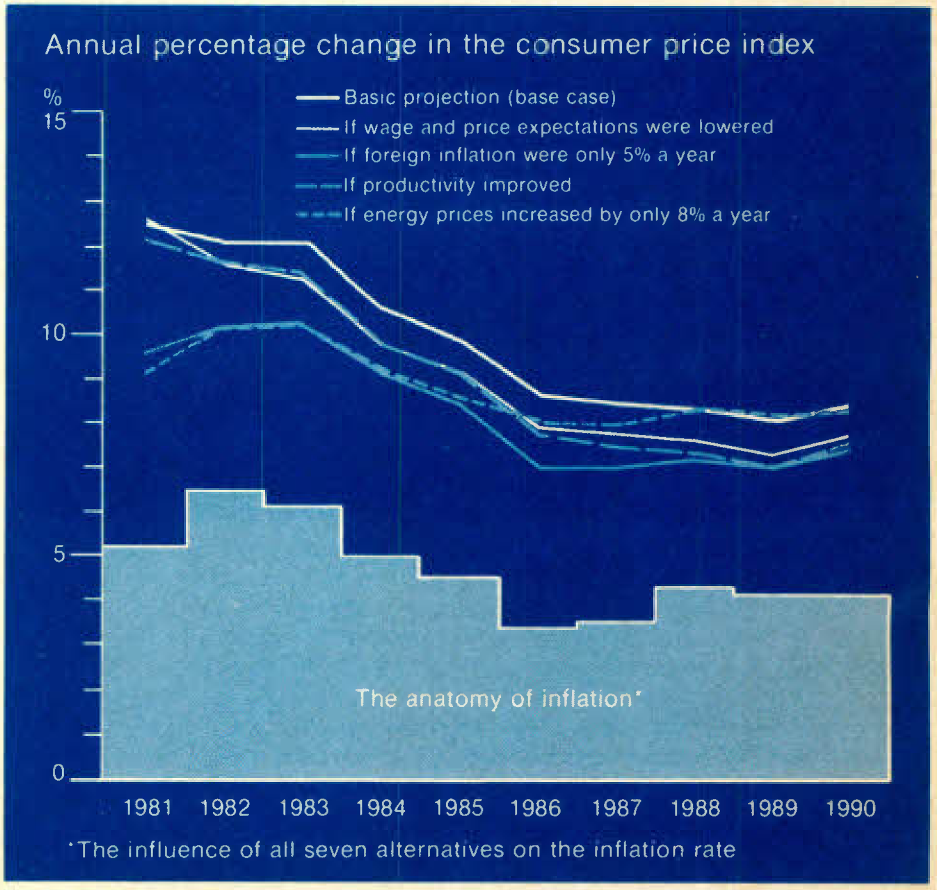
- Foreign inflation turned out to be lower than expected – suppose that it averages only 5 per cent a year?
- United States monetary policy becomes less restrictive so that U.S. interest rates are 3 percentage points lower than the basic projection assumed?
- The Bank of Canada tightened up its monetary policy more than expected so that the money supply grew at only 4 per cent a year instead of at 6 per cent?
- Productivity performance turned out to be better than expected?
- Labour markets were not as tight as projected so that the unemployment rate averaged 6 to 7 per cent instead of just below 6 per cent for the decade?
- Energy prices increased in line with all other prices – at about 8 per cent a year – instead of at a faster rate?
- Wage and price expectations changed so that people were not anticipating quite such high rates of inflation.

Although each one of these alternatives has some impact on inflation, the economists wanted to find out what was the influence of all the seven factors together. Through this analysis, they were able to identify what they called "the anatomy of inflation." The conclusion was that if all of those changes occurred at the same time, the Canadian inflation rate would be cut in half compared with the basic projection (which assumed no change in current policies.) The Council cautioned however, that this type of analysis probably underestimates the significance of monetary policy in the control of inflation.

To get inflation down to a rate of 4 to 5 per cent by the end of the decade would require much lower U.S. interest rates; money supply in Canada growing at around 4 per cent a year (the low end of the Bank of Canada target range); maintaining slack labour markets – in other words, higher unemployment; lowering expectations on incomes; better productivity growth; and domestic energy prices being kept in line with other components of the consumer price index. Some of these changes, such as U.S. interest rates, are outside Canadian control; others, like higher unemployment carry a high social cost; and in the area of energy pricing, the requirements would run counter to current policy directions.

That being the case, can inflation be reduced? The Council says it can, especially if other policies are brought into play instead of relying on monetary policy alone. "Certainly, a determined, persistent tight monetary policy will reduce inflation," says the Council, but "this process is widely recognized as entailing long delays." And the damaging effect this approach had on growth and employment opportunities in the past is well-documented. "Because inflation is the sum total of a variety of factors," says the Council, "what is needed is a broad approach to its solution, with less reliance upon a single policy."

How the inflation rate might change



New techniques for trying out policy options

"Significant improvement in Canada's economic performance can be achieved by changing the policy mix and making vigorous use of a variety of policy levers," says the Economic Council in its 1981 review of the Canadian economy. The monetarist prescription for solving Canada's economic ills now needs to be supplemented by other medicine, but the dosage need not be unpalatable. And now that the federal government seems to have more room for manoeuvre, other policy choices are open to it.

In the latter part of the 1970s, the main weapon used by many countries in the war against inflation was monetary policy. There was a strong feeling that the traditional armory of fiscal policy could not produce much of value to the battle and that, in any case, there were so many tradeoffs involved that it was just unrealistic to expect that all the objectives of economic policy could be met.

Economists at the Economic Council have used some new techniques to see just what those tradeoffs might be and what might be the rewards or penalties for achieving or missing the objectives that have been set. The results show that it is indeed possible to cope with such problems as inflation and economic growth, or inflation and the government deficit, at the same time, but it is going to require some major changes in the current mix of policies.

The basic projection for the economy over the next decade was made on the assumption that policies in effect in the fall of 1981 would not change. The results were not altogether discouraging. It would certainly be better if Canada could achieve a combination of lower rates of inflation and unemployment, higher rates of real growth and productivity, and further improvement in the fiscal position of the federal government and some of the provinces. The Council believes that it is possible to achieve these goals without deviating from the money supply targets of the Bank of Canada, without necessarily increasing the federal deficit or the deficit on the current account of the balance of payments, and without reducing the funding of social programs.

How can it be done? To figure that out, Council economists turned the traditional economic projection exercise on its head. First they chose a broad strategy – for example, one in which the two main objectives are to control inflation and to reduce the federal deficit. Then they selected five major economic indicators – the inflation rate, the federal deficit, the unemployment rate, the growth of demand for goods and services (real gross national expenditure), and the current account of the balance of payments. For each of these, they set targets consistent with the achievement of the objectives. Inflation should average no more than 8 per cent a year over the next four or five years, say, unemployment should average 6 per cent a year, and the total level of demand in the economy for goods and services (gross national expenditure) should increase at about 3 per cent a year, after allowing for inflation. In addition, they set limits for the growth of the money supply.

Having set these targets, the next step was to see what combination of policies would bring the economy closest to the targets. For this purpose, they examined five possible combinations – these are the policy levers referred to earlier. In each case, the projections arising from the basic set of projections (the base case) were changed in order to come as close as possible to achieving the targets. The analysis was made on a step by step basis, starting out with one policy lever, adding a second and then a third and so on:

- First, government spending on goods would be changed. (There would be no change in defence spending or on federal transfers to other levels of government or to individuals);
- Then in addition to the above change, changes would be made in indirect taxes, such as sales taxes;
- The next step would be to change corporate tax rates as well;
- As well as the above three initiatives, there could be changes in personal income taxes to help in achieving the targets;
- Finally, monetary policy could be eased slightly, but it would still remain within the Bank of Canada's target range for money supply growth, so it would not get too far out of line with the monetary policy being followed in the United States, and so there would not be undue pressure on the exchange rate.

Setting targets and identifying policy levers is traditionally an element of economic policy - making. The new element introduced here is the idea of examining a particular overall strategy and considering what policy mix might be used to implement it. Determining what might be the preferred strategy is really a question of political judgment – a decision as to what path might best meet society's needs, desires, capabilities, and constraints, as they are perceived through the political process.

Council economists examined in detail two possible strategies to see what policy mix would be necessary to achieve the objectives and what would be the impact on the economy of pursuing these particular goals. The first strategy concentrates on controlling inflation and reducing the federal government's deficit; the second strategy focuses on fighting inflation but at the same time stimulating economic growth, rather than making the reduction of the federal deficit a priority.

The results on this analysis are presented on the next two pages.

Output gap

Most economists are agreed that the Canadian economy is not achieving its potential – that is, the level of output that could be produced without creating undue inflationary pressures in the economy. There is perhaps less of a consensus on how to measure just what that potential is.

The Economic Council's 1981 annual review predicts that the gap between actual and potential growth will average \$7.8 billion a year (in 1971 dollars) for the first half of the 1980s and \$10.5 billion a year in the second half. The Council says that the persistence of the gap gives cause for concern and that action should be taken to correct it.

Policy options

Council economists analysed two possible overall strategies for the economy. In the first one, they assumed that the main objectives would be to control inflation and to reduce the federal government's deficit as quickly as possible.

The goals established for this exercise were to keep inflation down to an average of 8 per cent a year between 1981 and 1985, and to balance the budget of the federal government on average in the period from 1981 to 1985.

Targets were also set for other economic indicators, even though these were not to be the main focus of economic policy in this particular strategy. For the period from 1981 to 1985, these targets were:

- Real economic growth (after allowing for inflation) of 3 per cent a year – a rate consistent with the estimate of growth potential;
- An average unemployment rate of 6 per cent a year;
- Money supply growth that would be in line with the growth of gross national expenditure – that is, 3 per cent real growth plus 8 per cent inflation. This would give a maximum rate of growth for the money supply of 11 per cent a year, assuming there is no increase in the speed with which money changes hands (the velocity of circulation). If the velocity of circulation increases, this money supply growth target would have to be lower;
- The current account of the balance of payments would be in balance during the period 1981 to 1985.

The cost of eliminating the federal deficit quickly turns out to be very high. Unemployment would rise to 8.4 per cent of the labour force in the early years, compared with 7.1 per cent in the basic projection of the economy (the base case), there would be considerable loss of jobs and the gap between actual and potential growth might widen.

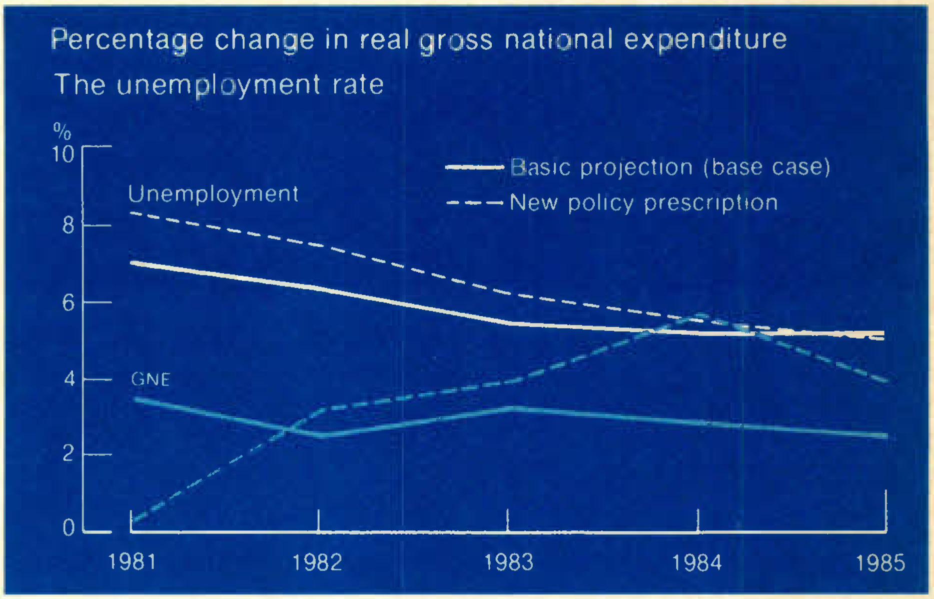
In looking at the five policy packages (outlined on page 6), here is how the basic projection would have to change to achieve the established targets:

- Government spending on goods would have to be reduced: indirect taxes would be reduced and so would corporate taxes; the growth in the money supply would increase slightly to give lower interest rates; and personal income taxes would have to be increased substantially.
- It will be hard to reduce inflationary pressures within Canada. In the short term, cutting indirect taxation on goods not related to energy might make a dent in the inflation rate. In the medium term, inflation might be controlled by encouraging investment in plant and machinery which would lead to improvements in productivity.
- According to these simulations, monetary and fiscal policy together would lower the inflation rate by only about 2.3 percentage points by 1983. Instead of a rate of 12.2 per cent projected in the base case, inflation could be reduced to about 9.9 per cent.
- Personal income tax rates would have to increase by an average of 25 per cent during the period from 1981 to 1985, to levels which, the Council says, most people would find politically unacceptable.
- As a result, a total of $9.6 billion of demand for goods and services (real gross national expenditure) would be lost over the five-year period. There would also be a cumulative loss of 1,215,400 person-years of employment.
- The higher personal taxes which would be needed to reduce the federal deficit quickly would mean a drop in the personal savings rate from 9.5 per cent of disposable income (projected in the base case) to about 7.4 per cent.

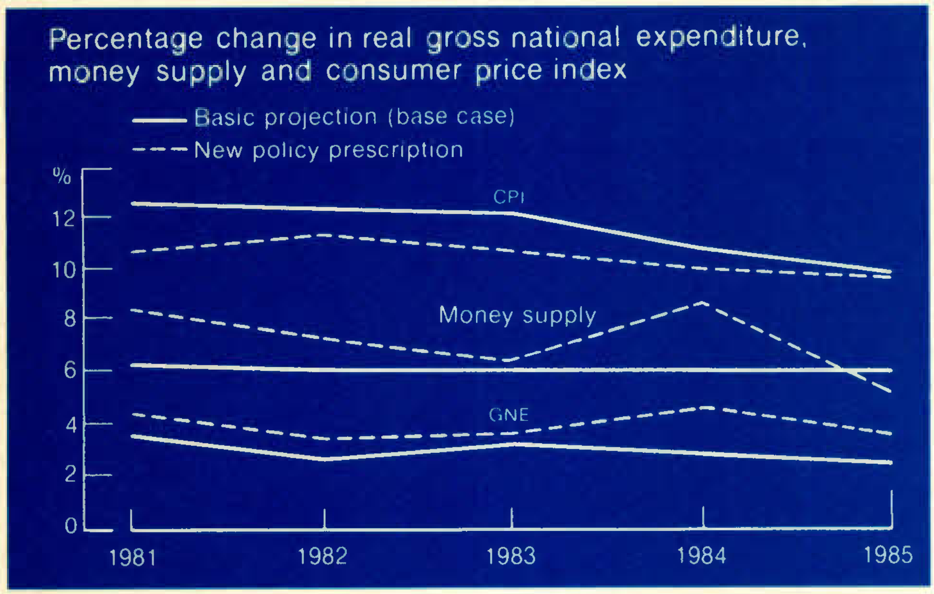
Summarizing the results of the exercise, the Council says that effective policies to improve Canada's economic performance will have to operate on both the demand and the supply side of the economy; otherwise, distortions will result.

Some people have argued that an easier monetary policy is inconsistent with the need to stabilize the dollar and control inflation, particularly in the short run. While acknowledging that there may be short-term constraints on monetary policy, the Council says that its results indicate that "greater emphasis on a different mix of fiscal policy could relieve monetary policy of some of the burden in this area, provide a much better performance in the achievement of inflation control and deficit reduction, and yet not deviate much from the mid-point of the target band currently established for monetary aggregates by the Bank of Canada," in the medium term.

Controlling inflation and reducing the federal deficit



Controlling inflation and improving economic growth



The fiscal position of the federal government is already well on the way to recovery as a result of the National Energy Program and the agreement between Alberta and the federal government, signed in September last year. In view of these developments, it might be more appropriate to choose a policy strategy that would give less emphasis to the federal deficit and concentrate more on closing the gap between actual and potential output – that is, the level of output that could be produced without creating undue inflationary pressures in the economy. This policy objective was, in fact, part of the second strategy that Council economists analysed in detail in the 1981 annual review.

The first step was to find out what level of demand for goods and services (gross national expenditure) Canada might realistically achieve by 1985. But there was already a gap of about $8.8 billion in 1971 dollars between actual and potential output in 1981. Suppose this gap were closed and the economy could start out the decade at a higher level of output. Having moved up on to a new higher path, suppose that the rate of growth from that point then continued to average 3 per cent a year. The result would be a particular level of output which the economists would like to reach by 1985. They then set a target of more rapid growth in actual output so as to close as much of the gap as possible by 1985, keeping in mind that it may not be possible to close the gap completely and still attain the other policy goals.

In addition, they assumed that unemployment would average about 5 per cent a year. In effect, this becomes "full employment" because at this lower unemployment rate, the resources of the economy are "fully employed" and further attempts to reduce unemployment would only increase inflation.

This is how the various policy levers would have to be adjusted from the basic projection to meet the objectives of this strategy:

- Indirect taxes and corporate taxation rates would be reduced;
- Government spending would remain unchanged;
- Personal taxation rates would increase only moderately, perhaps by about 6 per cent during the period from 1981 to 1985;
- Money supply growth would have to increase early in the period to the upper end of the Bank of Canada's target range so that interest rates could be lowered.

The results of the exercise may be summarized as follows:

- The changes in taxation would probably add about one percentage point to the real growth rate and close about 80 per cent of the gap between actual and potential output by 1985;
- The inflation rate would only be about one percentage point a year lower than projected in the base case;
- The unemployment rate could be brought down to 4.1 per cent by 1985;
- Lower interest rates would encourage investment activity. But lower interest rates and higher economic activity would also tend to weaken the Canadian dollar and add to inflationary pressures in the economy.
- Lower rates of corporate taxation would encourage investment activity, improve productivity and thus eventually tend to reduce inflationary pressures in the economy;
- Initially, the federal deficit would increase. And even if short-term interest rates were lowered by 2 to 3 percentage points, the deficit would still increase in the longer run.

In this strategy, as in the previous one, the question of monetary policy was examined very carefully. It had already been argued that if the mix of fiscal policy were altered and this, by itself, improved the inflation outlook, it would be reasonable to relax monetary policy. If reduction of the gap between actual and potential output were a priority, then allowing the money supply to grow at a higher rate and reducing interest rates might be appropriate. However, it would also be possible to achieve the same end by accepting a higher federal deficit.

In the early years of the decade, according to these simulations, the rate of growth in the money supply would be at the high end of the Bank of Canada's target range and in some years, it would slightly exceed this limit. It is only when the economy gets close to potential that growth in the money supply would fall back towards the low end of the Bank's target band.

Major change needed in economic policy mix

It will take a major change in the mix of economic policy to bring inflation under control and improve the real incomes of Canadians at the same time. But the Economic Council believes those objectives can be achieved and that the necessary policy changes should be made.

Such a change in policy mix would *not* mean abandoning the present monetary policy, which over the past few years has had to shoulder most of the responsibility for controlling inflation. But it would mean reinforcing monetary policy with tax and expenditure policies that would act on the supply side of the economy as well as on the demand side. And the emphasis on restraint of government spending would have to be maintained.

In other words, Canada has to be prepared to use a wider range of policy measures than it is using at the moment if it is going to control inflation and restore real growth.

The message of the Economic Council's 1981 annual review of the economy, which went to press before the release of the federal budget, was that economic policy should now concentrate on reducing inflation and restoring economic growth. Both of these objectives, the Council said, can be achieved without abandoning the present commitments to social programs. And, in fact, unless the economy gets back on a higher real growth path, government will find it difficult to maintain, let alone increase the real resources devoted to such programs in the 1980s.

At least some of the obstacles to such a shift in policy have been removed recently. The National Energy Program and the agreement on energy pricing signed between Alberta and the federal government last fall have opened the way to a considerable improvement in the federal government's fiscal position and given it more room for manoeuvre. But if the change in policy is going to be effective, it will have to be accompanied by a change in some of the perceptions about the economy.

Public discussion still centres on the federal government's deficit, for example, although the base case shows that there will probably be a substantial reduction of that deficit over the next few years, both in absolute terms and in relation to the country's total output of goods and services, the gross national product.

Many people seem to feel, too, that Canada has lagged behind the United States in developing policies to deal with difficult economic problems. But many of the elements of the supply-side economics recently introduced in the United States are already in place in Canada. Cuts in personal income taxes (Canada already has indexing of the personal income tax system which produces the same effect), increased capital cost allowances, and emphasis on savings incentives are all policies with which Canada is familiar.

> *"We believe that in the present context of high and stubborn inflation, the indexation of personal income taxes continues to offer distinct advantages. Certainly it imposes a discipline on governments, by forcing them to rely on discretionary tax increases rather than inflation in order to raise revenues, thus keeping the public more aware of government policy."*

Perhaps these policies have not been as effective as they might have been because of uncertainty over energy policy. But those uncertainties have been removed now. The change provides "a unique opportunity for instituting a range of new policy measures aimed at achieving a significantly stronger and more balanced economic performance than that which would result from a mere continuation of the present policy mix."

Perhaps most important of all, attention has to be focused on fiscal and monetary policy together and how they interact and relate to each other on both the demand and supply side of the economy, instead of concentrating on individual policies in isolation.

To put in place a strategy that would control inflation and improve economic growth would require reduced indirect taxation of non-energy goods and services, reduced rates of corporate taxation, continued restraint on federal government spending, and money supply growth close to 8 per cent a year, or the high end of the Bank of Canada's target range. This latter measure would suggest that domestic short-term interest rates should be about 2 or 3 percentage points lower than those of the base case. Depending on the importance given to reducing the federal deficit, personal income taxes might have to be increased slightly too.

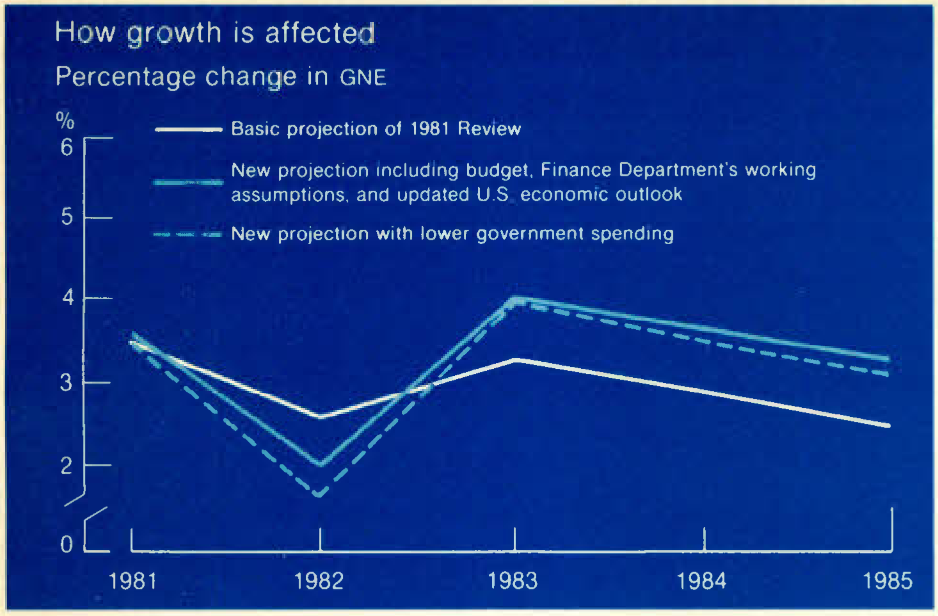
The proposed program attacks inflation both directly and indirectly from the supply side of the economy by restoring the incentive to invest, but it also works on the demand side and attempts to balance both aspects of economic policy to achieve the objective.

On energy, the Council says that "the federal government and the province of Alberta have not been timid in taking action that will result in higher energy prices to users." It might be wise to slow down the pace of Canadianization of the oil industry; otherwise this potential source of inflationary pressure may limit the scope of policy choice in other areas.

Essentially, the Council's message is that economic policy must move away from the attitude that restraining inflation is the only objective and that a restrictive monetary policy is the only way of reaching that objective.

The Council made six specific recommendations, including reduction of corporate taxes, continued restraint on government spending, reduction of indirect taxes on non-energy goods with monitoring to make sure that benefits are passed on to consumers, moderate increases in personal income taxes in 1983 and 1984, and a similar approach to changing taxes on the part of provincial governments. As well, it said that the federal government should have contingency plans to deal with the possibility of at least one sharp increase in world oil prices between now and 1990, and that explicit programs should be developed to help low-income groups cope with rapid oil price increases.

New projections reflect budget impact



The Economic Council's Eighteenth Annual Review of the economy and the policy recommendations, released in December last year, were prepared before the federal budget of November 12, 1981. Council economists developed additional projections to take account of tax changes proposed in the budget and the Finance Department's working assumptions about government spending and transfers to the provinces. The projections also incorporated a more recent (and more pessimistic) outlook for the United States economy.

The changed U.S. outlook alone meant that the basic projections (the "base case") of the 1981 review had to be changed. Because the Canadian economy is so closely tied to what happens in the United States, a sharper recession in that country would be expected to result in lower economic growth in Canada. And Council projections also showed lower inflation rates and higher unemployment for 1982 than was projected in the 1981 review. However, the quick recovery projected for the U.S. in 1983 is expected to bring higher real growth in Canada in the period from 1983 to 1985 than was projected in the annual review.

When the effects of the budget and of the Finance Department's working assumptions are included, growth in the economy's total demand for goods and services (real gross national expenditure) in 1982 is projected at 2.0 per cent instead of the 2.6 per cent expected when the 1981 review's basic projections were made. Real growth in the period from 1983 to 1985 turned out to be slightly higher than originally projected (see chart). Although the results showed a rather different growth profile over the five-year period from 1981 to 1985, with a sharper drop in 1982 and a bigger increase in 1983, cumulative real growth expected over the next four years remained the same as that projected in the 1981 review.

Both the changed U.S. outlook and the budget measures, together with the Finance Department's working assumptions about spending and transfers, mean lower inflation rates than originally projected, primarily because of the changed U.S. outlook for inflation. Instead of a 12.2 per cent increase in the Consumer Price Index (CPI) this year, Council projections now indicate an inflation rate of around 11.5 per cent for 1982. Inflation is projected to be down to the 9 per cent range by 1984, instead of the 10.6 per cent increase in the CPI which was originally projected for that year. New Council projections for 1985 indicate an inflation rate of just over 9 per cent, although the Finance Department's projection for that year (issued as part of the budget background papers) is 8.3 per cent.

In order to isolate the impact of the tax changes proposed in the November federal budget, Council economists developed a set of projections which included the Finance Department's working assumptions about spending and transfers to provinces, but excluded the effects of budget measures associated with personal, corporate and indirect taxation. They found that real growth improved. This suggests that the budget tax measures would depress real economic growth during 1982 and 1983, a consequence of the way in which these measures will dampen down the total demand for goods and services in the economy.

The changed U.S. outlook will tend to increase the Canadian federal deficit. But the calculations also showed that if the budget measures had not been introduced, the federal government's deficit might have approached 3 per cent of gross national expenditure (GNE) in 1982, instead of the 2.3 per cent projected when the budget measures are included.

The working assumptions on which the budget was based, besides implying slower growth in transfers of funds to the provinces, also make provision for reserves to meet future spending on programs and tax changes which have not yet been determined in detail. These unallocated funds could be spent for various purposes or they could be used to reduce the federal deficit or to reduce taxation. Council economists also developed a set of projections which assumed lower rates of government spending than the budget documents would imply, using the increased room for manoeuvre to reduce the federal deficit. These projections show a lower rate of economic growth than the other new projections which included the budget tax measures and all the working assumptions used by the Department of Finance in preparing the budget.

When the assumed government expenditures and transfers were reduced below the level of those included in the government's planning framework, the outcome was a projection for the federal deficit which was very similar to that projected in the 1981 review. The budget would be brought into balance by the middle of the decade, compared with a deficit amounting to about 1 per cent of GNE when the working assumptions of the budget were included. The policy question to be decided here is the importance of aiming for a target of reducing the federal deficit. And whatever the level of the deficit as a percentage of real gross national expenditure, decisions will have to be made on what priority should be given to expenditure programs or to tax reduction.

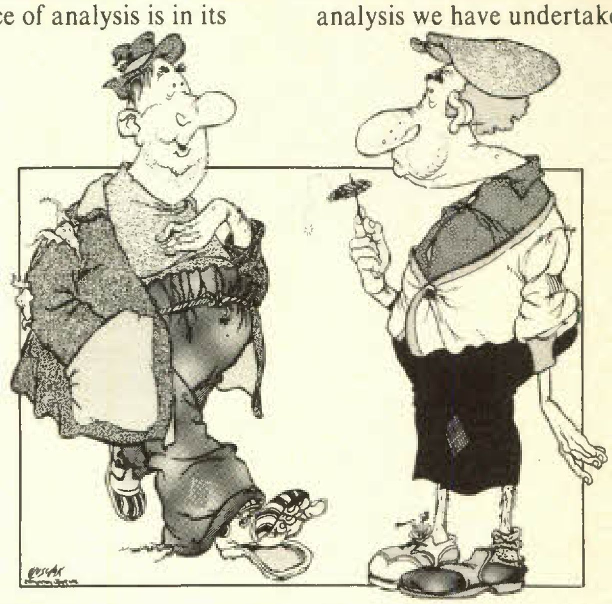
Council project in the works

Canada continues to suffer high rates of unemployment despite mounting, chronic shortages of skilled workers for many jobs. And the shortage of skilled workers persists despite federal manpower training programs, which each year spend $750 million teaching new skills to about 300,000 clients.

It was to find answers to the imbalances between unemployment and worker shortages that the Economic Council two years ago began a study of labour markets. That study is now nearing completion and a report is scheduled for publication this spring. *Au Courant* interviewed the director of the Labour Markets project, Keith Newton.

Au Courant: What were the concerns that led to the Council undertaking the present study of labour markets?

Newton: The Council has in the past undertaken work on a number of issues related to labour markets. This sustained interest in the field coincided with public concern over skill shortages and unemployment. The result was that, a couple of years ago, the Council decided to proceed with a major study of labour markets that examines the structure of the Canadian labour market, demographic changes that are affecting it, and other related issues.



Uluschak, The Edmonton Journal

"Great news! I'm no longer unemployed — I've been seasonally adjusted!"

Au Courant: What changes have you found in the present labour market from what it was in the 1960s and 1970s?

Newton: Well, first of all, there is a big difference between the labour market in those two decades. In the 1960s, unemployment was never *higher* than 5 per cent while in the 1970s, it was never *lower* than 5 per cent. The question was then to understand the reason for the deterioration in performance through those decades and therefore arrive at a view of the labour market of the 1980s. A major conclusion is that the composition of the labour market of the 1980s is vastly different from what it was. The common view that the labour force is made up of a majority of prime-age male workers who are the heads of families no longer holds. In the labour market of the 1980s, these men are greatly outnumbered by women workers and young people. This has tremendous implications for a range of policies, from the type of jobs that should be created to the types of training programs that need to be put into place to serve this changing work force.

Au Courant: What does your study reveal about the nature of unemployment?

Newton: Most of the burden of our unemployment is actually concentrated on a small group of the unemployed, perhaps about 16 per cent who are actually out of work on a long-term basis and probably account for about 45 per cent of all the measured unemployment. I think the importance of this particular piece of analysis is in its implications for policy because, if you think that unemployment is largely short-term and largely voluntary in nature, then the kinds of policies that you would tend to bring to bear would be things that would give people an incentive to search for jobs more intensively or more quickly and move to new jobs faster. If, on the other hand, you understand that a significant part of unemployment is long-term, then you start to look at structural causes of unemployment, or causes originating from a lack of demand in the economy. That suggests a whole different set of policy implications.

Au Courant: What are the causes of long-term unemployment?

Newton: It is fair to say that duration is related to the economic environment. There is a definite regional pattern and also a cyclical pattern. When economic conditions are plainly adverse, either because a particular location is having a bad time or because of recessionary conditions generally, then duration lengthens and the concentration of people in long-term unemployment increases. The policy implications are for the importance of job-creation policies, on the one hand, and manpower training policies, on the other.

Au Courant: What do you see as being the effect of your study?

Newton: On the one hand, we want to bring to the attention of Canadians generally, and policy makers in particular, some of the new insights which we think are afforded by the kind of analysis we have undertaken. And, in particular, we are anxious to make some recommendations for change that we think could contribute to the efficient functioning of the Canadian labour market.

Au Courant: How is the job market of the future going to differ from the past?

Newton: As mentioned earlier, the composition of the work force will have changed; there will be a majority of women and young people. The types of jobs coming on stream will also change. There will continue to be a big increase in employment in the service sector with consequent effects on such things as job training.

Training itself will figure more prominently in the future. It will become a lifelong process. People will leave jobs periodically for training sessions to assist them in adjusting to a labour market where types of jobs will change rapidly on account of technological change and adoption of new production methods.

Doctors' output varies among provinces

Maybe the air in certain parts of Canada has special therapeutic qualities. That might explain why people live longer in some areas than in others. But it can't account for the discovery that doctors in some provinces – Newfoundland and Saskatchewan, in particular – are more productive than their colleagues in other provinces, such as Nova Scotia and British Columbia.

So economists Ludwig Auer and John Menic found when they compared the provincial output of physicians – in terms of services provided – between 1974 and 1976. Carried out as part of the Economic Council's study of productivity for its seventeenth annual review (released in the fall of 1980) and for the forthcoming study of federal-provincial fiscal arrangements, their analysis focuses on this particular aspect of productivity performance in the health-service industries.

According to the authors, Canadian doctors were paid close to $2 billion in 1975, roughly one-sixth of the total amount spent on health services then. Provincial spending on physicians' services in that year varied widely though, ranging from $54 per capita in Newfoundland at one extreme, to $118 per capita in British Columbia at the other.

Part of the explanation for these differences, the authors explain, lies in provincial variations in the number of doctors per thousand people, in the degree of medical specialization, and in the fee charged for different services. And part is caused by provincial variations in the output of the doctors.

To make possible a cross-province comparison of output alone, the economists adjusted their calculations to put doctors in each province on a full-time, fee-charging basis, grouping them into 18 different specialties, and assuming that they each charged the Canadian average fee instead of the various provincial fees for each of 116 activities. Measuring the quality of service provided was more difficult. The authors based this aspect of their analysis on provincial differences in the mortality rate following surgery, in infant mortality rates, and on length of stay in hospital.

Their results are both surprising and interesting. The productivity of doctors apparently varies by as much as 23 per cent among the provinces. Newfoundland physicians lead the pack, with an output running at 13 per cent above the Canadian average, followed by doctors in Quebec at 6 per cent higher than average. In comparison, physicians in Ontario, New Brunswick and Saskatchewan turned in an about-average performance, those in Manitoba, Nova Scotia and Alberta were below average, and B.C. physicians had the lowest output at 10 per cent below the national average.

Highly productive general practitioners and medical specialists in Newfoundland accounted for most of that province's strong performance, while the weaker showing of British Columbia, Alberta and Manitoba came from not only GPs and medical specialists, but from surgeons and anesthetists as well.

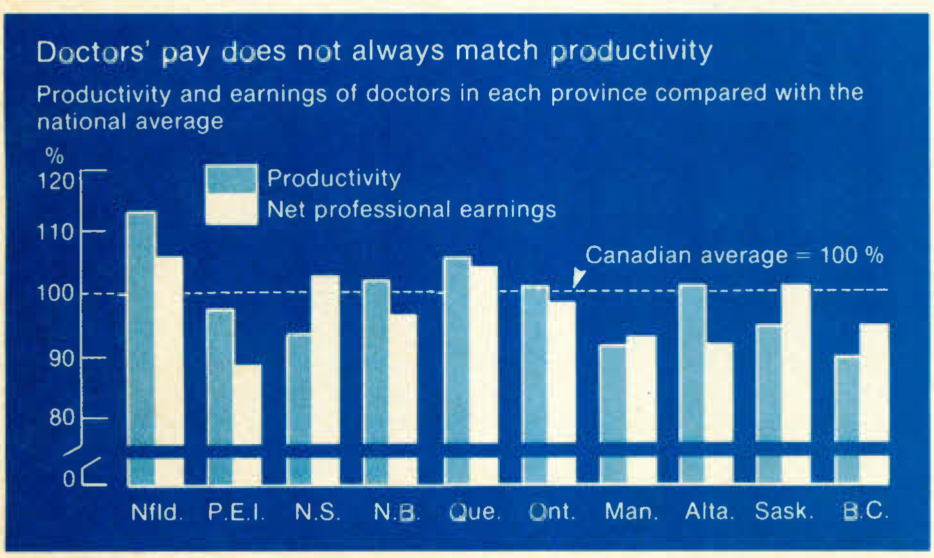
What's particularly fascinating about these results, the authors say, is that they run counter to those produced in an earlier analysis of productivity in the goods-producing industries. There, productivity performance was found to be consistently above the Canadian average in British Columbia, Alberta and Ontario, and below average in Quebec and the Atlantic provinces. The implication, point out Auer and Menic, "is that physicians in some of the high-income provinces have a lower output than their counterparts in some of the low-income provinces."

But are doctors paid according to their output, as proved in general to be the case for workers in the goods-producing industries? Apparently not, the authors find. As the chart shows, physicians in some provinces are underpaid in terms of their productivity performance, while others are overpaid, sometimes substantially.

And taking quality of service into account doesn't explain why this is so, they claim. There's no convincing evidence, say the authors, that patients received poorer care in provinces where doctors were paid less than their output warranted, or better care in areas where incomes outstripped productivity.

On the other hand, provinces did vary in the standard of care they provided, their results show. The chance of surviving surgery is at least 10 per cent better than average in some of the provinces, and at least 15 per cent poorer in several others. Infant deaths attributable to injuries at birth varied among the provinces even more. Post-operative care varied too. Patients in some provinces spent much more time in hospital following an operation than those in others.

When Auer and Menic looked into the question of regional differences in availability of medical services, they found that, despite federal and provincial funding, certain regions still provide a higher level of medical service than others. In this respect, the Atlantic region and the Prairies are 10 to 25 per cent below the national average.



"Provincial Variations in the Productivity of Physicians in Canada, 1974-76," by Ludwig Auer and John Menic. Discussion Paper No. 205.

Reforming Regulation

Political considerations

What prompts a government decision to give subsidies to theatre groups, say, or create agricultural marketing boards, or set product safety standards, or meet other policy objectives with a different approach? Understanding why these wheels are set in motion, and what motivates politicians to choose one policy instrument over another, is central to the whole issue of regulatory reform, say four University of Toronto professors.

In a paper written for the Economic Council's study of government regulation of the economy, Michael Trebilcock, Douglas Hartle, Robert Prichard and Donald Dewees contend that politicians are influenced by a whole grab bag of considerations when they decide how to implement policy. To begin with, their course of action may be limited by constitutional or legal constraints. But political pressures play an important role too. Whenever possible, the authors say, a governing party will pick policies conferring the greatest benefits on key voters – or on interest groups with voter influence – particularly at election time, while passing on costs to less critical voters.

And when a potentially unpopular policy has been chosen, a governing party will often try to disguise the fact, by appeasing or distracting voters with a symbolic gesture, or convincing them through an information campaign. Or it may assign administration of the policy to an "independent" government agency which can deflect criticism. At all times though, the authors say, politicians will favour strategies and governing instruments that emphasize the gains a policy offers, while downplaying the problems.

Reformers of regulation need to understand that some reforms will never be acceptable because of these political constraints, the authors say, and they should be looking instead for options politicians can live with.

As well, they point out, it's important to remember that decision makers have a wide range of policy instruments to choose from, so they can easily substitute one approach for another whenever they run into opposition. Reform of regulation will need to cover as wide a territory as possible, to allow for this kind of substitution, the authors caution.

To illustrate their theory, they analyse a number of cases in point, including the use of regulation to promote Canadian content in broadcast programming, and regulation and taxation policies to collect profits from the production of crude oil.

The Canadian government's intervention in the broadcasting field has been carried out, the authors say, with the proclaimed intention of promoting a distinctive national culture. To achieve this policy goal, decision makers in the federal cabinet relied on two policy instruments: public ownership through the Canadian Broadcasting Corporation (CBC); and government regulation by way of the Canadian Radio Television Commission (CRTC). In theory, both organizations are there to further Canadian unity and guarantee the continuing expression of Canadian identity, as required by the Broadcasting Act. To that end, regulations were enacted by the CRTC requiring broadcasters to include substantial Canadian content in their programming, particularly during prime time hours.

The Economic Council's report on government regulation of the economy was published in June 1981 and featured in the last two issues of Au Courant. On these four pages, we present reports on some research papers prepared as part of the study, along with highlights from a recent conference on regulation held in Vancouver.

In practise, this objective has not been met, the authors contend. Pressure from the private broadcasting industry has meant that Canadian content regulations have been watered down considerably in strength. A rule change redefining prime time as the hours between 6 p.m. and midnight (instead of from 7-11 p.m.) has allowed broadcasters to show Canadian programs outside peak viewing periods; and a change permitting broadcasters to average their programming over the year has enabled them to relegate many Canadian shows to the unprofitable summer months.

But in terms of rational political action, say the authors, the approach taken makes good sense. The symbolic appeal of the Canadian content policy remains untouched, satisfying most cultural nationalists, who are largely unaware of the more complicated results and implications of the guidelines. At the same time, the most influential interest group, the broadcasters, which bears the financial costs of the policy and so expects real benefits, has been pacified by subtle modifications in the rules.

Both the federal and the Alberta government have a keen interest in acquiring the surplus revenues – those remaining after costs are paid – resulting from oil production. And both governments must satisfy different constituencies in the use they make of these revenues, the authors say. Fundamentally, they claim, the federal government is keenest to confer benefits on the key ridings of southern Ontario, by promoting growth in eastern manufacturing, whereas Alberta's interest lies in directing revenues towards its own citizens and business interests.

So in deciding on policy objectives and their implementation in this field, federal and provincial politicians have to consider not only what constitutional authority they have, and what approach is most efficient, but also what political spin-offs might result.

The issue is complex, but on political grounds alone, the authors find the federal government has a clear interest in keeping energy prices below world levels by price regulation. This policy benefits manufacturing interests and consumers. The losers are the Alberta government and the oil companies, but the blow can be softened by giving certain tax concessions to the oil companies. Allowing producers to deduct certain exploration and development costs, along with some of their production profits, gives them a substantial concession without attracting much notice. While benefiting the oil companies in this manner, the federal government can also take a tough visible line by refusing to allow producers to deduct royalties paid to the provinces.

"The Choice of Governing Instrument: Some Applications," by Michael Trebilcock, Douglas Hartle, S. Prichard and Donald N. Dewees." Technical Report No. 12.

Another view of farm incomes

National Film Board of Canada

Commercial farms do better

It's time Canadian farmers started taking credit for their success – at least according to George Brinkman of the University of Guelph. In a study undertaken for the Economic Council and The Institute for Research on Public Policy in connection with the Council's work on regulation, he says that commercial farmers in particular "deserve to be recognized as good managers and as some of the most successful small businessmen in Canada."

The study covers the period from early to mid-1970s and paints an encouraging picture of conditions down on the farm. The great majority of farmers, it says, were, by the mid-1970s, pulling in a decent income and getting a fair return on their investment in time, labour and capital.

Not all farmers, though, were in this happy position, nor was the overall situation entirely rosy. Although the study was written before the recent period of soaring interest rates and extreme cash flow difficulties facing many farmers, some groups and regions were noticeably worse off than others, even in the mid-1970s. Poor farmers, most often owning small farms and lacking other sources of income, were concentrated in the Maritimes, Newfoundland and Quebec, although pockets can be found in every province. Also, farmers can't rely on a stable income from year to year, unlike other groups. And recent high interest rates have taken their toll too, raising costs, and discouraging young would-be farmers from starting out.

Still, as of the late 1970s, most farmers had seen their earnings improve steadily from 1973, Brinkman says. Farmers running large commercial operations (roughly 30 per cent of the total) have done best of all. And their situation is of some importance, because they account for 80 per cent of farm food production. But smaller-scale farmers on the whole were also earning satisfactory incomes, especially those holding a second job off the farm.

Reports claiming that farmers suffer from inadequate living standards come about, Brinkman says, because analysts tend to look at net farm incomes (which panned out at just over $4,000 on average in 1979, for example). For a number of reasons, though, this average is misleading, the author argues. First of all, it includes the earnings of hobby farmers, who often record net losses over the year. But few serious farmers are members of this group, Brinkman says; most, in fact, have a healthy income from another job.

Too, calculations of net income do not reflect some income-related benefits farmers receive. For example, they can treat their farmhouses as part of their business for tax purposes, by including the purchase price in business costs, and by deducting mortgage payments, taxes, and some home repairs as business expenses. And they save money too, by producing their own food. These savings are a form of hidden income, Brinkman argues, and as such, they should be included in calculations of farmers' welfare.

Thirdly, there's a good argument for including capital appreciation – the increase in value of assets such as land and buildings – in calculations of farm profits, Brinkman says, even though farmers don't usually cash in on these benefits until they stop farming. Even so, these assets mean that farmers may not have to save as much as others for retirement, and they have a sure source of collateral for borrowing money – two pluses other workers lack.

And not to be forgotten, Brinkman adds, is the soaring value of farm land in recent years, particularly in Ontario, Saskatchewan, British Columbia and Alberta. By the late 1970s many Ontario farmers who started out ten years before had tripled their original investment, Brinkman's figures show. On the other hand, the adage that farmers "live poor and die rich" has some truth, he says, so programs teaching them how to capitalize now on these assets may be in order.

When hidden income benefits and increases in capital appreciation are included in estimates of farm income, Brinkman's results show that in 1976, after accounting for inflation, small farms (with sales under $10,000) recorded average after-tax earnings of $22,000, and large farms (selling more than $50,000) brought in almost $54,000 on average. In many cases farmers, especially the large operators, are doing much better than urban workers and self-employed business people, the author found.

Whether this income represents a fair return on the investment farmers make in terms of labour, management, and capital is another question, Brinkman says. In other words if farmers are putting twice as much into their business as non-farmers, are they earning twice as much? Little analysis has been done in this area, but an Ontario study indicating that commercial farmers in that province were not underpaid for their efforts between 1971 and 1974 probably still holds there, and in some other provinces as well.

These results have many implications for agricultural programs and policies, Brinkman says. For one, they suggest that there is little justification for expanding agricultural assistance programs that tend to direct most of their benefits to the largest commercial farm enterprises. Instead, he suggests, special programs to assist small farmers feeling the pinch may be more appropriate. As well, he says, more attention should be paid to the question of capital appreciation and how it affects income security. Another consideration, he notes, is whether two classes of farmers are being created by virtue of current policies: the children of farmers, who inherit property without paying succession duties, and with it a financial base and a credit rating; and the others, who must fend for themselves.

Farm Incomes in Canada, by George L. Brinkman (EC22-97/1981E, $7.95 in Canada, $9.55 elsewhere).

New ideas for the fishery

The key to a prosperous fishery lies in cutting back on regulation and giving free enterprise a chance.

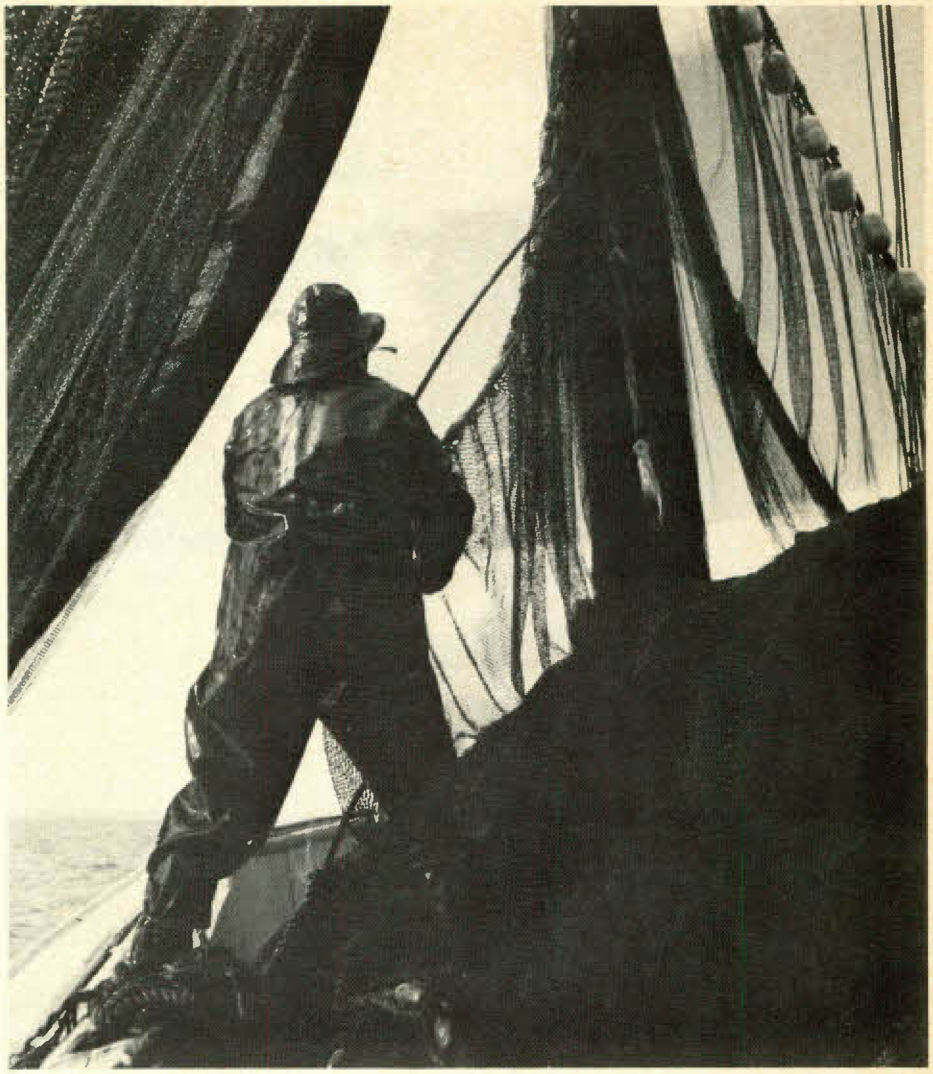
So say Anthony Scott and Philip Neher in a recent study undertaken for the Economic Council's report on regulation. They build on six case studies (on lobster, halibut, salmon, cod, roe herring and herring) to come up with a new proposal that they say will benefit the industry and consumers alike, by increasing efficiency and reducing costs.

Some regulation will always be necessary with a common property resource like the fishery, Scott and Neher begin. Without rules, fishermen would crowd the waters, rapidly depleting fish stocks. But as it is now a regulatory monster has been created. The nightmare of complicated and weighty rules that has grown up is so overwhelming, the authors claim, that "... in many cases the most honest fisherman cannot bait a trap, drop a line, or set a net without breaking some law."

Even with the best will in the world, fisheries officials responsible for administering the Fisheries Act and all its regulations can't enforce the rules uniformly. Administration costs too have become staggering. The fishery cries out for reform, the authors say, and their solution is to put its management, as far as possible, in the hands of those with the biggest stake in its prosperity – the fishermen themselves.

Put very simply, the authors propose dividing the total allowable catch (TAC) for each species of fish into shares or quotas, to be sold eventually on the open market. Share purchasers would have the right to catch a specified number of fish under controlled conditions (in the right season, for example, and using the appropriate fishing gear). Shares would be freely tradable too, so that fishermen could switch to a new area or species with ease. In effect, this tactic would make the fishermen part-owners in the industry, with a real incentive to see it do well. Individual freedom and initiative should flourish as a result, the authors say, and the most efficient use would be made of capital, labour and resource potential.

Fisheries and Oceans



Who should manage the catch?

Underlying this free enterprise system, the authors envisage a regulatory structure based on two distinct and independent institutions. The first, a Fisheries Management Branch (FMB) would be established in various regions to manage fishing activity and assets, by setting the TAC for each species, dispatching boats and opening and closing fishing areas.

The second, the Fishery Rights Registry Office (FRRO) would record ownership of shares in each TAC. Potential buyers or sellers of these quotas would be able to check on market conditions through this registry, a set-up greatly to the advantage of fishermen not in close touch with one another.

There are some real advantages to taking this approach, the authors say. First, it depersonalizes and depoliticizes management of the fishery. Right now, on-line managers – the fisheries officials – can make regulatory decisions on fishing areas, gear type, and so on that benefit some fishermen at the expense of others. And fishermen can easily use their political power, by voting, lobbying and negotiating, to persuade managers to bend the rules in their favour. But under the new system managers would know only how many quotas were held in a particular TAC (by checking with the FRRO) without any idea how or by whom the permitted fishing would be done. "Just as the passenger is unable to help a particular taxi driver by phoning the dispatcher for a cab," the authors explain, "so the fishery manager will be unable to affect the fortunes of particular fishing boats by his decisions."

Too, fishermen would have a new source of wealth from the ownership of fishing rights. To get the the system going, the authors advise giving (or selling) catch quotas to owners of current vessel licences. From then on, though, share-owners could buy available rights to fish other species as well; and they could lease, loan, or give away their shares through the FRRO. Foreign boats could only cash in on this system by buying or renting a quota.

Finally, this system allows the catch to be brought in with less overall effort and cost, so consumers should benefit too, from cheaper fish prices.

The authors expect some fishermen to lose out when this new plan takes effect, particularly in its early days. But unemployment shouldn't grow in the long run, despite what some critics say. Still, Scott and Neher suggest innovators should move cautiously at the outset to avoid alarming the industry. One possible approach might be to try out the new system in two model fisheries, one on the east coast, and one on the west.

The Public Regulation of Commercial Fisheries in Canada, by Anthony Scott and Philip A. Neher, editors. (EC-98/1981E; $5.95 in Canada, $7.15 elsewhere).

The following case studies used in compiling this report, can be ordered from the Communications Division at the Council (see ordering information on page 2).

"Regulation of the Bay of Fundy Herring Fishery," by H. F. Campbell

"Regulation of the Pacific Halibut Fishery," by A. Crutchfield

"Regulation of the Pacific Salmon Fishery," by J. D. MacDonald

"Regulation of the Northern Cod Fishery of Newfoundland," by G. R. Munro

"Regulation in the Maritime Lobster Fishery," by A. Scott

"Regulation of the British Columbia Roe Herring Industry," by James E. Wilson

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Vancouver conference

Current regulations designed to prevent massive overfishing on the east and west coasts of Canada create economic waste in that too much capital and labour are being employed to catch fish, David Slater, chairman of the Economic Council of Canada, told a recent conference in Vancouver.

Dr. Slater was one of the speakers at the last in a series of conferences held through the summer of last year to discuss the Council's report on government regulation of the economy, *Reforming Regulation*.

The conferences were a joint effort of the Economic Council of Canada and The Institute for Research on Public Policy, and were attended by representatives from business, government, labour and universities. Workshops were held on various sectors dealt with by the report, including telecommunications, fisheries, agriculture and transportation.

The problem in fisheries is not one of too many regulations, but rather the need to design a different set of regulations in which market incentives would play a greater part than they do in the present system, said Dr. Slater.

"Most of the regulations designed to prevent massive overfishing take the form of seasonal and complicated gear restrictions, and vessel licensing – restrictions on effort rather than output. This has led to far too much capitalization on the west coast and too many fishermen on the east coast."

In its report, the Council recommended that a simpler and more efficient regulatory scheme for the fisheries would be to permit the buying and selling of catch quotas, consistent with overall estimates of the total allowable catch.

Chuck Cook, M.P., addresses the conference

Chuck Cook, Conservative Member of Parliament for North Vancouver-Burnaby, and former vice-chairman of the House of Commons Special Committee on Regulatory Reform, told participants that, among other things, reforming government regulation of business activity could help save Canadian business millions of dollars. He said it now costs business $500 million a year to satisfy government requirements for keeping records. A bill now being prepared for introduction in the House will cut back that burden, relieving business of a least $100 million in costs, said Mr. Cook. The saving, he said, "hopefully might get passed to consumers."

Susan Burns, representing the Consumers' Association of Canada, "commended the report's recommendation to remove barriers that forbid the use of customer-owned equipment on telephone company networks." She compared telephones to toasters, saying there was no special rationale to permit anyone to limit the choice of consumers in buying one or the other.

Ms. Burns criticized the report for not having gone far enough into such areas as telephone rate structures, the principle of user-pay fees, and regulation of the broadcast industry.

Both B.C. Telephone and the Telecommunications Workers' Union defended the company's monopoly on equipment rentals, claiming it helps hold down monthly residential phone rates.

Union president, Bill Clarke, noted that the Canadian Radio-television and Telecommunications Commission has scheduled hearings on the question of terminal attachment. He criticized the Council for reaching its conclusions and publishing them in advance of these hearings and "without hearing evidence from many quarters."

Peter Pearse of the University of British Columbia told the conference that "the most staunch protectors of regulation are the regulated." Furthermore, he said, the federal bureaucracy is not seriously interested in deregulation because one of the effects would be to trim its present size. It is precisely those businesses which are the most regulated, including taxis, trucking and agriculture, which most vociferously oppose deregulation, he said, because they have the most to gain from the present system.

The Vancouver conference marked the end of a series of three conferences on regulation held by the Council last summer. Previous conferences took place in Montreal and Toronto.

The aim of the conference was to encourage public debate of issues raised by the Council's report and help build public support for the process of reforming regulation.

Tax breaks on retirement savings

Saving for retirement isn't made easy for people with low incomes. It's harder for them to put any cash aside for that purpose, of course. But also they aren't given the same incentive to save as higher-income earners, who profit much more from measures like the tax deductibility given to Registered Retirement Savings Plans (RRSPs) and private pension plans.

Economists Michael Daly and Peter Wrage, in two papers written in connection with the Economic Council's report on pensions, look at how successful Canada's present retirement income system has been in encouraging people, regardless of income level, to save for their retirement. This is an important question, they say, because the savings individuals put aside for that purpose now make up a major part of the country's total savings; so any shifts in the pattern caused by changes in public or private pension programs could have important implications for Canada's economic growth and stability.

With that in mind, the authors focus on two particular aspects of the present system: the effect on saving for retirement of income tax incentives, such as the special personal exemption given to those over 65, and the tax deductibility of contributions to private pension plans and RRSPs; and the impact of Old Age Security (OAS) benefits in that respect.

Private pension programs now play an important role in retirement saving, the authors point out. In 1977, over 40 per cent of Canada's workers were covered by employer-sponsored pension plans, with contributions totaling $6.2 billion. And RRSPs have become increasingly popular as a form of retirement saving in recent years; in 1977, about 1.3 million Canadians contributed well over $2 thousand million to such plans.

Allowing people to deduct the contributions they make to employer-sponsored pension plans and RRSPs from their income tax has been greatly to the advantage of taxpayers in the upper-income brackets, but of little benefit to the poor, who make little or no tax saving that way, Daly and Wrage argue. Statistics bear out this claim: in 1976, nearly 86 per cent of the million plus taxpayers who reported RRSP contributions had incomes of $10,000 and above; and people earning more than $25,000 contributed almost triple the amount of people earning between $10,000 and $14,000.

People with low incomes might be tempted to save more if they were given bigger tax breaks in this area, Daly and Wrage say. They suggest creating a new kind of RRSP, in which the government would pay low-income contributors a bonus in order to compensate them for their low tax savings on the RRSP deduction. An innovative step, without any question, they add, but one which has been tried out in West Germany with considerable success.

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Planning for a secure old age

Daly and Wrage also advocate dropping the old age exemption (allowing anyone over 65 to deduct a flat rate) from the tax form, for a number of reasons. First of all, they say, people tend to save slightly less for retirement because of this guaranteed exemption. Secondly, it is no longer needed as a buffer against medical expenses with the introduction of medicare and now that senior citizens in many provinces are either exempted from paying health insurance premiums, or entitled to rebates. And finally, this exemption too benefits the well-off more than the poor, for as the authors point out, people who pay low taxes or none at all receive little or no benefit from a tax exemption.

Instead, Daly and Wrage propose that the savings made by dropping this exemption be used to finance an expanded Guaranteed Income Supplement (GIS), as well as more generous provincial supplements, to provide more income for the needy.

In a second paper, the authors look at the effect the Old Age Security Program (OAS) has had on retirement savings. This scheme has had no adverse impact on economic growth, they say. As it is not income-tested, its influence on retirement saving and decisions about work and leisure is small compared with those programs which are related to income. On the other hand, a program like the GIS, which is income-tested, may discourage people from saving for their retirement because the more income they have from other sources, the lower benefits they will receive from GIS. Because everyone gets the OAS regardless of other income, it does not seem to present this kind of disincentive to saving through employer-sponsored pension plans or RRSPs, the authors says.

The universal OAS program has a slight effect on work patterns in that it seems to reduce the number of hours a person works before reaching age 65, but it does not seem to offer an incentive for early retirement.

"The Impact of Canada's Old Age Security Program on Retirement Saving, Labour Supply and Retirement," by Michael Daly and Peter Wrage. Discussion Paper No. 203.
"The Effect of Income Tax Incentives on Retirement Savings: Some Canadian Evidence," by Michael Daly and Peter Wrage. Discussion Paper No. 204.

New directors appointed to Council

The Economic Council's staff of economists and other specialists work under the direction of a Chairman and two full-time Directors. Two new directors were appointed in August last year to fill vacancies left by the resignation of Robert Lévesque and the appointment of David Slater as Chairman.

Peter M. Cornell

Peter Cornell will assume overall direction of the Performance and Outlook Group, which prepares the Council's annual review of the Canadian economy. He will also be responsible for the Labour Markets and the Growth and Productivity Groups. Dr. Cornell sees recent changes in the Review as efforts towards making the results of highly technical exercises and methods more easily understandable to the public, as well as to Members of Parliament or provincial governments and legislatures.

The Council hopes to improve the process of public discussion and political decision making, says Dr. Cornell, "by providing a framework which shows the outcome of adopting particular objectives or the consequences of using certain policy instruments to achieve these objectives."

For Dr. Cornell, this process fits into the general effort the Council has undertaken to improve its communications with the public and with those involved in the political process. Such efforts would extend beyond the annual review, to each of the Council's major reports and to the publicizing of the results of other studies prepared as part of the Council's on-going program of research.

The Labour Markets Group will publish what Dr. Cornell terms a "landmark" study in the coming year which "will do a lot to define labour market imbalances and will propose measures to deal with them." And the Growth and Productivity Group is conducting research that will also result in a major report.

"The problem in this area has been that people have tended to look at aggregate growth of productivity right across the economy. You can't do that alone because it becomes a very sterile field," says Dr. Cornell. The study of productivity must get down to the level of individual establishments if it is to fully identify the causes of the recent decline in productivity growth and the ways to improve productivity in specific sectors.

Dr. Cornell first came to the Council in 1966 and held a series of key positions before his appointment as Director.

The Economic Council's consultation and communications activities are the special responsibility of Patrick Robert, who will also supervise the overall administration of the Council and will oversee the work of the Financial Markets research group.

The process of consultation with labour, governments, business and other representative groups in Canadian society will in future be part of an "exploratory" process through which the Council will determine its research priorities.

"Since the appointment of the new Chairman, we have put into place a program to identify future problems in a more systematic way than in the past," says Mr. Robert. Before undertaking a major project there will be an exploratory study on the subject and it is at this early stage that efforts will be made to associate various socio-economic groups. It is hoped that the process of continuing consultation through the course of a project will "act as a catalyst to facilitate agreement on solutions, or at least to permit a certain unity of vision which will contribute the substance and the weight of policy recommendations emanating from the study."

On another front, Mr. Robert will continue to be active in responding to criticisms that the Council offers too few opportunities to francophone researchers.

Efforts to recruit more francophone researchers over the past two years have increased their proportion among the research staff from about 10 per cent in March 1980 to 24.5 per cent at present.

Mr. Robert sees great value in gathering at the Council anglophone and francophone researchers with "different cultures, different mentalities and often different philosophies, but utilizing the same economic techniques." The result goes beyond language, says Mr. Robert, since what we are really talking about is combining elements

Patrick Robert

which enrich and diversify the approach to economic research.

Before his current appointment, Patrick Robert was secretary-general of the Council.

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New policy options for 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 provided Canadians with an ongoing analysis of the economy, looking at economic policies and the effect of possible alternatives on the country's economic prospects. The projections, policy analysis and recommendations formulated by the Council in the past decade have played a significant role in 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, land use planning in Vancouver or the effect of the spruce budworm on Newfoundland's economy.

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