au courant

Economic Council of Canada Volume 2, No. 4 1982

A report on financing Confederation

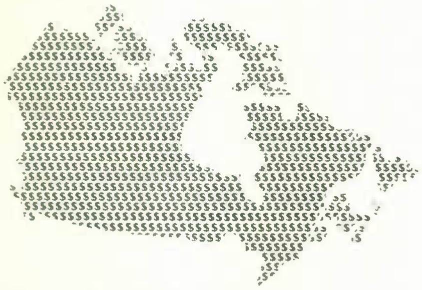
Innovation boosts exports

Freedom of information

Canada/U.S. conference planned

PUBLICATIONS

New Council report



Financing Confederation: Today and tomorrow (EC22-103/1982E, $9.95 in Canada, $11.95 elsewhere).

The Economic Council has taken a detailed look at the key issues bearing upon federal-provincial fiscal arrangements, and discusses its findings in this recently published report. *Financing Confederation* is available in bookstores across the country, and may also be ordered from the Canadian Government Publishing Centre (see below).

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*.

Meeting Skill Requirements: Report of the Human Resources Survey, *by Gordon Betcherman* (EC22-100/1982E; $6.95 in Canada, $8.35 elsewhere).

The Choice of Governing Instrument, *by M. J. Trebilcock, D. G. Hartle, J. S. Prichard and D. N. Dewees* (EC22-101/1982E; $8.95 in Canada, $10.75 elsewhere).

Economic Intervention and Regulation in Canadian Agriculture, *by J. D. Forbes, R. D. Hughes and T. K. Warley* (EC22-102/1982E; $7.95 in Canada, $9.55 elsewhere).

The following research studies have been reprinted and can be ordered according to information below:

Canadian Television Broadcasting: Structure, Performance and Regulation, *by R. Babe* (EC22-63/1979E; $5.00 in Canada, $6.00 elsewhere).

The Future Population and Labour Force of Canada: Projections to the Year 2051, *by F. T. Denton, C. H. Feaver and B. G. Spencer* (EC22-75/1980E; $3.50 in Canada, $4.20 elsewhere).

The Adoption of Computer Technology in Selected Canadian Service Industries: Case Studies of Automation in University Libraries, Hospitals, Grocery Retailing and Wholesaling, and Department and Variety Stores, *by Steven Globerman* (EC22-95/1981E; $5.95 in Canada, $7.15 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. 209 "Innovation and Export Performance in Canadian Manufacturing," *by Petr Hanel and Kristian Palda.*

No. 210 "Block-Funding and Provincial Spending on Social Programs," *by Constantine Kapsalis.*

How to order

The research studies and Council report 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.

Economic Council of Canada

P.O. Box 527
Ottawa, Ontario
K1P 5V6

au courant

Volume 2, No. 4 1982

Financing Confederation

A summary of the Economic Council's report released in February.

Fiscal Imbalance 12

The equalization program 13

Providing for the health care and postsecondary education of Canadians 17

The harmonization of fiscal and stabilization policies 19

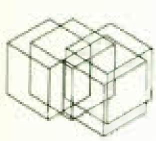
New appointments to the Economic Council of Canada 4

Inflation accounting discussed 4

Research and development helps exports 5

Reforming Regulation

More reports resulting from the Council's three year study of government regulation of the economy:



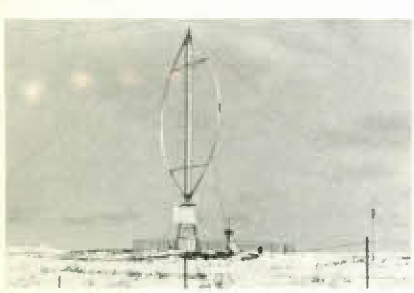
Controls on water pollution are not effective 6

The Economic Council will sponsor a conference to discuss de-regulation in Canada and the United States 6

The new Access to Information Bill will not solve all the problems 7

New research on women 8

Canadian companies need training programs 9



Visiting experts give their views at seminars held by the Council .... 10 and 11

Are we reaching you?

If your address has changed, please let us know. Send the address label from this copy, along with your new address to:

Au Courant
Communications Division
Economic Council of Canada
P.O. Box 527
Ottawa, Ontario K1P 5V6

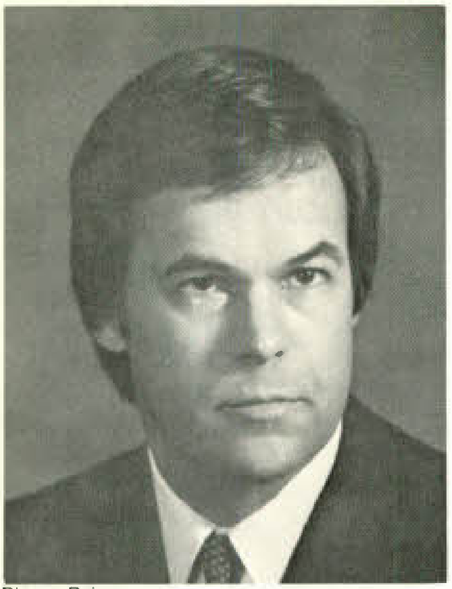
Au Courant est également disponible en français.

The major reports featured in *Au Courant* reflect the viewpoint of the Economic Council. Research studies, discussion papers, and other background papers are prepared for the use of the Council by members of its staff and others. The findings of these reports are the personal responsibility of the authors. Neither the original publication of these studies and papers, nor their condensation for the purposes of this magazine, should be taken to imply endorsement of their conclusions and recommendations by the members of the Economic Council.

Au Courant is prepared in the Communications Division of the Economic Council and published quarterly under the authority of the Chairman of the Economic Council of Canada, who bears final responsibility for the publication of the magazine under the imprint of the Council.

ISSN-0226-224X

New appointments to the Council


Pierre Brien

Pierre Brien was recently appointed vice-president in charge of development and communications for the Canada Lands Co. (Mirabel) Ltd. A former director-general of Canada Mortgage and Housing Corporation for the province of Quebec, he has also held positions with Treasury Board Canada, the Department of Secretary of State, and the Department of External Affairs.


Donald F. Forster

Donald F. Forster has been president of the University of Guelph since 1975. Prior to that appointment, he was vice-president and provost of the University of Toronto. He is author of many articles in the field of economics and political science, and has served as economic adviser to the governments of Tanzania and Papua New Guinea.


T. Earle Hickey

T. Earle Hickey, a retired chartered accountant, is director and chairman of the finance committee of the Prince Edward Island Heritage Foundation. A former member of the P.E.I. legislature, he served as minister of finance for that province from 1970 to 1974. He is past president of Polar Quick Freeze Co. Ltd., and past secretary-treasury of Gulf Broadcasting Co. Ltd.

Accounting for inflation

Accuracy and reliability were once the watchwords of every accountant. But that was before double-digit inflation began to raise doubts about the effectiveness of traditional accounting methods.

The distorting effects of inflation have long been a concern for economists. Accountants too have had the feeling that the financial pictures they prepare for their clients may also be distorted by inflation.

In its 1979 annual review of the economy, the Economic Council made recommendations for changes in accounting and taxation rules to deal with the effects of inflation, and in October last year it sponsored a conference in Toronto to air some of the complex issues raised by the effects of inflation on financial reporting and taxation.

The conference was organized with the participation of the Canadian Institute of Chartered Accountants, The Canadian Manufacturers' Association, the Canadian Chamber of Commerce, the Canadian Federation of Independent Business, and the Canadian Tax Foundation.

Council researcher Abe Tarasofsky told the participants that reliance on obsolete accounting rules that ignore the impact of inflation have produced seriously overstated measurements of corporate profits. Because such information affects decision-making by management, labour and participants in capital markets, the distortions may have adversely affected business performance in recent years.

Some corporations which did n measure the effect of inflation on profits may have paid out higher dends than was either intended o advisable for efficient financial administration, Tarasofsky said.

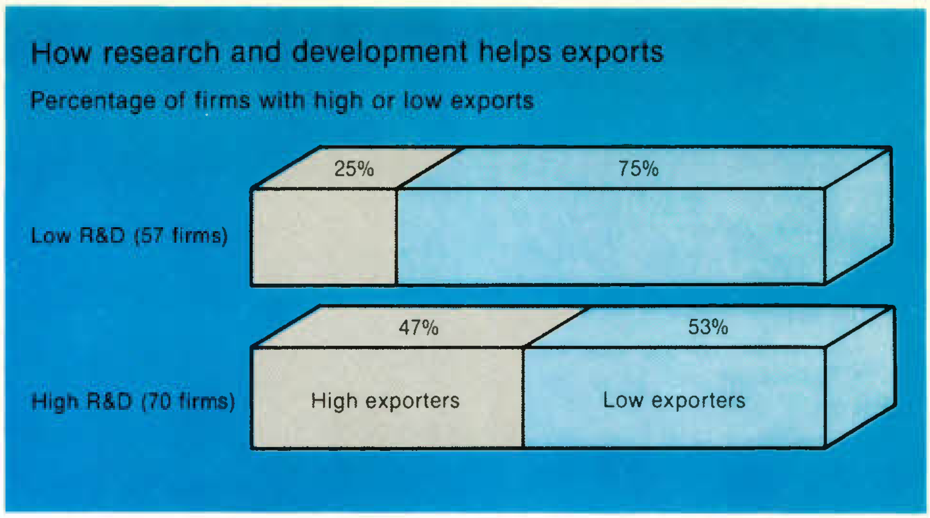
According to a study he prepa with Theodore G. Roseman and H. Bert Waslander, real rates of return during years of high inflation were as much as half the reported rates.

Participants at the conference also heard how tax rules based on archaic accounting conventions can impose inequities during periods of inflation, with some firms in an industry paying higher effective tax rates than others.

The proceedings of the conference will be published later this spring under the title "Peering Under the Inflationary Veil," and will include a summary of the discussions as well as abstracts of the score of papers presented.

The Economic Council has recently published a research study on this subject, *Ex Post Aggregate Real Rates* *urn in Canada: 1947-76*, by A. fsky, T. G. Roseman and H. E. der (No. EC 22-99/1981E; $4.95 nada, $5.95 elsewhere). See g information on page 2.

Innovation boosts exports



Canadian industry is often told that investing in research and development programs is bound to pay off in the long run. But have there been any signs to date that companies taking that initiative are reaping some rewards for their virtue?

A new Council paper points to one. Analysis of the relationship between innovation and export performance for Canadian manufacturing shows that firms with the newest technology do better in export markets, say Petr Hanel of the University of Sherbrooke and Kristian Palda of Queen's.

As the basis for their analysis, the two economists had access to data from a survey conducted by the Economic Council as part of its ongoing research into technological change. A large sample of manufacturing firms was asked to report on innovations which contributed significantly to their productivity during the period from 1960 to 1978.

National Film Board of Canada

New technology provides benefits

Hanel and Palda were able to use the information provided by 153 of the the responding firms in four industries: telecommunication equipment and components, electrical industrial equipment, plastic compounds and resins, and non-ferrous smelting and refining. Their chief interest in the data lay in discovering whether any connection showed up between a firm's commitment to the research and development (R&D) of new technology, and growth in its sales abroad.

With that in mind, they investigated the relationship between R&D spending (as a proportion of sales) and exports (as a proportion of sales) for each firm overall, and also for its main industrial activity, with a special eye to exports of newly developed products. In a further step, they followed the same exercise for two specific years in the history of an innovation developed or adopted by a company: the year of its launching on the commercial market; and 1978, the final year covered by the data.

The authors find that firms succeed in foreign markets for a variety of reasons – their size, type of industry, and so on – which differ considerably among the industries they studied. But one clear, consistent finding emerges across the board: the more R&D spending a firm did – whether overall, in a specific area, or on a particular innovation – the healthier its export trade became. As the chart shows, firms with high R&D expenditures were about twice as likely to have high exports. "Throughout our investigation," Hanel and Palda comment, "the positive influence of R&D. . . on exports . . . stands out like a beacon."

Most successful of all in this regard were Canadian-controlled companies doing their own innovating. Export opportunities were less bright, Hanel and Palda find, for Canadian companies importing technology, and dimmer still for foreign-owned firms borrowing new ideas from their parent companies.

The authors also discover that a company doesn't usually start exporting new technology until it sells a certain amount at home – approximately $78,000 worth in 1978, for example.

But surprisingly, Hanel and Palda hint that exporting new products may not be all that profitable – although they caution that their data are not extensive enough to settle the matter conclusively. Still, their analysis suggests that the more a firm exported its innovations, the longer it had to wait for a pay-off on its initial investment.

The authors also raise the question of government subsidies for R&D programs. If individual companies evidently can increase exports by stepping up their technological superiority, it may follow that government funding of industrial R&D will strengthen Canada's trade balance. But evidence in this area is contradictory, Hanel and Palda say. While they find that firms which had to pay the entire R&D shot themselves tended to do less exporting than firms getting outside help, they do not unearth any evidence that government support for a particular innovation helped to sell it in export markets.

New technology alone may not provide all the answers for a firm wishing to sell its products abroad, the authors conclude. Just as important may be the quality of management directing its efforts. The authors lack data to test this theory – although other economists have suggested management practices are of the utmost importance for successful international marketing. In any case, they say, they would hesitate to assume that incentives for R&D programs will necessarily help to strengthen the trade balance.

"Innovation and Export Performance in Canadian Manufacturing," by Petr Hanel and Kristian Palda. Discussion Paper No. 209.

Reformation Regulation

Controlling water pollution

National Film Board of Canada

Source of pollution

Pollution is usually a cheaper option for the pulp and paper industry than pollution control, so regulations requiring companies to clean up their act have not always had quite the impact that was intended, says a paper written for the Economic Council.

As part of the Council's study of government regulation of the economy, Peter Victor and Terrence Burrell take a look at measures taken by the federal government and by Ontario to control water pollution from the pulp and paper industry. Although Ontario is the only province considered in any detail, many of the findings apply to other provinces where the pulp and paper industry operates.

There have been some tangible improvements in water quality, but efforts to clear up water pollution would be more successful if companies were given powerful economic reasons for complying with regulations, in the authors' view. Since no such incentives exist at the moment, progress has been much slower than officials expected, they say. As it stands now, individual mills can negotiate their own pollution-control schedules with regulatory authorities, who too often, in the authors' opinion, are swayed by what the companies say they can afford to invest on abatement, rather than by what they should be spending.

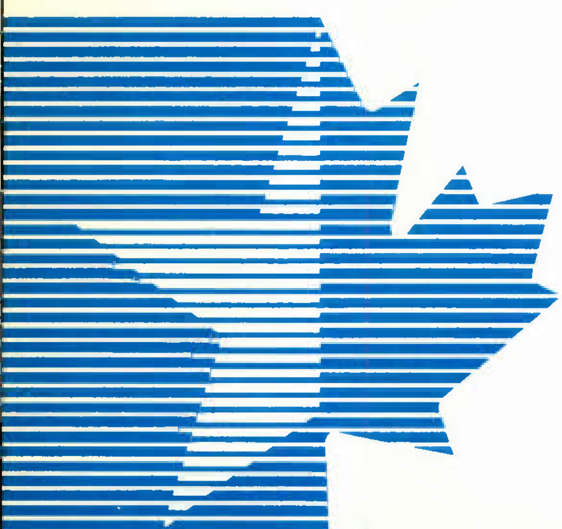
Officials tend to be soft on offenders. The Ontario and Quebec governments, for example, punish polluters by withdrawing part of pollution-control subsidies – hardly a devastating financial blow, the authors comment. And even on the rare occasions when a company has actually been prosecuted for breaking the rules, the fines imposed have been well below the limit allowed by the legislation.

Victor and Burrell argue for a much tougher approach that would require offending companies to pay fines based on the amount of unauthorized pollution they produce. This tactic would make pollution abatement a more attractive course of action for pulp and paper mills.

They also recommend more public involvement in the setting and enforcing of pollution-control objectives. As it is, they say, concerned citizens are usually excluded from this process, despite their interest in the outcome. Nor are they given the opportunity to register a protest in the market place, the authors add. Pulp and paper products rarely are sold under the brand name of the producing company, so consumers don't have the necessary information to stage a boycott, or signal their approval of a company's pollution record.

"Environmental Protection Regulation: Water Pollution and the Pulp and Paper Industry," by Peter A. Victor, Terrence N. Burrell, with Jim Evans and Charles Figueiredo. Technical Paper No. 14.

Canada-U.S. conference



Government regulation of the economy is now coming under scrutiny in both Canada and the United States. Regulatory reform will have significant implications for economic management and for North American society as a whole.

Key issues raised by reforms in both countries will be the subject of a conference, sponsored by the Economic Council, and The Institute for Research on Public Policy, with participation from The American Enterprise Institute.

To be held in Toronto on May 20 and 21, the Conference will include distinguished speakers from government, labour, and regulated industries in both Canada and the United States. Ralph Nader, whose research group, Center for Study of Responsive Law, has recently completed a study of the economic effects of deregulation, will speak on the evening of May 20. Other participants in the two-day conference include William Niskanen, a member of the U.S. President's Council of Economic Advisers, Elizabeth Bailey, vice-chairman of the American Civil Aeronautics Board, Claude Taylor, president of Air Canada, James C. Miller III, chairman of the U.S. Federal Trade Commission, Marshall Cohen, deputy minister of Energy, Mines and Resources, and E. S. Rogers, vice-chairman and chief executive officer of Rogers Cable Systems Inc.

The registration fee is $375. For further information, contact: Donald Wilson, Director of Conferences and Seminars, The Institute for Research on Public Policy, 275 Slater Street, Ottawa, Ontario KIP 5H9; (613) 238-2296.

> **T**he information you have
> is not what you want
> The information you want
> is not what you need
> The information you need
> is not what you can obtain
> The information you can obtain
> costs more than you want to pay
>
> *Finagle's Laws of Information*

Freedom of information

Canada needs a new Freedom of Information Act, but it should only be the first tier of any disclosure system, according to legal consultant Margot Priest. In a paper written for the Economic Council's study of government regulation of the economy, she says that Bill C 43 (the Access to Information Act) now before Parliament is only part of what's needed.

While Priest says the bill "is not bad," it shouldn't be seen as providing "a complete regime for information access," but she is afraid that it may turn out to be all the government intends to do on this important issue. In fact, she says, a second tier of criteria for information disclosure needs to be developed by individual departments and agencies which have to deal with requests for confidential information.

Most Canadians probably think they're entitled to the explanation behind any government decision affecting their health, their safety or their pocketbooks. At the very least, they'd expect people making or reforming regulations in these important areas to have all the key facts at their disposal.

But reality rarely measures up to these expectations, Priest says. Regulators need a steady stream of information from the private sector, as background for policy-making, for specific decisions, or for investigative and administrative purposes. Getting that information though is sometimes like pulling teeth, especially for government departments in charge of indirect or social regulations affecting health, safety and the environment.

The chore is often easier for direct regulators – agencies like the Canadian Radio-television and Telecommunications Commission (CRTC) or the Canadian Transport Commission (CTC) – dealing with specific details such as prices, rates of return, or a firm's request to enter or leave an industry. Companies often see a real benefit in complying with agency requirements, since the result could work in their favour – by providing them with a broadcasting licence, for example.

In contrast, government departments usually have a much tougher time, Priest says. Their job involves persuading numbers of companies in various industries to part with information that can be used to educate, warn and protect the consumer. Firms tend to regard many of these requests as time-wasting, costly and sometimes downright dangerous. Business people complain that much of the data they're asked to provide requires useless or duplicative effort. A company doing business across Canada, for example, may have to file reports in each of the ten provinces and probably with the federal government as well.

Worse still, in the view of many companies, is the fear that information provided to government may be released, inadvertently or otherwise, with harmful results – giving details on their union or contract negotiations, for example, or providing their competitors with trade secrets.

Some of this anxiety could be allayed by better departmental management, Priest says. But it also has to be balanced against other concerns, she adds, "such as the public's right to know what is happening within government, or a party's right to know the case he must meet in a judicial hearing, or the right of an individual to have the best possible information about matters that affect him, such as his work environment, food or financial investment."

What's really needed, the author says, is a sensible, systematic, clear-cut approach to the whole question of confidential information. And that's precisely what Canada lacks, in her opinion. Tests for confidentiality vary considerably from department to department and from agency to agency; few guidelines exist for either the regulator or the regulated; and data are often treated in an inconsistent manner, leading to uncertainty and complaints.

The net result though, errs on the side of too much, rather than too little secrecy, Priest says, as "the internal incentives of the bureaucracy are against disclosure." And Bill C 43 is weighted against the person requesting information. There are so many exemptions that there's no real balancing of competing interests.

Priest argues for the implementation of new steps to meet the objective of effective regulation by accountable regulators, including more stringent tests of whether information should be classified as confidential in the first place, and a thorough scrutiny by the appropriate department or agency of information meeting the criteria, so that competing interests are better balanced.

"Provision of Information in a Regulatory Context," by Margot Priest. Technical Report No. 22.

New research on women underway

In a lab

Controlling traffic

National Film Board of Canada

The massive surge of women into the labour force over the past decade has made economic history. Analysts of this phenomenon have been busy ever since, trying to work out its implications from every possible angle. As they fast learned in the course of their studies, easy answers just didn't exist for the countless new questions raised. Extensive and thorough-going research became top priority.

Now the Economic Council has entered the field, with a new project just under way. It is an attempt to study women's entry into the labour market in a "comprehensive economic fashion," according to economists Jac-André Boulet and Laval Lavallée.

In a paper outlining a possible analytical framework for this undertaking, Boulet and Lavallée stress that "the questions we intend to address are complex ones. We have published this working paper in the hope of obtaining as many comments as possible, so as to ensure that the subject matter is adequately covered."

The Council project was launched to discover why working women continue to suffer disadvantages in comparison with their male colleagues, especially in getting jobs, opportunities for promotion, and equal pay. Various explanations have been advanced to account for these differences, Boulet and Lavallée say, including educational background, sociological differences, stereotyping, and so on. But, they argue, two basic economic questions haven't received much attention: whether employers look on female employees as a riskier investment than males, for the simple reason that they will probably quit their jobs to have and raise a family; and whether this attitude means employers go on steering women into poorly paid jobs requiring less skill and experience, where their potential remains untapped and reliability is less important.

That might explain in rational economic terms why women continue to have problems in the labour market, the economists say. They plan to investigate their hypothesis by looking at such questions as the division of labour within the household, and how women's access to the labour market might be affected by educational opportunities and socio-economic considerations.

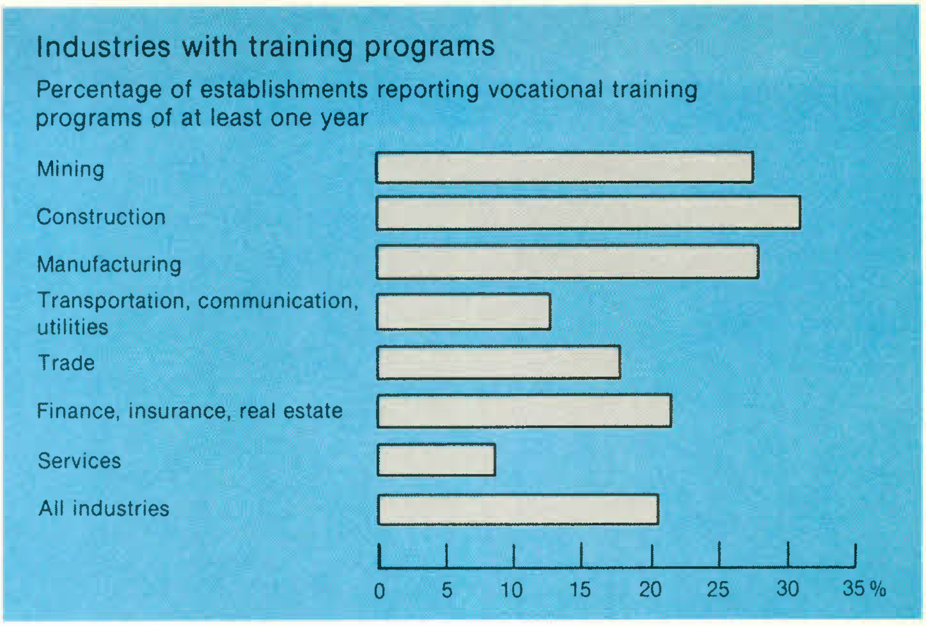
If their hypothesis can be proven, Boulet and Lavallée say, then governments, not employers, will have to take action. If indeed women make a positive contribution to society by having and raising children, the government "has a duty to intervene for reasons of justice, equity and efficiency so as to distribute the costs of having children between those who reproduce and those who do not." That might require giving women better chances at obtaining loans and scholarships for higher education. Or it could entail paying a premium to employers who hire women or keep them on the payroll through pregnancy and maternity leave. Or it could involve changes in family allowances, in tax policies or other forms of public financing.

"Women and the Labour Market: An Analytical Framework," by Jac-André Boulet and Laval Lavallée. Discussion Paper No. 207.

National Film Board of Canada

In an office

Training programs scarce here



Canadian industry has always been able to count on a steady flow of workers from Europe to fill its highly skilled jobs – at least until quite recently. Perhaps that's why apprenticeship programs are not well-developed in this country. In any event, existing training programs here don't seem to be turning out Canadians with the necessary skills to fill the jobs that are opening up. The irony is that, while unemployment is at record high levels, a serious shortage of skilled workers has emerged.

An Economic Council survey (see Au Courant Vol. 1, No. 2, p. 18), of almost 1,400 Canadian firms found that half were having difficulties finding workers with the necessary skills.

Besides identifying which industries were short of skilled workers, the survey was also designed to find out what kind of occupational training programs were being carried out by Canadian industries.

The original response was encouraging. Fully 60 per cent of business establishments surveyed reported that they had at least some vocational training programs. But it turned out that two-thirds of these programs lasted only three months or less.

Only 20.3 per cent reported training programs of at least one year's duration; 14.6 per cent carried out training designed to last two years or more.

Companies operating in western Canada, the survey found, were more likely to have training programs than those in Ontario, the Atlantic provinces and Quebec. Longer-term training programs were also more common in the West than elsewhere in Canada.

Companies involved in finance, insurance, real estate and mining reported the greatest (84.3 per cent) use of training programs. Construction, transportation and communication industries were the least likely to have vocational training.

Council researchers also asked companies why they were not undertaking their own training programs. The answer was simple. Of the companies which replied, 51.4 per cent said they felt no need to start training programs because they could generally fill their skilled labour requirements by hiring trained workers from outside.

As well, the researchers found that companies which did not engage in personnel planning, a majority, were also less likely to institute training programs.

Existing training programs were mainly in the areas of product fabricating and repair, clerical work, sales and management. The survey found that 58 per cent of all training efforts and 54.2 per cent of all trainees fell into these categories.

Most training programs cited were short term and so were not enough to give workers anything but the basic skills they needed to do specific tasks.

All of the longer-term apprenticeship programs were to be found in machinery, product repair and manufacturing, and in the construction trades. And only 15.7 per cent of the companies surveyed used the apprenticeship system. Most of those were situated in western Canada.

Interestingly enough, the European countries, which have provided most of Canada's skilled labour in the past, make extensive use of apprenticeship schemes for acquiring high-level skills.

Companies reported difficulty in fixing a cost for training, but their estimates indicate an average cost of $2,551 per trainee. Not surprisingly, longer-term programs were more costly, and this may deter firms from setting up long-term programs.

In spite of a widespread belief that governments provide the financial inducement companies need to undertake vocational training, the survey found that "most training instituted in the private sector goes on without any financial help from public sources."

Only 20.2 per cent of the companies with training programs got any financial help from governments.

Most government aid went to training for blue-collar skills. Subsidization of clerical, sales and management training was rare.

In a report on the Human Resources Survey, Council researcher Gordon Betcherman concludes that, although Canadian industry does have a fair amount of vocational training, it "is clearly not responsive to the most critical labour market demands." The report recommends that government training programs should be better designed to fill the void. "An obvious priority for government involvement concerns the development of skills for technical and trades occupations," says Betcherman.

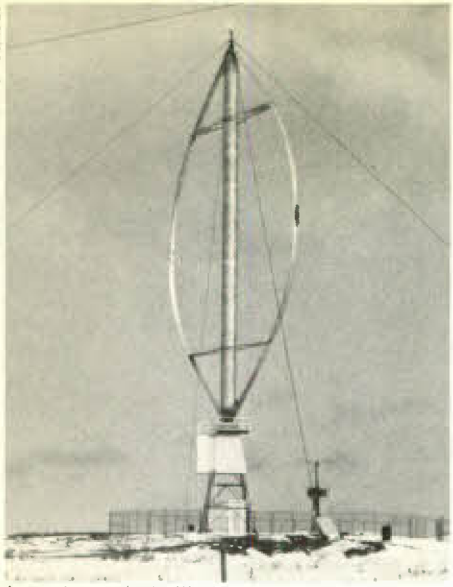
While on-the-job training is obviously needed, a school setting is often the best way of acquiring occupational skills, either on the basis of full-time instruction or in combination with on-the-job training.

Betcherman concludes that "by utilizing the resources of the education system to complement those in industry, a creative and adaptive work force can be developed to meet the future demands of the Canadian labour market."

Meeting Skill Requirements: The Report of the Human Resources Survey, by Gordon Betcherman (EC22-100/1982E, $6.95 in Canada, $8.35 elsewhere).

Visiting experts give thei

In keeping with its objective
with business, labour, gov
interest groups, the Econom
seminars featuring well-kno
policy issues. Three recent s



National Film Board of Canada

A modern windmill

Renewable energy

Canadians who suffer through long, cold winters want assurance that their furnaces will keep them warm for years to come. Likewise, industry in this country needs to count on sure supplies of energy on a year-round basis. So anything to do with Canada's sources of renewable energy – wood, wind, sun, water, and vegetation – is a popular topic nowadays.

A recent seminar at the Economic Council on this subject generated a good deal of interest as a result. Two experts in the field spoke at the session: Dr. Ralph Overend, of the National Research Council, who works on research and development of renewable energy; and Dr. Don Strange, senior research officer in the Conservation and Renewable Energy Branch at the Department of Energy, Mines and Resources.

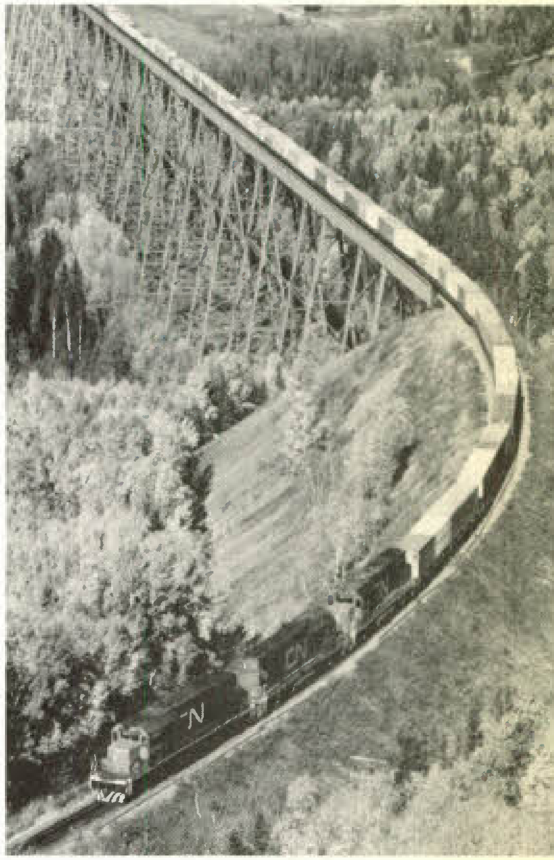
After five years of research and development into our renewable energy options, according to Overend, it is now possible to estimate their state of technological readiness. Developing technologies that make it possible to use these resources is a long, slow process, he cautions. The principles of nuclear energy, for example, were known by World War II, but the first commercial nuclear plant, in Pickering, Ontario, did not begin operating until the 1970s. So we can't count on renewable resources for a reliable energy supply much before the year 2000, he says.

But even so, their use is growing rapidly, he adds. Research and development at the NRC is well underway, and concentrates first and foremost on solar energy, followed by biomass energy, (wood and wood products, peat, straw, manure and so on), wind energy, and others.

The forest provides us with our largest source of biomass energy, Overend says. In fact, he adds, the pulp and paper industry in Canada could become energy self-sufficient, by developing processes that make use of its waste wood products.

Wind can be an excellent source of energy too, he points out, in areas where winds are high and continuous – the Gulf of the St. Lawrence, the coast of the Labrador, and the North, for example. Some remote communities are now using large windmills that can produce 100 kilowatts of power without batteries (at a cost of 10¢ per kilowatt hour), with diesel engines as a reserve. Newfoundland could have 100 of these windmills in operation by 1990, Overend observes.

The federal government is very involved in the renewable energy field, Don Strange says. A number of projects have been launched to encourage development in this area: one, for example, was designed to buy solar heating equipment for demonstration purposes in federal buildings; another gave grants to pulp and paper companies to install equipment to burn their own wood wastes; another is at work developing new liquid fuels to replace oil for transportation purposes; and another gives $800 to homeowners who undertake to convert to renewable energy.



National Film Board of Canada

First attempt at industrial policy?

Still searching for an industrial strategy

Although the debate continues on whether or not Canada has an industrial strategy and what that strategy should be, the concern about industrial policy is nothing new. In the nineteenth century, the railways were the chief instrument of industrial development but, according to historian Michael Bliss, the nineteenth century concept of industrial policy stopped at tariff protection, which was seen as sheltering Canadian manufacturing from foreign competition and creating jobs for Canadians

In a paper specially prepared for the Economic Council and presented at a recent seminar, the University of Toronto professor says that nineteenth century politicians were just as inclined towards government intervention as their modern counterparts. The crucial difference is that even though the potential wealth of government then was enormous, a meagre cash flow reined in their ambitions.

According to Bliss, most government attempts at intervention over the past hundred years have only produced results that would have come about in any case.

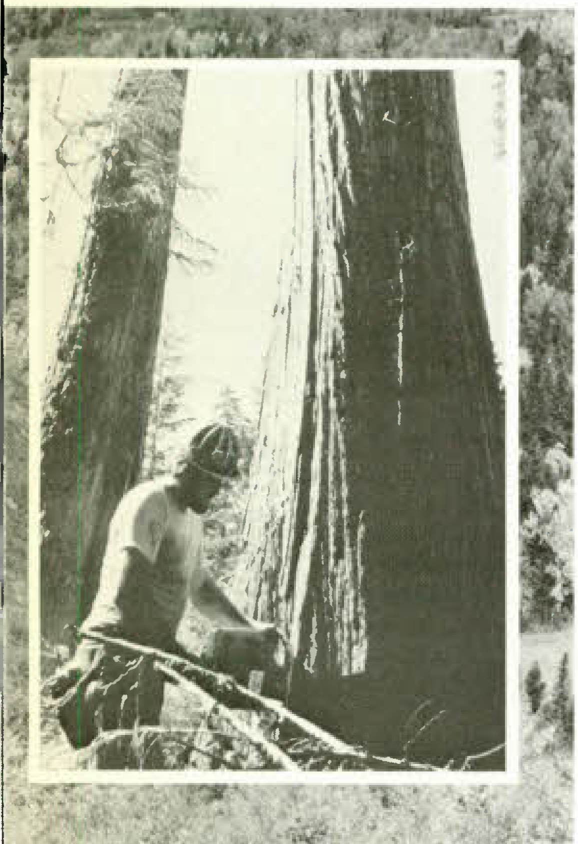
At the end of the last century, Canadian governments approached the railways with a fever only recently matched by investments in the search for frontier oil. They undertook a massive subsidization of railway construction.

But what might appear to have been a grand design for industrial development was nothing of the sort, Bliss argues. The policies were disparate and at times conflicting.

It was only in the 1930s that Canada began to look at industrial policies in terms of cohesive strategy. Prime Minister Bennett proposed an integrated tariff policy to

r views on current issues

of maintaining regular contact ernment, and issue-oriented ic Council periodically holds wn commentators on public essions are highlighted below.



Forest management needed

Forests

For Canada's first settlers, trees got in the way of good production. Entire forests were burned down to clear the land for crops.

Later in our history, logging was important because it provided masts for European navies. It was only at the end of the last century, when newsprint was in demand and construction was thriving that planners began to realize the economic potential of Canada's forests.

And even then, forests were thought to be virtually inexhaustible. We still list trees as a renewable resource today.

The problem, according to Les Reed, assistant deputy minister at the Canadian Forestry Service, is that harvesting is not matched by replanting of trees, with the consequence that our remaining forests could disappear. In a seminar on the future of Canada's forestry sector presented recently at the Economic Council of Canada, Reed says the consequences of such a loss would be immeasurable. Our water supply and the air we breathe would be affected. The blow to Canada's economy would be critical.

The forestry industry in Canada has grown to the point where it now creates direct employment for 310,000 workers from coast to coast.

Forestry production in 1980 was valued at $22 billion, with nearly $13 billion worth going for export or 17 per cent of Canada's total exports. Exports of grain, fish and other farm products together were valued at just over $8 billion.

Years of past neglect in forest management are now beginning to show, says Reed. He estimates that the annual demand for trees may now be more than the maximum allowable cut. And if that limit is exceeded for any length of time, then Canada will soon run out of wood. The allowable cut now stands at 228 million cubic metres of wood per year; but it is falling every year, while demand for wood continues to increase.

Reed says Canadians should adopt the attitude that the present generation did not inherit the forests from its predecessors, but rather has borrowed them from future generations.

It makes good economic sense, he says, and sound common sense too, to pass on the forests in a better state than we found them. Right now, the danger is that too little has been done in the past to ensure the renewal of forests. Private companies and governments have received tremendous benefits from harvesting the forests, he says, but have put very little of their earnings back into replenishing the supply of trees. Forestry firms return less than one cent out of every sales dollar to forest management.

In the past, the federal government has carried the burden of forestry research. Even today, its forestry research budget of $44 million exceeds that of all the provinces and the forest industries, which together spend about $20 million.

Greater attention to forest management will not only ensure the survival of current forestry industries, Reed says, but would mean that Canada could double its production and sale of forest products.

Fortunately, both government and industry are finally realizing that better husbanding of Canada's forests is needed, opening the possibility not only for the survival of the forestry industry but also for its expansion.

Canada is well-placed to take advantage of increased foreign demand for wood, Reed says. With research and proper forestry management, the timber harvest could be increased by 40 per cent between now and the year 2000. Such an expansion would create an additional 75,000 to 100,000 jobs and result in additional foreign exchange earnings of $12 billion.

---

protect Canadian industry and blast Canada's way into world markets, and this was "perhaps the closest a Canadian government has come to advocacy of a comprehensive industrial strategy," says Bliss.

After World War II, economic development was dominated by the proclivities of the Liberal government's minister-of-all-things-economic, C. D. Howe. Howe's industrial strategy was "premised on the belief that Canadian benefited from infusions of capital and skill from outside." Howe's policies, according to Bliss, "reflect a greater degree of coherence and conscious planning than any since Confederation."

But the country was entering several decades of new problems, including high unemployment, regional disparities and the decline of the traditional manufacturing sector.

By the early 1970s, soaring petroleum prices had been added to the list of problems. Governments reacted more with fervor and energy than with conscious planning. Public utilities were built up to provide basic services, the tax structure was adjusted to encourage investment, and protectionist policies were developed for agriculture and primary industries. The end result was a myriad of policy decisions designed to influence firms and their markets. These, according to Bliss, "evolved over time into a blooming, buzzing confusion of policies at every level of Canadian government."

The hope of modern politicians is that this collection of policies can be rationalized into a "new national policy" of industrial development.

Financing Confederation Today and Tomorrow

The Economic Council of Canada has undertaken a major study of the broad, complex and massive fiscal relationships between Ottawa and the provinces in an effort to promote greater public understanding of the issues involved and to contribute to the policy debate with respect to the current review of these arrangements being undertaken by the two levels of government.

These relationships, which to a considerable extent are now governed by the Federal-Provincial Fiscal Arrangements and Established Programs Financing Act, 1977, are little understood outside a small coterie of Ministers and their officials, yet they closely touch the daily lives of every Canadian.

In 1980-81, some $13 billion in cash was transferred to the provinces by the federal government, a sum that accounted for 20 per cent of the latter's expenditures. While these funds were of significance to all provinces, for those in the Atlantic region they represented as much as 50 per cent of total revenues.

Out of this $13 billion, nearly $10 billion in cash transfers was covered by two of the major provisions of the Fiscal Arrangements Act – the Equalization Program and Established Programs Financing (EPF), the latter involving transfers for health care and postsecondary education. In addition, the provinces collected nearly $4 billion in additional revenue as a result of tax points yielded to them by the federal government as part of the EPF provisions.

The third major element of the Fiscal Arrangements Act is that with respect to the Tax Collection Agreements between the federal and provincial governments, which contribute in an important way both to the harmonization of taxes and to reduction of the costs of collection by governments and compliance by taxpayers.

The current review of the fiscal relationships between the two levels of government is in line with that regularly conducted every five years throughout the postwar period. It is expected that the review will be completed and new legislation to replace the existing Fiscal Arrangements Act of 1977 put in place by March 31, 1982, when the provisions in the present statute with respect to equalization expire.

Far-reaching changes were made in the fiscal arrangements following the last intergovernmental review in 1977, particularly with respect to federal funding of provincial health care programs and postsecondary education. Nevertheless, the Council concluded in its report that "changing circumstances and practical experience dictate the need for further substantial reshaping of the policies governing these programs."

The Council said that the primary objective of its study was the determination of long-term principles to govern the fiscal arrangements between the two levels of government that were equitable, that would contribute to stability, and that were durable in the face of rapid economic change. While some of the recommendations flowing from its examination of the issues could be incorporated in the forthcoming revision of existing arrangements, the Council recognized that others required much more extensive study and debate before consideration could be given to translating them into practical instruments of policy.

In the course of assessing and evaluating the present state of federal-provincial fiscal relations so as to consider possible reforms for the future, the report examined the historical evolution of events leading up to the adoption of the existing legislation, a number of important developments that subsequently followed, and the results of practical experience with the new regime.

The study focused on five main areas of concern: the Equalization Program; Established Programs Financing and future arrangements with respect to health care and postsecondary education; fiscal co-ordination between the federal and provincial governments with respect to both taxation and economic stabilization policies; and the mechanisms and processes through which these arrangements are negotiated by Ottawa and the provinces.

The Council's report was completed before account could be taken of the major changes proposed by the Hon. Allan J. MacEachen, Minister of Finance, in his Budget of November 1981, with respect to the fiscal arrangements as they affected equalization and the financing of health care and postsecondary education. The Council's deliberations were, however, overshadowed to a considerable extent by earlier pronouncements by the Minister of Finance indicating his intention of seeking a saving in federal-provincial transfers between 1982-84 of $1.5 billion, which he suggested was necessary to help rectify the "fiscal imbalance" being experienced by the federal government. Because it is central to the entire issue of federal-provincial fiscal relations, it is this question of fiscal imbalance to which we first turn.

Fiscal imbalance

In the Budget which he brought down in October 1980, the Minister of Finance underlined the new priority which the federal government had assigned to expenditures aimed at promoting economic development. At the same time, the Minister also indicated his intention of seeking "significant savings" of some $1.5 billion between 1982-84 in transfers to provincial governments, particularly for those involving expenditures from the social affairs envelope (which includes transfers for health care and postsecondary education). The statement was of particular relevance because it marked the first time the federal government had approached fiscal negotiations with the provinces with the expressed intention of reducing the amount of transfers previously provided.

In a submission in April 1981, to the federal Parliamentary Task Force on Federal-Provincial Fiscal Arrangements established for the first time to consider such issues, the Minister sought to justify such a cut-back on the grounds that the federal government was suffering from a "fiscal imbalance." This, he maintained, was evident from the large and persistent deficit of Ottawa compared with the surplus position of the provinces as a whole.

In considering this issue, the Council acknowledged that the argument of the federal government might have merit if it could be shown that there were structural obstacles present in the federation which prevented either the federal or provincial governments from gaining access to revenues they required to fulfil their constitutional responsibilities. "Since both federal and provincial governments in fact have access to all major revenue sources, the Council sees no evidence that such a structural imbalance exists in our federal system," the report asserted.

While the level of the federal deficit had been a matter of concern to the Council, it concluded that there was no meaningful evidence to indicate that the increase that had taken place between 1975 and 1980 could be linked specifically to increases in federal-provincial transfers.

Although the provinces as a whole have been in a surplus position for some years, all but the three resource-rich western provinces have experienced deficits despite efforts to restrain expenditures over a prolonged period and it is anticipated these deficits will increase significantly over the next five years. Federal transfers constitute a large proportion of the revenues of a number of provinces. "Strictly from a budgetary point of view, therefore, the Council sees little merit in reductions in federal-provincial transfers that would, in effect, merely shift part of the burden of a declining federal deficit to less fortunate provincial governments." "Nor," the report said, "is the expressed desire of the federal government to strengthen national standards in the areas of health insurance and postsecondary education consistent with a simultaneous policy of restricting federal funding."

In addition to these considerations there was the fact that the recent federal-provincial agreements on energy pricing and revenue allocation had substantially improved the budgetary outlook of the federal government. For all these reasons, therefore, the Council urged the federal government to reconsider its proposal to reduce the level of transfers to the provinces below the level provided for under the existing arrangements.

The equalization program

Objectives and results

Canada's program of federal equalization payments to the "have-not" provinces has been described as the "glue" that holds the nation together. In 1980-81, payments amounting to $3.4 billion were made under the program to 7 of the 10 provinces.

Yet the equalization system has encountered significant difficulties in recent years. The fundamental goal of the program is to ensure that through the provision by the federal government of sufficient financial means, all provinces have the opportunity to provide reasonably comparable levels of public service to their citizens at reasonably comparable levels of taxation.

The program has, however, fallen well short of achieving the explicit objective set for it in 1967 of raising the revenue capacities of all provinces to the national average. In 1980-81, the financial capacity of seven provinces, including revenue from equalization payments, ranged from only 82 to 87 per cent of the national average when all provincial natural resource revenues are included and account is taken of all local property taxes, not just those for school purposes which are included in the present formula. Even if all federal transfers are considered, the revenue capacity of 7 of the 10 provinces in that year was still 8 to 14 percentage points below the national average.

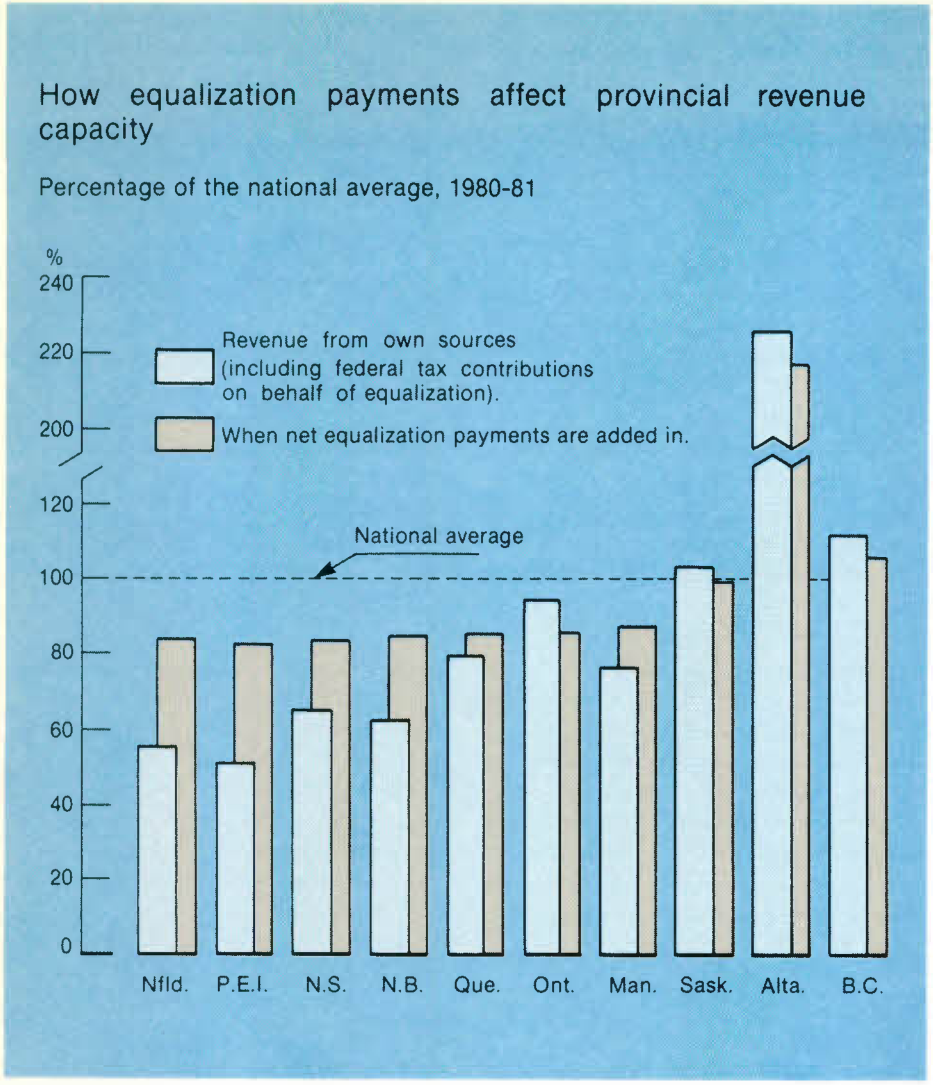
The primary factor responsible for the failure of the Equalization Program to achieve its underlying objective has been the substantial increase in revenues from non-renewable energy resources that have flowed into the coffers of the western provinces since 1973. "These increases in revenues did not accrue to the same extent to the federal government, which was nevertheless forced as a consequence to make large disbursements in equalization payments to the 'have-not' provinces out of its general revenues," the Council pointed out. "The resulting pressures on its budget led the federal government to impose a number of *ad hoc* limitations on the extent to which resource revenues enter the equalization formula and the extent to which provinces are eligible to receive payments."

While all provincial revenues from renewable natural resources continued to be fully included for purposes of calculating equalization payments, the federal government in 1977 revised previous constraints to provide for only one-half of revenue from non-renewable resources to be taken into account. Furthermore, it stipulated that no more than one-third of total equalization payments could result from the inclusion of natural resource revenues in the formula, a ceiling that could become effective in 1982. At the same time, Ottawa decided to phase out the inclusion in equalization of any revenues from the sale of Crown leases over the period 1979-81.

The report underlined the fact that Ontario had been particularly adversely affected by changing circumstances involving the Equalization Program. As the major contributors to the national Treasury, Ontario federal taxpayers bore the brunt of the increase that took place in equalization payments despite the constraints imposed by the federal government as a result of sharply increasing western resource revenues. In 1980-81, they contributed an estimated $1.5 billion of the cost of total equalization payments in that year of $3.4 billion. At the same time, however, the Ontario government was precluded by a special provision from becoming eligible for the equalization payments for which it would have otherwise qualified for the first time in history. By regulations adopted in 1978 and later by legislation, Ontario was excluded by a provision that denied such payments to any province in which personal income per capita was above the national average in the current and two previous years. It is estimated that Ontario would have been eligible to receive nearly $500 million in equalization payments in 1979-80 if that special rider had not been in effect.

The report calculated that in 1980-81, the financial capacity of Ontario in terms of its own revenue sources amounted to 92 per cent of the national average (in contrast to 53 per cent in Prince Edward Island and 232 per cent in Alberta). After equalization was taken into account, however, Ontario's financial capacity was reduced to 86 per cent of the national average, which was lower than that of some provinces receiving equalization payments.

At first glance, the report pointed out, the resource-rich western provinces



appeared to escape lightly from the burden of financing the costs of equalization payments because much of their resource revenue flowed into provincial Treasuries and, hence, was not liable to federal taxes as would be the case if such revenue ended up in the hands of individuals and private companies.

"This, however, is only part of the picture," the report emphasized. "Council research indicates that the amount of redistribution that takes place as a result of inclusion of natural resources in the Equalization Program is dwarfed by the amount of redistribution that has been taking place through other mechanisms. For example, an estimated $13 billion of natural resource rents were redistributed from Alberta to the rest of Canada in 1980 mainly as a result of the federal government's policy of maintaining the domestic price of oil and gas well below world levels. This implicit transfer exceeded *all* cash transfers from the federal to provincial governments in 1980-81."

In search of a foundation of principles

The evident shortcomings that have developed in the present Equalization Program as a result of a series of *ad hoc* responses to radically altered circumstances led the Council to search for a set of basic principles that might provide the foundation for a more sound and durable system of equalization in the future.

The report took as its starting point the fundamental conclusion that the underlying goal of equalization should be twofold – to achieve *equity* among Canadians wherever they lived in the country and the highest possible degree of national economic *efficiency*. The goal of equity is in line with the commonly accepted objective of government in Canada to reduce inequalities in real income between people and to ensure that individuals in similar economic circumstances are treated in the same way wherever they live in Canada.

The Council acknowledged that there were sharply different opinions with respect to the system that would best meet these objectives. Some observers who have argued that the present system of intergovernmental transfer payments has reduced a number of the provinces to an unhealthy state of dependence on federal largesse, contend it should be replaced entirely by a system of transfers to people. Others have argued that equalization payments and other forms of special assistance to governments and individuals in the less wealthy areas of the country have impeded economic efficiency by short-circuiting the adjustments that would otherwise take place – for example, through migration of workers from these areas to those experiencing greater economic activity.

The Council pointed out that such contentions also raised another basic question: "Why do we need an intergovernmental transfer system when we have in place, at both levels of government, a well-established system of taxes and transfers among persons, households and firms for regulating the allocation of economic activity and the distribution of its fruits?"

The report concluded that an equalization program involving transfers between governments was a necessary complement to the individual system of taxes and transfers because the latter is unavoidably based essentially on the nominal or "market" income of individuals. Such an approach, however, fails to take account of the net fiscal benefits of people in different provinces – that is, the goods and services they receive from provincial governments in many forms in relation to their cost through the imposition of various provincial levies. "Differences in net fiscal benefits may arise," the study explained, "because provinces with high per capita incomes can finance a given amount of public services with less tax effort (lower tax rates on income) than provinces with lower per capita incomes. These differences may also arise because a resource-rich province can use revenues collected from its natural resources (such as oil rents) to finance public services and at the same time maintain relatively low levels of taxation."

As a result of the impact of these fiscal benefits, a Canadian living in one province with the same market income as a fellow citizen living in another province can have a very different *real* income when the net fiscal benefits provided by their respective provincial governments are taken into account. If an appropriate degree of equity is to be achieved in these circumstances, a system of intergovernmental transfers is required to reduce or eliminate such differences.

Under the broad concept of equity that is generally accepted, such differences in the well-being of Canadians resulting from variations in net fiscal benefits available from various provincial governments should, in the view of the Council, be largely eliminated – as would be essentially the case in a unitary state. Such a goal however, must be modified to take account of the provisions of the Constitution, which appear to confer certain property rights on the provinces and their residents with respect to natural resources. The Council arrived at the conclusion, therefore, that only a portion of the revenues received by provincial governments from natural resources, and only that amount that was passed on to provincial residents as benefits in the form of various goods and services or tax relief, should be subject to equalization. Resource income channelled into savings, such as Alberta's Heritage Fund, should not be included. The balance would be treated, in effect, as if it were distributed to provincial residents in the form of income and made subject to federal tax.

While equity would appear to dictate only the partial equalization of provincial natural resource revenues because of the overriding considerations established under the Constitution, it was the Council's judgment that full equalization of such revenues was in fact required from the point of view of national economic efficiency. Although some have argued that equalization payments impede necessary adjustments in the economy that otherwise would take place automatically in response to market forces (such as the migration of workers within the country), the study arrived at the very opposite conclusion.

"Economic efficiency requires that factors of production be guided among activities (including those in different provinces when this is an option) by signals related to their productivity in different locations," the report said. "Differences in net fiscal benefits among provinces tend to distort the market signals that would otherwise be expected to do this job. The only solution to this problem is to eliminate the source of such distortions – that is, the differences in net fiscal benefits arising from provincial government activities."

The empirical research undertaken at the Council demonstrated that the past effect of equalization and of differences in provincial government financial capacity (arising from natural resource revenues in particular) on the interprovincial migration of labour have been significant enough to justify consideration of the potential efficiency costs of adopting alternative approaches to equalization in the future. It was shown that for low-income persons in particular, these aspects of fiscal structure have been of roughly the same importance as regional differences in employment and income in explaining the recent trends in interprovincial migration.

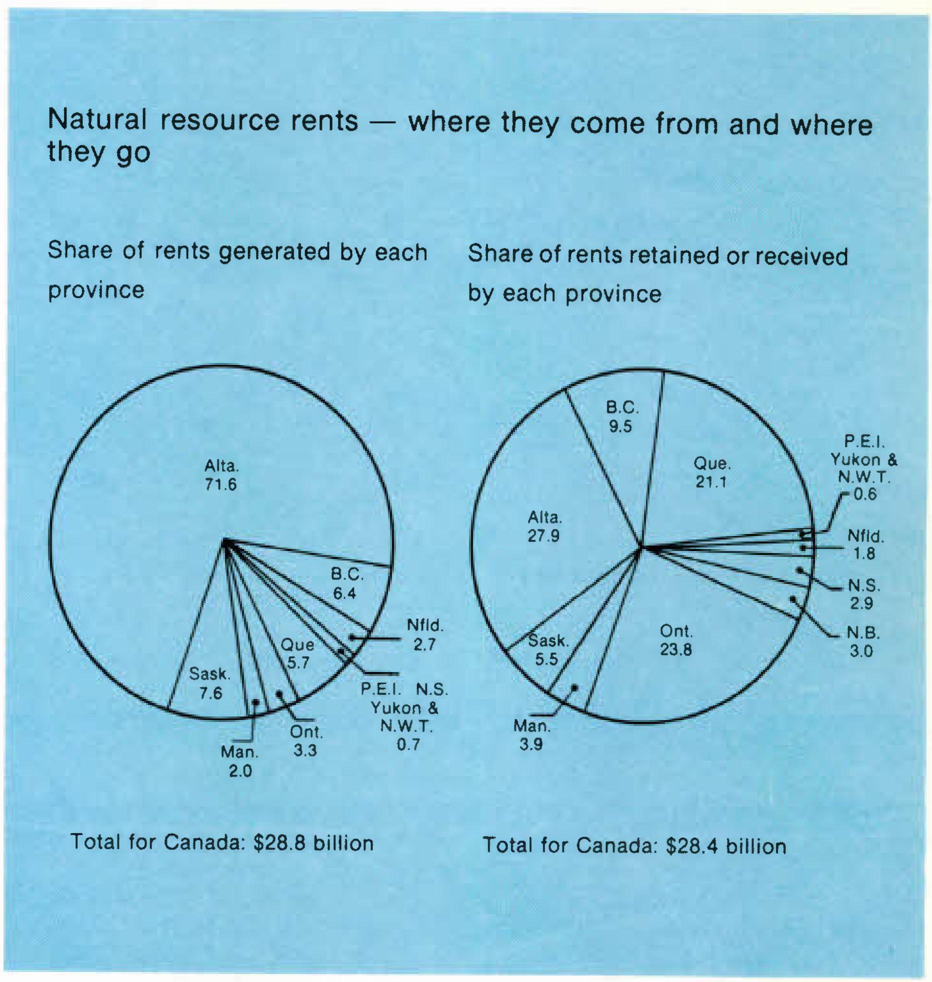
Given some unavoidable conflict between the requirements of equity and economic efficiency, the Council concluded that precedence had to be given to the considerations of equity, which dictated that only a portion of provincial resource revenues be taken into account for equalization purposes.

Economic "rents"

The massive rise that has taken place in the world price of oil since 1973 has resulted in a correspondingly large increase in the value of Canada's natural resource production related to energy – particularly of petroleum, natural gas and hydro-electricity. Because the cost of production of energy from conventional sources of supply has risen only moderately in comparison, huge unearned gains have resulted – what are often referred to as "economic rents."

Some of these rents have been absorbed by governments through increased levies on energy-related natural resources, as reflected in the substantially increased revenues over the past several years of the western provincial governments. Some of the rents have also undoubtedly been retained by private producers of such resources. But through a variety of mechanisms established by governments – pricing policies, taxation, contractual arrangements, and equalization payments – a substantial amount of these rents has been redistributed throughout Canada.

As a result of federal policies which



Natural resource rents — where they come from and where they go have held the domestic price of oil and natural gas well below world levels and well below the cost of developing many new energy sources, for example, a large proportion of these rents have been passed on to consumers across Canada in the form of reduced prices.

Similarly, the consumers of hydro-electricity produced by provincially owned utilities have also enjoyed considerable subsidy as a result of three major factors. First, most provincial utilities have not been imposing sufficient charges to recover a normal return on their investment. Second, the provinces have not been collecting the additional economic rents that are available because of the increase in the value of energy that has occurred over the past several years. Third, the price of electricity has been held down to the extent it is produced by thermal generation fired by oil or gas, which fuels themselves are subsidized.

All of these developments have important implications for the Equalization Program because, to the extent that economic rents are not collected by provincial governments, they are not taken into account for purposes of determining equalization payments. In fact, only a relatively small proportion of resource rents are distributed through equalization payments. As the Council emphasized, the economic rent generated from natural resources in recent years has assumed major proportions in the Canadian economy. The report estimated that in 1980 the economic rent from oil, natural gas and hydro-electricity, together with relatively minor rents from other natural resources, totalled $29 billion. This was equivalent to approximately 10 per cent of the gross national product in that year and twice the proportion of only two years previously.

Of the total of $29 billion in rents generated in the producing provinces, however, an estimated $13.5 billion were redistributed from the provinces in which production occurred. This sum exceeded the total of all federal cash transfers to the provinces in 1980 of nearly $13 billion. Seven provinces were net beneficiaries of this redistribution.

This redistribution of rents had important consequences for many provinces. For example, a total of $20.6 billion of such rents was produced in Alberta, but around $12.7 billion was redistributed to other provinces. Even after taking account of the fact that Ontario bears the lion's share of the cost of financing the costs of equalizing provincial natural resource revenues, its residents were still the prime beneficiaries of the redistribution of natural resource rents to the extent of $5.9 billion.

Reform of the program

As a result of its study, the Council reached the view that little change is needed in the present equalization system with respect to the determination of payments based on provincial revenues from areas other than natural resources. It recommended only one modification in this aspect of the program – the extension of the formula to cover all local government revenues from property taxes, rather than just school property taxes – which have been included since 1973.

The Council did propose, however, that significant changes be considered over the longer term with respect to the treatment of provincial natural resource revenues. It advocated that these changes be in line with the following principles:

- that all provincial natural resource revenues – including those economic rents which are not collected, but passed on to consumers directly in the form of subsidized prices – be fully included for purposes of determining equalization payments;
- that such resource revenues should be subject to equalization only when they are employed directly or indirectly to provide goods and services or other benefits, with funds diverted to savings funds being exempt;
- that the amount of intergovernmental transfer payments based on provincial resource revenues should be calculated according to the federal tax rate that would apply if such revenues were considered as personal income subject to federal taxation.

Pending the establishment of more permanent provisions for the treatment of resource revenues under the equalization formula, the Council urged that any interim arrangement constrain the growth of payments based on such revenues by limiting them to the rate of growth of equalization based on non-resource revenues or the rate of growth of GNP.

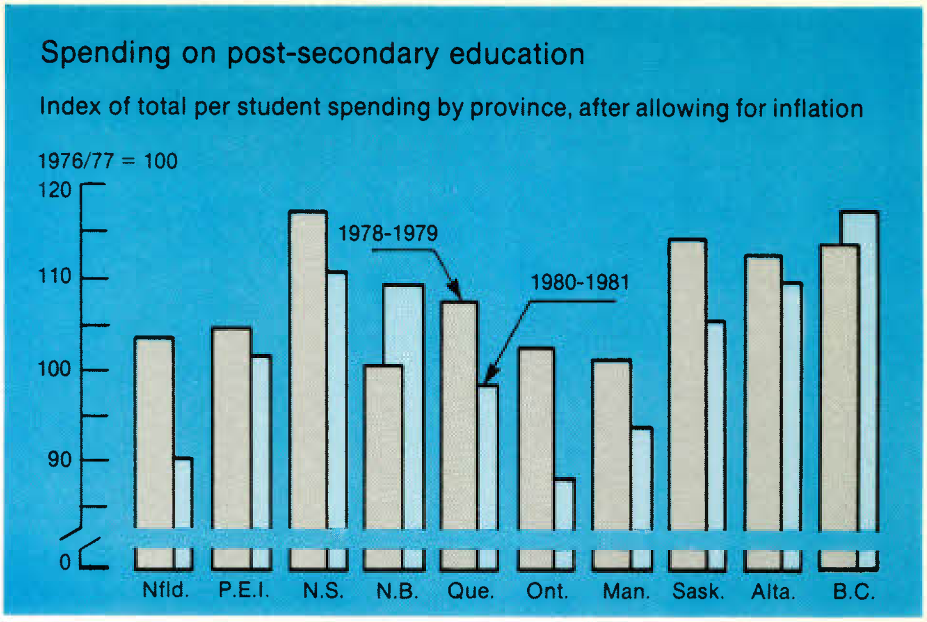
Finally, the Council concluded that special conditions such as that which at present make Ontario ineligible to receive equalization payments to which it would otherwise be entitled under the formula had no place in an equalization program. "The equalization formula should apply uniformly to all provinces without exception," the report asserted.

The application of the principles of equalization advocated in the study would have major financial implications for the federal government and many of the provincial governments. The inclusion of all municipal property taxes in the formula would have the effect of increasing total payments without substantially altering their distribution. The calculation of equalization payments based on the formula for dealing with resource revenues proposed by the Council would have the very opposite effect, tending to reduce the total amount of payments made by the federal government and extensively changing their distribution to individual provincial governments.

Had the system for treating natural resource revenues advocated by the Council – including that for uncollected hydro-electricity rents – been in effect in 1980-81, federal equalization outlays would have been reduced by some $760 million from their level under the current program of $3.4 billion. Because its residents receive substantial benefits from hydro-power consumption, payments to Quebec would have been reduced by $568 million to $1.15 billion under the existing program, and Manitoba's by $103 million to $240 million, while payments to Saskatchewan – which produces relatively little hydro-electric power – would have more than doubled to $88 million.

The report also included projections of the financial implications to 1986-87 of adopting a variety of different equalization formulas. It estimated that if all municipal property taxes were equalized, the rider excluding Ontario eliminated, and natural resource revenues treated in the manner proposed by the Council (except that uncollected hydro-electricity rents were excluded from the calculation), total federal payments would be lower than under the current program in every year over the period by 11 to 14 per cent. If instead, the growth of equalization payments associated with resource revenues were constrained to the rate of growth of GNP beginning in 1982-83 as recommended by the Council as an interim measure, it is estimated that payments would be about 8 per cent higher each year to 1986-87 than if the current program were extended.

Providing for the health care and postsecondary education of Canadians



Established Programs Financing

Under the Constitution, health care and education are primarily the responsibility of the provinces. During the postwar period, however, a broad national system of health care and postsecondary education was established in Canada with substantial financial support from the federal government. Up until 1977, Ottawa paid for approximately 50 per cent of provincial operating costs for postsecondary education and for insured hospital and medical care services which complied with detailed conditions laid down by federal authorities.

Over an extended period, the provinces increasingly chafed under what they regarded as the rigid and inflexible requirements they were obliged to meet in order to qualify for the sharing of health and education costs, while the federal government became increasingly concerned about its inability to curb rapidly mounting expenditures within the prescribed areas.

In an effort to meet both of these concerns, the previous shared-cost funding of health care and postsecondary education by the federal government was replaced by a system of block grants under what was termed Established Programs Financing (EPF), which formed part of the Fiscal Arrangements Act of 1977. EPF also provided additional funds to help cover the cost of Extended Health Care services provided by the provinces that went beyond those covered by the hospital and medical insurance programs. The provinces acquired considerably greater freedom to allocate spending in line with their own perceptions of need so long as they continued to adhere to the pursuit of certain broad objectives with respect to health care. At the same time, federal transfers were no longer linked to provincial costs. The federal government agreed instead to make annual cash payments to the provinces, the yearly increase being linked to the rise in gross national product, and also transferred to the provinces the yield from certain percentage points of personal and corporate income taxation. In 1980-81, the value to the provinces of these cash payments and tax revenues amounted to around $10 billion.

While the provinces have generally been satisfied with their experience under EPF, the federal government has not. It has suggested that its share of the costs of health care and postsecondary education services administered by the provinces has increased unduly, the corollary being that the provinces have been bearing a significantly lower proportion than they did under the shared-cost programs. As noted previously, the federal response has been to propose a reduction in the amount of transfers for these established programs under the new Fiscal Arrangements Act to be adopted in 1982. At the same time, however, Ottawa has also criticized the provinces for failing to maintain adequate services without resort to excessive user fees, such as the extra billing by physicians over and above the standard medical fees provided under provincial medical insurance plans. Federal authorities have indicated that an effective mechanism should be established to enable them to ensure that national health care standards embodied in existing or new legislation are maintained.

Based on its studies, the Council concluded that "the provinces, for the most part, have not taken undue advantage of the increased flexibility of Established Programs Financing to reduce their spending on health, higher education and related programs." While some spending restraints have occurred, "generally they appear to be in line with EPF objectives. The analysis also shows that some major changes have taken place in the type and range of health services, but these changes, too, could be expected under the more flexible arrangements of EPF funding."

The report noted that there had been virtually no decline in provincial spending on health care and postsecondary education since 1977 in relation to GNP. At the same time, however, it was also evident that federal transfers accounted for a somewhat larger proportion of provincial expenditures than they had prior to the adoption of EPF; in 1980-81 the increase in the federal share as a proportion of GNP was around 4.5 per cent (excluding additional payments made as part of the revenue guarantee offset). The study indicated that the primary factor responsible for this increase was the escalation formula under which the increase in federal EPF payments is linked to the average rise in GNP over the previous four years – an increase that was significantly higher in the period prior to the introduction of EPF than in the years that followed.

The Council nevertheless opposed any cut in federal transfer payments under EPF because it would only shift the burden of costs from one level of government to another, with the "brunt of the adjustment falling on the provincial taxpayer or recipient of services."

$$$$$$$$$$$$$$$$$$$

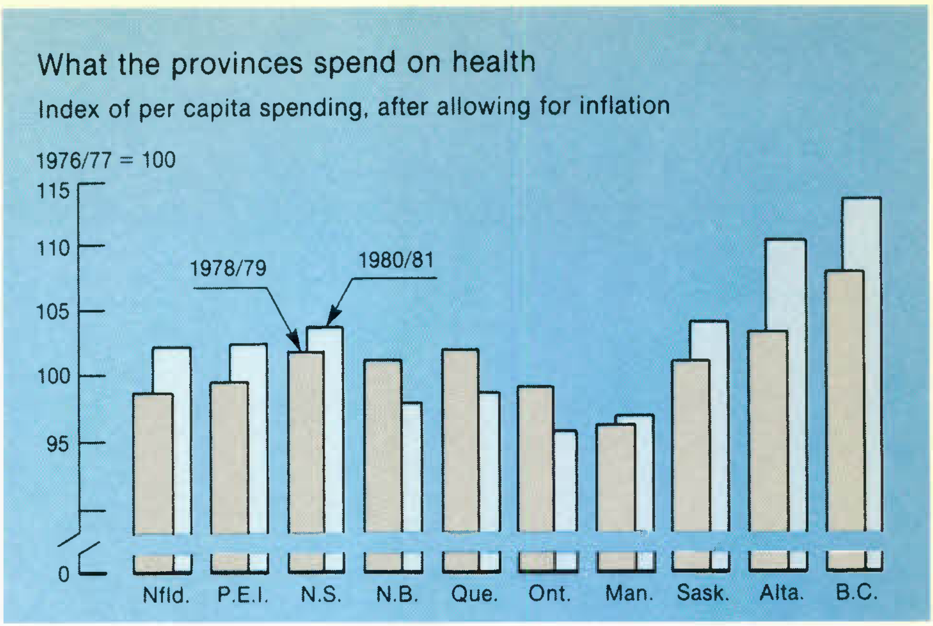
Strengthening Canada's health care system

During the 1950s and 60s, a national health insurance system was established with the broad objective of providing a reasonable level of health care to all Canadians regardless of income or where they lived in the country. In 1980-81, a substantial proportion of the $10 billion in cash transfers and revenue from tax points transferred to the provinces under EPF was aimed at covering the costs of provincial hospital insurance, medical insurance and extended health care programs.

Several years after the establishment of this national system, however, major disparities continue to exist in the level of health services provided across the nation. At the same time, the Council noted that some serious concerns have been voiced in recent years with respect to the future of the existing system.

"There is public concern that health care will become less accessible to Canadians because of budget trimming by governments and opting out by physicians," the report said. "The provinces are concerned that transfers from the federal government will not be sufficient to meet the cost of health care, especially in the case of the poorer provinces. The federal government is concerned about the growth in its expenditures and the danger that some provinces may be unwilling (and others unable) to maintain today's standards of health care if it should reduce or relinquish its role of providing financial assistance in these areas."

The Council's study indicated that wide variations existed in the level of health costs and services between provinces. During the period from 1976 to 1978, for example, hospital operating expenditures on a per capita basis ranged from a low of 66 per cent of the national average in Prince Edward Island to a high of 117 per cent in Quebec. Such variations were due in almost equal measure to differences in the number of patient-days in hospital on a per capita basis and of the costs per day of maintaining a patient in hospital. By the same token, the output of physicians in terms of the volume of services provided was found to vary by 20 to 30 per cent between provinces. Access to physicians also differed sharply, being 40 per cent below the national average in the Atlantic Provinces and as much as 10 per cent above the national average in Ontario and Quebec.



Notwithstanding these substantial disparities between provinces in the level of health services provided, the study underlined the fact that the level of health of Canadians, as measured by life expectancy and infant mortality, varied very little between provinces. "It is of some importance to attempt to determine why provincial health expenditures vary so much while provincial life expectancy varies so little," the report asserted.

It concluded that one important factor accounting for major differences in the average number of days that patients spent in hospital was differences in the average age of a province's population. Those provinces with a larger proportion of the elderly – such as Prince Edward Island, Manitoba, Saskatchewan and British Columbia – registered a higher number of patient-days in hospital per capita simply because treatment of older people took greater time on average than in the case of the young or middle-aged. A second important factor accounting for disparities in the level of health services generally appeared to be attributable to differences in the number of practicing physicians per capita, which in turn had an important bearing on the level of available hospital services.

Council recommendations

In its report, the Council proposed a series of measures both to strengthen health care and postsecondary educational services across the country and to improve the ability of Parliament and the public to maintain continuing scrutiny of developments in these two fields.

The Council underlined the need to establish a system that would provide for a greater measure of accountability as to the efficiency and effectiveness with which federal funds transferred to the provinces for health care and postsecondary education were being employed. "As a first step in the process of providing for greater accountability, we propose that the transfers by the federal government to the provinces under EPF for health care and postsecondary education be allocated separately so that the manner in which those funds are employed can be more readily determined than at present," the Council stated. "As a means of more closely monitoring developments over a wide area of concern with respect to health care expenditures and services, the Council concludes that it is essential for the federal government, in co-operation with the provinces, to establish a system under which all relevant and up-to-date statistics would be made available on an annual basis. This would include statistics on the operations of all hospitals and mental institutions, physicians' services, and extended care facilities."

As a final step in the accountability process, the Council recommended that the Minister of Health and Welfare Canada table an annual report in Parliament on the performance of the national health care system "so that all information pertaining to federal-provincial funding, levels of service, accessibility, provincial disparities, and quality of services will go on public record and the issues surrounding them will be open for public and parliamentary debate."

As one means of overcoming disparities in provincial health services, the Council urged that the amount of fed-

$$

eral transfers be linked to the relative age of the population of the various provinces, with greater per capita payments made to those with a higher-than-average proportion of the elderly in order to compensate for the resulting increase in hospital costs. Such an adjustment should be made without an increase in total expenditures by the federal government on health care.

While education generally is largely a provincial responsibility, the Council contended that the federal government had an important part to play in the postsecondary area. To eliminate existing uncertainty, however, the Council called on the federal government to define more clearly the role that it proposed to carry out in future.

The report recommended that the federal government continue to provide strong support to postsecondary education on an unconditional basis so long as there is no attempt on the part of provincial governments to discriminate against students from other parts of Canada. At the same time, however, the Council pointed out that at present the federal government has no official part in the process of co-ordination of postsecondary education activities across Canada, despite its substantial financial contribution. "To remedy this shortcoming, we recommend that the federal and provincial governments establish a formal and continuing dialogue for the purpose of improving federal-provincial co-operation on matters relating to postsecondary education policies." In addition, it was proposed that the Secretary of State table an annual report in Parliament "on the effectiveness of federal programs relating to postsecondary education."

The harmonization of fiscal and stabilization policies

An important objective of any federal state is the harmonization of the fiscal policies of federal and provincial governments, such as those involving tax, spending and other similar measures, and also of policies aimed at achieving stable economic growth.

As the Council pointed out in its report, the aim of fiscal harmonization is the establishment of arrangements "that permit provincial governments to institute expenditure and income distribution policies according to their own individual priorities – policies that, at the same time, cause the least fiscally induced distortion in the distribution of the economy's resources."

To a considerable extent, tax harmonization in Canada is achieved through the instrument of the Tax Collection Agreements between the federal and provincial governments, which form part of the Fiscal Arrangements Act. Under these agreements, the federal government collects personal and corporate income taxes on behalf of participating provinces subject to their acceptance of certain conditions – primarily the adoption of the federal personal and corporate income tax base. Ottawa currently collects personal income taxes for all provinces except Quebec and corporate income taxes for all provinces other than Quebec, Ontario and Alberta.

The Council concluded on the basis of its study in this area that the Tax Collection Agreements have generally worked well over a period of some 40 years. They had prevented a return to the "tax jungle" that prevailed for many years prior to the last war and contributed to the maintenance of uniform practices in areas where that was important, yet they had also provided for a substantial measure of flexibility in the shaping of tax policies of the individual provinces in line with their own priorities.

At the same time, however, there had been two developments in recent years that raised cause for concern – one involving discriminatory provincial tax measures and the other involving tax competition between provincial governments.

The report noted that on a number of occasions in the past provincial governments had sought to introduce policies that would discriminate in favour of provincial residents receiving dividends from companies with headquarters within their boundaries. While the federal government refused to administer such policies on behalf of provinces for which it collected taxes, it was powerless to stop such practices in the case of provinces which were not parties to the agreements or by provinces which were parties to the agreement but which implemented such measures by non-tax programs.

"The economic case against these discriminatory measures is a classic one," the Council asserted. "They create barriers to the mobility of capital and goods within the nation. Such restrictions impede the allocation of resources to their most productive uses."

The Council welcomed the initiative taken by a number of provinces to promote the adoption of a Code of Conduct which would require the provinces generally to abstain from the adoption of such discriminatory tax measures. But it was also important that any Code of Conduct take account of the fact that the objectives of such discrimination could be achieved by other means than taxation, such as through spending policies or regulatory provisions. The report acknowledged that there was a similar reason to be concerned about certain regional development policies of the federal government that also tended to balkanize the economy, which suggested that Ottawa should be prepared to accept some constraints on its own activities in these areas.

A lesser but still significant problem was posed by the efforts of some provinces, notably the more wealthy ones, to reduce taxes in general with the intention of encouraging the location of investment and other forms of economic activity within their borders. To prevent such competition, proposals have been put forward to "federalize" corporate income taxes or, alternatively, to require the adoption by the provinces of uniform corporate tax rates. The Council concluded that such measures were impractical and unworkable. "If wealthy provinces were determined to attract business away from other jurisdictions, they could just as easily do so by 'expenditure competition' as by granting tax breaks to business," the report pointed out.

Although in the past some observers had voiced concern that the growing fiscal power of the provinces might be wielded perversely to undermine the ability of the federal government effectively to apply policies designed to maintain economic stability, this danger had, in fact, not been realized in the judgment of the Council. On the basis of studies which it commissioned, the Council concluded that provincial measures had generally been supportive of federal stabilization policies. For that reason, the report rejected suggestions that Ottawa should take steps to encourage the provinces to adopt specific measures in support of federal stabilization policies, such as borrowing from Ottawa at lower federal interest rates in times of recession in order to promote increased demand for goods and services.

ECONOMIC ANALYSIS BRANCH
MIN OF TREASURY & ECONOMICS
FROST BLDG N 5TH FL
TORONTO ONT
1515304 M7A 1Z3

Canada Post / Postes Canada
Postage paid / Port payé
Bulk third class / En nombre troisième classe
926
Ottawa

au Courant

Economic Council of Canada

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.

Economic Council of Canada
P.O. Box 527
Ottawa, Ontario
K1P 5V6

Conseil économique du Canada
C.P. 527
Ottawa (Ontario)
K1P 5V6