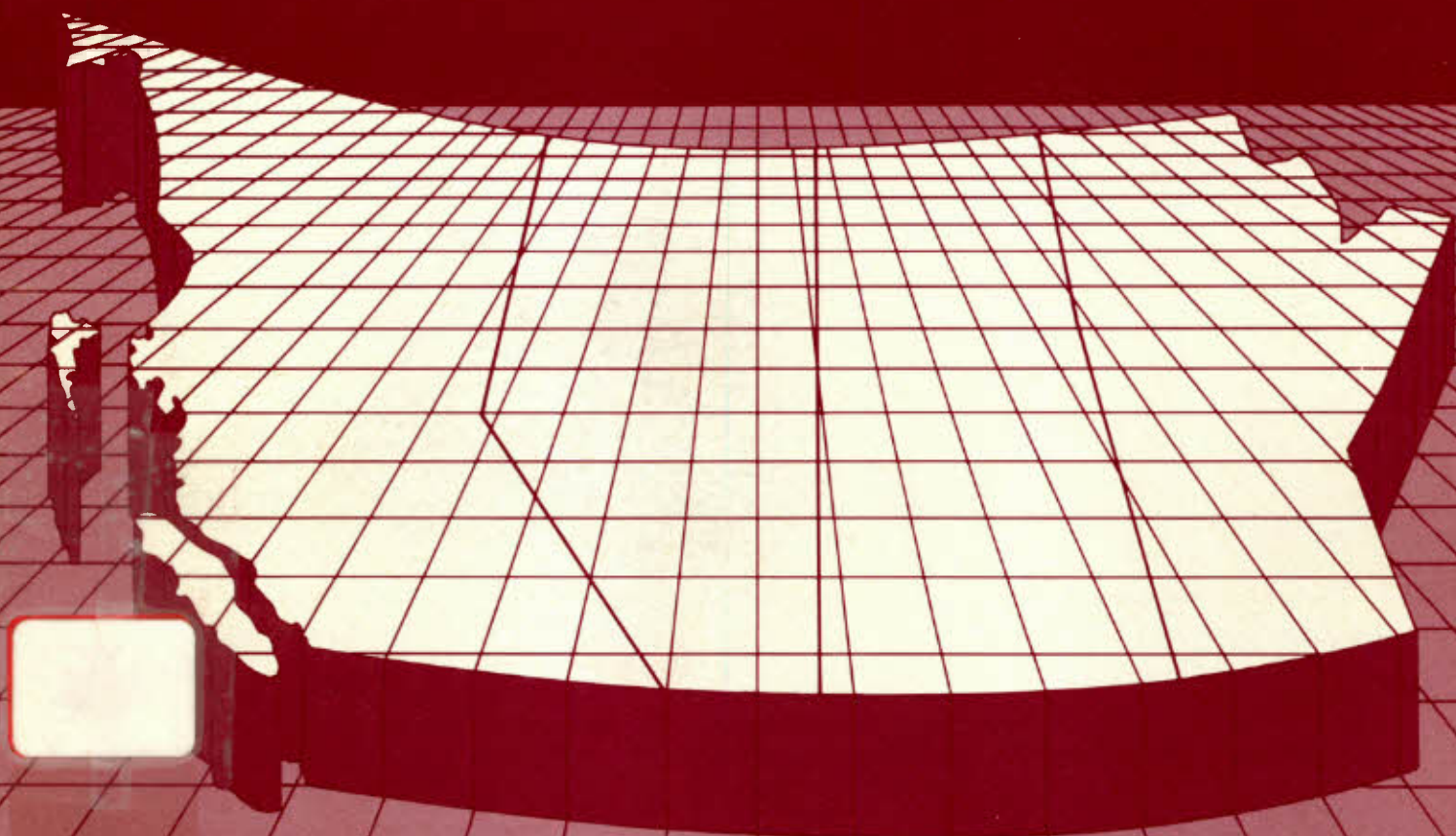


Economic Council of Canada

Volume 5, No. 2, 1984

au courant

A special issue on western Canada



PUBLICATIONS



New Council Report

Western Transition (EC22-123/1984E; \$9.95 in Canada; \$11.95 elsewhere).



What lies in store for Canada's four western provinces, given an anticipated slowdown in the growth of natural resources? The Council takes a close look at economic prospects for the West, and outlines the policies required to achieve future prosperity.

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WESTERN TRANSITION

Highlights from the Council's new report on the economic outlook for Canada's four western provinces:

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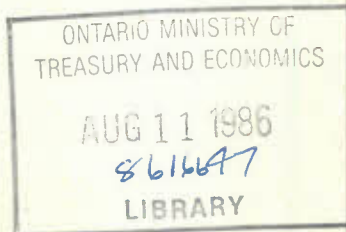


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Conference on the West

A conference on the outlook for the western Canadian economy will be held at the University of Alberta on Thursday, November 8th., and Friday, November 9th., 1984. Sponsored by the University's economics department, the conference will bring together participants from universities, research institutions, private industry and provincial governments to discuss the issues raised by the Economic Council report, *Western Transition*.

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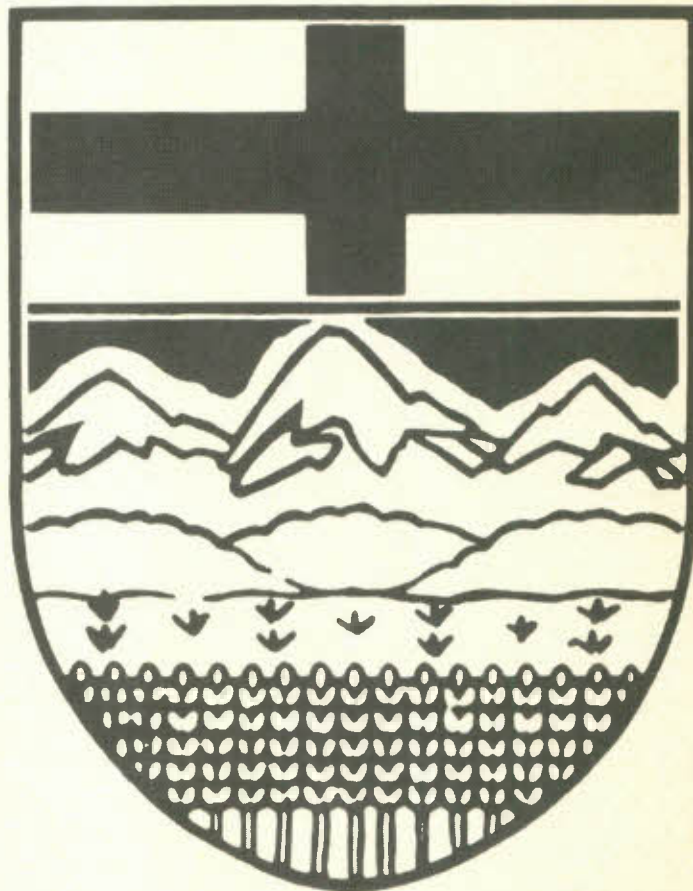
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WESTERN TRANSITION



“Western success requires only the absence of catastrophe, not fortuitous bonanzas”

WESTERN TRANSITION

The Economic Council is optimistic that a solid economic performance for the four western provinces is possible in the years ahead.

Future economic growth will depend less on natural resources than in the past and more on service industries, according to the Council's new report on the West. It will depend as well on major adjustments of policies for

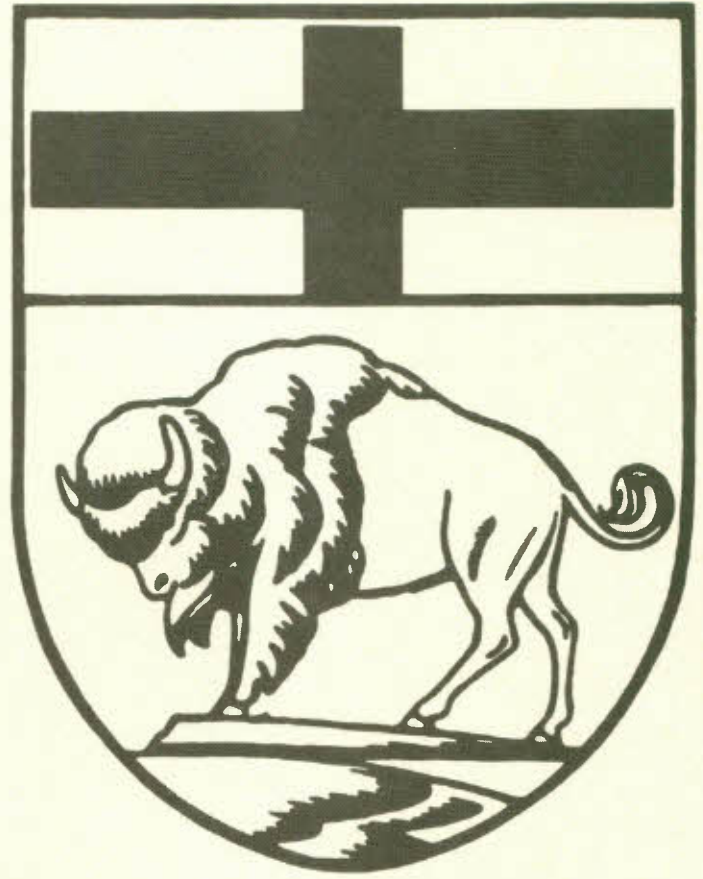
resource, manufacturing and service industries, mainly at the provincial level of government. Although the Council's outlook for growth is optimistic, it is unlikely that the "boom" years of the 1960s and 1970s will soon be repeated.

No single factor will ensure prosperity. What is needed, according to the report, is close attention to the economic

evolution already under way in the four western provinces. Historically, natural resources have provided the main economic impetus in the West – wheat, forestry, fishing and, more recently, oil and gas, and coal and minerals. Resources will still be important in the future, but will no longer be as central to prosperity as they once were. A dynamic and efficient service sector will also play a particular role. As a result of this transition, the future will likely hold more stable and solid prosperity.

The Council's view is "that the most important problem in the West is the lack of dependability of growth or the perception of such a lack." Other problems exist, but are less pressing, according to extensive analysis of various economic indicators, including the level, growth, and stability of incomes, job opportunities, and unemployment levels.

While income levels in the western provinces are somewhat above the national average, there are substantial variations among the provinces. Alberta and British



The Council's report looks at the western provincial economies and then outlines the policies needed to justify its optimism about the future of the West.

Many Canadians view the West as an economic "winner", but there are problems. The Council found that "perhaps the greatest problem is the Westerners' perpetual concern about their role as 'hewers of wood and drawers of water.'" That makes for a very unstable prosperity, heavily dependent year by year on economic forces largely beyond the control of the West. Worse yet, many worry that their resource-based economy will self-destruct as the resources are depleted. However, others believe – and just as firmly – that there can be a natural progression from a resource-based system towards a more diversified and stable economic structure.

There are problems unique to the individual provinces, as well as a perceived lack of variety of job choice, a feeling that the best jobs are seldom available in the West. As well, there is concern about transportation policies, existing trade and tariff practices, and federal spending and revenue policies.

Columbia are well above the average; Manitoba is a little below it; and Saskatchewan is about the same as the national average (although this is a recent development).

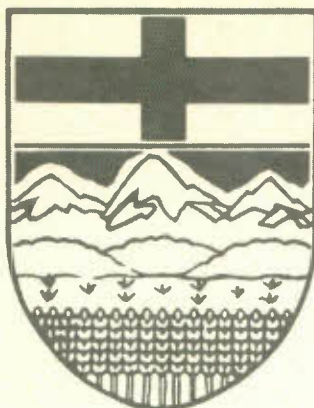
Growth rates of per capita income received over the past 50 years have varied slightly, with Saskatchewan doing better than the Canadian average, and British Columbia worse. As a result, provincial income levels have been gradually converging.

Compared with national levels, unemployment rates on the Prairies are usually low. In British Columbia, however, the rate is usually higher than the national average.

Another belief generally held in the West is that "good" jobs (those associated with high income, educational attainment, and social status) are to be found only in central Canada. Research, however, does not bear this out.

The so-called "good" jobs are not restricted solely to central Canada – they are available throughout the country in nearly equal proportions. Occupational patterns and opportunities show very little overall variation across Canada.

While long-term insecurity of growth is the most signifi-



cant concern, shorter-term instability is also seen in the West as an undesirable feature of their economies. To check how serious a matter income instability is, an analysis was done comparing income trends in the West with actual income for the two time periods 1926-45 and 1946-81.

The results were surprising. Income, as a whole, was found to be slightly more – not less – stable than the national average. This was so, despite the high instability of incomes from farming. There was a drastic drop in western income during the Depression, but an equally drastic increase during the Second World War. In the last 36 years, the West has gained far greater income stability. In fact, incomes in the western provinces as a whole are now no more unstable than those in Ontario, due mostly to the growing importance of the service sector and the more stable farm incomes there.

Whether the West gains or loses from being part of Confederation is a perennial question in the West. The Council felt that, although an overall decision on this issue was not possible, detailed investigation of some special aspects of it was most illuminating. The topics covered:

- The argument that Westerners pay the costs of tariff policy by having to pay more for goods imported from abroad or from elsewhere in Canada, while the benefits (which are seen as mainly manufacturing jobs) go to central Canada.
- A number of long-standing grievances related to transportation policy (this is dealt with in more detail on subsequent pages). Rate structures are said to discriminate against western producers and shippers to such an extent that diversification from primary resource production to processing is discouraged.
- Concerns that the federal government receives more from the West in tax revenues and royalties than it spends on the area. And, finally, there is a perception that public and private decision makers are unresponsive to the West because the seats of power are located, in the main, in central Canada.

Population growth is sometimes used as a benchmark for economic health. Surprisingly, the data show that the West's share of the total Canadian population has remained virtually the same for 60 years. Just over one in four Canadians is a Westerner, and this has been so for over half a century.

However, the general stability of the West's population share conceals major differences among the provinces. Alberta and British Columbia have shown large increases in both their total population and their share of the

Canadian total in recent years. On the other hand, Saskatchewan and Manitoba have shown only slight gains. There has been a westward shift of population within the West, rather than from eastern provinces to western ones.

The structure of the western economies is different from that in central Canadian economies. Yet despite the West's specialization in resources and central Canada's in manufacturing, the dominant activity in both regions is in services. Two out of every three employed people are in service industries. That means nearly two-thirds of all jobs in the West and in central Canada are in the service sector.

In every province except British Columbia, the service sector has shown enormous growth during the last 20 years. At the same time, there has been a very marked contraction in the relative importance of the natural resource sector. It is now about half as important as it was 20 years ago, again with British Columbia as the lone exception. However, even in this province there has been a significant relative decline. By 1981, the West was no more dependent on resources for employment than was central Canada in 1961.

The manufacturing gap between the Prairies and central Canada has narrowed quite considerably. It is not due so much to the growth of manufacturing in the Prairies as to its relative decline in importance in central Canada.

The western economies have become less dependent on external trade in recent years. The relative number of jobs in industries that trade internationally or are subject to competition from imports has dropped significantly. So, too, has the degree of sensitivity to the vagaries of international markets. Analysis shows that the instability of export receipts has probably been overblown in the West – it is not a significantly greater problem here than in the rest of Canada.

The kind of exports typical of the West (wheat, oil, and gas, etc.) have not made the western economies any more unstable than the rest of the country. That, according to the Council's report, "is a very surprising result."

However, there may be more instability in the years ahead, especially in agriculture. It is also possible that "counter trade" (partial or complete barter where the exporter must agree to accept full or partial payment in goods produced by the importer) could increase and lead to more instability.

It is clear that the western economies have done well over the years. Whether the prosperity can be maintained or will falter is the key question.

The remainder of *Au Courant* is devoted to looking at the issues involved in greater detail.

Transportation: the way ahead

Traditional notions notwithstanding, transportation problems need not pose any threat to western development. The Economic Council in fact foresees an open road ahead, provided that prompt action is taken to remove a few potentially serious obstacles.

The railway

While water, air, and particularly road transportation today play a significant role in the economies of the four western provinces, the railway has been the system most closely identified with their development from the outset, when the building of the Canadian Pacific opened up settlement and facilitated trade between West and East. Even now, while it is no longer the exclusive — or even perhaps the dominant — form of transport (given the formidable competition from trucking), the railway remains relatively more

important in the West than in the East, for reasons of demography, agricultural policy, location of natural resources, and absence of waterways. Its strong position has made it the target of a list of complaints throughout its history, some persisting to the present day. Two longstanding areas of contention have been the artificially low freight rate for statutory grain (the “Crow rate”), and the purportedly high rates charged for transporting manufactured products.

The Crow rate

In 1897, the federal government and Canadian Pacific concluded an agreement whereby the freight rate for the eastward shipment of grain and flour was set at 20 cents per hundred pounds. With the exception of some price fluctuations early in this century, that rate remained in effect until 1983, at high cost to the railroads. Calculations adopted by the federal government in

its legislation to reform the Crow indicate that the difference between a cost-covering rate and the Crow rate amounted to \$644 million for the 1981-82 crop year.

In 1983, on the basis of recommendations put forward by the Gilson Commission, the federal government passed Bill C-155, a milestone in Canadian grain transport. Essentially this Act decrees that freight rates should remain significantly lower for the transportation of “old grain” (i.e., for grain in the amounts produced in the 1981-82 crop year, as opposed to subsequent new production levels), but that the railways should receive a direct federal government subsidy (the so-called “Crow Benefit”) as compensation for losses thereby incurred. The Act also contains a “safety net” provision — to protect farmers from depressed world grain prices and high



Opening up the West

Canadian Pacific

interest rates – to the effect that the grainshippers' share of the freight rate should not exceed 4 per cent of the 1984 grain price, with the limit gradually increasing to 10 per cent in 1988 and thereafter.

In many respects, the Act succeeds in achieving a necessary reform of the old Crow regime, says the Council report. In particular, it should greatly

the railroads to charge a correspondingly appropriate freight rate (with due allowance for the "safety net" provision).

Shipping of manufactured goods

Westerners have long resented certain other aspects of the freight rate

being transported. A study to investigate the impact of this proposal on 40 manufacturing industries important to the West found it would strengthen the West's competitive position in 25 industries, weaken it in 14, and leave it unchanged in one. Overall, the EPP would reduce relevant transport costs by 40.1 per cent in the East, and by 40.5 per cent in the West. In other



National Film Board of Canada

Tough competition for the railroads

ease the problems of financing capacity expansion in the West. But it also retains some undesirable features. It encourages the growing of "statutory" grain (that is, crops so classified for purposes of the Crow rate) and also the use of railways over trucks. Furthermore, by subsidizing transportation, and thus allowing Prairie grain prices to remain high at the farm gate (farmers charge the world price minus transportation costs), the Act has an adverse impact on Prairie livestock owners.

Although the Council realizes that the payment issue is an extremely complex one, which is now under study by a parliamentary committee, it believes that, on balance, the evidence favours serious reconsideration of the present method. Consequently, it recommends that, in the event the Committee decides to reassess the situation, it include in its investigation the possibility of paying the Crow benefit directly to the farmers concerned, and allowing

system. One recurring complaint stems from the conviction that the railways have used their monopoly position to keep freight rates high on manufactured goods coming from the East, and so are to blame for a higher cost of living on the Prairies. While the Council agrees that rates are higher on shipments moving from east to west, it ascribes this to natural economic and geographic conditions rather than to unjustifiable practices on the part of the railroads.

Another criticism has it that the development of Prairie manufacturing has been hampered in several ways, especially by the imposition of higher freight rates for manufactured products than for raw materials going from western to central Canadian provinces. In response to this concern, the Alberta government suggested instituting an "Equitable Pricing Policy" (EPP), basing freight rates exclusively on distance, irrespective of the commodity

words, the advantage to the West would be minuscule.

The EPP would also require either a massive subsidy from taxpayers (rough calculations show this would have amounted to about \$990 million in 1980) or a proportional increase in all distance-based rates sufficient to cover full costs. A major problem with either solution is that costs would become covered automatically, so that management's incentive to hold them down would be very considerably weakened.

Given the drawbacks of the proposed policy and its negligible effect on the competitive position of western manufacturing, the Council believes that the present freedom of freight rate setting should be retained. If diversification or stimulation of western manufacturing is considered to be in the national interest, the Council adds, that goal should be achieved by methods other than manipulation of freight rates.

The outlook for natural resources

Westerners are understandably uneasy about putting all their eggs in the natural resource basket, arguing that such excessive specialization makes provincial economies extremely vulnerable to uncontrollable changes in production

and markets.

The Economic Council believes the West is becoming less dependent on its resource industries, but it is aware, too, that, since they will continue to have an important bearing on western develop-

ment in coming years, their prospects for growth remain important. The following pages feature the outlook for the natural resource sectors, and the policies required to keep them flourishing.

The forestry

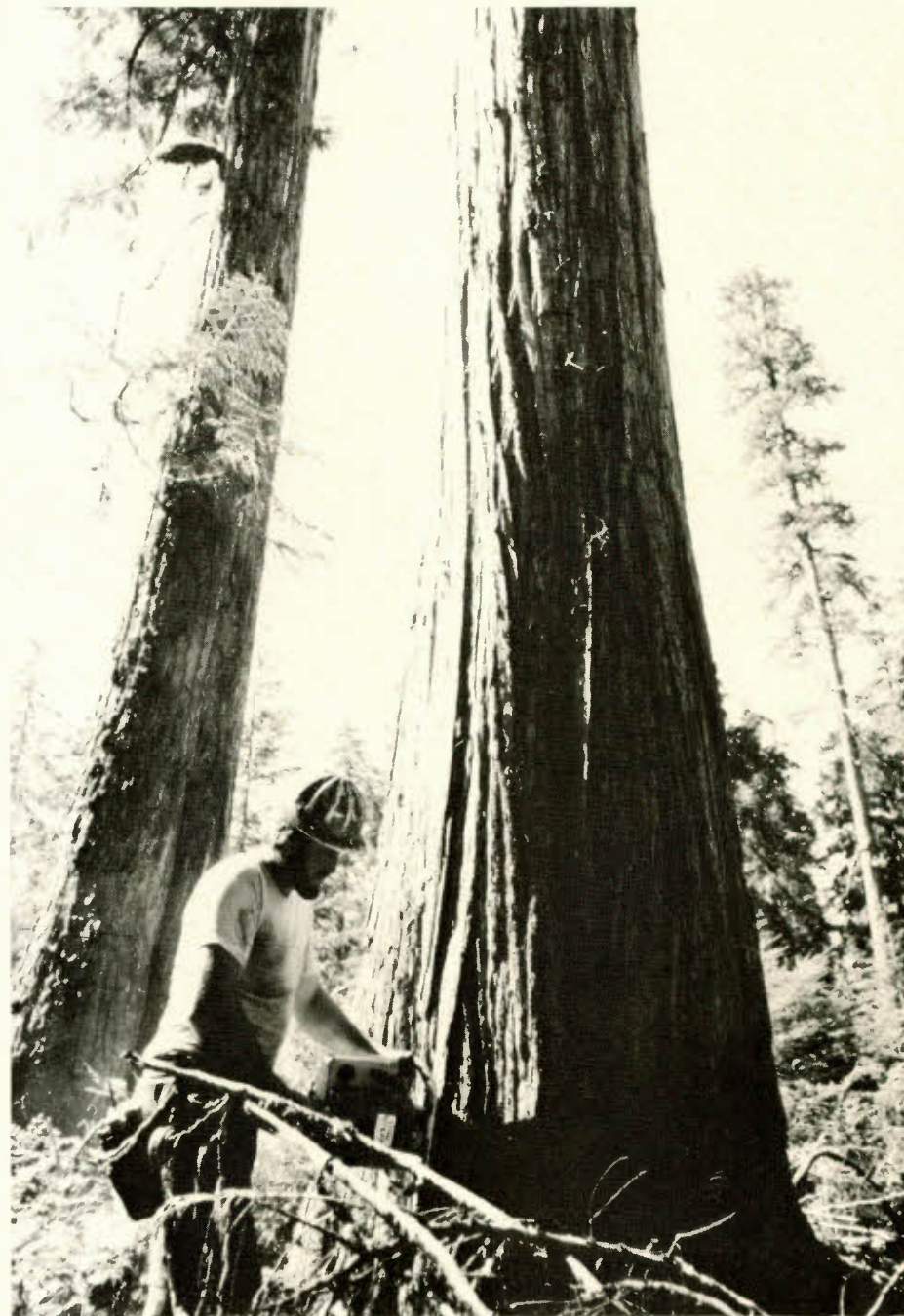
"We are recklessly destroying the timber of Canada, and there is scarcely a possibility of replacing it," lamented Sir John A. Macdonald over 100 years ago.

That concern has been expressed repeatedly by succeeding generations of Canadians – yet the forest industry has persevered, and even flourished over time. However, current fears that the West can no longer count on economic growth from that sector shouldn't be dismissed lightly, says the Economic Council, particularly given recent predictions of impending timber shortages.

Nevertheless, the Council is cautiously optimistic about the future for the forestry, provided that provincial governments undertake some fairly radical changes in management policy.

The Council selected the logging industry as the major focus of its analysis of British Columbia, partly because of its economic importance to the province, and partly, too, because its basic structure provides the key to achieving efficient operation in the forestry at large.

Forest products constitute the biggest single industry in British Columbia, accounting for 13.3 per cent of provincial gross domestic product, and 10 per cent of employment in 1980. The provincial economy is enormously dependent on this sector's continuing prosperity – but the outlook is not encouraging. Recent research showing it won't be easy to maintain, let alone expand, current harvesting levels, led the provincial government to freeze harvest quotas. This could create problems when world demand for forest products, sluggish from the recession, eventually picks up again. Slower growth or possibly even no growth in the forest sector in British Columbia



National Film Board of Canada

B.C. logging: new policies needed

could cause per capita incomes to grow more slowly than was usual during the postwar period, even if world demand for forest products fully recovers. That

would keep unemployment above normal levels, and inhibit immigration for decades.

But this gloomy scenario is not inevi-

table, says the Council, primarily because the provincial government has the power to solve the problem by making some key administrative changes.

The British Columbia government plays the dual role of regulator and owner of the industry. As regulator, it determines how many trees can be cut down (the "allowable annual cut"), and the appropriate harvesting age or "rotation period." In addition, it collects resource rents or revenues in the form of royalties or "stumpage."

Three fundamental changes in the government's regulatory policies could give the forestry the boost it needs, in the Council's view. To begin with, rotation periods should be shortened, allowing both harvesting and replanting to take place more often. At present, rotation periods are structured to ensure that the maximum amount of wood is harvested, which does not reflect the influence of timber prices, discount rates, and harvesting costs. Provincial coffers are considerably emptier as a result, with potential income from current harvestable timber forgone, and that from future harvests delayed.

Ideally, provincial residents should benefit as much as possible from the forestry, says the Council. Hence, it recommends that much greater emphasis be placed on economic and far less on physical criteria, when choosing rotation periods for second-growth timber, provided that this can be done with full provision for the protection of the environment.

Secondly, again with the welfare of society in mind, the Council recommends harvesting the stock of mature timber at a faster rate than present policies permit, as soon as and wherever market conditions make it profitable to do so.

Evidence shows that huge quantities of this timber occupy some of the most productive sites in the province. By failing to harvest and replant these sites, the province forgoes millions of dollars in annual revenue, and in some cases damages the forest itself. Ironically, the Council comments, "...the main fault may have been in not cutting the timber rapidly enough rather than too rapidly."

As a third key change in policy, the Council recommends that more importance be attached to "intensive forest management" – the term used to describe treatments to improve forest productivity, such as forest protection, backlog reforestation and research aimed at producing genetically superior

trees. Practices with a proven success rate should be set in motion, says the Council, using provincial government funds specially earmarked for that purpose.

Agriculture

Through good times and bad, agriculture has been closely tied to western development, particularly in the Prairie

ough investigation of the grains trade and of livestock production – the two areas accounting for the lion's share of the industry.

Grains

The Council cautions that adverse conditions lie ahead, not in any disaster sense, but relative to the uncharacteristically favourable 1970s. Real prices for grains are expected to resume their historic drift downwards. Further, both prices and output are likely to become increasingly volatile.



Improving the outlook for Prairie wheat

provinces. Today, the western agricultural industry employs close to 300,000 people, accounts for almost 7 per cent of total western output, and is a major exporter. So the outlook for this sector has significant bearing on western fortunes in the coming years.

But that future appears complex and difficult to judge, says the Economic Council. To appreciate what might be in store, the Council undertook a thor-

Measures must be taken to improve this outlook, says the Council, recommending two related but distinct courses of action: one directed at cushioning the industry from the volatility of world markets, and the other at encouraging faster growth through productivity increases.

Since international grains prices are extremely important to Prairie farmers, and a major cause of income instabil-

ity, the Council recommends that Canada redouble its efforts to seek an International Wheat Agreement providing better regulation of the grains trade. Canada should also be trying to diversify its markets through bilateral negotiation and, where necessary, counter trade agreements.

In addition, farmers should be compensated more adequately for the consequences of instability, the Council says. So it recommends strengthening the Western Grains Stabilization Program, a support program for farmers whenever their incomes dip below normal.

On the productivity front, policies should be aimed at promoting the researching and adoption of domestic and international technological advances. Since the present regulatory framework can occasionally impede this process, the Council recommends that selective deregulation and regulatory amendments be considered, especially with respect to the Canadian Wheat Board and the Canadian Grain Commission.

Livestock and meat processing

This industry, a strong contributor to western economic growth between 1962 and 1972, has fallen on tougher times over the past decade. But the Council believes it will probably recover from this setback if it can rise to the challenge of increasing its export penetration in the United States (particularly in the expanding California beef market) and in Japan, where quality beef and pork markets offer attractive possibilities.

To ensure that such initiatives are successful, the industry will need a great deal more information on the relevant export markets, says the Council. Consequently, it advocates the initiation of product-specific research on the California market. As well, it recommends that governments, product-marketing agencies, and if possible, the private sector, work towards establishing contacts and becoming familiar with the Japanese market, where operating methods and requirements differ markedly from Canada's. Finally, the Council advises a thorough-going examination and possible revision of the structure of the industry. It is set up now as a series of separate units, whereas a more integrated system might lessen the risk to firms interested in exploiting opportunities in Japan.



Problems in the oil patch

Oil and gas

The oil patch is not what it was, a fact with significant repercussions for Alberta.

Council analysis of the oil and natural gas sector leads to the unavoidable conclusion that "Alberta is close to a decisive point in its economic history." The province must inevitably move away from heavy dependence on its major resource during the next decade or two. Fortunately, the important role played nowadays by the non-resource industries there (notably the service

sector) will make that transition easier than might have been expected (see page 17).

Because it plans to publish an exhaustive report on energy issues later this year, the Council has restricted its attention in this report to the effect of oil and gas production on the economic growth of the western provinces (primarily Alberta).

The oil and natural gas industry has had a strong influence on Alberta's economic well-being, accounting for strong growth and low unemployment over the 1961-81 period, particularly during the 1970s. However, the boom years came to an end, and the Council's

prognosis for the future indicates they are unlikely to return.

The future of the petroleum industry is plagued by uncertainties, both international and domestic in nature. Conventional oil production is expected to decline by about 30 per cent by the year 2000. Even using the most optimistic assumptions possible, Council projections indicate that the total expected production of conventional oil by the end of the century will not exceed that of the early 1980s.

The news is somewhat better for output of natural gas. On balance, the Council assumes a 60 per cent increase in production between 1983 and 1991, and a maintenance of the 1991 level to at least the year 2000.

This increase in growth implies a very substantial increase in exports. At the moment, though, the export price set by the federal government often

renders Canadian gas uncompetitive with other suppliers in the all-important U.S. market. A bureaucratic mechanism of uniform price setting does not and cannot take advantage of the opportunities of rapidly changing markets and prices, the Council says. Consequently, the Council supports recent initiatives in this area, and recommends that both government and industry continue to seek out more flexible means of realizing the economic potential from natural gas exports.

Potash, uranium and coal

The potash, uranium, and coal industries won't be able to maintain their

truly spectacular performance of the past decade, but their future prospects look reasonably good. Furthermore, says the Economic Council, certain measures can be taken to speed up their growth rate.

Potash (an essential constituent of crop fertilizers) and uranium abound in Saskatchewan, and coal in Saskatchewan, Alberta, and British Columbia. Despite the slowdown in growth predicted in all three industries, the Council believes they will continue to do quite well in the future, and better still if policy makers focus on two key concerns: the need for both a judicious handling of the issue of market power, and an improved efficiency in resource taxation and domestic pricing.

Market power

The issue of market power is an important one for the three industries –



Potash needs careful management

on the supply side for potash and uranium, and on the demand side for coal.

Saskatchewan has substantial market power in North America, since it is by far the biggest supplier of potash there. While exercising that power to the full would benefit the citizens of Saskatchewan – by keeping prices and therefore provincial revenues high – it would be costly to the nation as a whole in political and international terms (since U.S. importers and producers would be worse off). After careful consideration of this issue, the Council decided to advise against any action “inconsistent with the spirit of Canada’s commitment to both freer world trade, and the canons of good international behaviour.” On the other hand, it warns policy makers against going to the opposite extreme, by encouraging the production of so much potash that prices drop beyond the point where full long-run production costs can be recovered. In that context, policies to stimulate rapid industry expansion in the province – which have been contemplated on occasion – would be risky, the Council says.

A fairly similar situation exists in the uranium industry, and again the Council suggests steering a careful course between extremes. The coal industry, on the other hand, faces problems on the demand side, in its heavy dependence on the Japanese export market. While little can be done to change that situation, says the Council, more of the risk involved should fall on the private sector, which has the greatest incentive to recognize it. Hence, the Council recommends that industry bear a substantial part of the costs of providing investments for new developments.

Policies to improve efficiency

The structure of resource taxation can at times impose heavy burdens on an industry, the Council observes. Resource taxes calculated as a percentage of revenue may mean that taxes are payable even if no profits are earned – the case for coal operations in British Columbia and Alberta. On the other hand, a tax based on profits can introduce new problems: if firms are allowed to offset profits on one venture by losses on another, for example, governments lose revenues, and new operations can become too large. To avoid these and other distortions, the Council recommends that resource tax (or royalty) systems be designed to be as neu-

tral as possible, with well-designed profit taxes employed whenever feasible.

The Council also recommends calling a halt to the western practice of subsidizing its domestic consumers of electricity by providing power stations

with coal at cost.

Finally, the Council recommends that the federal government recognize the benefits to Saskatchewan of exporting unprocessed uranium, whenever it does not replace refined exports from Ontario or other provinces.

Fishery reform a must

Reform of the British Columbia fishery is an absolute must. Countless studies of Canada’s troubled fishing industry agree on the need for wholesale revision, as much on the West Coast as on the East.

The Council has two recommendations to make in this area. The first deals with the well-recognized problem of how best to prevent Pacific fishing stock from becoming dangerously depleted. A Royal Commission on the Pacific Fishery has been the most recent to put forward proposals in this regard. The Council agrees with its principal ideas on how to limit the catch, and recommends rapid adoption of its recommendation for a quota system for all fish other than salmon and

roe herring – which would be regulated by revised controls on fishing inputs.

The Council’s second recommendation concerns the best method of achieving speedy reform. At present, it notes, British Columbians have little incentive to change the industry, since the federal government as responsible authority would reap the lion’s share of the gains. Reform is more likely, says the Council, if those directly affected have a stronger financial interest in the outcome. So it recommends that ways be found to provide this group with a share of any federal revenues obtained through industry rationalization.

Water won’t dampen prospects

Water shortages will dampen western growth only slightly in coming years, contrary to popular notions. Moreover, what problems there are can be readily solved by the use of intelligent water management policies, says the Economic Council.

While the West is water-rich overall, certain areas face current or prospective shortages, either through over-consumption (the agricultural basins of Milk River, South Saskatchewan, and Red Assiniboine) or pollution (the industrial North Saskatchewan basin).

In these problem areas, it is no longer economically efficient to allow water to be free for the asking, the Council says. Water charges, which now tend to cover only distribution costs, will have to be raised, however politically difficult that

might be. The Council suggests using a “block pricing” system, whereby water prices would rise in a progressive fashion.

The Council also finds the current licencing system of water use regulation to be “cumbersome and inflexible.” In the interests of greater efficiency, it suggests modifying that approach to allow holders of water rights to sell their rights to other users, subject to the veto of provincial management authorities.

Finally, the Council recommends continued government vigilance to protect the quality of water bodies for such uses as recreation, fish and wildlife habitat, and so forth. That could require the imposition of effluent charges on industries in order to keep pollution under control.

Service sector: engine for growth

Service industries are the largest and fastest-growing part of both the national and provincial economies. Nearly two-thirds of all jobs in Canada are in this sector.

A vast array of industries and activities are classified as services. They fall

ment decreased in all but British Columbia.

Two industries stand out as the major sources of job growth in the service sector: community, business, and personal services as well as trade (see chart). The main areas where new

economic policies. Services tend to be overlooked by policy makers who concentrate their efforts mostly on goods-producing industries.

Productivity improvements in services directly help living standards grow, and the indirect impact of service



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Health services, fast foods: major growth industries

into five major categories: (1) transportation, communications, and utilities, (2) wholesale and retail trade, (3) finance, insurance, and real estate industries, (4) public administration and defence, and (5) community, business, and personal services.

It is interesting to look at the distribution of employment in the western provinces in various industries. As can be seen in the accompanying chart, employment in the service industries far exceeds that in natural resources or other industries. This parallels the employment structure of the rest of Canada.

Over the last 20 years, services have accounted for about three-quarters of all new jobs in the West, as elsewhere. The large – and growing – size of this sector “puts a heavy premium on seeking to improve efficiency in it, if living standard improvements are to continue.”

Between 1971 and 1981, service sector employment grew in all four western provinces. Agricultural employ-

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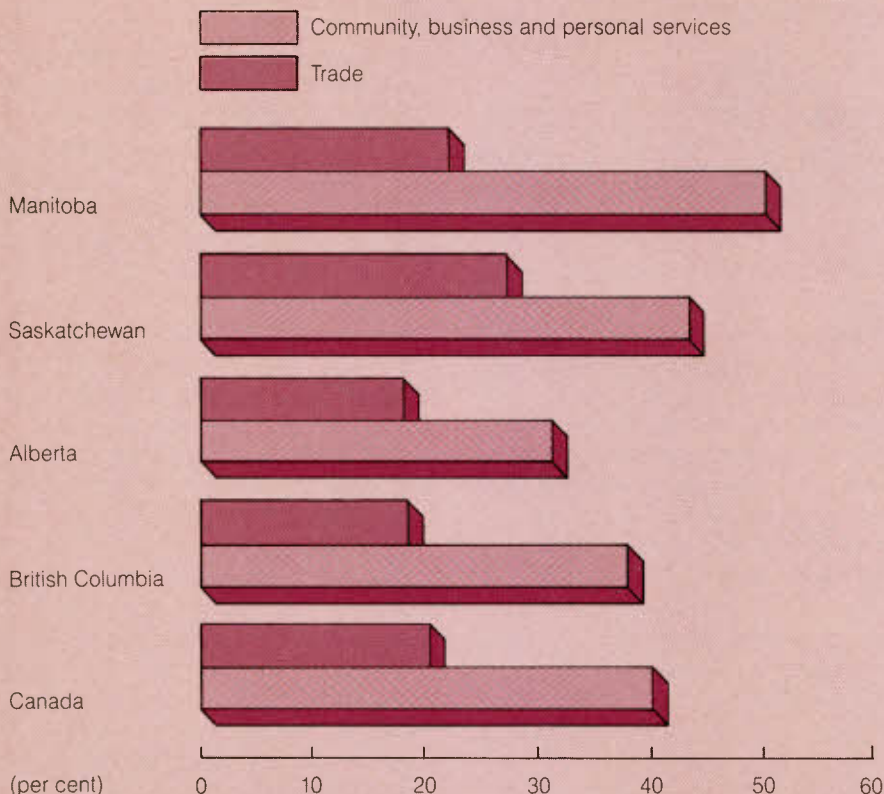
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New jobs in western service industries

Jobs created in two key service industries as a proportion of all new jobs, 1971-1981.



have to do with urban size, population distribution, and the benefits that accrue to firms because of the physical concentration of activities. Businesses tend to become more efficient when a large number of them are located in one area. "A growing population, or an increasingly urbanizing population, causes cities to grow. That growth permits rising efficiency through agglomeration economies. Living standards then go up. This growth in efficiency occurs in both the service sector and in the sector producing goods for local consumption."

It is likely that the service sector will continue to contribute substantially to growth in employment and in living standards in the years ahead. In the Council's view, that means economic policies will have to pay much more attention than hitherto to the service sector.

Municipal, provincial, and federal governments all have roles to play. They can encourage the establishment and growth of local service sector firms. They can work at attracting service industries to a particular city or region. They can provide better training and retraining programs, which will help to smooth the transition from Canada's traditional goods-producing orientation to a service-based economy.

To ignore the potential of the service sector is to miss the chance of improving long-term growth and prosperity not just in western Canada, but in the entire country.

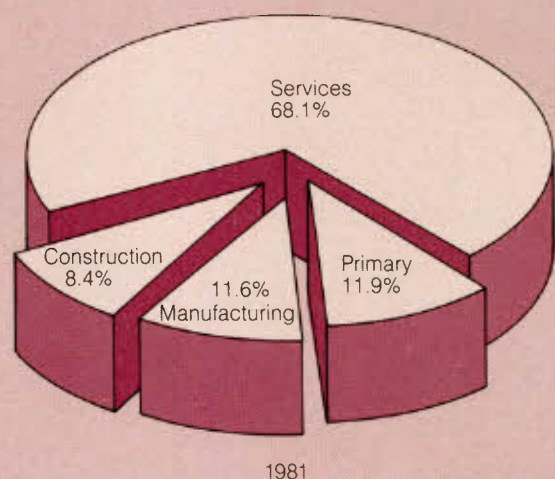
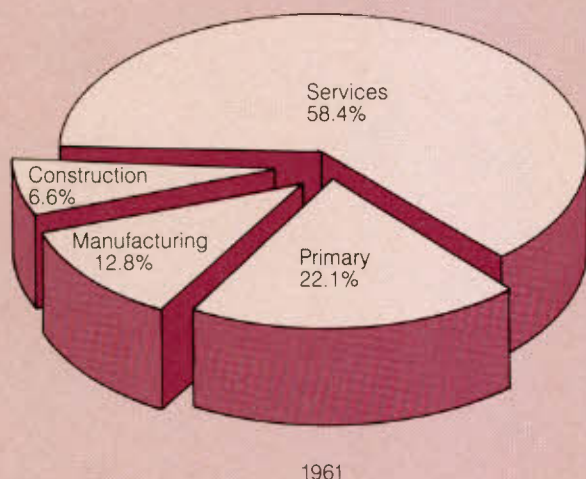
of new technologies in service industries happens quite quickly in some cases. Examples include containerization, new fast-food delivery techniques, office automation, and computerized warehouses. Often the impact of new

technologies in the service industries is to increase the range and quality of services offered.

A third source of productivity improvement derives from agglomeration economies (see page 14), which

Growing employment in the service sector

Distribution of employment in the western provinces, 1961 and 1981.



Where do services prosper?

Services are, by and large, an urban phenomenon. For most metropolitan areas, service sector employment increased between 1961 and 1981, while the manufacturing sector's proportion of employment decreased. This was due to differing growth rates in services rather than to any actual decline in manufacturing employment.

This structural shift to services requires a change in approach, particularly on ways to improve productivity. Some were mentioned in the previous section. Here, a closer look is taken at agglomeration economies and how productivity improvements can be associated with increases in urban size.

Much of the service sector represents unexploited opportunities, especially for productivity growth. Significant economic benefits could result from a shift in emphasis of economic development strategies from goods-producing to service industries.

Most work on agglomeration economies has concentrated on manufacturing. For this report, the Council carried out new research: the application of agglomeration economies to service industries.

There are three key elements in agglomeration economies: internal



Services do best in this environment

economies of scale, localization economies, and urbanization economies. Scale economies refer to the benefits of the average number of employees per firm in each industry in a city. Localization refers to the benefits that firms derive from locating close to one another. Urbanization economies are the advantages that businesses and households have from being concentrated in an urban area.

The Council finds by means of actual measurement that each of these elements does influence service sector productivity. The effects, as a whole, are quite important, meaning that large urban areas provide efficient locations for service activities. They encourage the growth of new firms and activities, and contribute to better productivity performance in existing firms.

The Council concludes that "urban growth, the attraction of sophisticated service activities, and the development of richly diversified urban environ-

ments should form an important part of the package of development strategies used by urban and regional development planners and policy makers."

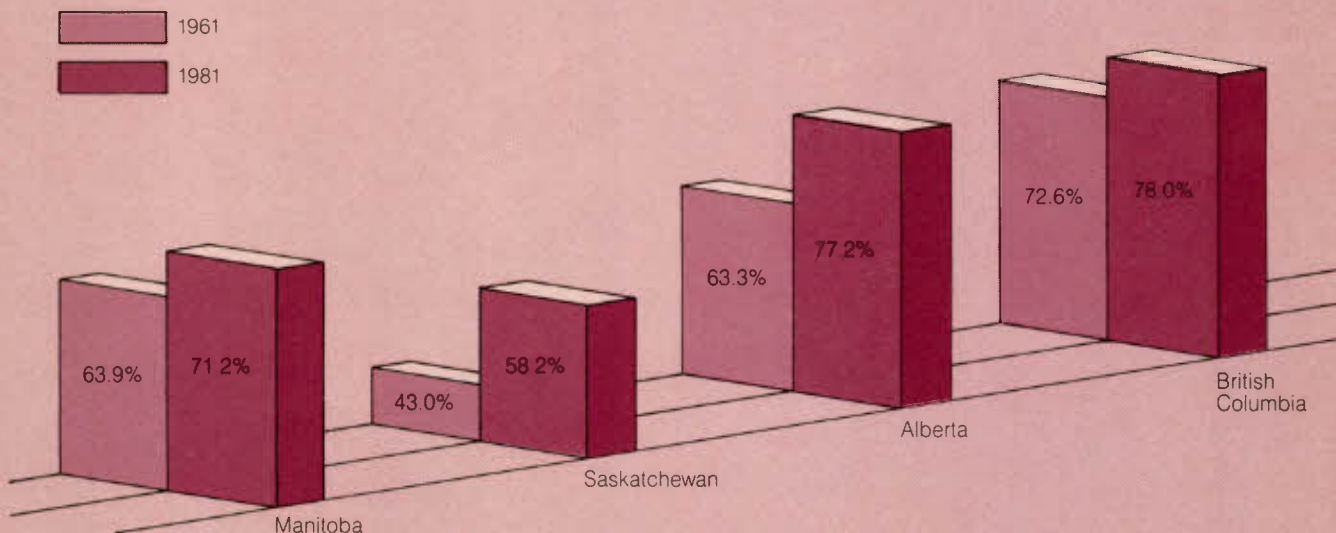
Unlimited urban growth is not being advocated. There reaches a point where diseconomies start resulting in undesirable changes in the quality of life, such as increased air pollution, congestion, noise, and the decay of city cores. Western cities are, however, well below the size at which these problems become serious, so that growth could be beneficial, because in most economies the largest cities are the most stable economically and the most successful in attracting new activities.

Municipal governments can encourage service industries through their zoning practices, by being innovative in management and the provision of public services, and by developing cultural, social, and recreational activities.

There are other ways to enhance productivity performance than the ones outlined in the Council's report, but those that have been highlighted (specialization, technological change, and agglomeration economies) have been underemphasized by policy makers in the past, and they warrant more attention in the future.

The move to cities

Urban population as a percentage of total population in the western provinces, 1961 and 1981.



Manufacturing: a plus factor

“... manufacturing growth would be helpful but not decisive”

WESTERN TRANSITION

How far can manufacturing growth help to offset the expected slowdown in natural resource growth?

“In discussing the growth prospects for manufacturing with Westerners, we were struck by their scepticism. There was a widespread conviction that the West is too distant and too small ever to become an important manufacturing centre. If ‘important’ means important enough to replace resources, we share that scepticism. But if important simply means important enough to keep on growing at past rates, or moderately faster, despite the resource slowdown, we do not share that scepticism.”

Statistics do not support the West's pessimistic view. Over the past 50 years (and especially during the last two decades), manufacturing has grown faster in the Prairie provinces than in central Canada (see chart). The sole exception has been in British Columbia, where manufacturing growth has been a bit slower than the national average.

Surprisingly, the growth has been broad-based and diverse. This suggests that manufacturing has not been linked to the rapid growth of natural resources. On the contrary, research done for the Council found there is a relationship between slower resource growth and faster manufacturing growth. The evidence suggests that the last natural resource boom crowded out some manufacturing activities that were unable to compete for labour and materials.

Additional research found that manufacturing in the western provinces has been helped by urban and population growth. The continuing trend towards urbanization means that agglomeration economies will likely be a positive factor in the years ahead.

There is another issue that is probably more important than most people would think. Despite apparent disad-

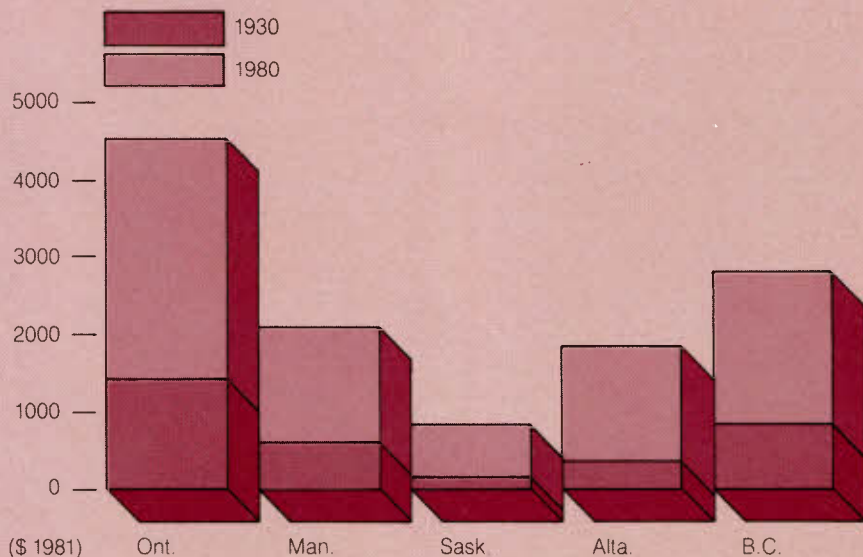
vantages in terms of distance and small local market size, there are numerous manufacturing activities that have succeeded through determined effort.

long-term trends indicating a deceleration of growth in this sector. A larger and more diversified manufacturing sector would be one way of achieving that goal, and it would help to increase economic stability in the region.

The Council is generally optimistic about future growth prospects for manufacturing. In the provinces where manufacturing has been growing significantly, Alberta and Saskatchewan, it will not only continue to do so, but will probably speed up. Manufacturing

How western manufacturing has grown

Value of manufacturing output per capita in the western provinces and in Ontario, 1930 and 1980.



Can manufacturing provide significant economic impetus and employment stability without subsidies? The Council believes that subsidies should not be given to individual firms. However, co-operative effort, requiring a modicum of government assistance, may well turn out to be one way to encourage diversification in manufacturing. Municipal and provincial governments could work together to identify particular kinds of activities or unexploited opportunities.

There is no doubt that Westerners would like to reduce their dependence on natural resources, especially with

growth has not been particularly strong in British Columbia. That pattern is not expected to change. Manitoba is the most difficult to predict. Because population growth and urbanization are slower in Manitoba than in the other western provinces, agglomeration economies will not help a great deal.

Manufacturing is expected to pick up a bit with a slowing in natural resource growth. It will therefore be a useful supplement to the important role of the service sector in maintaining good growth in jobs and living standards.

Into the future

In examining the West's future growth prospects, two conflicting points of view emerge. One argues that resource-based economies grow only while the output of the resources grow. If only constant or falling production is possible, there is little cause for optimism. The other argues, just as strongly, that resource-based economies grow and evolve, with manufacturing and especially services gradually increasing in importance compared with resources and, in the end, being dominant over them.

There is no doubt that natural resources will continue to be an important ingredient in future western economic performance. However, the West is in transition and resources will not be quite so dynamic as they were in the past.

the provincial governments are the key to much of the West's future prosperity.

There are policy and attitudinal changes that can lead to improvements in natural resource industries as well as

repay study and research. Allocating rights to a fixed annual fishery catch would brighten prospects in British Columbia. Finally, greater price flexibility for natural gas exports would be of particular help to Alberta.

"I have been into the future and it works"

LINCOLN STEFFENS

in manufacturing and the service sector.

Resources

First, resources, where the Council believes some changes in policy are warranted. Forestry growth in British Columbia is at risk of slowing down, even if recovery from its present situa-

Manufacturing

Manufacturing activities can also be influenced by provincial governments. Certain kinds of industries (rather than individual firms) should be pinpointed for help. The Council expects manufacturing will continue to grow moderately, but without providing a major



British Columbia legislature



Alberta legislature

This need not pose a major problem. The economic structure of the West (as in the rest of Canada, the U.S., and much of Europe) is changing. As a result, the service sector employs about two-thirds of all western Canadian workers now and these numbers will probably continue to grow in the years ahead. Because the service sector is so big, improvement in productivity there could, if achieved, readily compensate for the expected slowdown in resource growth. These improvements would maintain living standards and contribute to the competitiveness of the West.

While municipal, provincial, and federal governments all have roles to play,

tion is achieved. The damaging consequences this would have on living standard growth and unemployment in the province can be avoided, but only if important policy changes take place (see page 7).

The grain industry would benefit from selective deregulation to improve productivity, and from improved arrangements to cope with instability. Another positive step would be to push for international agreements that would ease year-to-year fluctuations in grain prices. With regard to the livestock industry, California and Japan represent potential markets for Canadian red meat, which would richly

breakthrough for economic performance.

Services

Service industries dominate every provincial economy – and not just in western Canada. Consequently, any improvements in this sector would have significant results in terms of jobs and living standards. Traditionally, government economic development policy has emphasized the goods-producing industries. The Council, through research carried out for this report, has shown this no longer reflects reality. It is time to change the policy emphasis to encourage the service sector. Promoting

technical change and its diffusion and helping small business acquire capital and management skills are two possible methods of achieving this goal.

Because services are, by and large, an urban phenomenon, there is much that could be done by municipal planners to encourage the establishment and growth of such industries. Aside from zoning procedures, the provision of cultural, social, and recreational facilities help to attract services. There are benefits to be realized by the location of firms in urban areas — agglomeration economies. As a result, the Council recommends development policy should “take due note of not only the social value of small towns and rural life but also the economic benefits to be obtained from encouraging growth and diversification in larger cities.”

The individual provinces have slightly varying prospects.

British Columbia

Of the four western provinces, British Columbia is the most resource-

in Alberta is expected to settle back at or perhaps slightly below the national average, as the output of conventional oil and gas slows down.

“The ability to withstand a major slowdown in the growth of such an important natural resource without significant economic hardship may be due partly to the important role played nowadays in job and real income growth, by the non-resource industries in Alberta, notably those in the service sector,” the Council says.

The Council suggests that provincial and federal policies on transportation, gas pricing, jobs and productivity in the service sector could mean the difference between average or above-average economic performance in the future.

Saskatchewan

Traditionally, Saskatchewan has experienced the greatest income instability of the western provinces. In recent years, however, the gap has narrowed somewhat. Unfortunately, greater instability in the grain industry, and slower growth in other resources,

only Ontario has grown more slowly. The province has been the provider of many services to the other western provinces.

In the years ahead, income growth will probably slow down, but not as much as in the other provinces.

The best chances for success lie in the grain industry, manufacturing, and services, especially transportation.

While concerned over the sustainability of economic prosperity in the West, the Council is fundamentally very optimistic. Governments can help justify this optimism by appropriate action in all sectors of the economy. Much can be done to improve resource growth — the West's traditional area of strength. But much can also be done by paying attention to the structural change towards services, which has been under way for more than 20 years. There are great unexploited opportunities to be seized in the service sector — opportunities for speeding up technological change, fostering growth in living standards, and stimulating produc-



Saskatchewan legislature



Manitoba legislature

dependent: forestry dwarfs all other goods industries. Even manufacturing and service sector employment in the province is heavily tied to forestry. The future of this sector, while not particularly bright under current policies, could be much improved by the provincial government. Action in the fishery and coal industry could also brighten British Columbia's future resource prospects. Finally, as in all the provinces, significant gains could be made by paying more attention to the service industries.

Alberta

In the years ahead, economic growth

are expected in the years ahead. While this will likely translate into more unstable and slower real income growth, the province's income levels will probably continue converging toward the national average.

Improvements in grain productivity, transportation efficiency, and sales of natural gas would be beneficial. Productivity improvements in services could make a significant contribution.

Manitoba

Manitoba's future is probably the hardest to call. Over the past 20 years, Manitoba has had the lowest real income growth in the West. Nationally,

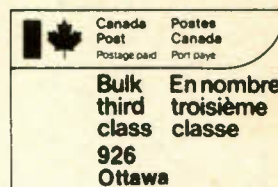
tivity improvements. Attention to services, together with a judiciously balanced policy mix, can give a major impetus to the western economies.

Changes are definitely in store for the West. “While remaining recognizably resource-specialized, the success of the West may come to depend as much on high performance in the service and manufacturing industries as in the resource industries,” the Council concludes. If this comes to pass, western economies should continue to grow and prosper: the words of Lincoln Steffen sum up the general outlook: “I have been into the future and it works.”

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WORKING TO IMPROVE CANADA'S POLICY PERFORMANCE

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The Council pursues its goal of improving Canada's economic performance in three ways:

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