Economic Council of Canada
Volume 5, No.3, 1985

au courant

A new report on energy

Plus: The Council's annual review of the economy

PUBLICATIONS

New Council Report

Connections: An Energy Strategy for the Future (EC22-124/1985E; $9.95 in Canada, $11.95 elsewhere).

In a wide-ranging report on Canada's energy industry, the Economic Council proposes a new energy strategy, designed to increase economic benefits for all Canadians. Deregulation of oil and gas prices, and reform of regulations in the electricity sector are key elements of that strategy.

The Twenty-First Annual Review

Steering the Course (EC21-1/1984E; $5.95 in Canada, $7.15 elsewhere).

In its 1984 review of the economy, the Council focuses on the dual problems of high unemployment and a rising federal deficit. The two concerns can be tackled simultaneously, the Council concludes, and provides some suggestions on how this can be done.

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 authors 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. 269 "Old Myths and New Choices: Railway Freight Rates and Western Economic Development," *by Thomas T. Schweitzer.*

No. 270 "Exhaustible Resources and Economic Growth: The Case of Uranium Mining in Saskatchewan," *by Harry F. Campbell.*

No. 271 "Productivity, Scale Economies and Technical Progress in the Canadian Life Insurance Industry," *by Michael J. Daly, Randall Geehan and P. Someshwar Rao.*

No. 272 "Grains in Western Canadian Economic Development to 1990," *by R.M.A. Loyns and Colin A. Carter.*

No. 273 "Farm Income Insecurity on the Prairies," *by Jacques Jobin.*

Research Studies

Research studies are published by the Economic Council in both official languages. A list of titles is available on request. Each study clearly attributes the findings and conclusions to the individual author or authors rather than to the Council (ordering information below). Three new titles have been published since the last issue of *Au Courant*:

The Changing Economic Status of Women, *by Jac-André Boulet and Laval Lavallée* (EC22-122/1984E; $6.95 in Canada, $8.35 elsewhere).

Blue Gold: Hydro-Electric Rent in Canada, *by R. C. Zuker and G. P. Jenkins* (EC22-120/1984E; $5.95 in Canada, $7.15 elsewhere).

The Subsidization of Innovation Projects by the Government of Canada, *by Abraham Tarasofsky* (EC22-121/1984E; $7.95 in Canada, $9.55 elsewhere).

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Government Loan Subsidies, *by S. Damus* (EC22-116E; $5.95 in Canada, $7.15 elsewhere).

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Volume 5, No.3, 1985

au courant

Connections: An Energy Strategy for the Future

Highlights from a new Council report:

Steering the Course

Highlights from the Council's Twenty-First Annual Review:

A REMINDER...

...about the conference on "Strategy for Energy Policy", to be held at the Calgary Convention Centre on January 28th and 29th, 1985. Sponsored by the University of Calgary's Department of Economics, and Faculty of Continuing Education, the conference will focus in large measure on the Economic Council's new energy report. Participants from energy industries, universities and government will be in attendance.

For further information, and details on registration, contact Madeleine Aldridge, (403) 284-5051.

Au Courant est également disponible en français.

The major reports featured in *Au Courant* reflect the viewpoint of the Economic Council.

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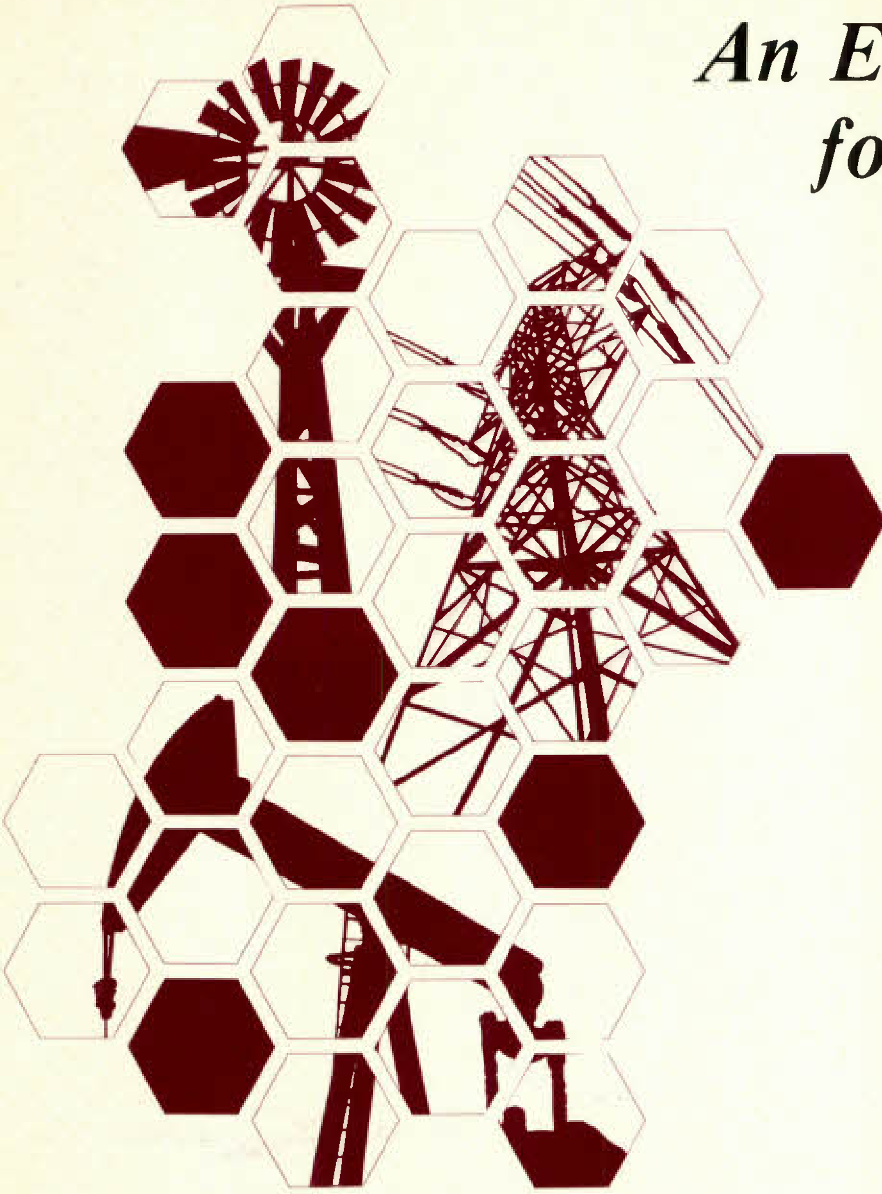
CONNECTIONS:

An Energy Strategy for the Future



The time has come for a fresh new energy strategy, placing much greater emphasis on economic growth and development. That means bringing all domestic energy prices more in line with the world price of crude oil, says the Economic Council in a wide-ranging report on Canada's energy industry.

Canadian public interest is not especially well served by current federal and provincial energy policies, in the Council's opinion. While they try to cover a somewhat breathtaking range of objectives (resource development, increased Canadian ownership and national economic concerns, to name just a few) they fail to pay enough attention to three critical economic realities: the impact of domestic oil pricing on every aspect of the Canadian economy; the responsiveness of energy markets to economic factors such as prices; and the sheer complexity of resource management.

The development of an energy policy based on these realities won't be easy, given the political, regional and institutional concerns that need to be considered. But the Council firmly believes that better resource management producing greater economic growth, "could make the resolution of Canada's social and political problems easier and less costly."

The potential benefits from improving energy policy are very large. The energy-producing industries – primarily oil and gas, electricity, coal and uranium – form a substantial part of the nation's economy, delivering in 1982 some 43.2 billion dollars worth of energy to Canadians, and exporting some $12.8 billion, with domestic investments reaching about $20 billion that same year. In addition to its economic role, energy's importance to society has led federal and provincial governments to seek some degree of control over supply and distribution, either through regulation, or through direct government ownership.

Historically, energy policy tried to balance these two issues of economic development and control, along with a host of other concerns. Until the advent of the OPEC crisis in 1973, petroleum (i.e., oil and gas) policy managed this feat reasonably well: economic objectives were usually accorded top priority in an atmosphere of federal-provincial accord.

The years following 1973 however, gave rise to dramatic shifts in policy, and serious weakening in consensus. The fundamental goals of economic growth, development and efficiency were overshadowed by pressing political concerns, such as economic stabilization and the sharing of energy revenues.

> ***"...Canadian prices for crude oil, natural gas, coal and even electricity should be more aligned with the world price of crude oil."***
>
> ***Connections***

Federal-provincial differences over resource management surfaced in the 1970s and hardened with the introduction of the federal National Energy Program (NEP) in 1980 and its subsequent revisions. Over the past 15 years, the Council observes, "The long-run economic foundations of petroleum policy have yielded to short-term conflicts of interest. Detailed agreements have been hammered out and subsequently revised, item by item, to meet changing circumstances."

While the decade of the 1970s left its mark on the electricity sector as well (principally due to excess supply at the end of that period), little friction developed between the federal government and the provinces on policy matters. Developments in the sector – which has a number of monopolistic aspects and thus requires provincial government involvement – have been characterized by a move towards public ownership and control, and integration at the provincial level. Now that the sector is well developed, the Council says, provincial policies have more room to focus on such issues as economic efficiency in pricing, investment decisions and the development of profitable export markets.

The Council's assessment of the current energy situation in Canada leads it to conclude that "... energy policy in recent years has tried to juggle too many issues." Instead, "its aims should be kept within reasonable bounds; it should be shifted back to its economic underpinnings ...." But that will require integration of many political, regional, economic and international considerations. Chief among the issues forming the current policy setting are the following:

- *Division of powers*: unclear and overlapping constitutional powers affect the respective roles of federal and provincial governments with regard to the management and taxation of energy, primarily in the oil and gas industry;
- *Diversity of provincial interests*: the stand taken on such energy issues as oil pricing, taxation, and resource development has varied considerably among the provinces over time. For example, the two major energy consumers, Ontario and Quebec, have differed over domestic oil pricing policy, not only with the energy-surplus provinces, but also with each other;
- *National economic concerns*: burgeoning economic problems on the national scene – the recession, slow productivity growth, high interest rates, rising unemployment – concurrent with increasing fiscal deficits, have limited Ottawa's ability to play a major role in economic management, equalization of provincial revenues, and the conduct of major national policies;
- *Energy security*: the events of the 1970s triggered a drive by both levels of government towards energy self-sufficiency, exemplified in a wide variety of measures, including conservation programs and incentive grants;
- *Energy exports and imports*: energy exports accounted for more than half of Canada's total trade balance for merchandise trade in 1983, signifying a very bright overall energy trade picture. But Canada continues to import light crude oil as well;
- *World oil markets*: the outlook in this area remains uncertain. Council research shows the great difficulty involved in predicting long-term trends in oil prices (see *Au Courant*, Vol. 5, No. 1). While world demand for oil is unlikely to average much above one or 2 per cent a year – lessening the likelihood of future shortages – the causes of oil price instability persist (the nature of the OPEC cartel, and the concentration of reserves in the politically volatile Middle East);
- *Ownership and control*: the large foreign ownership of Canada's oil and gas industry has been a source of concern for policy makers. The creation of Petro-Canada in 1975, and various measures included in the NEP are indications of federal government efforts to gain greater domestic control over events in the energy sector, and to provide Canadian oil companies with the same access to capital as their international counterparts;
- *Constraints in current petroleum agreements*: a plethora of programs launched by the NEP, and numerous federal-provincial agreements covering energy pricing and taxation are locked into fairly long-run commitments which act as a constraint on policy changes.

Given the complexity of this policy setting, it is clear that any new energy strategy will need to integrate a welter of political, social and regional concerns, and will require continuous consultation among all the many groups involved. At the same time, though, says the Council, the emphasis must be placed on developing the economic potential inherent in Canada's substantial resources. In the case of oil and gas, that means replacing the current set of rigid rules, regulations and pricing formulas with a more flexible system, allowing prices to adjust to changing conditions in the market place. Electricity policy will require action as well.

> ***"...energy policy in recent years has tried to juggle too many issues."***
>
> ***Connections***

The bearing that current policies have on oil, gas and electricity supplies, as well as on demand, conservation and alternative energy technologies is discussed in the following pages, followed by the Council's recommended approach for a new energy strategy.

The outlook for energy supplies

Oil

Two major changes in domestic oil policy would lead to a sizable increase in Canadian oil production, Council analysis shows.

The first key change involves tying domestic oil prices to prevailing world prices; the second, establishing more efficient tax and incentive structures to encourage exploration and development.

The Council arrives at these recommendations by a three-part process. First, it tests and confirms the theory that "the supply of oil will increase if Canadians are willing to pay more for it." Secondly, it reviews the major Canadian sources of oil supply (both existing and prospective) from the viewpoint of costs, estimated profitability, and supply responsiveness. Finally, it assesses the impact that existing policies on oil pricing, incentives for exploration and development, and the collection of taxes and royalties, have on Canadian oil production.

Present and future prospects

Evaluating the prospects for Canadian oil production has become an increasingly important exercise. Study of the evolution of the Canadian oil industry shows that over the past decade, oil production has been dropping, that remaining established reserves of conventional crude oil have also been going down (because additions to reserves have not kept pace with production), and that the cost of finding oil has been going up. Moreover, according to the federal government's energy regulating agency, the National Energy Board (NEB), the outlook for future supplies is not very encouraging. The present NEB forecast, which reflects current government policy, is pessimistic with respect to one of Canada's major sources of oil supply: the reserves of conventional light oil in the Western Sedimentary Basin (WSB), an area extending over much of western and northwestern Canada.

Responsiveness of supplies

Assessing future oil supplies is never easy, the Council points out, because of the many uncertainties surrounding the supply process, and also because prices, costs and policies have a substantial impact on industry activity. But Council analysis of the oil supply process – through studies of particular geological horizons and four enhanced oil recovery projects in Alberta – succeeds in making one important point, by confirming that oil supplies do respond positively to price increases. These results "dispel the notion, which seemed to underlie policy in the 1970s, that productive oil capacity in the Western Basin would not increase in response to higher economic incentives." The Council takes the position that, with the right policies in place, the outlook for conventional oil supplies will brighten.

Case study results

Before considering the question of policy reform, the Council sketches in the broad picture of costs, prices and profitability of Canada's sources of new oil supply. A series of case studies – on existing oil reserve projects, on the Alsands and Wolf Lake oilsands projects, and on possible developments in the frontier areas of the Beaufort Sea and Hibernia – produce the following assessment:

- the lowest cost oil is found in the Western Basin;
- substantial reserves of light and heavy oil from existing oil reserves can be developed by means of "enhanced recovery" methods, given supportive government policies;
- recovering oil from oilsands remains costly at this stage. Given current technology, attempts to develop supply from the oilsands in smaller increments are preferable to the megaprojects of a few years ago;
- frontier oil offers long-term potential, but until commercial discoveries are made and marketing can begin, profitability will remain uncertain. Changes in certain federal government energy taxes would improve expectations.

National Film Board of Canada

Oil price deregulation makes economic sense

Policy changes required

From that review, the Council concludes that developing the enormous potential of Canada's oil resources at the lowest possible cost will necessitate some important policy changes. First of all, supply management should be geared to efficiency and to making it profitable for industry to explore and develop new sources. But the current pricing policy – whereby "old" oil (i.e., oil discovered before 1974) is priced below world levels, and "new" oil at the world price – fails on both those counts. Keeping domestic prices down has limited industry's profitability and its capacity for exploration and development. Further, discriminating between "old" and "new" oil has distorted supply, encouraging production of the more costly new oil over the old. To eliminate these problems, the Council recommends that all domestic oil be priced at world levels.

In addition, the incentive system needs to be changed. The federal government's National Energy Program (NEP), established in 1981, put emphasis on promoting the discovery of oil in frontier areas, and so introduced a system of grants for exploration and development, known as "Petroleum Incentive Payments" (PIPS). This form of subsidy isn't the most effective means of achieving NEP targets, the Council says. But even more important, it encourages frontier development at the expense of potentially more productive activity in the Western Basin. Priority should be given to improving economic incentives for activity in the WSB area, the Council says.

Finally, the federal government method of collecting economic rent through taxes and royalties needs an overhaul. While provincial royalty schemes tend to take account of the profitability of a given oil field, the federal Petroleum and Gas Revenue Tax or PGRT (which allows for the deduction of operating costs only) does not. That can lead to overtaxation of projects with low profits, and undertaxation of those with above-normal profits. Preferably, the PGRT should also allow deductibility of certain capital costs, in the Council's view.

Gas

Policies dealing with natural gas should be more flexible, and, over several years, should provide for deregulated domestic gas prices, according to the Economic Council.

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Frontier oil: long term potential

At present, an overly rigid approach – apparent in gas pricing and the structure of taxes and royalties – is preventing the industry from realizing its full potential. Although policy changes over the past few years have begun to address these problems, the Council believes they may not have gone far enough.

The most glaring characteristic of the natural gas market at the moment is the current imbalance that exists between supply and demand. The industry is awash with surplus supplies of available gas, and thus is operating far below capacity – graphically illustrated by the fact that, in 1983, there were as many as 11,000 shut-in wells in Alberta.

While that situation has its downside, it does offer Canadians a number of opportunities, the Council says. Alowing deregulation of gas prices would restore a better balance between supply and demand, would allow Canadian consumers to enjoy lower gas prices in the short to medium term, and would encourage the substitution of gas for more costly forms of energy.

Furthermore, Canada's abililty to take advantage of this situation is reinforced by the massive long-term gas potential that exists in the Western Sedimentary Basin and in the frontier areas.

Rigid price system

The present state of affairs is attributable in part to a rigid and complicated system of setting gas prices. In the Council's opinion – based on research confirming that gas supplies will respond to changes in price – new policies with the flexibility to adapt quickly to market realities could turn things around.

In 1981, a two-price system (the "Toronto city gate price," and the "Alberta border price") was introduced into the domestic market. Now domestic consumers pay a price set by the federal government at approximately 65 per cent of the blended Canadian oil price, evaluated at the Toronto city gate (i.e., including transportation costs to that point, as well as federal taxes and subsidies). Producers, on the other hand, are paid at the other end of the transmission system, with prices at the Alberta border defined by federal-provincial agreements.

The major drawback to this administered price system is that governments are rarely – if ever – able to bring prices in line with market conditions, due to the many supply and demand considerations involved.

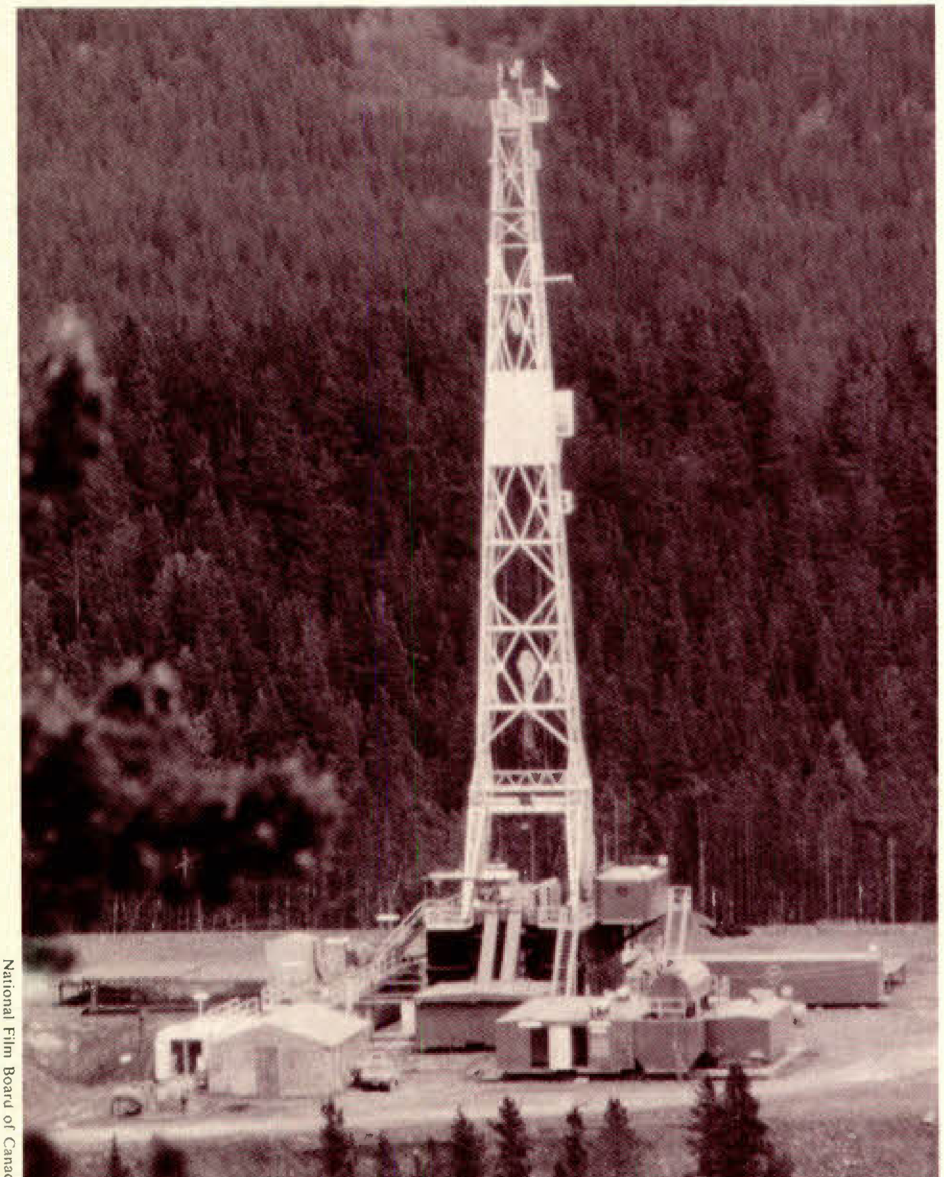
Solution to problems

The best solution is to move towards eventual deregulation of natural gas prices, says the Council. It recognizes though that, in the short term, a transitional arrangement will be necessary. Consequently, it suggests that the federal government continue to set the gas price over a transitional period to allow producers and buyers of gas to adjust to the new system. Then, with gas prices deregulated across the country, the Alberta border price would no longer be separately determined, but instead would be "market-sensitive" – that is, calculated at the Toronto price minus transportation costs.

Measures also need to be taken to provide industry with the incentive to find and develop new supplies. A more flexible fiscal system, bringing taxes and royalties in line with industry profitability, would go a long way to achieving that goal, the Council says.

While changes are essential insofar as domestic policy is concerned, export policy (providing for more export licences and lower prices) is now on the right track, the Council finds, and policy improvements should involve "doing more of the same." In particular, the Council believes that the present system of regulating export gas prices should continue, in order to ensure a fair return on Canadian gas exports.

Even though export sales to the United States are low at the moment (largely because the U.S. is busy soaking up its own gas surpluses), the long-term outlook is good. As the NEB has indicated, there are potential new markets in the northeastern U.S. and in the north-central region of the Midwest.



National Film Board of Canada

Huge gas surpluses in Canada, U.S.

Electricity

Sound economic management of the electrical industry requires changes in the regulatory structure. In particular, says the Council, provincial policy makers who manage the resource need to take a close look at their pricing and investment strategies.

The present structure of the electrical industry reflects the desire of provincial governments to achieve not only economic efficiency, but also a range of other objectives – including energy self-sufficiency, economic development and social concerns. Overall, one of the primary policy objectives to date has been to ensure the lowest possible rates for electricity consumers.

There is some concern now, however, that this approach results in the selling of electricity at prices below its real cost, leading to overconsumption and waste of valuable resources.

Now that the industry is mature and a major force in the energy market, the Council believes that greater emphasis should go to achieving economic efficiency. The fundamental problem from this particular standpoint lies in the complex business of regulating prices for a natural monopoly – as electricity is – in order to avoid excessive monopoly profits and create supply conditions beneficial to the economy. Because of this monopolistic aspect, the Council sees the need for a more comprehensive and systematic regulatory framework.

Regulation of monopoly prices generally involves two steps. First, regulators determine the "revenue requirement," or the revenue necessary both to cover reasonable production costs and to yield an acceptably fair return on assets. Then, costs are allocated across sales, and a rate structure is designed to meet the revenue requirement.

Underpriced electricity

The present-day method of calculating the revenue requirement for public utilities tends to undervalue the true cost of electricity for a variety of reasons. One is that the return on the massive amount of assets employed in the industry is too low, because utilities are not required to make a competitive rate of return on investment, because they have access to low-cost debt, and because their method of assessing costs could lead to the undervaluation of new or prospective assets.

While a low return on assets plays in favour of lower electricity rates, to the short-term benefit of the consumer, this approach also has some negative consequences. It slows the development of energy conservation, and it adversely affects investment decisions in both the electricity and non-electricity sectors.

Several alternative approaches to financial management would be more efficient, the Council believes. As one option, governments could recommend a target rate of return for investment decisions by utilities. Or, utilities could be required to obtain debt capital on their own behalf without any provincial guarantee, except in exceptional circumstances. Improving capital structures within the utilities is an essential first step in effecting these reforms, the Council notes.

Another reason for artificially low electricity prices lies in the preferential treatment governments give utilities, in the form of income tax exemptions and low collection of economic rent. Yet another cause is found in the government practice of applying profits from export sales of electricity against the costs of domestic supplies – in effect, subsidizing consumers – rather than collecting them as provincial revenues.

Policy changes are definitely called for, in the Council's view, in order to bring electricity price levels more in line with the true economic costs of electricity supply. But these changes will need to be gradual enough to allow consumers to adjust and policy makers to realign economic development policies. Key in that process will be alterations in the detailed rate structure of electricity prices.

Rate Structure

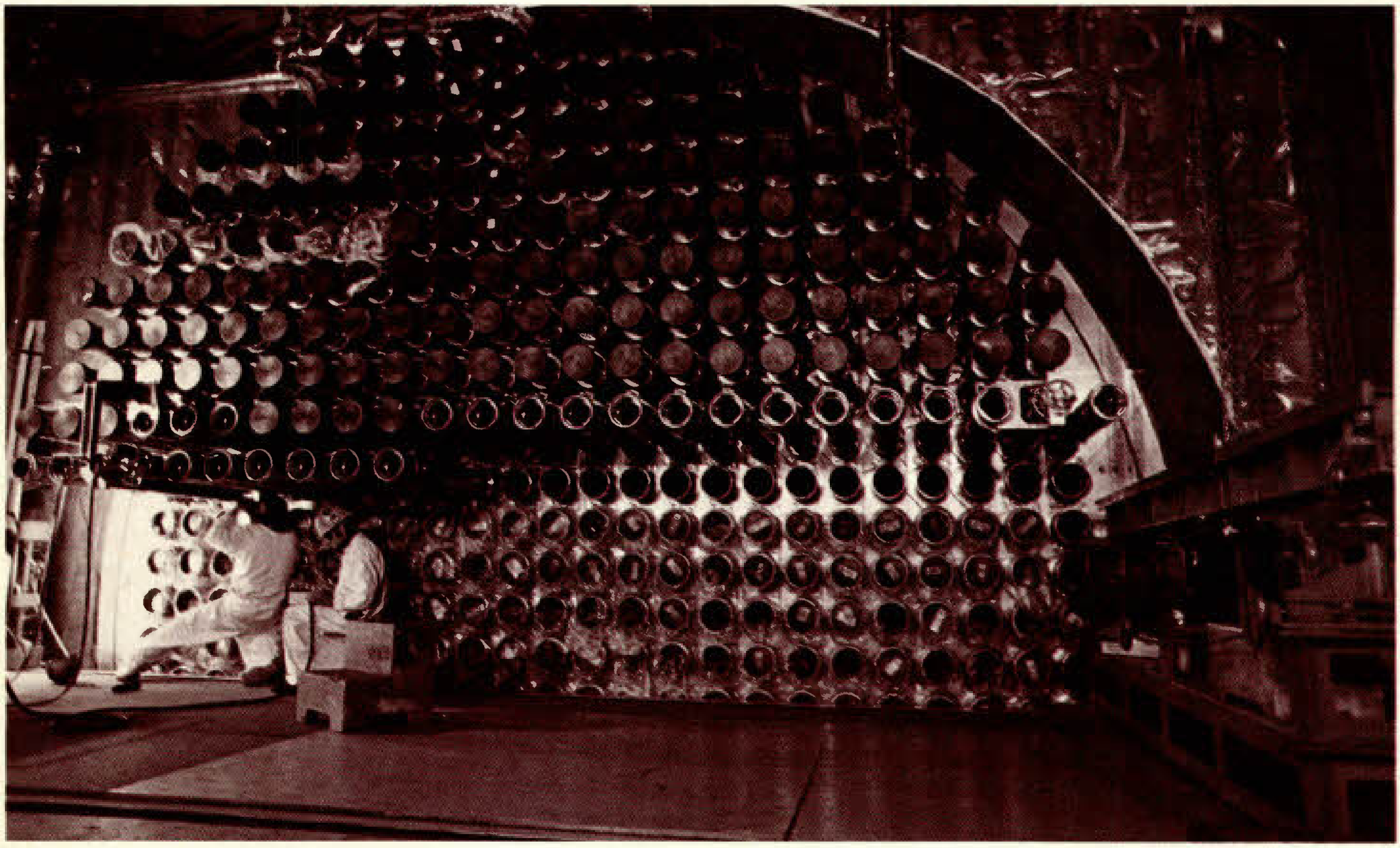
Insofar as rate setting is concerned, the mandate of provincial regulatory boards has been and remains to ensure fair and reasonable rates. Rates also must meet the revenue requirement and attempt to satisfy a number of other concerns (economic and regional development, for example).

Once again, says the Council, the keynote in this area should be economic efficiency – but that will mean making some changes in the system. At the root of the problem is the enormous variability in electricity demand, both during the day (it is greatest in the morning and early evening) and over the year (it is heaviest in winter). That variability makes it extremely difficult for utilities to plan a system which simultaneously minimizes costs and meets peak demand – when costs for the most part are higher. Their answer has been to impose more or less uniform rates with no allowance for time of use, with the result that some consumers pay too much and others too little.

A better approach lies in the implementation of "time of use" rates, the Council says. Encouraging a shift to offpeak, lower-cost periods, by offering discount rates (much as telephone companies do for long distance calls) would not only end price discrimination, but would bring other benefits as well. Overall costs would be reduced for utilities over the longer term, through the reduction of capacity requirements, and energy conservation in more costly time periods would be encouraged.

Exports

Canada exports about 10 times more electricity to the United States than it imports – and trade is expected to grow substantially in the future. That favourable outlook raises an important policy question, the Council says. As exports increase, so will their share of the revenues going to the utilities. As that occurs, "it will become increasingly inappropriate to pass on the export profits to domestic consumers in the form of reduced rates." Creating separate utility subsidiaries to handle export sales and deal with export profits might be the best solution to this particular policy problem.



National Film Board of Canada

Low cost electricity for Canadians

Shaping energy demand

Canadians used to believe that their climate, geography and high living standards meant they would never be able to scale down their heavy energy demands.

But the events of the past decade disproved that notion, as the oil price shocks of the 1970s stopped energy demand in its tracks. Now it is widely recognized that demand is flexible, responding to energy prices, policies and technology.

That means policy makers can rely more on pricing policies to shape demand than they once thought, says the Council. Letting energy prices adjust to supply and demand conditions would not only restore balance to the market, but also – together with improved information and more selective government initiatives – would stimulate energy conservation and encourage the efficient use of energy sources through subsitution.

Although energy demand has always been affected by technological, economic and policy issues, its adaptability was never more apparent than in the years following the oil price shocks. Over the succeeding decade, energy demand grew at an average of less than one per cent a year, rather than at the 5 to 6 per cent that prevailed earlier. Energy use in homes and industry dropped by 13 and 17 per cent, respectively, and consumers in droves switched to energy sources other than oil, which declined in market share from 45 per cent in 1973 to 35 per cent ten years later.

During this period, consumers were compelled to adapt to an entirely new energy situation – and that was not easy, especially in certain regions and sectors. People in the Atlantic provinces had a particularly tough time when oil prices exploded, due to their heavy oil dependency. Moreover, they found it difficult to switch to alternative energy forms, because options were limited and costly. Certain sectors also received a jolt. The transportation sector, for example, is to this day almost totally dependent on oil products such as gasoline, and thus had a major adjustment to make. Smaller, lighter cars and reduced speed limits are two examples of how the automotive sector coped.

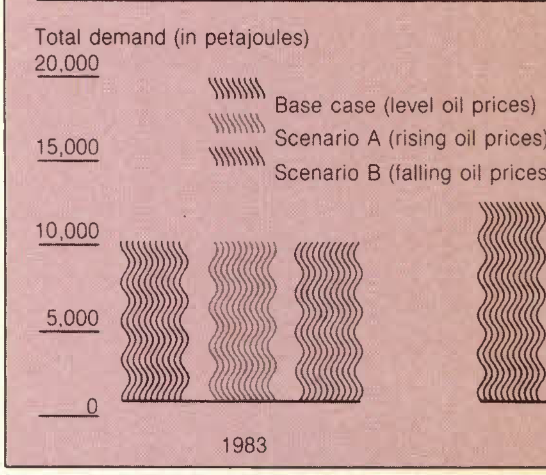
Understandably, there is considerable interest in what demand will do in the future. Although more changes will inevitably occur, says the Council, their nature is somewhat difficult to predict, since market conditions play such an important role in determining demand. However, working with a model developed by Energy, Mines and Resources, the Council traces general demand trends through to the year 2000, by developing three scenarios. All three assume that present policies will continue and that economic growth will average 3 per cent a year over the period. The first scenario, or "base case" – used as a point of reference – assumes that the world oil price will not change in real terms. The other two scenarios are based on the hypotheses that between now and the year 2000, prices will rise by 5 per cent a year in real terms (Scenario A) or fall by 5 per cent (Scenario B). The accompanying chart shows what happens to energy demand under all three assumptions. Work with the model also indicates that oil use drops in all three scenarios, with consumers shifting to hydro and nuclear electricity rather than to natural gas. That is explained by the current policy of setting gas prices at 65 per cent of the blended Canadian oil price, says the Council, and it implies that, under current price regimes, "there will be little expansion of the market for natural gas."

Energy conservation

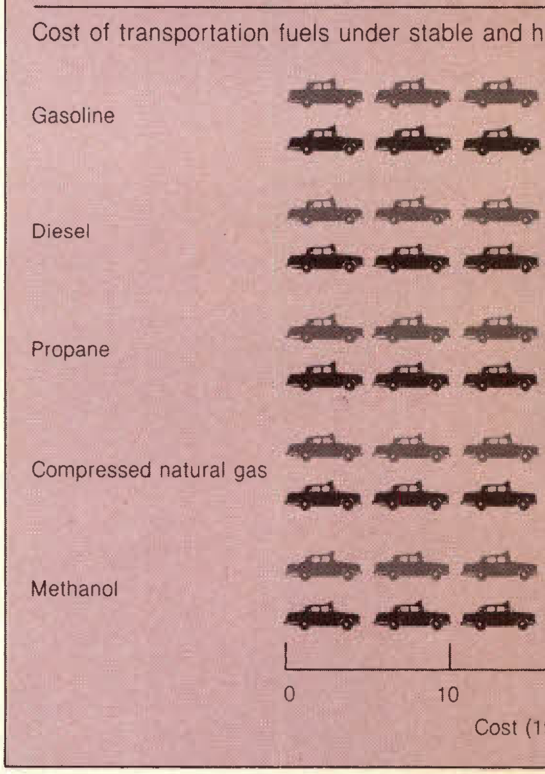
Measures to encourage conservation in Canada have been under way since 1973, with varying degrees of success – some sizable – across regions and sectors. There has been some concern, though, that for a variety of reasons – including the pricing of conventional energy, and the lack of consumer awareness of new technologies – sensible energy options have been overlooked. With that in mind, the Council undertook to examine the competitiveness of new energy technologies capable of replacing conventional forms, in the residential, industrial and transportation markets, and to determine whether current market conditions speeded up or impeded their introduction.

The Council study examines space heating devices for homes (the condensing gas furnace, the heat pump, and the central wood furnace); three technologies for industrial use, comprising industrial co-generation, waste heat recovery, and energy from waste;

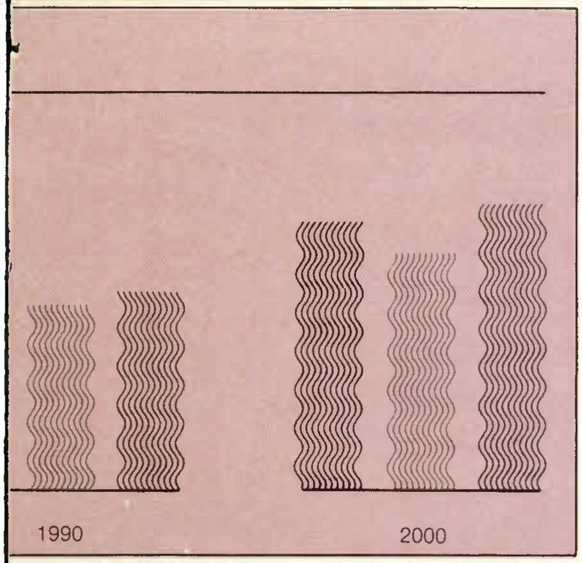
Future energy demand: three possibilities



Diesel is cheapest fuel for fleet cars



and alternative automotive fuels (diesel, propane, compressed natural gas and methanol). All were analysed over an investment horizon beginning in 1995, the time span considered necessary for the emerging technologies to penetrate the market. As a reference



point, the Council assumes world oil prices increase only fractionally, that gas is valued at 85 per cent of the world oil price in 1995, and that electricity prices a) stay the same or b) increase by 30 per cent.

Home heating devices

The study reveals the condensing gas furnace to be a most attractive option for householders (see *Au Courant*, Vol. 5, No. 1 for a detailed presentation of results). But although there are clear advantages to investing in this option, current trends tend to favour conventional heating forms instead. The problem in the Council's view stems from a lack of consumer information. Governments should be suggesting energy targets to homeowners, and also to builders who decide what form of heating to install in new homes.

Industrial co-generation

Industrial co-generation – or the simultaneous generation of electric power and useful heat from a single plant and energy source – is somewhat dependent for its success on future energy costs. If electricity prices go up, the economic potential for co-generation increases enormously. Under high oil and gas prices though, it becomes relatively less attractive because it is a fuel-intensive means of electricity generation. Still, over the long term, co-generation could meet an increasing share of electricity demand, the Council believes, given active cooperation and involvement by the utilities.

Waste heat recovery

Much of the heat energy that is wasted when energy is consumed in Canadian manufacturing and mining industries can be recovered and used again in the industrial sector. Council analysis of 31 waste-heat recovery projects shows they are characterized by low investment costs and high energy savings. Moreover, the technology is sufficiently competitive on the market today to attract investors. But industrial managers may not be giving this process their full consideration, nor applying the right kind of financing criteria to new projects. Governments can help here through information programs or by encouraging new forms of financing.

Energy from waste

Producing steam from municipal solid waste also has considerable potential at reasonable cost, the Council finds. But although sufficient financial incentives appear to exist even now for implementation of new plants, these projects are not going ahead. Some technical problems, along with the large degree of cooperation required from numerous parties at all levels of government and industry, probably explain why this is the case. One solution might lie in the acceleration of demonstration projects promoted by a multipartite task force dedicated to energy-from-waste technology and project planning, suggests the Council.

Automotive fuels

Some of the results of Council analysis of alternative fuels for private and fleet cars (such as taxis) are illustrated in the accompanying chart. (See also *Au Courant*, Vol. 5, No. 1). While it is apparent that diesel is the cheapest fuel for fleet cars under static or rising oil prices – a finding that proves true for private cars as well in the latter scenario – current government policies providing tax breaks and conversion incentives for propane and compressed natural gas are promoting the use of these fuels instead. These policies need to be revised, the Council says, to achieve a more cost-oriented market balance.

The results of Council analysis of promising energy conservation and substitution technologies reveal that in many cases markets are not adopting the cheapest energy solutions. A first requirement for policy in this area, concludes the Council, is "to recognize fully the capacity of the market to adjust to a changing environment" by enabling prices to reflect real energy costs. Government programs can then be implemented wherever necessary to complement or stimulate the market response, through providing information, support of research and development, and on occasion, financial assistance.

A new energy strategy

Devising a new energy strategy is no easy matter, given that energy issues impinge on a staggering range of economic, political and social concerns in Canada.

But the Economic Council is convinced not only that such a strategy is possible, but also that it can create a better tomorrow for Canadians.

"We believe," the Council says, "that our proposals can contribute, to a significantly greater extent than current policies, to the achievement of efficient resource management, the functioning of fair and resilient mechanisms for the sharing of resource revenues across the country, increased Canadian participation in the oil and gas sector, greater energy security, and stronger economic development in the short and longer term."

Furthermore, Council analysis of the effect its proposal would have on the economy illustrates that this can be done without increasing the financial burdens of the federal government.

Revenue-sharing and resource management

An essential first step in developing an energy policy with efficient resource management as its cornerstone, says the Council, lies in settling the contentious issue of the sharing of resource revenues. The root of the problem in this regard is typically Canadian – a divided jurisdiction over unequally distributed resources. While the intricacies of that situation affect all resources, oil and gas have come in for particular attention lately, because of their huge recent revenues. In the Council's opinion, though, revenue sharing should be discussed, not in terms of oil and gas, or even energy policy in general, but rather in the context of federal-provincial fiscal relations. The fundamental issue as the Council sees it concerns distributing the costs and benefits of Canadian life fairly among Canadians.

The Equalization Program ensures that all Canadians can receive the same basic public services at approximately the same cost, by means of a system of unconditional transfer payments, through the federal government, from the rich to the poorer provinces. That program, with some modifications, can also see to it that Canadians everywhere benefit from resource windfalls, the Council says. But the federal government should have access to some of the provincial resource revenues to finance equalization payments and to distribute the costs of federal services and activities fairly among Canadian taxpayers. That requires clarifying constitutional provisions regarding federal taxation of provincial resources.

To resolve this issue, the Council recommends that federal and provincial governments should "enunciate principles and establish mechanisms for the sharing of government revenues from all natural resources." Although resource royalties (or rent) should be collected by the resource owner (in most cases, the province), the federal government should be guaranteed a share, regardless of provincial collection and distribution policies.

With the prospect for an agreement on revenue sharing, the Council says, the way would be clearer for the government owning the resources to assume paramount responsibility for the management of production and development of the resources within its jurisdiction, including the direct collection of resource revenues. That, however, does not preclude governments from collaborating on the establishment and administration of a particular regime.

The Council recognizes that concluding and following through on such an agreement will take time. Meanwhile, the federal government will need to continue taxing resources, preferably in co-operation with provincial governments. So the Council proposes the implementation of certain interim measures designed to improve taxation efficiency in the oil and gas sector. Essentially, it recommends scrapping a major federal government tax (the Incremental Oil Revenue Tax) and revising another (the Petroleum and Gas Revenue Tax – PGRT) to allow for capital costs as well as operating costs (see page 4). It further recommends that, by agreement between Ottawa and the producing provinces, the modified PGRT rate be allowed to

"...economic growth and development for the benefit of all Canadians – keyed to efficient resource management – should be the primary objective of energy policy in Canada."

Connections

"The critical challenge confronting governments is to devise an energy strategy and implement policy measures that...will result in the most beneficial utilization of Canada's energy resources."

Connections

rise and fall along with world oil prices, thereby acting as a cushion against world market instability.

has become less pressing lately, with growing excess capacity in the Middle East, and with Canada's reduced

"...it is possible to develop an energy strategy for the future that can integrate both economic and noneconomic objectives without sacrificing any one of them in any way."

Connections

The consultation process

Even with a clearer delineation of management responsiblities, consultation between the two levels of government will remain essential, the Council says, since federal powers and responsibilities – for trade, the overall economy, national security and so on – impinge on provincial resource development. The past decade witnessed a serious breakdown in the consultative process, with devastating results for federal-provincial cooperation and public confidence. The Council believes that process needs to be revived, and so proposes the establishment of a permanent federal-provincial Council of Energy Ministers, to meet formally at least once a year. It also suggests that this Council consider the creation of a Secretariat for a trial five-year period, to co-ordinate consultation with private sector interest groups.

Canadian ownership

Canadian ownership and control in the oil and gas sector has been a major policy objective for some time. There are certain short-term costs in pursuing this goal, the Council warns: in the past it has contributed to the debt situation of Canadian energy industries, as well as to declining foreign investment. In the Council's view, Crown corporations such as Petro-Canada have a role to play in this regard. So, too, does the private sector. Policies should therefore aim at encouraging Canadians to invest in the equity of petroleum companies operating in Canada, and should provide a built-in mechanism favouring the more successful ones.

Self-sufficiency

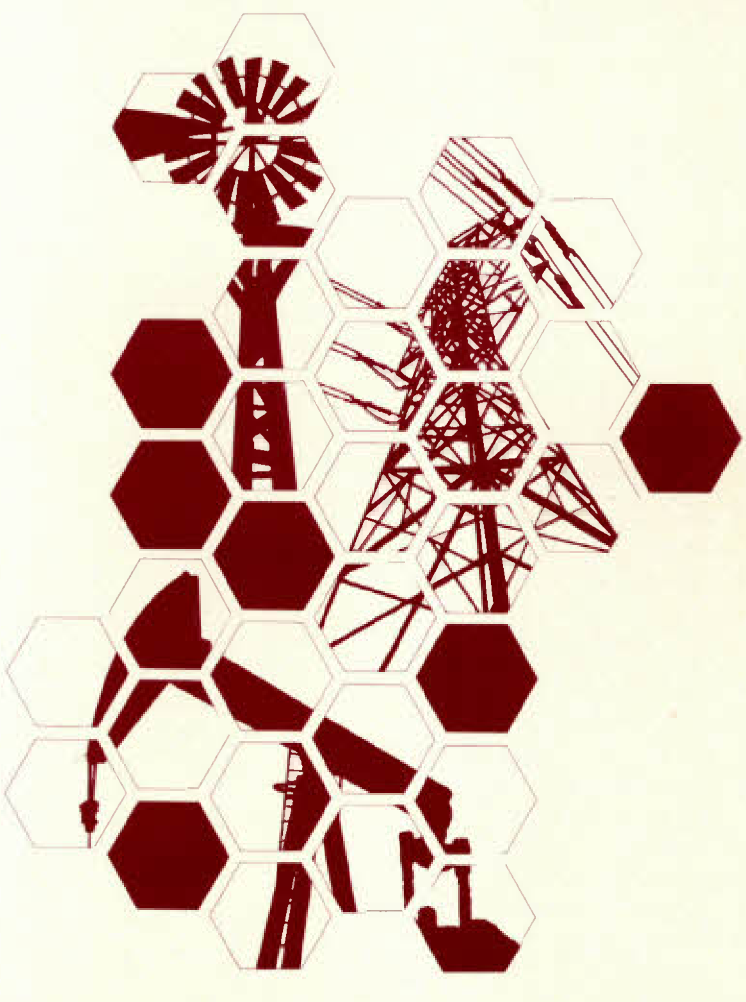
The fundamental issue here, the Council says, is security of supply – particularly oil supplies. That concern

dependence on oil from that source. The development of frontier oil potential and of efficient conservation technologies would be further security measures. In addition, with an eye to protecting eastern Canadians who remain the most heavily dependent on oil supplies, the Council suggests adopting a modest storage policy. It notes as well that measures to improve the economics of Canada's heavy oil upgrading capacity would enhance security as well.

Oil, gas and electricity

The broad outline of Council proposals to improve efficiency in these three sectors has been discussed on preceding *Au Courant* pages. In addition to recommending price deregulation for oil and gas, the Council calls for improvements in federal taxation, both on provincial lands and on Canada Lands (the areas owned by the federal government). Lastly, the Council proposes a change from grants to refundable tax credits on Canada Lands. Implementation of its major recommendations, the Council's economic model indicates, would improve overall economic performance without increasing the federal deficit.

A more systematic and comprehensive regulatory framework would benefit the electricity sector. As well, improvements are needed in utility financial and pricing policies. Given the current uncertain outlook for the CANDU nuclear system, the Council also suggests that the federal government should provide funds to keep the technology alive for the next five years, pending the outcome of a full inquiry into the industry's future.



STEERING THE COURSE

Unemployment and the federal deficit are the key problems facing Canada, despite good economic growth in the past year. In its *Twenty-First Annual Review*, the Council examines these problems and some of the options available for dealing with them over the medium term.

The strong economic recovery in the United States has provided some of the stimulus for the Canadian economy but, on a negative note, slower growth in other industrialized nations has been a moderating force. Throughout the world, the recession has left a legacy of large public and private sector indebtedness, high unemployment, and concern about the impact of technological change.

Worrisome, too, is the pattern of the Canadian recovery. While the economy has moved above its prerecession peak, investment remains weak and unemployment persists in double digits. Investment in new plants and equipment has been discouraged by high real interest rates, excess capacity, and the level of corporate indebtedness (although business indebtedness has been reduced in the last year or so). Instead, companies have been restructuring their balance sheets as the recovery has progressed. In the United States, by contrast, investment activity has been strong and unemployment has improved substantially in the recovery.

Federal government deficits in both countries have generated considerable debate. No longer is it generally accepted that deficits will disappear with full employment. Instead, attention is turning to an examination of structural issues, and the effects of high real interest rates on future economic growth prospects.

The base-case projection

The medium-term outlook depends on many things. The base-case projection is the Council's judgment on what is likely to occur between 1984 and 1990, based on economic policies in place in September.

Here are the highlights:

- Real economic growth will average about 3.1 per cent for the rest of the decade, with the exception of a growth pause in late 1985 and 1986 (see the first chart). The pause will not be another recession; rather, it is part of the normal growth slowdown of the business cycle and will be linked closely to an expected slowing of economic activity in the United States;
- Employment growth will average about 2 per cent, except during the 1986 slowdown, and should stay slightly ahead of growth in the labour force. That should translate into some downward movement of the jobless rate over the medium term;
- However, the unemployment rate will remain in double digits until near the end of the decade (see the second

The outlook for the economy

Selected economic indicators, using three scenarios

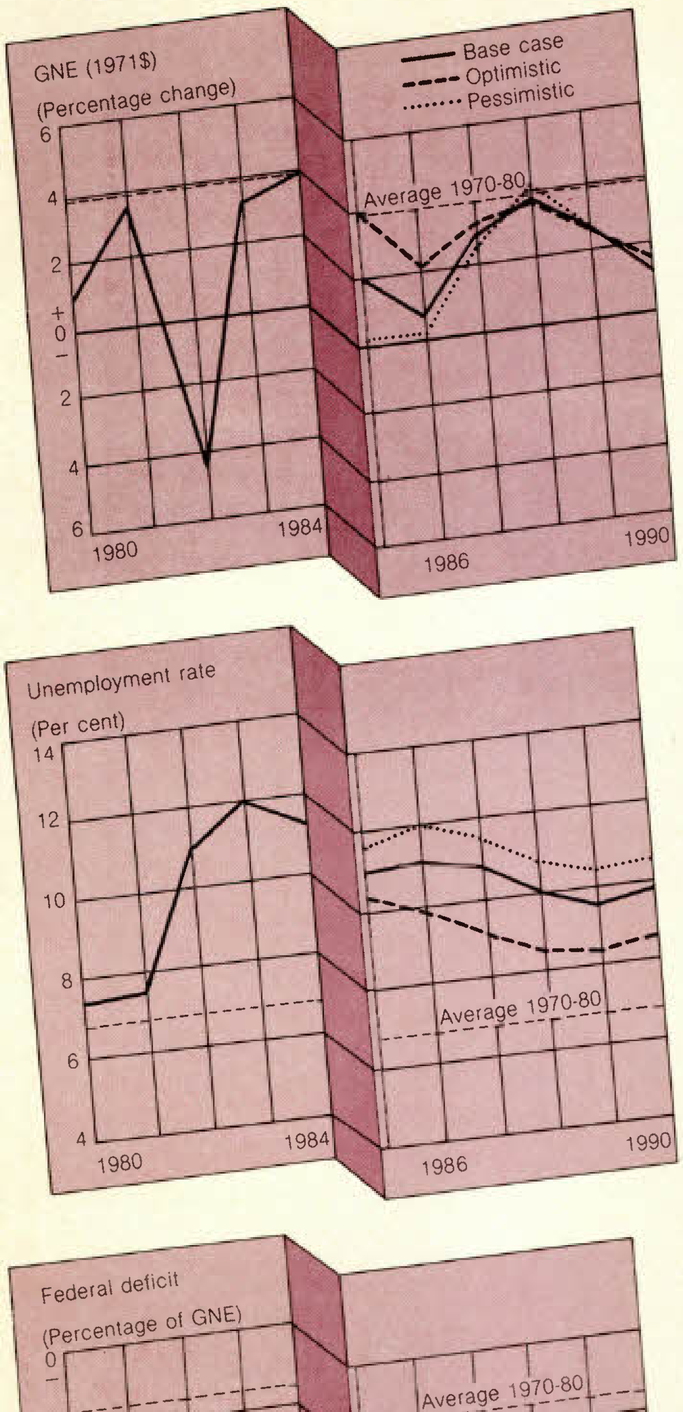


chart). It is not expected to drop below 10 per cent until 1987-89;

- Inflation will continue its downward trend, staying below 5 per cent for the rest of the decade;
- Labour productivity will grow by about one per cent a year until after the 1986 pause. The rate of growth is expected to nearly double after that;
- The personal savings rate will remain close to 10 per cent until 1986;
- The level of the federal deficit is not expected to show much of a change (see the third chart). The ratio of the deficit to Gross National Expenditure (GNE) will drift downward to just below 5 per cent barring direct action;
- The surplus on the current account balance will start to deteriorate and move into a deficit position of between 0.5 and 1.5 per cent of GNE by the end of the decade.

Alternative outlooks

Canada's economic performance could turn out to be better or worse than the base case. Key factors will be the handling of the U.S. deficit, investment spending in Canada, fiscal policies adopted by both countries, and the level of personal savings.

The optimistic scenario assumes lower U.S. interest rates, lower Canadian savings, and higher investment than in the base case. The pessimistic scenario assumes higher U.S. interest rates, higher Canadian savings, and lower investment than in the base case.

The highlights of the alternative outlooks include:

- Real growth ranges from an average of 3 per cent (for the optimistic case) to 2 per cent (for the pessimistic case) because of the mid-decade slowdown (see the first chart);
- Unemployment is about 8.5 per cent for the optimistic scenario, and remains at about the present level in the pessimistic one (see the second chart);
- Inflation drops below 3 per cent in the optimistic case, and averages about 5 per cent in the pessimistic scenario;
- The federal deficit, as a proportion of GNE is reduced to about 2 per cent in the optimistic outlook, while it climbs to 7 per cent in the pessimistic alternative (see the third chart).

The federal deficit remains sensitive to economic conditions because many of the transfer programs and the tax base are influenced by the private sector's activity. Higher interest rates have had a significant influence on deficits because a higher proportion of expenditures is required to service the debts. And, for investment, even the optimistic case does not show tremendous growth.

The simulations carried out indicate the importance of addressing the U.S. deficit and its implications for Canada. If the wrong choices are made in the United States, the economy could come to a standstill and move North America into a recession for the third time in six years. This could have serious repercussions for the Canadian economy. On the other hand, the outlook could improve. Fiscal measures in the U.S. allowing a reduction in interest rates would benefit Canada and the mid-decade adjustment would not be intensified by tight credit conditions.

It must also be noted that the assumptions used in the base case and alternative scenarios incorporate monetary and fiscal policies that were in place prior to the September election in Canada and the Finance Minister's economic statement in November. New policy directions for the economy (and the energy sector) will likely affect the medium-term projections contained in the Annual Review.

The employment picture

The persistent high rate of unemployment can no longer be attributed solely to the recession. Clearly, other factors are at play, including a changing labour market, new and different employment opportunities, and a wealth of new technologies.

A key element is the growth and importance of the service sector in creating jobs. More than 70 per cent of the Canadians who work have jobs in services. The largest impact has been on women and young people, one-third of whom work part-time, primarily in the service sector.

The growth of service activities, says the Council, has probably contributed to higher frictional unemployment – the unemployment that results from workers moving between jobs or in and out of the work force. Structural unemployment, which is associated with seasonal joblessness or unemployment due to technological change, has also increased and is usually of longer duration. This situation intensified as the baby boom generation and older women flooded the labour market, as unemployment insurance was made more generous, and as new labour-saving technologies were adopted.

It is estimated that technological change slowed employment growth between 1971 and 1979 by about one per cent a year. However, Council research shows that the decrease was more than offset by employment growth stemming from increases in demand, which averaged about 4.2 per cent annually through the same period.

All sectors of the economy will likely be affected by technological change in the future, but it is extremely difficult to try to predict how, and at what pace, these new developments will be implemented.

Some general estimates were devised using the Council's CANDIDE econometric model. As population growth slows, and the population ages, future economic growth will likely be slower than in the 1960s, but stronger than in the late 1970s. The strongest employment growth (barring major unexpected developments) is expected to be in energy-related industries and non-residential construction. The slowest employment growth is expected to be in fisheries, forestry, manufacturing, and trade. The Council says that "technology plays a role in shaping the pattern of employment growth, perhaps not only in the most visible way – the emergence of totally new occupations combined with the decline of old ones – but more through changes in the functions, expertise, and work instruments within occupations."

New technologies will increase output and productivity, as well as lead to higher personal incomes and additional expenditures, savings, and jobs. Adoption of new techniques and processes is not expected to cause revolutionary disruptions in employment patterns, but structural unemployment and demand deficiencies will be continuing problems that governments will have to address.

The public debt: cause for concern?

Governments have spent increasing amounts of money to provide the services demanded by Canadians: education, health care, pensions, and support for the poor, the aged, and the unemployed. Between 1952 and 1983, the amount that federal, provincial, and local governments spent on every man, woman, and child rose from $438 to $7,200. Government revenues – mostly from taxes – have not risen enough to keep up with these expenditures. And as a result the federal deficit (on a national accounts basis) stood at $24 billion in 1983.

The majority of the government's revenue comes from taxes. The slowdown in the rate of growth of income tax revenue is the combined result of slower economic growth in the 1970s and of a decline in the government share of increases in real personal income, due to changes in personal income taxes and of various tax expenditures. Had the government collected the same proportion of the increase in real personal income in the 1975-83 period as in the 1960s, it would have secured $40 billion in extra revenue. Had Canada's real growth rate and the marginal revenue collected been higher, the extra revenue brought in over that period would have been close to 100 billion dollars.

The largest amount of spending goes to social services, followed by debt charges (see chart). So far, the debt and the cost of servicing it have not presented serious problems for the federal government, but it is clear that increased spending and reduced revenues are a recipe for trouble in the future. There are many who worry that government deficits and debt management have an impact on interest rates by crowding out the private sector. At current debt levels, and under recent economic conditions, this does not appear to be a problem in Canada, although deficits limit the government's ability to undertake new expenditures.

There is a need to stabilize the level of public debt outstanding so that the increasing debt charges do not lead to a self-sustaining deficit. There is no magic level for the ratio of public debt to GNE. Using the base case assumptions (with interest rates of between 12 and 14 per cent), a debt-to-GNE ratio of 53 per cent would emerge by 1990, and 31 cents of every tax dollar would go towards servicing the public debt. On the other hand, at a 65 per cent debt-to-GNE ratio, two-thirds of tax revenues would be devoted to the payment of debt charges, and newly issued debt might be insufficient to cover new debt charges. However, the solution does not lie simply in strong economic growth and a reduction in interest rates. At this point, more will be required to make a substantial dent in the deficit.

Increasing indebtedness is also a growing problem for the private sector. In 1981, almost one in five small independent firms had more debt than assets. The debt-to-asset ratio of firms of all sizes – not just smaller ones – rose, indicating that the problem was getting broader, not narrower. Borrowers favoured shorter-term arrangements as a result of volatile interest rates and fluctuating inflation. However, since then, the situation has shown some signs of improvement.

Corporate indebtedness becomes a problem when firms cannot afford their debts. One indication of this is the amount of operating revenue spent on interest payments. In 1982, corporations spent, on average, more than half of their income on interest payments. By 1983, that had dropped slightly but remained at an historically high level.

The international debt problem also affects the Canadian economy. The chartered banks are active abroad and nearly 40 per cent of Canada's bank assets, plus a slightly higher proportion of their deposits, are in foreign currency. This large international involvement has also increased their sensitivity to international developments.

The difficulties that many less developed countries (LDCs) are having in repaying their debts has affected banks in Canada. In 1982, these nations had $600 billion outstanding in debts, with Canada's exposure estimated at between $20 and $25 billion ($15 billion of that with the "big four" debtors: Mexico, Venezuela, Brazil, and Argentina). Exposure to Mexico and Brazil together account for more than 120 per cent of the capital of the Bank of Montreal and 160 per cent of the National Bank's. Any partial write-off of these loans would have a significant effect on the chartered banks. More realistically, according to the Council, the impact of the international difficulties "reduces the profitability of Canadian banks, particularly in their foreign lending operations."

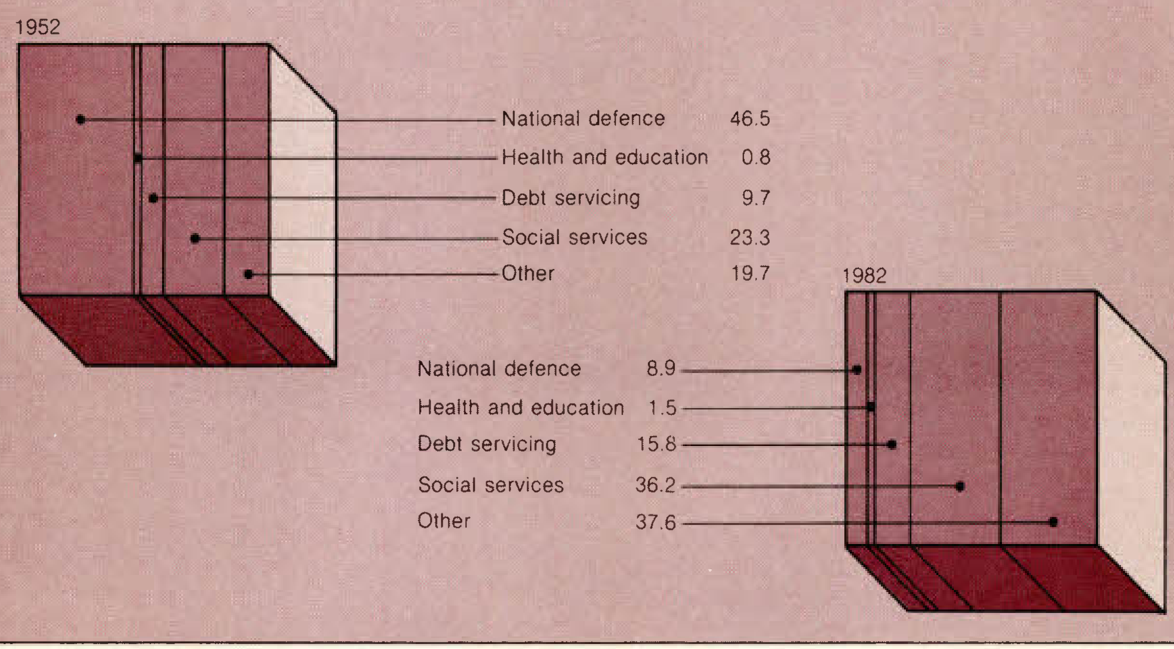
However, the banks have made a great deal of progress in the past year in strengthening their capital base. Further, they have been encouraged to make adequate provision for possible losses on their international loans. It is possible that, in the future, the banks may become more cautious in both their international and domestic activities – at a time when their full and aggressive support is needed to strengthen the economic recovery.

Debt overhang continues to constrain the expansion of world trade, with a spillover into Canada's economic expansion prospects. In April, the International Monetary Fund (IMF) was slightly more optimistic than it had been about the international debt situation. "The conclusion is reached that most groups of LDCs can achieve adequate rates of growth of [gross domestic product] while restoring a manageable position with respect to their current accounts and debt service burden." Critics have said this scenario is too optimistic and the higher interest rates or a serious growth pause would be significant.

The long-term solution requires solid economic growth worldwide, along with trade opportunities for the LDCs to help them meet their debt service obligations. The Council urges the Canadian government and banking system to continue working within the IMF and other international groups to find a solution to the problem of international indebtedness. As well, in the Council's view, the government has a chance to increase confidence domestically among investors and financial institutions by encouraging the strengthening of the financial and equity base of Canadian financial and nonfinancial corporations.

A look at government spending

Relative share of certain federal government expenditures, 1952 and 1982



Creating jobs and reducing the deficit

As a possible strategy, the Council (using the CANDIDE economic model and the assumptions for the base case) simulated the effect a combined effort to create jobs and reduce the deficit would have on Canadian taxpayers. Reducing the unemployment rate by one percentage point (to 10 per cent) in 1985 and 1986, would require a $3 billion spending program. To continue the program for the period from 1987 to 1990, would require an additional $8 billion. Part of the cost of the program in the initial two years would be offset by additional personal income and other tax revenues from a wider tax base. However, in subsequent years, negative offsets would cause a rise in the federal deficit.

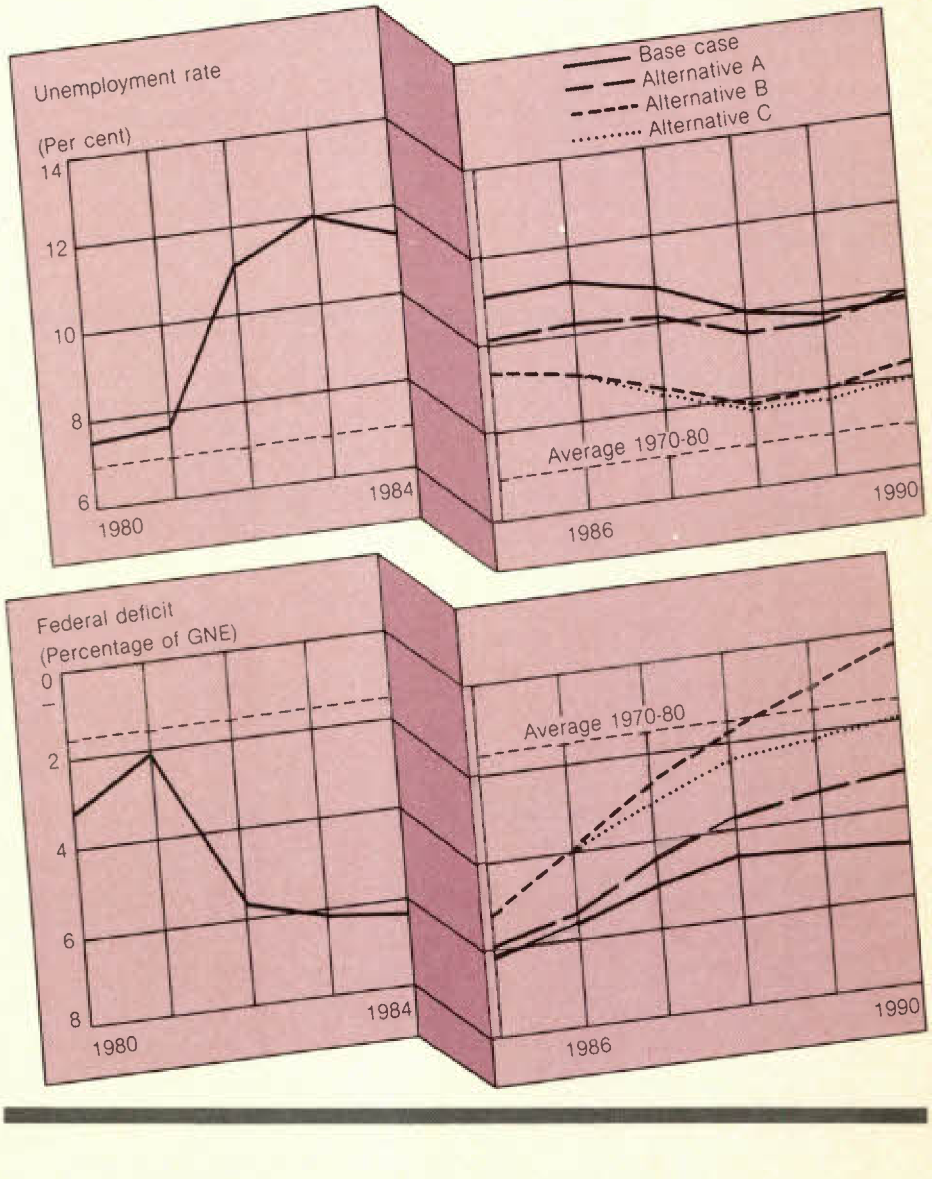
A program of this kind might be combined with some tax increases. They would cover the direct costs and also leave room for some deficit reduction. Further simulations were carried out to examine this. In Alternative A, the assumptions were: the spending on jobs plus a 3 per cent increase in personal income taxes in 1985, followed by a 2 per cent increase in the following year. The result would be an unemployment reduction of one percentage point and a deficit reduction of $1 billion a year. If the program were continued from 1987 to 1990, by increasing taxes by 2.5 per cent each year, the deficit could be cut in half by 1990, to close to 3 per cent of GNE. However, while tax increases would lower the deficit, they would also dampen growth and, by 1990, the unemployment rate would return to double-digit levels, despite the extra spending for job creation.

Tax increases are not the only way in which to fund job creation and/or skill upgrading. Programs could be trimmed in other areas or there could be a combination of spending cuts, tax increases, and a redirection of existing funding. Further simulations were carried out to test other theories. In Alternative B, the assumptions from the optimistic case were used (presuming stronger investment, consumption, and exports than in the base case). It also assumed that personal taxes would increase in Canada (by 2.5 per cent a year), and that the U.S. would enable interest rates to drop by seriously tackling its federal deficit. In this simulation, the federal deficit (in Canada) would fall to 2 per cent of GNE after 1987, and to 1 per cent in 1990. At the same time, unemployment would drop to 8 per cent by 1987.

In Alternative C, the assumptions change slightly. If Canadians were willing to accept a federal deficit of 3 per cent of GNE in 1990 (approximately the same level as in the late 1970s), tax increases would not be needed after 1986, and unemployment would be further reduced.

These simulations are not intended to be definite policy recommendations. But they show that unemployment and the deficit can be reduced together, without inflicting extreme pain on Canadians. However, this presupposes that the United States would implement policies to reduce its deficit, which would give Canada lower interest rates, increased investment, stronger consumer demand, direct job creation programs, and redirected or new fiscal resources equivalent to a personal tax increase of about 5 per cent, phased in over two years (beginning in 1985).

The impact of deficit-reduction and job-creation strategies, 1980-90



Targets and guideposts

The Canadian economy has shown good growth during the past year and, despite the pause expected in 1986, the medium-term prospects look relatively bright. However, over the medium term, governments must take steps to restore investor confidence, tackle the federal deficit, and deal with the persistent high rate of unemployment.

In this Annual Review, the Council traces the growth of the role of governments in the economy and the financial difficulties they have faced as economic growth slowed and inflation increased. Governments, business, and financial institutions overextended their fiscal reach, and many corporations ended up with large debts and cash flow problems. These led to cuts in expenditures, reductions or postponements of investment, and an increase in bankruptcies. At the same time, Canadian consumers started saving more, spending less, and paying down their mortgages. Unemployment climbed and started to affect workers who had never before been affected by layoffs or spells of unemployment.

The Council concludes that "the prospects for renewed economic vitality are sound, provided that Canadians have the confidence and the will to act, and that the international setting turns favourable." Of foremost importance, in the Council's view, are measures to get people back to work and policies to bring down the federal deficit.

There is little doubt that the new government faces a dilemma. There are many programs that Canadians want and which they expect their governments to provide – and these programs are costing more and more. At the same time, marginal rates of corporate and personal income taxes have not risen enough to cover the increased costs. Increased tax expenditures, the transfer of tax points to the provinces, slower economic growth, and the recession have contributed further to an erosion of the federal tax base.

In the *Twentieth Annual Review* (see *Au Courant*, Vol. 4, No. 2), the Council set out a package of targets for medium-term performance of the Canadian economy. The goals set were more ambitious than the outlook for the same period. This year, a sixth target has been added (see box), calling for a lower deficit. Attainment of the targets is not impossible; it will, however, require effort and cooperation by governments, business, and labour.

In the Council's view, it is possible to improve the unemployment situation and lower the federal deficit simultaneously. The most attractive route would combine some spending cuts with revenue increases over several years.

For unemployment, as with the deficit, there are no magic remedies. The number of Canadians looking for work has increased faster than jobs have been created. Of the jobs that have been generated, the majority have been in service industries and the initiative has come from the private sector – mostly from small and medium-sized businesses. In the short term, it is likely that the federal government will have to undertake some of the initiative, by boosting opportunities in the service sector, and by working more closely with the provinces to identify, develop, and match jobs, skills, and training.

Unemployment needs to be addressed more efficiently to get help to those who need it the most. The Council has previously recommended a close examination of the Unemployment Insurance compensation system, with an eye to channeling some of the funds in more effective ways. This year, the Council has urged the government to establish a commission or parliamentary task force to examine the options available for providing jobs and income security for the unemployed.

The federal deficit has not yet reached the point of severe trouble for Canada. However, to avoid real problems down the road, there is no doubt the deficit must be lowered. The Council's view is that deficit reduction should be done gradually and through a combination of spending cuts and revenue increases.

The Council sees only modest room for expenditure savings other than those from possible changes in the profile of the population. Some savings may be found by moving away from universal to more selective programs. However, the Council believes that most Canadians would prefer to see their contributions to such programs increase rather than see the benefits or coverage diluted or removed. No doubt there are other programs that could be managed more efficiently or whose usefulness has been outlived.

However, the fact remains that, at the federal level, most of the budgetary shortcomings are on the revenue side. Therefore, it is likely that Canadians will have to accept the proposition that additional revenues are going to be required to start reducing the deficit – and that means tax increases. In terms of how much of GNE goes to taxes, Canada ranked fourteenth in 1982 out of 23 OECD (Organization for Economic Co-operation and Development) countries. The timing and extent of tax increases will depend on the economic climate. The Council's simulations suggest that "with luck, a favourable international environment, the restoration of domestic business confidence, and a timely mix of job-creating expenditures and tax increases," both unemployment and the deficit could be lowered significantly by the end of the decade. If the measures are taken during a time of stronger economic growth – when real incomes and employment are expanding – then the burden will be less painful for all Canadians.

TARGETS

1. Productivity growth of 1.5 to 2.0 per cent a year.

2. Employment growth of 2 to 3 per cent a year in order to lower unemployment to a range of 6 to 8 per cent.

3. Annual inflation of 5 per cent or less.

4. Net capital inflows of less than 2 per cent of GNE.

5. The maintenance and improvement of existing social policies.

6. A gradual reduction of the deficit as a percentage of GNE.

MR KEVIN DOWD
ADMIN OFFICER
ONT ECONOMIC COUNCIL
81 WELLESLEY ST E
TORONTO ONT
T204103 M4Y 1H6

WORKING TO IMPROVE CANADA'S POLICY PERFORMANCE

That has been the chief concern of the Economic Council of Canada since its creation as an independent advisory body in 1963.

Over the past two decades, the Council has focused on public policy issues of key importance to Canadians - including economic growth, the role of new technology, the impact of government regulation and the changing job market, to name only a few.

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

Consultation

Members of the Council, representing a wide cross-section of Canadian society, meet regularly with governments and groups to study, analyse, and make recommendations on significant economic issues.

Research

An expert staff originates research and provides background information on a variety of topics, with particular stress on the medium- and longer-term problems of the Canadian economy.

Information

The need for better information on economic issues has led the Council to place strong emphasis on its contact with the public, through the use of topical publications, speeches, conferences, workshops and media relations.

Economic Council of Canada

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