

Recommend a plan to sustain economic growth for Canada.

Graeme Elliott,

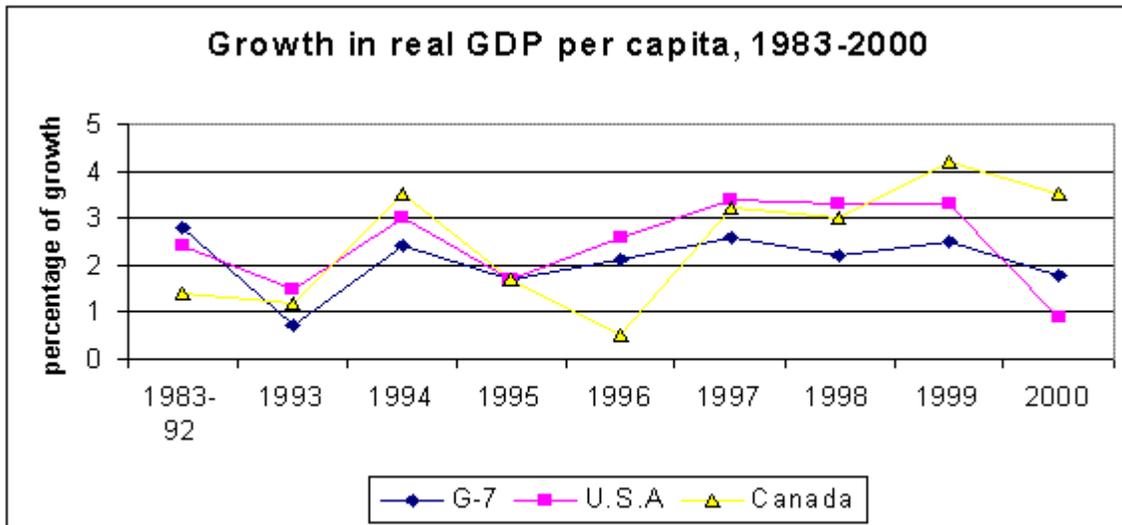
**Economics, Introductory
SCS 0980-018,
John Lille**

“Recommend a plan to sustain economic growth for Canada”.

At first glance, a plausible recommendation is to do nothing new.

Over the period of Confederation, from 1870-1997, we see a continued growth in GDP for Canada, in real terms, of 1.95% annually [1]. A great deal of this growth can be directly attributed to our geography. We have lots of land, well stocked with natural resources and arable areas, right next door to the most powerful economic engine the world has ever seen. Standing pat, in the sense of continuing as we have, might prove to be the best way to maintain this growth.

We are doing some things right. We could be doing more things right, and we could identify the things we are doing wrong, and stop them, always mindful of the trade-offs between the greater good of the market and the economy and the greater good of society at large. Markets (free or otherwise, small or global) can do and have done a lot of damage to societies, and need to be monitored. The economy we build should fit into and mesh with the society we want; the society should not be greatly transformed to fit the economy.



Source: IMF World Economic Outlook, October 2001

In the most recent years for which we have data, we have seen growth in the 3~4% range, and we have outperformed our G7 partners and our largest trading partner, the US. And, despite continued troubles in Japan, and the much-touted almost-recession that has not quite got started in the US, Canada is still posting growth in GDP, quarter after quarter, though the most recent numbers are indicating a slowdown.

Overall growth in the early 1990s was disappointing, as can be seen in Charts 1 and 2 below [9], with a negative growth per capita for the period. This was a period of large-scale change in Canada, as adjustments for the free trade agreements were being felt

throughout the economy, and particularly in the manufacturing sector, and the tightening of fiscal policy to reduce deficits had ramifications in every sector and region.

Chart 1
Growth of Per Capita Real GDP in 13 OECD Countries, 1989-96

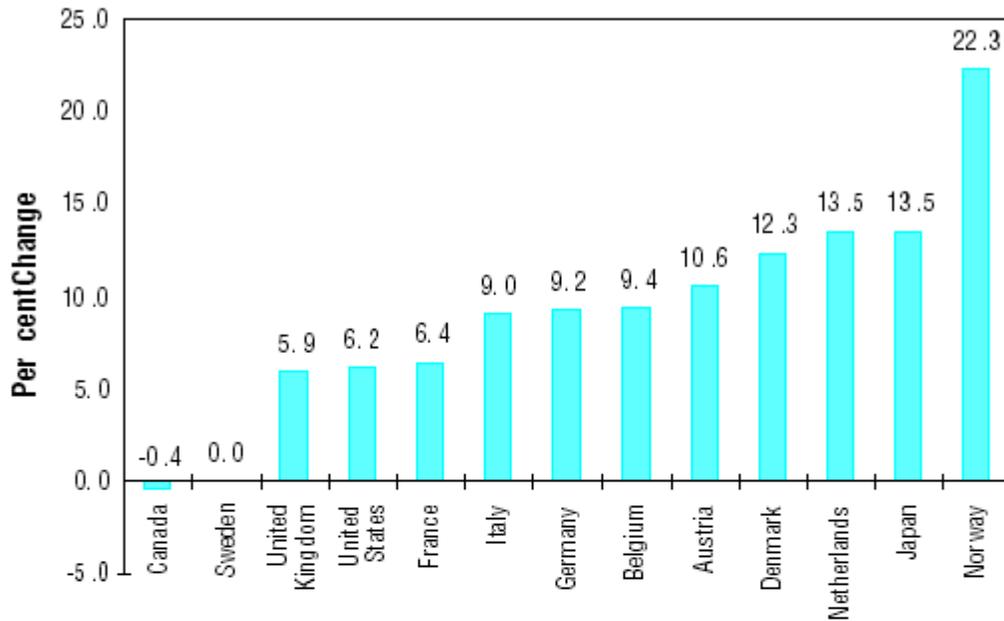
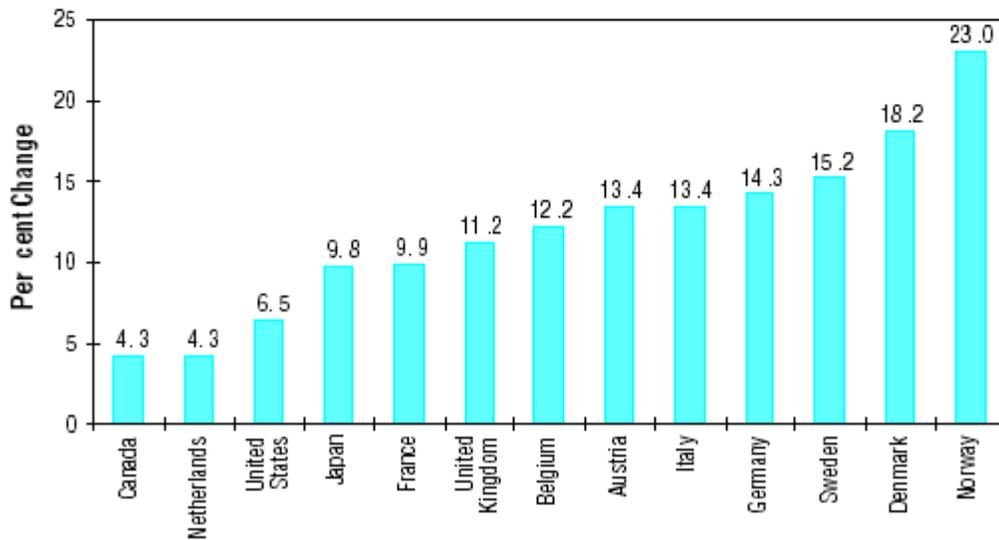


Chart 2
Growth of Real GDP Per Employed Person in 13 OECD Countries, 1989-96



One can argue that, in the face of global warming, Canada should look for a sustainable economic growth rate that just accommodates a growing population, and manages to allow for redistributions of income to redress the poverty rates we see today. Recommending policy to sustain a 4~5% annual real growth rate is unconscionable if the future price of growth is melting of the polar ice caps, with the resulting rise of the ocean levels eliminating all current seaports. We need to live within our means, and the planet's means. Anything else and "you can just kiss all this goodbye"[7].

In fact, Rosenbluth and Victor [8] present a plausible zero-growth scenario. We must look carefully at these ideas, and others like them. In the long run, it may be better to institute changes that the developing world can look to as examples and see that feeding, sheltering, educating and employing a population is possible within a zero- or slow-growth scenario.

Despite the opposition to ratifying the Kyoto Accord, led by Premier Ralph Klein of Alberta, ratification could spur an enormous amount of economic activity, both in developing new and renewable energy sources and in innovations to reduce consumption to conserve old sources. Kyoto could foster a structural change in the economy. Ratification will spur at least as big a change in the economy as the OPEC oil crisis of the 1970s, with a chance this could be a lasting and positive change. Some analysts forecast that ratification of Kyoto will yield an increase in energy sector jobs, with a relatively modest \$1 billion cost over a decade to ease the transition for those losing their jobs in the sector. [18]

Unfortunately, the potential for long term return on investment in new energy technologies cannot be easily estimated. What is true is that the current uncertainty surrounding ratification could curtail some investment through the next few quarters. Business rarely likes to commit to large investments when the playing field is being redrawn.

Regarding the conditions economists perceive as necessary for economic growth, Canada has a generally favourable mix of those, and no political or social upheaval seems imminent that would destroy that base. Those conditions can be summarized as:

- Ongoing research and development
- Control of population growth
- Free trade and outward policies
- Political stability and property rights
- Education
- Foreign investment
- Natural resources
- Savings and investment

These contribute in varying measures to GDP, which can be expressed thus:

$$Y = C + G + I + NX$$

where Y is GDP, C is all consumer spending, G is all government spending, I is all investment in capital, and NX is net exports. [2]

Obviously, there are some simplistic approaches to increasing Y. Since any increase in a variable on the right-hand side (RHS) increases Y on the left-hand side (LHS), we could argue to raise anything on the RHS without limit.

Increasing C:

A large and fast increase in C has an undesirable consequence, as savings is reduced and thus investment will probably drop as the supply of loans falls. Increases in C may require increases in money supply, which potentially spells inflation, unless the Bank of Canada is careful about the bank rate, controlling without choking out growth. There is nothing wrong with low to moderate inflation, say less than 3%, but the 70s taught us about high money supply (Ms) and high inflation. We can buy a great GDP for the current year at the cost of the future years.

However, perhaps the best way to raise C with a long term beneficial impact is to increase employment, thereby increasing the amount of money in consumer pockets, with a concomitant increase in tax revenues, and a decrease in government transfer payments. The Canadian unemployment rate lags behind our major trade partner, the US [6]. A decrease of unemployment, with a goal to bringing the natural rate to the 4~6 % range enjoyed in the 50s and 60s, without the increase in money supply allowed in the 70s could boost GDP, and reduce poverty and especially child poverty, a travesty in a country this rich.

National Unemployment Rate

1950s	4.2
1960s	5
1970s	6.7
1980s	9.3
1989	7.5
1992	11.3
1997	9.2
1998	8.5
1999	7.6

Adapted from [11]

A cutback in unemployment benefits may provide some of the needed incentive to look for or hold onto a job. Welfare rates have been slashed in most jurisdictions to make welfare quite unattractive as a wage replacement, especially for an able-bodied single recipient without a child; all across the country the benefit for this category is well under the poverty line.

There is agreement amongst economists that there is a short-run tradeoff between inflation and unemployment [5C]. Careful manipulation of the inflation rate levers could allow an overall gain in employment with a modest and reversible inflation. There are some in the markets who prefer a lean, hungry workforce and the low inflation rate that

implies, but overall, a one to two percent cut in the unemployment rate will swell the tax coffers and reduce the government transfer payments.

Increasing G:

Raising G somewhat indiscriminately was attempted to a degree in the 70s and 80s, and finally redressed in the 90s to curb the ever-growing debt that was stifling the economy through the choking out of private borrowings due to the government demand for loanable funds. The cure was and is painful, as the federal government has sought to balance successive budgets by pushing costs back to the provincial budgets, and those budgeteers have pushed costs back to the municipal level, and they have pushed the costs back to the individual.

The federal government is poised to post a modest surplus again for this budget year and possibly next. There is always debate over how to spend the surplus, with tax cuts an ever-popular proposal from business interests[17]. It would be prudent to be cautious with tax-cutting or new spending while there is still room to make inroads on the mountain of federal debt that still is being serviced. Any move to overspend now might be misinterpreted as a return to the bad old days, especially 1997, by the international investment community.

Net federal debt

Public accounts basis

Fiscal year ending March 31

Millions of dollars

Year

1993	466,198
1994	508,210
1995	545,672
1996	574,289
1997	583,186
1998	579,369
1999	576,257
2000	563,544
2001	545,396
2002	536,489

Source: Statistics Canada

11/27/02

Investment:

It can never be overstated that investment today will pay off with greater prosperity tomorrow. This assumes that our investments are not totally ludicrous (growing cucumbers in Newfoundland) or simply generate excess capacity (office space building boom in Toronto), and really are into factories that will later produce a salable good, or a mine for which there is a market for the output.

Given our definition of GDP (Y);

$$Y - C - G - NX = I;$$

by definition, we have the identity,

$$S = I;$$

where savings is represented by S, such that,

$$S = Y - C - G - NX;$$

rearranging, and accounting for taxes (T), we get,

$$S = (Y - C - T) + (T - G - NX);$$

or

$$S = \text{Private Saving} + \text{National Savings}. [5]$$

We also have, for our small open economy with perfect capital mobility, the identity

$$S = I + \text{NFI}$$

where NFI means Net Foreign Investment

and the identity

$$\text{NFI} = \text{NX} [5A]$$

It is worth noting that NX (and thus NFI) has been running positive for some time now because of trade with the US. The trade balance is negative with many other countries, but overall the trade surplus with the US suffices to put NX in the black (see table, *Imports and exports of goods on a balance-of-payments basis*, below).

Since investment and saving are sides of the same coin, to increase investment implies to increase savings. Tax policies to increase private savings, are reasonable to recommend. Tax policies to encourage investment, in meaningful capital expansions, are reasonable to recommend.

These fiscal policies always have to take into consideration that tax giveaways will hinder reaping the benefits of lowering federal debt, not the least of which is reducing the government demand for borrowing.

These policies also must be carefully drafted, such that those who cannot take advantage of them do not feel taken advantage of by them. It does not take much agitation to make a politician shy away from a reasonable policy. It is beyond the expertise of this author to recommend specifics; there are legions of qualified people in Ottawa and elsewhere who can and do draft the necessary words.

Favourable depreciation and write-off schedules go a long way to encourage investment, but at the end of the day, long-term investment decisions are a complex matter for any given firm, and the fiscal policy can only be expected to do so much to encourage investment. It is probably best to strive for policies that do not overtly discourage investors.

Unfortunately, the fight against inflation and its short-term effect on employment is a monetary policy that is to the benefit of the investor, specifically the holders of long term

bonds, to the detriment of the unemployed sidelined by the Bank's policy. At the end of the day, we must be sensitive to the tradeoffs between society and the market.

Increasing NX:

The Free Trade Agreement and the refinement into the North American Free Trade Agreement have had undeniable effects on NX. Exports have increased dramatically, mostly to the US. This has left Canada with a positive trade balance with the US, although one finds that the balance is almost universally negative with other trading partners. The Team Canada forays abroad to increase trade with other partners have not yet swung those other balances to the black. We should always be marketing the country as a place to do business, but the Team Canada approach has not paid off. Sales pitches that yield positive results should be undertaken.

There were and still are ongoing social and structural changes brought on by the free trade agreements. An Industry Canada report by Dungan and Murphy[10] shows some 200,000 jobs lost as a direct consequence of the pacts. When the pacts were being sold to the public, this structural cost was downplayed somewhat, but no one was really surprised at the job losses. Those were expected, only the numbers were unknown. We must recall that Brian Mulroney only mentioned three jobs ("jobs, jobs, jobs.")

The enormous trade increase with the US may be a case of putting too many eggs in one basket, but, on the other hand, we must make hay while the sun shines. It is left to the future to tell whether there will be a cost for increasing our dependence on the US economy. It goes without saying the more we depend on the US, the more we are affected by its economic downturns.

The biggest disappointment in the free trade pacts is that they failed to produce the main item on the Canadian negotiation agenda, free trade, as in preferred free access to the American market. Certainly, despite the pacts, the US trade law remains protectionist, as shown most recently in the softwood lumber industry, which has been targeted with a large countervailing duty, at an enormous social and long-term job cost, particularly in British Columbia. The American invitation to each province to enter into individual agreements makes one wonder at the real agenda being pursued; an overt attempt to sidestep the federal government could be interpreted as an affront by some.

It is not the case that the provinces are wholesale subsidizing the softwood lumber industry. It is the case that the US *is* protectionist, despite the regional "free trade" agreements, and they have the clout to harass us. We have to live with it, and from time to time, truly subsidize our industry through the rough patches, as has been done with the softwood industry. We must be preemptive on this issue, and identify and protect industries that are subject to US protectionism. Interventions in US trade policy do work, but it takes time and effort on our part.

The US recently investigated complaints against offshore steel dumping. A common front of the Canadian steel producers and the union, the United Steelworkers of America (USWA), argued before the US International Trade Commission (ITC) that the

North American steel industry constitutes an integrated market, and that Canada should be exempt from tariffs. That argument was successful, and President Bush announced last March that Canada should not be subject to the punitive tariffs.

Imports and exports of goods on a balance-of-payments basis

	1996	1997	1998	1999	2000	2001
	\$ millions					
Exports	280,079.3	303,378.2	327,161.5	367,170.9	425,587.2	414,638.2
United States ¹	222,461.3	242,542.3	269,318.9	309,075.1	359,671.6	350,908.1
Japan	12,423.4	11,925.5	9,745.8	9,855.3	10,701.3	9,481.5
United Kingdom	4,608.5	4,689.5	5,323.3	5,844.1	6,903.1	6,573.5
Other European Economic Community countries	12,796.3	13,260.4	14,000.5	14,068.0	15,982.0	15,726.7
Other OECD ²	5,087.8	8,849.0	9,120.9	9,514.4	10,899.3	10,925.4
Other countries ³	22,702.0	22,111.6	19,652.2	18,814.1	21,429.9	21,023.0
Imports	237,688.6	277,726.5	303,398.6	326,961.2	363,431.8	350,622.7
United States ¹	180,010.1	211,450.8	233,777.6	249,420.6	267,753.6	255,028.2
Japan	7,227.4	8,711.0	9,671.8	10,592.2	11,728.6	10,585.2
United Kingdom	5,581.1	6,126.5	6,083.1	7,685.4	12,287.0	11,863.4
Other European Economic Community countries	14,994.7	18,112.9	19,141.2	20,765.8	21,176.3	23,225.1
Other OECD ²	9,040.6	11,376.7	11,398.8	13,257.2	18,947.1	18,626.2
Other countries ³	20,834.6	21,948.7	23,326.1	25,240.1	31,539.3	31,294.7
Balance	42,390.7	25,651.7	23,762.9	40,209.7	62,155.4	64,015.5
United States ¹	42,451.2	31,091.5	35,541.3	59,654.5	91,918.0	95,879.9
Japan	5,196.0	3,214.5	74.0	-736.9	-1,027.3	-1,103.7
United Kingdom	-972.6	-1,437.0	-759.8	-1,841.3	-5,383.9	-5,289.9
Other European Economic Community countries	-2,198.4	-4,852.5	-5,140.7	-6,697.8	-5,194.3	-7,498.4
Other OECD ²	-3,952.8	-2,527.7	-2,277.9	-3,742.8	-8,047.8	-7,700.8
Other countries ³	1,867.4	162.9	-3,673.9	-6,426.0	-10,109.4	-10,271.7
1. Includes also Puerto Rico and Virgin Islands.						
2. Organisation for Economic Co-operation and Development excluding the United States, Japan, United Kingdom and the other European Economic Community.						
3. Countries not included in the European Economic Community or the OECD.						
Source: Statistics Canada, CANSIM II, tables 228-0001, 228-0002, 228-0003.						

Critics of NAFTA and the Free Trade Area of the Americas and the World Trade Organization negotiations suggest these pacts are less about free trade and more about

improving investors privileges, sometimes hampering the ability of signatory governments to pursue social policy [20]. The fact that people took to the streets of Seattle and Quebec City to protest WTO and FTAA meetings is a signal that these pacts are regarded with suspicion by the public, especially as the investor's privileges are seen to be conferred without any reciprocal investor's responsibilities. NAFTA provisions have allowed an American company to launch a lawsuit against the Canadian government for banning a product suspected of being a health risk, thereby curtailing the corporation's 'right' to profit [22]. Some see in these pacts another great transformation and are reacting to these new "enclosures" with the same anger as the people in Tudor England [23]. We would be wise to exercise caution regarding the FTAA and the WTO, as there are long run political consequences to these pacts.

Productivity:

Increasing productivity is the most important factor in growth of GDP.

As Industry Canada says:

"Productivity improvements allow companies to pay higher real wages to their employees and greater returns to their shareholders without jeopardizing their competitive position. Similarly, at the national level, productivity is the single most important determinant of sustained improvements in the standard of living of its citizens. Furthermore, productivity also underpins a nation's quality of life. Productivity improvements and wealth creation would facilitate increased spending on social programs, health care, higher education, cleaner environment, etc."[12]

As the Centre for the Study of Living Standards stated in a paper for the TD Forum on Canada's Living Standards:

"The key conclusions of the paper are twofold. First, a focus on improving Canada's productivity growth performance, and in particular, eliminating the Canada-US productivity gap, is by far the most important and effective way to attain the objective of Canadian living standards exceeding US living standards by 2016. Second, an objective for Canada of matching or exceeding the US productivity level is probably a better societal objective than equaling or exceeding US living standards, as measured by GDP per capita. Attaining this objective would certainly give Canadians the opportunity to have the same level of per capita income as Americans, but it would also give Canadians the option of choosing more leisure time, a component of economic well-being that is currently not incorporated into GDP."[13]

These are the conditions that lead to productivity gains that drive economic growth: if production (Y) is a function of labour(L), physical capital (K), human capital (H), and natural resources (N) and A is a scalar, such that

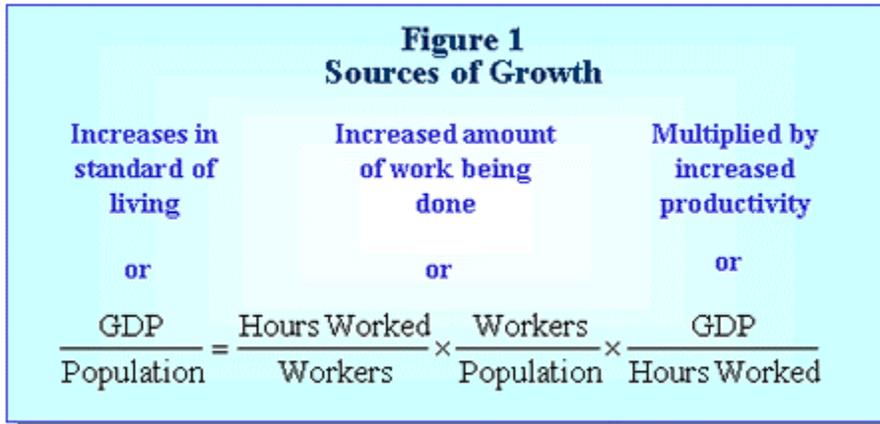
$$Y = A \cdot f(L, K, H, N)$$

then productivity is defined as the output per hour worked, or

$$xY = A \cdot f(xL, xK, xH, xN)$$

where $x = 1/L$. [3]

The key to increasing economic growth is increasing productivity, the output per hour worked. Increasing hours worked will increase production trivially, at the cost of leisure time and well-being of workers. Increasing the employment rate (workers/population) has a social benefit as noted above. Neither increasing hours nor adding workers can give long-term growth, however, as both values have definite upper limits. In the long-term, to sustain growth of GDP per capita, as a rough measure of the standard of living, we are more concerned with increasing the efficiency of converting input to output.

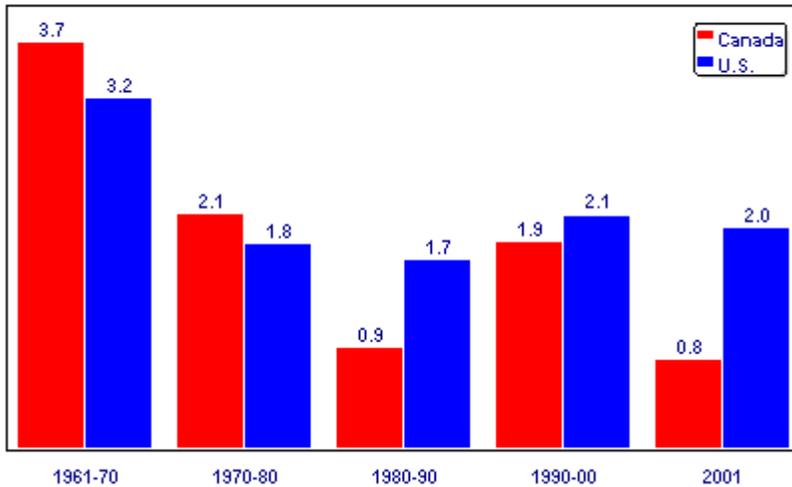


[12]

The scope of the problem can be seen in Industry Canada document http://strategis.ic.gc.ca/epic/internet/inpro-pro.nsf/vwGeneratedInterE/h_pr00008e.html.

In 2001, the gap in productivity growth between Canada and the US widened significantly as depicted in figure 2, and the gap in manufacturing as depicted in figure 3 is cause for alarm, since we still are very dependent on manufacturing for much of our trade and well-paid jobs. In figure 3, the 7.1 growth in the US, makes one wonder 'what did they do?' as much as it makes one wonder 'how do we catch up?'

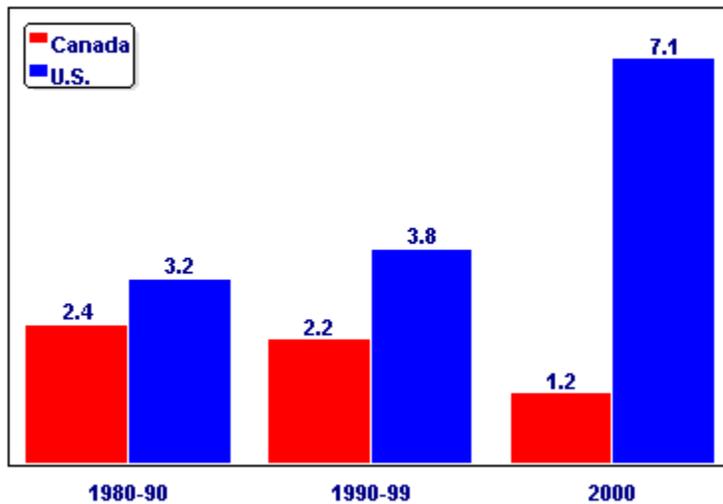
Figure 2: Average Annual Growth of Labour Productivity*
Business Sector: Canada and the U.S. (Percent)



*Real GDP per hour worked.
Source: Statistics Canada and U.S. Bureau of Labour Statistics

[12]

Figure 3: Average Annual Growth of Labour Productivity
Manufacturing Sector: Canada and the U.S.(Percent)



*Real GDP per hour worked.
Source: Statistics Canada and U.S. Bureau of Labor Statistics

[12]

We catch up by ensuring we have a skilled, well-educated labour force with a stake, an up-to-date physical plant, and access to natural resources. This implies investment in human capital (i.e. education, both at the secondary and post-secondary level) and physical capital, and fiscal policies that encourage those investments from the private sector.

Policies must be in place to ensure public sector investment will be available to keep the infrastructure in good repair and modernized as needed. A transportation system that works well is extremely important in a manufacturing technology that is ever more

reliant on just-in-time delivery to reduce costs. A telecommunication system that is state-of-the-art is critical, and the federal government still has a role to play here, especially in the area of space-based communication systems. Deregulating the electricity market may be a detriment to both investment and productivity. Factories run on electricity, and security of supply and stability of price is an important factor in making a decision to build a factory, and in the subsequent ability of the factory to produce goods efficiently and profitably.

Catching up also requires a willingness to concentrate on the technologies and products that return the highest value (i.e. where we have the comparative advantage). In the fathers' and grandfathers' times, we were hewers of wood and drawers of water; now we are developers of software and designers of telecommunication equipment that is the best in the world. We need to sell products with the highest value added.

Arguably, knowledge is one of the best places to add value, and our computer software and hardware industry is booming, with an \$80 billion business investment, and untold billions in household investment. ATI and Matrox are industry leaders in their market. Nortel may yet survive the bursting of the telecom new economy bubble. Corel limps along. There is no shortage of good ideas in Canadian software industry; there is a shortage of business investment. In the aftermath of the dotcom bubble bursting, we will see a short-lived continuing reluctance to invest. One can only hope the investors who got burned then are more sophisticated now, and can see where the true value lies.

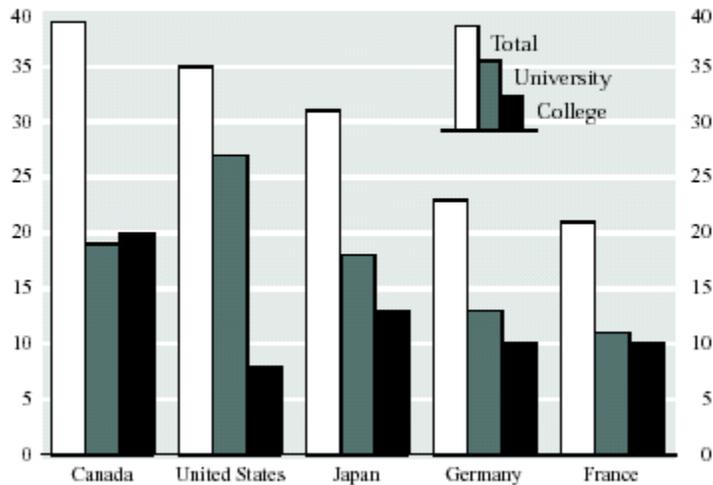
Canada has long standing policies that ensure a reasonable education will be available through high school, but the recent rises in tuition fees suggests the university system may be tending towards an elitist system that may become too expensive for the dwindling middle class. As it is currently, close to 40 per cent of Canadians aged 25 to 64 have completed some form of post-secondary education, which is the highest proportion among OECD countries. Additional evidence on the quality of human capital is provided by a recent OECD study cited by Crawford, which reports that 15-year-old Canadian students outperformed their US counterparts and the OECD average in international exams on reading, mathematics, and science [14]

As Crawford [14] notes regarding education:

"While there are encouraging signs, there are also challenges that could affect the pace of future productivity growth: (i) shortages of skilled workers are reported in some specialized areas, and there is strong international competition for people with these skills, (ii) relative to the United States, Canada has a lower proportion of people with advanced research degrees, and (iii) employer-sponsored training is less prevalent in Canada than in the United States."

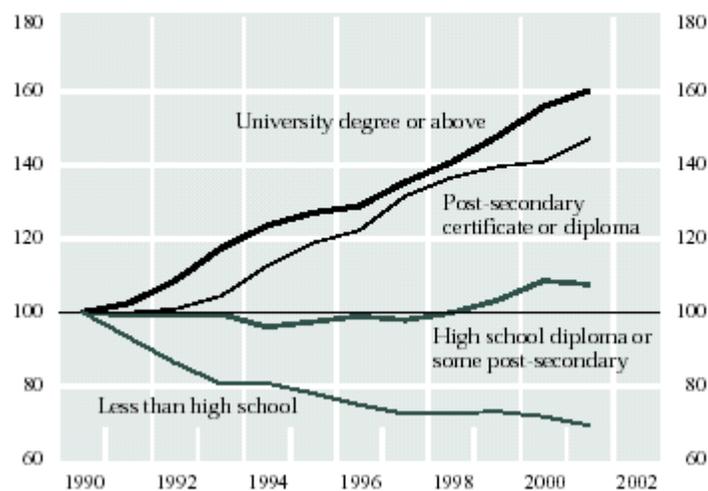
Clearly, we may have to encourage people to enroll in technical schools to redress particular skill shortages. This encouragement could come in the form of reduced tuitions or easier access to bursaries. Chart 6, reproduced below from Crawford [14], shows we already have a well-educated working age population, and Chart 7, from the same source indicates that education is ever more a prerequisite for employment.

Chart 6
 Percentage of the Population Aged 25 to 64 with Completed Post-Secondary Education, 1999



[14]

Chart 7
 Employment by Education Attainment in Canada
 Indexed to 1990=100

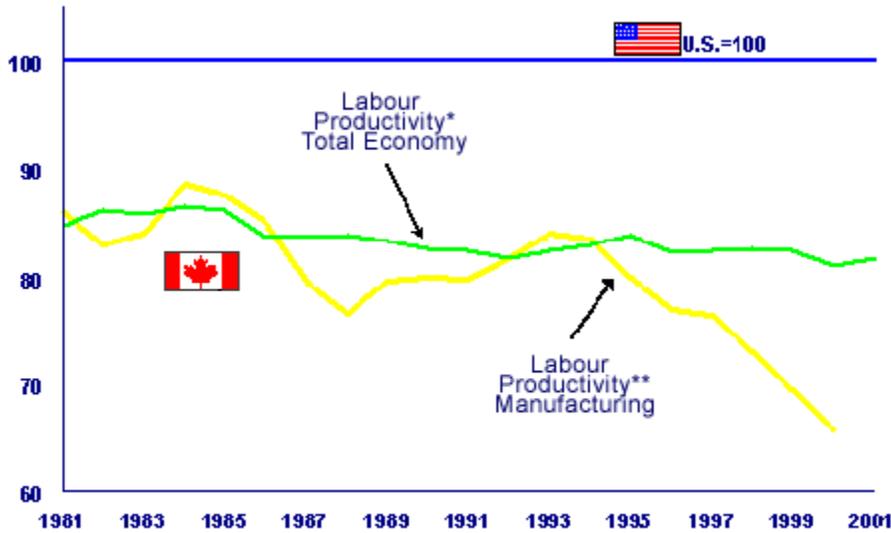


[14]

Tradespeople are an important part of the human capital stock. Despite the value of higher education to many, we will always need competent and well-trained mechanics, electricians, pipefitters and similar trades. Apprenticeship programs must be established in provinces that do not have them, Ontario being a glaring example, and reviewed in provinces that do have them.

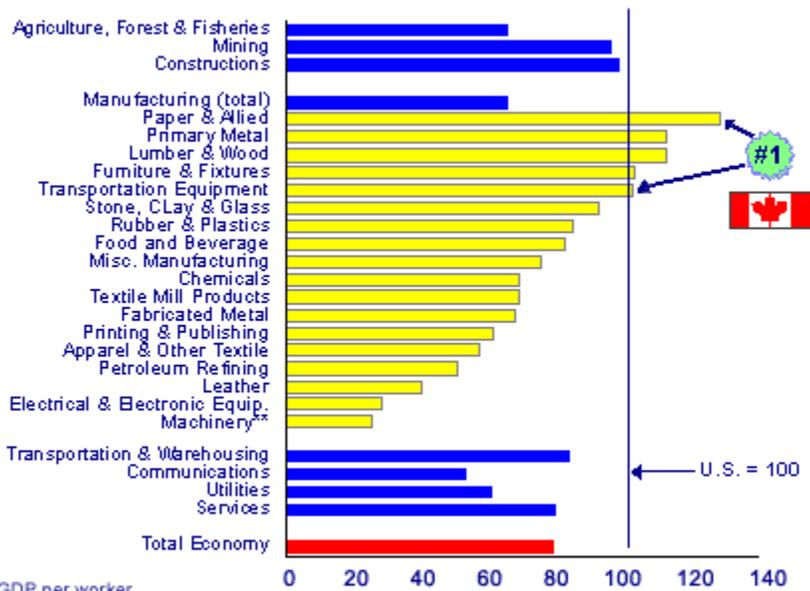
Helping people get the skills they require or desire, whether that is a computer science degree or a master mechanics license is an essential part of increasing productivity. Education is a provincial matter, but the federal government can certainly offer guidance and assistance, particularly in identifying skills that will be required down the road so people can learn what they will need to know..

Figure 4: Canada-U.S. Labour Productivity Gaps



*Real GDP per hour worked, PPP based.
 **Real GDP per hour worked, based on the methodology of the Centre for the Study of Living Standards.
 Source: Industry Canada compilations based on data from Statistics Canada, U.S. Bureau of Labour Statistics and U.S. Bureau of Economic Analysis.

Figure 6: Relative Labour Productivity* of Canadian Industries, 2000



*GDP per worker.
 **Machinery includes computer and office equipment industry.
 Source: Industry Canada computations based on data from Statistics Canada, U.S. Bureau of Economic Analysis and OECD STAN

[12]

One key to achieving productivity gains is longer production runs. Canada's small domestic market has never allowed manufacturers to achieve the economies of scale of long runs enjoyed by competitors in the US. The federal government must always be seeking greater access to markets through freer trade agreements, whether bilateral or global, to help attain larger markets. There is always the risk that cheaper imports will entirely displace the domestic production, forcing closure of factories and permanent loss of jobs, however. One of many examples is the closure of the Inglis plant in Toronto after a century-and-a-half of operations. The plant closed in 1989, as the ink was still drying on the Free Trade Agreement.

Fiscal policy allowances, either through subsidizing purchases or accelerated depreciation schedules, to encourage investments in new technologies that make workers and existing factories more productive will pay off in the long run, as long as there are review procedures in place to guard against wasting the public purse. Part of Japan's and Germany's manufacturing success was the ongoing adoption of new technologies and upgrading of existing technologies. Government support of these types of investments through tax policy is a clear signal to business that productivity gains are on the national agenda.

Research and Development:

We have a long history of research and development, but that may be impaired if the universities become available only to the children of the rich. With a population only 1/10 the size of our major trading partner, we have to identify and help educate the best brains we have.

There is merit in research and development parks devoted to the next big technology, if we can identify it early enough. Biosciences is the latest buzz word, and it behooves us to listen, and invest education dollars now, to lay the knowledge infrastructure along with the physical infrastructure.

Crawford notes:

“Several pieces of Canadian evidence are consistent with the hypothesis that openness contributes to growth. First, Trefler (1999) finds that tariff reductions under the Canada-U.S. Free Trade Agreement increased labour-productivity growth in the manufacturing sector over the 1989–96 period. Second, productivity growth has been stronger at foreign-controlled establishments in the manufacturing sector, and these establishments are more likely to adopt computer-based technologies than domestically-controlled companies (Baldwin and Dhaliwal 2001). Other evidence of openness effects is provided by Gera, Gu, and Lee (1999). Using industry-level data, they show that spillovers from foreign research and development (R & D) spending (embodied in purchases of imported intermediate goods and services) are a significant determinant of labour-productivity growth in Canada.²² These R & D spillover effects are particularly important in the case of imported information technology goods. The intensity of domestic R & D spending is a significant determinant of productivity growth in the empirical literature. To some extent, the spillover

effects from foreign R & D offset the impact of low domestic R & D spending in Canada. In 1997, Canada had the second lowest ratio of domestic R & D spending to GDP among the G-7 countries, although this gap has closed somewhat since 1990.”[14]

In the long run, we should not depend on importing technology (R&D) from foreign-owned enterprise. Policies to encourage domestic R&D must be put into place. Review of copyright and patent laws vis a vis those found in other jurisdictions with the intent of ensuring we are giving domestic R&D the protection it deserves is always a good idea. The common good and the public domain must always be considered in this area, however. This debate is lively in the biotechnology area; see Kimmelman [15] and Canadian Biotechnology Advisory Committee [16] for a taste of the patent discussion as it pertains to biotechnology. Firms are more likely to invest in R&D if they are assured they can protect and profit from their investment. Tax credits or other fiscal policy to provide incentive for domestic industry to engage in R&D should also be reviewed.

Political stability:

Political stability and property rights are cited as a necessary condition for economic growth. Those who invest want the law to back the contracts they enter into and to protect the wealth they extract. Governments are expected to last longer than the bonds they issue. The potential official separation of Quebec is not gaining the media spotlight as it once did, so it would seem Quebecers now realize the merits of federalism. We need not worry about a true political separation agitating our G7 partners.

Fiscal Policy:

There is a temptation to recommend a legislated cap on budget deficits, but laws can be repealed. Legislators should rely on prudence and wisdom, rather than having strictures put in place that could hamstring the ability of government to jump-start the economy when it does appear to be sliding into a recession. The jump-start always requires new spending. It may be better to hope that politicians of all stripes now realize the danger of budget deficits, and curtail the urge to splurge in the future.

The borrowing to pay for the budget deficits and accumulated debt of the mid-70s to mid-90s has cost a lot of potential GDP growth. See figure in [4]. The diagram shows the percentage of GDP to debt through those years. Either the GDP did not grow, or despite its growth, the debt increased at a faster rate. The borrowings of the federal (and provincial) government during this period removed from the economy savings that potentially would have been invested in more productive, growth-engendering ways. It is a tenet of economics that saving yesterday allows for investment today to create growth tomorrow. It is fruitless to estimate the loss to growth of GDP, but it may well be in the range of a 1 to 2 % annually, maybe more. Some provincial governments, and state governments south of the border have legislated caps on deficits. We must watch these jurisdictions closely, and perhaps in the long run come up with a federal policy, perhaps with weight of law, to cap the deficit. It would be unwise to bind the federal government too tightly in this regard, as the senior government should have the last

resort ability to stimulate the economy when such stimulation is clearly needed in the short-run. There is nothing wrong with short-run deficit financing, particularly if it follows periods of surplus building, such that the debt stay manageable. The folly of deficit financing shows in the long-run, as the *crowding-out* phenomenon curtails long-term investment, and that curtails long-run growth. Thus, long-term deficit financing may cure some pain in the short run, and may even win an election, but at the cost of greater ailments later. We can only hope that future governments can resist the temptation to spend it all now.

Natural resources:

Natural resources are still relatively abundant. More can be found in the storehouse, one hopes, when the need arises, or those that are known to exist can be exploited if their value rises to make extraction profitable.

We must always be cautious of the possibility of a once-renewable or seemingly inexhaustible resource suddenly becoming so endangered as to become commercially valueless. Obvious examples are the decimation of the cod stock on the East Coast , with the resulting unemployment and structural changes to the economy, and the need to farm Atlantic salmon on the West Coast, as the natural stock has been reduced significantly. We should also note the destruction of the old-growth forest across the country, but most significantly in the steep terrain of British Columbia, where the loss of the forest cover always involves massive loss of the thin skin of soil that sustained the thousand-year old organism, thereby endangering any reforestation attempts.

The loss of these fish stocks and the forest to unsound husbandry practices should raise an alarm. One can only hope it will be heard.

Policies to preserve or sustain the regional economic dependencies on certain of these natural resources may all become obsolete if Russia breaks out of the doldrums and begins to exploit its vast mineral and forest wealth on a larger scale. Once Russia does get its economy turned around, now that it is free of the military spending imposed on it by the Cold War, it will be a tough competitor with Canada in forestry and mineral and energy extraction.

Social Development:

One need only look to Russia to see what a massive structural change in the economy can do to a society, especially one that is ill-equipped for the new order. Russia simply did not have the laws and traditions and individual and social behaviours in place to embrace capitalism overnight. Poverty has increased, unemployment has increased, health services have decreased, and social upheaval is rampant, and some observers even suggest social disintegration is possible.

This is not to suggest that Canada is heading in that direction, only that we must always be ready to stand on guard for our society, sometimes at the expense of narrow commercial interests.

We lead our trade partner to the south in many areas, though admittedly we follow the US and other parts of the world in other areas (see Appendix, [6]). We are better educated, have less crime, live longer, and our poverty rates are lower. There is a lot here worth protecting, and policies that can lead to a society that is more polarized between the haves and the have-nots should be rejected.

Labour rights are sometimes seen as an impediment to growth. In the southern US, states have attracted substantial investment in automobile manufacturing, and at least part of the reason is labour laws that are seen as less restrictive on the employer. The “final solution” to labour rights can be seen in Peru, where those rights have essentially been liquidated, according to the United Steelworkers of America [21]. The Peruvian model would be rejected by most Canadians. That is not the society we would want.

Unions do not spring out of a vacuum. They arise from basic principles of economics; rational people think at the margin and people face tradeoffs. Unionization is people’s response to corporate exploitation. For a large number of people, unionization gives them a marginal benefit, and the tradeoff of collective bargaining over individual negotiation is worthwhile. Unions do raise the bar as far as wages go. They also raise the bar for health and safety standards, set sectoral benefits packages, provide a stable work force for firms, negotiate equitable pensions, and generally redistribute incomes, sometime abroad, as evidenced by the United Steelworkers of America’s Humanity Fund [21]. And, their members pour the wages and benefits back into the economy as consumers and savers and investors, promoting further growth. Mankiw et al state:

“In the end, there is no consensus among economists about whether unions are good or bad for the economy.”[5B]

Thus, there is no reason to conclude organized labour is an impediment to growth. In the long run, organized labour may promote growth. Higher wages and benefits make more productive workers, all else equal, and when the workers get paid, they put on their consumer hats and head off to the mall to increase C.

We must not try to compete with or emulate the new “Satanic mills” of the Third World, the Free Trade Zones or Export Processing Zones, as chronicled by Klein[24]. These employ some 27 millions in 70 countries. Working conditions vary, but 12–16 hour days are common, and wages range from US\$6 a day in the Philippines to US\$0.87 in China. These post-Industrial Revolution factories are every bit as horrific and exploitative as their earlier English cotton mill counterparts. These factories are all the evidence the opponents of globalization need to confirm that capitalism is as mean-spirited as it ever was. Economists can be found who support these zones, the general sentiment being that a bad job is better than no job. These economists, acting as apologists for the status quo, all have much better jobs.

Conclusion:

To sustain growth, we have to “stay the course.”

In general, Canada has the fundamentals in place that allow for sustaining growth. There is no single panacea or policy that will make everything work better and sustain growth into the future. Sustaining growth is a matter of all players in the economy adapting constantly to domestic and global economic situations, and selecting the best solutions from the menu of possibilities. Governments at all levels, businesses, households, individuals, the financial system and society are the players. Occasionally they will work at cross-purposes, occasionally some degree of cooperation will exist.

Government has to listen to the other players. There are many groups lobbying, advising and recommending. All are more or less well-meaning, though the scope may be wide or narrow, the advice may be based on the left, right or central bias of the group, and some may be more self-serving than others. Examples are everywhere of good advice, see [19]. From all the advice, solicited and otherwise, the government and the central bank must synthesize policies that benefit all, but also must promote a climate that allows business to prosper.

At the end of the day, business must be able to make profits to be able to pour resources back into investment to engender future growth.

We must encourage domestic and foreign investment without selling out to either.

We have to encourage domestic R&D, both through favourable fiscal policy and through patent laws that provide an opportunity to gain a return on investment.

We have to continue to provide a first-rate and accessible education system. Adoption of most or all of Mr. Romanow’s rather modest recommendations for the health care system will allow us to continue to provide first-rate health care to all, at a per capita cost that is less than the Americans achieve.

We must protect the environment, and must husband and more efficiently exploit the natural resources we have.

We are the highest per capita energy users in the world, mostly due to our cold climate. We would be advised, Kyoto or no, to institute conservation measures, including higher taxation on fuel prices if that is necessary to reduce consumption. Investing in more efficient energy conversion technology will pay long run dividends.

We must be careful of the trend to deregulate and privatize. As an example, a secure source of electricity at a sure price is attractive to potential factory builders.

Continued fiscal prudence and reduction of the federal debt should continue for the next few years. People are now used to the reduction in government services, and understand that it needed to be done and that there is more to do. To give it back in tax cuts now, only to have to recapture the losses a few years down the road would be foolish.

A reduction in unemployment, even at the expense of a modest inflation would help either bolster the surplus or pay for tax cuts if those are contemplated. Spending some of the current budget surplus on investment in infrastructure or restructuring the energy market, could generate that employment increase.

Political or social forces will often conspire to prevent us from doing what the left- or right-leaning economists deem to be the right thing at the right time. Historically, we do a lot of the right things at the right time, and have built a society worth preserving. A pragmatic approach rather than dogmatic or ideology-driven policy will allow us to continue to grow an economy that supports a society, rather than a society that is the victim of an economy.

References:

- [1] Principles of Macroeconomics, Second Canadian Edition, Mankiw et al, p241, table 12-1.
- [2] *ibid*, pp247-60
- [3] *ibid*, pp245
- [4] *ibid*, pp 283
- [5] *ibid*, pp 272
- [5A]*ibid*, pp 399-405
- [5B]*ibid*, pp 309
- [5C] *ibid*, pp 15
- [6] CANADIAN COUNCIL ON SOCIAL DEVELOPMENT, Canada Beats US - But Loses Gold to Sweden.htm.
- [7] Aliens, 1986; Sigourney Weaver as "Ellen Ripley"
- [8] THE CANADIAN ECONOMY WITH FULL EMPLOYMENT, NO GROWTH, NO POVERTY, AND NO GOVERNMENT DEFICIT: A KEYNESIAN EXERCISE
Gideon Rosenbluth, University of BC, Peter Victor, York University
- [9] Canada's Disappointing Economic Performance, The Centre for the Study of Living Standards
- [10] The Changing Industry and Skill Mix of Canada's International Trade
By Peter Dungan and Steve Murphy, University of Toronto, April 1999, for Industry Canada
- [11] Falling Behind, The state of Working Canada, 2000; Andrew Jackson, David Robinson, Canadian Centre for Policy Alternatives
- [12] http://strategis.ic.gc.ca/epic/internet/inpro-pro.nsf/vwGeneratedInterE/h_pr00003e.html
- [13] Raising Canadian Living Standards: A Framework for Discussion
Background paper prepared by the Centre for the Study of Living Standards for the TD Forum on Canada's Living Standards, October 7-8, 2002, Ottawa, Ontario
- [14] Productivity Growth: Past Trends and Future Prospects in Canada
Allan Crawford, Bank of Canada
- [15] Unlimited License: An Analysis of the Canadian Biotechnology Advisory Committee's Report on Patenting Higher Life Forms ; Jonathan Kimmelman, Ph.D.
<http://www.policyalternatives.ca/publications/unlimitedlicense.html>
- [16] PATENTING OF HIGHER LIFE FORMS AND RELATED ISSUES: Report to the Government of Canada Biotechnology Ministerial Coordinating Committee: Canadian Biotechnology Advisory Committee, June 2002
http://www.cbac-cccb.ca/documents/en/E980_IC_IntelProp.pdf
- [17] The Taxman marches on, Jack Mintz, Canadian Business, Nov. 11, 2002.
- [18] Making Kyoto Work A transition Strategy for Canadian Energy Workers, Dale Marshall, Brian Payne, and Gerry Scott, Canadian Centre for Policy Alternatives
- [19] Ensuring Competitiveness and Future Economic Prosperity: A Pro-Growth Fiscal Policy Agenda For Canada, June 2002 THE CANADIAN CHAMBER OF COMMERCE, June 2002
- [20] Another World is **Possible**: Report of the Commission of Inquiry into Corporate Conduct in the Americas; September 6, 2001: SECOND PEOPLE'S SUMMIT OF THE AMERICAS, QUEBEC CITY: 19 APRIL 2001, www.uswa.ca/eng/humanity/report.pdf
- [21] The Liquidation of Labour Rights in Peru; The Steelworkers' Humanity Fund
www.uswa.ca/eng/humanity/fujimo_2.htm
- [22] All You Can Eat; Linda McQuaig, Penguin Canada; p 57, Ethyl Corporation lawsuit against Environment Canada
- [23] The Great Transformation: The Political and Economic Origins of Our Time; Karl Polanyi, Beacon Press, Boston
- [24] No Logo; Naomi Klein, Flamingo

Appendix:

[6] GDP per capita is not always the best measure of one economy against another. Canadians value their society, the final outcome of all activity, economic and otherwise, and it is useful to see where we measure against the US on a variety of other indicators.

The following is adapted from the original HTML published by CANADIAN COUNCIL ON SOCIAL DEVELOPMENT. (some coloring is lost in the translation to Word.

<http://www.ccsd.ca/pubs/2002/olympic/indicators.htm> The lightly shaded block is the best in each row.)

Twenty-Five Key Indicators of Social Development			
Legend:	Canada	US	Sweden
INCOME AND POVERTY			
1. Income per Person (%US)	79.0%	100.0%	70.2%
2. Poverty Rate	10.3%	17.0%	6.4%
3. Child Poverty Rate	15.5%	22.4%	2.6%
JOBS			
4. Employment Rate	71.1%	74.1%	74.2%
5. Unemployment Rate	6.8%	4.0%	5.9%
6. Working Long Hours	22.0%	26.0%	17.0%
7. Low Paid Jobs	20.9%	24.5%	5.3%
8. Earnings Gap	3.7	4.6	2.2
EMPLOYMENT SECURITY			
9. UI Benefits as % Earnings	28.0%	14.0%	29.0%
10. Jobs Supports (%GDP)	0.5%	0.2%	1.8%
11. Unionization Rate	36.0%	18.0%	89.0%
SOCIAL SUPPORTS			
12. Health Care (Public Share)	69.6%	44.7%	83.8%
13. Tertiary Education (Public Share)	60.0%	51.0%	91.0%
14. Private Social Spending	4.5%	8.6%	3.0%
HEALTH			
15. Life Expectancy (Men)	75.3	72.5	75.9
16. Life Expectancy (Women)	81.3	79.2	81.3
17. Infant Mortality/100,000	5.5	7.2	3.5
CRIME			
18. Homicides per 100,000	1.8	5.5	NA
19. Assault/Threat per 100,000	4.0	5.7	4.2
20. Prisoners per 100,000	118	546	71
EDUCATION			
21. Adults/Post Secondary Ed.	38.8%	34.9%	28.0%
22. High Literacy (% Adults)	25.1%	19.0%	35.5%
23. Low Literacy (% Adults)	42.9%	49.6%	25.1%
24. Grade 12 Math Score	519	461	552
CIVIC PARTICIPATION			
25. Voter Turnout	56.2%	49.1%	83.2%

As we've all heard ad nauseam, Canada lags behind the US in terms of productivity. But how are we doing in when it comes to our social performance? In the aftermath of

our gold-medal victories over our neighbours to the south, it seems timely to present a scorecard.

The bottom line? Canada beats the U.S. hands down on most social indicators, but we still fall well short of the Swedes. So there's reason for pride, but not for complacency. Our 25-indicator scorecard looks at income and poverty; jobs; employment security; social supports for families; health; crime; education; and civic participation.

In terms of average income, it's no surprise that we lag behind the U.S. Adjusted for purchasing power, the average Canadian family has 21% less income than the average American.

But our income is much more equally distributed. Using a common definition of poverty (having less than half the income of the average family), one in ten Canadians are poor compared to one in six Americans and just one in sixteen Swedes. One in six Canadian kids is poor, compared to almost one in four American children.

When it comes to jobs, the U.S. wins in terms of low unemployment, but there is little difference between the three countries in the proportion of people who have jobs. The U.S. does worse than Canada, however, when it comes to the quality of jobs, and here we both compare badly to the Swedes.

A common definition for being "low paid" is being paid one-third less than the national average. If we use this definition to compare the workforces of the three countries, 21% of Canadian workers are low paid, compared to 25% in the U.S. and just 5% in Sweden. More Americans than Canadians and Swedes work in jobs with very long hours. And Americans are much less likely to be in a union, to have access to unemployment insurance, and to qualify for government paid retraining programs.

One of the biggest differences is in terms of social supports, where Canada again stands between the U.S. and Sweden. American families have to pay much more out of their own pockets for health care and education, which wipes out a lot of the benefits of those vaunted lower taxes.

Governments pick up 70% of the cost of health care and 60% of the cost of higher education in Canada, compared to 45% and 51% in the U.S. Overall, American families spend 9% of GDP on social protection – everything from health care to pensions – out of their own pockets, compared to only 4% in Canada and 3% in Sweden.

Greater income equality and more citizenship entitlement programs make Canada and Sweden clear winners over the U.S. when it comes to health outcomes, crime rates, and educational attainment. And we get to enjoy it longer -- Canadians live more than two years longer than Americans: 75 years compared to 72 years for men, and 81 years compared to 79 years for women.

We in Canada are much, much less likely to be victims of violent crime than Americans. The murder rate in the U.S. is a staggering three times higher. And, for every 100,000 people, the U.S. has 546 prisoners, compared to 118 in Canada and just 71 in Sweden. Based on the results of the International Adult Literacy Survey, 50% of Americans have low literacy skills, compared to 43% of Canadians and just 25% of Swedes. At the other end of the skills scale, 39% of Canadian adults have completed post secondary education, compared to 35% of Americans and 28% of Swedes.

Finally, Canadians are more likely to be politically involved than Americans, though both of us compare badly to the Swedes: 56% of Canadians vote in Parliamentary elections, compared to 49% of Americans and 83% of Swedes.

Beating the U.S. for the silver medal is something to be proud of, but we should be aiming to wrestle that gold away from the Swedes. Perhaps it's time to put some of our national pride to work to better our social performance.

Final Standings			
	US	Sweden	Canada
GOLD	2	20	4
SILVER	3	2	19
BRONZE	20	2	2

NOTES AND SOURCES

- Unless otherwise indicated, data are from the OECD Social Indicators Database.
1. GDP per capita at purchasing power parity for 2001 (OECD estimate.)
 2. Poverty defined as less than half the median income of an equivalent household.
 3. Definition of poverty as in 2. Source: UNICEF. Child Poverty in Rich Nations. 2000.
 4. Proportion of population age 15-64 in employment. OECD Employment Outlook. 2001.
 5. Source as in 4.
 6. Men working more than 45 hours per week. OECD Employment Outlook. 1998.
 7. Low pay is employed in a full-time job and earning less than 2/3 the median hourly wage.
 8. Ratio of the top to bottom 10% (ie top of 9th decile to top of 1st decile of earners.)
 9. Earnings replacement rate: average by family type and unemployment duration.
 10. Public spending on training and labour adjustment (excluding income support) as % GDP.
 11. OECD Employment Outlook. 1998.
 12. Public share of total health care expenditures.
 13. Public share of tertiary education sector revenues. Education at a Glance. OECD.
 14. Private social spending (health, pensions, disability insurance etc.) as % GDP.
 15. and 16. Life expectancy at birth.
 18. Rate per 100,000 population. Statistics Canada Daily. December 18. 2001
 19. Victimization rate as reported by persons per 100,000.
 21. Percentage of adults with post secondary qualifications (not including CEGEPs.)
 22. and 23. Data from International Adult Literacy Survey.
 24. Data from Third International Math and Science Survey.
 25. Voting in Parliamentary elections, 1995-99