CANADA

A POLITICAL AND ECONOMIC ASSESSMENT

NOTES FOR DISCUSSION

FOR A BRIEFING OF RAND ARASKOG

CHAIRMAN

ITT CORPORATION

TORONTO, NOVEMBER 24, 1981

BY

THOMAS d'AQUINO

PRESIDENT

BUSINESS COUNCIL ON NATIONAL ISSUES

INTRODUCTION

Tom Savage asked me to present you with an overview of Canada's political economic situation. This afternoon I plan to focus on four major areas in my remarks.

First, a review of the political setting including comments on the current political leadership and the role of the major parties.

Second, a discussion of Canada's recent and significant steps in nation-building as represented in proposed changes to our constitution.

Third, a discussion of key economic issues, particularly in light of the federal budget and related economic statements tabled less than two weeks ago; and

Fourth, some concluding comments on the state of Canada's relations with the United States.

POLITICAL SETTING

Canada has a federal system with two levels of government.

At the national level, dominated by the Liberal Party which has held power most of this century.

The two major parties, Liberal and Progressive Conservative, are essentially broadly based, mass parties - pragmatic rather than ideological - alliances for power rather than instruments of philosophy.

The New Democratic Party is social democratic rather than Marxist and at the national level has, with few exceptions when it held the balance of power, not been a decisive factor on the political scene.

The current standing in the House of Commons

Liberals	148
P.C.s	102
N.D.P.	132

(We have an appointed Senate which is ripe for reform.)

A serious political problem is posed by an imbalance regionally of elected party representation: Liberals two seats in the West (British Columbia, Alberta, Saskatchewan, Manitoba) although one-third of Canada's population lives there and more than 60 seats are situated there. The Progressive Conservatives likewise cannot claim to be a national party with only one elected representative from Quebec.

These imbalances are both contributing causes and effects of conflicts and animosities within the Canadian federation.

These imbalances have led partly to the strengthening of provincial governments which, within the Canadian federal system, exercise a degree of power and influence considerably greater than that of provinces and states in most other federations.

This has implications for governing in Canada - it has added a dimension of complexity to our political system which many foreigners find bewildering. In recent years, and particularly in recent months, federal-provincial conflict has sapped a great deal of our national energies.

Concerning the question of political leadership: after twelve years of leadership interrupted only by a nine month Progressive Conservative interlude, Pierre Trudeau remains a strong and enigmatic political chieftan - best described by Richard Gwyn in The Northern Magus. He remains solidy in command of his Party and is expected to give over the reigns of power during this term of office.

The Leader of the Opposition, whose strength in the Progressive Conservative Party has been considerablly weakened since his fall from office, is not expected to survive to contest another election.

Within two to four years, we will likely witness substantial change in the higher levels of influence within the two major parties. With the succession of Messrs. Trudeau and Clark, will come new faces, new styles and new policies.

Shifts of significance in the essentially broad, centrist main-line parties are unlikely. Both major parties will likely continue to defend federal government jurisdiction against attempts by the provinces to exercise even greater powers. Both major parties will strive to broaden their bases in areas of tradional weakness. Both major parties will employ interventionist instruments in the economy without philosophical remorse.

Even with the advantage of a constitutional settlement politics in Canada will continue to be "stormy" for the decade to come.

CONSTITUTIONAL DEVELOPMENT

I would like to turn now to a second major area of focus - a discussion of Canada's recent and historic steps in nation building - as represented in proposed changes to our constitution.

Only a few weeks ago, on November 5, 1981, the Prime Minister and nine of the ten Premiers of the Provinces reached a compromise on a constitutional package. Only the Government of Quebec refused to endorse the agreement, warning that it would strongly oppose the agreement's implementation.

The Agreement has three main parts:

1. The patriation of the British North America Act from Great Britain to Canada to form part of a new Canadian constitution.

2. The adaption of an amending formula which will require the approval of the Federal Parliament and the legislatures of seven of ten provinces whose total population would represent at least half of the national population for future constitutional change.

3. The entrenching of a Charter of Human Rights which, in addition to guaranteeing certain fundamental rights such as freedom of religion, the press, etc., will state that English and French are the two official languages of Canada and that Canadians will have the right to have their children receive primary and secondary school instruction in the minority language where numbers warrant.

Quebec's opposition to the Agreement is partly because the new language protection provisions would force the Province to accept English once again in what is now an officially unilingual Province. Also, the new amending formula eliminates Quebec (and Ontario's) veto over future constitutional change.

Although negotiations with Quebec are proceeding, the Federal Government intends to proceed with the constitutional changes. While agreement is anathema to the Quebec Government, the Lévesque Government does not appear to have sufficient support to wage a life or death battle.

Caution: the Quebec independence movement is far from dead. Conflict with Quebec will continue for some time to come. At some future date a referendum or election on the independence question remains a possibility so long as the Parti Quebecois Government remains in power.

Foreigners Note: Canada's deep pre-occupation with constitutional questions is more than a sterile, legalistic exercise - it is a reaching out for maturity - albeit by a limited number of political and governmental elites. It is also a struggle for power at a time when modern realities differ with concepts introduced in 1867.

THE ECONOMY

Turning now to the principal thrust of my remarks - some comments on the Canadian economy and major national economic issues.

The Federal Government Budget tabled on November 12 and accompanying statement on Economic Development provides us with a useful window on our economic world.

Inflation and slow economic growth remain the most intractable problems facing the Canadian economy according to Finance Minister MacEachen's Budget.

The resolution of these problems in a medium-term policy framework represents the primary economic policy initiative.

Despite increasing evidence that we are in the throes of the second recession in eighteen months, the budget avoids short term responses: rising unemployment and spreading weaknesses throughout the economy are virtually ignored; the Budget deals only sparingly with the most acute symptoms of the present malaise, namely high borrowing costs for homeowners, farmers and small business.

As expected, gradually reducing the deficit is a key element of the Minister's overall strategy to combat inflation. On this budget, he in fact proposes a faster reduction in the deficit than he did a year ago.

The Minister appears determined to restrict the rate of growth in federal expenditures to below the growth rate for the overall economy.

On the revenue side, the recent energy agreements between Ottawa and the petroleum producing provinces have enhanced Ottawa's fiscal manoeuvrability considerably. Reliable estimates are that these agreements will net the federal treasury roughly $2.0 billion in 1982, even after accounting for all energy-related spending.

Despite this, the Minister has increased total tax collections by an estimated $1.4 billion in the 1982/83 fiscal year. These revenues will come from the corporate sector through reduced capital cost allowances for new assets and the extension of the corporate surtax. A combination of reduced tax rates and the elimination of many personal special tax preferences will increase personal income tax revenues significantly starting in 1983/84.

While a major theme of the budget is economic renewal, the underlying economic projections, as well as actions taken in the budget, do not suggest substantial initiatives towards this end.

Two shifts suggest the reverse: greater constraint in expenditures in the Economic Development Envelope, and increased personal income tax liabilities for higher income groups which could adversely affect future personal savings and investment.

Underlying the budget is a more cautious view of the prospects for economic growth in the 1980s than appeared in the projections accompanying last year's budget.

Despite the strategy of renewal, estimates of both productivity and employment gains through the mid 1980s are significantly lower with a more prolonged period of higher unemployment.

On the other hand, inflation is now projected to be relatively higher than anticipated a year ago.

Significantly, the Minister of Finance has rejected income and price controls stating that "Canadians do not want this much intervention by the government in their affairs...". He has also dismissed exchange controls as unworkable.

While I believe his commitment to non intervention of the controls type is sincere, he has expressed to me in private his growing concern about wage settlements getting out of hand.

Both the Minister and the Governor of the Bank of Canada are worried about the sharpness of the economic downturn both in Canada and the United States.

Turning now to the issue of overall economic philosophy and strategy.

By tabling with the budget a document entitled Economic Development for Canada in the 1980s, the Government sets out the country's policies and priorities for economic development.

The wording of the document was carefully chosen following an elaborate exercise in policy assessment and priorities setting by an ad hoc committee of the Cabinet under the chairmanship of the Minister of Finance. (Process commenced in June at Meach Lake - comment on background if time.)

This economic statement is of particular importance for a number of reasons.

- First, it returns the Government of Canada to a more balanced, moderate approach towards the role of the national government in the economy. It signals a modest retreat from an interventionist posture which has so characterized the Trudeau Government's actions during the past almost two years.

- Second, it outlines a sound strategy based on the realities of the Canadian economy - that the leading opportunities lie in the development of Canada's natural resources - that linked to this growth and flowing from it are exceptional economic development opportunities in manufacturing activity, both to supply machinery, equipment and materials needed for resource development and to extend the further processing of resource products beyond the primary stage.

- Third, it draws special attention to areas of high growth potential -the manufacturing, engineering and service areas such as nuclear technology, aerospace, communications, electronic data processing, retailing and urban transportation equipment.

I will return to these points in a moment.

I would like to comment on an important factor of change within the Canadian economy: namely the shifts that are taking place in regional growth. These are appropriately acknowledged by the Government.

In contrast to tradional expectations and historical economic trends, the Atlantic region is entering the 1980s well positioned for a decade of growth. Traditional out-migration trends have reversed. Off-shore resources promise significant new opportunities for growth and development.

Quebec faces distinct problems of industrial adjustment, notably in labour intensive and low technology industries such as textiles, clothing and footwear. The province has a number of mature industries that will be facing increasing international competition.

Some elements of Ontario's manufacturing industry will need to restructure to meet changing demand patterns and international competition. But Ontario is in a position to derive substantial benefits from major projects within its borders and elsewhere in the country. For example, it is estimated that over 60,000 person-years of employment will be created in Ontario from major pipeline projects in Western Canada; and pipeline projects are only a small fraction of major projects planned for the next decade.

Over half of the investment in major projects in Canada to the end of this century will be in the West. Investments of this magnitude will certainly strain capacity. The Minister of Employment advises that in the absence of immigration, or substantial inter-regional migration, the West would have a shortage of many thousands of workers by the end of the decade. The expected influx of people will strain the region's capacity to absorb migrants, especially in Alberta.

Returning to the principal thrusts of the Government's economic development strategy.

I said that it signals a retreat from an intervenionist posture. That this is the real intent of the Government, I have no doubt. But let us examine the evidence.

First, the Government re-iterates its commitment to enhance the free flow of goods, capital, service and people within Canada and promises to gain provincial government co-operation in removing potential bottlenecks in the development process.

Second, the Government confirms that it continues to regard regulatory reform as essential - aimed at guiding business enterprise rather than inhibiting it.

Third, the Government promises a regime of anti-trust laws that will facilitate expansion rather than burden initiative.

Fourth, the Government promises public policy support for business seeking out and realizing new opportunities, and re-affirms its commitment to the consultive process.

Fifth, and of special relevance to our discussions today, the Government has moved towards a more conservative position on the question of ownership of Canadian industry:

- it re-affirms that foreign capital and technology will continue to play an important part in Canada's economic development;

- it states that special measures being employed to achieve more Canadian ownership and control of the oil and gas sector are not appropriate for other sectors;

- it advises that a review of administrative procedures of Foreign Investment Review Agency (FIRA) is now underway; *

- and perhaps most significant of all in connection with the debate about FIRA, expansion of the mandate of the Foreign Investment Review Act in two areas - promised by the Prime Minister, the Minister of Industry, Trade and Commerce, and in the 1980 Speech from the Throne - has been halted for the time being.

---

*Areas under review: clarification of the significant economic benefit test; considerably higher thresholds for review; a more satisfactory treatment of indirect transfers of control; a tighter time frame for review and Cabinet decision-making; proper regulation of third party interventions; and improved accountability for decisions at the Cabinet level.

This retreat from interventionism is motivated by a genuine desire to correct certain problems and perceptions both within Canada and abroad - but let us recognize that two factors always have been, are, and will be at play in Canada:

one is an acceptance by Canadians of government intervention in the economy (historical examples; short lived Clark attempt at neo-conservatism);

the other is the almost certain recurrence of economic nationalism, the obvious and not surprising product of living side by side with the most powerful economy in the world.

A final point: in this sudden gush of "repentence" on the part of the Government, all is not exactly what it seems - it rarely is in politics. Every effort will have to be made on the part of business to ensure that the Government sticks to its freshly enunciated principles. Having said that, we must keep a viligant eye on

- renewal efforts to resuscitate FIRA amendments in due course
- extension of Canadianization provisions more subtbly, or through the back door e.g. Office of Industrial and Regional Benefits
- extension of direct intervention through increased Government ownership
- extension of Government control through the consultation process: e.g. exchange of information p.12 Economic Development paper.

I wish to conclude this section on the economy by pinpointing the industries which the Government of Canada recognizes as having the greatest potential from the economic development strategy

- mining machinery and equipment
- forest machinery and forest products machinery
- transportation equipment
- farm equipment
- steel pipe
- generating equipment
- compressors
- machine tools
- electronic and communications equipment
- chemicals and petrochemicals

In the service sector, Canadian business is expected to have particularly attractive opportunities in

- project financing and management
- engineering services
- computer software and communication services

In support of this development, the Government has promised

Industrial Development	-	Better co-ordination of government activities in support of industrial and regional benefits flowing from major projects.
	-	A major increase in the level of R&D.
	-	Assistance in industrial adjustment.
Natural Resource Development	-	Oil self sufficiency by 1990: the Government will be spending over $18 billion through 1985/86 in support of exploration and investment activity.
	-	Development of an Agri-Food Strategy with particular attention to the development of export markets.
	-	Development and strengthening of the fisheries sector where Canada is now the world's leading exporter.
	-	Enhance the longer term performance of the forest based industries.
	-	Maintaining the competitiveness of the Canadian mining sector.
Developing Transportation	-	Capturing the benefits of resource - based expansion will place heavy demands on the transportation system. The Government recognizes that export led expansions in grains, coal, fertilizers and forest products will require the movement of much larger volumes of bulk commodities to markets: hence particular attention to ports and mail line upgrading.

Exports

- Government is taking steps; representation in key foreign market posts in being strengthened; an Export Trade Development Board has been created to give business a more direct input in trade policy.

- In area of export financing the Government continues to seek agreement on concessional financing practices.

  In the meantime, in order to ensure that Canadian interests are not jeopardized, the Government has agreed to match, through the provision of "credit mixte" facilities by Export Development Corporation, the concessional financing offered by foreign governments in selective cases where the competitive position of Canadian bids is at stake.

  National Trading Corporation?

Human Resource Development

- An ambitious program is planned.

Conclusions:

All in all, attractive economic potential
Relative stability
Moderate governments
Attractive investment climate
if cards are played correctly