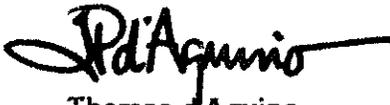
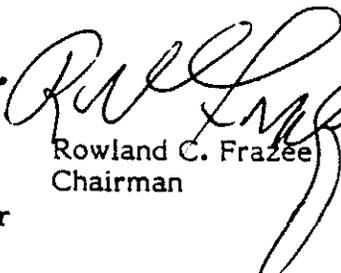

THE CANADIAN ECONOMY
CHALLENGES AND IMPERATIVES

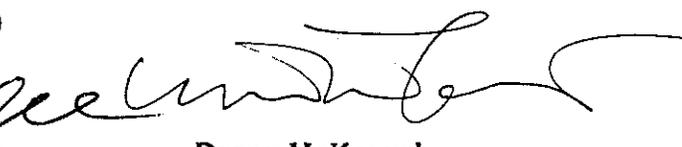
A Statement
by the
Business Council on National Issues

September 18, 1985

Ottawa


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The Business Council on National Issues is composed of chief executive officers of 155 leading Canadian companies, representing all sectors of the Canadian economy. The Council is the means by which business leaders in Canada have chosen to contribute personally to the development of public policy and to the shaping of national priorities.

The corporations which make up the Business Council administer in excess of \$650 billion in assets which produce annually more than \$240 billion in revenues. The member companies employ more than 1.5 million Canadians.

Business Council task forces are active in the areas of economic policy, international trade, industrial and competition policy, taxation, social policy, government institutions, and foreign policy and defence.

TABLE OF CONTENTS

Highlights and Recommendations	Page i
Introduction	Page 1
Macroeconomic Policy and Fiscal Management	Page 3
Fiscal Policy and the Deficit	Page 7
Tackling the Deficit	Page 12
Other Priority Framework Policies	Page 19
Trade and Market Access	Page 19
Tax Policy	Page 26
A New Competition Policy	Page 29
Government Regulation and Intervention	Page 30
Conclusion	Page 33
Footnotes	Page 34

HIGHLIGHTS AND RECOMMENDATIONS

- o The policy initiatives launched by the Progressive Conservative Government during its first year of office have helped to improve Canada's economic prospects. But further initiatives will be needed in the future if the cause of economic growth and renewal is to be advanced over the remaining years of the government's mandate (pp. 1-2).

Macroeconomic Policy and Fiscal Management (pp. 3-18).

- o **Sound macroeconomic policy** must be the cornerstone of efforts to develop a more competitive and prosperous Canadian economy. The economy continues to grow; 1985 was the third year of economic recovery. **Economic growth remains quite strong, and business investment** has begun to pick up (p. 3).
- o Canada has made impressive progress in reducing **inflation**. Although the Business Council welcomes this, we continue to emphasize the need for government policies and private sector practices that work to moderate inflationary pressures. **The important gains that have been made against inflation could be easily lost through inappropriate macroeconomic policies and a rise in inflationary expectations** (p. 3).
- o Nominal **interest rates** have declined in the last year. Real interest rates, however, are likely to remain high until there is a conviction in financial markets that inflation has been decisively defeated, and until credible steps are taken to **lower public sector deficits** in Canada and the United States (p. 3).
- o The Business Council does not share the view of those who hold that the Bank of Canada could act unilaterally and costlessly to lower domestic interest rates, in the absence of fundamental economic justifications and lower rates in the United States. Such a strategy would lead to depreciation of the Canadian dollar, large capital outflows, declining confidence in the Canadian financial and economic system, and higher inflation (pp. 3-4).

- o **Unemployment** has continued to decline slowly since 1983, but unfortunately it still hovers above 10 per cent. The Business Council regards this as an unacceptable situation. The creation of more jobs is an urgent national priority (p. 4).
- o Viewed over the longer term, **Canada's job creation record is actually the best in the industrialized world.** From 1970 to mid-1985, the annual compound employment growth rate in Canada was almost 2.4 per cent, and 3.5 million net new jobs were created. Some 260,000 more Canadians are working today than one year ago (p. 5).
- o The high unemployment of recent years is a result of both cyclical and structural factors. Prominent among the latter has been the country's **rapidly growing labour force.** In the 1960s and 1970s Canada's labour force was the fastest growing of any major industrialized country. This contributed to a slow rise in the underlying unemployment rate throughout the 1970s (pp.5-6).
- o The labour force growth rate will continue to decline in the late 1980s and early 1990s. This will help to ease Canada's unemployment problem in the years ahead (p. 6).
- o The most effective way to bring down unemployment levels is by **creating an attractive climate for investment, growth and entrepreneurship.** In addition, measures are needed to improve the working of the labour market and to make government training and employment programs more effective and market-oriented. The Business Council welcomes the introduction of the new federal Jobs Strategy and the decision to review the unemployment insurance program (pp. 6-7).
- o Figures and projections released by the Minister of Finance with his May 1985 budget reveal that the **federal government's fiscal position** has become an increasingly serious problem. Despite efforts to trim spending and to raise revenues, the deficit during the current fiscal year is expected to approach \$34 billion, equivalent to 7.5 per cent of GNP. This follows deficits in the previous two fiscal years of \$32 and \$36 billion. Particularly worrisome is the fact that the deficit remains very large despite three years of solid economic growth and recovery from the 1981-82 recession (p. 7).

- o Moreover, with current policies in place, it is likely that the **national debt** will more than double between now and the 1990-91 fiscal year, from \$190 billion to \$400 billion. At this level, debt interest payments could well account for almost all of Ottawa's annual deficit. The growing burden of debt-servicing costs may threaten the government's ability to maintain essential programs (p. 8).
- o Continuing deficits in the range of 6-8 per cent of GNP in the years ahead will push up interest rates; require the government to spend a growing share of its revenues on interest payments; erode business confidence; raise fears that taxes will be sharply increased; contribute to higher inflationary expectations; and undermine the prospects for future growth, employment and improved living standards for Canadians (p. 8).
- o The Business Council urges the government to develop and adhere to a coherent fiscal policy strategy over the remainder of its term. **This strategy should not be held hostage to short term economic changes. It should aim to stabilize the growth in the debt-to-GNP ratio within the next four years. Thereafter, the goal should be to reduce this ratio** (p. 12).
- o Over the past year the government has moved to reduce expenditures and to increase revenues. The Business Council has supported these steps. However, **we believe that the focus of future efforts to tackle the deficit must be on expenditure restraint, not tax increases** (p. 13).
- o **We believe that additional real expenditure cuts of at least \$3-\$4 billion are needed in the next budget in early 1986.** Expenditure reductions are still possible in the Economic and Regional Development envelope, and in government overhead and operating expenses. The Social Development envelope, which has grown considerably in recent years and now accounts for more than 55 per cent of all federal spending on programs, also offers scope for significant future expenditure restraint (pp. 13-16).
- o More can be done to better target income transfer programs to ensure that those who really need such support receive it, while those who do not get less. **We support the partial de-indexation of Family Allowances, and urge that further consideration be given to restructuring elderly benefits so as to restrain the growth of spending in this area and better target existing spending on the elderly poor. In addition, the growth in intergovernmental transfers to the provinces must also be carefully controlled** (pp. 15-16).

- o The Business Council recommends that the government move to make effective use of the detailed and valuable work being done by the **Task Force on Program Review**, chaired by the Deputy Prime Minister and assisted by a Private Sector Advisory Committee. It is understood that the Task Force has identified hundreds of government programs and practices that could be changed in ways that would allow the government to achieve substantial savings (p. 17).

Other Priority Framework Policies (pp. 19-32)

- o The prospects for economic growth and job creation in Canada are closely linked to the ability of Canadian industries to obtain **assured access to major foreign markets and to compete in those markets**. Exports now account for almost 30 per cent of Canada's GNP, and have become more critical to Canada's economic welfare in recent decades. As the international economy grows more interdependent, and Canadian industry seeks to become more efficient, Canada's reliance on foreign trade will increase (p. 19).
- o The principal objective that should guide Canadian trade policy is the **urgent need to develop an improved competitive position for Canada within the international economy**. Secure access to larger markets is an essential element of any strategy to strengthen Canada's international competitiveness (p. 20).
- o Canada has a vital stake in global trade liberalization and in an effectively functioning multilateral trade system centered on the **General Agreement on Tariffs and Trade (GATT)** (p. 20).
- o Canada is the only major industrialized country that does not enjoy free and secure access to a market of at least 100 million people. The United States offers the only realistic prospect for obtaining such access. Accordingly, the Business Council favours early efforts to negotiate a comprehensive, bilateral trade liberalization agreement with the United States that gradually liberalizes trade between the two countries and provides for more assured reciprocal market access (p. 21).

- o Non-tariff barriers, including contingency protection measures and government procurement preferences, have become the chief threat to Canadian trade and must be addressed in future bilateral trade negotiations with the United States (p. 22).
- o Most experts who have studied the subject are confident that **Canada would benefit from freer bilateral trade** through higher per capita incomes, increased productivity, and more jobs. However, some Canadian industries and sectors would encounter difficulty in adjusting to freer bilateral trade. Thus, tariffs should be reduced only gradually, particularly in sensitive sectors. Transitional measures will be needed, and consideration should be given to exempting a very small number of sectors from bilateral trade liberalization, at least initially (pp. 23-4).
- o In addition, as Canada moves toward liberalized bilateral trade, it will be necessary to address **interprovincial barriers to trade** and other domestic policies and practices which raise business costs and impair efficiency. Canadian industry will be better equipped to compete internationally if the Canadian domestic market is made to function more effectively (p. 24).
- o There is no contemporary evidence to suggest that trade liberalization agreements between countries of disparate size lead to a substantial erosion of the sovereignty or political independence of the smaller signatory countries (p. 25).
- o If Canada and the United States seek to negotiate a comprehensive bilateral trade agreement, it will be necessary to ensure that steps are taken **to protect Canada's cultural industries** so that they may continue to exist in an environment of liberalized trade (pp. 25-6).
- o **Tax policy** is another crucial framework issue that requires action. In our view, the chief purpose of the tax system must be to raise revenues for governments in a way that is consistent with broad principles of fairness and that respects the need to ensure that Canada's economy is competitive (p. 26).
- o The Business Council shares the concerns of those who have criticized the tax system for being **too complicated** and for containing an **excessive number of special deductions, incentives and preferences** that collectively have eroded the personal and corporate income tax bases.

We believe that existing tax preferences and incentives should be examined to determine to what extent they are meeting their objectives, and indeed whether those objectives should continue to be treated as priorities of government policy (p. 27).

- o The Business Council is examining closely the discussion papers on corporate taxation released with the May 1985 federal budget. We will be responding to these important documents in due course (p. 27).
- o All tax reform proposals must strive to achieve a measure of balance among such criteria as **economic efficiency, fairness and equity, and administrative feasibility**. This is a difficult task, one that is likely to necessitate lengthy deliberation and study. Because of this, **the Business Council recommends that the government proceed cautiously in the area of tax reform**. Sudden and massive change clearly would be counterproductive. Moreover, the government should evaluate specific tax reform proposals in relation to the overall tax system that Canada needs in the years ahead (pp. 27-8).
- o In considering the subject of tax reform in Canada, close attention must be paid to relevant **developments in the United States**, where tax reform has become a priority of the Reagan administration. Canada will suffer if it develops a tax structure that is significantly more onerous and restrictive than that of the United States (p. 29).
- o **Competition law** is a key framework policy that has a major impact on the economy and on business organization. In recent years considerable effort has been made to devise appropriate amendments to the current Combines Investigation Act. The Business Council has closely followed this issue, and **we believe that a new competition policy should be a priority for the federal government during the coming year** (p. 29).
- o In developing a new competition policy, it will be essential to bear in mind the need to maintain and strengthen Canada's international economic competitiveness. A major thrust of the government's economic strategy should be to encourage and improve the capacity of Canadian firms and industries to compete in global markets that are everywhere characterized by intensified competition. Given the restricted size of the Canadian domestic market, it is important to allow firms to develop an economic base of sufficient size to permit them to compete with the major firms found in other nations (p. 30).

- o **Government regulation and intervention** in the economy constitutes another important framework policy issue that requires attention. The Canadian economy is characterized by a high degree of both government regulation and direct state intervention in economic affairs. This bias in favour of increasing intervention has caused many **inefficiencies and rigidities** to develop in the economy, the cumulative effect of which has been to reduce economic growth and flexibility (pp. 30-31).
- o The Business Council favours efforts to **gradually reduce the degree of government regulation, intervention and ownership** in the Canadian economy. We welcome the recent announcement by the Minister of Transport that the regulatory regime governing transport will be reformed, and the decision of the federal government to sell its holdings in a number of crown corporations. We look forward to further initiatives consistent with this policy thrust (p. 32).

INTRODUCTION

As the Progressive Conservative Government enters the second year of its mandate, the Business Council on National Issues is pleased to offer a perspective on some of the key economic issues confronting Canada. We have been impressed with the government's record of leadership and economic management over the past year. A number of worthwhile initiatives have been taken to stimulate growth and restore confidence in the Canadian economy. The new energy agreements, the Western and Atlantic Accords, have gone a long way toward creating an appropriate regulatory and fiscal regime to govern Canada's oil and gas industry, and have also helped to foster more harmonious relations with the energy-producing provinces. The federal government's legislation establishing Investment Canada, which put in place sensible and streamlined rules to regulate foreign investment, represents a bold and necessary step toward the development of a more attractive climate for enterprise and job creation in Canada. The new Jobs Strategy recently unveiled by the Minister of Employment and Immigration merits support for its frank recognition that government employment and training programs should be market-sensitive and must equip Canadians with the skills required to permit them to participate in our changing labour market and economy. The efforts that have been made by the Prime Minister, the Minister for International Trade and other government ministers to evolve an improved trading relationship with the United States have also earned deserved praise. And the government's determination to engage in wide-ranging consultations prior to making decisions on many of the key issues facing the country has been a useful and welcome step.

Underlying and giving a measure of coherence to all of these policy initiatives is the sound approach to overall macro-economic management that has been adopted by the government since it assumed office. The Minister of Finance's Economic and Fiscal Statement of November, 1984, painted a

realistic and sobering picture of Canada's serious fiscal problems, and announced a host of measures intended to slow the growth of government spending and the federal deficit. The launching of the Task Force on Program Review, under the aegis of the Deputy Prime Minister, has borne fruit in the identification of a plethora of public programs where significant expenditure savings can be made. Finally, and most important, the budget introduced on May 23, 1985, indicated that the government intends to pursue a policy of fiscal prudence, and at the same time brought forth a number of concrete initiatives designed to reduce gradually the size of the federal deficit and the growth in Canada's national debt.

The Business Council believes that these and other steps taken by the federal government have done much to improve Canada's economic prospects. However, further decisive initiatives clearly will be needed in the months and years ahead. We have commented in detail in previous policy and discussion papers on most of the issues canvassed below, and we intend to offer further concrete policy recommendations on issues such as fiscal policy and tax reform in the future. This economic statement is primarily concerned with broad, framework policy issues. We will first explore the macroeconomic situation presently facing the government and the country, and offer our views on such issues as inflation, the deficit, and unemployment. The paper will then turn to several other important framework issues that must also be addressed if the cause of economic growth and renewal is to be advanced over the remaining years of the government's mandate.

MACROECONOMIC POLICY AND FISCAL MANAGEMENT

Sound macroeconomic policy must be the cornerstone of efforts to develop a more competitive and prosperous Canadian economy. The economy has performed well during the past year. The post-recession recovery which began in 1983 entered its third year, and the economy continues to grow. Real GNP growth was almost 5 per cent in 1984 and has remained close to 4 per cent in 1985. Most forecasters also believe that the economy will continue to grow through 1986, despite slower growth in the United States.¹ Business investment, after a prolonged slump, has begun to pick up. Inflation fell to a thirteen-year low of 4.4 per cent in 1984, and it has now dropped below 4 per cent measured on a year-over-year basis. There is little evidence at present that inflationary forces are strengthening, but it would be wrong for policy makers to conclude that Canada has decisively overcome this macroeconomic problem. **Although we welcome the recent fall in inflation, we continue to emphasize the need for government policies and private sector practices that work to moderate inflationary pressures.** The important gains that have been made on the inflation front could easily be lost through inappropriate macroeconomic policies and a heightening of inflationary expectations.

The past year has also seen a drop in nominal interest rates. Real rates, however, are likely to remain high until there is a conviction in financial markets that inflation will be kept under control, and until credible steps are taken to implement a multi-year strategy to lower public sector deficits in the United States and Canada. **The Business Council does not share the view of those who hold that the Bank of Canada could act unilaterally and costlessly to lower domestic interest rates, irrespective of developments in the United**

States and elsewhere. We fear that such an approach would have disastrous effects on Canada's longer-term economic performance. Canada is a medium sized, open economy, highly sensitive to and dependent on external economic developments. Efforts to force domestic interest rates lower in the absence of underlying economic justifications (especially lower interest rates in the United States) would precipitate a substantial depreciation in the value of the Canadian dollar, rising inflation, large capital outflows, declining confidence in the Canadian financial and economic system generally and, eventually, higher interest rates.² This is not to suggest that the Bank of Canada has no scope to conduct a carefully managed trade-off between interest rates and the exchange rate. However, **overall the central bank's policy should not deviate from the medium term objective of price stability, and must also remain sensitive to the constraints imposed on Canada by its close economic interdependence with the United States and the wider global economy.**

The recent success in lowering inflation unfortunately has not been duplicated to the same degree in the case of unemployment. Although it has declined since 1983, the unemployment rate continues to hover above 10 per cent, and more than 1.2 million Canadians are seeking but cannot find employment. This is cause for great concern. The Business Council does not regard a 10 per cent unemployment rate as acceptable in a country such as Canada. The creation of new jobs is thus critical, both for those who are unemployed and for the long term health of our economy as a whole. We believe that this can only be accomplished through appropriate policies designed to spur growth and investment, and to make the Canadian economy more efficient and flexible. In particular, efforts must be made to reduce existing impediments to job creation and to ensure that Canadians are better

equipped to enter and remain in the work force during a period of technological and economic change. In this connection, we believe that the important recommendations recently offered by the Macdonald Royal Commission with respect to education and training deserve careful consideration by policy makers and the private sector.³

In considering the current unemployment problem, it is also necessary to take a longer view of the overall performance of the Canadian labour market. **The fact is that Canada has demonstrated a very impressive capacity to create employment.** From 1970 to mid-1985, the annual compound employment growth rate was almost 2.4 per cent, and more than 3.5 million net new jobs were created. Total employment rose by 45 per cent, giving Canada the best job creation record of any OECD country. However, the labour market has been under severe pressure because of the millions of new entrants seeking work over the past two decades. Canada had the fastest growing labour force of any major industrialized country during the 1960s and 1970s, as the huge baby-boom generation entered the work force. In addition, the female labour force participation rate rose sharply, from 36 per cent in 1971 to almost 54 per cent in 1984. The proportion of young people (under 25) seeking employment has also risen, from 60 per cent in 1973 to more than 66 per cent one decade later. Despite record employment growth, this extraordinarily rapid rise in the number of relatively inexperienced labour market entrants has put upward pressure on the underlying unemployment rate. This situation was, of course, exacerbated by the 1981-82 recession, the effects of which continue to be felt in many key industries.

Fortunately, the job-creation picture has brightened considerably. Since 1983 net employment has climbed by almost 1 million, and the number of jobs exceeds the pre-recession peak employment level by close to 400,000.⁴

Some 260,000 more Canadians are working today than one year ago. In the past two years, the rise in the labour force has been surpassed by the employment growth rate. The Department of Finance, the Economic Council of Canada and most other forecasting agencies predict that employment will increase by close to 2 per cent or more per year between now and the end of the decade.⁵ Moreover, the labour force growth rate will slow in the late 1980s and early 1990s, falling to perhaps 1 per cent per year, versus the 3 per cent recorded in the 1970s and in 1981. **These labour market trends should work to ease considerably Canada's unemployment problem in the years ahead.**

The Business Council is convinced that the most effective way to bring down present unacceptable unemployment levels is by establishing an attractive climate for investment, growth and entrepreneurship. Given already massive public sector deficits, it would not be prudent to try to reduce unemployment through additional fiscal stimulus. **But there are measures that can be taken to improve the working of the labour market, create jobs and thus bring down the unemployment rate.**⁶ These include restructuring the unemployment insurance system to reduce the disincentives to work, and to job creation, associated with it; providing better skill training, retraining and mobility programs to enable Canadians to participate more effectively in a rapidly changing labour market; practising moderation in respect of the growth of wages and labour costs in both the private and public sectors; making collective bargaining, wage arrangements and work rules more flexible and adaptable; and targetting government programs at those groups which face the greatest difficulties in the labour market, and which stand to gain the most from more training and job placement assistance. Many proposals consistent with our views on these issues are discussed at length in the Report just issued by the Macdonald Royal Commission, to which the Business Council

will be responding in the future. The federal government has begun to address some of the key issues related to employment growth through its recently announced Jobs Strategy, and through its decision to review the unemployment insurance program with the aid of a private sector committee. The Business Council welcomes these decisions, invites further consultation on these issues, and urges the government to explore further how the reform of labour market and employment policies may be able to stimulate private sector job creation.

Fiscal Policy and the Deficit

The government has made clear that deficit reduction is a key element of its overall economic strategy. **However, the background documentation and fiscal projections released by the Minister of Finance at the time of the May 23 budget portray a fiscal situation that is deeply worrisome.** Despite the steps taken in November 1984, and the measures announced in the recent budget to reduce expenditures and to increase revenues, the size of both the current and projected federal deficits remains disturbing. In fiscal 1985, the deficit is projected to be almost \$34 billion, equivalent to 7.5 per cent of Gross National Product (GNP). This follows recorded deficits in fiscal 1983 and 1984 of approximately \$32 and \$36 billion, respectively. The provincial governments collectively are also in a deficit position of approximately \$9-10 billion in 1985. Although our economic recovery has been comparatively vigorous, Canada continues to have the highest deficit-to-GNP ratio of all the major industrial economies except Italy. Successive large and rising deficits over the past several years have pushed up the national debt and the debt-to-GNP ratio at an alarming pace. Canada's net public debt reached some \$190 billion (45 per cent of GNP) at the end of fiscal 1984; and as shown in Chart 1,

in Chart 1, it will continue to rise rapidly even under favourable economic assumptions. **With current policies in place, the government predicts that the national debt could well skyrocket to more than \$400 billion, or 63 per cent of GNP, by 1990-91. At this level, debt charges could account for almost all of the annual deficit, eat up close to half of all federal revenues, and threaten the federal government's capacity to maintain many key programs and services.**⁷

The projected sharp rise in Canada's public debt caused by persistently large federal deficits is a source of growing concern among most economists and in the business community.⁸ Heavy, continuous federal government borrowing to finance public sector programs and activities will put upward pressure on interest rates, and may crowd out other borrowers and force up yields on other financial instruments. A quickly mounting public debt will require the government to use a large share of its revenues simply to service its accumulated debt. The rising debt-to-GNP ratio threatens to erode business confidence, both within Canada and abroad, as the fear grows that public sector finances are out of control and that taxes will be raised significantly in the future. It will also transfer to future generations an enormous financial burden that could prove very difficult to meet in light of the uncertainty surrounding the future prospects for economic and productivity growth in Canada. In addition, year after year of deficits in the range of 6-8 per cent of GNP may fuel fears that the government eventually will resort to accelerated money supply growth to reduce the real burden of its liabilities, thus resulting in higher inflation. And if the pattern of large deficits established in recent years continues unchecked into the future, the government's room to manoeuvre in the event of future swings in the business cycle will be restricted.

TABLE 1

International Comparisons of Government
Budget Balances and Debt Outstanding,
Total Government Sector
(percentages of GNP)

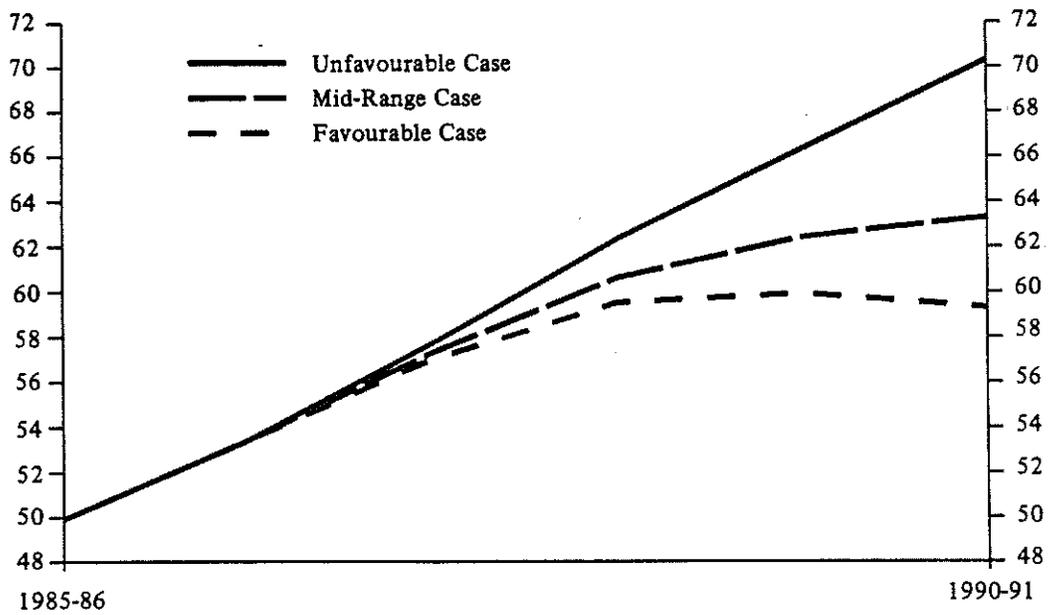
	Budget Balances, Total Government Sector			Debt Outstanding
	<u>1977</u>	<u>1980</u>	<u>1984</u>	<u>1983</u>
Canada	-2.4	-2.7	-6.4	55.5
United States	-0.9	-1.2	-3.3	45.8
Total, seven leading industrialized nations*	-2.1	-2.6	-3.7	50.8

*Weighted average for the seven leading OECD industrialized nations: United States, Japan, West Germany, France, United Kingdom, Italy, and Canada.

Source: Department of Finance, The Fiscal Plan, May 1985, pp. 58, 62.

CHART I

**The Debt-to-GNP Ratio and Alternative Economic Scenarios
(Percentage of GNP)**



Source: The Department of Finance, The Fiscal Plan, May 1985, p. 46.

The federal government appears to recognize the economic damage that will result if the country's fiscal problem is not forcefully addressed. As stated in a major document released with the budget:

"It is essential that fiscal policy in Canada be directed to fostering sound economic performance over the medium term. In this regard, the growing public debt and the prospect of a rising trend in the ratio of debt to national output pose a serious obstacle to...economic renewal and sustained non-inflationary economic growth over the remainder of the decade."⁹

In accordance with this view, the government decided to reduce net discretionary expenditures by some \$2 billion in November 1984; with the May 1985 budget, an additional expenditure cut of \$1.8 billion in the 1985-86 fiscal year has been announced. A number of revenue raising measures are also being put in place, especially in 1986, which are projected to increase Ottawa's revenues by more than \$2 billion in fiscal 1986-87. **The Business Council has taken the position that expenditure restraint should play a greater role than tax increases in the quest for deficit reduction.** However, because of our concern over the deficit and the escalating public debt, we very reluctantly supported the surcharges on individual and corporate taxes and the decision to partially de-index tax brackets and exemptions announced in the May budget. But we wish to stress that we view these as temporary steps that are only justifiable in the short term. The main focus of future efforts to tackle the deficit over the remainder of the government's mandate must be on expenditure restraint.

Tackling the Deficit

We believe that the government should develop and stick with a clear strategy as it seeks to address the country's fiscal problem over the remainder of its first term. The temptation to allow short-term demand management considerations to dominate fiscal policy decisions should be resisted. What is far more important is that a sound overall strategy of fiscal and macroeconomic management be chosen. Such a strategy should not be held hostage to short term shifts in the economy. In order to be effective, it must be implemented and adhered to over a period of years. Canada is a medium-sized, open economy, highly dependent on the international economy and greatly influenced by economic forces and trends that lie outside of our direct control. We must therefore accept the disciplines which the world economy imposes on us, and eschew the notion that persistently large government deficits are an effective and viable tool to cushion Canada from the realities of the international marketplace. **The Business Council suggests that, in adopting a policy to deal with the deficit, the federal government should embrace the goal of stabilizing the debt-to-GNP ratio within the next four years.** This recommendation is similar to that recently made by the Macdonald Royal Commission.¹⁰ In subsequent years it would be highly desirable to reduce this ratio, but the medium-term challenge is to slow and then halt its rise. Economic growth and reasonably favourable macroeconomic conditions will of course help to meet this goal. However, additional fiscal measures will also be required.

Despite the worthwhile initiatives adopted by the government in the past year, the deficit remains in the range of \$34 billion, and it is not projected to fall very much below this level over the next few years. Even if

modest economic growth is assumed to continue over the balance of the decade, this pattern of large deficits likely will lead to a doubling of the national debt between 1984-85 and 1990-91, a period of just six years. In April of this year, we recommended that the government reduce its expenditures by at least \$5 billion, in addition to the measures brought forth in November 1984.¹¹ The May budget fell short of this target. **Accordingly, we believe that real additional expenditure cuts of at least \$3-\$4 billion are needed in the next budget in early 1986.** Thereafter, fiscal policy should continue to be guided by the need to stabilize the debt-to-GNP ratio by the late 1980s. This undoubtedly will necessitate further changes in expenditure policies and priorities.

Where are further expenditure reductions to be made? This is a question to which the Business Council has given a good deal of thought. In August of last year we made public a study which suggested how expenditure savings of \$5-\$7 billion annually could be achieved by cutting both programs and government overhead expenses in a wide range of areas.¹² The C.D. Howe Institute published a similar study at roughly the same time.¹³ We identified a number of specific programs falling under several key envelopes of federal spending -- Economic and Regional Development, Social Development, and External Affairs and Aid--that we believed should be subject to expenditure restraint. During its first year in office, the government has moved to trim spending in many of these areas. In particular, projected spending on programs falling under the Economic and Regional Development envelope has been reduced considerably. Total spending through this envelope is currently projected to decline from \$13.3 billion in fiscal 1984-85 to \$9.8 billion by fiscal 1986-87, with the elimination of the petroleum compensation account

being the major source of savings. Spending on transportation subsidies, and on grants to business through the Industrial and Regional Development Program, has also been subject to restraint. **We believe that economic and regional development programs, including those that benefit business, can yield additional savings as further efforts are made to limit the growth of government expenditures.**

The government has also sought to reduce its overhead and operating expenditures and to slow the rate of growth in foreign aid. The May budget announced a series of measures to achieve savings through reduced overhead expenses and better management of government resources (e.g., property and cash balances). **We believe that further expenditure savings can be made through continuing efforts to control overhead expenses, including personnel years and public service salaries, and to manage government resources and activities in a more businesslike manner.** Public service wage and salary increases must not be permitted to outstrip those in the private sector or to exceed inflation rates. And government personnel, at both the federal and other levels of government, should be reduced gradually through attrition and program restructuring.

Business must be willing to accept expenditure restraint in relation to programs that benefit the private sector. But restraint must also be practiced in the case of the Social Development envelope, which encompasses a host of discretionary programs as well as statutory transfers to individuals and to other levels of government. In 1984-85 it accounted for no less than 55 per cent of all federal program spending. At present, spending on this envelope is scheduled to rise to \$46.7 billion by 1986-87 (up sharply from \$38.9 billion in

1983-84), by which time it will comprise almost 58 per cent of Ottawa's total spending on programs. **Given both the absolute size of the Social Development envelope and the rate at which it has increased, we doubt that the federal government can pursue a successful policy of expenditure reduction unless it applies a measure of spending restraint to social programs.**

The November Economic Statement and the May budget introduced a limited number of initiatives to control spending on certain programs in this envelope. Most important in this respect was the Minister of Finance's decision to partially de-index Family Allowances, a decision which we support. However, we are persuaded that additional savings in the Social Development envelope can and should be made without seriously jeopardizing the federal government's important responsibilities in the area of social policy. Spending on transfers to persons can be controlled by introducing a greater measure of selectivity into the transfer programs, and tax clawbacks can be used to reduce the benefits accruing to households which do not require financial support. The Business Council has argued that both Family Allowances and the Old Age Security should be made more selective in order to control the rising costs of these programs and to ensure that the benefits are better targeted. The May 1985 budget took action on Family Allowances, but the government backed away from its initial decision to partially de-index the OAS. **We believe that de-indexation of the OAS continues to deserve serious consideration, provided that offsetting measures are taken to protect the incomes of the elderly poor who receive the Guaranteed Income Supplement. This will become an increasingly urgent issue as the proportion of Canada's population aged 65 and older rises in the years ahead.**

The provinces must accept that the growth in intergovernmental transfer payments from Ottawa will have to be moderated if the federal government is to get its deficit under control. For example, federal transfers to the provinces under the Established Programs Financing (EPF) arrangements are projected to rise by more than 28 per cent between 1983-84 and 1986-87 (from \$7.6 billion to \$9.8 billion). Increases of this magnitude cannot be maintained if Ottawa's fiscal problem is to be successfully addressed. Consultations with the provinces on this subject will be required in connection with the EPF renegotiations in 1986.

In considering the subject of Canadian fiscal policy and the deficit, it is important to recognize that there are a number of developments that may combine to put upward pressure on government spending in the years ahead, and that this prospect makes even more urgent the attainment of a more balanced fiscal posture as soon as possible. **First, the fact that Canada's population is aging must be factored into assessments of future social and fiscal policies.** As noted recently by the Macdonald Royal Commission, "The changing age structure of our population ... represents a formidable challenge to which it would richly pay our nation to begin to respond now."¹⁴ Although a gradually aging population need not pose a crisis for the Canadian social support system, this trend obviously will tend to push up public spending on programs directed at or heavily used by elderly citizens. **A second development that will exert pressure on government spending is the requirement for Canada to make greater efforts to protect its sovereignty and contribute to the collective defence of the Western democracies through NATO, NORAD and other security arrangements.** That Canada is near the bottom among the OECD nations in terms of defence spending as a share of

GNP is widely known. Defence spending has been rising quite significantly in recent years, and the need to equip the Canadian Armed Forces with modern equipment and additional personnel suggests that this trend will continue. **Finally, a development which may also entail increased government spending in future years is the negotiation of freer trade with the United States and perhaps multilaterally as well.** Lower Canadian trade barriers will impose adjustment burdens on some industries and communities, burdens which will call for government programs designed to facilitate retraining, mobility and adaptability. Those programs will of course require the expenditure of public monies.

The Business Council recognizes that attaining an improved federal fiscal posture will require action extending over a number of years and more than a single budget. The additional expenditure reductions of recommended here are modest and manageable in comparison with total federal spending of more than \$105 billion in the 1985-86 fiscal year. **In this respect, we are hopeful that the government will make more effective use of the detailed and valuable work being done by the Task Force on Program Review chaired by the Deputy Prime Minister and assisted by a Private Sector Advisory Committee on which the Business Council is represented.** It is understood that the Task Force has identified hundreds of programs and government practices that could be changed in ways that would result in the achievement of substantial efficiencies and savings. **The Business Council believes that many of the proposals suggested by the Task Force should be acted upon at an early date as the government continues to work to strengthen the country's national finances.**

A strategy to lower the deficit and slow the growth of the public debt must feature prominently in the federal government's overall approach to economic policy over the balance of its mandate. **Careful macro-economic management, coupled with a determined effort to correct gradually Ottawa's serious fiscal imbalance, will go a long way toward enhancing the prospects for non-inflationary economic and employment growth in Canada.** The United States has begun to register some success in tackling its deficit and debt problem, even though the combined government deficit in the United States is considerably smaller, as a share of GNP, revenues, and government expenditures, than is the case in Canada. As the United States reduces the size of its current and projected federal deficit, real interest rates in North America will decline and Canada's economic growth and public finances will improve. However, Canada should not simply wait for the United States to address its deficit and avoid efforts on its own to adopt a more balanced fiscal policy. Regardless of whatever measures the United States may take, Canada will benefit from a lower deficit and a less rapidly accumulating national debt. As noted in a recent Ontario Economic Council position paper, if action is taken to reduce the Canadian deficit, "inflationary expectations would be lower, our balance on current account would be improved because we would not have to draw in foreign capital, and future tax liabilities would be...reduced."¹⁵ In addition, with a credible program to cut the deficit and moderate the rise of the national debt, it may prove possible to ease monetary policy somewhat, and thus to lower domestic interest rates relative to rates in the United States.

OTHER PRIORITY FRAMEWORK POLICIES

Sound macroeconomic and fiscal policy is essential if economic renewal is to proceed over the remainder of the decade. There are also a number of other framework policy areas where new initiatives can help to stimulate growth, create more jobs, and improve Canada's competitive position in a rapidly changing international economy. The framework policies which the Business Council feels should receive priority attention over the next year or so are outlined in this section of the paper.

Trade and Market Access

The prospects for economic growth and job creation in Canada are closely linked to the ability of Canadian industries to obtain secure access to major foreign markets and to compete in those markets. Canada is one of the most export-oriented of the major industrialized economies, with close to 30 per cent of GNP accounted for by the sale of Canadian goods and services abroad. (Comparable figures for the United States and Japan, Canada's two largest trading partners, are approximately 10 and 14 per cent, respectively.) Up to 3 million Canadian jobs depend on international trade. And the importance of exports to the Canadian economy has been increasing over the past three decades. In 1965, merchandise exports amounted to 15.6 per cent of Canada's GNP; today, the figure exceeds 25 per cent.¹⁶ As the international economy grows more interdependent and Canadian industry seeks to achieve greater efficiencies, Canada's reliance on foreign trade will continue to increase.

For Canada, trade policy should not be viewed in isolation or as an end in itself. Instead, it must be understood primarily as a vehicle for achieving other, more overriding objectives. **In our view, the principal objective that should guide contemporary Canadian trade policy is the need to develop an improved competitive position for Canada within the international economy. Secure access to larger markets is an indispensable element of any strategy to strengthen Canada's international economic competitiveness.** Canada has long been committed to the goal of gradual trade liberalization, and has participated actively in seven rounds of multilateral trade negotiations held under the General Agreement on Tariffs and Trade (GATT) in pursuit of this objective.¹⁷ The crucial trade policy issue facing the country today is not whether to continue to press for lower global trade barriers. As a medium-sized, open economy heavily dependent on international commerce and capital flows, Canada unquestionably is a net beneficiary of trade liberalization and has a major stake in an effectively functioning international trade system. **The real question that Canada must now address is whether our undoubted interest in reduced trade barriers and improved foreign market access is best served by continuing to work solely through the GATT, or whether we should also seek to develop mutually acceptable arrangements on a bilateral basis with the United States, our preponderant economic partner.**

The Business Council has concluded, after much study, that while continuing to work within the multilateral framework of the GATT, Canada should also explore the prospects for trade liberalization with the United States. We are pleased that the Macdonald Royal Commission has also endorsed this view in its recent Report. During the 1970s, the United States accounted for 60-66 per cent of Canada's growing volume of export trade. The

first few years of the present decade have brought an even greater dependence on the American market, in the range of 75 per cent today. Exports to the United States amounted to more than \$85 billion in 1984, while imports from the U.S. totalled some \$68 billion. More than 2.2 million Canadian jobs are traceable to our exports to the U.S. Canada is also by a significant margin the most important foreign market for American exports, accounting for 19-20 per cent of U.S. exports in recent years. About 2 million U.S. workers depend on exports to Canada, and Canada is also the biggest foreign supplier of American industries.¹⁸

The Business Council believes that trade with the United States is so vital to Canada that an intensification of bilateral negotiations is now an urgent national priority. There are several reasons for this. First, in order for Canadian industry to achieve the efficiencies that are essential to long term competitiveness, secure access to larger markets will be increasingly important. **Canada is the only member of the group of seven leading industrialized nations, and indeed is one of the few industrialized democracies anywhere, that does not enjoy free and assured access to a market of at least 100 million people.** To become more competitive, Canadian industry must over time produce a smaller range of products in greater volume than has been the case hitherto. And as noted by a leading Canadian trade expert: "Access to the U.S. market is absolutely imperative in any scenario of specialization in Canada."¹⁹ **The United States offers the only realistic prospect for obtaining the access to a large market that Canada badly needs.** Those who question this would do well to ponder the following statistics: in 1984, the increase in Canada's exports to the United States exceeded our total exports to Europe and Japan; and over the period 1970-84, the average annual growth in

Canadian exports to the U.S. exceeded the growth in our exports to either Western Europe or Japan.²⁰

Second, no country in the world is more threatened by protectionism in the United States than Canada. Fuelled by a huge trade deficit, protectionist pressures are gaining strength in the United States. Most American policies and legislation to restrict trade are not primarily, or even significantly, aimed at Canada. But because no bilateral agreement or framework exists to govern trade between the two countries, there is no way that Canada can realistically expect to negotiate its way around or insulate itself from U.S. trade actions and import restrictions. **With an agreement, it may prove possible to gain greater protection from U.S. trade barriers than we enjoy today. In particular, it may be possible to reach agreements that reduce the impact of American non-tariff barriers on Canadian trade, and that create an improved bilateral regime to govern such barriers.**

Third, the progressive lowering of Canada's own tariffs has exposed the country's industries more than ever before to the harsh winds of international competition, including competition from the United States. **Yet although Canada has bargained away much of its tariff protection through successive GATT negotiations, secure access to a large market has not been obtained in return.** As the Senate Standing Committee on Foreign Affairs pointed out in its 1982 report on bilateral trade relations, "Canadian industry (is now) in the worst of both possible worlds -- with tariffs too low to be an effective protection, and, at the same time, still without free access to a huge assured market as enjoyed by its competitors, the European Community, Japan and the United States."²¹ Canadian industry is being forced to become more

competitive, but it lacks the benefits that more assured access to a major international market can provide.

As noted by the Macdonald Royal Commission, the vast majority of economists who have studied the subject in depth agree that Canada would benefit from bilateral trade liberalization, with eventual increases in per capita GNP in the range of 3 to 8 per cent predicted by many analysts.²² Canada would reap several advantages from freer bilateral trade. Canadian consumers would benefit from the lower prices associated with the removal of tariffs and other barriers imposed on imports from the United States. Canadian exporters would no longer have to pay tariffs on their sales to American customers. An important long run gain for Canada would be the restructuring and increased specialization of Canadian industry that would result from liberalized and more secure Canada-United States trade. This in turn would raise productivity levels in many Canadian industries, which are considerably lower than in comparable American industries. A bilateral trade agreement that provided Canada with more assured access to the U.S. market would also permit firms to invest in Canada to serve this large market without having to fear that existing or future American trade barriers might restrict their ability to sell to the United States.

Although the Business Council favours efforts to reach new trade arrangements with the United States, we are sensitive to the concerns that have been raised about such a prospect. It is clear, for example, that some Canadian industries would encounter difficulty in adjusting to increased import competition from the United States. To some extent this can be addressed by ensuring that tariffs are reduced very slowly, especially in sensitive sectors.²³

A phase-in period of up to a decade may be desirable. The adjustment burden can also be eased through the use of such devices as tariff quotas and other short-term transitional arrangements often found in international trade agreements, as well as government assistance for industrial restructuring. It may also be necessary for Canada to seek to exempt a very small number of sectors from bilateral trade liberalization, at least initially. And as Canada moves toward freer bilateral trade, it will be essential to address in a determined fashion interprovincial barriers to trade and other domestic policies and practices which raise business costs and impair efficiency. Canadian industry will be better equipped to compete internationally if the Canadian domestic market is made to function more effectively.

The subject of industrial adjustment to freer trade should be viewed in a long term perspective. Canadian industry already has been required to restructure and adapt in the face of the gradual lowering of Canada's trade barriers and increasing foreign competition. This process can be quite painful, but it cannot be avoided forever. It will eventually take place regardless of whether new bilateral trade arrangements are put in place.²⁴ The vast majority of Canada's goods-producing industries have become more export-oriented over the past two decades, and the number of manufacturing jobs likely to be threatened by trade liberalization has been reduced as this key sector of our economy has grown more internationalized. Moreover, studies carried out by the Economic Council of Canada and other experts have demonstrated that the process of adjustment occasioned by trade liberalization is more gradual, and far less disruptive to industry and to employment patterns, than many critics appear to believe.²⁵ **Previous trade**

liberalization has raised per capita incomes in Canada and resulted in net increases in employment. There is no reason to suppose that future trade liberalization will not have the same effects.

On balance, the Business Council is persuaded that a Canada-United States trade agreement that gradually liberalizes bilateral trade and provides for more assured reciprocal market access would be in Canada's economic interests. The preponderance of evidence available strongly indicates that small and medium-sized open economies are beneficiaries of trade liberalization. We recognize, however, that much of the criticism of possible new bilateral trade arrangements has focused on non-economic issues. For example, it is sometimes alleged that closer economic relations with the United States would lead eventually to political union or full-fledged economic integration. If this were the case, one would expect that other bilateral and multilateral commercial agreements involving countries of disparate size would have had such a result. There is virtually no contemporary evidence to support this view.²⁶ The type of agreement we have in mind would aim to achieve a liberalization of trade and more assured market access; it would not embrace the objective of economic integration, or drastically curtail Canada's policy autonomy relative to what it presently enjoys. **There is little evidence to suggest that existing bilateral trade liberalization agreements have extinguished the political independence or sovereignty of the countries that have signed them.**

It is clear, however, that care must be taken to protect sensitive sectors that are essential to the maintenance of Canada's political and cultural values. In this respect, the situation of the country's cultural industries

deserves special mention. Closer economic relations with the United States need not entail the undermining of Canada's cultural industries.²⁷ The Canadian government no doubt would reject the idea of unrestricted "free trade" in the cultural sector. Public support for cultural activities and industries is a longstanding tradition in this country, and the Business Council believes that this policy should be continued. Through a variety of policy instruments, a viable Canadian culture can continue to exist in an environment of liberalized bilateral trade. And where necessary, foreign investment and foreign competition in the cultural sector can be controlled to ensure that this important area of our national life is not sacrificed in the quest for a more competitive Canadian economy.

Tax Policy

Tax policy has an enormous influence on the overall climate for business and investment, and thus it is a key framework policy issue. Both the Canadian Income Tax Act and the Canadian tax system as a whole have been subject to mounting criticism in recent years. Not only is the tax system exceedingly difficult for Canadians to understand, but doubts about the fairness and efficiency of the system are also on the rise. The Business Council shares these concerns. **In our view, the basic purpose of the tax system should be to raise the revenues required by governments in a way that is consistent both with broad principles of fairness and with the need to ensure that Canada's economy is competitive.** In recent years, both the personal and corporate income tax bases in Canada have been narrowed through a

proliferation of special exemptions, preferences, credits and other exclusions that collectively are known as "tax expenditures."²⁸ This trend has made it more difficult for the federal government to raise revenues. Many criticisms have been levied against the rationale and effectiveness of current tax incentives and preferences. We believe that existing measures should be examined with a view to determining to what extent they are meeting their objectives, and indeed whether those objectives should continue to be treated as priorities of government policy. In this connection, the Business Council, through its recently constituted Task Force on Taxation, is examining closely the discussion papers on the corporate tax system released with the May 1985 budget, and we will be responding to these important documents in due course.

In considering the subject of tax reform generally, there are basically three major criteria according to which reform proposals should be evaluated. First, taxation policy can be examined from the perspective of economic efficiency. We believe that this perspective deserves more attention in discussions of future tax reform in view of the significant competitive pressures facing Canadian industry and the economy more generally. Tax policy can be said to be economically efficient to the extent that it does not cause resources to be used in ways at variance with what would occur under free market conditions. Current tax policy in Canada often tends to distort the allocation of resources, and thus serves ultimately to reduce economic growth and vitality. A second perspective from which tax policy can be examined is that of fairness and equity. According to this view, the taxes levied on citizens should be based in large measure on their ability to pay, and all taxpayers in a similar position should pay roughly comparable amounts of

tax. In the Canadian context, a tax system that is "fair" involves not only an acceptable distribution of tax burdens, but also a consideration of the impact of the overall tax system on growth and employment. In the long run, the tax system will only be truly fair if it provides the maximum possible opportunity for Canadians to obtain employment and to achieve personal betterment. Finally, tax reform can also be analyzed in terms of its administrative feasibility, which relates to such issues as the system of collection, tax avoidance, and mechanisms to ensure and enforce compliance.

All proposals for tax reform must strive to achieve some balance among these often conflicting criteria. This is a difficult task, and one that is likely to entail lengthy deliberations and study. For this reason, **the Business Council recommends that the government proceed slowly in the area of tax reform.** Sudden and massive change would be disruptive and should be avoided. However, given that taxation constitutes a crucial framework policy for government, and that the existing tax system is far from perfect, there is merit in proceeding carefully to reform current tax laws and practices. **In our view, the primary focus of such reform efforts should be on creating a less complicated tax system, and on moving gradually toward a broader taxation base coupled with reduced tax rates.** Consideration should also be given to replacing the present manufacturers' sales tax with a broader and less distortive federal sales tax.

In addition, politicians, the business community and other groups must recognize that there are costs involved in seeking to use the tax system to achieve many of the social and economic policy objectives that have been pursued through tax policy in recent years. The primary purpose of the tax

system must be to raise revenues for government in a way that minimizes costs and distortions to the economy. Finally, in considering the subject of tax policy in Canada, it will be essential to pay close attention to developments in this area in the United States, where the administration has made tax reform a cornerstone of its economic policy during President Regan's second term. **Canada will suffer if we develop a tax structure that is significantly more onerous and restrictive than that of the United States.** Thus, decisions that may be taken in the United States on such issues as the tax base, tax rates and indirect taxation policy must be borne in mind when formulating Canadian tax policy.

A New Competition Policy

It is difficult to think of a statutory regime that has as pervasive an impact upon the economy and upon business organization as competition law. Canada's competition policy is embodied in the provisions of the The Combines Investigation Act. In recent years, successive Ministers of Consumer and Corporate Affairs have proposed major changes in existing competition law. The Business Council, along with other key horizontal business associations, has participated in lengthy discussions with the federal government with a view to developing a new competition law that meets the needs of both business and consumers. **We believe that a new competition policy should be a priority for the federal government during the next year, and we welcome the efforts made by the current Minister of Consumer and Corporate Affairs to continue the valuable consultative process initiated by his predecessors.**

In considering how existing competition law should be changed, it will be essential to bear in mind the need to maintain and strengthen Canada's international economic competitiveness. **A primary thrust of the government's overall approach to economic strategy should be to encourage and improve the capacity of Canadian firms and industries to compete in global markets that are everywhere characterized by more intense competition.** Canada's own relatively small domestic economy is not large enough to allow several firms to operate efficiently in many industries. Given the restricted size of the Canadian market, it is important to allow firms to develop an adequate domestic base. In at least some sectors, Canadian industry will be required to re-organize and restructure into units that are more comparable in size to those found in other major trading nations. This necessary process must not be unduly impeded by competition laws that establish too low a threshold for government intervention in respect of mergers, or that fail to provide realistic exemptions in respect of exports. Nor should the fact that Canada has one of the highest import propensities of any major industrial country be overlooked when drafting new combines legislation designed to protect the interests of consumers.

Government Regulation and Intervention

Thanks to the steady economic growth of the post-war decades, rising tax revenues allowed governments to greatly expand their activities. Through a host of regulatory initiatives, the role of government in the economy and in income distribution increased markedly. This regulation often allowed a hidden transfer of resources to take place between consumer and producer

groups (and among each of these groups). The increased reliance on government by both business and individuals decreased the relative role of individuals' own productive efforts, and heightened the importance of government. This process resulted in the growth of government with a bias favouring economic intervention and redistribution. Commenting on this phenomenon, a leading Canadian economist has stated:

"In recent decades Canada has put a high priority on policies that provided income security and an important degree of income redistribution. This emphasis was in line with policies being followed in Europe and to a lesser degree in the United States. When the private sector responds to the taxes, subsidies and broad incentives that such a policy emphasis implies, they become less effective competitors than firms in societies that put higher priority on growth, savings, investment in physical and human capital and efficiency"²⁹

The bias favouring ever increasing intervention has created many inefficiencies and rigidities in the economy, the cumulative effect of which has been to reduce economic growth below the rate which would otherwise have prevailed. The magnitude of the economic loss incurred thereby is uncertain, though it is no doubt large. Some estimates suggest that the current level of GNP would be higher by several percentage points had economic regulation not been so pervasive.³⁰ In short, government regulation is far from a costless policy instrument.

The Canadian economy today is characterized by a high degree of both government regulation and direct state involvement in economic affairs.³¹ In some cases government regulation and intervention promote important social

and cultural objectives. **However, we are concerned that the growth of economic regulation and intervention has eroded the competitive vitality of the nation's economy. Accordingly, we recommend a gradual reduction in the degree of regulation in the economy.** We welcome the recent announcement by the Minister of Transport that the regulatory environment governing transportation will be reformed.³² And we are encouraged that the government has recognized that the goals of economic growth, entrepreneurship, and job creation can all be furthered by reducing state regulation and involvement in economic affairs.³³

We also believe that the federal government should move to divest itself of some of the hundreds of crown corporations that it now controls. In some cases, it may be advisable to sell partial interest in certain corporations to the private sector; in others, liquidation or the sale of all the assets of public corporations may be in order; and in others, no change in current ownership conditions may be warranted. The government should accept the principle that, in the absence of truly compelling reasons for public ownership, privatization of crown corporations should take place. Privatization is no panacea for the problems besetting many government-owned enterprises. Nonetheless, we are persuaded that privatization can relieve the government of some financial obligations associated with its crown corporations, and increase the likelihood that such enterprises can become more commercially successful and viable over the long run. **In this regard, we commend the government for its decision to sell its holdings in the Canadian Development Corporation, Teleglobe Canada and Canadian Arsenals Limited, and look forward to further initiatives along these lines, including at least the partial privatization of Petro-Canada.**

CONCLUSION

The Mulroney government faces many economic challenges as it enters the second year of its mandate. Adoption of a more prudent fiscal policy that lowers the deficit and slows the precipitous rise in the national debt is essential if lasting economic and employment growth are to be achieved over the balance of the decade. At the same time, the government will be required to make important decisions in such areas as Canada-United States trade, tax reform, and competition policy within the coming year. The challenges now confronting Canada demand a willingness to accept hard truths and to take action that will not be universally welcomed. The federal government must play a leadership role in this regard. Governing Canada has never been an easy task, and in the remaining years of the twentieth century it may well become more difficult still. The consultative process to which the government has been committed during its first year of office has proven its worth. The National Economic Conference was useful in providing key groups within Canadian society with an opportunity to talk with each other as well as with government. Consultation and dialogue unquestionably can help to narrow differences and to foster an improved understanding of the country's problems and of the possible solutions available to address them. However, the government must now decide upon a course of action and take a leadership position on several of the major issues facing the country. During the past year the federal government has demonstrated that it recognizes the responsibilities of governing. We urge it to adhere to and build upon the strategy of economic management outlined in the November 1984 Economic Statement and the May 1985 budget.

FOOTNOTES

1. See Conference Board of Canada, Quarterly Canadian Forecast, July 1985; Economic Council of Canada, Steering the Course: Twenty-First Annual Review (Ottawa: Supply and Services, 1984), p. 3; Department of Finance, The Fiscal Plan, May 1985, p. 23.
2. Robert B. Bryce, "Can We Have 'Made in Canada' Interest Rates?", Choices (Institute for Research on Public Policy), February 1982; Bank of Canada, Annual Report, 1984 (Ottawa: Bank of Canada, 1984), pp. 6-8.
3. Royal Commission on the Economic Union and Development Prospects for Canada, Report: Volume Two (Ottawa: Minister of Supply and Services Canada, 1985), pp. 733-69.
4. The pre-recession employment peak was reached in June, 1981, at 11.04 million (seasonally adjusted). Employment fell to 10.45 million in October, 1982, but had risen to 11.4 million by June, 1985.
5. See Department of Finance, Canada's Economic Prospects, 1985-1990: The Challenge of Economic Revival, May 1985, Table 5, p. 14, and Chart 3, p. 23; and Economic Council of Canada, Steering the Course, p. 105.
6. Edward A. Carmichael, Policy Review and Outlook, 1985 (Toronto: C.D. Howe Institute, February 1985), chapter 2.

7. Department of Finance, The Fiscal Plan, May 1985, pp. 46-7; Economic Council of Canada, Steering the Course, p. 49.
8. On the potential problems associated with large deficits and the rapid rise in the national debt, see *ibid.*, pp. 35-50; Lloyd Atkinson and Richard Lesage, "Deficits Do Matter," Policy Options (July 1983); Thomas Maxwell, "Government Deficits," Canadian Business Review (Autumn 1984); John S. McCallum, "An Unmanageable Economy," Policy Options (November 1984); and the recent Ontario Economic Council Position Paper, Deficits: How Big and How Bad? (Ontario Economic Council, 1985).
9. Department of Finance, The Fiscal Plan, May 1985, p. 1.
10. Royal Commission on the Economic Union and Development Prospects for Canada, Report: Volume Two (Ottawa: Minister of Supply and Services Canada, 1985), p. 389.
11. Business Council on National Issues, A Perspective on the Mulroney Government's Agenda for Economic Renewal, April 1985, pp. 13-15.
12. Business Council on National Issues, The Federal Deficit: Some Options for Expenditure Reduction, August 1984.
13. Edward A. Carmichael, Tackling the Federal Deficit (Toronto: C.D. Howe Institute, 1984).

14. Royal Commission on the Economic Union and Development Prospects for Canada, Report: Volume Two (Ottawa: Minister of Supply and Services Canada, 1985), p. 572, and pp. 571-75 generally.
15. Ontario Economic Council, Deficits: How Big and How Bad? pp. 47.
16. Government of Canada, A Review of Canadian Trade Policy (Ottawa: Supply and Services, 1983), Tables 3 and 4; Minister for International Trade, How to Secure and Enhance Canadian Access to Export Markets (Department of External Affairs, January 1985), p. 4.
17. Frank Stone, Canada, the GATT and the International Trade System (Montreal: Institute for Research on Public Policy, 1984).
18. Minister for International Trade, How to Secure and Enhance Canadian Access, pp. 17-20; Secretary of State for External Affairs, Competitiveness and Security: Directions for Canada's International Relations (Department of External Affairs, 1985), pp. 18-19, 31.
19. Harold Crookell, "Specialization and International Competitiveness," Business Quarterly, vol. 49 (Fall 1984), p. 27.
20. Competitiveness and Security, pp. 16-17.
21. Senate Standing Committee on Foreign Affairs, Report on Canada-United States Relations: Volume III, Canada's Trade Relations with the United States, March 1982, p. 18.

22. Royal Commission on the Economic Union and Development Prospects for Canada, Report: Volume One (Ottawa: Minister of Supply and Services Canada, 1985), pp. 297-384; R.J. Wonnacott, Canada's Trade Options (Ottawa: Economic Council of Canada, 1975), p. 24; Richard G. Harris with David Cox, Trade, Industrial Policy and Canadian Manufacturing (Toronto: Ontario Economic Council, 1983), pp. 114-115; and Richard G. Lipsey and Murray G. Smith, Taking the Initiative: Canada's Trade Options (Toronto: C.D. Howe Institute, 1985), pp. 38-40.
23. Under the GATT Tokyo Round trade agreements, for example, tariff reductions have been gradually phased in over a period of 8 years.
24. Lipsey and Smith, Taking the Initiative, pp. 106-114.
25. Ibid., pp. 110-111; Economic Council of Canada, The Bottom Line: Technology, Trade and Income Growth (Ottawa: Economic Council of Canada, 1983), pp. 121-5.
26. Lipsey and Smith, Taking the Initiative, p. 91.
27. The legislation establishing Investment Canada specifically allows the government to restrict foreign investment in culturally sensitive sectors. The Business Council supported this provision.
28. See Richard M. Bird, Tax Incentives for Investment: The State of the Art (Toronto: Canadian Tax Foundation, 1980); Roger S. Smith, Tax Expenditures: An Examination of Tax Incentives and Tax Preferences in

the Canadian Federal Income Tax System (Toronto: Canadian Tax Foundation, 1979); and Donald G. McFetridge and Jacek P. Warda, Canadian R & D Incentives: Their Adequacy and Impact (Toronto: Canadian Tax Foundation, 1983).

29. Donald J. Daly, Canada's International Competitive Position, background paper prepared for the National Economic Conference, March 22, 1985, p. 8.
30. The GNP loss resulting from greater regulation of economic activity in the United States has been estimated at 4-5 per cent. See J.V. Koch, Industrial Organization and Prices (New York: Prentice-Hall, 1980), p. 464. Given that the Canadian economy is more regulated than that of the United States, the GNP loss could easily be larger. See C. Green, Canadian Industrial Organization and Policy (Toronto: McGraw-Hill Ryerson, 1980), p. 132.
31. Economic Council of Canada, Responsible Regulation (Ottawa: Economic Council of Canada, 1979), chapters 1 and 2.
32. Minister of Transport, Freedom to Move: A Framework for Transportation Reform, Ottawa, 1985.
33. See, for example, Department of Finance, A New Direction for Canada: An Agenda for Economic Renewal, November 1984, pp. 56-62.