

Closing Session

The Response of Government to the Economic Challenges Facing Canadians

K. Lynch ... that is facing Canadians. I'm also the, the Deputy Minister of the Department of Industry, Industry Canada. And as the latter, Industry Canada is certainly very pleased it had the opportunity to co-host this conference with the Centre for the Study of Living Standards and I particularly kind of appreciate the cooperation we've had, Ian Stewart and particularly Andrew Sharp who've kind of, have worked extremely hard with everyone else to make this joint venture conference happen. The theme ladies and gentlemen of the conference is certainly challenging, as it should be, "Canada in the 21st century, a time for vision"; that's not a modest theme. And one challenge, our challenge as economists and researchers and policy makers in many ways is to live up to the challenge of the theme. Not just at this conference today. As Fred was saying, you know, the discussion yesterday and today is an incredibly good start, but it is just a start. And these can't just be once off, we've got to carry this understanding forward and turn it into potential areas of action, not just for the public sector, but also for the private sector. And I believe strongly - and that's one of the reasons we co-hosted this conference - that good public policy requires research excellence under PANAN. Equally, and I think the last session showed that, a dynamic private sector requires research excellence in understanding markets, technology, management and global behaviour. Now the purpose of this session is "the response of government to the economic challenges facing Canadians". Again, that's not a modest title. And a pessimist might say that it's highly unlikely even if you only had one economist here in the room you'd have trouble getting agreement on what the list of challenges is, let alone what the data allows us to say about them and certainly not what the responses should be. But I'm not a pessimist, I'm an optimist and I think that economic and policy understanding has moved a long way in recent years. And I think just the, the crux of this conference has shown, I know we're moving I think relatively quickly towards a much greater consensus on what the key economic challenges facing Canada are. What the interrelationships among them are, and I think that certainly will come out on this panel, and what can be done about them, which we'll be starting today. But I think that's going to have to unfold in, in future ones. In this vein let me modestly suggest 3 possible economic challenges facing Canada and other countries to just contribute to part of the discussion. And they pick up on topics that came up through the course of yesterday and today and I hope it comes up in this session. First is the issue of improving the standards of living and quality of life through higher productivity. As you know and the research certainly pointed out yesterday and today, I mean a key issue

for us is how do we improve the living standards of Canadians. They want higher standards of living, they want higher quality of life, how do we do it and how important is productivity to achieving that aim? And second, and again came up in the previous session and through the course of the last 2 days, is how do we get greater business dynamism in Canada? How do we have Canada and Canadian business and Canadians at the leading edge of high value added opportunities. As Dan Tefler said, how do we actually focus on product innovation as a key aspect of our productivity enhancement? And third, how do we manage increasing, and it really is increasing, international integration and particularly Canada, U.S. to Canada's maximum advantage. It's a reality and it's happening, but how do we make sure that we have the maximum advantage for Canada from it? But look, those are just 3 among many possible economic challenges and the objective of this session, both from the 3 panelists and from all of you, is to sort out what the key pressure points are, what the key opportunities are and what can be done about them. What are our priorities and where do we have to move next. And we have 3 very distinguished panelists who can do just that. The 3 people who can answer that challenge. Each panelist is going to speak for about 15 minutes and that'll follow, leave us probably about 20 to 30 minutes for discussion from the floor and else. Now I've been asked by the organizers to do something that I've never attempted before and that's to actually end the session on time. And I'm going to try and do that and set a first. So we will end at 5:00. Alice Nakamora will then come up to close the conference and allow everyone to meet their various appointments. If I can then turn to our, the 3 panelists that we, we have today. And they will speak in the following order. First panelist today will be Fred Gorbet. Fred is a principle in Strategy Solutions, a public policy consulting firm he founded in January '97 after a very long and extraordinarily distinguished career in both the public and the private sector. He concluded in, recently a 20 month assignment as the Executive Director in the Task Force on the Future of the Canadian Financial Service Sector, the Ian McKay Task Force. Prior to that he worked in various positions in government in the OECD. His last position there was as Deputy Minister of Finance from 1988 to 1992. He's also held a number of positions in the private sector and I must say as a personal note, I think Fred is one of our most distinguished public servants and I certainly was honoured to work for him in the Department of Finance. Fred.

F. Gorbet Kevin thank you very much. When somebody like Kevin, who I have worked closely with and have tremendous respect for, says something like that about me you can understand why I am delighted to be at this conference. I thank Andrew Sharpe for the invitation and I commend Industry Canada on the excellent job it is doing in supporting this type of research in Canada and in finding opportunities to disseminate it widely.

I'm sorry that, that Ron Daniels isn't here to deliver his paper. I commend it to you. It is a good paper, as are all the papers in this series. I'm really not going to comment directly on the paper, except in a couple of particular instances. What I want to do is to talk about how I think government can respond in some areas to the kinds of challenges we've talked about yesterday and today. I'm going to go first because I'm going to be at a pretty high level. I'm sure that my fellow two panelists will begin to drill down, but if they don't drill down far enough we'll try and get through in time to leave some time for commentary and questions.

The list of challenges is impressive. We talked about them for the past two days. In addition to the ones Kevin mentioned and the ones that are focused on in the papers, there are others. It is hard to go through a day without reading in the newspaper or listening on newscasts to questions about the stagnation of real disposable incomes in Canada over the past decade; the increasing polarization of income distribution; child poverty and questions about our social programs and Medicare in particular. Our health system, which only a few short years ago was given the status of a defining element in the Canadian identity (a status neither it nor Canada deserved) is now under enough pressure that 50% of people in a recent poll are prepared to consider the introduction of a private tier in the health care system.

The list of challenges goes on. My challenge is to get focused and talk about the government response. I'm going to begin by making three assertions that really remind us about some realities of governance. Not just now, but always. I want to talk about a couple of constraints and then I want to talk about four areas where I think government can and should act in the next while to address some of these issues.

My first assertion is that for many of these issues it's important to recognize that there are no silver bullets. Government can make a difference, government has a role to play, but very often that role is the net result of doing a lot of little things right that don't always get the headlines. Searching for one big answer that may make good headlines might be politically attractive, but more often than not it may do more harm than good. And the flip side of that coin, of doing a lot of little things right is trying to avoid doing the wrong things. There is a lot government can do to make things worse and we've heard in the course of the discussion earlier today examples of particular policies that government has introduced -- most specifically in the industrial policy area that have ended up doing just that.

My second assertion is we should remember that government is a messy business. It's not neat. It's messy for at least three reasons. First, whether one talks about special interests or whether one uses Ron Daniel's

terminology of rent seeking behaviour, the reality is that there will always be more people seeking to share the pie than there is pie to be shared. And there is no objective utility function that helps government make choices in a very clear or a very precise way. The flip side of that coin is that a lot of those interests are vested and again, as we heard this morning when Don McFetridge talked the difficulty of bringing about change in education, it is often very difficult to try to effect change without running into constitutional, institutional or vested interest constraints. The tyranny of the status quo is a problem everywhere, but it appears to be more entrenched in public policy than in other areas.

The second reason why government is messy is that in many instances we have what I call a knowledge deficit, or at least an understanding deficit in the broad public about some of important public policy issues. Two examples:

- we often seem to be debating public policy in an environment where we have an abundance of information but a lack of understanding. To a large extent the recent debates on productivity and the brain drain in terms of policy implications are examples that indicate that where there's a lot of heat there's not always light.
- a second example is where government does not provide basic information that can help to illuminate debate on public policy issues. An example I would use here is the federal budget, which continues to forecast balanced budgets when everyone in the country knows that we're looking at major surpluses year after year after year. This has even led some commentators to opine that the old adage "where there's smoke there's fire" should be restated -- for government work -- as "where there's smoke there's mirrors".

I will come back to this knowledge deficit or understanding deficit a little later. Suffice it to say for now that the implication is that very often we have public policy debates that although well motivated may be ill-informed.

The third reason why government is a messy business is that politics is a blood sport. I said before that governments don't have a clearly defined, objective utility function but in fact they do. All governments that I have served would acknowledge that their prime objective, based on a profound, sincere and deeply held belief about what is best for the country, is to be reelected next time out. And most governments would claim, and indeed have claimed, that good policy is good politics. In fact, I believe that it is, but that is sometimes true only in the longer term and in the short run good policy is not necessarily good politics. Where there is a conflict

politics generally trumps policy and that also makes government a messy business.

My third assertion is that government today is better placed than it has been in decades to address in a constructive way the economic challenges that are confronting us. And here I take some issue with Ron Daniel's paper. I think the paper is a little too backward-looking, kind of a rearview mirror perspective, in terms of being premised on the notion that resources are still quite scarce and that we really can't make a lot of choices that I believe we can make. I think that with the discipline we've had in monetary policy, and with a return to fiscal health, we do have choices that we have not had for a long time now. And how we make them and what we decide will matter very much.

Now, against this background of internal complexity and opportunity there are constraints on what government can do. I want to recognize two important constraints that we talked about through the course of the day. They both derive from globalization and the integration of economies. Globalization, particularly in the last 10 years, has taken on dramatic dimensions. It is still not quite a decade since the Berlin Wall came down. Technology and globalization are not only shrinking the world, but they are changing it in very fundamental ways. About 10 or 12 years ago, only about a billion people in the world lived in a market economy and now we've got more than 5 billion people living in a market economy. Some of them are struggling and all of us are learning some important lessons about the necessary conditions -- legal, political and cultural -- for market-based economies to function well. But at this moment in history it does not appear to me that we are going to retreat from that continuing integration through trade, through investment, through the globalization of financial markets that we've seen pick up steam over the past decade.

There are two kinds of constraints that this imposes: one is the constraint on sovereignty that we voluntarily engage in when we enter into international agreements that limit our autonomy. We've talked about that through the course of the day. Canada has operated for a long time now on the premise that as an outward looking country, relatively small, we do better in a rules-based system than we do when we can be sideswiped by arbitrary political action. That has been a conscious tradeoff, an approach that I believe has been appropriate, and an approach that I believe government must continue. I think Michael Hart's comments this morning are very relevant. I agree that the nature of the game will change qualitatively, and that we may well find future international agreements seeing to intrude into areas where we have not traditionally been willing to consider ceding sovereignty. But I don't think we have an option to exit the game. This does not mean that we should negotiate blindly and naively or without regard to Canadian interests. But it does mean that we

have got to be at the tables that matter to us, and we have got to live with the results of the agreements that we do negotiate. That is one constraint. The other constraint that arises from globalization is related to what Ron Giammarino talked about this morning. The fact that we are facing mobile pools of capital, and with globalization mobile resources are more footloose, means that we have competition in public policy that can be very important in locational decisions. My comment on this is that the debate about the international competitiveness of the policy framework seems to me, at least, to focus too much on tax levels and structures. This may be because, as Hufbauer said this morning, they are found to be important in a lot of the empirical work. But it may also be simply because we can measure them better. And what we tend to be able to measure better often gets more attention. It does seem to me that we should not lose sight of the principle that what is important in a logical location decision is the total net return to mobile resources and that is influenced by more than relative tax schedules. The point was made very well by Morck in his remarks when he cited Buchanan, and by David Slater in his intervention from the floor just before lunch, so I won't belabour it.

Perhaps in the general context of globalization I could make a comment on the brain drain. We all recognize that the plural of anecdote is not data, but anecdotes can nevertheless provide important information. My anecdotal evidence, based on two of my three sons who are now living and working in the United States, suggests to me that U.S. opportunities and salary levels are much more important magnets than tax structure. This does not mean that our tax levels and structure are appropriate or should not be lowered. Indeed I believe that substantial tax cuts are warranted. But it does suggest to me that the focus of some on broad income tax reductions as a solution to all of our productivity and brain drain problems is squarely in the category of searching for that magic silver bullet that really doesn't exist.

So, in this messy complex constrained framework what should government do? Let me discuss four areas.

First, government can, and it must, focus on the fundamentals of good macroeconomic policy. Repairing the dysfunctional conditions of the 1970's and the 1980's has exacted a heavy price from Canadians and we must not allow ourselves to return to either high inflation or chronic government deficits. Monetary policy must continue to be focused on domestic price stability and the Bank of Canada must continue to receive strong support from the Prime Minister and from the Minister of Finance. Fiscal policy needs to be managed in a way that ensures that we do not once again slip into structural deficits. But we are a long way from that today. And one issue that ought to be considered now that options exist is

whether the mix of monetary and fiscal policy is optimal or even most appropriate for our circumstances. I don't know if Tom Courchene is still here. I delight in listening to Tom speak about North American monetary union. The first time I heard him give his talk my reaction was -- interesting, but not in my lifetime. I still don't agree with him, but every time I hear him give it again I think maybe I'm going to live a little longer than I thought I was. But one of the points Tom made in passing, which I would echo, is that while we were constrained on the fiscal side we put a tremendous amount of reliance on monetary policy to try to sustain aggregate demand because we did not have fiscal options. And I think that it is the case that this has put added pressure on the currency and introduced added volatility in our currency markets. And I think there is also a case that the structural implications of a persistently undervalued or unnecessarily volatile currency can be serious. So it does seem to me that, given where we are now, it would be useful to have more discussion and debate about whether a looser fiscal policy and tighter monetary policy would have important structural implications over the longer term.

The second area I want to comment on is the policy agenda itself. It seems to me that government can and should play a much more assertive role in defining the economic policy agenda. And I interpret the economic policy agenda quite broadly to include issues of human capital, including education, health and other social programs, as well as sustainability. One of the problems we continue to have is that we live and work too much in silos. I believe that government is well positioned, has the opportunity and should take it as a responsibility to try to break those silos down and to encourage multi-disciplinary approaches to issue of sustainable increases in our standard of living and quality of life. Government should be at the leading edge here.

Kevin Lynch talked about the big issues of productivity, dynamism and innovation, and our relations with the United States. I have my biases about what we should do to meet these challenges, as I suppose each of you does. I think personally that we could use a flatter tax structure. We could use greater returns to risk taking. We could use more resources more innovatively deployed in education and health. We could use better physical infrastructure than we have now. But quite frankly, my biases, while possibly interesting to you and certainly interesting to me, are not as relevant as the pressing need to create and sustain an informed debate on the issues and the choices.

I commented earlier to Kevin that the work that is being done through Industry Canada at this conference is tremendously important. But it has to be taken out of this environment and into an environment where it can be exposed to broader public debate and comment in a way that can help shape a policy agenda. And government should lead that process, or cause

it to happen. It may well be that the time has come to think about a rerun of the Macdonald Royal Commission of the mid-1980s, or some kind of Task Force that could examine where we have come from in the past decade, take our experience and research, and build a public policy agenda that can be the focus of some debate. And if I were going to start that process, I would put as its first term of reference to try to get a better understanding of how we have performed across a number of critical areas relative to the U.S. economy over the past decade. I think that would be an interesting and helpful comparison.

I can't leave the issue of leadership in agenda building without talking again about the budget. And I don't want to leave this notion of "smoke and mirrors" just hanging out there. The budget is an important vehicle for defining priorities and for making choices and we have important choices to make now. I have two observations in this regard.

- The first relates back to the comments I made earlier about the knowledge deficit, or the understanding deficit. I think the government needs to do a better job of trying to get its own act together on some of these critical issues. Groups like the Centre for the Study of Canadian Living Standards, which focuses on productivity, and the Institute for Research on Public Policy, which has just published an excellent issue of Policy Options dealing with the brain drain, are making an important, solid contribution. But it's hard to achieve consensus in the country on these difficult issues when there's not only no consensus in the Cabinet, but when senior Ministers are publicly disagreeing with each other about what the facts mean. When I ask myself why this happens my answer is that it seems to be because the acknowledgement of a problem in the public mind has automatically become identified with a solution. In this case tax cuts. And if you don't happen to like the solution then you try to deny the existence of the problem. This is not a very effective way to have a serious public policy debate. We need to distinguish between diagnosis and prescription and we need seriously to work to ensure that the tax cut issue is not allowed to be positioned as a moral issue or an ideological issue as opposed to an economic issue. I take some considerable comfort from the fact that the NDP and the CLC have both put tax cuts back on their agenda. This may allow a no less heated but more informed debate about what kind of tax cuts we should pursue, and why, which I believe is the real issue.
- My second comment on the budget process is that the government has a responsibility to assist this debate by providing a hard look and an honest look at what resources it believes we have available to allocate over a reasonable timeframe. Now, I think that when Mr. Martin was dealing with the deficits he had to manage he was absolutely right to

maintain short-term focus, to under-promise and over-deliver and to build credibility and momentum in the way he did. But dealing with surpluses is not the same. What we have now is a medium-term budget outlook that is not only not credible, but that actually biases the decision making process away from tax cuts and towards expenditure decisions. This happens because the failure to recognize an ex-ante surplus over a period of years does not allow sustained tax cuts to be considered as fiscally responsible. And when the surplus magically shows up at the end of the year, the easy option to dispose of it is to offload it as expenditures. Millennium scholarship funds, innovation foundations and one-off increases in the CHST may all be good things, and indeed I believe they are good things, but their substance and their form are driven by a process that is less than ideal. I am encouraged by recent press reports that suggest that this time around the Minister of Finance is sharing forecasts with private sector economists as he prepares his pre-budget presentation. I think this is good, and I am hopeful it will provide a set of public estimates prior to the upcoming budget that will assist a more rational discussion about the choices that we have.

So far I've talked about focusing on macroeconomic fundamentals, and playing a more assertive leadership role in shaping the public policy agenda. A third area where I think government can do more than it's doing now is to be a little clearer on industrial policy issues, and one aspect of industrial policy that I particularly want to mention. I agree very much with the comments made in the previous session about industrial policy generally. In fact, when I was in the Department of Finance we had a saying that trying to successfully execute industrial policy was similar to trying to win the Stanley Cup by putting the Montreal Expos on the ice. Nevertheless, the way the world works is such that government does have considerable flexibility and it has discretion in some very important industrial policy decisions. I'm not really talking now about the subsidization aspect of it. I agree very much with Ron Daniels and his paper that we've got to try to get neutrality in the policy framework. But even with a neutral policy framework there will continue to be big issues like bank mergers and airline mergers where the nature of the policy framework is going to require government action of one sort or another. I believe that this kind of flexibility in the framework, coupled with the exercise of government discretion, will continue and it may indeed become relatively more important as globalization intensifies. But I also believe that it carries with it a responsibility to be transparent and open with regard to the public policy imperatives that condition proposed transactions. It will be important to make the rules of the road as clear as possible so that participants in the marketplace have a good idea of the probable decision process they will have to go through and the kinds of outcomes they might reasonably expect.

Let me conclude with my fourth point.

My final observation is about people. The overall theme of my remarks is that the challenges are multifaceted, they're complex and they're going to continue to increase in complexity. The basic task of good government is to anticipate and understand these challenges, to demonstrate their importance to the public, to develop measures appropriate in the circumstances and to lead a public dialogue that can be inclusive and that can build consensus for action. To do that consistently across a range of issues, and to do it well, requires exceptional people. People who are not just competent, but who excel at what they do. People who understand the complex issues and can distill them to their essence, communicate them well and lead in promoting understanding. People who are innovative in their thinking and above all, people who are committed to public service. These observations apply equally to our elected representatives and to the public servants that support them. The most critical challenge government will face will be attracting and retaining the people that it needs to govern well.

My sense – I've been away for a while – my sense is that the malaise that has afflicted the public service for so long has indeed bottomed out. I think opportunities are increasing, conditions are improving. I think morale is on the way back up. But I also believe there is a long way to go to get back to the level that the country deserves. This is going to be a continuing challenge and a demanding one. But putting in place the culture and the reward system that will encourage a strong, professional, dedicated public service is undoubtedly one of the most important ways in which government can address the economic challenges of the next millennium. Thank you.

APPLAUSE