The Way Ahead: A Framework for Discussion

Working Paper: Government of Canada

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PREFACE

In October of 1975 the government introduced a temporary program of direct controls of income and prices. Since that time, the successful implementation of the Anti-Inflation Program has been the most urgent priority of the government.

It is not enough to dampen current inflationary expectations. The root causes of inflation—the conditions which led the government to impose controls in the first place—must also be assessed and solutions found. Towards that end, the government has been involved in a fundamental examination of the major structural components of our economy and our society.

This review has not been restricted to Ministers and senior officials alone. The consultation effort has been widespread. Within the Liberal Party, informal policy groups have been active. Caucus has held special meetings to assess post-control problems. Parliament has debated economic issues on many occasions and the government has listened with care to the views presented by members from all parties. Over the past several months, Ministers have met often with representatives of labour organizations, business associations, farmers' groups, fishermen, representatives of consumer and other public interest groups.

These discussions have been useful. But in order to better focus future consultations and to aid national understanding, many groups and individuals have asked for a general paper outlining the economic and social directions the government intends to take after controls end. This Working Paper outlines these principles and strategies and provides a context for further consultation. It sets new directions for the application of liberal philosophy in the light of the economic and social conditions of our time. Some measures, consistent with these new directions, will be announced in the Speech from the Throne. Other measures, as the paper makes clear, require further consultation with all segments of Canadian society. The government will actively pursue such consultation before proposing further measures to Parliament.

Canada's economic prospects are excellent. The talent of our people and the richness of our resources assure us of a bright future. How best to utilize these talents and resources in a manner that will promote national unity, assure balanced growth without inflation, and enhance individual freedom and opportunity, is one of the pressing issues of our time. The government hopes that this Working Paper will assist Canadians in understanding both the economic and social challenges which all of us must face and the principles and strategies which this Liberal Government advocates to meet them.

THE WAY AHEAD: A FRAMEWORK FOR DISCUSSION

I. INTRODUCTION

In October of 1975, the federal government introduced a temporary program of direct controls on incomes and prices. It did so only after a sustained effort to arrive at a voluntary consensus had broken down: It was becoming apparent that rapidly rising expectations with respect to future levels of inflation posed grave threats to the stability of the Canadian economic and social system. A period of restraint on the part of labour and business, together with government restraint in spending, was and is essential in order to reduce the rate of inflation to the point where it would no longer threaten the continued well-being of Canadians.

The program is working. The rate of inflation is coming down. But inflation is still Canada's greatest problem and the uncertainty it has created about the future, and about the future role of government in the period beyond controls, persists.

Controls will lapse in 1978. The government will remove them sooner if conditions allow. Shortly after the Anti-Inflation Program was introduced the government began a search for the conditions and policy directions that would be necessary for the removal of the controls program and for the post-control period. Policies were sought that would assure necessary economic growth, consistent with the full use of our human resources, a continued increase in the quality of living conditions, and freedom from inflation.

The principles and strategies that have emerged from this process amount to a statement about the role that the federal government will play in Canada's future. These strategies, and the principles that have shaped them, are presented in this paper. The central principles are a continued pursuit of liberal ideals, consistent with fiscal responsibility, and continued and reinforced reliance on the market economy. Strategies required to give effect to those principles entail a search for policies that will improve the workings of the market system and stand against pressures for rapid increases in government expenditure and the size of bureaucracies.

This government has no intention of lessening its commitment to its fundamental social goals. It reaffirms its commitment to a society in which all Canadians their potential to the fullest degree possible, a society in which justice, compassion, tolerance and understanding lead to a strong and united Canada, a society based upon individual initiative and marked by personal freedom. However, the government believes that the preservation and enhancement of individual freedoms and opportunities depend critically on our ability, not only as a government but as a society, to control inflation.

New means must be sought to achieve our goals and new policies will be required. Important aspects of these policies must be not only their capacity to serve individual well-being but their capacity to convey to all Canadians a sense of living responsibly in a responsible society. An important dimension of the task to be accomplished is to achieve a shared appreciation of how the economy works and how governments and individuals can best work together to serve individual and collective economic and social goals.

Canadians will recall that one advantage of the controls program is that it provides a "breathing space" to reflect on the economic directions that would be appropriate after controls are removed. This statement presents the government's assessment of where we are and the directions in which we must move. It outlines strategies designed to ensure the efficient, effective and equitable performance of Canada's social and economic system. The first policy measures in the implementation of these strategies will be presented in the Speech from the Throne. These specific actions flow from principles that the government has adopted.

These principles, and the further policies that they suggest must be pursued, could ultimately reshape the nature of government's role in our society. Most critical in this process is the need for close and continuing consultation with all segments of the Canadian public. A common understanding of our future prospects and the challenges that confront us is essential if we are to act, as governments and individuals, in ways that serve our longer-term interests and objectives. The policy directions that are set out in this paper can be viewed as an agenda for further consultation. The government seeks the active participation and advice of all Canadians in the modification or further elaboration of these policies.

II. THE INFLATIONARY PROCESS

A search for future directions must begin with an understanding of current economic conditions and, in particular, the inflationary process. Simplistic explanations of inflation are bound to be incomplete and misleading. Inflation is a complex economic, social and political phenomenon, both in its origins and in its effects. One of the characteristics of a period of continuing, rapid inflation is that expectations that prices will continue to escalate become deeply entrenched. Groups with market power demand higher wages and prices in order to offset not only past inflation but anticipated future price increases. Those individuals and groups who cannot 'keep up' in this process—those with fixed incomes, those who cannot work or cannot find work, and many who simply lack market power—suffer a loss of real purchasing power. This leads to increased demands on governments to redress the inequities bred by inflation. Increased government spending can lead to higher prices if the government simply prints the money or if additional taxes levied to finance these expenditures are passed on to others through higher wages and prices. Excessively high wage settlements and pricing decisions impose higher levels of cost, leading directly to higher prices. Expectations escalate and inflation continues to feed upon itself.

The debilitating effects of inflation extend beyond economic considerations to threaten the very nature of our institutions and traditions. The problems that unrestricted inflation creates were spelled out in the Budget Speech of June 23, 1975:

> ...inflation ultimately inflicts grievous damage to the fabric of society. It lowers the living standards of those on fixed incomes, including pensioners. It leaves people without reliable, understandable guideposts by which to arrange their economic affairs. It injects grave uncertainty into decisions on family budgets, housing, savings and provision for old age. It provokes deep frustration, social tension and mistrust of private and public institutions. Collective bargaining is embittered. Industrial relations are damaged. We in Canada are already beginning to live some of these experiences.

There is a real sense in which the stability and endurance of our economic system and the social and cultural traditions on which it is based will be measured by our ability to respond to the challenge of inflation.

Inflation is not just a recent phenomenon. Escalating prices, and concern about their impacts on the economy and society have been with us for at least the past thirty years. For a large part of this period inflation was fairly moderate, though slowly increasing. It was widely, if reluctantly, accepted as a necessary and fairly tolerable cost of maintaining adequate levels of employment. Only in the late 1960's and early 1970's when inflation began to accelerate rapidly in Canada and in other countries, were its dangers clearly perceived.

There have been many reasons advanced as to why industrialized countries appear to be increasingly vulnerable to inflation. At one extreme, inflation is seen as a purely monetary phenomenon that can be eliminated by controlling the supply of money. Others argue that governments' monetary and fiscal policies must be viewed together, and assert that excessive government spending in pursuit of social goals together with a government commitment to full employment create inevitable inflationary pressures. There are those, as well, who would argue that even if governments do not incur deficits, increasing levels of taxation required to fund growing expenditures lead to the erosion of incentives, a shift of income from investors to consumers and a consequent reduction in available output that is accompanied by rising prices.

There is a further view that asserts that inflationary forces are deeply embedded in the very structure of our society. A rapid shift of employment to the service industries and declining rates of productivity growth, as well as broad differences in income and wealth and the ability of powerful groups to protect too narrow interests, are factors which are said to lead inevitably to continuously rising prices. In this view, the market system as we know it does not always allocate resources efficiently and cannot provide a socially acceptable distribution of the fruits of growth.

In addition, there are those who point to the worldwide inflationary experience, in part a result of the rapid expansion of international liquidity, and to the sudden and severe increases in food and energy prices. They argue that Canada, as a trading nation, is extremely vulnerable to imported inflation.

There is a real sense in which the growth experience of the past thirty years has, itself, been seen as a basic factor in the inflationary process. Since World War cyclical slowdowns that occurred were short and quickly reversed by expansionary government policies. One of the legacies of this period, fundamental to an understanding of inflation, is a deeply rooted expectation that real growth will continue at past rates and an increasing willingness on the part of both individuals and governments to borrow against anticipated future income to support higher current living standards.

There is no single cause of inflation. Not all observers would rank the importance of the factors noted above in a similar way. There would nonetheless be general agreement with the following conclusions:

1. Industrialized economies for the last three decades, but more particularly since the mid-1960s, have become increasingly vulnerable to a long-run, continuing increase in measured inflation rates.
2. Continuing inflation creates short-term problems—internal inequities and a possible reduction in the ability to compete in world markets. These, together with the longer-term disruptions that accompany behaviour modified to anticipate inflation, exacerbate the inflationary process.
3. Once inflationary expectations have become entrenched, corrective policy measures can be offset—particularly in an economy as dependent on world trade as Canada's—by price increases that the government may not be able to control. The eradication of inflation can therefore be a long and painful process.
4. Continuing inflation, particularly in North America, has been accompanied by an increase in measured unemployment rates. Over the long term, continuing inflation is inconsistent with the maintenance of full employment. Fiscal and monetary policies directed at the control of inflation, unless associated with other measures, will have increasingly costly and socially disruptive unemployment consequences before they have a significant effect on inflation rates.
5. Continuing inflation inevitably results in greater public demand for government intervention in the economy, to offset the structural disabilities and inequities bred by the inflationary process. It is therefore imperative that inflation be controlled if governments are to be free, in responding to and serving social and economic objectives, to opt for less rather than more intervention in the economy.

III. CANADIAN ECONOMIC PERFORMANCE: RETROSPECT AND PROSPECT

The force of these conclusions is that a careful and critical assessment of the sources of the inflationary process is essential. This assessment demands an understanding of the growth we have experienced and our prospects for further growth.

The period following World War II has been as sustained a period of real growth as the industrial world has ever known. In most industrialized countries real after-tax income per person almost doubled through this period. Industrialized economies were characterized by the continued substitution of relatively cheap capital and energy for increasingly expensive labour in primary and secondary manufacturing processes, leading to rapidly increasing output per person employed. This was an important factor in sustaining and enhancing economic growth, which increased employment opportunities.

This growth process, through the broad rise in real incomes and living standards it provided, greatly expanded the opportunities and increased the well-being of all Canadians. In Canada, real after-tax income per person more than doubled in the thirty years following World War II. Our population almost doubled. New houses were built and jobs were created for the fastest growing labour force in any of the industrialized countries. Working and living conditions improved dramatically and the opportunities for individual Canadians to choose—where they wanted to live and how they wanted to live—continued to expand.

Sustained growth, and the benefits it brought, were in substantial part attributable to the successful economic management policies of the governments of industrialized democracies. Internationally, new economic institutions contributed to economic stability and the rapid expansion of trade and prosperity. Domestically, a collective determination that the widespread suffering of the Great Depression must not occur again led to government commitments to supplement the market system with policies to enhance job creation and minimize unemployment.

At the same time, rising incomes led to increasing government tax revenues. In Canada, these revenues were used to provide programs designed to equalize opportunity, through the construction and operation of schools, hospitals and transportation facilities and through the extended provision of direct income assistance. The introduction or strengthening of such programs as unemployment insurance, family allowance, public pension plans, and hospital and medical care sought to assure that the fruits of growth were distributed to all Canadians in a just and equitable manner. Through this period the growth in federal government expenditure as a proportion of Gross National Product was almost entirely related to increasing transfer payments to individuals and to provincial governments. The goods and services provided directly by the federal government grew at roughly the same rate as the national economy, although growing transfer payments increased access by all Canadians to a growing array of goods and services financed by tax dollars rather than private after-tax incomes.

However by the late 1960's and early 1970's—even before the rapid escalation of inflation accompanied by recession and high unemployment recently experienced—several disturbing features of the post-war growth period had begun to become apparent. Not only in Canada, but in other countries as well, disquiet was increasing over the ability to manage the economy with traditional policies alone.

Of primary concern was the growing evidence, particularly marked since the early 1960's, that periods of cyclical expansion were taking off from successively higher plateaus of inflation. As well, successively higher rates of unemployment in cyclical pauses were associated with substantial and continuing price increases. There was an increasing apprehension that the growth process itself was unbalanced, creating the very pressures which threatened its continuation.

From an international perspective, continued growth had been of disproportionate benefit to the industrialized world. Despite increasing demands for the raw materials of the developing countries, income and wealth disparities between the developed and much of the developing world continued to widen. The result was a number of attempts by export-dependent developing countries to force a more rapid redistribution of income and wealth by acting in concert to restrict the supply of their export commodities and so drive up the price. Attempts to form effective export cartels generally met with failure until, in the fall of 1973, the Organization of Petroleum Exporting Countries was able to quadruple the price of oil. The immediate success of OPEC has led to renewed efforts by other countries to accelerate a redistribution of income and wealth.

From a domestic perspective, as well, the growth process has produced, along with its obvious and tangible benefits, increasing social and economic pressures:

1. Although the proportion of people living below the poverty line decreased, the gap between the rich and the poor showed little evidence of narrowing. This has led to claims that growth did not adequately serve social goals. It must be recognized, however, that a comparison of relative living standards must take into account, as well as incomes, the increased availability of publicly provided goods and services such as low-cost medical care and post-secondary education. To the degree that these are low-cost because they have been financed by taxpayers as a whole, a substantial extension of a common standard of basic protection for the individual within our society has taken place. It has occurred, however, together with and as a direct result of an increasing responsibility assumed by governments at all levels for the direct provision of goods and services.
2. This growing role of governments, in response to real needs for social assistance and legitimate desires for equality of access to basic necessities, was essentially financed through the 1960's by the increased government revenues that accompanied rapid growth. By the late 1960's and through the early 1960's however, as the pace of economic growth slowed, the net financing requirements of governments became quite large. As a result there was an increase in borrowing against expected future income in order to finance existing programs and this, together with an accommodating monetary policy, reinforced inflationary pressures. As inflation increased, so did the pressures on government to redress the inequities that were created, and the cycle threatened to intensify.
3. A further concern about the nature of the growth process is reflected in a heightened awareness of the adverse effects on the natural environment and in some instances the health and safety of individuals. Continued growth presses further against the natural constraints that are imposed by the capability of air, water and land to support industrial, agricultural and

urban activity. Increasingly, concerns are expressed that growth, as we know it, is less responsive than it might be to our collective demands for adequate health and safety standards and a decent environment.

4. Finally, the size, power and complexity of institutions and organizations have increased. This has been accompanied by a growing sense of alienation from, and mistrust of, big corporations, big labour organizations and big government.

The explosion into double-digit inflation in 1974-75 in Canada and in the rest of the world, must be viewed against this general background. The demands created by the rapid growth experienced in most industrial countries were beginning to press severely against available international supplies. These inflationary effects were compounded by the quadrupling of oil prices and the resulting rise in other energy prices, and by drought and crop failures, leading to widespread food shortages. These inflationary forces, through the real income losses they imposed on oil and food importers and through the constraining actions of governments which they made necessary, forced a severe cyclical contraction on most of the world economy through 1974 and 1975. However, while real production declined in other industrial countries, it continued to advance moderately in Canada. This relatively healthy economic performance, combined with continuing labour settlements that contained not only elements of 'catch-up' but anticipated inflation as well, threatened to prolong and to intensify inflation in Canada which would erode further Canada's competitive position in the international trading economy.

Prior to the summer of 1975, it appeared that the rapid international inflation would run its course as the industrial economies adjusted to much higher price levels for basic commodities and for energy. Indeed, the rate of inflation in most of our major trading partners had begun to ease considerably. In the United States, the annual rate of inflation had fallen from 12.2% at the end of 1974 to 7.8% by September 1975. In Canada, however, the annual rate of inflation was still over 10.5% in September of 1975. Inflationary expectations had become deeply entrenched and there were indications that they were about to increase to extraordinary levels. In late summer and early fall of 1975, it was not unusual to read of demands for wage and professional income increases in the range of 30%-60%. The risks were great that Canada would effectively price itself out of international markets. While the rest of the world shared in economic recovery Canadians would suffer a continuously deepening recession, until the rate of unemployment rose high enough to restrain price and wage increases to a range that would restore our ability to compete. The government viewed such a prospect as intolerable.

It was in this context, and only after a sustained effort to achieve a consensus on voluntary restraint had failed, that the government took its decision, in October of 1975, to impose controls and to adopt a posture of fiscal and monetary restraint. The immediate target of the government's Anti-Inflation Program was to reduce inflation below 8% by the fall of 1976. It is now clear that this target will be achieved. The target for the coming year is 6%. To support these objectives the government will limit the rate of growth of government expenditures to no more than the rate of growth in GNP. The Bank of Canada has also adopted targets for managing the money supply that are consistent with the overall objectives of the program. The government's Anti-Inflation Program is working. The process of economic recovery is underway and inflation has been decreasing to a rate that is more tolerable, if not yet acceptable.

There is still a long way to go. The annual rate of inflation in Canada has decreased from 11.1% in August of 1975 to 6.2% in August of 1976. Some deterioration in this performance can be anticipated through the next two months resulting from higher oil prices and municipal property taxes. In addition, our inflation rate remains higher than the inflation rates of certain of our important trading partners. Continuing high wage settlements, together with relatively poor productivity performance, threaten the competitive position of Canadian exports. The deficit in the current account of our balance of international payments increased to record levels in 1975 and was financed by record borrowings from other countries. In large measure, this deficit arose because Canadian growth was greater than that of our trading partners. Our exports declined while our imports remained high. As worldwide economic recovery proceeds the demand for Canadian exports is strengthening. But to take full advantage of this opportunity it will be necessary to ensure that the competitive position of Canada's export industries is not only safeguarded but improved. Cost increases must be constrained and, most important, expectations that prices and costs will continue to rise must be further reduced.

Continued determination, and the development and implementation of new policies, are needed to guard against a repetition of the experience of previous economic recoveries. By mid-1976, resumed growth in industrialized countries was widespread. The early strength of the recovery and strengthening prices for natural resources and food raised concerns that another inflationary spiral might begin, this time taking off from a plateau much higher than the last. These concerns were heightened by continuing levels of wage settlements that were inconsistent with future reductions in the rate of price increase.

The Government of Canada—like other governments—is determined to prevent a renewed outbreak of inflation. However, the high rate of growth of the Canadian labour force will continue through the remainder of the 1970's. This, together with the need to carefully manage the economic recovery and the controls program, and the necessity to further reduce inflation, means that new strategies must be found if currently high unemployment rates are to drop significantly before the end of the decade.

Looking beyond this decade to the 1980's, Canada's economic prospects are excellent. Indeed, they are matched by few other industrialized countries. Canada's opportunities for continued real growth lie in its relative wealth of resources, its abundant food-producing potential, its technology, and of course, its highly skilled and educated population. They lie, not least, in Canadians' capacity for enterprise. But to take advantage of these opportunities, to ensure that our substantial potential is indeed attained, Canadians and their governments will have to meet a number of major challenges.

The international economy is likely to be marked by strong competition for productive resources and markets. Continued growth will lead to increasing demands for food, energy and mineral resources, all of which will become increasingly more expensive. As their prices rise, competition for the financing, equipment and skilled labour necessary to produce them will increase. Such increases in the prices of scarce commodities must be accepted in order to provide the incentives and the conditions necessary to increase production, lead to more efficient use and stimulate the development of substitutes. It is this dynamic process of adjustment that leads to innovation and growth. It is imperative, however, that price adjustments for particular commodities not be allowed to feed a general inflationary process, to the detriment of all.

In Canada, the rate of growth of the labour force will slow during the Continuing economic growth may lead to tighter labour markets, together with problems of adjusting to new economic opportunities. Estimates of our energy requirements, even with much lower rates of growth in demand, indicate that a substantially higher proportion of our total resources will be allocated to the development or importation of higher cost energy in the future than has traditionally been the case. Additional investment requirements and opportunities—in minerals, transportation, manufacturing—suggest that conflicting demands will have to be carefully reconciled if shortages in the supply of equipment or skilled labour are not to result in renewed inflation.

In addition to the necessity to avoid overloading the economy, a number of other potential problems must be addressed:

- Anticipated demands for Canada's resources by other countries, together with rapidly increasing investment requirements, raise the issue of foreign investment in the Canadian economy. It will be necessary to reconcile Canadians' desires to develop their potential to the fullest with objectives to increase the ownership and participation of Canadians in the Canadian economy. In effect, Canadians must recognize that this can only be achieved by increasing even more our already high rates of saving.
- Similarly, it will be necessary to balance the need for increased competitiveness in the international economy, and the large-scale organizations that may imply, with the continuing objective of more balanced economic and population growth within and among the regions of Canada.
- It will, as well, be increasingly important to rationalize Canada's trade and industrial strategies with the growing demands of the developing world. Particularly in secondary manufacturing, Canada will face an increasingly competitive international environment and a continuing shift in comparative advantage towards the developing world for some labour-intensive industries. Canada must respond to this challenge positively and constructively. However, the adjustment problems created for Canadian industries, communities and individuals could be considerable and must be eased.

Canadians have always faced challenges and it would be naive to assume that we will not continue to do so. Recognizing their existence is not cause for pessimism, but necessary in order to face them realistically and resolve them successfully. The coming decades offer tremendous opportunities to Canada and to Canadians. To seize these opportunities, however, requires a shared appreciation of the nature of the prospects and problems confronting us.

IV. SOURCES OF INFLATIONARY PRESSURE

The gravest threat to our ability to meet these challenges would lie in our incapacity to arrest inflationary pressures. The 1980's promise to be an environment in which such pressures will be continuously latent. Our ability to resist them requires an appreciation of the forces that produce them, an appreciation that transcends narrow economic considerations and examines inflationary pressures in the context of Canadian society, its existing institutions and economic prospects.

The notion that inflation results from excessive government spending is a popular one and, indeed, there may be instances where governments must bear a large share of the responsibility for inflation. To diagnose the inflationary spiral we have recently experienced as largely attributable to a profligate government, however, is simplistic to the point that it is misleading. Such a diagnosis ignores the fact that the recent acceleration of inflation was a worldwide phenomenon. It ignores the fact that all industrialized democracies have experienced gradually increasing inflation for at least the last three decades. Most fundamentally, it ignores the institutions that make up the Canadian economy and the complex relationships that define Canadian society.

To understand the inflationary process, and the issues surrounding the role that governments play in that process, it is necessary to examine those aspects of our social and economic structure that lead to inflation directly or indirectly through demands on government to spend money and to intervene in the economic system. The existence of market power, declining productivity growth and rising expectations, Canada's role in the world economy, economic growth itself and the issues it raises, all contribute to the nature of the role that government plays in the economy and the responsibility that the government bears for inflation.

Freedom from inflation in the post-control period demands an understanding of these issues so that effective policies can be developed to deal with the basic pressures they produce.

A. Market Power

The market system is a continuously evolving set of relationships. The notion that private markets are characterized, always and everywhere, by competition that leads to flexible prices is patently a stereotype that ignores the evolution of private and public institutions over hundreds of years. At the same time, the view that all markets are dominated by powerful groups is no less a stereotype. A balanced view must acknowledge that in some markets, at least in the short to medium term, organizations and institutions exist that have substantial economic power, including the power to set wages and prices in a way that may bear little relation to supply and demand.

Although the ability to set prices in this way may not be a critical source of inflation, the use of market power to "administer" prices can pass on and hence aggravate inflation originating from excess aggregate demand or from specific price increases. "Administered" prices frequently embody inflationary expectations as well. Powerful economic groups, on the assumption that inflation will continue and acting to protect themselves, create cost pressures that in fact lead to higher prices, the realization of their own expectations and a continuing process of self-fulfilling prophecy. This is particularly the case when governments and monetary authorities act permissively out of a concern to avoid unemployment and to protect those affected by inflation.

Such prices are typically rigid in a downward direction; they are not lowered when demand falls. When overall demand is not excessive, but prices are rising in some sectors, this rigidity can create an inflationary bias even in the presence of substantial unemployment. Instances of employees accepting reduced wages or of industries reducing prices in order to sustain output and employment are becoming rare in today's environment.

A particularly serious consequence of widespread market power is that increases in the prices of goods or services that are relatively scarce tend to be interpreted as an increase in inflation generally. Wages increase, labour costs increase and prices of other goods and services increase as well. The price "signals" that result in efficient markets are impaired and the market system fails to work as effectively as it should.

Although one typically thinks of market power as characterizing the private sector, a serious administered pricing problem also exists in the public sector, where governments must often provide essential services that are widely considered to be "vital at any cost", and where labour does not feel there is any danger of "driving the company bankrupt" by asking for substantial increases. The development of collective bargaining in the public sector has served to remove many of the inequities which existed between public and private sectors in the past. But the process has nonetheless directly contributed to higher spending by governments and can indirectly increase inflationary pressures by providing high-profile settlements which give other workers an inflationary target to aim at. It is important that public service collective bargaining not be allowed to overshoot and go beyond what is fair. Modifications in public sector relations are an essential element in a broad anti-inflation strategy, along with improved labour-management relations in the private sector and policies to sustain and enhance competition.

B. Declining Productivity Growth and Rising Expectations

Demographic trends will reduce the rate at which the Canadian labour force will grow in the 1980's. A continuing shift of employment to the service sector, together with some evidence that the productivity of capital goods may be declining, implies a future in which average productivity may grow less rapidly than it has over the past thirty years. Lower rates of productivity increase and slower rates of growth in the labour force would result in a potential for growth that would be lower in the future than it has been in the past. The confrontation that may occur between lower rates of future growth and increasing income expectations of Canadians could create new inflationary forces.

The amount and type of goods and services that can be produced will have to be reconciled with Canadians' expectations of higher levels of real consumption, as well as with the large and growing requirements for investment. This reconciliation is likely to be difficult. It will ultimately be dictated by the interplay of market forces. In the process, however, frustrated expectations can lead to concerted attempts to maintain relative positions. In an international context, the structural adjustments that will be called for may be exacerbated by continuing short supplies of energy and food and increasing demands by the developing world for a better distribution of wealth.

Policies will have to be developed to ensure that these necessary adjustments occur with the least possible disruption and do not lead to a renewed outbreak of inflation. An important component of such policies will be to establish measures to increase productivity. New investment will obviously be required, as will the capability to develop new and improved technologies, entrepreneurial skills and organizational structures.

C. Canada in the Economy

Exports account for about a quarter of Canada's gross national product. Similarly, about a quarter of all the goods and services that Canadians consume is imported. This relatively large dependence on international trade raises concerns, not only about the capacity of the Canadian economy to compete internationally and the need to resist internal inflationary forces, but also with regard to Canada's vulnerability to inflationary forces originating abroad. While a flexible exchange rate can accommodate modest deviations in relative rates of inflation, it cannot cope easily with large discordant swings in price levels and has little role to play in periods of world-wide and coincidental price increases.

The broad prospects for the world economic community should favour Canada's trading interests. The rise in relative prices for natural resources which can be anticipated through the 1980's will benefit Canada as a seller. They will be, however, a mixed blessing. Not only are there commodities, such as oil, for which Canada's net dependency will increase but rising resource prices in general could result in inflationary income adjustments in an attempt to offset them.

In addition to the direct concerns arising from the impact of inflation, whether domestically or foreign induced, on Canada's trading prospects, there exists a more fundamental concern. Severe inflation breeds recession, and periods of high unemployment and low growth such as the one we have recently experienced, typically lead to pressure by nations to limit imports and expand exports through measures such as tariffs, quotas, and export subsidies.

Such rounds of national self-protection would not only harm Canada's ability to compete but in the longer run would also present the gravest threat to an expanding and stable world trading community—a community on which Canada as a major trading nation greatly depends. The process of trade restriction must be resisted.

A further serious element in our prospects is the recent marked deterioration in Canada's balance-of-trade. Traditionally, Canadian merchandise exports have exceeded imports and the balance has been adequate to service the foreign debt we have incurred. In 1975, however, mainly because Canada continued to grow while other countries experienced a severe recession, merchandise imports exceeded exports, putting Canada in a position of borrowing abroad to make up the balance as well as to pay the interest and dividend charges on previous borrowings. To the extent that such borrowing is used to finance consumption rather than investment it lowers the rate of future growth and thus shifts some of the burden of supporting current living standards to future generations.

As the world recovery proceeds and resource prices firm, demand for Canadian exports will increase and our merchandise balance should again become positive and continue to increase. This general prospect is endangered, however, by the declining rates of productivity growth referred to above and recent, high levels of wage settlements which together have resulted in increases in the unit labour cost of production that seriously threaten our competitive position.

The government will continue to seek broader and mutually beneficial trading relationships with the European Community, Japan and our other trading partners, and to preserve and intensify our already substantial trade relationship with the United States. It will be necessary, as well, to seek measures that will increase the productivity of the export sector and ensure that cost increases do not erode its ability to compete.

D. Growth and Growth-Related Issues

Growth itself has been a contributing factor to inflation. While growth has brought about a substantial increase in average levels of economic well-being, the inequity of the distribution of its benefits both within and among nations has been a principal source of a restless quarrel over shares that has seriously escalated over the past few years. The very success of the growth process has created firmly embedded expectations of the continuing capacity of the economic system to deliver a continously increasing array of goods and services.

The debate over growth has shifted from the earlier issues of whether continued growth was desirable, or indeed, sustainable to a more meaningful discussion of "quality of growth" concerns. There are a number of pressing problems that must be the legitimate concern of governments.

Earlier concerns that absolute limits to growth might exist are being recast in a more sophisticated, but no less disturbing, form. It is increasingly recognized that, as resources become depleted, prices will rise'to reflect scarcity and that higher prices will lead to more efficient use of existing resources, development of less accessible and more costly resources, and concerted efforts to develop substitutes. This process of adjustment, however, raises questions about the ability of high consumption societies to generate the savings necessary to finance the higher investments required for the extraction of less accessible resources and for the development of substitutes. The necessary adjustments will require further shifts in relative prices to provide the signals essential to the successful operation of a market economy. All of these price shifts must be accomplished without renewing the inflationary process.

In addition, concern is increasing about the continued environmental degradation associated with high energy using and high resource extractive activities. This is a particular manifestation of a general concern that continued growth imposes increasing "social costs", because of the incapacity of the market system, as it currently functions, to provide balanced growth. It is particularly important to understand the relationship between the growth process we have experienced, the social costs that this process has generated, and the increased direct role of government in the economic system.

The market economy, and the price system on which it rests, is the most efficient allocative mechanism available. The billions of daily decisions that are freely taken by individuals and together comprise a viable, functioning economy make it obvious that any alternative to the market system would require a massive bureaucracy to administer with the unacceptable result of diminution in individual freedom of action and choice.

Our belief that the market system provides the greatest efficiency and growth rests on the presumption that prices direct scarce resources to their most valuable use, that the price charged for a commodity reflects both the incremental cost of producing it and the incremental benefits that accrue through its purchase. There are obvious cases, however, where prices measure private cost and benefit but fail to reflect the costs and benefits to society as a whole. In such cases resources will not be put to their most appropriate social uses.

For example, the presumption that air and water are "free" has led to production processes and consumer decisions in which the costs of polluting the air and fouling the water are not reflected in the prices of the products produced and consumed. This leads to greater demands for, and increased use of, such products than would occur if individuals had to pay to protect the environment. At the same time, it leads to growing demands for government expenditures to redress the damage done to the natural environment. The provision of individual commodities demanded by some is, therefore, subsidized by all consumers in their role as taxpayers. Industrial pollution is a popular example, but consumers also pollute. Garbage disposal, automobile exhausts, non-returnable bottles are all examples of consumer decisions that impose a social cost, leading to increased demands on governments to intervene in the economy to provide environmental protection or abatement—to try to "balance" the growth process.

One view is that these social costs should be charged more directly to the recognized production costs of business so that they are reflected in the prices consumers pay. On the other hand, it is clear that forcing Canadian producers to absorb costs that their competitors in other countries do not reflect would increase their competitive disadvantage. It is important, however, to be clear about the issue. Social costs can be ignored: rivers can be polluted, urban congestion can worsen, transportation systems can deteriorate, the quality of working life can be impaired. The real costs will, in the end, be borne by society as a whole and often by future generations. Ultimately the accumulation of such costs leads to intense social pressure to have them alleviated. They become a claim on governments, as "spenders of last resort", and are met by general tax measures. We are paying now to redress the social costs of previous actions.

Meeting social costs leads to a reduction in real disposable incomes, through higher prices, lower wages and profits, or higher taxes required to defray the real costs. The simple fact is that we cannot protect the quality of our life unless we are willing to pay for it. The issue is who pays. To the degree that such costs are charged directly to the private sector, Canadian prices would rise further, or wages and dividends would be lower, in those industries most affected than they would under a more generalized and dispersed tax burden. But it is precisely these relative price changes—in a healthy market system—that will stimulate a search for new methods of production and new technologies that will be less wasteful of naturalresources and less damaging to the environment, providing healthier and better balanced growth. Through such measures as the *Canada Water Act*, the *Clean Air Act* and the *Arctic Waters Pollution Prevention Act*, the government has taken steps which have this effect and seek to assure that the quality of our natural environment is protected and enhanced.

As well as concerns raised by depleting resource availability and increasing social costs, the question of who should pay for publicly provided goods and services is becoming increasingly important. Governments have traditionally provided goods and services that are, in large part, financed by all taxpayers—parks, educational facilities, transportation systems, and many others. There are obviously instances where such subsidization is appropriate and necessary to provide broad access and equality of opportunity. In many instances, however, the true costs are inadequately perceived and this may result in levels of demand that increase government expenditure to the point where the capacity of the economy to support their provision can become strained. Better information about how the costs of publicly provided goods and services are met is required to provide an increased understanding of the process and to facilitate a determination of the appropriate sharing of costs between users and all taxpayers.

Finally, there is mounting social concern that the economies and efficiencies of large-scale operation have led to the creation of corporate conglomerates and growth in labour organizations and government. Increasing scale has led to centralist forces that have created conflicts with objectives of regional and demographic dispersion and have contributed to the present unease with "bigness" and the remoteness of decision-making processes. There is also a view that increasing concentration and scale result in a vulnerability of systems to sudden and severe shocks. In the context of a future which is likely to be characterized by continued economic tension in the international economy, with the possibility of serious and sudden economic disturbances, it will be necessary, as we develop policies to deal with the period beyond controls, to consider carefully the resilience of our economy and our society.

E. The Responsibility of Governments

The issues that are in dispute about the responsibility that governments bear for inflation can be clarified by distinguishing three basic views as to the role of government in the social and economic system.

(i) A Minimal Role for Government

In economic terms, this view asserts that the market system allocates resources most efficiently resulting in the highest possible production and growth. It is this growth and only this growth that enables the government, through the tax system, to raise the revenues necessary to pay for public goods or serve social purposes. Intervention or interference in the operation of the market system impairs this efficiency and leads to rigidities that threaten growth. Adherents of this view would admit that imperfections in the price system exist and that the distribution of income that results may be socially unacceptable. They would emphasize, however, that the "benefits" to be gained by government intervention—whether through regulation, taxation or direct expenditures—are short-term and outweighed by the longer-run "costs" of lost efficiency and output, and higher inflation.

Philosophically, this view sometimes acknowledges a public responsibility to provide "equality of opportunity". But it is characterized by the belief that government intervention in pursuit of "equity of outcomes" has led to the loss of individual freedom and initiative and could undermine the market system, which it sees as the best guarantor of a better life for all.

In this view, governments play a central role in the inflationary process through

- levels of taxation that erode incentive;
- social assistance payments that bias production in favour of consumption and against investment;
- regulations that reduce enterprise; and
- adherence to full employment policies that bias the economic system in the direction of excess aggregate demand and enhance inflationary pressures.

(ii) A Continually Expanding Government Role

This view emphasizes governments' responsibility to support economic growth, equity, the public provision of goods and services, and intervention in the working of the market system to ensure socially acceptable outcomes. In this view inflation is seen not merely as an economic phenomenon but rather as a result of a complex interplay of economic, social and political forces. The ultimate sources of inflation are to be found both in market "failures" and in the incapacity of the market system to serve social goals, with a consequent need for increasing government intervention. These "failures" and incapacities would include:

- the fact that market economies cannot assure a socially acceptable distribution of incomes, both among persons and between wages and profits;
- the inability to recognize the increasing demands put upon public authorities arising as a result of private decisions, for example the provision of social capital such as transportation systems, roads, sewers;
- the failure to account properly for social costs, which leads to demands on governments to remedy pollution, urban congestion, and to correct for resource misallocation generally; and
- the failure to provide all persons equal access to a growing range of perceived necessities such as education and health care, leading governments to undertake the provision of such goods and services either directly or through the subsidization of private production and consumption.

To a considerable degree, therefore, this view would assert that the growing role of government has been thrust upon it by the incapacity of the private market economy to serve social goals. Many adherents of this view would go further to argue that social direction of production is imperative if a socially optimal array of goods and services is to be assured.

(iii) A Middle Road

There is a middle view that resists both of the more extreme views outlined above. This view would not accept the social costs of a minimal role for governments. It would not deny the legitimacy of the goals that governments have generally pursued. It would assert that the principal sources of expanding government expenditure have derived from the pursuit of greater equity in income distribution, wider access to basic goods and services, and the necessity to offset or repair the social costs that result from the operation of the market system as it has evolved.

This view, however, would acknowledge that at any point in time it is indeed possible for governments, in pursuit of social and economic goals, to damage the engine of economic growth, contribute to excess aggregate demand, and hence originate or exacerbate inflationary pressures. In this view, it is entirely possible for governments to:

- establish commitments to a range and volume of expenditure goals that either demand a tax structure beyond the community's ready acceptance or lead to recurring deficits which in turn are financed by borrowing from Canadians and non- Canadians or by selling government debt instruments to the central bank, thus increasing the supply of money;
- contribute to "rising expectations", either by underwriting the costs of unemployment or by a series of accessions to public demands that cause the public at large to lose sight of economic constraints;
- intervene excessively in pursuit of social goals and better social performance of the economic system, with a consequent erosion of incentives, initiative and personal freedoms and responsibilities.

There is an emerging middle view that essentially argues that the inflationary consequences of government actions reside less in the ends that governments have sought to pursue than in a choice of means, including timing, that may not always have been most appropriate.

Those who hold this view would not deny that the pursuit of social goals can damage the economic fabric. They would emphasize, however, that the pursuit of narrow economic goals can as easily damage vital social fabrics, which are just as important. Rather than relent in the pursuit of social goals, they would seek new and effective means to pursue them, and recognize that all segments of society must work together in this pursuit. They would seek a rationalization and simplification of the vast array of government programs. They would argue that it is both possible and desirable to seek a substantial reduction in the rate of growth of government expenditure and direct government intervention, and to search for alternative strategies—less expenditure oriented—to serve the legitimate social concerns of government, and in fact to better serve society.

It is this emerging middle view that has been adhered to by the present government in its search for appropriate policies for the post-control period and for the principles that will shape the role that the government will play in this period.

V. THE ROLE OF GOVERNMENT IN THE POST-CONTROL PERIOD

Current government policies of controls and determined restraint in fiscal and monetary policy are appropriate if the inflationary forces unleashed by the events of 1973-75 are to be wound down. Looking beyond the period of controls it is clear that the posture of fiscal and monetary restraint must be sustained. If these policies are to be supported, however, it is critical that the deeper structural issues in the inflationary process which contribute to inflation directly, or indirectly through their expenditure pressures on governments, be addressed. Some clear directions have been noted in the discussion of particular sources of inflationary pressure. The government has concluded, however, that what is ultimately required to meet the challenges of the future goes beyond the introduction of new policy measures to a basic and fundamental reassessment of the role of government itself.

An essential theme emerging from this reassessment is the necessity to increase both the reliance on and the effectiveness of the market system. The role of government policy should not be to direct and manage the economy in detail. The interplay of dynamic forces that results from the market system and has led to continuing economic growth must be encouraged. It is not only growth that is at issue. Governments can become too pervasive and oppressive actors in the daily lives of Canadians.

At the same time, however, it must be recognized—certainly by those who wish to strengthen the market system—that market-directed economic growth has not fully served the social goals and aspirations of Canadians. This government has no intention of reducing its deep commitment to liberal ideals of individual freedom, equality of opportunity and social justice. It does not intend to participate in, or to allow, a dismantling of the socially progressive society Canadians have built in this country. Indeed, the preservation and improvement of this society is a paramount reason for the government's determination to control inflation. It will therefore be necessary to seek and to implement a broad range of supportive public policies that will enable improved operation of the market economy. Such supportive policies must be developed and managed in a way that allows governments to fulfill their legitimate responsibilities, but to do so with less, rather than more, direct intervention in the economic system. Such policies must provide effective alternatives to increasing expenditures and expanding bureaucracies.

A number of policy initiatives have been identified as consistent with the above themes and necessary to the successful functioning of the Canadian social and economic system in the period beyond controls. Some directions have already been indicated and specific policies will be announced to Parliament in the Speech from the Throne. Necessary as these policies are, they will not in themselves be adequate to ensure the elimination of inflationary pressures and to produce the balanced growth necessary to provide continuing increases in the quality as well as the standard of our living conditions. It will be essential to pursue additional strategies. These strategies must serve effectively the government's social concerns—and certainly its commitment to enhance the welfare of the individual—in those areas which most seriously threaten the government's resolve to restrain its own growth. The government is committed to the strategies. The precise policy implications are clearer for some than others. The government looks to the processes of consultation to lead to further elaboration of policies consistent with these strategies.

A. Employment Policies

Continued high rates of unemployment impose enormous costs on individual Canadians and heighten disparities among the regions of Canada. The high level of unemployment currently prevailing and the prospect that the unemployment rate may be reduced only gradually over the balance of the 1970's pose the greatest threat to the government's determination to exercise fiscal restraint.

Social policies, and particularly unemployment insurance, have enormously reduced the element of 'hardship' accompanying unemployment and have been a major factor in sustaining total demand. A prolonged period of severe unemployment, however, imposes a significant expenditure strain on the government, a strain that has no direct counterpart in productive employment.

The average government payment to unemployed Canadians, through programs such as unemployment insurance, welfare and retraining, currently exceeds 75% of the average industrial wage. The total cost of unemployment is even greater if one considers the indirect costs as well. Not only does the cost of unemployment to society remain high in this sense, but there is also abundant evidence that the true cost to the unemployed individual, despite the maintenance of his income, is also high. All evidence available indicates that the vast majority of Canadians prefer wages in reward for work to transfer income. Periods of prolonged unemployment are a disaster for the individual, eroding moral strength and personal dignity. This is particularly the case when unemployment rates are high, as they are now, among young entrants to the work force and in particular regions. In addition, the most rapid erosion of poverty and the most significant narrowing of income disparities occur in periods of high employment, and not through income transfer policies. New employment policies, that increase productive work and reduce all of the appalling costs associated with unemployment, are clearly called for. Such policies must be implemented within the general framework of monetary and fiscal policies of government but must supplement these policies by focussing on specific employment problems and particular regions, in ways that do not increase inflationary pressures.

Excessive tightness in job markets, as in any market, can be an inflationary force. The unemployment problems we may experience through the remainder of this decade may slowly transform themselves into problems of shortages of workers and workers with particular skills in the early 1980s, particularly in certain regions. During this decade a number of changes in the structure of our economy will be both necessary and desirable. As the nature of economic activity shifts so will the nature of employment opportunities. Government employment policies must help match people with jobs, both in occupational categories and in different regions of the country, and thus avoid inflationary pressures created by shortages in the supply of skilled labour. This will require the reexamination and intensification of manpower training and mobility programs. But government neither can nor should play this role alone; industry and labour organizations must assume a greater share of the responsibility for ensuring that job markets function efficiently and effectively.

While enhanced labour mobility and training are essential elements of a viable employment policy for the future, there will continue to exist unemployed persons who are actively seeking productive work but not able to find employment. From any point of view—enhancing the welfare of individuals, reducing the total cost to society, providing valuable services that the market system does not now offer—it is both appropriate and desirable to introduce programs of direct job creation. Imaginative programs of direct job creation, community employment schemes, and the developing experiments in the use of unemployment insurance funds to support job creation will be indispensable elements of the government's commitment to sustain a fuller employment society consistent with fiscal restraint and an anti-inflation objective.

These programs will be designed to ensure that the job opportunities created will not be in competition with the private sector. At the same time, the government is anxious to confer with private employers on means to sustain private employment when industries or firms experience short-term reductions in the demand for their products.

B. Social Policies

The government's commitment is to a society in which incomes from productive and satisfying employment, rather than from government transfers, sustain the dignity and the income requirements of most individuals of working age. However, programs to assure minimum levels of income to those who cannot work, or whose work income is inadequate, and to provide greater access to basic services for all Canadians are a continuing commitment of the government. Over the past decade the number, scope and scale of such programs have expanded greatly, providing real benefit to millions of Canadians. The rapid and continuing growth of these programs, however, creates potential conflicts with the need to restrain government expenditures to responsible levels. Excessive demands upon government to equalize opportunities and to protect the disadvantaged could create formidable pressures to depart from fiscal restraint.

An additional dimension of these potential pressures arises from the fact that a large number of government programs have multiple objectives, one of which is frequently a social concern. For example, food and energy policies have in the past been shaped by a desire to intervene directly in pricing decisions in order to protect the interest of particular regions or to ease adjustment problems for individuals most seriously affected. It is anticipated that the decade of the 1980s will be a period of important structural price changes. If the necessary adjustments that these price changes call for are to occur in an orderly manner, it is imperative that the price changes themselves neither give rise to, nor reinforce, a general inflationary process. Successful management of the economy in a way that will facilitate balanced growth and freedom from inflation will depend upon the ability of individuals and institutions to react to these market forces. At the same time, however, the government must develop an enhanced ability to provide adequate relief to those Canadians affected most adversely by particular price changes and to do this in a manner that does not compromise the operation of the market system by directly controlling prices.

It is in the context of these concerns that the government has undertaken to redesign social programs, with an emphasis on focussing assistance more directly towards those in need through greater integration of existing programs and an enhanced reliance on programs that encourage self-help. The rationalization, simplification and redesign of programs in the social policy area will provide governments with instruments that are more flexible, efficient, and capable of serving government objectives more compassionately-instruments that can effectively constrain rapidly expanding expenditures, increasing bureaucracies and the direct manipulation of strategic prices to serve social policy goals. What is required is not less commitment, but greater efficiency together with delivery systems that protect the dignity of individuals in need. To accomplish this, it will be necessary to pursue an examination of the integration of income transfers with the tax system. The results for those who need it will be more help, not less.

C. Labour-Management Relations

The government remains committed to the collective bargaining system as the fairest and most publicly acceptable method of determining wages and working conditions, in both the private and public sectors. However, the collective bargaining system is, in many instances, not working as equitably or effectively as it should. The increasing number of working days lost through strikes is not only a burden for all involved, but severely threatens the satisfactory performance of the economy. In some cases, strikes have imposed particular hardships on the general public, especially in the public sector where essential services have been withdrawn.

The collective bargaining process has been seriously strained by the inflationary experience of the past few years. Escalation of the quarrel over relative shares and growing pressures to protect against expected future inflation have resulted in increasing confrontation between labour and management. To the degree that the Anti-Inflation Program is successful in constraining the increase in living costs to tolerable levels, it will itself reduce the tension surrounding labour-management relations. But, if social and economic strains are to be minimized, new directions in which labour-management relations can continue to evolve through the post-control period, becoming more cooperative and less adversarial, are necessary in both the private and public sectors.

Closely related to concerns about the collective bargaining process are deep concerns about the productivity performance of Canadian industry. Low rates of productivity increase, together with continued high levels of wage settlements, threaten the international competitive position of our existing industries and reduce the attractiveness of Canada as a location for new industries.

Governments have a responsibility to develop a framework that will encourage a continuing search for productivity increases. But within this general framework, the major initiatives that can improve Canada's productivity performance should, and indeed must, be taken at the level of the individual plant or industry.

It will be necessary for labour, management and governments to seek measures that can broaden the scope of labour-management relations and the collective bargaining process in both the private and public sectors. Employers must become more responsive to demands for high standards of industrial health and safety and more sensitive to the overall quality of the working environment. Employees must become more aware that continued employment opportunities depend upon the continuing viability and profitability of the enterprise. Over the longer term sustained increases in real labour income can be supported only by advances in productivity. Both employers and employees must become more responsive to the interests of the general public in settling disputes.

D. Social Responsibility

This paper has discussed a number of difficult challenges to *government's* social responsibility. That matter is far easier to discuss than the subject of the social responsibility of individuals and institutions. No theme sounds more utopian—yet none is more crucial if Canadians are to fulfill themselves, as individuals and as a society, without expanding government spending and bureaucracy; without giving free rein to the inflationary pressures that have threatened our economy in the recent past; without abridging personal freedoms; and without retreating to the social dark ages of the 1930s. It is a constant theme of this paper that if we truly want governments to do less—for us, and to us—we as individuals and in our private institutions will have to do more for each other.

The question of social responsibility is becoming both more important and more difficult. The increasing size and complexity of the economy make it difficult for any institution or individual to perceive the social, as opposed to the private, consequences of economic behaviour. The result has been a heightened concern about issues of common interest that affect all Canadians but are the responsibility of no single individual or institution. Ultimately, the government becomes a focus for such concerns.

The capacity of the individual to perceive how the economy is working can be significantly improved through the establishment of better information and public and private accounting practices which make social costs more visible. Other countries, particularly the United States, are moving towards the establishment of such practices within businesses and the development of social accounting measures as a counterpart to the gross national product. More information on the way in which the economic system functions—its benefits as well as its social costs—cannot but help encourage both better understanding of the sources of claims upon governments and more socially responsible decisions by the private sector.

The government has spoken often about the need for voluntary restraint as the alternative to restraint by government. What is needed is a reaffirmation of values which embrace a greater sense of sharing, compassion, tolerance and responsibility towards others, values which reflect a sense of Canadian cooperation and common direction. Individual values cannot—and indeed should not—be imposed by governments. It is nevertheless clear that as social responsibility has shifted from individuals to their governments, the direct role of government in the economy has increased.

Experience confirms that Canadians, when made aware of the challenges we face and the nature of the choices open to us, act responsibly and in their own long-term interest. The government will therefore act to improve the information available to Canadians on the manner in which the economic system operates, its opportunities and its constraints, and to develop appropriate forums in which such information can be critically discussed.

Beyond the development and distribution of such information, the following areas merit further consultation and consideration:

1. Ways and means to encourage the recognition of social costs and to lead to their being taken into account by private companies and individual consumers so that they do not become the expenditure responsibility of gov-

ernments. For example, taxes might be placed on production or consumption decisions that breed social obligations and costs (as road use and automobile weight are now taxed) or on polluters generally. Another area that deserves further scrutiny is the more realistic pricing of publicly provided goods and services. For example, the user's price of an airline ticket might reflect more—and the public's tax bill reflect less—of its true cost.

2. Mechanisms to encourage a broader recognition and acceptance of social responsibility by both corporations and labour organizations, as well as an understanding of that responsibility by the general public. Such mechanisms might include the increased participation of employees in plant management and profit sharing, and heightened corporate responsibility for training, job maintenance and the quality of the working environment.
3. Mechanisms to encourage the further development of cooperatives and voluntary organizations.
4. The possibility of the private sector providing goods or services that are now provided through government enterprises and programs.

The appropriate balance between the public and private sectors with regard to how social costs should be met will depend on particular circumstances. The development and implementation of appropriate measures will require extensive consultation with those organizations and individuals that will be most affected. Any changes that might be introduced must be carefully considered and phased over a time period sufficiently long to allow the necessary adjustments to take place with a minimum amount of disruption.

E. Decentralization

One change that could foster greater social responsibility in the private and public sectors is greater decentralization. The openness of the Canadian economy, the dependence on exports and the competitive world trading environment foreseen for the 1980s, all create a continuing need to sustain and improve Canadian competitive capacity. In some instances this will require the reorganization and rationalization of Canadian industry in order to gain the economic advantages of large scale production. The increasing scale of organizations, however, has resulted in major centralist tendencies in the economy.

These have conflicted with government objectives to promote regional balance. They have also led to a heightened sense of individual alienation from decision-making processes and have contributed to the increased direct intervention of government in the economic system.

The capacity of any single trading nation, and particularly one so dependent on international trade as Canada, to stand against centralizing forces is extremely limited. In many cases the economies of scale are real and important and outweigh the social costs that "bigness" might entail. Nevertheless, there is a growing appreciation in many countries that "bigger is not necessarily better". In many cases the efficiencies of scale may be overestimated, and when the resulting social costs are considered, may indeed be non-existent. While objectives of economic efficiency and decentralization must be carefully balanced, opportunities may arise where it is possible and desirable to lean against centralizing forces.

One such opportunity that the government intends actively to pursue is the elaboration of a consistent and comprehensive small firm development strategy that will preserve and enlarge the role of small businesses—most of them owner-managed—in our economy. While much public attention is devoted to corporate giants, small to medium-sized business forms the life-blood of most Canadian communities. To the degree that it is necessary to devise further policies to ensure that this continues to be the case, the government intends to do so. No theme is more consistent with the government's objectives to maintain a healthy and regionally diverse economy and to enhance individual opportunity and enterprise.

The government will pursue vigorously its own decentralization program, to bring the delivery of government services closer to those they serve, and to resist needless centralism. It is eager to pursue consultations with the private corporate sector on the capacity of that sector to sustain maximum regional diversification consistent with efficient and competitive operations.

Decentralizing policies can make an important contribution to a regionally diverse and equitable economy. Assurance of regional equity will, however, continue to depend either upon the capacity of the federal government to assist less advantaged regions or upon decisions of the private sector to do so. While the federal government will restrain its growth, it cannot and will not forsake its capacity to sustain and deepen the sense of national unity flowing from its regional equalization and development policies.

A further opportunity, and indeed obligation, that must be pursued is the continuing search for a more productive and constructive basis for federal-provincial relations. No attempt has been made in this paper to continuously note issues and directions in which federal-provincial collaboration will be essential. The principal policy directions outlined above will, of course, require intensive federal-provincial cooperation in their implementation. Without such cooperation, success can only be limited. The government will actively seek more effective federal-provincial consultative mechanisms, to discuss the sharing of responsibility and capability for public programs and to ensure that such programs are efficiently implemented.

F. Growth

Continuing real economic growth is essential to the health of the economy and the well-being of Canadians. But unbalanced growth imposes "costs" on society. If these costs cannot be accommodated within the growth process itself, they will lead to increasing public demands for direct government intervention. Concerns have focussed particularly on issues of environmental degradation and continuing high rates of resource use.

It has been suggested that the 1980s may be a period of severe strain on world resources—labour and equipment as well as investment capital. The investment requirements foreseen for energy in Canada, though feasible with careful management, may be only one component of a severely stretched economy. It is in this context that policies that can provide more balanced growth, by increasing social responsibility and by serving the objectives of decentralization and smaller scale, take on added importance. Government policy can increase the range of choices and provide the information that can allow Canadians to be more selective about growth.

There are a number of policy directions that offer the potential to ease the adjustment problems of the 1980s, to enhance our ability to avoid inflationary pressures and, generally, to assure that the growth process results in an improved quality of life. Energy conservation programs, for example, are a least-cost, least-risk direction for Canadian energy policies and a critical contributor to the reduction of inflationary pressures. Such programs must be intensified and expanded.

In this same regard, the capital intensity and large scale of present energy supply alternatives, together with their adverse environmental implications, strongly suggest that urgent attention be given to less capital intensive, more decentralized, renewable energy alternatives. Solar space heating, for example, even in a Canadian climate may become economically competitive well within the next decade. This, and other renewable energy options, offer substantial potential that needs to be carefully assessed and, where appropriate, vigorously developed.

Finally, there are a number of other areas where government may have a role to play in ensuring that our limited resources are utilized for the greatest benefit. The advantages of recycling increasingly scarce and expensive mineral resources, the increasing concerns expressed that some forms of advertising serve little social purpose, and the growing resistance to wasteful, built-in obsolescence that seems to characterize growth as we know it, are all areas that merit further consideration.

Investment

One of the major challenges posed by increasing capital requirements will be the need to generate sufficient domestic savings. Over the past few years the government has introduced a number of measures to increase the incentives for Canadians to save—for housing, for their own retirement, and to facilitate more investment by Canadian industry.

Large investments will be required over the coming decades—for energy and other resources, for transportation, and to improve the productivity and competitive performance of Canada's secondary industries. Satisfying these capital demands may lead to structural adjustments in the economy that could, if not carefully managed, result in a renewed outbreak of inflation.

It is imperative that these investments occur in order to produce the range of goods and services and the quality of life that future generations of Canadians will demand. Fostering a climate in which Canadians and others will invest with confidence in the future of this country is a primary objective of this government. For the shorter term, the Anti-Inflation Guidelines have been revised to encourage investment. In the longer run, our continuing capacity to provide attractive opportunities for new investment will be measured by our ability to control inflation and to pursue the responsible implementation of the policies required to sustain balanced growth.

VI. CONCLUSION: THE NEED FOR CONSULTATION IN THE DECISION-MAKING PROCESS

Inflationary forces are deeply embedded in industrial economies. There is no simple source of the problem nor any simple solution. Bringing inflation under control will be a long and painful process. There will be a continuing threat of renewed inflationary pressures both internally and from world-wide forces beyond Canada's control. The growth of government expenditure must bear some of the burden of responsibility for inflation. It is clear, however, that the pressure on governments to continue to grow rapidly and to increase areas of intervention will be intense unless inflation can be arrested and unless inflationary pressures arising in the market economy can be allayed.

The imposition of controls, the commitment to fiscal restraint and the adoption of monetary targets were, and are, the appropriate short-term responses to the current Canadian inflation. The policy proposals that will shortly be announced in the Speech from the Throne form a broad and consistent package addressed to a further reduction in the sources of inflationary pressure. Though each is necessary, they are not likely, alone or as a package, to provide a sufficient solution to the longer-run inflationary problem. A fully developed strategy for the continuing reduction of inflation requires both an examination of the sources of increasing government expenditure and the articulation of a role for government which might reduce expenditure and interventionist pressures.

In establishing its priorities in the summer of 1974, the government highlighted five themes:

- a more just, tolerant Canadian society
- with greater balance in the distribution of people and in the creation and distribution of wealth between and within regions
- which makes more rational use of resources and is sensitive to the natural and human environment

- accepting new international responsibilities particularly with regard to assisting developing countries
- with an evolving federal state capable of effective national policies as well as sensitive, responsive and competent government at all levels.

The government remains committed to these priorities. They are essential if we are to create a strong and united Canada.

It is clear, therefore, that principles of fiscal responsibility, less direct intervention, and increased reliance on the market economy demand, for consistency, policies which will both reduce pressures upon governments arising from 'imperfections' of the market economy and which will permit the government's priorities to be served in a less expenditure-oriented and interventionist manner. New strategies for pursuing employment and social goals, improving labour-management relations, promoting social responsibility, and encouraging decentralization, balanced growth and investment, are all necessary avenues for further pursuit.

Underlying many of the themes developed in this paper is the central role that broader public understanding of the Canadian economic system, its opportunities and its problems, can play in the development of appropriate policies for the post-control period. Indeed, it is a basic assumption of this paper that when presented with the information necessary to assess our future options and opportunities to discuss the directions in which we should be moving will make their choices in a manner that is both responsible and in accordance with their longer-term interests. The concept of a new sharing of social and economic responsibility is fundamental to the search for new directions that will assure balanced growth without inflation.

The further elaboration of these new directions cannot and should not take place without a focussed public dialogue. What is at issue is nothing less than the nature of Canada's social and economic future and the role that government will play in that future. The government believes that a concerted and coordinated process of responsible consultation with all segments of Canadian society will enhance our understanding of the options available to us and the directions in which we must move. In the final analysis, the responsibility for the decisions that must be taken and the policies that must be implemented will rest with the government and with Parliament. In the process of formulating those policies, however, the government seeks the advice and views of all Canadians.

The government will initiate a formal process of discussion, dialogue and consultation with all elements of Canadian society: provincial governments, representatives of business, labour and consumer organizations, other special interest groups, and individual Canadians. This paper represents a major step in such a process.

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