# Rising to the Challenges of Economic Transformation: A Canadian Priorities Agenda

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The world economy is undergoing rapid interrelated changes in this decade, the like of which we have not seen in our lifetimes. The world's two most populous economies, China and India, have joined others in integrating into trade, capital and labour markets, creating a positive supply shock with strong growth and low inflation. The speed of this integration and the sizes of the labour forces to be absorbed pose major challenges in this decade.

Canada's economy has fared relatively well, even as our relative economic clout declines. We are a major beneficiary of openness; as we are an exporter of natural resources, the terms of trade are running strongly in our favour. We are also enjoying the fruits of our efforts during the past decade to restore prudent macroeconomic policies as the cornerstone of our economic framework. We are both blessed by our proximity to the world's largest and most dynamic economy and cursed by the asymmetry and dominance of that relationship.

In this generally benign economic environment, we have an opportunity to scrutinize our policies and institutions to ensure that they sustain growth in living standards and increase our ability to anticipate and successfully respond to rapid change. However, the tendency at such times is to become complacent and by default to allow crises to force reforms at the worst possible time. The economic policies of the minority Conservative government generally move in the right direction, but some of the measures it has adopted — often for short-term political advantage — are scattershot, and they will not achieve the required response.

The project represented in this volume has a long-term focus and a rich menu of proposals for ensuring steady improvements in future economic and social well-being. My purpose is to choose a package from this menu. I begin by setting out my views on the context that influences and constrains our objectives. I then explain my choices in light of the selection criteria and evaluate the policies individually and as a package. A brief examination of the rationale and implications of policies I have not chosen follows, and I end with a discussion of the likelihood of implementation.

## [subhead level 1] **Context**

For Canadians, the international context is deeply and inescapably influenced by proximity to the United States. Our neighbour has grown more fearful, inward-looking and internally divided in the past decade, increasing our vulnerability — a subject to which I will return in the next section. In North America and beyond, the speed and magnitude of China's emergence as a major exporter of standard-technology manufactures has, and will continue to be, disruptive, initially creating a disinflationary supply shock. Declining prices for a wide range of consumer goods have increased the purchasing power of the world's consumers. Returns to capital have increased as production costs have declined, and strong import competition has reduced the bargaining clout of labour in the importing countries, stoking concerns about rising inequality, especially in the United States. At the same time, China's position as the assembly platform in many global supply chains means that it is also a major importer. Since 2000, its demand for oil and raw materials to feed its manufacturing machine has been an incremental factor in higher commodity prices. But the effect on consumer prices outweighs this impact on commodity prices, and this has been a factor in the surprisingly low interest rates of recent years. India's entry has been more gradual, its liberalization more modest due to its historical ambivalence toward market forces. As higher growth rates appear to be turning into a higher potential growth trajectory, domestic political support for necessary reforms is growing.

Both countries are emerging as significant outward investors. India's largest companies are led by experienced entrepreneurs and are international forces in the information technology, steel, pharmaceutical and auto industries. Chinese government entities are major portfolio investors; China's state-owned enterprises are encouraged to invest abroad, not only to secure natural resource assets but also to reduce pressure on the exchange rate. Plans are underway to create a government investment corporation to channel about 20 percent of China's trillion-dollar foreign exchange reserves into real assets.

And there is more to come. Between 2000 and 2010, the United Nations projects that the global labour force pool (people aged 15 to 64) will grow by 665 million; nearly

40 percent of that figure will reside in China and India.[1] [Please provide a source reference for this UN statistic — an author-date short reference here in the text and a full citation on the reference list, where indicated.] Canada's share of this growth is a mere 1 percent. In theory, a large increase in low-wage workers in world markets is a positive-sum game in which all are better off. Living standards improve in developing countries, while developed countries move into complementary higher-productivity, higher-paying activities. But with the current abrupt transition, this has not happened. In the United States, productivity growth has been strong, but income gains have been concentrated and workers' incomes have been squeezed. At the same time, India and China are producing large numbers of skilled workers and moving rapidly to higher value-added activities. There is general agreement that we should encourage investment in human capital, integrate immigrants and drive our flagging productivity performance to higher levels. As we go through this industrial transition, we should also be continuing to do our homework — begun a decade ago with the Organisation for Economic Cooperation and Development (OECD) Jobs Study — on more effective social safety nets as well as active labour market policies.

Rapid and ongoing change in patterns of production, employment and trade is one inescapable determinant of our policy choices. Another is a growing concern about the global commons, where consensus is forming that governments should create incentive structures for reducing pollutants and carbon dioxide emissions. It is naive to accuse the large emerging market economies of being free riders. They will most likely take action when their major customers in the OECD countries do. As well, their own problems of air, land and water pollution are creating domestic pressure to achieve energy efficiency and pollution reduction — indeed, both are compulsory targets in China's eleventh Five-Year Plan, for 2006-10 (Zhang 2006).

## [SH 1] Policy Analysis

The purpose of this exercise is to select a five-part policy package that contributes to the future economic and social well-being of Canadians. My selection criteria are straightforward: policies should be politically and administratively feasible; they should reflect an appropriate role for government; they should be affordable and cost-effective; they should be equitable; and, as far as possible, they should maintain an external macroeconomic balance. My main operating assumption is that any package chosen from this menu will preserve Canada's fiscal and monetary prudence — that is, budget balance and price stability.

These criteria are plain, but the appropriate role for government requires brief discussion. Since the collapse of central planning two decades ago, there has been a shift from the state to a market in which governments create sound economic frameworks for sustained growth and ensure that there are appropriate incentives for markets and market-based institutions. [In the previous sentence, we have "a shift to a market in which governments ensure incentives for markets" — idea of the market is compounded. Would this clarify? "Central planning collapsed two decades ago, and since that time, governments have shifted their approach, working to create sound economic frameworks for sustained growth and appropriate incentives for markets and market-based institutions."] Governments should also test market outcomes to determine whether markets are delivering growth as well as fairness, a sustainable environment and an affordable retirement for Canadians. A long-run view of Canada's policy options should recognize that markets can fail, and if they do, support for government intervention will grow. My policy package seeks to reflect an appropriate mix.

With these criteria in mind, my recommended package anticipates and responds to the changing world economy, both directly and through emphasis on strengthening human capital and productivity, and it begins to address the growing pressures on the global commons. It is comprised of the following policies:

- **Trade and globalization**: Improve Canada-US border administration and infrastructure.
- **Health outcomes and human capital**: Invest in a system of early childhood development/education (ECD/E).
- **Aging and demographic change**: Step up immigration policy support and credential recognition.
- **Productivity**: Remove provincial sales tax (PST) on machinery and equipment purchases.
- **Climate change**: Begin the phased introduction of a carbon-management-standard incentive framework for greenhouse gas (GHG) emissions reduction.

I have two runners-up: in the area of trade and globalization, build institutional capacity and frameworks to improve the cross-border movement of goods and services; and in the area of natural resources, introduce a conservation tax and dedicate the revenues to the purchase of strategic natural capital.

What is the rationale for these five (plus two) components, and for the overall package? Before applying my criteria, I should note what is missing from the menu. First, in a smaller, open economy like ours, policy-makers should prioritize the efficient use of resources, yet Canadians allow their governments to indulge in costly overlapping policies, regulations and institutions. First among these are the persistent interprovincial trade barriers; Canada negotiates free trade agreements (FTAs) with other countries, but it has failed to create free trade among its own provinces. A second example is the existence of 13 securities and exchange commissions in Canada; this keeps the cost of capital higher than it would be if there were a single agency. A third indulgence is the prohibition on mergers among domestic financial institutions and the lack of international competition in the domestic market; this effectively denies a major industry access to sources of efficiency through innovation and economies of scale.[2]

Furthermore, there are two dogs that don’t bark in the master menu. Neither addresses challenges of efficiency, neutrality and fairness to the Canadian tax system. As tax experts warn, Canada’s tax system needs “a heavy dose of pro-growth reform that would increase Canadians’ standard of living” (Mintz 2006). Canada should be moving, as other countries are, away from taxing personal income and toward taxing consumption. Yet federal policy, with a few exceptions in the 2007 budget, has failed to do this — instead, it has reduced the GST and created and expanded special preferences. The other area of silence is Canada-US trade policy. Here the next logical step is to negotiate a common external tariff (CET), but not a common commercial policy, to eliminate costly rules of origin and enhance market access. These points are discussed in the next section, where I explain the rationale for my choices.

## [subhead level 2] Trade and Globalization: Canada in the World

Canada currently lacks a clear strategic framework for its external economic policy. When everything matters, nothing happens. We are making incremental progress on resecuring US market access, but with little vigour or leadership. A global economic strategy is indiscernible. Canada's economic position in the world needs to be viewed within the context of the priority we must accord our bilateral economic relationship with the United States,[3] so the bilateral proposals Michael Hart makes in his contribution to this volume are sensible ones, but there are broader issues to which he gives short shrift.

The Canada-US trade relationship is central to our economic well-being. Around 70 percent of this trade is intra-industry, reflecting the importance to Canadian firms of their participation in US supply chains (Beckman and Goldfarb 2007). Much technology comes from, and many knowledge industry opportunities lie in, the US market (as both the Chinese and Indian governments will readily acknowledge). Much of the flow of trade, capital and people is market-driven, but NAFTA, as an intergovernmental agreement, has brought undeniable economic benefits.[4] Cumbersome rules of origin remain, however, as do regulatory differences that make little economic sense in key industries; and obstacles to the free flow of people, capital and ideas within the North

American economic space persist. The competitive challenges from China and India should be a catalyst for us to renew our efforts to remove the barriers that remain post-NAFTA and thus increase North American economic efficiency.

Another inescapable fact of North American life post-9/11 is the determination of US lawmakers to reduce the vulnerabilities of economic openness. Middle East violence, military failure in Iraq and the international proliferation of terrorism all feed a climate of fear and insularity, and in such a climate, a terrorist attack or catastrophic health event in either country could trigger a border closure. The revival of the fortunes of the US Democratic Party, which has traditionally favoured protectionism, adds to Canada's market access risks and is reminiscent of the early 1980s, when protectionist sentiments pervaded the US Congress. It remains to be seen whether the clout of key, tightly integrated auto, steel and energy industries, which rely on North American supply chains that often span both US borders, will prevail against protective and protectionist pressures in times of adversity.

Hart's proposals may be characterized as "expedited incrementalism" — they are things that need to be done sooner rather than later and that need to be pushed along by regular monitoring on the part of leaders. I agree with all of his proposals, but I have chosen expedited border administration and infrastructure development, with institutional arrangements a runner-up. Much more innovation would be required to facilitate the movement of low-risk cargo and people, and large investments in border crossings would also be needed. According to the selection criteria, these measures are no-brainer incremental improvements and politically and administratively feasible. Their benefits — reductions in business costs deriving from border measures — are large relative to their expense (which can be defrayed by private-public partnerships in infrastructure). We should also note that progress on securing market access requires the interrelation of a number of policies. For example, progress on cooperative security arrangements (not on the menu) would facilitate a border more open to the movement of goods and people. Progress on smarter regulation — based, as much as possible, on mutual recognition of domestic regulations — would reduce the need for active customs administration and release resources for other uses.[5] And regular high-level leaders' meetings would be required to push the agenda along.

Hart's exclusive focus on the bilateral relationship is understandable, but I would not go as far as he does in declaring the ineffectiveness of Canadian trade policy initiatives in the rest of the world. Although we have been marginalized at the World Trade Organization (WTO) — in part our own doing — we should surely not become a free rider. As the current round of WTO negotiations languishes for want of political will in the largest countries, Jonathan Fried and Keith Head, in their responses to Hart, make a case for initiatives with large and dynamic economies like China and India. This approach is valid and potentially important (see Dobson 2002, 2004, 2006). Indeed, if those two governments' current study of a bilateral China-India FTA ever reaches the negotiation stage, pan-Asian trading institutions will not be far behind. No trade policy expert would advocate allowing the world trading system to fragment into regional trading blocs; the best way to prevent this is through multilateral negotiations, but since these have become unwieldy and ill-focused, one alternative is to ensure cross-regional trading ties based on WTO principles, as a number of countries have already done. Canada should keep up with the United States on Korea, although a NAFTA accession arrangement makes a lot of sense. But, as Hart argues, we should stop pursuing FTAs with small countries, since the World Bank has amply demonstrated that the benefits are negligible relative to the resources expended in such negotiations (World Bank 2004).

Finally, as Hart's chapter is the only one in this volume that looks at Canada in the world, it is unfortunate that time and space did not permit him to pay more attention to the new trade theory of global supply chains (see, for example, Trefler 2005) and offshoring, which he mentions only in passing. Hart argues that by securing and deepening North American integration, we will give Canadian firms access to global supply chains. This is probably necessary, but it is not sufficient. The evidence indicates that Canadian businesses have much to learn about offshoring in third countries to increase the efficiency of their North American operations (PricewaterhouseCoopers 2004; Scott and Ticoll 2005).

[SH 2] The Human Capital, Health Outcomes Menu and Strengthening Our Human Capital

The major changes in the world economy require adjustments that burden some industries and their employees and boost others. In the aging advanced industrialized countries, skills-biased technological change is one of the main reasons individuals lose their jobs and must find new ones, sometimes repeating the process several times in the course of their working lives.[6] The attraction of the early childhood development/education (ECD/E) proposals put forward in two contributions to this volume — one by Robert Evans, Clyde Hertzman and Steve Morgan, and another by Craig Riddell — is that they address a key determinant of better outcomes in peoples' lives in an uncertain world: give children better early-life experiences and education and they will gain the skills they need to respond to challenges and opportunities later in life.

Complementary research on health outcomes (in the Evans, Hertzman and Morgan chapter) and economic outcomes (in Riddell) suggests that a public good would be produced — in the form of healthier, more resilient and more able populations — that should be supported by public resources. But how much in the way of resources? Evans, Hertzman and Morgan would allocate as much as 1.5 percent of GDP over the next 10 years to reduce the ratio of Canadians reaching adulthood without the competences they need to cope in a modern economy to less than 10 percent from over 25 percent. The authors' comprehensive system of nonprofit, community-based service delivery programs would be financed by federal-provincial transfers along the lines recommended by the Council for Early Childhood Development. Riddell predicts that his proposal, an early childhood education (ECE) program targeted at disadvantaged children and families, would produce high returns at the margin, because Canada invests a relatively small amount of public resources. But evidence of the impact of ECE is also limited. How much displacement of voluntary private resources would a universal program entail? [But it seems that the program Riddell proposes is <u>not</u> universal. And how does the idea of resource displacement follow from the idea of limited impact? Is clarification needed here?] Riddell notes that as many as 50 percent of Canada's preschool children are already enrolled in some kind of care program that may or may not have an educational component.

The equity and cost-effectiveness trade-offs in these proposals are significant. The authors of both chapters agree that targeted social programs are probably more cost-effective, but such programs tend to lack broad support, which makes them politically vulnerable. Riddell provides no cost estimates, while the universal program proposed by Evans, Hertzman and Morgan would cost roughly 1.5 percent of GDP after 10 years. To illustrate in 2006 dollars, the cost of a mature program would have been more than $21 billion (nominal GDP was $1,400 billion), almost as much as federal transfers to the provinces for health and other programs ($27.2 billion) in that year. I will evaluate the fiscal implications in the next section.

First, however, a central policy issue raised in these two chapters needs informed and thoughtful public debate. Riddell, and Evans, Hertzman and Morgan provide scientific support for public sector program delivery of a public good. Yet the Conservative government in the 2007 federal budget revealed differing assumptions based on public finance and political preferences. The reinstatement of the universal child tax credit, from a tax policy perspective, recognizes the costs borne by parents in raising their children, and it is desirable in that it is fair. The implicit political assumption is that child care is a private good, so give parents the means and subsidize the services ($250 million in the budget). Policy is silent on what the science reveals: high-quality services produce positive outcomes; low-quality services can produce negative outcomes. Nothing is said about setting standards or regulations to ensure that the market produces positive outcomes. Can Canada afford to take a wrong turn in a policy area that has been shown to be significant to the future of our human capital? An essential adjunct to the new approach should be experimentation, with careful monitoring of the market to determine whether it delivers the goods. The experts have documented reasons for concern; the jury is out.

[SH 2] Immigration Policy: Improved Quality of Assimilation

The other priority related to Canada's human capital is to get more of it. In his chapter in this volume, David Foot presents the only proposal that examines immigration policy, and so I address it here, based both on his reasoning and contributions from the human capital proposals on the menu. [Please clarify highlighted phrase. What, specifically, is "based"? Link between "reasoning," "proposals on the menu," and the first part of the sentence is unclear.] Foot argues that Canada should rectify the labour force shortages caused by population aging by selecting skilled younger immigrants seeking better economic opportunities. He would also speed up the immigration certification process. [Or "immigrant labour certification process"?]

Existing immigration policy is passive; it makes no attempt to match the supply of skills with the demand for them. There are other dimensions to this issue: the relative earnings of international immigrants to Canada deteriorated in the 1990s, as Serge Coulombe observes in his response to Riddell's chapter. One reason is an inappropriate emphasis in the selection process on educational qualifications rather than on skills and employability. Economists often make the mistake of inserting into their models numbers of people of labour force age without correcting for employability (determined by such factors as basic literacy and numeracy, quality of schooling and experience). Coulombe notes that Australian immigration policy selects immigrants with skills currently valued in the domestic labour market; Quebec is moving in the same direction.

Changing Canada's immigrant selection criteria costs relatively little and promises relatively high returns. But is this enough? As Don Drummond points out in his response to Andrew Sharpe's chapter on productivity, much more should be done to integrate international immigrants and their children. We do an inadequate job of absorbing immigrant children into the school system; many are unable to function in the language of instruction because they read and speak another language at home. Our attempts to involve parents in the learning process are also inadequate. This is an area where experimentation is underway, some of it funded by school boards and some of it by voluntary organizations. More is needed.

[SH 2] Productivity: Growing the Capital Stock

The desirability of removing the remaining PST on machinery and equipment purchases has been extensively studied. A simple policy change is required; we simply need to act. Sharpe notes that Canada's lagging machinery and equipment investment accounts for 25 percent of the business sector labour productivity gap between Canada and the United States. If Ontario, British Columbia and three smaller provinces removed the PST on the purchase of capital goods, the marginal effective tax rates on capital would be five points lower in 2010. The cost of removing the PST on machinery and equipment in the five provinces that still impose it would not be high, since the burden of the tax is carried by consumers. The benefits relative to costs are very high, as Sharpe argues. The main barriers to action have been political: provinces fear that eliminating the PST on machinery and equipment would force them to raise taxes elsewhere. Yet the idea is popular with business, and enacting it would be an important contribution to reducing the cost of capital, which is already higher than it needs to be — in part, because of overlap and duplication in federal-provincial responsibilities that are not on the menu but continue to raise the cost of capital in Canada. Just do it![7]

[SH 2] Climate Change: The Carbon Management Standard

I have also selected Mark Jaccard and Nic Rivers's centerpiece proposal, a carbon management standard, as presented in their contribution to this volume. It is a prudent, flexible and innovative approach to what I accept is a threat to the global commons that requires collective action. Their policy analysis is impeccable and persuasive. Canada's voluntary approach has had almost no impact on our record as one of the world's largest emitters of GHG in both absolute and per capita terms.

The carbon management standard is similar to the obligation and certificate-trading approach that California applies to vehicle emissions (which specifies a minimum aggregate level of zero- or low-emissions vehicles in the vehicle fleet). To Jaccard and Rivers, the issue of using the atmosphere "as a free waste receptacle" is settled. A value should be placed on its use either by means of a broad-based GHG tax or market-oriented regulations that force reductions in waste-generating activities. The authors' goal is a 60 percent reduction from today's levels by 2050. Their evaluation criteria emphasize the need for an incentive framework strong enough to change producers' and consumers' behaviour over time and to induce innovation without unduly compromising economic efficiency or international competitiveness. They also consider administrative feasibility and political acceptability in their design.

The carbon management standard is imposed on fossil fuel producers and importers, and it is phased in gradually to allow the economy to adjust. The key attribute of the Jaccard and Rivers proposal is the requirement over time for fossil fuels to have zero life cycle GHG emissions. Producers would have to certify their own progress or face stiff financial penalties. Government monitoring would be required for at least two reasons: to verify certifications and to monitor and adjust the certification process in the face of unexpected outcomes. Jaccard and Rivers argue that this system is superior to the better-known cap-and-trade programs because it produces zero emissions — the desirable good — while cap-and-trade schemes regulate a maximum amount of emissions — the undesirable good. They also reject a broad-based carbon tax because, while more efficient, it does not guarantee production of the desirable good and shifts potentially large new financial resources to the public sector.

Why should Canada act in such a draconian way in the absence of movement on the part of the United States? Gradualism helps to address the competitiveness concern, since through this approach the phase-in can be slowed or accelerated in ways the authors discuss. In the meantime, the adoption of the incentive framework is a positive signal to innovators (a Canadian firm is a world leader in carbon capture technology, for example) who may be future technology exporters. Jaccard and Rivers emphasize that the priority is to create the incentive framework and let markets work, rather than to procrastinate because of remaining uncertainty or disagreement about instruments.

[SH 1] **Evaluating the Package**

As I mentioned earlier, I selected this five-part package because its components improve our ability to navigate successfully in a rapidly changing world economy by reducing risk and strengthening our assets; one part also begins to address the collective action problem in the global commons. In this section, I evaluate the package as a whole with respect to three sets of implications: first, the appropriate role of government; second, costs, benefits and fiscal impacts; and third, equity and external balance. [I recast this list as "three sets of implications," because when we get to the phrase "The third implication" on p. 20, it's not clear what the first and second were. Is this all right?] I also explain briefly why I did not choose other proposals.

Market failure in relation to GHG emissions has been demonstrated by scientists. Collective government action is required to create a more appropriate incentive framework that prices private use of the atmosphere. The ECD/E proposals make the case that governments must deliver programs that strengthen the capabilities of the disadvantaged (and promote greater equity) when market forces deliver greater benefits to some groups than to others. Other parts of the policy package are aimed at the risks involved in failing to manage proximity to the US market, improve our productivity performance and increase human capital, but they are uncontroversial in their approach to government's role. They need to be used faster and more effectively.

Having made these choices, I put less weight on other valuable and well-documented proposals that rely on major public interventions, such as Evans, Hertzman and Morgan's Pharmacare (entailing the transfer of billions of dollars from the private to the public sector to achieve significant overall cost savings), [Idea of transferring dollars to "expenditures" seemed unclear. Is it all right to say transfer to "sector" instead, as in the Olewiler example that follows?] Nancy Olewiler's conservation plan (also entailing a major transfer of financial resources and natural capital to the public sector) and Jean-Yves Duclos's guaranteed annual income proposal. The arguments Duclos makes in his contribution to this volume are compelling, but I question whether his proposed radical changes in personal income taxation are the best we can do. A powerful case has been made by tax policy experts for moving away from personal income taxation toward consumption taxation (with refundable tax credits). Would the same resources be better expended on less interventionist or tax-distorting policies? More work is required.

In the area of fiscal impact and cost-effectiveness, improving bilateral border infrastructure will be costly, but the proposal has large benefits in the form of reduced transactions costs. Public-private partnerships are also a less-costly delivery mechanism. The proposal to remove the PST on machinery and equipment as well as the immigration proposal are low-cost relative to their potential benefits. The ECD/E proposal is the most costly item in the package, but it has potentially impressive returns. Clearly, experimentation with less-costly designs is needed — such as targeted services approaches and careful monitoring of the outcomes of publicly and privately supplied programs. Finally, Jaccard and Rivers's carbon management standard has the attractive feature that it relies on a regulatory rather than a tax-based approach and so avoids transferring resources to the public sector. The authors also argue that gradual phase-in helps control costs, but this remains to be seen.

The third set of implications involves equity and external balance. This package has been assembled with an emphasis on efficiency concerns; even so, the ECD/E proposal (particularly if it were targeted) and the immigration proposal are fundamentally important in equipping those most at risk in a world of skills-biased technological change to adjust. External balance is addressed in this package by reducing risks of border closure or disruptions. The enhancement of competitiveness and fairness is a key factor in the selection of the immigration, ECD/E and productivity proposals, and competitiveness is taken into account in the design of the carbon management standard.

Finally, most of the proposals that I did not choose are sensible ones, such as Foot's workforce and health care policies, and Sharpe's proposals for SME (small and medium-sized enterprise) technology adoption and tax credits for job search. Others — by Jaccard and Rivers, Duclos, Olewiler, and Riddell — are linked to their major proposals. [Please clarify previous sentence. "Proposals are linked to their [whose?]

proposals" seems unclear.] Still others, such as Hart's regulatory harmonization proposal, need refining, since other measures — such as mutual recognition — could achieve the desired outcome.

## [SH 1] **What Are the Probabilities of Implementing This Package?**

In the short term, the probabilities are small, in part because big proposals — like those concerning ECD/E, climate change and PST reduction — are anathema to minority governments. In the longer term, these proposals should attract the support of Canadians, but not without further public debate about the role of government. The Conservative government's actions on child care and climate change reflect its preference for market-based measures over regulation or government intervention.

Despite the high level of public concern expressed about climate change in early 2007, the political calculus also seems to reflect the conviction that voters would be unwilling to pay the price of effective emissions reduction policies. Historical experience may be a guide here. In the mid-1980s, seemingly endless public sector fiscal deficits became a public concern. The economic case for spending cuts and/or tax increases was clear, but voters were initially willing to support such actions only if they were not personally affected; firing civil servants and privatizing the post office were acceptable, for example. Only after 12 years of debate and a financial crisis was an effective strategy adopted, which spread the cost widely across the population. Today, the chances of substantial political capital being spent on radical preventive actions seem small in the absence of crisis or a major change in US policies. Early childhood education will suffer the same fate: the short-term fix of a universal but modest tax benefit may be popular, but perhaps because there is no high-profile public debate that takes account of the science.

In conclusion, this package rises to the challenges Canada faces in this period of rapid global transformation. Major initiatives are balanced by relatively uncontroversial ones, and the latter gain prominence and urgency as part of the strategic agenda proposed here.

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[SH 1] **Notes**

[1] If these numbers were corrected for skills and employability, they would be smaller, but the ratios would be similar.

[2] The federal government indicated in Advantage Canada: Building a Strong Economy for Canadians its intention to deal with some issues — such as those described in my first two examples — but progress is slow (Canada, Department of Finance 2006).

[3] The US accounts for more than 80 percent of the real value of Canada's exports, and nearly 60 percent of the real value of its imports.

[4] Two-way merchandise trade grew significantly between 1990 and 2000 because of trade liberalization and the dynamism of the US economy; this was followed by slight declines in 2000-05.

[5] This would have to be supplemented by domestic initiatives, like the 2004 Smart Regulation strategy, in order for Canada to eliminate overlap, duplication and outdated or unnecessary regulations.

[6] Adjustments are also required in developing economies, but in such economies incomes are likely to be on the rise, because more productive jobs become available during liberalization and policy reform.

[7] The issue was addressed in a temporary fashion in the 2007 budget through a reduction in the capital consumption allowance. This will not foster as efficient an allocation of resources as removing the PST would, but it avoids federal-provincial complications.