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Canada Watch

PRACTICAL AND AUTHORITATIVE ANALYSIS OF KEY NATIONAL ISSUES

SPECIAL DOUBLE ISSUE ON CANADA–U.S. RELATIONS IN THE NEW MILLENNIUM

Convergence or divergence?

BY CHARLES F. DORAN

Charles F. Doran is the Andrew W. Mellon Professor at the School of Advanced International Studies, John Hopkins University, Washington.

Two roads diverged in a yellow wood,
And sorry I could not travel both
And be one traveler . . .

— from "The Road Not Taken," by Robert Frost

HOW SIMILAR OR DIFFERENT?

The question is whether Canada and the United States are converging or diverging in important respects concerning society and economy. In Canada, a presumption may exist that long after having completed its gradual shift away from "the Empire" and British values and customs, Canada now is veering toward a more "American" way of doing things. In the United States, the opposite view is likely to hold—namely, that although set against a world scale of national comparison, Americans perceive Canadians to be quite similar to themselves in preferences, appearance, and behaviour, but they do not observe or expect additional convergence.

Ascertaining whether Canada and the United States are converging or diverging appears a quite simple exercise. Observe whether the U.S. and Canadian economies, or social policies, or political institutions are becoming more similar. Plenty of casual evidence exists

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Canada–U.S. relations at the dawn of the new millennium

How public policies designed to strengthen a nation might end up destroying it

BY JAMES GILLES

James Gilles is professor emeritus at the Schulich School of Business, York University, and a former member of Parliament and senior policy adviser to the prime minister of Canada.

One of the major consequences of the development of the global economy is that, while the raison d'être for much of Canada's traditional industrial policies may still be present, the ability of any government to continue such policies is over. As a result convergence between Canada and the United States will be much greater in the 21st century than it was in the 20th—not because of external threats, but rather because of internal indifference.

INDUSTRIAL POLICY: A PRIMER

Canada's economic prosperity is largely based on international trade.

The new millennium, page 79

FEATURES

UNIVERSITÉ YORK UNIVERSITY

From the editor

This special issue of *Canada Watch* examines the pivotal issue of Canada–U.S. relations, at a time of unprecedented economic integration.

Since the signing of the two free trade agreements Canada–U.S. relations have undergone enormous change, and many experts predicted that integration in public policy would accelerate in such strategic areas of importance as health care delivery, social and cultural policy, labour market management, and tax reform.

According to the experts in this issue, our assumptions need to be rethought in light of empirical evidence. Wholesale convergence is not occurring between these two look-alike societies. There is strong evidence that national governments remain on separate but parallel paths, in many spheres of public policy. In some areas, such as labour market policy, there is strong evidence of convergence. In other areas, such as cultural policy, Canada's vision of culture remains markedly apart from the United States'. What emerges from this complex picture is that policy management by Ottawa and Washington has become an arena of conflict between the two countries. Power is what matters, and Canada does not have the punch when it matters.

At the root of so much friction is that so far the benefits of greater economic integration have proven to be much less dramatic for Canadians than predicted. If there is a success story, it is largely an American one. Americans continue to have higher incomes, more jobs, stronger industries, high-tech industries to spare, and cheaper consumer goods than Canadians. What is worrying is that the gap between the two countries is growing, not shrinking, despite continental free trade.

But economic policy is not the only defining element in the relations between the two countries. Canadian health, cultural, and social programs demonstrate that Canadian values and institutions remain strikingly different from those in the United States and will keep the two countries on parallel paths, well into the future.

Compared with American political culture, ours is strongly pragmatic. We allow prayers in school, have strong gun control legislation, and support redistributive social policies and a universal public health care system. Canada still has a strong sense of collective entitlements despite the corrosive influence of globalization and neoliberalism. In the United States their political culture is fiercely and often naively idealistic. Gun control is not on the books, a universal health care system remains in perpetual no man's land politically, and an adequate social policy a distinct memory. The problem is that, in the Republic, entitlements are seen as a grant from government largesse for the undeserving. Hence entitlements are despised and vulnerable to attack from many different quarters. Canada and the United States are not an echo of each other.

The defining reality is that Canada still has a "leaky" border with the United States, with goods, services, and capital pouring in. As many of the contributors to this special issue demonstrate, Canada needs, in the words of Jim Gilles, "imaginative new public policies" to meet the needs of all of its citizens. So far the Chrétien Liberals have few ideas of how to build that capacity. It is unlikely that the pending federal election will generate a bold new vision or even the beginning of one. This policy crisis has not been addressed. It ought to be. We are a country without a new set of policy initiatives to take Canada into the 21st century. That's troubling.

— Daniel Drache
Co-editor-in-chief
Canada Watch

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PRACTICAL AND AUTHORITATIVE ANALYSIS OF KEY NATIONAL ISSUES

EDITORS-IN-CHIEF
Daniel Drache, *Robarts Centre for Canadian Studies, York University*
Patrick Monahan, *Osgoode Hall Law School, York University*

MANAGING EDITORS
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PRODUCTION
WordsWorth Communications

CONTACT FOR INFORMATION
Canada Watch
227 York Lanes, 4700 Keele St.
Toronto, Ontario M3J 1P3
Phone (416) 736-5499
Fax (416) 650-4321
www.robarts.yorku.ca

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Integration without convergence? The North American model of integration

BY DANIEL DRACHE

Daniel Drache is director of the Robarts Centre for Canadian Studies and a professor of political economy at York University.

A DECADE OF FREE TRADE

After a decade of the FTA, NAFTA, and intense globalization, Canada and the United States have entered a period of transition, yet the emergence of a North American policy space with shared values, assumptions, policies, and goals has failed to coalesce. The newest development is that the Canadian state is not being dismantled, as was once confidently predicted. Rather, it is being redefined in many ways that can only be explained by changes in elite politics and notions of governance. While NAFTA and globalization are powerful benchmarks, they do not alone account for the fundamental changes in the Canada–U.S. relationship.

With among the highest levels of economic integration in the industrialized world, it was expected that the dual effects of NAFTA and globalization would lead to greater convergence in key policy areas between Canada and the United States and, further, that Canada's distinctive programs, policies, and values would be jeopardized. Certainly there is now a greater degree of interconnectedness between the local economies in Canada and the larger American-centred north–south regionally based markets than ever before. Trucks, railways, airlines, ports, e-commerce, water, and electricity grids transect the continent in real time.

In the past, many experts claimed that such a high degree of integration meant that Canada would not sustain its own particular social and institutional arrangements. It was considered that the worlds of the state, politics, and economics had to have congruent boundaries so that state action and the behaviour of economic actors could be addressed through strong, nationally based politics. This proposition has to be rethought for one basic reason—after a decade of integration, the leading indicators do not reveal, to the degree predicted, strong evidence of across-the-board convergence.

> Wholesale dismantling has not occurred in key areas of public policy. But program reforms carried out by the national and provincial governments have had dramatic impacts on Canadians.

DIVERGENCE IS ALSO THE TREND

The theory predicted that in government spending Canada would adopt the "less state, less tax" U.S. model. In productivity, the gap between Canadian and U.S. firms would close. In social program expenditures, Canadian spending would drop to U.S. levels. In health care, Canada's health care system would move toward the U.S. private system of health delivery. As for labour and collective bargaining, Canadian unions were expected to go down the U.S. road toward a non-union workplace. Finally, with regard to values, American individual self-interest would replace the Canadian belief in collective responsibility and fairness. So far, all these critical gaps have not disappeared; many have grown more pronounced, despite the promise of closer economic integration.

Wholesale dismantling has not occurred in key areas of public policy. But program reforms carried out by the national and provincial governments have had dramatic impacts on Canadians. All this is evidence of an unexpected trend—namely, that of integration without deep convergence.

The bare-knuckle reality is that the disciplinary code of markets is less than anyone could have imagined and that the NAFTA effects are far less significant, as a public policy factor. Canadians have held their own despite the pressures from the Republic's moving frontier, not well, but better than most of the policy experts anticipated. Contrary to almost every prediction, Canadian economic and social space, although troubled, is more resilient. The traditional structural fault lines of the economy—low per capita spending on new technology, too few Canadian middle-ranking firms, the absence of a developed venture capital market, and a poor skills acquisition strategy to upgrade the workforce—continue to drag down Canada's economic performance. Any or all of these factors would undermine Canada's competitive position with or without integration. If the critical test is to examine the gaps be-

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In social spending, the two countries are worlds apart. Canadian public authority spends significantly more on health, education, pensions, and social welfare from the public treasury. The "more" amounts to 4 percent of GDP.

tween Canada and the United States in key areas of the economy, it reveals something quite startling: high levels of integration marked by many characteristics of social divergence and spatial distinctiveness.

How can so much divergence be accounted for?

The best explanation is that the motor for change comes as much from within Canada, due to the fiscal and monetary polices adopted by Ottawa, as from without. Institutions make a real difference. The evidence may not be conclusive but it is compelling enough to sit up and take notice of it.

WHAT THE EVIDENCE SHOWS—KEY INDICATORS

In terms of tax policy, there has been no collapse of the higher tax regime in Canada over the decade. We remain above all of our trading partners but only slightly above the G7 average. We continue to be 8-9 percent higher than in the United States and Canada continues to rely more on personal income taxes. By comparison, Ottawa taxes middle- and upper-income Canadians more, while lower-income Canadians are better off than their U.S. counterparts. The villain is that, since 1986, Canadian tax rates were not indexed against inflation, while in the United States they were and thus the tax bite in Canada has been deeper.

In terms of per capita income, Canadians earn roughly 20 percent less than their U.S. counterparts and there is no closing of this gap. Indeed, many experts, such as Benny Tal, believe it is widening. Since 1989, real pre-tax income rose in Canada by Can.$500 compared with U.S.$2,850 in the United States. If Canadian family incomes are rising by the late 1990s, it is because more people are working and a strong job market has helped reverse a decade-long income decline. In 1998, income tax increased 3.7 percent, the biggest single year gain since 1989. But with taxes and transfers no longer balanced, income inequality has also grown more pronounced, although still less than in the United States.

In social spending, the two countries are worlds apart. Canadian public authority spends significantly more on health, education, pensions, and social welfare from the public treasury. The "more" amounts to 4 percent of GDP.

In the area of employment the two countries again diverge. Between 1989 and 1997, employment rose by 10.4 percent in the United States, this is compared with only 6.5 percent in Canada. Statistics Canada found that, in the United States, most of the growth occurred among full-time employees, while in Canada self-employment accounted for 80 percent of the overall employment increase.

One of the largest areas where the two countries differ is their unemployment rate. In 1981, Canada and the United States had the same rate. During the 1980s this grew larger and by the 1990s the gap had risen 4 percentage points. With a lower rate of inflation, Canada had almost twice the U.S. level of unemployment. The productivity gap in manufacturing has only marginally changed. In 1988, the gap in manufacturing was 78 percent of U.S. levels and by 1998 it had fallen to 72 percent. Canada persistently lags the United States in research and development (R&D), equipment, machinery, and new product development.

NORTH AMERICA IS NOT A SEAMLESS MARKET

At the provincial and state levels, all Canadian provinces have had higher unemployment rates. With few exceptions, American states experienced an overall decline in unemployment rates. The contrast with Canada could not be sharper. Provincial unemployment rates have not succeeded in reducing unemployment to the same degree. Also, in the area of job creation, the labour market experience is sharply contrasting. In the land of opportunity and risk taking, full-time employment played more of a role in the U.S. economy. In the more conservative Canadian society, a greater number of jobs were created by self-employment.

In terms of collective bargaining and trade-union coverage, the latest figures indicate that, with about 38 percent of the workforce covered by collective bargaining, there has been no collapse of the Canadian union movement equivalent to that in the United States. There is a decline in private sector unionism but this has been in effect for the last 40 years and, more recently, this decline has largely been arrested.

Industry Canada has commissioned a new series of studies to examine the effects of foreign direct investment (FDI). FDI has more than doubled in Canada in the past decade, reaching 22.6 percent of GDP. Here a brief comment is in order. Canadian industry is getting the short end of the stick. FDI inflows promise much but, in terms of their impact on output, domestic spillovers pay larger dividends, if these studies are to be believed. At present, only about one-third of FDI flows into manufacturing, and the technology and transfer spillovers on productivity are disappointing. There appears to be no significant relationship between foreign direct investment and R&D capital.

Domestic R&D spillovers were greater than those from new capital inflows. Total factor productivity, one of the key measures that economists rely on to explain the different contributions to a better industry performance, was a meagre 0.11 percent per year over the period 1973 to 1992. By contrast, Germany gets a big increase from FDI flows, 0.27 percent for every 1 percent increase in FDI. So, if a productivity gap is still significant, more integration is not likely to have much of an impact on making Canadian firms more competitive now that they have new access to the U.S. market. The large differences in productivity that have dogged Canadian industry for the last 40 years have more to do with best managerial practice and technological know-how than any other significant factor. In both categories the differences between Canadian and U.S. firms have deteriorated since free trade was introduced. Evidently management strategies are not responding to optimal market price signals.

Since 1984, Canadian exports to the United States have jumped from $85 billion, rising to $100 billion in 1988, the year of the first trade deal, and topping $200 billion in 1996. At the same time, interprovincial trade also rose from $106 billion to $160 billion. By the end of the 90s, eight out of ten provinces—with only Nova Scotia and PEI being the exceptions—traded more internationally than interprovincially. If the Canadian economy is buoyant, it is because of the $.67 dollar and the recovery in international commodity prices. There is nothing new in the fact that Canada's best industrial hope, at the moment, is to ride on the back of the U.S. business cycle until it abruptly runs out of steam. Every Canadian government has tied its star to the same policy, seemingly indifferent to being burned at the stake of U.S. policies.

[D]espite all the talk about the triumph of markets, the Canadian state has not been dismantled as once feared. This is hardly reason to be complacent because the combination of NAFTA effects and globalization dynamics raises a whole array of governance issues that need addressing.

DEFYING CONTINENTALIST LOGIC

None of these "leading" indicators explains the unique situation of North American integration—high levels of interdependency without convergence. With so much policy divergence, instead of lockstep convergence, the role of government and the organization of civil society continue to defy either a strict continentalist logic or the nationalist cri-de-coeur. The empirical evidence is a powerful reminder that despite all the talk about the triumph of markets, the Canadian state has not been dismantled as once feared. This is hardly reason to be complacent, because the combination of NAFTA effects and globalization dynamics raises a whole array of governance issues that need addressing. These are the hard issues of public life for which no political party seems to have readied answers.

First, since the income gap between Canada and the United States is larger than ever, can it be closed? Second, with so much pressure on English Canadians and their identity, does it have the political desire to differentiate the Canadian experience from the American any longer? Finally, will the political elites protect Canadian identity and distinctiveness when these collide with the free flow of ideas and goods?

Becoming more Canadian rather than North American could be helped by the fact that there is hardly anything left of what used to be called the special Canada–U.S. relationship. Old-fashioned "good neighbourliness" has been replaced by U.S. foreign policy largely carried out on behalf of private rather than public interest. The NAFTA linkage has not given Canada a step up in U.S. policy circles. At present, Ottawa has to line up with all the other lobbyists to cut deals with the U.S. Congress when it has special needs or concerns. One unintended consequence is that, in the hemisphere, Canada is increasingly seen as an indispensable counterweight to U.S. policy by many Latin American countries in the OAS and other regional bodies.

In this new environment, rethinking North America will be helped by the fact that the Canadian economy is booming and, after a decade of disappointment, unemployment is down and growth is much stronger than ever before. So the question is, does it matter anymore that Canada and United States are on two different paths economically and politically? Who cares if NAFTA did not create the great level playing field? No one save a few diehards seemed to notice that all the hype around market access has turned out to be a false penny.

Canadian and American social values

BY MICHAEL ADAMS

Michael Adams is president of Environics Research Group, one of Canada's leading marketing and public opinion research companies.

Canadians are more readily rejecting traditional authority knowing that they, living in a more ordered and peaceable kingdom than the one to the south, may assert new social norms with comparatively little risk and fear.

THE GREAT DIVIDE

Individualism is an important value in both Canada and the United States. Americans have held and venerated values of individual autonomy since their nation's inception. Canadians, on the other hand, have traditionally favoured more collectivist values and have been, as sociologist Seymour Martin Lipset has indicated, more deferential to institutional authority.

The divide between the two nations in this respect can, of course, be traced to the American Revolution. In electing to stand apart from this movement, Canadians essentially assented to the maintenance of old world Toryism, which values group identities over individual rights. This particular world view and the institutions that reflect this world view, along with the nation's climate, geography, and smaller population, have made Canadians generally more accepting than Americans of state intervention in their daily lives. Individualism, an almost sacred value for many Americans, has yet to be mythologized to the same extent north of the 49th parallel, although numerous registers indicate that Canadians, in fact, place greater emphasis on personal freedom and harbour less deference to traditional institutions such as the state, the family, and religious organizations than do their American neighbours.

Today Americans are clinging to traditional institutions as anchors in a chaotic, changeable, and Darwinistic world. More vulnerable than Canadians to the vicissitudes of the market, Americans depend more than Canadians on the institutions (family, religion, and a harsh justice system) that offer stability and protection.

By contrast, Canadians are more readily rejecting traditional authority knowing that they, living in a more ordered and peaceable kingdom than the one to the south, may assert new social norms with comparatively little risk and fear.

BIG DIFFERENCES STILL

One key feature that distinguishes Canadians' social values from those of Americans is Canadians' lesser and still diminishing commitment to traditional religious institutions. When polled,* Americans (48 percent) are more likely than Canadians (32 percent) to agree strongly that children should receive a religious education, and are more likely to consider themselves members of a religious faith (75 percent of Americans consider themselves members of a religious faith, compared with 64 percent of Canadians). Americans are also more likely to report that they often or sometimes meditate on the meaning of their lives, and that religious beliefs are very important to them. Even among Quebeckers, with their legendary Catholicism, religiosity is in precipitous decline.

One reason for the more serious decline in religiosity in Canada than in the United States is likely the nature of faith institutions in the two countries. The Catholic and Anglican churches, both extremely hierarchical organizations, have historically played a dominant role in Canadian life. They have done so with explicit government sanction, in part through constitutional provisions that protected Catholic and Protestant denominational schools.

By contrast, the American constitution separated church and state more starkly and so evangelical or populist sects had to compete for the attention and adherence of worshippers, thus lending religion in the United States a less institutional character.

In the past, this difference in the two countries' faith organizations has favoured greater religiosity in Canada. With the power of religious ideology declining in both countries, however, the more fundamentalist orientation of religion in the United States has proven the more resilient and "market sensitive." In Canada, mainstream Judeo-Christian denominations are losing their grip on the population and many of the values traditionally associated with these religious organizations have come under critical scrutiny, if they have not been discarded altogether. These values include deference to state authorities, patriarchal definitions of the family, guilt, duty, and fear of divine retribution.

THE FAMILY AND GENDER

Although common law unions and families including gay or lesbian partners are gaining acceptance on both sides of the border, on the whole Canadians have adjusted their definition of the family to include these non-traditional domestic arrangements more readily than have Americans. When asked whether society should regard people who live together without being married as a family, 69 percent of Canadians agree (29 percent disagree), compared with only 52 percent of Americans (almost half of U.S. respondents—47 percent—disagree).

Polling data indicate that even Canadians' ideas about the traditional nuclear family are changing more rapidly than those of Americans. While both countries are moving away from a hierarchical and patriarchal model of the family unit, Canadians have moved more rapidly from the conviction that father knows best. When asked to agree or disagree with the statement "The father of the family must be master in his own house," fully 80 percent of Canadians disagreed. Most Americans also disagreed, but the majority was weaker: 55 percent of American respondents disagreed with the statement while 44 percent agreed that father must rule, compared with only 20 percent in Canada. These numbers offer strong evidence of Canada's moral decay in the minds of this country's "social conservatives."

Also significant to the issue of hierarchy within the family is the following datum: when asked to agree or disagree with the statement "Good parents make and enforce strict rules for their children," 37 percent of Americans agreed strongly, compared with only 22 percent of Canadians. Clearly, Americans are at present less willing to abandon the traditional family structure than are Canadians.

[G]reater willingness on the part of Canadians to accept diversity, as well as Canada's lesser inclination to demand ardent patriotism of its citizens, does not necessarily indicate that Canadians are apathetic about Canada as a nation. Rather, and paradoxically, they feel strongly about their weak attachments to the state, its institutions, and their fellow citizens.

IDENTITY AND HIERARCHY

With respect to fluidity on gender identity, when asked to agree or disagree with the statement "It's perfectly normal for even the most masculine man to demonstrate what are thought of as feminine qualities," almost three-quarters (74 percent) of Canadians agreed (23 percent disagreed), while 65 percent of Americans agreed (33 percent disagreed). In the same vein, when asked to agree or disagree with the statement "I don't like seeing men and women who dress and behave so much alike that I have trouble telling them apart," less than one-quarter of Canadians (23 percent) agreed totally, while 37 percent of Americans agreed totally. Thus, in terms of gender roles, Canadians exhibit greater tolerance than Americans.

Under traditional patriarchy, the family and indeed gender itself have been sites at which hierarchy has entrenched itself as a dominant mode of organization. As Canadians increasingly reject hierarchy in the private sphere of the family, they may also be seen, more than their American counterparts, to eschew the idea of hierarchy in the workplace.

There is a stark division between Canadians and Americans on the issue of heterarchy versus hierarchy. Canadians are much more likely to embrace heterarchical modes of organization—that is, models in which there is no single leader and in which tasks are assigned based on the interests and experience of those involved, while Americans are more likely to appreciate the clarity of a hierarchical chain of command. When asked to agree or disagree with the statement "In organizations, things work better when there is no single leader in charge," almost half (47 percent) of Canadians agreed, compared with only 19 percent of Americans.

This pattern of pluralism north of the border and greater demand for conformity south of the border holds in other areas as well. The two countries' different approaches to immigration are well known: while the United States has attempted to create a melting pot of integration and assimilation, Canada has striven to create a multicultural mosaic in which immigrants maintain many of the values and customs of their nations of origin.

Most Canadians (59 percent) agree with the statement "Our country would be a better place if ethnic groups maintained their cultural identities"; slightly less than half (49 percent) of Americans agree. An unwillingness to welcome non-white immigrants is also slightly more common in the United States. When asked to agree or disagree with the statement "Non-white immigrants should not be allowed to immigrate to our country," 11 percent of Canadians agreed (87 percent disagreed) while almost one-quarter (23 percent) of Americans agreed (77 percent disagreed).

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Welfare repeal: How low can we go?

BY ANDREA CALVER

Andrea Calver is the coordinator of the Ontario Coalition for Social Justice.

CANADA AND THE UNITED STATES CONVERGE ON WELFARE REFORM

Welfare used to be as low as you could go—the bottom of the barrel. Not anymore. Welfare is now harder to get in both Canada and the United States. Increasingly, needy people are being disqualified from receiving assistance, and are being turned away from the welfare system. True, some of those turned away do find jobs; but others cannot and do not find work. Poverty activists in the United States despair at what they call "welfare repeal." They have seen "welfare reform" give way to new regimes that make it impossible for some people to get any help at all. This is the key convergence in welfare policy between Canada and the United States

On both sides of the border, we have come to expect that some people in our communities will have no income whatsoever—not from welfare and not from work. The growth of homelessness and the staying power of food banks are a sad testament to this new acceptance. Correspondingly, changes in welfare policy reflect inherent expectations of what can and should be done about poverty. The rise of "welfare repeal" means that welfare cannot be properly called an option of "last resort" anymore. Many people are increasingly barred from that "last resort."

A VERY CONDITIONAL "SAFETY NET"

There is still a peculiar wariness in Canada and the United States that their welfare systems are too generous. The predominant thinking is that people should not enjoy welfare as a "right." Not if they have done drugs. Not if they don't work(fare) for their welfare. Not if they have been convicted of fraud. Not if they are 16. Not if 5 years have passed. Not if their papers are not in order. (There will be more on these specific examples later.) Being needy is not enough. Welfare has become a very conditional safety net. "Ending welfare as we know it"—the popular refrain of President Clinton—has become both theory and practice in both countries.

We once viewed welfare as the last safety net—below which a person ought not fall. Now there is no limit to how far you can fall. Both Canada and the United States have moved away from granting welfare assistance based on the simple neediness of a potential recipient.

Of course, there is some divergence between Canada and the United States with regard to the specifics of system privatization: the reasons people are disqualified from receiving benefits, and the precise implementation of workfare protocols. However, the overwhelming sameness of the thrust toward "welfare repeal" is remarkable. As someone who has opposed many of the changes to welfare in Ontario, I often find policy precedents for a tighter system in the United States.

THE WRONG TESTS: LIFETIME BANS AND BENEFIT LIMITS

In the United States, the 1996 *Personal Responsibility and Work Opportunity Reconciliation Act* mandated work activities for all recipients, and a five-year total lifetime limit for receiving welfare assistance. As of yet, there are no lifetime limits in Canadian jurisdictions. However, in Ontario, the Harris government has introduced a "lifetime ban" for people convicted of welfare fraud. These are the wrong tests for the wrong reasons.

Both lifetime benefit limits and the implementation of a lifetime ban fundamentally challenge the core purpose of welfare. Both are arbitrary protocols, indifferent to the objective needs of people who may well require help. We once viewed welfare as the last safety net—below which a person ought not fall. Now there is no limit to how far you can fall. Both Canada and the United States have moved away from granting welfare assistance based on the simple neediness of a potential recipient. Exclusion is also the focus of other new welfare rules in Ontario, such as mandatory drugs testing, and ending benefits for 16 and 17 year olds.

Even without assistance, needy people still have to try to pay the rent and try to feed themselves. Without assistance, many people simply cannot manage. The new "*non*-needs-based" rules do remove people from the welfare system. The trouble is that these people may actually be worse off without assistance.

RULES TO CONFUSE, DISCOURAGE, AND DISQUALIFY

A report from the U.S.-based Children's Defense Fund called *Welfare to*

When you take a close look at Andersen Consulting's "efficiencies" and "innovations," they create savings by making welfare harder to get—whether a recipient actually needs help or not.

What?—published in December 1998—details circumstances where families are denied assistance, not because they are no longer needy, but because of a failure to meet bureaucratic requirements. For example, the following situation is cited: "In Iowa's PROMISE JOBS experiment, the majority of families punished for failure to meet welfare-to-work requirements told researchers they did not understand those requirements."

The experience in Ontario is no more illustrious. Mandatory workfare, with its "participation agreements," is about eventually disqualifying people from receiving assistance, more than it is about preparing people for work. This thrust is detailed in the 1999 *Broken Promises* report, by Workfare Watch:

> They use language in here like . . . "noncompliance," "recipients," "cancellation," "first occurrence," "each subsequent occurrence," and it's put out as an information sheet but in fact it's a contract and it says, "the contents of this document have been explained to me and I've received a copy." Well, I mean when you're in that situation with a couple of kids you'll sign anything. I didn't even really read it, I just said OK.
>
> —Kelly, Peterborough, Ontario

PROFITING FROM "WELFARE REPEAL"

Multinational companies like Andersen Consulting have successfully won contracts across Canada and the United States to implement the mechanics of "welfare repeal." Andersen Consulting negotiates payment as a percentage of the savings to the state treasury. It is a seductive offer for client governments. The Harris government is paying Andersen Consulting a percentage of welfare savings, up to $180 million, for savings achieved in "modernizing" the province's welfare system. The company will have no difficulty meeting its target. When you take a close look at Andersen Consulting's "efficiencies" and "innovations," they create savings by making welfare harder to get—whether a recipient actually needs help or not.

In Ontario, Andersen Consulting's *Consolidated Verification Project* is a rigorous review of every aspect of every welfare recipient's file. As opposed to judging people's need, the focus is on finding the criteria to disqualify people. For example, if a document is missing, whether it's two days old or 20 years old, if the recipient's paperwork is not in order, they get kicked off. The more people off welfare, the more money Andersen Consulting makes. Simply set up obstacles that vulnerable people find too difficult to manouevre, and more people fall off the rolls. One strike, and they're out.

Another example from Workfare Watch:

> On October 1st I read my mail—welfare said I needed all of this documentation: proof of my land tax, proof of my utility bill, proof of admittance and release date from rehab, contract from CAS [Children's Aid Society] for the two kids, school attendance records. I had to get all of this by October 21st. On October 7th I had a meeting with my worker. They said if they didn't get the documents they would put my cheque on hold. I just didn't get the documents together when all of this other stuff was going on. I phone the welfare office two days before I was to get my cheque to tell them I was working on getting the documents but I didn't have them yet. They told me I was

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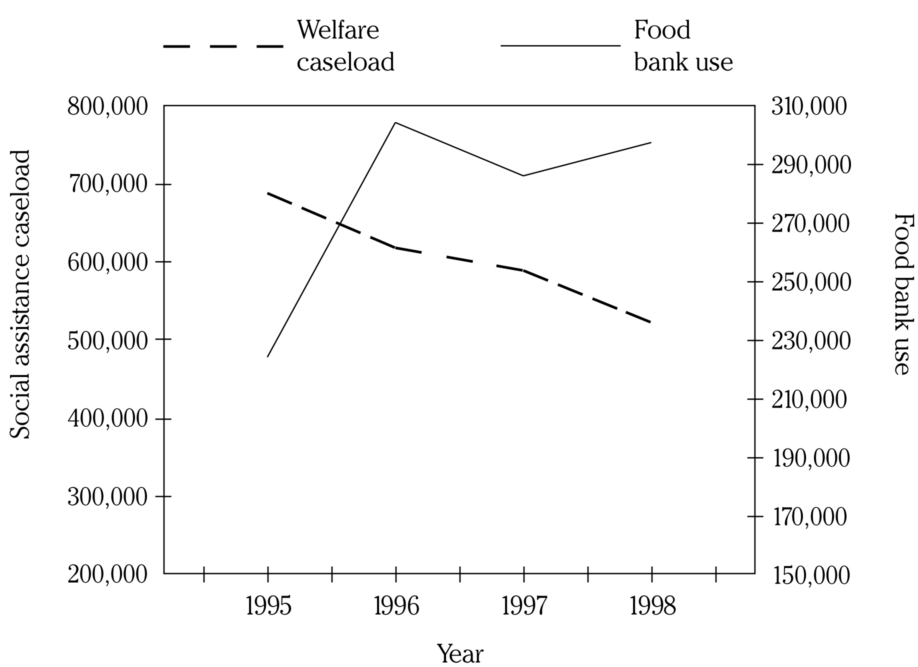
Welfare caseload down, food bank use up



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> going to be terminated because I didn't have the documents in. They didn't want to hear any explanation.

In past contracts, Andersen Consulting has helped governments privatize and contract out functions in the welfare system like employment counselling and training, job preparation, and even the administration of the program itself. The following observation appeared in *The New York Times* in 1996:

> Before the new welfare law, moving people from welfare to work was the domain of nonprofit organizations and three relatively small businesses (America Works, Curtis and Associates, and Maximus). Now, some large companies see a potentially multibillion-dollar industry that could run entire welfare programs for states and counties.

CONCLUSION

In both Canada and the United States, "welfare repeal" is taking hold not just in policy, but in the public imagination.

When it comes to welfare, the "truly needy" have become the exotic object of our collective concern. They exist in rhetoric, contrasted against the fraudulent claims made by the "lazy pregnant cheats" of political lore. On both sides of the border, governments encourage our suspicions about the "undeserving."

When it comes to welfare, the "truly needy" have become the exotic object of our collective concern. They exist in rhetoric, contrasted against the fraudulent claims made by the "lazy pregnant cheats" of political lore. On both sides of the border, governments encourage our suspicions about the "undeserving." Welfare is now very rarely upheld as a fundamental right of citizenship. Rather, welfare is a tab that every level of government would rather not pay. And it is certainly an expense that governments' encourage their taxpaying citizens to scorn. The answer to "how low can we go?": there is no bottom.

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DIVERSITY AND PATRIOTISM

But this greater willingness on the part of Canadians to accept diversity, as well as Canada's lesser inclination to demand ardent patriotism of its citizens, does not necessarily indicate that Canadians are apathetic about Canada as a nation. Rather, and paradoxically, they feel strongly about their weak attachments to the state, its institutions, and their fellow citizens. They feel strongly about the right to live in a society that allows its citizens to be detached from ideology or critical of organizations, and in which they do not feel obliged to be jingoistic or sentimentally patriotic.

While the recent popularity of Molson's ostensibly nationalistic "Joe" character may seem to controvert the widely held view that Canadians take an *understated* pride in their country, this young man is more a parody than an example of the patriot. After all, at the conclusion of his rant tinged with self-deprecation, what does Joe do but thank his audience for having listened—a nod to the stereotype of the mild and courteous Canadian that undercuts whatever flag waving he may have attempted during the preceding address. But Joe, if not a classic chest-beating hero, certainly hasn't failed in the task of telling us something about ourselves. It is of course Canadians' very lack of nationalism, particularly when compared with Americans' famous patriotism, that is in its own way a distinguishing feature of the country.

Quite simply, Canadians are pragmatic rather than ideological. They desire a sustainable welfare state, perhaps not the social-democratic paradise envisioned by the Canadian left, but certainly not the almost unfettered free market that exists to the south. Although there has been a turn to the right of the political spectrum in Canada during recent years, rather than a sign of increased Americanization, this seems to be a symptom of Canada's adapting to the forces of globalization in much the same way as other social-welfare states, such as Germany, New Zealand, and Sweden. Canadians do have a distinct vision of what their country should be, but part of that very vision is that they should not have to wave flags in order to convince others of their dedication to the ideals of their country.

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* All data drawn from Environics's 1996 3SC social values survey of representative samples of Canadians and Americans aged 15 and older.

PUBLIC POLICY

Are Canadian and U.S. social policies converging?

BY R. KENT WEAVER

R. Kent Weaver is a Senior Fellow in governmental studies at the Brookings Institute, Washington, D.C.

NOT A SIMPLE ANSWER

Are social policies in Canada and the United States becoming more alike, more divergent, or staying about the same distance from each other as in the past? There are reasons to believe that any of these patterns might occur.

Critics of FTA and NAFTA, for example, argue that convergence is likely to occur as a result of North American economic integration, which compels Canada to "race to the bottom" (that is, become more like the United States) in order to keep its payroll and income tax rates comparable to those in the United States.

Cross-national lesson drawing is another reason to expect some convergence—although with different outcomes than a "race to the bottom." With two countries sharing a long border, the English language, enormous economic interaction, and many common social problems, we might expect them to learn from each other—although, as Margaret Atwood's metaphor of the one-way mirror suggests, Canadians are likely to be far more aware of U.S. developments than vice versa.

Parallel pressures in the two countries to bring government expenditures in line with revenues and get their fiscal houses in order for the impending retirement of the baby boom generation might also be expected to produce some convergence. This is so because Canada's Westminster system of centralized policy making means that when retrenchment is in the air, Ottawa's Finance Department is likely to be more effective at getting it enacted into law than its U.S. counterpart.

STILL BIG DIFFERENCES

There are equally plausible reasons, however, to expect continued, if not increasing, social policy divergence between Canada and the United States. Differing policy choices made long ago can create distinctive "accidental logics" of policy development, as University of Toronto political scientist Carolyn Tuohy has called them. Countries may, therefore, face very different followup choices once they have put initial policies into place. Continuing variations in the values of Canadians and Americans may also lead to continuing policy differences. For example, Canadians continue to place a higher value than Americans on equality, social order, and avoidance of poverty. While Canadians view their (somewhat tattered) health care system as a matter of national pride and identity, Americans view their (very tattered) health care system primarily in terms of the benefits it provides to them and their families, rather than how it serves the nation as a whole; most feel only a mild discomfort, rather than a sense of national shame, that so many Americans are left uninsured.

> **Retrenchment in the contributory Canada Pension Plan has been minimal, because of Canada's own version of institutionalized stalemate: a requirement that any change to the CPP be approved by a super-majority of the provinces.**

The very much higher salience of race in the background of U.S. social policy can also contribute to continued social policy divergence, most notably in welfare policies involving single-parent families. Finally, there are the political constellations involving governing parties. Social conservatives are an important part of the Republican coalition in the United States. In contrast, they were not so important in the Mulroney Conservative coalition. Although they are prominent in the Reform/Alliance party, that party has never held power federally in Ottawa. Thus we might expect that social conservatives in the United States would at least have success in blocking new social policy initiatives that they do not like (for example, child care subsidies that make it more likely that mothers will work outside the home), even if they are not successful at enacting their own agenda.

DISTINCTIVE STORIES: PENSIONS

With so many conflicting forces at work, it should not be a surprise that there is no simple answer to the question whether U.S. and Canadian social policies are converging or diverging. And indeed, different sectors of social policy do tell distinctive stories.

In the public pension sector, for example, long-term distinctions remain

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largely intact. Both countries have retained their basic multitiered pension structures (a quasi-universal pension, mandatory contributory pension, minimum income guarantee, and tax-subsidized retirement savings in Canada; only the last three are in the United States). Canada's pension system continues to provide a more generous guarantee for low-income seniors than is the case in the United States.

And when the two countries' contributory pension tiers encountered serious funding difficulties (in the early 1980s in the United States, in the late 1990s in Canada), Canada reacted with a substantial increase in payroll taxes, while these were rejected in the United States. But there have been similarities as well.

In both countries, efforts by conservative governments (Reagan in 1981; Mulroney in 1984-85) to impose across-the-board cuts in public pensions were rebuffed. Both countries have in recent years enacted changes that imposed income testing at the upper end of the income scale, through the old age security clawback in Canada and increased taxation of social security benefits for upper-income seniors in the United States.

However, the current Liberal government backed down on imposing a more severe means test it had originally proposed through a Seniors Benefit. Retrenchment in the contributory Canada Pension Plan has been minimal, because of Canada's own version of institutionalized stalemate: a requirement that any change to the CPP be approved by a super-majority of the provinces. And, while Canada moved with minimum controversy to invest CPP surpluses in equity markets, the notion of a large collective investment fund in the United States has been completely rejected by the Republican congressional majority. Many Republicans, including presidential candidate George W. Bush, have instead endorsed allowing employees to divert some of their social security contributions into individual defined-benefit accounts.

There is less evidence, however, of a "race to the bottom" in social policy. Both governments have tried to preserve middle-class pension entitlements, and their record on benefits for low-income families (at least those thought to be "deserving" because they have an employed parent) has been ambivalent.

FAMILY POLICIES

In policies toward low-income families with children, there is evidence of both convergence and continued divergence. The convergence is evident in benefits focused on working families. Canada's child tax benefit has imposed increased targeting in place of universal Family Allowances. The United States never had a universal family allowance, but the earned income tax credit was created in 1974, and has repeatedly been expanded, as an income supplement for low-income families with at least one working parent. Although there are very important differences in the two programs' design, delivery, and impact, both represent a move toward targeted support for this vulnerable group.

Continued differences, and indeed increased divergence, are evident in programs to support the most vulnerable families. While several provincial governments in Canada, most notably the Harris government in Ontario, have cut benefits and begun to impose work tests, the United States has gone much further.

The temporary assistance to needy family (TANF) program, enacted in 1996, imposed not only a strict work requirement for custodial parents, but also imposed a five-year lifetime limit on receipt of TANF benefits. And while both the *Canada Health and Social Transfer Act* (CHST) and the *Personal Responsibility and Work Opportunity Act* (which created TANF and made other program cuts) in the United States cut social expenditures, there was a moralistic tone in the latter that was missing in the former. The authors of the CHST thought that they were making the best of a bad situation by dealing with their own budget problems and foisting off the consequences on the provinces; the authors of the *Personal Responsibility and Work Opportunity Act* thought that they were doing the right thing, period.

A "RACE TO THE BOTTOM?"

These patterns, in short, suggest a variety of causal forces at work rather than a simple uni-causal world dominated by pressures of globalization. There is clearly evidence in both countries of fiscal pressures leading both governments to lower social expenditures. There is less evidence, however, of a "race to the bottom" in social policy. Both governments have tried to preserve middle-class pension entitlements, and their record on benefits for low-income families (at least those thought to be "deserving" because they have an employed parent) has been ambivalent. The greater weight of social conservatives within the Republican party helps to explain the more conservative thrust of U.S. welfare policies. Similarly, a greater role for free-market conservatives explains Republican rejection of collective investment of social security funds in equities markets. Evidence of cross-national lesson drawing in social policy is limited in both directions.

Politicians in both countries have cited the other country's health care system primarily as something to be avoided. But the impact of U.S. work requirements in Canadian welfare policy remains modest.

In short, Canadian and U.S. social policies remain distinct—reflecting different societal pressures, different institutions, and different policy legacies. Most of these differences, in particular Canada's more generous and redistributive welfare state, are likely to remain for the foreseeable future. These differences are sustainable so long as Canadians are willing to pay higher taxes for them, and see themselves as benefiting from the welfare state. Thus far, those commitments show little sign of ebbing, and the political forces that would move away from those commitments remain weak and divided.

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for comparisons and contrasts. Political commentators in Canada often suggest that the Canadian *Charter of Rights and Freedoms* corresponds to the American *Bill of Rights* and hence will make Canada more litigious and individualistic. Americans frequently are taken aback by what they perceive as "anti-Americanism" in Canada, which would make Canadians quite different from Americans.

[T]he Canadian health care delivery system is far better than the anxious patient realizes. During structural change, in the haze of political punch and counterpunch, misperception can become as real as perception.

Such unsystematic observations, singular experiences, and casual or reflexive judgments, however, provide a very weak base for generalization about whether entire societies are changing in a consistent and meaningful way.

OPERATIONALIZING CONVERGENCE

First, convergence/divergence must be correctly "operationalized." What is converging or diverging? Is the subject of change the economy, the legal system, political values and preferences, social policies, or folkloric customs?

Second, only a thorough and reliable analysis can lend "authority" to the conclusions. Ideally, the "research design" would parallel the "analysis of variance." Compare regions within Canada with regions in the United States on a set of measures. If the means (averages) are sufficiently different, and are becoming more different (similar) over time, the countries are diverging (converging). While a formal analysis of variance may never be carried out, the "logic" of the design governs all the comparisons, regardless of framework or data employed.

Third, a number of important further questions arise with regard to convergence or divergence in the North American context.

OTHER POSSIBILITIES

Parallelism: Perhaps the present degree of convergence/divergence in Canada–U.S. relations will be perpetuated, as sociologist Seymour Martin argued eloquently and with a marshalling of support in *Continental Divide*. Lipset believes that Canadian and U.S. values, and the historical origins of these values, are very different and will keep the two countries on this course of parallel difference (but not divergence) into the future.

Convergence and Divergence: Both convergence and divergence may be occurring simultaneously, cancelling each other's effect. Canadian health care gives companies operating in Canada, such as the automakers, a cost advantage over operating in the United States; yet productivity in the auto sector is about the same in both countries because other factors equalize the health care edge in Canada.

Perceived Change vs. Real Change: Ted Marmor has argued that the Canadian health care delivery system is far better than the anxious patient realizes. During structural change, in the haze of political punch and counterpunch, misperception can become as real as perception.

Direction of Change: Who is converging toward *whom*? The usual assumption is that Canada is converging toward the much larger United States. Standards applied would be the U.S. mean, not some intermediate value. The central question is whether convergence will be asymmetric. When Canadian energy policy collapsed after the 1982 recession and the drop in world oil prices, its market-oriented solution looked very much like the original U.S.-based energy proposal that eventually

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became part of the Canada-U.S. Free Trade Agreement.

What this posited asymmetrical convergence neglects is that Canada as "first mover" and more focused player may adopt a policy before the United States does. Canada recognized China before the United States did. The Canadian move to provide health insurance universally is a stimulus to the United States, at least among health experts, to rethink its own stand on universality.

Neither Convergence nor Divergence as Conscious Policy: To correctly analyze whether a country initiates convergence or divergence, the analyst must "control for" a multitude of background variables.

NAFTA created a "North American integration scare" about huge unemployment and a great migration of firms to some other allegedly more attractive country. Underlying this fear of unremitting catastrophes, so much in contrast to attitudes in Europe regarding the European Union, are concerns about sovereignty.

THE IMPACT OF GLOBALIZATION AND OTHER FACTORS

Industrialization is sometimes confused with U.S. influence or presence. Worried about the influx of fast-food restaurants, critics wrongly associated this phase of food processing and delivery as American. *Regionalism* may overwhelm bilateral Canada–U.S. influence. The garment industry in Montreal or New York City cannot afford to ignore Mexico City today. *Democratization* creates changes that appear North American. Worldwide movement toward relaxed social and business dress codes, as in Japan, reflects the rise of popular sovereignty in these matters across many of the democratic, market-oriented states.

Globalization is transforming modes of ownership, distribution, and production. That many companies in Canada/America have been taken over by foreign management has much to do with the mobility of capital worldwide and the flexibility of exchange rates without which the global trading and financial markets could not operate. That Canadian investors choose to place their money in a variety of foreign stocks rather than keep that money at home in the ownership of Canadian companies reflects the efficiency of world capital markets in which Canadians participate actively and fully.

Each of these external influences can easily be mistaken for bilateral sources of influence by either country, especially the larger. Likewise, the task of actually identifying these separate influences and then attempting to hold the influence "constant" is subject to error and other difficulties.

NAFTA created a "North American integration scare" about huge unemployment and a great migration of firms to some other allegedly more attractive country. Underlying this fear of unremitting catastrophes, so much in contrast to attitudes in Europe regarding the European Union, are concerns about sovereignty.

Canadians and Americans want the fruits of greater economic integration (access to economies of scale and scope). Each wants the benefits of greater efficiency in terms of enhanced economic growth, higher personal incomes, more and better jobs, and cheaper consumer goods. But neither wants to give up any sovereignty in terms of cultural preferences, social policies, or political institutions. They want the benefits of greater economic integration without having to forgo perceived "social costs." To date, very few social costs have arisen on either side of the border as a result of the Canada–U.S. Free Trade Agreement or NAFTA.

THE NEW BOTTOM LINE

Whether Canada and the United States are converging or diverging may never be ascertained in any encompassing or definitive sense. Yet, intuitively, Canadians and Americans know that even divergent roads are part of the same forest, and that they can take the same road without forsaking treasured or "core" values. Experience with integration reduces the fear that the countries will become political facsimiles. A North American in this sense can "travel both [roads]/ And be one traveler." The two countries can choose the path of economic interdependence without fear of loss because of the "path not taken."

On the horizon is an effort to eliminate many of the problems at the border for movement of both people and commerce. To accomplish this, North Americans will need to consider a more explicit customs union. The question is open. For citizens caught in customs lines at the border, or for frustrated truckers attempting to get their produce to market on time, the new bottom line of interdependence beckons.

PUBLIC POLICY

Social policy: U.S.–Canada convergence or divergence?

BY MICHAEL MENDELSON

Michael Mendelson is a senior scholar with the Caledon Institute.

LOOKING AND HEADING SOUTH

Over the last two decades, Canada's market sector has become not just convergent with that of the United States—Canada has become an integrated part of the North American market. All firms, including those in the financial sector, now see their future in terms of North America, not Canada. In the auto sector, production processes extend across the international boundary as if it did not exist, and the idea that a car is "made" in any particular country is becoming a peculiar bit of old-fashioned terminology left over from another day. The auto sector is not special in this regard, perhaps only a little more advanced.

There can be little doubt that over the coming decades Canada's market sector will become increasingly indistinguishable from that in Anyplace, U.S.A. Driving into a mall in suburban Toronto or Boston or Atlanta, perhaps with a few cute local features dreamed up by a mall designer, who is also a resident of Anyplace, U.S.A., will be largely a homogeneous experience. Same shops, same sales, same ads, same food, and—if much of Canada's business sector has its way, and everything we have seen in the past would indicate that it will have its way—same currency too.

SO WHAT'S SO SPECIAL ABOUT SOCIAL POLICY?

Rather than asking whether Canada and U.S. social policy is convergent, the question can be phrased more aptly as: is there any reason to suppose that Canada will maintain an independent social policy as its economy becomes fully integrated with that of the United States?

My answer to this question is that Canada can maintain a distinct social policy, but only if we do so as a conscious and deliberate political act, accepting the tradeoffs inherent in that distinctiveness. However, if we continue to stumble along, some Canadian regions will retain certain social policies that are unique and different. But the range of social policies in each region will fit quite comfortably and indistinguishably within the range of variation among U.S. regions. For all intents and purposes, we will have converged.

> In comparing circumstances in Canada with those in the United States, we often commit the classical error of contrasting averages for each country without inquiring too closely about distribution.

To explain what is meant by "fitting within the range of variation among U.S. regions," let me pursue a short methodological digression.

In comparing circumstances in Canada with those in the United States, we often commit the classical error of contrasting averages for each country without inquiring too closely about distribution. But if the variation *within* the United States is as great as the variation between the United States and Canada, what does the difference in averages mean? Put another way, rather than comparing the United States, as one great lump of an entity, to Canada, another little lump of an entity, we should be comparing regions in North America. If we line up the United States and the Canadian regions, and measure according to any given criteria, say, personal income, where would the Canadian regions fall? Would all the Canadian regions be clumped together as a recognizable entity or would they be scattered amidst the United States, as unrecognizable as North Carolina or New Jersey? The answer for most economic measures is that Canadian regions are distributed among the U.S. states and are not recognizably different as a group.

So when we ask whether any particular circumstance is the *same* in Canada as the United States, what we really need to know is whether the variation between Canada and the United States is greater than the variation between regions of the United States.

MEDICARE: A CRITICAL BUT FRAGILE INSTITUTION

Returning to social policy, let us look at the social program that most distinguishes Canada from the United States—medicare. In Canada, every resident is entitled to hospital and physical care without charge at the point of service, based only on health needs. In this we are not all that different from some European countries. But we have gone one step further and do not allow our citizens to purchase access to a private tier

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If governments *today* cannot or will not muster the resources needed to respond to the current threats to medicare, we may end up following a path that leads inexorably in exactly the opposite direction to where most Canadians want to go.

of health care, at least not in Canada. In this regard, we have what is perhaps the most egalitarian medicare system among modern nations with market economies.

The Canadian system of medicare has many advantages, which have been well documented. It is also wildly popular and even critical to our sense of being Canadian. Nevertheless, medicare is a fragile institution.

At the heart of medicare, as we have known it, is "the middle-class bargain." The vast majority of Canadians whose incomes fall somewhere around the middle are willing to forgo their right to buy health care services on their own, in return for the government maintaining a very high quality health care system. If large numbers of Canadians feel this bargain is not being kept and lose faith in the quality of care that they and their families receive, then the political basis of Canada's system is undermined. Today this faith is being put to the test.

To keep this faith, governments must respond by extending and modernizing public coverage. They need to improve the perceived quality of care, find ways to provide new technologies where these are efficacious, decrease waiting lists where they do exist, and implement other measures that will improve Canadians' perceptions and experiences of medicare. Most of these strategies, however, cost money, and, if the system is to remain publicly funded, the money must be paid through taxes. This is the essence of Canada's system: governments must pay the entire bill from tax revenues. But does this run contrary to emerging economic realities? Aside from Canadians' usual reluctance to pay taxes, Canada may be losing some of its ability to set its own tax levels on an independent basis, due to the integration of our economy in North America.

NORTH AMERICANIZATION

If the pressure of North Americanization means that we cannot maintain our tax revenue base, not only today, but also when times are not as buoyant as they are now, then government cannot respond to these pressures and cannot restore the middle-class bargain.

Ironically, the eventual result may well be higher, not lower, taxes for Canadians. Although the public sector is responsible for a much lower percentage of total costs in the United States than in Canada—46.4 percent, and the private sector for 53.6 percent of the total health care budget, while in Canada the public sector is responsible for 69.8 percent and the private sector for 30.2 percent—the cost of health care is so much higher in the inefficient U.S. system that the public system in the United States absorbs about 6.6 percent of that country's GDP, while Canada's public system absorbs about 6.3 percent of GDP.

But the probable end result of still higher taxes for Canadians does not matter right now. If governments *today* cannot or will not muster the resources needed to respond to the current threats to medicare, we may end up following a path that leads inexorably in exactly the opposite direction to where most Canadians want to go.

Unfortunately, there are plenty of signs that this is exactly what we are doing. Not the least of these signs is Alberta's health privatization Bill 11. If the Alberta government survives public reaction, and if the federal government is not effective in its response, I predict that after the next election in British Columbia, assuming there is a change of government, similar measures to permit private health services will be introduced there.

The result of these and other pressures a few decades from now could be a patchwork medicare system across Canada, with some provinces continuing to offer a single-tier public system, while others have moved definitively to a two-tier system, perhaps a kind of hybrid of the U.S. and the U.K. systems. In comparison with the United States, this will mean that some Canadian provinces will be similar to the U.S. states that now have close-to-universal medicare—for example, Hawaii—while others will retain the distinctive Canadian system, at least for the time being.

Medicare is our strongest social program. More forceful arguments could be made for the potential convergence of income security programs, especially as we have seen support so quickly erode for the social safety net.

While all of this convergence is probable, none, in my view, is inevitable. If Canadians are willing to take a step back and accept that better social programs are going to require ongoing support, if we are willing to accept tradeoffs, then we can maintain a distinctive social policy even in the face of economic integration. The challenge, however, is enormous.

HEALTH REFORM

Fact and fiction: The medicare "crisis" seen from the United States

BY T.R. MARMOR

T.R. Marmor is a professor of public policy and management and a professor of political science at Yale University School of Management.

MEDICARE: SOUND OR TROUBLED?

There are at present two conflicting images of medicare available to the visitor from the United States. One is the conventional media portrait of crisis, from both U.S. and Canadian sources, an image of a program in deep trouble, overcome by problems of access, cost, and quality. The other image is far more favourable: medicare as a structurally sound program of universal health insurance that largely satisfies those who use it, but, like all programs, one that requires managerial adjustment and attention to the concerns over medicare's future. This is the conclusion of the recent report of the Canadian Institute for Health Information (CIHI). Both portraits cannot be accurate. What is an American interpreter to make of this dispute?

THE EMERGENCY ROOM STORY: A SIMILAR TALE WITH TWO MEANINGS

One place to begin is the crowded state of the North American emergency room (ER), a familiar story in both Canada and the United States over the past decade. When this past winter's flu season aggravated overcrowding in North American ERs, the U.S. and Canadian media took special notice. Between mid-December and early February, the *Washington Post*, *The New York Times*, and ABC News did stories on the quality of emergency rooms in Canada. This paralleled Canadian media treatment and in fact amplified those stories.

During the same period, *USA Today* and *Time* magazine published substantial reports on U.S. emergency rooms. But there was a distinct difference in the stories told. The three reports on Canada used the overcrowding problem to suggest medicare is critically flawed. The two extended reports on American overcrowding did not, by contrast, indict America's overall health insurance arrangements.

> **The claim of critical shortages appears universally in systems of "single-pipe financing" of health insurance. This phenomenon, called "orchestrated outrage," is a familiar bargaining ploy.**

The important point is not the parallel reports, but the different interpretations placed on them. The stories about U.S. conditions attributed the problem, in part, to the flu, while the reports about Canadian ERs either ignored the flu or dismissed it as an attempt by Canadian public officials to put a happy face on a medicare system in crisis. Steven Pearlstein, of the *Washington Post*, asserted that "most experts" agree that Canada's medicare program is doomed, that "while money might alleviate the shortage of advanced machinery, hospital beds, and medical school slots, it will only be a matter of time before the demand for medical services once again overtakes the willingness of voters to pay for it." (Readers' alert: Most experts actually know that the demand for medical care is practically limitless and distinguish demand from serious needs. The claim of critical shortages appears universally in systems of "single-pipe financing" of health insurance. This phenomenon, called "orchestrated outrage," is a familiar bargaining ploy. To conclude circumstances are dire requires evidence other than claims of shortage, as every national health insurance official in the Western world knows.)

What the U.S. media portrayed as programmatic failure was both reflected in and amplified in Canadian emergency room stories. Most Canadian papers got at least a month's solid copy out of hospital overcrowding, the turning away of patients from emergency rooms, and the deaths of individual patients unable to get emergency treatment. The shortage of 24-hour health care services outside the hospital is obviously the flip side of the emergency room story. So, why the near universal North American press assumption that these strains show a medicare program in serious trouble, not as good as it once was, and likely to get worse?

THE PRESS AND THE PROBLEMS: OR WHY THE STORY OF MEDICARE IN CRISIS?

The image of a critically flawed medicare program is one predictably put forward by interest groups, regularly employed by political leaders in their battles, widely amplified in the Canadian me-

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dia, and intermittently so in the United States. Given that, it is no wonder Canadians worry about medicare's viability. (Between 1988 and 1998, the proportion of Canadians reporting only minor problems with medicare fell from 56 to 20 percent.) And yet the fearful portrait of medicare is strikingly at variance with the recent and balanced CIHI report. How can one explain the differences?

The differences are, in fact, obvious and rather easy to explain. The CIHI report represents a synthesis of research on medicare and is explicitly critical of the press, both in print and on television. Canadians are, indeed, more concerned about medicare's future than they were in the 1970s and 1980s. But there is a sharp distinction, according to the report, between the satisfaction of Canadian users of medicare and the fears of the general public. Indeed, 54 percent of Canadian users regarded the care their family received in the previous 12 months as excellent or very good. This discrepancy between use satisfaction and system trouble is important, one that helps to explain the conflicting images of medicare. The stories of emergency room crises awaken concern among everyone; all of us fear not having care when it is urgently needed.

The CIHI portrays Canadian medical care as institutionally stable, financially pressured, and with pockets of trouble. It reports sharp increases in hospital workloads and constrained budgets. Tight budgets necessarily mean limits on the incomes of doctors, nurses, and others in the medical field. To understand why the selected problems identified by research can turn into a medicare crisis requires attention to the habits and stakes of the press, pressure groups, and political elites.

Canadian newspapers, television programs, and politicians regularly treat medicare as front-page news. For most of its history, it has been the jewel of the postwar Canadian crown. Polls from the 1970s through to 1990 regularly reported overwhelming Canadian approval of medicare, dismay at the U.S. experience, and no interest whatsoever in following America's health insurance lead. With disinterest southward and persistent scrutiny domestically, the Canadian press reported most any incident of apparent medical deprivation.

From the United States, journalistic interest in Canadian medicare reflects the place of health insurance issues on the national agenda. The attention is intermittent and not very well informed, and mostly reflects the preoccupations of American interest groups.

With the recession in the early 1990s, Canadian journalism turned its attention to the belt tightening that took place. Frozen budgets meant real strain, disappointed nurses and doctors, and, in the hospital world, downsizing, closure, and merging. There was, in short, much to be concerned about and Canadian reporters followed the complaints that straitened economic circumstances understandably generate. In doing so, they amplified the demands of stakeholders much more than they systematically portrayed the circumstances of Canadian medicare.

The truth about a medical care system is complicated and the pressure groups have no or little interest in truth telling as such. Journalists too have a very difficult time evaluating complex, major programs through particular stories. That is why the high quality of the CIHI report is so important. It is both a voice to counterbalance vocal pressure groups with a stake in crisis talk and a reliable source that every journalist covering medicare needs to master.

From the United States, journalistic interest in Canadian medicare reflects the place of health insurance issues on the national agenda. The attention is intermittent and not very well informed, and mostly reflects the preoccupations of American interest groups. So, for example, there has been a recent flurry of articles (and ads) in the United States about the dangers of Canadian "price controls" on pharmaceuticals. This story emerged in March just as the U.S. Congress debated adding outpatient drug coverage to the (U.S.) Medicare program.

At the end of March, a group called "Citizens for Better Medicare" launched a multimedia campaign "urging American seniors to reject the Canadian model of health insurance and coverage of prescription drugs." These "Citizens" include the U.S. Chamber of Commerce, the National Association of Manufacturers, and the pharmaceutical trade association. They say that Canadians suffer from a "big government-run system that rations health care, delays access to treatments including new technology and medicines, and harms too many patients." Since few American reporters know enough about Canada to question any of these caricatures, the claims get amplified rather than analyzed.

WHY SUCH DISMAY AND DISTORTION?

The incompatible portraits of medicare are not accidental. The conventions of the press help to explain what image of medicare is available to the average North American. In Canada, medicare is a major story and ordinary Canadians not only care about the program but pay attention to reports about it. As a result, they hear from the media more about distress than anything else. Mainstream journalists in both countries treat dramatic problems as more interesting than explanations of complicated programs. American interest groups provide a spur to critical stories and the richest of such groups overwhelmingly want to attack the Canadian model. It is precisely because Canada has achieved comparatively good value for money through medicare that it represents an ideological threat to these American interest groups and their Canadian counterparts. To the extent that these North American interest groups bring stories and documentation to the press, the media's commitment to evenhandedness actually undermines a balanced view of medicare.

That is once again why systematic evidence of the kind presented in the first annual CIHI report is so vital. The portrait of medicare will never be painted properly by episodic, dramatic representations of particular trouble spots. What those trouble spots suggest can be revealed only by systematic evidence. Moreover, the very structure of medicare brings with it necessary and open conflict. Paying for medical care from a single provincial budget—where other competitors for public funds help restrain medical demands—means necessary and predictable controversy. That controversy is about how much to spend, on what, for whom, and under what conception of fairness. This brings accountability, but the other side of that program accountability is constant media attention, constant claims of need, and considerable exaggeration of the state of medicare.

As long as stories are the mechanism for understanding medicare, distortion of the program's strengths and weaknesses will continue. Evaluating a system requires systematic evidence and that is what the CIHI has provided. From the perspective of an American analyst of Canadian medicare, the CIHI presents a program not critically flawed, but simply in need of targeted adjustments. But you would never know that from the tales political adversaries tell or the portraits painted by the North American media. One hopes the availability of systematic evidence will condition the future behaviour of the press and the politicians.

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Defined in the broadest sense, public industrial policy has, with some minor aberrations such as Macdonald's National Policy, been directed at gaining access for Canadian products into as many world markets as possible. In the 1930s, the Canadian government hosted the Ottawa Conference on Imperial Preferences, designed to increase free trade within the British Empire. Immediately after the First World War, Canada was a leading advocate of the formation of the International Trade Organization and the liberalization of trade. In the 1960s, the Auto Pact was enacted by the federal Liberals. The ultimate culmination of this policy direction, free trade with the United States, was achieved when the North American Free Trade Agreement was signed in 1989.

[B]y the end of the 20th century, the largest degree of foreign ownership in any Western industrialized country was in Canada.

Since the days of Confederation, however, industrial policy with respect to domestic activity has been interventionist and protectionist. To induce Nova Scotia to join the new confederation, the national government agreed to build a railroad linking it to central Canada. A few decades later, the government of John A. Macdonald was involved in financing the CPR. In the 1930s, R.B. Bennett laid the foundation for the CBC, while C.D. Howe formed Air Canada. In the 1970s, René Lévesque nationalized Quebec Power and Pierre Trudeau brought forth the National Energy Policy and the *Foreign Investment Review Act*. Throughout the 20th century, practically every economic sector, from farming to automobile production, enjoyed a direct subsidy or some other form of government assistance. By the mid-1970s, more than 50 percent of the gross domestic product flowed through government hands and half of the 10 largest corporations in the nation were owned by government. More than 700 Crown corporations were involved in everything from selling liquor to producing nuclear reactors.

"DEFENSIVE EXPANSIONISM"

This enormous intervention by government in the economy was justified by all political parties, on the grounds that a public policy strategy was essential to maintain the identity, indeed the sovereignty, of the nation. This strategy, which came to be known as "defensive expansionism," was recognized as necessary because without it the proximity and power of the United States would overwhelm the country.

Interestingly enough, although these domestic policies were designed to keep control of the economy in Canadian hands, to a great extent they failed.

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By the mid 1920s, when the United States became Canada's largest trading partner, more than 30 percent of Canadian manufacturing had been acquired by American firms. Since then, petroleum refining; production of chemicals, electrical machinery, and automobiles; much of retailing; as well as a host of other sectors have become dominated by foreign ownership. In fact, by the end of the 20th century, the largest degree of foreign ownership in any Western industrialized country was in Canada.

[I]t is reasonable to expect that within a quarter of a century there will be much more integration between the United States and Canada, perhaps the adoption of some type of common North American currency and with it a single North American monetary policy.

AS THE NEW CENTURY BEGINS

The current extent of foreign ownership does not appear to be a major concern for most Canadians. Today it is difficult to believe that in the early 1970s Canadian nationalists, led by Walter Gordon, a prominent Liberal politician, achieved considerable political support by attacking foreign ownership. Their argument was that foreign-owned subsidiaries operating in Canada did not make an appropriate contribution to the economy because they did little research and development work; their Canadian boards did not determine strategy or appoint senior officers; their donations to the community were inadequate; and their legal, accounting, and professional management work was not done in Canada. They charged that Canada was becoming, if it was not already, a branch plant economy. The political power of the nationalists was such that during the 1972 Trudeau minority government a *Foreign Investment Review Act* was passed.

How times change. With enormous developments in communication and transportation, and the decline of trade barriers, the very large multinational firms no longer even operate on a country level. Their strategies and methods are global, not national. Ironically, only three decades after the height of the nationalists' strength, if there is any major concern in Canada, it is that, since the enactment of the *North American Free Trade Act*, the Canadian economy is being "hollowed out" because transnationals are closing their Canadian subsidiaries.

THE HOLLOWING OUT OF CORPORATE CANADA

The results of more than 100 years of schizophrenic Canadian industrial policy—international free trade and domestic intervention—have now become abundantly clear. Support for and membership in international organizations has led to almost universal free trade in goods and services in Canada and a situation whereby the traditional nation-building policies based on subsidies, tariffs, and regulations are no longer legal. Although these domestic policies had significant consequences for the economy, in terms of the stated reasons for their adoption—that is, maintaining domestic ownership and control over business and resources—they have failed. As a result, it is reasonable to expect that within a quarter of a century there will be much more integration between the United States and Canada, perhaps the adoption of some type of common North American currency and with it a single North American monetary policy.

This inevitability is not necessarily a cause for concern. While nothing in economics is totally predictable, greater integration should result in a higher standard of living for more Canadians. They will become part of a larger market, where the economies of scale are great and the management is, arguably, the best in the world. What is a cause for alarm, however, is that the cost of embracing globalization and greater free trade—that is, giving up the ability to enact domestic industrial strategies—may be greater than the structure of the nation can withstand.

A FEDERATION IN DISTRESS

Canada is a confederation of regions—the Maritimes, Quebec, Ontario, the West, and British Columbia. While to differing degrees these regions do not have a great deal in common, they have all historically benefited substantially from being part of a larger entity. They have done so because of the implementation of a host of national domestic industrial strategies, most often designed to meet regional needs. Federal governments, since Confederation, have negotiated tariffs for Ontario manufacturers, organized farm price support programs for Quebec milk and egg producers, subsidized the Maritime and British Columbia fisheries, sold western grain through the Wheat Board, and protected the lumber industry in British Columbia. It has been the role of national political parties to broker these benefits in such a way that, as well as helping the regions, they also strengthen and maintain the national interest.

Many programs were designed, or at least justified as necessary, to maintain the integrity of the state against external forces, such as foreign ownership. The actual result of their implementation, however, has been quite different. It has been to link, in very positive, understandable, and recognizable economic terms, the various parts of the nation to the centre. Because of international treaties, these types of policies are no longer permissible. Consequently, in terms of domestic industrial policy, the most the federal government can now do is manage the equalization grants from the richer to the poorer provinces, make small direct loans for social purposes, and negotiate with the provinces the costs of shared responsibilities. The linkages are breaking down.

Given the federal government's loss of the ability to enact major domestic industrial strategies, it is not surprising that there has been a major decline in interest in the national government and national parties. Many Canadians believe that their parliamentary system leaves them with little true representation, that the defence of the nation and Canada's role in international affairs are really not that important, and that the federal government spends all its time on constitutional problems that should have been settled years ago. The major public issues that citizens have a direct interest in—health, education, and welfare—are all provincial responsibilities.

POLITICAL REGIONALISM: A STEP TOWARD CONVERGENCE

In the past two federal elections, Canadians have voted overwhelmingly on a regional basis. At the time, many believed the 1993 election was an aberration, the result of the great dislike for Prime Minister Mulroney and the rise of the Parti québécois in Quebec. They were wrong. In the next election, in 1997, the results were repeated. Canadians voted on a regional basis according to regional interests. The evidence of the most complete and comprehensive study of voting patterns ever made in Canada, the 1997 *Canadian Election Study*, indicates that Canada, politically, has become a nation of regional political parties and that the day of the all-embracing national party is over.

As Canada enters the 21st century, a small industrialized country, without any natural boundaries, situated next to an economic giant, it finds that the economic policy weapons that had been used by the federal government are gone. . . . The forces leading to convergence with the United States are much greater, or, put another way, the weapons to prevent convergence are much weaker.

One of the major reasons for this political regionalization may well be the devolution of national sovereignty to international organizations, in pursuit of free trade. Devolution has resulted in the inability of the central government to enact specific domestic industrial policies—tariffs, subsidies, grants, and regulations—for the benefit of regions. Consequently, the prosperous regions no longer have any major economic reason to maintain allegiance to the centre. What do they need Ottawa for? Do they really want their taxes to support less prosperous areas? Cynics make the case that the federal government doesn't do anything except collect taxes and continuously debate how the national state should be organized.

As Canada enters the 21st century, a small industrialized country, without any natural boundaries, situated next to an economic giant, it finds that the economic policy weapons that had been used by the federal government are gone. Because they are gone, the power at the centre is greatly diminished, and because the power at the centre is diminished, the pressure, and possibly the economic and social advantages, for the regions to go their own way is undoubtedly increasing. The forces leading to convergence with the United States are much greater, or, put another way, the weapons to prevent convergence are much weaker.

Whether or not this scenario comes to pass depends on the capacity of political leaders to develop and enact "imaginative new public policies" designed to meet effectively the needs of all citizens. When such policies are being designed, the lessons of the 20th century should not be forgotten. Schizophrenic policies always result in conflicting conclusions and have unpredictable consequences. There must be clear recognition that the old policies—subsidies, tariffs, regulations, etc.—are basically, in this world of international treaties, often illegal and not very useful. Canadian leaders and Canadian citizens must define themselves by something other than who owns the factories and who they are not. To the extent that they can do so in a global village will determine the viability of the country of Canada in the 21st century.

Big differences matter: Canadian and American health care finance

BY TERRY SULLIVAN

Terry Sullivan is the director of the Institute for Work and Health, Toronto.

THE FUNDAMENTAL DIFFERENCES

There are two ideas that distinguish the Canadian health care system from the U.S. system. Like the majority of OECD nations, Canada ensures reasonably comprehensive health insurance for all citizens, regardless of capacity to pay, as a function of citizenship. Through a series of fiscal and administrative levers (and some legal bars), however, Canada remains the *only* jurisdiction in the OECD where there is no way to buy your way to the front of the line for medically necessary medical and hospital services, short of crossing the border into the United States. In spite of all the rhetoric on this, as the Canadian Institute for Health Information has found, recent factual assessment on such migrations suggests that far less than 1 percent of Canadians actually cross the border for health care and the majority are "snowbirds" who are already in the U.S. when their health needs arise. This "solidarity of access" idea fills up much of our public discourse on health reform.

Second, Canadian health policy has embraced—albeit with more rhetoric than substance—the growing evidence on the social and economic determinants of health, and the need to look beyond conventional health care spending for improvements in the health of the nation's population. We refer to this as the "social production of health idea." This embrace includes a long tradition of "official" federal and provincial reports supporting action on the social determinants, as well as a strong scholarly tradition reinforced most recently through the work of the Population Health and Human Development Programs of the Canadian Institute for Advanced Research (CIAR). Both of these ideas face serious challenge in the marketized *regime discourse* of health services consumption ideas that dominates in the United States.

> The relationship between income inequality and health status in advanced economies has moved from one of controversy and conflict to one of exciting empirical and theoretical work.

INCOME INEQUALITY AND HEALTH

Much of the current fracas surrounding private clinics in Alberta is about the solidarity of access issue and how this idea may be threatened by for-profit medicine. The more interesting problem, in my view, is how to sustain the methods by which we finance (not deliver) health care services in Canada.

One area associated with the social production of health that has attracted quite a lot of heat and, at least, a little light has been the relationship between income *dispersion*—that is, degree of income inequality and health. Richard Wilkinson caught the attention of the policy community by arguing that Britain could add two years to its overall life expectancy if it were to adopt a more egalitarian income redistribution policy.

The relationship between income inequality and health status in advanced economies has moved from one of controversy and conflict to one of exciting empirical and theoretical work. Much of this originates in the United Kingdom, thanks to the efforts of Wilkinson and his colleagues. Recent work in the United States has replicated and refined the measurement issues, especially which measures of income inequality appear optimal for exploring the links. In this regard, a recent study published in the *British Medical Journal* highlights some comparative work being carried out by a group of Canadian and American researchers looking at income disparities and health in Canada and the United States, supported through the Canadian Population Health Initiative.

Nancy Ross, Michael Wolfson, and colleagues carefully examined the relationships between household income inequality (measured at the census metropolitan level) and mortality in Canada and the United States. They found that Canadian provinces and census areas generally had less income inequality and better mortality rates than U.S. states and census metropolitan areas. When age was considered, the relationship between income inequality and mortality was most pronounced for the working-age populations where a 1 percent increase in the share of income to the poorer half of households resulted in a decline of 21 deaths per 100,000. In fact, within Canada, income inequality and mortality were not associated, either at provincial or metropolitan area levels.

One can easily see from the figure on this page, "Working-age (25-64) mortality by median share, U.S. and Canadian metropolitan areas," that the slope of the gradient in proportion of income received by the less well off 50 percent of the population is far steeper in the United States than in Canada.

This raises questions about the social arrangements and material conditions between the two countries that buffer (Canada) or exacerbate (United States) the relationship between inequality and mortality.

The authors from both countries suggested two complementary explanations for these findings. First, economic segregation in large U.S. cities creates a mismatch between workers' housing and job locations, and also creates inequalities in locally financed public goods and services like schools, policing, recreation, etc., by pooling individuals with high social needs in municipal areas with poorer tax bases. Second, health care and high-quality education are more sensitive to the marketplace and ability to pay in the United States. By contrast, in Canada, they are publicly funded and universally available. Public and social infrastructure in the United States is more market sensitive (based on the ability to pay) than in Canada. This fact may go some way to explain the selective income disparity/mortality relationships between our two countries.

DISTRIBUTIONAL IMPACTS

One of the most significant features of the Canadian health care system has been the distributive consequence of health care financing and health use. Cameron Mustard and colleagues calculated estimates of the incidence of household tax payments and the use of public insured health care services. Using a cross-sectional analysis of Manitoba households, Mustard and colleagues linked insured hospital services, long-term care, and medical services with 1986 census records at the individual level for 16,627 Manitoba households (representing about 5 percent of the Manitoba population).

Public and social infrastructure in the United States is more market sensitive (based on the ability to pay) than in Canada. This fact may go some way to explain the selective income disparity/mortality relationships between our two countries.

In 1986, 42.4 percent of the public portion of health expenditures was generated by tax revenues from the top income quintiles and 6.4 percent from the bottom income quintiles. By contrast, health care services were distributed in an inverse fashion: 11.7 percent of health care service expenditures were received from the top income quintiles and 24.6 percent from the bottom income quintiles. The progressive redistributive effects of health care financing and benefits in Canada are significant. This work stands in stark contrast to the regressive effects of private insurance and out-of-pocket payments in the United States and Switzerland—the two

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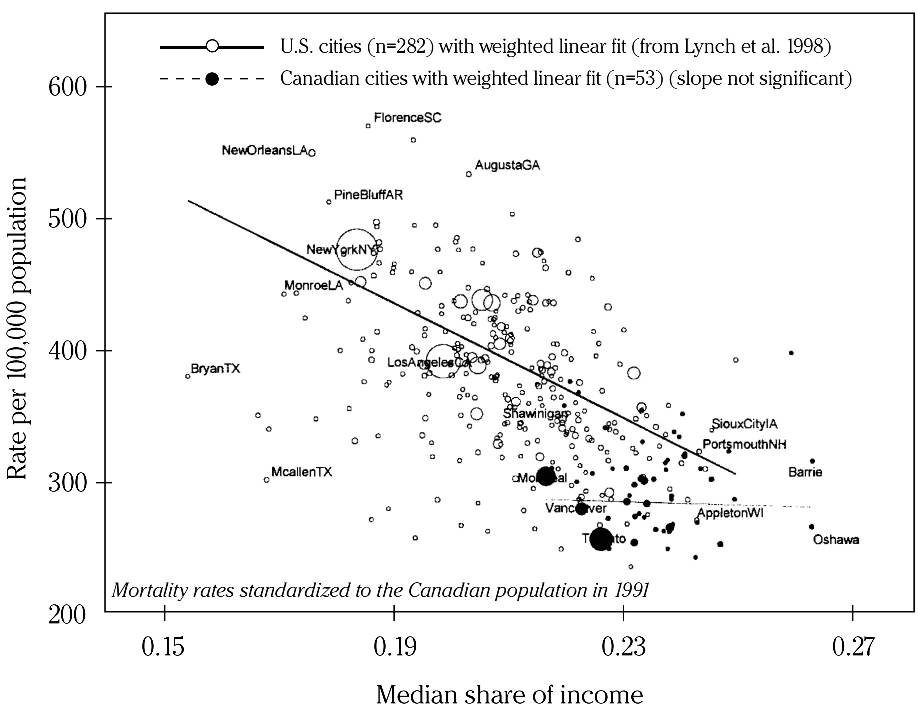
Working-age (25-26) mortality by median share, U.S. and Canadian metropolitan areas



"Working Age Mortality by Proportion of Income Belonging to the Less Well Off Half of Households, U.S. (1990) and Canadian Metropolitan Areas (1991)." From N. Ross, M. Wolfson, J. Dunn, J.-M. Berthelot, G. Kaplan, J. Lynch, "Income Inequality and Mortality in Canada and the United States: A Cross-Sectional Assessment Using Census Data and Vital Statistics" (2000), 320 *British Medical Journal* 898-902.

Making Canadian culture in the 21st century: An oxymoron?

BY JOYCE ZEMANS

Joyce Zemans is professor at the Faculty of Fine Arts and director, Not for Profit Management and Leadership Program, Schulich School of Business at York University.

CULTURE AS COLLECTIVE SECURITY

Throughout its history, Canada has faced what has more recently been described internationally as "the Canada problem"—the predicament of a sovereign state that sustains "massive cultural invasion by a neighbour." To foster Canadian cultural expression, Canada has viewed culture, in the policy domain, as the United States views national security—essential to its sovereignty and to the country's capacity to preserve national values and its unique identity.

In contrast, the United States, as the dominant world force in cultural trade, continues to view the cultural sector primarily in economic terms and it remains committed to ending restrictions that infringe on or are likely to limit its trading capacity. Entertainment remains the second largest American export. The Americans know that the United States' ability to export its culture is closely tied to its dominance in other domains. In Canada, as in Europe and Asia, the United States is standing firm in its claim to unrestricted access to its foreign markets and the profits associated with that access.

Today, the parameters of the debate have broadened substantially, throwing into question the capacity of states to create policies in the cultural sector that may run counter to economic liberalization and international trade agreements. The Canada–U.S. debate centres on several key questions. Should Canada ensure that the emerging digital networks provide a communications space for Canadian content? Are current content rules still appropriate? Are investment and ownership regulations in the cultural industries still relevant? Should Canada continue its current initiative to make the case for a true cultural exemption in the international trading domain?

Entertainment remains the second largest American export. The Americans know that the United States' ability to export its culture is closely tied to its dominance in other domains.

THE ARGUMENT TO LIMIT GOVERNMENT'S ROLE IN CULTURE

The argument is being made that whatever Canada's earlier needs for so-called protectionist policies might have been, these are no longer necessary or implementable. Cultural products are now being transmitted through new communications technologies that make traditional content requirements obsolete. Canada has succeeded in the international cultural marketplace. Today it is the world's largest exporter of animated programs; its film industry has become Hollywood North and 2000 is already a record-breaking year for Hollywood films shot in Canada. Why then should it still require policies to support its cultural sector?

Examining the future of Canadian trade policy in the cultural sector for the C.D. Howe Institute in 1997, Daniel Schwanen argued that Canada should abandon its reliance on content regulations in favour of providing accessible "shelf space" for channels or sites with high Canadian content. Schwanen argued that it was not investment or ownership regulations but the provision of shelf space for Canadian products that was necessary to provide Canadian citizens with access to cultural products that reflect their experiences.

The argument is also being made, by some Canadian as well as American interests, that it is time to abandon national policies on investment and ownership in light of the need for larger and more integrated businesses in the cultural sector that will oversee production of content and also provide the most efficient means for worldwide distribution. Canadian investment and ownership restrictions, the argument goes, limit the capacity of businesses to compete internationally and offer no guarantees of Canadian cultural content.

CULTURAL POLICY: MORE RELEVANT THAN EVER

What then is the case for national cultural policies in an increasingly globalized environment? The 1980 MacBride International Commission for the Study of Communications Problems documented how the imbalances in the flow of information and cultural expression reinforce the advantage of larger and wealthier countries. It concluded, as Canada has long known, that intervention is required to achieve a more just and equitable balance. In 1986, Donald Macdonald, reporting to the Culture/Communications Industries Committee on free trade and cultural identity, reinforced the need for policies to ensure a variety of identifiably Canadian products and services. He wrote that "if we want to see the survival of cultural content produced by and for Canadians," Canada must seek continued competitive access to its own markets. "Canadian cultural content will simply not survive if our goods and services are required to be substantially repackaged to meet the tastes of a North American market, 90 percent of which does not share Canada's interest in things Canadian."

In a 1998 publication, former Deputy Minister of Heritage Canada Victor Rabinovitch, basing his case for intervention in the cultural policy sphere on the economic notions of "public good" and "merit good," cited the following statistics:

- 70 percent of the music on Canadian radio stations is foreign in content;
- 60 percent of all English-language television programming available in Canada is non-Canadian, reflecting the importation of many American channels and programs;
- 33 percent of all French-language television programming available in Canada is foreign;
- 70 percent of the Canadian book market consists of imported books;
- 83 percent of our newsstand market for magazines is made up of foreign magazines;
- 84 percent of retail sales of sound recording in Canada is foreign content, including 69 percent of French-language retail sales;
- 95 percent of the feature films screened in theatres in Canada are foreign (this can be even higher in English-language markets);
- 86 percent of prime-time drama on English-language television is foreign, mostly from the United States; and
- 75 percent of prime-time drama on French-language television in Canada originates outside the country.

While it is a given that Canadian cultural policies must reflect the evolving nature of cultural production and the impact of change resulting from new digital and multimedia technologies, it is also clear that Canada must continue to be able to maintain and to develop policies that will promote not only its history but the reality of its living culture and its cultural diversity.

CULTURAL SOVEREIGNTY: STILL ON THE AGENDA

Arguments to the contrary, the conflict between open-economy assumptions and cultural sovereignty remains. Canadian cultural policy must continue to address the need to reflect the Canadian experience to Canadians and to the world. Despite the growth of niche markets and the argument that the growing worldwide need for content will ensure Canadian production, there is little Canadian content in most of the cultural products that Canada produces for the export market. The trend toward cultural harmonization and the erosion of indigenous cultures has been reinforced by the dominance of transnational media.

There is, as well, well-founded apprehension concerning the rapid growth in concentration of media ownership and cross-ownership among press, audio-visual, and telecommunications companies and the joint ownership of both production and distribution networks. Concentration of power allows a few individuals to decide what information and cultural products consumers receive. For example, in Canada in 1993-94, the top 10 companies accounted for 76 percent of film distribution revenue and 79.3 percent of total sales of recordings.

Issues associated with content regulation, foreign investment and ownership, and the use of subsidies and fiscal measures in the cultural sector will continue to serve as red flags to our American neighbours. While it is a given that Canadian cultural policies must reflect the evolving nature of cultural production and the impact of change resulting from new digital and multimedia technologies, it is also clear that Canada must continue to be able to maintain and to develop policies that will promote not only its history but the reality of its living culture and its cultural diversity.

As countries throughout the world struggle to maintain indigenous cultures and cultural diversity in the new millennium, Canada has, in the last year, been instrumental in creating both an international forum of governments and one of non-governmental

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organizations to address this situation. Convinced that cultural diversity, like biodiversity, must be maintained and seeking partners in the face of strong American opposition, Minister of Canadian Heritage Sheila Copps has fostered the development of a government organization to make the case for sustaining cultural sovereignty in the face of economic liberalization. At the same time, the Canadian Conference of the Arts has assumed a leadership role in developing an international network of cultural NGOs to promote cultural diversity and to develop an agreement designed to remove culture from the discipline of international trade agreements.

What is really at stake in this discussion is whether, in an increasingly integrated economic environment, a sovereign nation is able to create, produce, and disseminate arts and cultural products that reflect its own experience.

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OECD countries with predominantly private financing mechanisms.

While there continues to be much hopeful (some would say fanciful) talk in the Canadian reform debate on "influencing" the social and economic determinants of health, it may be that national, provincial, and local tax structures, and their consequences on health care use, constitute the invisible hand that buffers the effects of income inequality on the health status of Canadians. One of the main "influencers" on the health status of Canadians and health inequalities in Canada may well be progressive tax and equalizing benefit structures of the Canadian state, relative to the United States. Canadian health data show a strong relationship between health status and income, but unlike the United States and Britain, the apparent particular effects of income disparities may be muted at least partially by tax policies and health use benefit incidence that implicitly favour social equity!

Health data show a strong relationship between health status and income.

MORE MONEY FOR CANADA'S AILING HEALTH CARE SYSTEM

On September 11, Canada's First Ministers' Meeting agreed to invest $23.4 billion federally over the next five years on health care, with $2.2 billion of this devoted to early childhood development. This is at once tremendous news and disappointing. The social reinvestment of major transfer dollars is a welcome contrast to the downward fiscal pressure of the early 1990s.

This social reinvestment in transfers, with its progressive distributive consequence, is welcome in light of what we are beginning to understand as the health consequences of polarized income shares on the health of populations and how these consequences are felt in Canada and the United States. The agreement may also begin to buffer the panic talk about the fundamentals of the Canadian health care system.

On the other hand, the first ministers' announcement is disappointing for two important reasons. There are no new conditions on the new Canada Health and Social Transfer funds (http://www.scics.gc.ca/cinfo00/80003807_e.html). Why is this a problem?

In the last 15 years, the proportion of health services covered under the mandatory sweep of the *Canada Health Act* has shrunk from something in the order of 57 percent to something in the order of 45 percent of all health services. This shrinking base of coverage has occurred in part because of passive privatization—the shifting of costs for pharmaceuticals and care from hospitals where they are virtually completely publicly financed to community and home care where the base of public coverage has a threefold variation from one province to the next.

National health reform in Canada requires the extension of insured coverage under the *Canada Health Act*, if only to keep up a reasonably comprehensive base of public coverage. Although there is a political imperative, nothing in the first ministers' agreement compels any extension of coverage in the form of a national standard.

The government of Canada has at once bought political silence in a pre-election period and shrewdly reinvested in a progressively distributed social benefit. These moves will not only ease the panic in our delivery system, but may well help to sustain the health of our population because of the salutary health effects of this progressive social transfer.

This is in stark contrast to the United States, where the main "big ideas" being considered by Congress are the expansion of medical savings accounts and tax credits. Both of these measures will send people into the marketplace of insurance, where carriers still weed out those with health problems. If they do offer policies to sick people, the cost of such policies effectively shut them (and the poor) out of the market.

As Larry Levitt from the Kaiser Family Foundations says of these U.S. developments: "It's potentially a cruel hoax to give people something and then there's nothing to buy." These are not small differences between our two countries.

Child care in Canada and the United States

BY LINDA A. WHITE

Dr. Linda A. White is a visiting assistant professor, Department of Political Science and assistant director, Centre for the Study of the United States, University of Toronto.

BALANCING WORK AND FAMILY

Parents in Canada and the United States are acutely aware of the continuing difficulties of balancing work and family life, as well as the lack of governmental or employer support for child care and other family programs. Their governments' abysmal records become even starker when the programs and services for parents and children are held up to those available in other countries. Current initiatives at the federal, state/provincial, and local government levels thus must be placed in the context of what other countries already provide in terms of child care and family policies.

EUROPEAN EXAMPLES

Child care coverage in Sweden is nearly universal. Families with very young children are additionally given assistance in balancing work and family responsibilities. Parents are entitled to approximately 15 months' total parental leave, which can be taken until the child is 8 years old, with high wage replacement rates (80-85 percent) for most of the parental leave period.

Similarly in France, government support for children is very generous. Numerous policies for families exist, including family allowances, young children's allowances, school allowances, tax benefits for families with dependent children, an extensive system of child care supported by state revenues, allowances for the hiring of independent childminders, extensive maternity and parental leave programs, and preschool programs for all children from the age of three.

CANADA AND THE UNITED STATES

In contrast, child care and family programs in both Canada and the United States are quite paltry, although, ironically, child care is one area where Canada does not lead the United States on all measures. While working families in Canada have access to maternity and parental leave benefits of much longer duration than those in the United States, levels of program development, both federally and provincially, are quite negligible, save for recent developments in Quebec, and levels of government spending are low even relative to the United States. No provincial government in Canada provides early childhood education programs for three year olds. In contrast, more than one-third of the three year olds are enrolled in early childhood education programs in the United States. Enrollment levels for four and five year olds are also higher in the United States than in Canada.

> Neither country has extensive maternity/ parental leave benefits, although Canada's programs do exceed those of the United States.

Neither country provides much in the way of direct support for child care, such as to encourage the expansion of child care spaces, even more so in Canada since the federal government eliminated federal cost sharing under the Canada Assistance Plan for day care services. The U.S. federal government, however, has increased funding for child care subsidies for low-income working families as a result of changes in social assistance legislation (the *Personal Responsibility and Work Opportunity Reconciliation Act*) in 1996.

A large portion of U.S. and Canadian funding for child care services, other than for low-income families, is in the form of tax expenditures. While the maximum deduction is relatively generous in both countries (up to $7,000 child care expense deduction per child per year, in Canada, and up to $2,400 dependent care tax credit in the United States), many lower-income working parents are unable to take advantage of the programs because they must be able to pay for the costs of care up front.

COVERAGE GAPS BUT STILL WORLDS APART

Neither country has extensive maternity/parental leave benefits, although Canada's programs do exceed those of the United States. Federal employment insurance legislation in Canada permits up to 17 weeks' maternity leave at a replacement rate of 55 percent of workers' salaries to a maximum of $413 per week for 15 of those weeks (with a two-week waiting period for benefits). The claimant must have worked 700 hours in the previous 52-week period to be eligible for benefits. In addition, either parent is eligible for up to 10 weeks of parental leave benefits at the same wage replacement rate. The federal government, in its February 2000 budget, announced that, as of January 1, 2001, the parental leave period will be extended to up to 35 weeks, with no two-week loss of salary if the spouse takes the leave. It also is reducing the number of hours needed for eligibility from 700 to 600. Still, with wage replacement rates so low, strict eligibility criteria, and a tax "clawback" for higher-income earners, this maternity/

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parental leave program leaves much to be desired compared with many programs in Europe.

U.S. maternity and parental leave benefits are even more paltry. No federal maternity legislation exists, although maternity benefit programs exist at some state and local levels. The federal government mandates 12 weeks of unpaid job-protected leave for family/medical reasons, including the birth and care of a newborn child. It is only available, however, for employees of companies with more than 50 employees, where the worker has been employed for at least one year, and worked 1,250 hours during that year. It excludes workers in the top 10 percent of the company's pay scale if they are considered essential and their leave would cause "substantial and grievous economic injury" to the employer. Because of these exemptions, it is estimated that the Act covers about half or less of all U.S. workers.

U.S. maternity and parental leave benefits are even more paltry. No federal maternity legislation exists, although maternity benefit programs exist at some state and local levels. The federal government mandates 12 weeks of unpaid job-protected leave for family/medical reasons, including the birth and care of a newborn child.

FAMILY ALLOWANCES

Unlike in many European countries, no family allowances exist in either Canada or the United States. Low-income allowances are available in the form of the Canada child tax benefit (CCTB) in Canada and the earned income tax credit (EITC) in the United States. The CCTB, like the EITC, represents the largest single expenditure by the federal government on family benefits, totalling approximately $7 billion in 2000, with increases of $2.5 billion over four years announced in the 2000 federal budget. In the United States, the estimated amount of revenue forgone under the EITC program totalled $27.7 billion in 1998. These tax expenditure programs do not directly support child care, but can be used to help defray the costs of child care.

Recently, though, some interesting developments in child care policies and program delivery have occurred on both sides of the border—in Canada, by province, and in the United States, by group.

RECENT DEVELOPMENTS IN CANADA

Quebec

Increasing asymmetry in program delivery and levels of public involvement at the provincial level has emerged in Canada over the past five years. The Quebec government has led the other provinces in introducing a comprehensive, low-cost child care program for all preschool age children. Until the mid-1990s, however, Quebec was not a policy leader on the day care front. In 1995, for example, Quebec had a below-average number of child care spaces for children ages 0 to 12 compared with other provinces, and levels of commercial care exceeded those in Ontario, Manitoba, and Saskatchewan.

Quebec, however, distinguished itself in other ways from the rest of Canada with its family policy. The provincial government's emphasis on the preservation of French language and culture meant that the Quebec government has been more concerned about birthrates (among Francophone Canadians) than have governments in the rest of Canada. Thus, in 1988, the provincial Liberal government instituted a baby bonus—monetary incentives for families to have children—that increased based on the number of births. It also provides a parental leave period more extensive than that provided at the federal level or in other provinces.

In recent years, the Quebec government has worked to implement a more expansive child care and parental leave benefit in response to parents' concerns that a baby bonus was not enough incentive to have children because the costs of care are so high for working parents. As a result, the Quebec government implemented full-day kindergarten for five year olds, and $5-per-day child care for four year olds in September 1997. It has gradually expanded the program so that by September 2000 the program will be universal for young children. The Quebec government is also in negotiation with the federal government to provide more generous maternity and parental leave benefits than those planned by the federal government.

British Columbia

The British Columbia government also announced in March 2000 that it planned to have the first phase of a universal day care program in place by January 2001, beginning with subsidized before- and after-school care for 6 to 12 year olds, with parents paying about $7 per day. Low-income parents would receive further subsidies. The B.C. government is proceeding more slowly with its plans to expand the program to all toddlers and preschool children than has the Quebec government. It argues that it does not want to experience the same problems as occurred in Quebec, where the tremendous popularity of $5-per-day child care caused huge demand for spaces, shortages, and overcrowding. It also has qualified its promised expansion to only so long "as the budget permits," leaving room for the government to back away from its pledge of universality if budgetary concerns arise.

The Quebec and British Columbia initiatives stand in sharp contrast to developments in other provinces. Susan Prentice recently documented the decline of the regulated child care system in Manitoba due to funding cuts at both the federal and provincial levels. In Ontario, total provincial child care expenditures have increased only slightly under the Conservative government of Premier Mike Harris. Child care expenditures in the province of Alberta have declined quite significantly over the past five years. This decline in spending in Alberta and the minimal increase in Ontario reflects, to some extent, the social conservative philosophy of those Conservative governments in office, and contrasts sharply with many other provinces, who managed to increase spending during the same period.

RECENT DEVELOPMENTS IN THE UNITED STATES

Surprisingly, the United States leads Canada nationally on child care spending as well as in numbers of children in formal care. One additional area where the United States distinguishes itself is in early childhood education provision, an area where Canada desperately lags. As mentioned above, a larger percentage of children ages three to five attend preschool programs in the United States than in Canada.

A number of U.S. states have recently expanded their early childhood education programs, prompted in great part by "early years" studies that point out the importance of high-quality early childhood education programs on children's later education and success at school. In all, 42 states now offer free or subsidized preschool, some of which are aimed at children from low-income families, and others to all children. These programs are offered in addition to or coordinated with federally funded Head Start programs.

Future provincial government child care initiatives continue to be hampered by lack of cash on the part of provincial governments, as well as ideological resistance, both at the governmental level and from social conservative groups, to care outside the home.

One other area where government involvement in child care provision has expanded is child care for children of military personnel. The federal government greatly increased Defense Department expenditures on military child care over the past decade in response to criticisms of poor quality care, lack of standards, and high staff turnover due to low salaries. Child care advocates hope that the rapid improvements in military child care will provide a model for other state and national programs.

PORTENTS AND PROSPECTS FOR FUTURE DEVELOPMENT OF CHILD CARE PROGRAMS AND SERVICES

It is possible that continued initiatives at the provincial level, combined with federal–provincial cooperation on a national early childhood development (ECD) program, will cause levels of child care funding and numbers of children in formal care in Canada to surpass those in the United States. The federal and provincial governments reached an agreement in September 2000 on a new federal transfer program for early childhood development, with initial transfers of $300 million in 2001 and total transfers of $2.2 billion over five years.

There is, however, still reason for pessimism. Further federal–provincial negotiations with regard to new national social programs are constrained by political and strategic concerns on the part of both the federal and provincial governments that prevent coordinated and standardized responses to the issue of child care and early childhood education provision. Indeed, the federal government agreed to provide the new ECD funding with no strings attached, which means, in a worst-case scenario, that provinces could spend the money on programs other than ECD. At best, huge differences in levels of provision and types of support will likely emerge.

Future provincial government child care initiatives continue to be hampered by lack of cash on the part of provincial governments, as well as ideological resistance, both at the governmental level and from social conservative groups, to care outside the home. In the United States, we will likely continue to see increased spending at the state and federal levels on early childhood education initiatives, and child care funding for low-income families under the current welfare program. However, funding to expand the supply of high-quality child care services specifically is likely not to be forthcoming. Parents can only stand by in frustration as they observe these continuing incremental and piecemeal approaches to child care in both countries.

Labour market policy in Canada and the United States: Beyond "flexibility"

BY JIM STANFORD

Jim Stanford is an economist with the Canadian Auto Workers.

In recent years, the paradigm of "labour market flexibility" has exerted a decisive influence on labour market policy making in developed industrial economies. This paradigm rests on the central notion that competitive labour market forces will generally attain the most efficient match between labour supply and labour demand, and hence a lower rate of long-run structural or "equilibrium" unemployment. Government interventions aimed at enforcing particular labour market outcomes, such as minimum wages, unemployment insurance programs, collective bargaining structures, and other employee protections, tended to disrupt these competitive market forces and produce a less flexible, adaptive, and efficient labour market.

THE "FLEXIBILITY LENS"

As a result of the intellectual and policy dominance of the labour market flexibility view, most recent international comparisons of labour markets have tended to be conducted through a "flexibility lens." In an international context, the typical depiction is to arrange countries on a one-dimensional scale of labour market flexibility. The United States is considered to have a highly "flexible" labour market and hence more efficient outcomes, including a lower rate of unemployment. Continental Europe is considered to have an "inflexible" labour market with, therefore, less efficient outcomes, including higher unemployment. Canada is typically placed somewhere between these two extremes—although generally in a position considered "too close" to the European end. The emergence of an unemployment gap between Canada and the United States in the last two decades is often ascribed to Canada's labour market inflexibility.

When flexibility is interpreted in the concrete, popular sense of being "able to change and to respond to change," Canada's labour market is highly flexible

A closer look at recent economic experience, however, suggests that in the common understanding of the word, Canada's labour market does not at all seem "inflexible." When flexibility is interpreted in the concrete, popular sense of being "able to change and to respond to change," Canada's labour market is highly flexible, by many measures, more so than that of the United States.

Empirical evidence suggests that sectoral employment patterns, measured in both relative and absolute terms, are more volatile in Canada than in the United States. This indicates that Canada's economy is, at least, as adept in moving workers from one industry into another. Employment levels also tended to be more closely and predictably tied to changes in GDP in Canada than in the United States. This implies that employers here do not face barriers to the quick hiring (and firing) of workers as demand conditions change.

Similarly, labour force participation decisions are more predictably linked to labour market conditions in Canada. Again it shows that Canadian workers more flexibly adjust their labour supply decisions in the face of macroeconomic circumstances. Rates of self-employment and part-time employment are significantly higher in Canada than south of the border, again indicating that the form of the employment relationship is also very flexible in Canada. And geographic labour mobility within Canada is also high. Contrary to the stereotype that income support programs provide a perverse incentive for unemployed workers to stay in depressed regions, the rate of out-migration from Newfoundland and other poor provinces was very high in the 1990s and higher than the out-migration from corresponding depressed states in the United States.

Canada's labour market has reflected a fast pace of change. Canadian workers have responded to the difficult circumstances they face with new forms of flexibility: working in different industries, under different forms of employment contracts, and in different parts of the country. All too often in the 1990s, Canadians have simply withdrawn from the world of work altogether. If "flexibility" is indeed interpreted as an ability to change and to adapt to change, it is hard to argue that Canada's labour market is inflexible.

Nevertheless, there is surely something to the one-dimensional labour market taxonomy described above. This taxonomy places the United States on one end, continental Europe on the other, and Canada somewhere in between. This continuum may indeed illustrate some real pattern of structural variability in labour markets. It is just that this pattern has been misnamed with the deliberately inoffensive and seemingly neutral term "flexibility." What are the real differences that distinguish Canada's labour market from that of the United States, on one side, and from those of Europe on the other?

U.S. workers remain insecure despite a relatively low unemployment rate, and hence compensation gains—until 1998, anyway—remained muted as unemployment fell.

"FEAR FACTOR"

In his famous 1997 testimony to the Senate Banking Committee, U.S. Federal Reserve Board Chairman Alan Greenspan listed what he believed to be the key structural features of the U.S. labour market that had contributed to the surprising coincidence of low unemployment with low inflation. Many of the features highlighted by Greenspan reflect precisely a *lack* of flexibility in the labour market: a lack of response of compensation to tight labour markets, a reluctance of workers to leave their jobs, and the prevalence of long-term labour contracts that lock in employment arrangements for six or more years at a time. All of this suggests that something other than flexibility is the key ingredient at work.

It seems, perhaps, that a high degree of labour market *discipline* is key to U.S. macroeconomic functioning. U.S. workers remain insecure despite a relatively low unemployment rate, and hence compensation gains—until 1998, anyway—remained muted as unemployment fell. In this environment, the monetary authority is willing to allow the unemployment rate to fall below previously acceptable levels, without fear of shrinking profit margins and accelerating inflation. Greenspan's story is more about *fear* than it is about flexibility and hence this famous quotation has come to be known as Greenspan's "fear factor" testimony, in which he concisely described the importance of labour market discipline.

In applied practice, most proposals for flexibility-enhancing policy reforms have tended to promote models of a more disciplined labour market: less social insurance and income supports, available to fewer workers, less ability for unions and wage regulations to influence incomes, and a reduced degree of upward wage pressure corresponding to any given level of unemployment. With more reliance on private market forces as the dominant determinants of employment and compensation, this is a highly *deregulated* labour market. In other words, the paradigm of labour market flexibility can in practice be considered a model of labour market deregulation.

With the focus placed more appropriately on the varying intensity of labour market regulation, rather than on the revealed degree of flexibility, a comparison of labour market structures and institutions in different OECD economies can be conducted as follows. Table 1 (on page 92) summarizes 7 dimensions of labour market regulation for a sample of 17 OECD countries, as of the mid-1990s. A numerical index of labour market regulation is then constructed from data on each of these series.* This index of regulation does indeed roughly correspond to the commonly expressed scale of "flexibility." The United States places far at one extreme of the scale, with what is by far the most deregulated (or "disciplined") labour market in the OECD. Several European countries (particularly in Scandinavia) rank at the other extreme, with tightly regulated labour markets. The continental European countries demonstrate more moderate degrees of regulation. Canada scores somewhere between the United States and Europe but by international standards, Canada's labour market is relatively *deregulated*. In other words, while Canada's labour market is more regulated than that of the United States (characterized by more generous social programs, stronger unions, and less poverty), by the standards of the industrialized world as a whole, Canada's labour market is relatively freewheeling.

LABOUR MARKET PERFORMANCE

While this taxonomy summarizes international differences in the intensity of interventionist labour market *regulations*, it does not shed much light on international differences in labour market *performance* during the 1990s. Some countries with deregulated labour markets enjoyed relatively strong employment outcomes in the 1990s, including the United States and Japan, but so did several countries with relatively regulated labour markets, including Ireland, the Netherlands, and Norway. Similarly, some countries with deregulated labour markets experienced declining employment rates in the 1990s, including Canada, Australia, and the United Kingdom, as did other countries with regulated labour markets, such as Italy and Germany. There is no significant correlation whatsoever between the intensity of labour market regulation in OECD countries, in the 1990s, and their corresponding employment performance.

The one-dimensional model of comparative labour market performance which informs the argument for deregulation needs to be supplemented, therefore, with additional information. The uniquely difficult aggregate demand circumstances that were experienced during most of the 1990s were surely important in explaining Canada's poor employment performance during that dec-

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Table 1 Indices of labour market regulation, by selected OECD countries, 1995

	UI coverage (% unemployed)	TU penetration (% employed)	Labour market programs (% GDP)	Payroll taxes (% average wages)	Dismissal protection (OECD index)[1]	Poverty (% population below minimum)	Government program spending (% GDP)	Index of labour market regulation[2]
Canada	67	37	1.9	11	0.9	11.7	40.9	–6.9
OECD[3]	89	40	2.9	23	1.9	9.3	37.5	—
U.S.	36	14	0.5	14	0.2	19.1	30.8	–16.6
Japan	39	24	0.5	14	2.7	11.8	35.0	–7.7
Germany	87	29	3.8	34	2.8	5.9	46.6	2.2
France	76	9	3.1	42	2.3	7.5	50.8	4.5
Italy	na[4]	44	2.0	39	2.8	6.5	41.8	3.7
U.K.	94	33	1.8	17	0.8	13.5	41.4	–6.2
Australia	101	35	2.1	2	1.0	12.9	33.9	–7.9
Belgium	138	52	4.2	36	1.5	5.5	45.1	6.4
Denmark	100	80	6.6	10	1.6	7.5	55.8	6.7
Finland	108	79	5.5	26	2.1	6.2	56.8	9.5
Ireland	149	49	4.3	16	1.6	11.1	33.8	0.4
Netherlands	125	26	4.8	37	3.1	6.7	46.4	7.4
N.Z.	127	24	1.9	0	1.7	9.2	37.2	–4.5
Norway	94	58	2.1	18	2.4	6.6	48.3	2.6
Spain	40	19	2.8	29	2.6	10.4	40.2	–2.9
Sweden	109	91	4.5	29	2.8	6.7	62.9	11.8

1 Index calculated for "late 1990s."
2 A positive number indicates a relatively regulated labour market, a negative number a relatively deregulated one.
3 Unweighted averages.
4 Data unavailable; regulation index calculated on basis of 5 componenets for Italy.

Source: Author's calculations from *OECD Economic Outlook*; OECD, *Tax and Benefit Position of Workers*; OECD, *Country Survey: Ireland*; United Nations Development Program, *Human Development Report*.

Accounting for a widening U.S.–Canada income gap

BY BENJAMIN TAL

Benjamin Tal is a senior economist in the Economics Division of CIBC.

Despite recent improvements, real disposable income per capita in Canada is still Can.$400 lower than its level in 1989. This is significantly different from the trend observed in the United States, where real per capita disposable income has risen by about U.S.$2,400. This weak income performance in Canada requires a closer examination.

THE DIRECT IMPACT OF TAXATION

The high personal income tax rates in Canada, relative to the United States, are clearly an important factor to consider when analyzing the income gap between the two countries. Indeed, Canadians pay a larger percentage of their income in taxes and other transfers to governments. As of 1999, close to 25 cents of each dollar earned in Canada went to the various governments. This compares with only 19 cents in the United States. Over the decade, Canadians also saw the rate at which they transferred their income to governments rise faster than in the United States. Since 1989, transfers to governments, as a share of personal income, rose by close to 16 percent in Canada and by 13 percent in the United States.

However, the direct impact of taxes did not explain all, or even most, of the increase in the income gap between the United States and Canada over the decade. One way of showing this is to compare pre-tax (gross) income and post-tax (disposable) income in both countries. Since 1989, real gross income per capita in Canada rose by only 2.1 percent or Can.$500, while in the United States it rose by 20.6 percent or U.S.$2,850. This 18.5 percent performance gap is relatively close to the 20.0 percent performance gap observed for disposable (after-tax) income. Thus, the direct impact of taxation in accounting for the increase in the income gap was comparatively minor.

> As of 1999, close to 25 cents of each dollar earned in Canada went to the various governments. This compares with only 19 cents in the United States.

THE ROLE OF LABOUR INCOME

Since the impact of taxation did not play a significant direct role in accounting for the increase in the income gap since 1989, the focus should turn to the relative performance of gross (pre-tax) personal income. As illustrated, since 1989, income growth in the United States has outperformed income growth in Canada in each and every category of income. The most important factor here is the significant gap in the performance of labour income, which in both countries accounts for about 60 percent of total personal income. On a per capita basis, and adjusted for inflation, this component of income rose in the United States by U.S.$3,000 since 1989, accounting for over 60 percent of the total increase in personal income. At the same time, in Canada, labour income per capita rose only $350 since 1989.

In fact, the smaller increase in labour income in Canada accounts for close to three-quarters of the entire increase in the U.S.–Canada income gap since 1989. Lower growth in interest and dividend income in Canada along with slower growth in transfers from governments accounted for most of the rest.

Given that labour income is, by far, the most important factor that contributed to the widening in the U.S.–Canada personal income gap, it is important to determine what prevented labour income in Canada from growing as rapidly as it did in the United States. In this context the focus should be on the factors that determine labour income growth—wage increases and job creation.

THE ROLE OF WAGE INCREASES

Between 1989 and 1996, wages in Canada rose at a rate higher than or equal to that of the United States. However, over the past three years, reflecting the different realities in their respective labour markets, wage increases in the United States have risen much faster than in Canada. Annual wage increases in the United States averaged 2.1 percent (after inflation), between 1996 and 1999, compared with just 0.2 percent in Canada. In order to account for this factor, we imposed the same wage growth observed in the United States since 1989 on Canadian wages and found that if Canadians had experienced the same wage growth as in the United States, the labour income gap between the two countries would have been narrowed by 25 percent. In other words, the wage increase factor contributed about 25 percent to the in-

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crease in the labour income gap between the two countries.

THE ROLE OF JOB CREATION

Between 1989 and 1996, U.S. employment rose by an average of 1.6 percent per year, significantly stronger than the 0.6 percent in Canada. Since then, the pace of job creation accelerated in both countries, with annual employment growth averaging close to 2.5 percent in both countries. How much did this factor contribute to the increase in the labour income gap between the two countries? By imposing the rate of employment growth observed in the United States on Canadian employment data, we find that weaker job creation in Canada accounted for 41 percent of the increase in the U.S.–Canada labour income gap since 1989.

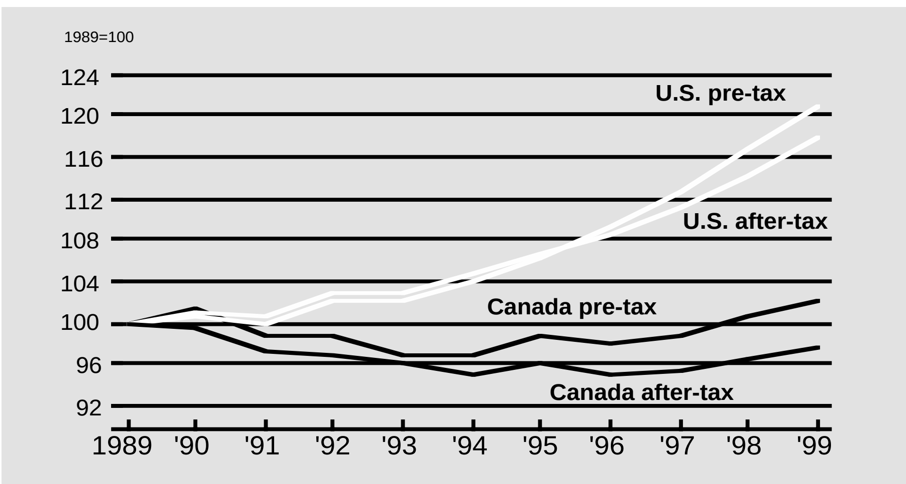
Accordingly, the combined role of wage increases and job creation accounted for about two-thirds of the increase in the U.S.–Canada labour income gap since 1989 and, thus, for close to 50 percent of the entire increase in the personal income gap.

What accounts for the rest? An additional factor to be considered is the differences in the nature of the jobs created in both economies. In this context, of particular importance are the role that self-employment has played in overall job creation in Canada since 1989 and the different sectoral distribution of employment growth in the two countries.

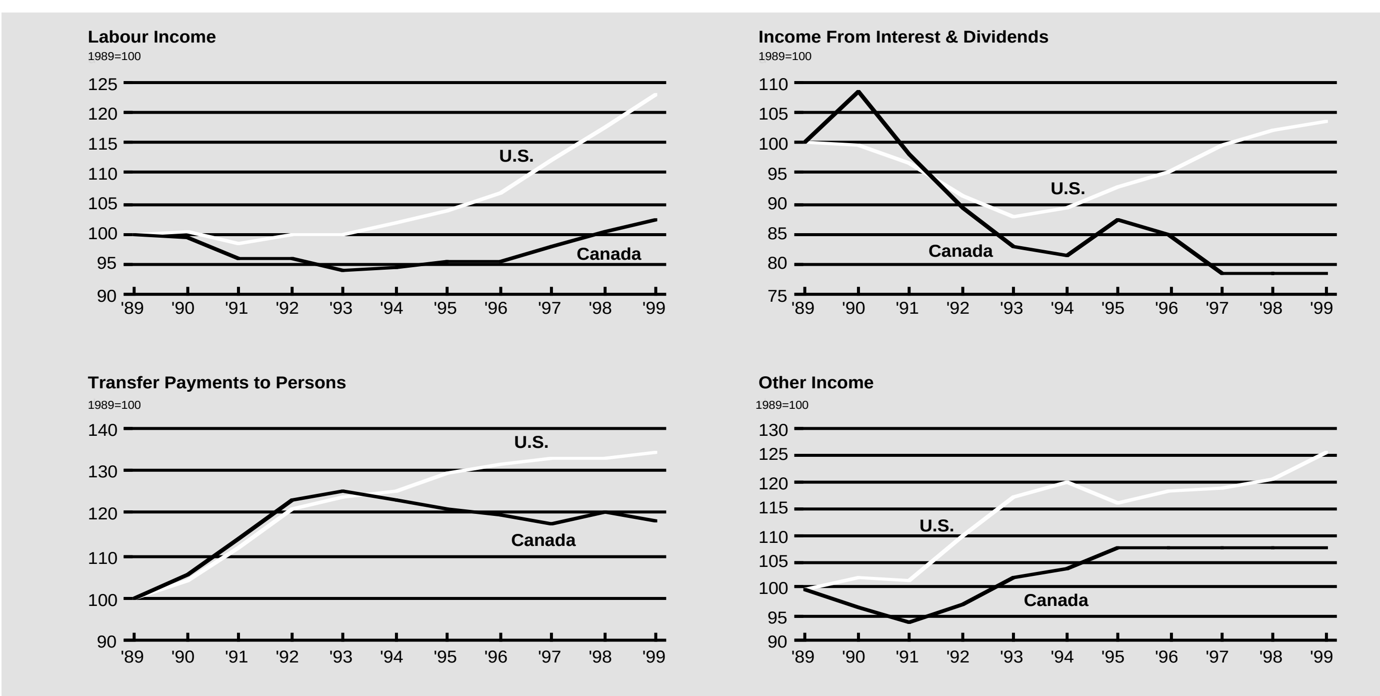
THE ROLE OF SELF-EMPLOYMENT

One of the most striking differences in labour market activity between the United States and Canada during the 1990s was the role played by self-employment. Since 1989, the number of self-employed in Canada rose by about 36 percent, while in the United States it rose by 10 percent. In fact, close to 45 percent of all jobs created in Canada over the past decade were in the form of self-employment. The self-employed in Canada now account for close to 17 percent of all workers—a significant increase from the 14 percent observed in

Income growth



Growth in real gross per capita personal income by source



1989. In the United States, the current share of self-employed is about 10 percent, unchanged from 1989.

Furthermore, almost of all the increase in self-employment in the United States was in the form of incorporated businesses, while the vast majority of the increase in Canada was in unincorporated entities. In fact, out of the 660,000 self-employment jobs created in Canada since 1989, 645,000 were in the form of one-person operations (self-employed with no paid help). This is significantly different from the trend observed in the 1980s, when one-person operations accounted for only one-third of the overall growth in self-employment in Canada.

This trend is significant. The fact that almost all of the increase in self-employment in the 1990s was in the form of one-person operations helps to explain the weak employment growth in Canada in the 1990s versus the 1980s (one-person operations do not hire paid help). This trend also helps to account for some of the weakness in the overall personal income growth in Canada during the 1990s as, on average, the reported income of a self-employed who runs his or her one-person operation is about 75 percent of the income earned by a paid employee.

In fact, controlling for this factor by imposing on Canada the same growth rate for self-employment and paid employment observed in the United States shows that the self-employment factor accounted for an additional 15 percent of the increase in the labour income gap between the two countries since 1989. In other words, the fact that most of the jobs created in Canada in the 1990s were in the form of self-employment and not paid employment, as was the case in the United States, added to the overall increase in the income gap between the two countries.

THE ROLE OF SECTORAL DISTRIBUTION

It is well known that in both the United States and Canada growth in service-oriented jobs during the 1990s was much stronger than in the goods-producing sectors. However, a closer look at the sectoral distribution of employment growth in both countries reveals some important differences. Reflecting stronger retail and wholesale activity in the United States, since the 1991 recession, employment growth in these sectors was stronger in the United States than in Canada over the decade. As well, employment growth in the construction, transportation, and financial industries was much stronger in the United States. Another important difference was in the public sector, where employment has risen modestly in the United States since 1989, while declin-

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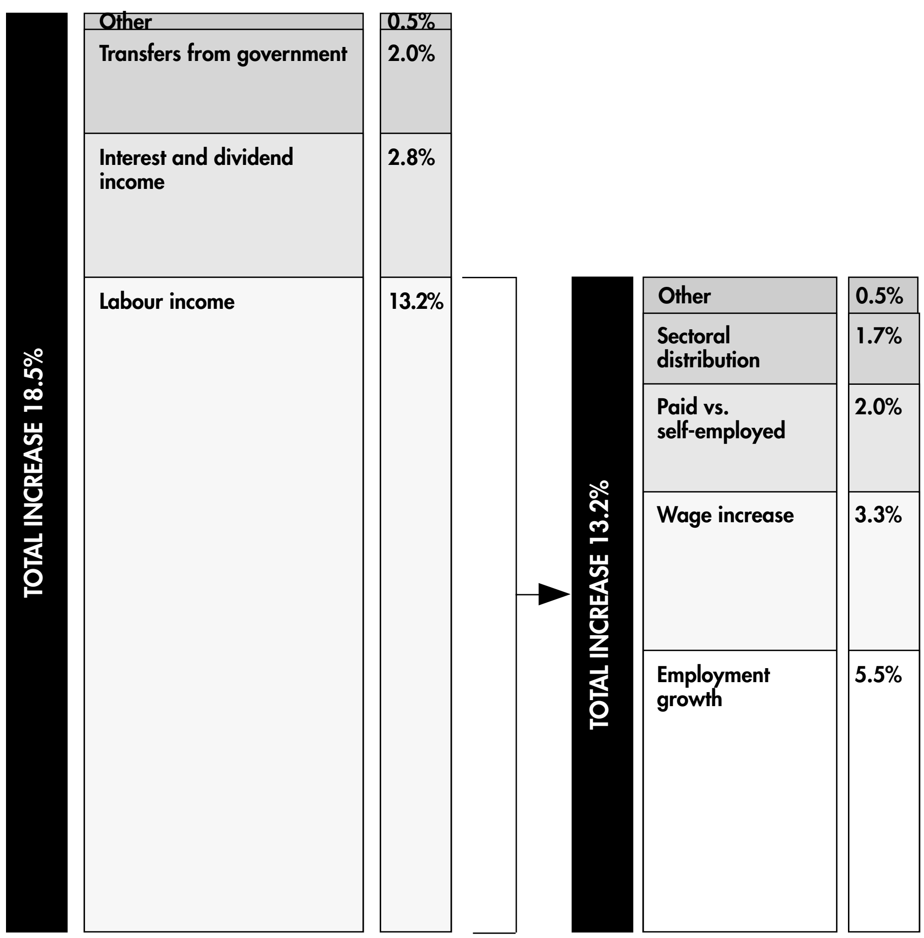
Since 1989, the number of self-employed in Canada rose by about 36 percent, while in the United States it rose by 10 percent. In fact, close to 45 percent of all jobs created in Canada over the past decade were in the form of self-employment.

Accounting for the increase in the U.S.–Canada personal income gap (1989-99)



Accounting for a widening gap continued from page 95

ing in Canada due to government cutbacks. Employment growth in the manufacturing sector was very similar in both countries, as was the trend in business services.

Distinguishing between employment gains in high-paying industries (that is, finance, transportation) and low-paying industries (that is, retail trade, personal services) among paid employees in both countries reveals that, since 1989, the share of jobs created in low-paying industries in Canada was about 65 percent of all new jobs created. This is higher than the 55 percent observed in the United States. This fact is important because it adds another dimension to the increase in the U.S.–Canada income gap. In fact, by imposing the same sectoral distribution of employment growth observed in the United States on Canadian data, we find that differences in the sectoral distribution of employment growth accounted for 13 percent of the increase in the labour income gap between the two countries since 1989.

Even putting aside the weakening of the Canadian dollar, the U.S.–Canada income gap widened by 18.5 percent since 1989. One-quarter of this gap was due to lower interest and dividend income and transfers from governments in Canada.

PUTTING IT ALL TOGETHER

Even putting aside the weakening of the Canadian dollar, the U.S.–Canada income gap widened by 18.5 percent since 1989. One-quarter of this gap was due to lower interest and dividend income and transfers from governments in Canada. The rest was due to lower growth in labour income in Canada—of which two-thirds is attributed to the combination of slower wage growth and weaker job creation in Canada and one-third to the different nature of jobs created in both countries since 1989.

Despite recent improvement, it seems unlikely that Canada will be able to close the income gap with the United States any time soon. This chronic lack of income growth in Canada reflects not only the weakness in employment and wage growth but also the inability of the Canadian economy to generate comparably high-paying jobs.

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ade. On two key performance indicators, Canada ranks second worst among the OECD countries: Canada's average output gap (the difference between actual output and potential output) during the decade was exceeded only by Finland's, and Canada's rate of real per capita GDP growth was faster only than Switzerland's. According to numerous macroeconomic policy indicators, Canada's macroeconomic policy stance was significantly more contractionary than that experienced in the OECD as a whole. In particular, the decline in government program spending was the fourth largest in the OECD, and Canadian short-run real interest rates averaged more than twice as high as those in the United States.

In summary, Canada experienced relatively negative labour market outcomes in the 1990s, even though it demonstrates a relatively deregulated labour market. Canada's macroeconomic circumstances during that decade were uniquely poor. In terms of Canada–U.S. comparisons, aggregate demand conditions differed much more between the two countries than did regulatory structures. In an international context, Canada is relatively similar to the U.S. in labour market regulation, both countries have relatively deregulated labour markets, but was strongly dissimilar in terms of macroeconomic conditions through most of the decade. U.S. conditions were expansionary, while Canada's were contractionary. This suggests that the importance of Canada's labour market institutions in explaining our comparatively poor labour market performance has been considerably overstated.

* Consistent data on each of these 7 dimensions of the degree of labour market regulation are gathered for each of the 17 OECD countries. Each data series is oriented so that a higher score reflects a higher degree of regulation. Each variable is normalized such that the unweighted mean score for the sample equals zero (and hence a positive score implies a relatively intense form of regulation, and a negative score a relatively passive one). Each variable is further normalized such that the standard deviation of each series is a constant. Finally, an index of labour market regulation is calculated by averaging each country's scores over the seven indices considered.

INCOME GAP

The Canada–U.S. income gap

BY ANDREW SHARPE

Andrew Sharpe is the executive director of the Centre for the Study of Living Standards, Ottawa.

GETTING BIGGER

In the 1990s, the gap between Canadian and American income levels widened significantly. Real personal income per capita in Canada fell 9 percentage points from 87.2 percent of the U.S. level in 1989 to 78.1 percent in 1999, the largest 10-year decline recorded in recent Canadian economic history. This decline in Canada's standard of living relative to the United States has important implications, such as the greater financial incentive it gives Canadians to pursue careers south of the border. This article provides a brief overview on the dimensions of the growing Canada–U.S. income gap, the factors behind it, and likely future developments.

SOME CONCEPTS AND CAVEATS

It is useful to review several concepts and caveats pertaining to the measurement of income across countries. First, three concepts of aggregate income are used in the debate on income trends—gross domestic product (GDP), defined as the total income received by all factors of production; personal income (PI), which includes transfer payments but excludes undistributed corporate profits and depreciation; and disposable personal income (DPI), defined as personal income after taxes. A major weakness in the use of DPI for international income level comparisons is that this measure does not include the public services provided by government, and the relative importance of these services varies across countries.

A second point is that international comparisons of income levels must be made with purchasing power parity (PPP) exchange rates, not the market exchange rate, if they are to accurately portray relative living standards. The purchasing power exchange rate is the rate at which a basket of goods costs the same in two countries. The PPP rate used in this article is based on the Statistics Canada benchmark of U.S.$0.813 per Canadian dollar for 1992. Given the lower inflation in Canada than in the United States since 1992 (5 percentage points for the GDP deflator), the PPP rate, for 1999 dollars, was U.S.$0.856.

> [I]n the discussion of income performance, one should always be careful to distinguish income levels from rates of growth, because it is the latter that drive the former. For example, Canada's growing income gap in the 1990s reflects lower rates of real income growth relative to that in the United States.

Two other points to note in income comparisons are the following. First, the recent change by the U.S. Bureau of Economic Analysis to include software as part of investment, not intermediate consumption, has increased real GDP growth in the United States in the 1990s. Because Statistics Canada has not yet incorporated this change into its national accounts time series, there is an upward bias in the U.S. real income series relative to the Canadian series. Second, in the discussion of income performance, one should always be careful to distinguish income levels from rates of growth, because it is the latter that drive the former. For example, Canada's growing income gap in the 1990s reflects lower rates of real income growth relative to that in the United States.

CANADA–U.S. INCOME TRENDS

Table 1 provides data on three aggregate income measures for Canada and the United States in absolute terms (expressed in 1992 U.S. dollars) and relative terms for the last business cycle peak of 1989 and 1999, the most recent year for which data are available, and provides average annual growth rates between the years.

A number of observations arise from these data. First, Canada's income gap with the United States is much greater for disposal personal income than for the other two income measures (30 percentage points versus 21-22 points in 1999). This reflects the greater share of personal income devoted to taxes in Canada, offset to be sure by greater government services (and larger interest payments on public debt).

Second, all three income measures show a marked deterioration in Canada's living standards relative to those in the United States, in the 1990s, after an

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improvement in the 1960s and the 1970s and some deterioration in the 1980s. The gap for disposable personal income rose 9.6 points from 1989 to 1999, that for personal income 9.1 points, and that for GDP 6.9 points. These trends reflected the slower growth of all three income measures in Canada.

Third, two of the three income measures show that living standards in Canada, in the 1990s, either declined in absolute terms (−0.2 percent per year for per capita DPI) or experienced very slow growth (0.2 percent for per capita PI). Only per capita GDP showed some progress, growing at 1.1 percent per year. This large gap between GDP and personal income growth reflects the larger increase in the consumer price index (2.2 percent per year), which is used to deflate personal income, than in the GDP deflator (1.5 percent per year), which is used to deflate GDP. This in turn was due to the declines in the prices of investment goods and exports, which are included in GDP, but not in personal income. From the point of view of trends in current living standards, the CPI is the more appropriate deflator.

The Bank of Canada adopted a very tight monetary policy in the early 1990s in its zealous pursuit of price stability. The resulting high interest rates and recessionary conditions produced large government deficits. This in turn caused governments in mid-decade to adopt restrictive fiscal policies to reduce deficits.

Table 1 Per capita real income levels and growth rates in Canada and the United States (expressed in 1992 U.S. dollars)

	GDP per capita	Personal income per capita	Disposable personal income per capita
Canada			
1989	$21,011	$18,339	$14,565
1999	23,499	18,751	14,269
United States			
1989	24,438	21,042	18,372
1999	29,705	24,024	20,472
Canada as a percentage of the U.S.			
1989	86.0	87.2	79.3
1999	79.1	78.1	69.7
Change in points	−6.9	−9.1	−9.6
Average annual rate of change, 1989-99			
Canada	1.13	0.22	−0.21
U.S.	1.97	1.33	1.09
Canada–U.S. difference	−0.84	−1.11	−1.30

Source: CSLS database (www.csls.ca) based on data from Statistics Canada, U.S. Bureau of Economic Analysis, and U.S. Bureau of Labor Statistics.

EXPLANATION OF INCOME TRENDS

GDP per capita is determined by the proportion of the population that is working and the output of each worker. The former variable in turn reflects the demographic structure (the proportion of the working-age population (15 years and over) in the total population, and the employment rate (the number of persons employed as a share of the working-age population). The employment rate is determined by both the participation rate and the unemployment rate.

Canada's growing income gap in the 1990s reflected both poorer productivity and employment rate growth relative to the United States. Output per worker advanced only 1.1 percent per year over the 1989-99 period in Canada versus 1.7 percent in the United States. Canada's employment rate actually fell 0.2 percent per year due to a falling participation rate, while the employment rate in the United States advanced 0.2 percent. On the other hand, the ratio of the working-age population to the total population advanced at a faster rate in Canada (0.3 percent) than in the United States (0.1 percent), reducing the income gap.

Thus, of the 0.8 percentage point gap in real per capita GDP growth between Canada and the United States over the 1989-99 period, 0.6 points were contributed by slower productivity growth, 0.4 by poorer employment rate growth, and –0.2 points by a more favourable demographic structure.

The relative contribution of the productivity and labour market factors varied significantly within the period. Our inferior labour market performance was the key factor behind growth in the income gap in the first half of the decade. Employment rate growth was 0.9 points per year less in the 1989-95 period in Canada, whereas in the 1995-99 period it was 0.3 points faster. Slower relative productivity growth was the key factor behind the growing income gap in the second half of the decade. The Canada–U.S. productivity growth rate gap averaged 1.3 points per year versus only 0.2 points in the first half of the 1990s.

Canada's poor labour market performance in the first half of the 1990s reflected our much weaker economic growth. This was largely due to our macroeconomic policy choices. The Bank of Canada adopted a very tight monetary policy in the early 1990s in its zealous pursuit of price stability. The resulting high interest rates and recessionary conditions produced large government deficits. This in turn caused governments in mid-decade to adopt restrictive fiscal policies to reduce deficits, at the cost of economic growth.

The increase in the Canada–U.S. productivity growth rate gap in the second half of the 1990s was not due to any absolute deterioration in productivity growth in this country (in fact, productivity growth actually picked up 0.2 percentage points). Rather, it reflected the doubling of productivity growth in the United States (from 1.2 percent per year in the 1989-95 period to 2.4 percent in the 1995-99 period for GDP per worker). It appears that the productivity gains from information technology (IT) have finally manifested themselves south of the border, but not yet in Canada.

[A]s economic developments in the United States eventually spill over to Canada, we may soon begin to enjoy the productivity gains of the IT revolution that the United States is currently experiencing. Our productivity levels can then converge toward U.S. levels.

FUTURE INCOME DEVELOPMENTS

In 1999, aggregate income measures show Canada with a historically large income gap compared with the United States. In my view, this gap will narrow over the next decade. There are at least three reasons to expect this trend. First, with the strong economy, the federal government and provincial governments will enjoy growing fiscal surpluses and will reduce these surpluses by cutting taxes and thus increasing disposable personal income. Business demands that our tax rates be competitive with lower tax rates in the United States and this will also contribute to the trend to lower taxes.

Second, Canada's higher unemployment rate and lower participation rate relative to that in the United States mean that there is greater potential for faster employment rate growth in this country, which will reduce the income gap.

Third, and most important, as economic developments in the United States eventually spill over to Canada, we may soon begin to enjoy the productivity gains of the IT revolution that the United States is currently experiencing. Our productivity levels can then converge toward U.S. levels. Productivity growth in the United States now appears to be spreading from the IT-producing industries to the much more important IT-using industries. This augurs well for Canada because our IT-producing sector is much smaller than that in the United States.

It should be noted that the expected improvement in productivity growth in Canada will translate into significant real income gains, even if the Canada–U.S. income gap does not close. These real income gains in themselves would represent a very positive development after the real income stagnation of the 1990s.

POLICY IMPLICATIONS

All Canadians would like to see a reduction in our income gap with the United States. This should be a goal of public policy, to be balanced with all the other competing public policy objectives. A key condition for closing the gap is that the economy remains robust. Strong aggregate demand growth will foster productivity growth, increase the employment rate, and improve government finances, allowing further tax cuts. It is crucial that monetary policy does not turn restrictive and throw the economy into a recession, as happened in the early 1980s and 1990s. Hopefully, we can learn from our macroeconomic policy errors of the past.

Do we have to harmonize down? Canadian tax policy in a continental context

BY ANDREW JACKSON

Andrew Jackson is senior economist with the Canadian Labour Congress.

Does a relatively high and progressive tax system undermine investment, growth, and productivity? Or are social advocates bang on about the need to maintain a larger and more progressive fiscal base than the United States, if we are to sustain lower rates of poverty, insecurity, and income inequality? What we need to understand is that pressure to harmonize the Canadian tax system down to U.S. levels undoubtedly exists to the extent that taxes do influence the locational decisions of higher-income taxpayers and corporations. However, the higher Canadian tax "burden" is offset by efficiency and not just equity gains. As a result, we have significant room to shape and reshape the implicit social bargain and preserve Canadian distinctiveness.

The U.S. tax "burden" *increased* in the 1990s expansion (from 28.9 percent of GDP in 1992 to 31.0 percent in 1999) and personal tax rates were made more progressive by the Clinton administration reforms of 1993, which increased the top rate of income tax from 31 to 39.6 percent. Stronger U.S. growth in the 1990s has been associated with reversal of some of the Reagan era "supply-side" tax cuts, which produced large deficits rather than stronger GDP growth. Advocates of harmonization of Canadian taxes to U.S. rates and levels seldom dwell on certain progressive features of the U.S. tax system, such as the existence of a not negligible tax on larger gifts and inheritances, and the absence of special income tax treatment for dividend income.

Finally, it is worth noting that Canada–U.S. productivity growth differences in the 1990s reflect important differences in industrial structures and, above all, the much greater weight of high-tech industries in the United States. Tax factors may play a role here, but the structural difference is also very much a product of past patterns of historical economic development.

> **Low-income Canadians are significantly better off than low-income Americans in absolute purchasing power terms, and poverty rates are much lower.**

THE TAX AND TRANSFER SYSTEM

It is true that the total tax share of GDP is significantly higher in Canada than in the United States (42.8 versus 31.0 percent of GDP in 1999). Most of the difference arises from the fact that upper, middle and high income earners incur a significantly higher income tax burden. Income and profits taxes provide about half of all tax revenues in both Canada and the United States. The major difference in tax structure is higher payroll taxes in the United States, balanced by higher consumption taxes in Canada.

Because of the combined workings of the tax/transfer system operating on top of a modestly more equal initial distribution of market incomes, the *median* Canadian in 1997 (someone at the precise midpoint of the national household income distribution) was, as a careful analysis by Michael Wolfson of Statistics Canada has demonstrated, better off than the *median* American in real after-tax terms, adjusted for differences of purchasing power. Significantly, the *average* American was better off than the *average* Canadian. (Canadian GDP per capita, adjusted for purchasing power, is currently calculated by the OECD to be 20 percent below the U.S. level.)

Low-income Canadians are significantly better off than low-income Americans in absolute purchasing power terms, and poverty rates are much lower. If poverty is defined as less than half median national income, the child poverty rate in Canada is 14 percent, compared with 23 percent in the United States, and the elderly poverty rate is 5 percent, compared with 24 percent (*Luxemburg Income Survey* data). In short, the advantages of higher U.S. GDP per capita accrue almost entirely to the advantage of the top 20 percent or so of U.S. citizens who are, indeed, markedly better off than affluent Canadians.

PUBLIC SERVICES

Canada's relatively more redistributive tax/transfer system is also complemented by a higher level of delivery of public services, replacing, to some degree, expenditures from after-tax income. In the United States, medical care expenses consume a startling 13.96 percent of after-tax household income, compared with just 3.2 percent in Canada. (See Andrew Sharpe and Lars Osberg, *International Indicators of Economic Well-Being*, table 6.)

A recent OECD study found that private U.S. household spending on social security—contributions to pensions, health, disability, and similar plans—amounts to more than 8 percent of U.S. GDP, well above the 1-3 percent range in continental European countries, where such security is typically delivered through public programs. (See *OECD Labour Market and Social Policy Occasional Paper #32*, Willem Adema and Marcel Einerhand, "The Growing Role of Private Social Benefits," 1998.) Comparable Canadian data are, unfortunately, lacking.

The key point is that a higher tax "burden" is associated not only with income redistribution programs, but also with offsetting access to free or heavily subsidized programs and services, which have to be paid for out of after-tax income in the more market-oriented United States.

Canada remains a "kinder, gentler" or at least modestly more equal society than the United States, in significant part because of the greater relative size of the tax/transfer system and higher levels of provision of public services. These differences have been eroded in recent years because of cuts to transfers (EI and social assistance) and to a range of spending programs. Total public expenditure on programs has fallen from 41.4 to 36.4 percent of GDP, 1990-99, but Canadian governments still spend about 9 percent more of GDP on programs than do U.S. governments. (Data from *OECD Economic Outlook*.)

This leaves us with an implicit social decision to have a higher-tax burden, particularly on higher-income Canadians, in order to maintain a more generous transfer system and a higher level of public provision of services. The key question that has to be answered is whether this implicit, albeit constantly politically contested, social decision in favour of greater equity and security carries a price in terms of forgone growth.

A simple OECD cross-country comparison shows that there is, in fact, no statistically significant link between the tax "burden" and GDP per capita growth or productivity growth, while there is a strong, positive relationship between the tax "burden" and low after-tax income inequality.

EQUITY AND SECURITY AT THE PRICE OF GROWTH?

A simple OECD cross-country comparison shows that there is, in fact, no statistically significant link between the tax "burden" and GDP per capita growth or productivity growth, while there is a strong, positive relationship between the tax "burden" and low after-tax income inequality. (For a detailed examination, see Andrew Jackson, "Tax Cuts: The Implications for Growth and Productivity," (2000), vol. 48, no. 2 *Canadian Tax Journal* 276-302.) In the 1990s, several smaller European countries—notably Denmark, the Netherlands, and Norway—with relatively high tax-to-GDP ratios (and low rates of income inequality) grew faster than the United States in GDP per capita terms, and achieved comparably low levels of unemployment. Clearly, the notion of a large growth payoff from lower taxes per se is unfounded.

There are several key reasons why such a link does not exist. First, to the extent that higher taxes simply represent a choice to finance social security and some services from taxes as opposed to after-tax income, the "burden" is simply a reallocation of funds from private to public consumption. The tax "burden" is offset by free or subsidized public goods. This may have positive efficiency effects, as in the case of public health care and public pensions, which have demonstrably lower overhead costs than market equivalents.

Second, redistribution to raise the after-tax incomes of low- and middle-income families may have positive growth and efficiency impacts above and beyond the realization of equity goals. A recent, authoritative survey in the *Journal of Economic Literature* noted that, despite the economic dogma of an equity/efficiency tradeoff, cross-country surveys almost universally find a negative correlation between growth rates and inequality (Philippe Aghion, Eve Caroli, and Cecilia Garcia-Penalosa, "Inequality and Economic Growth: The Perspective of the New Growth Theories" (December 1999), vol. 37 *Journal of Economic Literature* 1615-60.)

HUMAN CAPITAL/ SOCIAL CAPITAL

The key linkage from low rates of inequality and poverty to growth is through higher accumulation of "human capital" and "social capital"—two concepts that are now at the centre of much economic theorizing about the sources of "endogenous" growth. Put another way, social deprivation and exclusion are economically counterproductive because of the waste of talent and skills, and because of high overhead social costs arising from unequal and divided societies.

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Corporate Canada and foreign ownership

BY STEPHEN BLANK

Stephen Blank is a professor at the Lubin School of Business, Pace University, New York.

RESTRUCTURING CORPORATE AMERICA

Critical structural changes have occurred in the nature of the global economy, affecting in turn the structure of national economies and patterns of foreign investment and ownership. Even more powerful changes are under way.

In 1975, when I came to Canada to do research for a five-nation study of host country-MNC relations, U.S. subsidiaries were facing intense regulatory and political pressures to increase Canadian content and control. Many Canadian managers were pushing for greater autonomy and, at that time, most U.S. firms were willing to be better "corporate citizens."

By the 1980s, however, powerful changes in the global economy had forced U.S. firms to rethink their corporate strategies and structures in North America. Among the many pressures precipitating this corporate rethink were changes in policy trends—for example, the long-term impact of GATT liberalization, and the more immediate policy shifts after the 1982 oil price crash. As well, the impact of new technology in reducing the effect of distance in complex production processes and in altering the nature of control systems had greatly heightened competition in global markets.

Reducing overcapacity was central to meeting these competitive pressures. Although many Canadian branch plants had generated substantial profits for their corporate parents, such plants had become painful liabilities in an increasingly competitive environment. As distinctly national markets began to blur, firms worked out more rational, less expensive sourcing, production, marketing, and distribution networks in North America, resulting in a more integrated continental system. Subsidiaries increasingly became operations located in Canada or Mexico rather than operations producing for Canadian and Mexican markets.

As distinctly national markets began to blur, firms worked out more rational, less expensive sourcing, production, marketing, and distribution networks in North America, resulting in a more integrated continental system.

A NORTH AMERICAN MARKET

Companies adopted a variety of arrangements. Some sought to capture efficiencies and synergies globally through centralized control of key activities. Subsidiary managers were, with good reason, apprehensive of this approach, as control over their own operations was centralized to strategic business units or operating companies. Lacking an overall view from headquarters of a Canadian role, these units often reduced the scale of Canadian operations and autonomy—as subsidiary morale, output, and productivity all deteriorated.

An alternative model envisaged a different dynamic at the core of global organizational change. Instead of being constrained by centralization, this model viewed subsidiaries as driven by the competition between different operations. Under this approach, even though Canadian operations report directly to U.S.-based business units, Canadian managers are able to collaborate to maintain a high level of Canadian identity in their identification of possible production, research, or sales mandates.

Despite these different approaches, though, the overall result was much greater specialization for Canadian businesses. Canadian operations that had produced a wide range products for their parent companies now focused on single products or even components. Thus, an increasing share of cross-border trade in North America takes place within corporations.

PATTERNS OF CHANGE

Patterns of change have not been homogeneous across all sectors. The emergence of a North American economic system has been most visible in manufacturing. While in financial services and telecommunications, for example, change has been slower.

The trend toward deeper integration intensified in the 1990s. Cross-border trade (much of it intra-company) rose to more than a billion dollars a day, and flows of investment increased dramatically. Canada's inward stock of foreign direct investment (FDI) rose from

Can.$90 billion in the mid-1980s to upward of Can.$190 billion in the mid-1990s. Acquisitions soared. Americans bought stock in Canadian firms and also bought Canadian firms outright.

The internationalization of markets for corporate shares makes the whole question of foreign ownership even more complex. On any given day, even a Canadian icon, like Canadian National, might be heavily foreign owned. As well, companies have much greater choice in raising capital. In 1988, just seven Canadian companies issued new equity in the United States, raising only U.S.$94 million. In 1998, 30 companies raised nearly U.S.$2 billion on U.S. markets.

WHY WERE AMERICANS BUYING CANADIAN?

The cheap exchange rate was one reason. Canada is viewed as a very good buy, both for quality and for bargain basement prices.

Canadians are active foreign investors, too. Canada's outward stock of FDI increased by the same magnitude as inward FDI, from Can.$90 in the mid-1980s to Can.$190 in the mid-1990s. Canada is the fourth-largest investor in the United States. As well, during the 1990s, Canadian direct investment abroad grew twice as fast as foreign investment in Canada. Despite tax credits for owning local stocks and a government-mandated cap on Canadian pension funds' foreign investments, Canadians own upward of $60 billion of foreign stocks.

A SINGLE NORTH AMERICAN ECONOMY?

What this reveals is that goods and capital markets are no longer national: Canada, the United States, and Mexico increasingly share a single economy. Investment decisions are influenced by a wide array of factors, including federal, provincial/state, and local regulations and benefits, currency values, labour costs, and so on. Each of these decisions are also made within the context of competition for continental and global markets, rather than being seen as strategies to gain access to national markets.

> **While there are fewer auto companies worldwide, these giant companies are outsourcing significant pieces of their business. Smaller, locally owned firms may discover high-value niches in this system.**

Is it useful to consider these issues on a national basis at all? Probably not. Sectors and regions are the critical variables. As Courchene observes in *From Heartland to North American Region State* (University of Toronto, 1988), "It is time to view Canada as a series of north–south, cross-border economies with quite different industrial structures." Patterns of foreign investment, incoming and outgoing, will differ in each of these economies.

Sectors may be even more important. The auto industry, for example, accounts for more than 11 percent of Canada's manufacturing GDP, more than 4 percent of total GDP, one-third of all retail sales and manufacturing exports, and nearly 5 percent of total employment. As Pradeep Kumar and John Holmes say, in a new study of the Canadian auto industry,

> The most significant and distinctive factor that has shaped the Canadian automobile industry over the past three decades is the high level of integration with its counterpart in the United States. . . . The rationalization of production and trade triggered by the Auto Pact has led to the full integration of production of both parts and assembled vehicles into one industry that supplies the combined U.S. and Canadian market.

As more sectors operate like the auto industry, national borders, while still relevant, will simply be one of an array of factors that create the context in which corporate strategy emerges.

QUESTIONS FOR CANADA IN THE GLOBAL MARKET

First, how powerful is foreign investment in explaining Canada's well being? How important is it that firms be headquartered in Canada? One might ask if Canada has been ill served by the continental integration of the auto industry. There are no Canadian auto companies, but there are a lot of jobs, production, and exports. Has Canada been better served by a more protected financial or telecom sector?

Second, foreign ownership might soon become a very old issue as technology-driven change in business structure may render this debate irrelevant. If one trend in the global economy is toward amalgamation, another is toward outsourcing and unbundling value chains in many industries. While there are fewer auto companies worldwide, these giant companies are outsourcing significant pieces of their business. Smaller, locally owned firms may discover high-value niches in this system.

In this emerging era of alliances, out-sourced, networked, and virtual companies, foreign investment may grow less prominent in international business, as alliances and networks link companies rather than ownership and investment. Levels of foreign ownership are much less important where economies are no longer protected or national. Canada's future will be more influenced by decisions regarding its macroeconomic policy, social policy, infrastructure, and relations between Ottawa and the provinces than by levels of foreign investment or foreign ownership.

Foreign investment in the new millennium: A view from the Canadian side of the border

BY BERNARD M. WOLF

Bernard M. Wolf is professor of economics at the Schulich School of Business, York University.

THE WELCOME MAT

Public sentiment and government policies toward foreign direct investment (FDI) have varied over time and the behaviour of multinational enterprises has correspondingly responded to the differing government policies. In Canada, the late 1960s saw a fairly hostile view of FDI, which culminated in the establishment of the Foreign Investment Review Agency in 1974. By contrast today, Industry Canada has a welcome mat out for FDI, except in the case of a few industries such as telecommunications, broadcasting, airlines, etc., where foreign ownership is limited. Trade policies are also one of the key variables affecting FDI. Canada's investment climate has changed with the adoption of the 1965 Canada–U.S. Auto Pact, the 1989 Free Trade Agreement (FTA) with the United States and its extension, in 1994, to Mexico in the North American Free Trade Agreement, as well as with the multilateral trade liberalization rounds under GATT auspices.

TRENDS IN FDI AND THE IMPLICATIONS FOR CANADA*

The Auto Pact allowed the major auto manufacturers, based in the United States, to substantially increase the length of their production runs and thereby obtain scale economies. Vehicles would no longer be produced in Canada solely for the domestic market. Rather, there would be substantial intra-firm, intra-industry trade between the United States and Canada. The agreement was, and still is, highly successful, especially for the province of Ontario, where new investment was stimulated by a surge in Canadian demand for vehicles.

In the early 1990s, during a critical phase in the implementation of the FTA, investment in Canada was discouraged by the very high value of the Canadian currency brought about through tight monetary policies. The overvalued currency meant a lack of competitiveness in the export sector as well as low domestic demand. While Canada has continued to attract inward FDI, outward FDI has grown much more rapidly in recent years, with Canada becoming a net outward investor in 1996.

While Canada has continued to attract inward FDI, outward FDI has grown much more rapidly in recent years, with Canada becoming a net outward investor in 1996.

In 1998, the latest year for which we have data, the stock of outward FDI was 10.5 percent above that of the inward stock. It amounted to nearly 27 percent of GDP. Between 1990 and 1997, the United States was the destination for more than a third of Canada's cumulative net FDI outflows, down from two-thirds between 1982 and 1989. Increasingly, Canadian outward FDI has been directed into services, accounting for 44 percent of the stock of outward FDI in 1998, up from 29 percent in 1985.

The 1990s have seen a very significant increase in inward FDI (to 24.2 percent of GDP in 1998), with the United States accounting for more than 70 percent of those inflows. Cross-border capital accounted for 76.5 percent of the net FDI inflows, compared with only about 32 percent during the 1980s. The composition of the inward FDI has been fairly constant except for some fall in the area of resources. Inward FDI is highest in the manufacturing sector. In the 1990s, the importance of inward FDI flows for business investment has increased from 4 percent in 1991 to 21.2 percent in 1998. Foreign-controlled firms in Canada also outperformed Canadian-controlled firms in terms of revenues. Between 1989 and 1996, the share of foreign-controlled firms (mostly U.S.) in total corporate revenue increased about 6 percentage points, whereas their asset base remained stable. The relative superior performance also extends to productivity.

Overall, Canada's productivity performance in the 1990s was very weak, relative to that of the United States. Beginning from a lower base, between 1990 and 1998, productivity growth in Canada was only 16.4 percent, compared with 29.2 percent in the United States. However, a substantial drop in the value of the Canadian dollar vis-à-vis the American one, combined with lower compensation costs in Canada, led to a significant fall in Canadian unit labour costs, compared with the United States. In a few industries, such as motor vehicle production, lower wages and higher productivity provide a significant advantage for Canada.

PRODUCTIVITY PROBLEMS

Why on average is productivity lower in Canada than the United States? We do not have very definitive answers but some hypotheses certainly can be considered:

1. With the Auto Pact, tariffs were cut more substantially, on average, than with subsequent trade liberalization.
2. Unlike the rationalization under the Auto Pact, where product run size was the key variable, under subsequent trade liberalization, the gains may be different and perhaps less dramatic. There may also be a geographic factor—that is, that rationalization between operations, which are close by, may be different from those in another continent.
3. Even though Canada's inward stock of FDI is nearly 2.5 times that of the average for the G7 countries, further FDI could increase productivity given the evidence indicating that foreign-controlled firms operating in Canada exhibit higher productivity than domestically controlled ones, although this could be partly due to the size of operations. Had Canada's currency not been so high, due to a tight monetary policy, we might have attracted more FDI during the early stages of the FTA.

Other factors less related to FDI may also be important, including:

4. The Canadian economy lagged behind the recovery in the United States during the 1990s. Consequently, Canada has not been operating at close to capacity for as long as the United States, resulting in less capital expenditure, and it is the latter that often triggers productivity increases.
5. Canadian firms have been consistently bailed out by a falling currency that has allowed them to remain competitive without making major changes to enhance productivity. Some have termed the phenomenon "the lazy dollar hypothesis."
6. The industry composition in the two countries is different. Although the high-technology electrical, electronic products, and industrial machinery sectors are growing rapidly in Canada, they are relatively less important than in the United States.

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MOBILIZATION

In summary, Canada's position in terms of FDI has changed to a country that now has more outward FDI than inward. However, there is still much that we need to know about how FDI affects the Canadian economy, especially in the area of productivity growth. The evidence that we do have suggests that on balance it has a very positive impact. Hence, perhaps we should be thinking about further liberalization of inward FDI in those areas where restrictions now apply. This view is strengthened by the fact that if a relatively small economy such as Canada is going to have globally reaching multinational enterprises (MNEs), these will have to be large. Without effective competition afforded by foreign firms operating in Canada, there may be too much industrial concentration. The current situation in the airline industry is a clear example. In addition, controls on foreign multinationals operating in Canada may result in retaliation directed against Canadian-based MNEs abroad.

* Data are taken from Industry Canada, *The Trade and Investor Monitor*, Fall–Winter 1999/2000.

Canada: The best of times and the most challenging of times

BY JOHN McCALLUM

John McCallum is vice-president and chief economist of the Royal Bank of Canada.

THE GOOD NEWS

We Canadians are living in both the best of times and, perhaps, the most challenging of times. As of mid-2000, we seem to combine short-run optimism, if not euphoria, on the state of our economy, with medium-term concerns over the future of our country, our employers, and ourselves in a world of globalization and increasing continental integration.

On the first point, there is no doubt that the Canadian economy is on a roll. We have enjoyed super-strong job creation over the past couple of years. This has fed into rising disposable income, consumer confidence, and consumer spending. Tax cuts by the federal government and many or most provincial governments are further raising disposable income. Investment spending on machinery and equipment has been picking up nicely. On top of all that, the United States continues to forge ahead, with positive effects on our exports.

In recent weeks we have been subjected to solid evidence of a slowing U.S. economy. This is a good thing when compared with the alternative. That alternative is a boom-and-bust U.S. economy with U.S. interest rates rising very substantially. Sharply rising U.S. interest rates would have presented the Bank of Canada with a dilemma—follow the U.S. rate hikes and risk stalling the economy, or not follow the U.S. rate hikes and risk an attack on our currency. Moreover, whatever the Bank of Canada did, the bust phase of a U.S. boom-and-bust cycle would have been bad news for Canada. We are still the mouse, and they are still the elephant. The good news is that the recent statistics from south of the border increase the chances of a soft U.S. landing, with minimal further U.S. interest rate hikes. This, to repeat, is further good news for us.

> [T]here is a risk that the invasion of our university campuses by the Microsofts of this world, not to mention continuing relative decline in living standards, will exacerbate the brain drain issue in coming years.

A BIG DROP IN LIVING STANDARDS

So much for the short-term outlook, which is about as good as it gets. On the other side of the ledger, many Canadians are worried about our medium-term future in a world of apparently shrinking borders and globalization. Notwithstanding our recent progress, for much of the 1990s Canada experienced declining absolute living standards and sharply declining incomes relative to the United States. Although the brain drain numbers are not particularly large (only a fool would argue against UBC economist John Helliwell on the question of numbers), there is a risk that the invasion of our university campuses by the Microsofts of this world, not to mention a continuing relative decline in living standards, will exacerbate the brain drain issue in coming years. Canadians are worried about the powerful drawing power of a U.S. economy that has clearly been on a roll. People are also worried about the border-eroding effect of the Internet.

People are right to worry about these things. If we measure living standards by after-inflation, after-tax income per person, then two decades ago Canadian living standards were more than 80 percent of U.S. living standards. One decade ago, that number had dropped to 75 percent. Today, it stands at a little more than 60 percent. At the rate we're going, a decade from now Canadian living standards will be a mere 50 percent of living standards south of the border. Alternatively, we could measure living standards by real gross domestic product per capita, which includes not only take-home pay but also government-provided services in such areas as health and education. Even on that measure, Canada's living standards have declined relative to the United States over the past two decades, but at a less precipitous pace.

THE PRODUCTIVITY GAP

The other reason for medium-term concern is Canada's less than stellar performance on the productivity front. Over the last three years, Canada's productivity growth has shown only a modest increase, notwithstanding booming job growth. The United States, on the other hand, has experienced a very large increase in productivity growth over this same period. Much of our underperformance has been in the so-called new economy, in which the United States has experienced double-digit productivity growth and has also benefited from a much larger new economy relative to the total economy in the first place. Clearly Canada faces major challenges to keep pace with our southern neighbour in the new economy.

Now the reader may challenge this contention with the point that just about every economy in the world is behind the U.S. new economy. And the reader would be right. So, if we Canadians want to feel better about ourselves, we could compare our performance with that of non-U.S. economies. If we really want to feel good, we could compare ourselves with Russia. The problem, though, is that the United States is our dominant trading partner and neighbour. Like it or not, Canada–U.S. comparisons are most relevant for Canada.

My point, then, is that business-as-usual, status quo policies are inadequate for Canada in the new century. Let me offer two alternatives to the status quo.

AMERICANIZATION

One option would be to copy the Americans in the hopes of replicating their superior performance. If you can't beat them, join them. We could copy the Americans on everything from external tariffs to taxation and social policy. We could even go for a common North American currency, which is a euphemism for Canada using the U.S. dollar.

We're much better off with a flexible exchange rate than we would be if we simply used the U.S. dollar.

There are two dimensions to this issue—politics and economics. On the politics, it's a question whether we attach any value to a distinct Canadian identity. Personally, I do, but that's just the political judgment of one citizen. On the economics, the question is whether we'd do better economically through the Americanization route. Here, my answer is "yes and no"—yes, we'd do better if we could reduce remaining border impediments, since that would enhance investment, both Canadian and foreign, on the northern side of the border; and no, we're much better off with a flexible exchange rate than we would be if we simply used the U.S. dollar.

CANADIAN ADVANTAGE

The better option, in my opinion, is for Canada to seek to do better than the Americans in selective areas, rather than simply to copy them. On the tax front, we should strive to reduce the Canada–U.S. gap on personal income tax. I also agree with Jack Mintz that we could do an Ireland by getting our business tax rates lower than those in the United States, and this could be done at the relatively low cost of around $3 billion.

In terms of non-tax policy, there is a role for government in fostering basic research and innovation and also in providing funds to the most pressing social needs, such as the homeless and the aboriginal population. At the same time, in both health and education, there is scope for Canada to outperform the Americans, with very positive longer-term implications for our economy and citizens.

It is important to emphasize that this is a problem involving the private sector as well as governments. Indeed, a recent report by Michael Porter and Roger Martin suggests that the problem resides at least as much in Canadian companies as in Canadian governments. So we have to hope that better policies will have a positive impact on the performance of Canadian businesses.

Finally, recent Canadian budgets have moved in the direction I am recommending, so it is possible to end on a note of guarded optimism for the medium-term outlook of the Canadian economy, as well as a note of guarded euphoria on the short-term outlook.

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Finally, a huge economic literature documents the positive impacts on growth and productivity of public investment in infrastructure, education, training, health care, basic research, and development, and so on. The notion that public investment is unproductive is manifestly wrong. The thrust of current research is to show that the growth-enhancing impacts of well-selected public investments outweigh any inefficiency costs arising from the taxes needed to finance the investment.

These points suggest a conclusion that is intuitively fairly obvious: good public programs can have economic benefits that justify the cost in terms of taxes. This leaves open a huge set of questions with regard to the mix of programs and tax measures that represent the best balancing of equity and efficiency goals. The implicit Canadian social bargain of higher taxes in return for greater equality, greater security, and higher levels of "social cohesion" does not appear to have greatly eroded. "Tax rage" is easier to discover in editorials and columns than in public opinion surveys. That said, there is no reason for progressives to deny the case for some tax relief as growth picks up, as the cost of servicing accumulated public debt shrinks, and as needed reinvestments in public programs are made.

The papers that are included in this special double issue of *Canada Watch* were originally presented at the conference "Canada–U.S. Relations at the Dawn of the New Millennium: Convergence or Divergence?" The conference was held at York University on May 12, 2000 and chaired by Daniel Drache and Patrick Monahan.