The future is now: facing Canada's looming challenges
Notes for a talk by Brian Lee Crowley
Managing Director, Macdonald-Laurier Institute
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Thanks to the OEA and in particular my successor as Clifford Clark Visiting Economist, Chris Ragan, for the invitation to be here today.

Being the wrap-up speaker at an event like this is a notoriously thankless task, and my job is made doubly hard by the exceptionally high quality of the talks that have preceded mine. I think that this has been a conference worthy of the challenges posed by the cusp at which Canada currently stands, and I'd like you all to join me in expressing our thanks for the impressive thoughts and ideas that have been so ably laid out for you over the last 24 hours…

Canada stands at a cusp or a turning point in its history -- I believe this so profoundly that I wrote a book devoted to that theme: *Fearful Symmetry*. The title of the book mystified some people. Leaving aside the fact that it is one of my favourite quotations from the poet William Blake, the reason that the title appealed to me was because it seemed to me to sum up the challenge of where Canada stands today. And the turning point where we stand is not merely at the upswing following a painful recession, for recessions come and go. I believe that we stand at the midpoint in a century long period of profound change in Canadian society and the economy. The last 50 years have seen the change flood in, the next 50 will see the change recede, like the tide, revealing what has been concealed beneath for all to see.

And the change that we have lived through is relevant to every issue we have discussed over the course of our deliberations here. It is related to productivity, to ageing and retirement, income security, monetary policy and public finances. It is even related to Canada's role in international trade, and how we handle natural resources from a policy point of view, a topic that Peter Hall dealt with so eloquently. It is even directly relevant to a number of things we have put less emphasis on, such as federal-provincial relations and our transfer system.

The change I am thinking of, of course, is one that Chris Ragan spoke to us about so ably. The demographic change that has so transformed Canada over the last 50 years is about not merely to change course, but to reverse course. And I say this not because I subscribe to theories of demographic doom or collapse. I do not. In fact it is not the period we are *entering* that is so unusual – it is the period we are *leaving*. And the big question is: how do we return to what is for most industrialized societies, something pretty close to normality…

I believe that markets and societies are rife with self-corrective mechanisms that spring into action to cushion the adjustments that changed circumstances require. Thus those who accuse me of being some kind of "demographic determinist" are actually quite deeply mistaken. My view is that there are many policy responses to the changes that are coming, some of which will ease the transition, and some of which will send absolutely the wrong signals and make the transition harder and more painful than it needs to be. That we will make the right choices is by no means a certainty.

What is certain, however, is the size and nature of the change that is coming. What is equally certain, in my view, is the historical record of how we responded to the changes that have already occurred. Where we retain great freedom of action, however, is what comes next in terms of our response.

I won't repeat what Chris has already told you, but I will summarise what I think the salient facts are for understanding what I want to say. Canada had the largest baby boom generation of any western society, and by a wide margin. Over the last 50 years, for example, our labour force grew by 200 percent, a fabulous number. America, our next closest rival in the baby boom sweepstakes, saw its labour force grow a mere 120%. Put another way, every year, regular as clock work, a quarter of a million net new workers entered the workforce.

The consequences were fairly predictable in hindsight. We used to be a society in which people were expected to be responsible for themselves and unemployment was a personal failing. In the New World, unlike the Old, work was plentiful and welfare state provision tightly limited.

But by the late Sixties, as Boomers began to enter the workforce in large numbers, our society's underlying assumptions began a decades-long evolution. We began to lose faith that there was work available for everyone who wanted it and we put in place a lot of programmes designed to tide people over a lack of work. Unemployment became the number one political preoccupation of the public and hence of governments in every part of the country. And as we ramped up poorly designed welfare state programmes, we began to create a permanent class of people stuck on reliance on benefits of various kinds because we were afraid there wasn't enough work for them. We worked hard as a matter of policy to undermine our productivity, because in a time of unemployment, there is little public appetite for policies that might be seen as reducing the need for workers. So we subsidised declining industries in low-productivity parts of the country to keep working, and we subsidised their workers not to move. We paid people to retire early, giving us a relatively poor record in keeping those over 55 in work compared to our peers in the OECD. And we did a great many other things besides. For all the very legitimate concern that has been expressed about the numbers of people out of work in the recession we are just leaving, people forget that we went through a 25 year long period during which unemployment was always higher than it was at the trough of the recession. Indeed we went through a four year long period when unemployment was always in double digits.

But that was then and this is now. There are reasons why unemployment during the recession was, as these things go, *relatively* mild. Because we have begun to turn the corner on the demographic change that I mentioned and that is already causing major changes in the economy and our society. That is why we stand at the turning point of the symmetry in my book's title. For unlike the last 50 years, when our labour force grew 200%, in the next 50 it will grow a mere 11%, and in the next few years it will grow scarcely at all. That means that the policies that we put in place over the last 50 years, policies that frequently paid people not to move to where greater opportunity was available, that paid companies not to shift to high value added activities, that paid older workers to retire early, and that ran up our public debt so we wouldn't have to confront the cost of the choices we were making, all of these policies were the outgrowth of a temporary, transitory state of affairs. And indeed they are already ill-suited to our current circumstances even though the labour supply tide will only begin to turn next year, in 2011.

Consider the issue of retirement policy. Because of the temporary circumstances created by the downturn, we have come to be preoccupied in certain quarters with the adequacy of the retirement incomes that people have set aside for themselves, even though Jack Mintz has, I think offered powerful evidence that if this is a problem, it is so for only a relatively small minority of workers, and that our retirement income system overall has actually held up remarkably well.

What gets relatively little attention from people right now, however, is the extent to which is will be imperative for us to change the retirement behaviour of Canadians, and not merely because it would be good for the economy. It would, of course, BE good for the economy if we could encourage people to retire later and to keep working longer, because actually the single biggest source of workers available to the Canadian economy in the next few decades will be the Boomers, and in this I need to qualify slightly something that Don Drummond said last night. Don pointed out that all the *growth* in the supply of workers would come from immigration in the coming years, and this is correct. But that is only the growth increment. The biggest single source of workers will still be the Canadian school system. And the biggest unexploited pool of available workers, workers we could put to work quickly and at relatively little cost, is people who might in the recent past have retired.

People who a few short years ago we were happily pushing into retirement we are going to want to keep in work for as long as we possibly can to ease the tightness of constrained labour supply. If you want to know why this will be important, just cast your mind back to the circumstances of the Alberta economy just before the downturn, where unemployment fell to 3 % and the population grew by 3% in a single year. In well less than a decade, similar circumstances are going to obtain in virtually every corner of the country except without the population growth.

And there is a further benefit, of course, to keeping people in work. For every year that they delay retirement, these workers do not just add their productivity to that of their fellow workers, and their taxes to those of fellow taxpayers, but they also delay drawing costly public pension benefits. Not only does that reduce the cost to the public purse in the short run, but means that these workers' savings will need to finance one less year of full retirement.

Is this heartless disregard of the need for older workers to stop working? Nothing could be further from the truth. In fact the evidence is virtually all on the other side: workers who work longer stay healthy longer and are happier, because human beings need to feel useful in order keep mentally and physically well. Thinking of ways to change the incentives so that people want to work longer rather than retiring is just about the most important thing we could do in our emerging circumstances, and yet too many people are still focused on the issue of how to offer people a full pension at the earliest possible moment. The question of how we support people who are physically or mentally incapacitated or otherwise unable to keep working is a separate issue. Our top policy priority needs to be to keep those who are able to keep working in work, and that means incentives for them and employers, greater work place flexibility, more flexibility in retirement schemes so that people can withdraw gradually from working rather than facing incentives that penalize them for working and that treat working and not working as mutually exclusive rather than complementary states.

And of course changing our retirement behaviour is only one of the man things we'll have to do. As Don Drummond reminded us last night, we will no longer, for example, be able to afford an EI system that pays thousands of people not to work for ten months of the year, and does so not just occasionally and justifiably, during economic downturns, but repeatedly, year after year, when there is work available in

Canada for everyone who wants it, as will be the case in a few short years. We will no longer be able to use EI as a way to subsidise low productivity work when one of the best ways to raise our productivity is to encourage people to move from low-productivity regions to high productivity ones, as we did for a century and more in Canada before the Boomer generation's huge numbers made us doubt the wisdom and the fairness of that policy.

Chris Ragan, in his talk to use earlier today, underlined the fiscal squeeze that demographic change could lead to, and to that, of course, must be added the fact that as a result of the downturn and the related fiscal stimulus we have added significantly to the public debt and will continue to do so in the next several years before we return to budget balance. I personally am sceptical that we will do so as quickly as the folks at Finance Canada seem to think, but that is not my concern here. My concern here is that one of the big looming challenges is whether the state will help or hinder the transition to the new circumstances that are looming. As I said at the outset, I am a great believer in the self-corrective mechanisms of the economy, but there is a great deal that government can do to ease the road for those changes, or to obstruct them. And which one we choose will affect enormously the costs of the transition to a new population equilibrium.

We could, for example, choose a big government response to the coming changes, struggle even more strongly to keep people from having to move to find work, to encourage people into premature retirement, to offer social programmes that provide an alternative to being in paid work. And we could reverse the decline in the tax burden we have enjoyed in the past few years while continuing to run up the public debt as a way to pay for such expansive government.

Fortunately we have some recent history that I believe offers us some powerful lessons about the wisdom of choosing that course over the one of fiscal discipline, lower taxes and high expectations that people who are capable of work should in fact work.

In response to our very unusual circumstances of the last half century, Canada underwent a large expansion of government. In 1960 we were spending roughly 28 percent of GDP on government at all levels (about the same as the US). By 1993, when the US was spending roughly 34% of GDP on government, we hit our peak at 53% of GDP.

It was at that point that Canada did a fiscal u-turn, falling from 53% of GDP devoted to government to a low of roughly 41% just before the recession.

We went from economic basket case (an honourary 3rd world country according to the Wall Street Journal in the early 1990s) to leading the G7 in economic growth for a decade from 1997-2007.[1] While Canada has unfortunately regressed in a number of areas of fiscal policy over the past few years, the reforms of the 1990s continue to provide enormous benefits.

And by the way, those reforms were by no means limited to Ottawa or the Liberal Party. These reforms were embraced in every part of the country and by every political party: the Saskatchewan NDP, the Alberta Tories, the New Brunswick Liberals and others all played their part in reforming Canada's fiscal position and, along the way, reforming the way we run government and the expectations we should

[1] Organization for Economic Co-operation and Development (2009). Economic Outlook June 2009. Available digitally at www.oecd.org. The G7 includes Canada, France, Germany, Italy, Japan, United Kingdom, and United States.

have of the state. This tremendous Canadian success story, which stands in marked contrast to the partisan gridlock and inability to control spending of our American neighbours, is a little understood and very under-appreciated Canadian success story that has conferred tremendous competitive advantage on us compared to the US.

The critics of the fiscal reforms (at the federal and provincial levels) predicted dire, in some cases near-apocalyptic economic and social consequences from those reforms. In fact, the reforms of the 1990s ended up being a major — perhaps *the* major — contributor to the country's robust economic performance of the past decade.[2] By robust economic performance, I mean bread and butter prosperity for average Canadians in the form of lower unemployment, higher rates of investment and job creation, increasing economic opportunity, and rising incomes.

As governments reduced and constrained spending in the 1990s, a greater share of the resources in the economy began being controlled by individuals, families and businesses rather than governments. In other words, individual Canadians were increasingly making the decisions about how best to use and allocate resources compared to governments. It's not surprising that Canada began to prosper since individuals with skin in the game (vested interest) are far more likely to make productive decisions than remote bureaucrats and politicians with little or no vested interest in the outcomes of such decisions.

As deficits were eliminated and debt-to-GDP declined, interest rates came down and private investment increased. Tax reductions that followed improved the incentives for work, savings, investment, and entrepreneurship. As a result, Canada exceeded the U.S. and most other G7 countries on a host of economic indicators.

Economic Growth

Perhaps most indicative of Canada's economic success after the fiscal reforms of the 1990s is economic growth, measured using inflation-adjusted gross domestic product or the total value of goods and services produced in a country. Many of the critics, relying on a Keynesian view of the world, predicted that Canada's effort to put its fiscal house in order would provoke a collapse of GDP growth and social unrest. The reality was exactly the opposite.[3]

From 1997 to 2007, Canada fared well on economic growth relative to other industrialized countries. Specifically, average economic growth among the 30-member group of industrialized countries known as the Organization of Cooperation and Development (OECD) was 2.7 percent relative to 3.3 percent in

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[2] It is important to note that other macroeconomic policies contributed to Canada's robust economic performance. For example, Canada's monetary policy promoted price stability (low inflation) which reduced the impact of inflation on economic decisions made by Canadians. See http://www.banqueducanada.ca/en/index.html

[3] Please see: Alberto F. Alesina, Silvia Ardagna (2009). Large Changes in Fiscal Policy: Taxes Versus Spending. Cambridge, MA: National Bureau of Economic Research (NBER). NBER Working Paper No. 15438 (October). Available at http://www.nber.org/papers/w15438; Alberto Alesina, Roberto Perotti, Francesco Giavazzi and Tryphon Kollintzas (1995). Fiscal Expansions and Fiscal Adjustment in OECD Countries. Economic Policy, Vol. 10, No. 21 (Oct., 1995), pp. 207-248; and Alberto Alesina, Roberto Perotti (1996). Fiscal Adjustments in OECD Countries: Composition and Macroeconomic Effects. Cambridge, MA: National Bureau of Economic Research (NBER). NBER Working Paper No. 5730 (August). Available at http://www.nber.org/papers/w5730.

Canada.[4] While seemingly small, these differences have a material impact on the growth of economic activity when compounded over the course of several years.

Canada also truly stood out among a smaller subset of the G7 countries (France, Germany, Italy, Japan United Kingdom, and the United States) by achieving the highest average rate of economic growth.[5]

In terms of GDP per person, the most commonly used measure of average income, Canada again excelled. From 1997 to 2007, inflation-adjusted per person GDP grew 2.3 percent in Canada, higher than any G7 country including the United States which registered per person GDP growth of 2.0 percent. Over time, these seemingly small differences can result in big differences in income growth.

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[4] Data in this section is from the Organization for Economic Cooperation and Development (2009). Economic Outlook 85 (June). Statistical Annex, Table 1 and Table 5, available at http://www.oecd.org/document/61/0,3343,en_2649_34573_2483901_1_1_1_1,00.html; and, Organization for Economic Cooperation and Development (2009). OECD.STATS Extracts, available at http://stats.oecd.org/index.aspx.

[5] While Canada performed relatively well with respect to economic growth from 1997 to 2007, we performed poorly on productivity growth, particularly compared with our southern neighbour the United States. This is especially true with respect to labour productivity -- the average value of output (measured by GDP) produced per hour worked -- the most common and widely understood measure of productivity.

Specially, in 2007 Canada's GDP per hour worked was 79.1 percent of that in the US down from 85.0 percent in 1997. Sources: Statistics Canada (2009), Labour Force Historical Review 2008, Catalogue No 71F0004XCB (CD-ROM); Statistics Canada (2009), Provincial Economic Accounts Data Tables, available at http://www.statcan.gc.ca/bsolc/olc-cel/olc-cel?catno=13-018-X&lang=eng; US Bureau of Economic Analysis (2009), National Income and Product Accounts Tables, available at www.bea.gov; U.S. Department of Labor, Bureau of Labor Statistics (2009), Regional and State Unemployment, 2008 Annual Averages, available at http://www.bls.gov/lau/;

Productivity growth is a critically important as it ultimately determines future living standards. A country with significant productivity growth is able to produce more output (goods and services) with a given set of inputs. This is especially important as Canada's population ages in coming years and we increasing will rely on a smaller working population.

There is little question that without the fiscal reforms at the federal and provincial level Canada's productivity record would have been much worse. As discussed elsewhere in this section, when governments borrow (run deficits) they ultimately compete with and displaced (crowd-out) other borrowers in the private sector which reduces the amount of investment and capital available -- one of the main drivers of productivity. This is precisely why Canada needs to replicate the successful reforms of the Redemptive Decade to solve our current problems and extend the economic benefits.

In addition, it is important to note that Canada has performed poorly on productivity growth for reasons unrelated to our fiscal situation including our industrial structure (and government policies that help maintain that structure), an under-valued currency for much of the period, and a long-term record of weak innovation by Canadian business. For more information on the reasons for, and solutions to, Canada's productivity performance see: Andrew Sharpe (2007). *Three Policies to Improve Productivity Growth in Canada*. Ottawa, ON: The Centre for the Study of Living Standards. Available at http://www.csls.ca/reports/csls2007-05.PDF; Andrew Sharpe (2006). *Lessons for Canada from International Productivity Experience*. Ottawa, ON: The Centre for the Study of Living Standards. Available at http://www.csls.ca/reports/csls2006-02.pdf; Brian Lee Crowley (2009), *Fearful Symmetry: The Fall and Rise of Canada's Founding Values,* (Toronto: Key Porter Books, 2009); TD Economics (2005). *In Search of Well Being: Are Canadians Slipping Down the Economic Ladder?* Toronto, ON: TD Bank. Available at http://www.td.com/economics/topic/bc0105_wellbeing.pdf; and TD Economics (2005). *Who's To Blame for Canada's Productivity Woes?* Toronto, ON: TD Bank. Available at http://www.td.com/economics/topic/cg0605_prod.pdf; The Council of Canadian Academies (2009). Innovation and Business Strategy: Why Canada falls short. The Expert Panel on Business Innovation. available at http://www.scienceadvice.ca/documents/(2009-06-11)%20Innovation%20Report.pdf

Jobs, Jobs, Jobs

Another important measure of economic performance is the ability to generate jobs. High job creation rates lead to increases in the demand for labour (workers) and ultimately drive up wages.

From 1997 to 2007, Canada outperformed most other member countries of OECD in terms of average employment growth. Specifically, Canada ranked sixth out of 30 OECD countries with an average total employment growth of 1.9 percent, nearly doubling the OECD average (1.0 percent). Moreover, total employment growth between 2000 and 2007 exceeded employment growth in the United States (0.9 percent) and every other G7 country.

Investment – Building for Future Prosperity

Between 1997 and 2007, Canada outperformed most OECD countries in attracting business investment. Business investment is critical for Canadian living standards as increases in the amount of capital (i.e. machines, equipment, technology) each worker has at their disposal ultimately makes them more productive. A more productive workforce is able to produce more goods and services with a given amount of inputs and workers that produce more for each hour they work are able to demand higher wages. Indeed, the key single factor explaining wage growth over time is productivity. Make people more productive, and they will earn more.

Canada experienced an average increase of 5.4 percent in investment ("inflation-adjusted capital formation") from 1997 to 2007 compared to average of 3.2 percent among the 30-member countries in the OECD. Moreover, Canada's growth in such investment was greater than any other G7 country (including the United States) from 1997-2007.

All Boats Rose on the Reform Tide

Perhaps most concerning to critics of fiscal reform was the potential implications for the less well-off. Indeed, many critics predicted a dramatic increase in poverty and hardship for lower income Canadians as a result of the spending cuts and fiscal reforms more generally. Fortunately, Canada's growing economy, in large part due to reforms at both the federal and provincial level, benefited rather than hurt those with the lowest incomes.

In 1997, 15.3 percent of all Canadians were considered to be in the low income category[6] -- defined by calculating the income level at which a family is more likely to devote a larger portion of their income to food, shelter, and clothing than the average Canadian family.[7] By 2007, the proportion had decreased to 9.2 percent, a reduction of nearly a third.[8]

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[6] Statistics Canada (2008). Income in Canada, 2006. Catalogue no. 75-202-X. Available at http://www.statcan.gc.ca/pub/75-202-x/75-202-x2006000-eng.pdf

[7] Statistics Canada measures "low income" by calculating the level at which a family is more likely to devote a larger portion of their income to food, shelter, and clothing than the average Canadian family. The low income cut-off, or LICO, is calculated by adding 20-percentage points to the average, such that if a family spends 64 percent of its after-tax income on food, shelter, and clothing, it is considered to experience "low income." See Cotton, Cathy (2001). Recent Developments in the

Low Income Cutoffs. Statistics Canada: Ottawa. Available digitally at http://www.statcan.gc.ca.

[8] Statistics Canada (2009). Income in Canada, 2007. Catalogue no. 75-202-X. Available at http://www.statcan.gc.ca/pub/75-202-x/75-202-x2007000-eng.pdf

Poverty rates, which are distinct from low-income measures[9], also fell substantially between the mid-1990s to the mid-2000s. Specifically, 6.8 percent of all Canadians were in poverty in the mid-1990s; that had fallen to 4.9 per cent by the mid-2000s.[10]

None of this is surprising when we consider that StatsCan says that the most effective way for low-income families to improve their economic position is for more family members to work more hours.

Restoring fiscal prudence in Canada through reduced and constrained spending, the elimination of deficits, and the reduction in taxes not only reduced the debt burden Canadian were passing onto future generations, but also contributed greatly to Canada's economic performance. On a host of indicators from economic performance, job creation and business investment Canada outperformed most industrialized counties from 1997-2007. Importantly, the robust economy Canada experienced also provided benefits to the less well-off.

In fact I'd like to take a moment to focus on this issue of equity further, because it is a key argument in the arsenal of those who would argue for an expansive state in Canada, one that would make up the ground lost by the 1990's trend toward smaller, more efficient government. So let's take a moment to ponder what we learned about income support programmes and activist well-meaning government during the period of reform I've been referring to.

Perhaps a concrete example will help to illustrate what I have in mind. If we set aside the CPP, perhaps the deepest and broadest example of social program reform in Canada over the last twenty years is welfare reform.

As we know, the federal and provincial governments in the late 1980s and early 1990s were increasingly struggling with budget deficits and how to constrain spending. The combination of needing to restrain and reform spending coupled with the worrying rise in the number (and percentage) of Canadians receiving welfare[11] set the stage for fairly dramatic reforms in the mid-1990s.[12]

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[9] Poverty rates measure the percent of the population that does not have sufficient income to meet basic needs such as a nutritious diet, satisfactory housing, clothing, health care, public transportation, household insurance, telephone service, and a host of other items. In other words, poverty rates differ from low income rates in that poverty counts the percent of individuals or families who cannot afford basic necessities rather than the percent of those who are less well-off than their neighbours (low income).

[10] Sarlo, Chris (2006). Poverty in Canada: 2006 Update. Fraser Alert. Fraser Institute. http://www.fraserinstitute.org/commerce.web/product_files/PovertyinCanada2006.pdf

[11] In 1990, some 1.9 million Canadians (including dependents) or 7.0 percent of the population were receiving welfare benefits from government. Provincial and local spending on welfare reached $8.6 billion in 1990/91 (inflation-adjusted 1996 dollars). The combination of the 1991 recession and a general trend towards greater dependency resulted in the number of Canadians receiving welfare benefits reaching 3.1 million in 1994, representing an astonishing 10.7 percent of the population. Real spending on welfare by local and provincial governments hit $14.3 billion in 1993/94. The growth in dependency by the Canadian population coupled with the increasing pressure on governments to balance their fiscal affairs set the stage for reform. See Ross Finnie, Ian Irvine and Roger Sceviour, *Social Assistance Use In Canada: National and Provincial Trends in Incidence, Entry and Exit*, Analytical Studies Research Paper, no, 245. Catalogue no. F0019M1E, (Ottawa: Statistics Canada, May 2005). Available at http://www.statcan.gc.ca/pub/11f0019m/11f0019m2005246-eng.pdf; F. Roy (2004). *Social Assistance by Province, 1993-2003*. Ottawa, ON: Statistics Canada, Canadian Economic Observer, November 2004. Catalogue no. 11-010. Available at http://www.statcan.gc.ca/pub/11-010-x/11-010-x2004011-eng.pdf; and Chris Schafer, Joel Emes, and Jason Clemens (2001). Surveying U.S. and Canadian Welfare Reform. Vancouver, BC: The Fraser Institute. Available at http://www.fraserinstitute.org/researchandpublications/publications/2559.aspx.

A number of smaller reforms[13] had been made in the late 1980s; the fundamental reform of welfare began, however, in 1995. And the trigger was Paul Martin's dramatic changes to the financing of social programs in the 1995 federal budget, and specifically the switch from a system of cost-sharing grants to a block grant to the provinces to provide social assistance. This meant that any new extension of programs or benefits would be paid for by the provinces exclusively. It clearly placed the financial responsibility for these programs on the shoulders of the provincial government. Crucially, the reforms also provided more flexibility and autonomy to the provinces with respect to the delivery and design of social programs (excluding health care).

There were a number of common reforms implemented by most, if not all of the provinces. One common feature of reform was a reduction in benefit levels, particularly for single employable people. While the narrative of reform's opponents was often about balancing the books on the backs of the poor, the changes were actually rooted in an increasingly widespread acknowledgement that incentives mattered for low-income work decisions.[14] Specifically, there was an increasing understanding that when welfare benefits surpass comparable income available from low-paid work, strong incentives are created to enter or remain on welfare.[15] Many of the reductions in benefit levels and particularly those for single employable people were aimed at restoring the balance between welfare benefits and the income available to workers from low-paid work.

Another fairly common reform was to integrate welfare and related services with employment programs provided by the province. In addition, a number of provinces improved the administration of welfare and related programs including reducing fraudulent claims.

Unsurprisingly, given the altered incentives created by Paul Martin's restructuring of transfers, many provinces also reformed their welfare systems to focus on better results, improved value-for-money in

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[12] Professor John Richards of Simon Fraser University was instrumental in both raising awareness of the fundamental problems present in the country's welfare systems as well as offering possible solutions. For an excellent summary of his work please see John Richards (1997). *Retooling the Welfare State: What's Right, What's Wrong, What's To Be Done*. Toronto, ON: C.D. Howe Institute. Also see the more recent John Richards (2007). *Reducing Poverty: What has Worked, and What Should Come Next*. Toronto, ON: The C.D. Howe Institute. Available at http://www.cdhowe.org/pdf/commentary_255.pdf.

[13] For example, the 1990 federal budget imposed a "cap on CAP". It limited the annual increase in federal cost-sharing under CAP to 5 percent for the three "have" provinces: Ontario, Alberta, and British Columbia for the years 1990/91 through 1994/95.

[14] An important experiment with respect to take-home income and employment incentives was completed in Canada. The Self-Sufficiency Project (SSP) was launched in 1992 by the Human Resources Development Canada (HRDC). The project encouraged single-parent welfare recipients who had been on welfare for at least one year to find full-time employment by offering them up to three years of additional (top-up) income. The supplemental income essentially doubled the average participant's earning compared to a minimum-wage job or welfare benefits. There have been disagreements about the longer-term implications of the study. For further information please see Reuben Ford, David Gyarmati, Kelly Foley, and Doug Tattrie (2003). *Can Work Incentives Pay for Themselves? Final Report on the Self-Sufficiency Project for Welfare Applicants*. Social Research and Demonstration Corporation; Michalopoulos Card and Phillip Robins (1999). *When Financial Incentives Pay for Themselves: Early Findings from the Self-Sufficiency Project's Applicant Study*. Ottawa: Social Research Demonstration Corporation; and Todd Gabel and Sylvia LeRoy (2003). *The Self-Sufficiency Project: No Solution for Welfare Dependency*. Fraser Forum (September). Vancouver, BC: The Fraser Institute.

[15] For an empirical examination of this issue during the 1990s please see: Joel Emes and Andrei Kreptul (1999). *The Adequacy of Welfare Benefits in Canada*. Vancouver, BC: The Fraser Institute. Available at: http://oldfraser.lexi.net/publications/critical_issues/1999/welfare_benefits/.

the services and support they offered people, and controlling cost. But different provinces focused their attention on different things, tailoring reform to their local circumstances.

Provincial welfare reform highlights the power of decentralized delivery of government services and the varied and innovative approaches different provinces took to improve their welfare and related programs. The results of these reforms were dramatic. By 2000, the number of welfare beneficiaries in Canada had declined to a little over 2 million (6.8 percent of the population) from a peak of 3.1 million (10.7 percent of the population).[16] In addition, welfare-related spending had been curtailed, helping governments to balance their budgets. Most importantly, however, the programs being delivered seemed to be achieving better results by getting more employable individuals into the job market and dealing with some of the more pressing underlying problems that caused people to consider welfare as an alternative to work. And don't forget the evidence already cited about how this period coincided with a marked reduction of both people on low-income and of people in poverty.

My view is that these reforms would not have occurred without transfer reform at the federal level, reforms that changed fundamentally the incentives for provincial governments by making them much more accountable for their spending decisions and the consequences of poor programme design. I think there are lessons for us here, among other things, in the most promising route available to us to get the spending on our other great unreformed entitlement programme – medicare – under control. EI, as I have already mentioned, is still in need of further reform, although we have made major strides over the years, but it is not nearly as big a nut to crack as health care reform.

There is a very great deal more I'd like to talk about, including Canada-US relations [1) the need to deepen our trading and institutional relationship; 2) the imperative to manage the fundamental risk posed by our border vulnerability; and 3) the need to make Canada, especially through competitive taxation, the preferred North American destination for investment and workers] and the world of international trade, but I have run out of time and I think that's enough to give us some guidance as we think about our responses to the looming challenges this conference's programme has urged us to focus on. We are leaving the unique circumstances of the past 50 years, and the edifice of social programmes and preoccupation with employment and income support at the expense of productivity that characterized those years cannot long survive in our very different circumstances.

We had workers to spare in the old days, and could be profligate with them. In the Canada we can see ahead of us, every worker will be a precious resource and we will be obliged to spare no effort to attract them and keep them in the workforce at high levels of productivity. The reforms necessary to meet these new circumstances will require us to return quickly to balanced budgets, to keep our taxes and the size of government from expanding so as to encourage investment in our capital stock and hence our productive capacity, just as these circumstances will require us to keep social programmes and income

[16] Ross Finnie, Ian Irvine and Roger Sceviour, *Social Assistance Use In Canada: National and Provincial Trends in Incidence, Entry and Exit*, Analytical Studies Research Paper, no, 245. Catalogue no. F0019M1E, (Ottawa: Statistics Canada, May 2005). Available at http://www.statcan.gc.ca/pub/11f0019m/11f0019m2005246-eng.pdf; F. Roy (2004). *Social Assistance by Province, 1993-2003*. Ottawa, ON: Statistics Canada, Canadian Economic Observer, November 2004. Catalogue no. 11-010. Available at http://www.statcan.gc.ca/pub/11-010-x/11-010-x2004011-eng.pdf; Ross Finnie and Ian Irvine (2008). *The Welfare Enigma: Explaining the Dramatic Decline in Canadians' Use of Social Assistance, 1993–2005*. Toronto, ON: The C.D. Howe Institute. Available at http://www.cdhowe.org/pdf/commentary_267.pdf; and Chris Schafer, Joel Emes, and Jason Clemens (2001). *Surveying U.S. and Canadian Welfare Reform*. Vancouver, BC: The Fraser Institute. Available at http://www.fraserinstitute.org/researchandpublications/publications/2559.aspx.

support tightly focused on those who cannot work, giving those who can every reason to contribute their productive capacity to enriching themselves and their fellow Canadians.

Thank you.