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THE CONTINUING CHALLENGE OF FULL EMPLOYMENT

Notes for an Address

CANADIAN CLUBS IN ALBERTA

February 16-18, 1987

**A.R. Dobell,
President**

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As you have just heard, I am President of the Institute for Research on Public Policy. The Institute is a national, independent, non-profit organization—a "think tank"—created about fifteen years ago when it was thought that independent advice on public policy would help to increase the degree of reason and rationality in public affairs. Now as we come up on our fifteenth anniversary, we in the Institute feel that we have put together a pretty impressive body of background research, and are beginning to be heard on some important issues—but I wouldn't want to claim all the credit for the recent massive increase in logic, reason, and progress evident in national affairs.

The Institute was created as an independent body, with its independence to be assured by an endowment fund built upon a federal government offer to match provincial and corporate contributions. The Government of Alberta together with the Government of Ontario were the two major provincial contributors to our endowment fund, so it is a particular pleasure for me to be talking to you folks here. In a way, this visit is perhaps a bit of a progress report on the investment Mr. Lougheed made on your behalf about a decade ago.

Rather than concentrating on short or medium-term economic policy or problems of domestic economic structure, our research program spans quite a range of questions, from international trade and other international economic issues, through problems of governance and institutions of government, to questions of demographic change and social policy. A further research topic

which underlies all these in some respect is that of technological change and economic transition. I want to return to that topic later, in part because this Institute is supporting a research project by Professor Barry Cooper at the Calgary Institute for the Humanities on the University of Calgary Campus--a study of the impact of technology on society.

Our closer involvement with questions affecting Alberta most directly, however, has been through our research under what we have called the Western Resources Program. It was launched in mid-1982 with Barbara Hodgins (herself an Albertan by birth and a westerner by persuasion) as Director of the program. Initially her office was located at the University of Calgary. Later, in 1984, when I became President and opened an office for the IRPP in Victoria, the program was relocated to that office.

Since then we have worked together in development of research and commentary on issues related to the development of natural resources in the four western provinces and the North. The first publication of the Western Resources Program dealt with the 1982 constitutional amendment on resources, Section 92A, that the Government of Alberta (along with Saskatchewan) had long sought as a way to confirm and protect provincial jurisdiction. A number of other topics have been either of particular interest to Alberta or featured Alberta researchers (under contract). For example, in the wake of the National Energy Program, a working paper was produced on business-government relations in the resource industries, in an attempt to examine some of the underlying causes for breakdown—and for harmony—in the relationship. Another study, nearing publication, looks at the concept of economic rent from resources and compares the different fiscal regimes of oil-producing jurisdictions around the world, including Alberta and the Canada Lands. A respected petroleum economist in Calgary, Dr. Campbell Watkins, is writing a part of the forthcoming book on this. (Preliminary findings indicate that Alberta's system gets high marks in several important respects.) Also close to completion is a project on the softwood lumber countervail case, being jointly conducted by Professor Mike Percy at the University of Alberta and Christian Yoder, an international

trade lawyer with the Calgary firm, MacLeod-Dixon. They analyze the softwood lumber example and determine what the implications may be for our trade in natural resource products more generally and for Canada's bilateral negotiations with the United States.

Not all of the activities under the Western Resources Program have been in the nature of research projects, however. Another sort is the use of conferences to address public policy problems. One such conference, that attracted the interest of Albertans (and showcased their expertise), was held a year ago on the subject of "Towns, Wheels or Wings? for Resource Development"—the question of whether new towns should be built to support resource development or greater reliance placed on short-or long-distance commuting to resource sites. One impression from that meeting is that we have probably seen the last of resource towns as we used to know them.

The five-year workplan of the Western Resources Program is scheduled to be completed this year. A final initiative may broaden the scope to encompass the role natural resources could play in diversification of the economy in western Canada. I want to return to that question in a moment, too.

Finally, just to finish the story of our on-going involvement in Alberta, we have developed our messaging and communication systems in the Institute around the electronic conferencing capabilities at the University of Calgary. We have seen this focus on computing and communications technology developed in Calgary not only as fitting very naturally into Alberta's strategy for economic development and some of our immediate Institute research interests, but also as serving my particular concern to have the Institute run effectively in an integrated manner even though our research program is dispersed from Victoria to Halifax (with interests in Newfoundland as well). We haven't yet succeeded in making our spread-out organization a fully integrated working group, but we're still working on it.

These three topics, interestingly enough—the impact of technological change on social organization, the need for economic diversification, and the possible applications or markets for high-tech services—are all important to the topic I was asked to address here, which is **The Challenge of Unemployment.**

It is clear that to address the problem of sustaining high employment it is necessary to address questions of productivity, innovation and competitive position. And that in turn demands encouraging an orientation towards markets, and an opening of our borders to competition. But the cost of such an orientation is dramatic: jobs in one place disappear, and when they open up in another place they are different jobs for different people. Investments in plant or in training or in housing fail to pay off because the economic environment changes too rapidly. I don't need to tell you folks in Alberta about the costs of being tied to volatile world markets.

Nor do I need to remind you that the industrial structure in Canada seems to be such that boom times in the resource industries tend to spread benefits across the country. Backward and forward linkages, in the economist's jargon, mean that service and equipment suppliers, and downstream processing activities all benefit from a buoyant resource sector, and hence central Canada benefits significantly. When the manufacturing sectors of Ontario are buoyant, by contrast, the influence seems not to spread East and West so much as it flows North and South.

When I was here in 1981, around the hearings of the Parliamentary Task Force on Fiscal Arrangements, it was widely thought that the economic centre of gravity of Canada had shifted westward once more, with the Western resource-based provinces leading in fiscal capacity, the Maritimes trailing, and Ontario and Québec in the middle. There was much talk about how the new distribution of economic power—the new fiscal realities—should be reflected in provincial contributions to equalization payments and so on. There was even discussion about what to do with the role of Ontario as a recipient province in the equalization program.

Now, only six years later, it seems clear that the problems of overcapacity, increased competition, and reduced demand are likely to be here for a good long time in the mineral resource sector, as in agriculture. Employment prospects are unlikely to be rosy in either area; even if output levels are maintained, the challenge of sustaining full employment is not likely to be met by expanding jobs either in the non-renewable resource sector or the renewable resource sector, including agriculture. (And there is no point in trying to sustain incomes or employment there forever by artificial subsidies and price supports.)

Thus it seems clear that the Western provinces do have to pursue the prospects for diversification, for transition to new service-based, knowledge-intensive activities, based on new technologies and oriented toward foreign markets. (One could stop to argue the case for a coordinated western regional strategy for this purpose and indeed, with the Canada West Foundation, the IRPP is preparing the ground for provincial governments to get together for just that purpose.)

But again, these kinds of changes are disruptive, both financially and socially. If there is going to be an opening to market forces and successful diversification of this kind, there has to be a social fabric which permits people to absorb some of the risks to which they will be exposed as a result.

But I also don't have to tell you here in Alberta that public resources are strained, and that costs of health care and social services and education will be rising quickly enough without my arguing for enriching social insurance schemes. So what to do?

I am going to take a cue from one of your more newsworthy Albertan colleagues and build my argument up from Peter Pocklington's idea for a flat tax. The basic case will be that only through the creation of a solid social safety net can one effectively build a responsive and innovative society open to a changing international economic environment. And that safety net has to be designed so as to make it easy to get off it, as well as non-demeaning to enter.

The job, then, is to find an affordable social contract which provides essential support to people facing the risks of a rapidly changing economy while not discouraging full participation in that economy and in that process of change. To that purpose our system of personal income taxes and social insurance is central. My pitch to you tonight is that fundamental reform of that tax-transfer system is conceivable, and should be pressed as actively and vigorously as possible, at the grass-roots of all political parties as well as at the centres of government.

It is not easy, though. Mr. Wilson has postponed the papers on tax reform, initially scheduled for the budget later this week. It has been generally argued that there are too many interests at stake—that in the end, thorough-going reform of our tax system and income security programs is "just not on", because too many oxes will be gored (just as it is argued that in the end bilateral freer trade will not prove feasible, because too many special interests will be threatened).

But you will remember that this was said in the US as well, until a groundswell of political momentum built up unstoppable support for a simpler, fairer tax structure. The same thing could happen here.

And I believe it must. We need an opening to the market generally, and particularly to international competition, as Donald Macdonald's Commission argued. But their report also argued that some strong "universal income security plan" and extensive adjustment assistance are essential prerequisites to any such move.

We need reform of the unemployment insurance program, as Claude Forget's more recent commission and, indeed, the House Commission in Newfoundland—both argued. But their reports also emphasized that some guaranteed annual income plan is a prerequisite to creation of a tighter unemployment insurance program focussed more on principles of social insurance.

So how to begin?

In Vancouver recently, Peter Pocklington reiterated his argument for a "flat tax"—a simplified personal income tax structure with incomes below some base level—say \$14,000/year—bearing no tax at all, with tax at a fixed rate—he suggested 17%—on incomes between \$14,000 and \$30,000, and a higher rate—23% in his scheme—on incomes above that second threshold. The precise numbers don't matter, but the essential idea is clear: in exchange for all the elaborate deductions and exemptions cluttering up our present tax system, one would substitute a simple schedule at about the present average tax rate, raising about the present level of revenues.

The point is to bring the marginal rate—the tax paid on the last dollar of income—down to the average rate actually paid—that is, the ratio of the total tax bill to total assessed incomes. Despite all the apparent "progressivity" of our current tax schedules, that average rate is only about 20%.

The argument for doing so is twofold: first, the presence of high tax rates on additional income creates a massive industry for loophole-finders and deduction-creators; immense resources go into the contest between the bright boffins inside the government and the sharp tax consultants outside to close off or open up opportunities to drain income away from taxable forms by any legal sleight of hand, no matter how artificial. The waste and cynicism generated by this process are obviously immense, even though an elaborate rhetoric has built up to defend the legitimacy of all this "tax avoidance" effort. It is, after all, only taking advantage of the law as written, the argument goes—nothing dishonest or fraudulent about it.

Secondly, the very high marginal tax rates may pose a disincentive to further work effort, investment undertakings, or other initiatives to generate extra income. Why bother, if the tax man is going to take more than half of it anyway?

Pocklington argues that we would do better to close all the loopholes, simplify the structure, and lower the marginal rates, and I think he is right.

Notice that exactly the same arguments can be made on the other side of the system—our systems of social support through income transfers.

Just as high income taxpayers build up a massive industry to exploit the letter of the tax law to defeat its spirit, so low income recipients of unemployment insurance or social assistance are encouraged to work the system for the maximum benefits it can be made to offer. In neither case is there much outright fraud or illegality, perhaps, but the sense of the system being "abused" is strong. (This concern for legalized "abuse" is probably particularly strong amongst middle-income wage earners who feel that they neither benefit from tax dodges and tax shelters nor qualify as eligible for income supplementation and social insurance.)

And nowhere are incremental tax rates higher than at the low incomes where withdrawal of social assistance in various forms accompanies any efforts to earn more market income. These disincentive effects must be immense. Just as high marginal tax rates may discourage investors or high income professionals from efforts to generate additional income, so high marginal taxback or withdrawal rates may discourage efforts to leave the safety net of social insurance or to earn more market income through employment. This problem of the "poverty trap" has been recognized for some time—certainly since some pathbreaking work at the OECD in the early seventies—but was highlighted recently in Canada in the 1984 Québec White Paper on the Personal Tax-Transfer System.

It is feasible in principle to design a guaranteed income system combined with a simple tax structure that gets around a lot of these problems. Our Institute has been pursuing these questions for some time, particularly in association with Dr. Michael Wolfson of Statistics Canada. I will leave with your Chairman a copy of a couple of Institute documents sketching how this might be

done—if the political will can be mobilized. (These include our September 1985 Choices article and the January, 1986 issue of Options containing Wolfson's article on a guaranteed income scheme which he calls the guaranteed income/simple tax, or GI/ST for short.)

The scheme is affordable—it is possible to design a scheme of this kind within the resources already allocated to programs in the sector—to do the deed within the resources of the social policy envelope, in other words. It would be better to use some of the revenues generated by the reform of the corporate and sales tax systems to transfer into the social envelope, in my view—but it is possible to create the GI/ST within existing resources.

Moreover, the scheme can be approached incrementally. A strengthening of the tax credit system together with much reduced emphasis on tax deductions would provide the right start. So the whole idea is not just pie in the sky.

And if it can be done, then we can go on to pursue the essential reforms of Unemployment Insurance outlined by the Forget Commission, the opening to the market advocated by the Macdonald Commission—and even the leap of faith into freer trade with the US advocated by its chairman. (For this last we need a few other assurances about which we can talk later if you wish.)

Notice that what is really going on here is a basic balancing of two fundamental objectives always present in a highly interdependent, highly complex, highly uncertain world. On the one hand, as technologies, tastes, and the world trading environment all change, it is necessary to reallocate existing resources, redirect new investment, and rechannel efforts at innovation and research. To guide these processes of adjustment and adaptation, an openness and responsiveness to market signals is essential. In no other way can the competitive strength of the economy be maintained. In no other way, in other words, can we maintain our ability as Canadians to earn our living in the wide world outside.

But it has to be remembered that there are a lot of false starts in the world of market signals. A lot of changes reflect short term, transitory, speculative fluctuations, driven by dreams of financial windfalls, not fundamental forces in the world economy. Building up plant and economic infrastructure and skills and social infrastructure takes too long, and change is too costly, to be following every speculative blip in market quotations.

There is some need to cushion the risks and the shocks encountered in dealing with an uncertain world, in other words, not to reinforce them. This would be true simply in order to have a rational system, efficient in making the best use of resources over time, even if we had no interest in a system that was also compassionate.

The sharing, pooling, mutualization, or averaging of risks and shocks, in other words, may be part of any system designed to be efficient over the longer pull. The pooling of risks through social insurance schemes, social assistance measures, regional adjustment mechanisms is a natural response of any community observing the problems individuals face in adapting to changing circumstances.

My point is that these social goals of adequate measures for "helping out" are not in fundamental conflict with the economic goal of a system that is efficient in its use of resources over the long term.

Peter Pocklington can argue for a reformed flat tax system in order to reduce disincentives and promote economic growth. I can argue for extending that same case to income support and supplementation in order to promote basic social justice. The integrated system promotes both, and fuller employment as a result. The foundation of a social contract provides the security from which the risks of economic competition can be more readily assumed, individually and collectively.

The task is to smooth the transitions, both ways, between the world of work and economic competition and the world of income maintenance and social support.

Effective transition, in my view, demands the maintenance of universal eligibility for entry into income transfer programs coupled with training, adjustment, and placement measures designed to encourage, assist, and ultimately force—if necessary—exit for those for whom a return to employment is feasible.

In practical terms, what does an approach like this entail?

1. an integrated approach to economic and social policy, recognizing that the two are mutually reinforcing, not competing;
2. an openness to international competition coupled with a willingness to cushion the shocks of adjustment (and negotiation of a deal with the US that recognizes our right to such domestic assistance programs as purely internal matters without trade impacts—not "counter available", in other words);
3. an attention to market signals coupled with maintenance of a universal safety net from which exit is not deterred;
4. a willingness therefore to live with a "work for welfare" requirement as part of a general placement/training/re-entry activity designed to encourage full utilization of all available resources even in the absence of commercially viable employment;
5. as part of this last, a recognition of the necessity for mobilization of resources at local levels, through community development councils and community investment corporations as proposed by Forget and others;
6. public investment in human resources.

I'm aware, of course, that Alberta may not be the most plausible or hospitable environment in which to push the case for income security or guaranteed annual incomes. But it is perhaps a good place for pushing the idea of a deal—a mutually advantageous exchange.

What I have in mind is a deal, in effect, between social groups (or social partners, as the European expression goes). Its purpose would be to ease a current blockage, a stalemate in Canadian economic development, Canadian economic strategy, which seems evident at the moment.

On the one side, this bargain entails accepting the need for social investment in human capital formation—health, education, social services, training, adjustment assistance, day care, conservation corps, and the like—and in renewable resources—fisheries conservation, silviculture, soil conservation, water quality, and the like—as a legitimate charge on the public purse.

The catch, here, or the quid pro quo in this bargain, is the willingness to accept some "work for welfare" concept, to back off on union (or at least CLC) opposition to the essential Forget proposals, and, in effect, to accept that one can have career or employment security, but cannot, in a changing world environment, have job security. This, in other words, is the old idea of trading lower current earnings for higher lifetime incomes. Most Canadian corporations may fall short of the scale and stability of the Japanese corporations which have (until recently) been offering a form of lifetime employment to their (male) employees. But we can, as a community, offer something like the same deal—and we should.

Conclusions

As a general strategy, a greater sense of economic security through a strengthened social contract will permit a greater degree of reliance on market forces both domestically and internationally. The major pre-requisite to this

strategy is thorough reform of the tax/transfer system along Pocklington-Wolfson lines.

With such reform, a tightening and strengthening of unemployment insurance, a tightening of employability tests designed to assist re-entry into public or private sector employment, and a tightening of the tax system are all feasible and, I would argue, acceptable.

In these comments, I have tried to suggest both a general strategy or orientation, and a few specific measures to which such a strategy would lead. Essentially these boil down to the claim that it is possible to have public expenditure restraint with fairness, a tightening of social programs without too great a loss of solidarity and civility, and tax reform without tears. In my view, such a program is not only possible, it is the only approach that is likely to lead us toward sustained high employment in the increasingly competitive economic world Canada faces.

But it is a lot of territory to cover, and I would be happy to talk with you about any particular aspects which seem interesting (or suspect).

