

Dobell, Rod  
“How Ottawa Decides Economic Policy:  
Implications for the Powers that the Federal Government Needs.”  
*Policy Options* 1.3 (1980) 12-19.

Reprinted with permission from  
The Institute for Research on Public Policy

# How Ottawa Decides Economic Policy

*Implications for the powers that the federal government needs*

By Rod Dobell

In the first issue of this magazine, Tom Kent referred to the necessity for sustained federal responsibilities and "a continuing central government which provides reality for a Canadian national economy". In the second issue, Irving Brecher asserted that "Canada's viability rests on the continuing exercise of very substantial power by the central government".

Even the Task Force on Canadian Unity, although it proposed that the provinces should have "the main responsibility for the development of their economies and the exploitation of their natural resources, and ... jurisdiction over matters pertaining to (among other things) immigration, manpower and training, natural resources, regional economic development ... with correspondingly adequate powers to tax", nevertheless argued the necessity for continuing central government having the major voice in economic policy, on the grounds that economic integration yields significant benefits.

However, even if there is, among the participants in the current discussions, substantial resistance to the dismemberment of federal economic powers, there are several pressing questions about the identification of the powers which Ottawa really does need to "provide reality for a Canadian national economy".

Before coming to grips with these questions, it is desirable to examine the processes by which economic policy is presently formed in Ottawa, and to consider some of the ways in which the process appears to be changing. This article reviews these preliminary matters, by way of invitation to others to enter the debate on the more substantial problem of the proper division of economic powers.

The thread of the argument is as follows:

The importance generally attached to

economic criteria in government decisions has, in practical terms, declined substantially. There are a variety of reasons, but perhaps the most significant is the broader interpretation now attached to social policy.

Arguments against both activist macroeconomic policy and interventionist microeconomic policy are widespread. The first set of arguments is directed against the traditional (postwar) role of Finance Ministries and Treasuries, while the second set is directed by Finance Ministries and Treasuries against the expanding structural or social policy initiatives of "spending" departments.

A backdrop to all this is the recent torrent of analysis of the "realbureaucratik" of decision-making in Ottawa. The underlying theme in this literature is the need to recognize the messiness of the policy process and hence the need to pass to a "procedural", as opposed to a "consequential", criterion for appraisal of decisions within government. Although it does not strictly follow, this seems often to be taken to imply that political, as opposed to economic, criteria must be dominant.

In the present process of economic policy formation in Ottawa, therefore, the roles of the Department of Finance and other players are altered, and a number of problems are evident. Provincial concerns with the division of economic powers and the goal of regional balance—through regionally differentiated economic policies or otherwise—relate in part to these problems.

The article closes with some conclusions as to the formation of economic policy and some reflections on a possible approach to a proper division of economic powers.

*Is the criterion of economic efficiency obsolete?*

"Economic efficiency... is rejected by the Board as not being a measurable, achievable, or a valid goal for Ontario Hydro." So (with emphasis added) says the December 1979 report of the Ontario Energy Board dealing with the proposals of a special Ontario Hydro study team responding to earlier recommendations of Task Force Hydro on the pricing of electricity.

This statement was not a hasty observation in response to a reporter's question or a printer's deadline, but the fruit of almost a full decade of debate and study ending in more than two years of hearings and review by the Board prior to its Report. In 1969 the Ontario government established its Commission on Government Productivity. In March of 1971 the Speech from the Throne in the Ontario Legislature requested the Commission to review the function, structures, operations, financing, and objectives of the Hydro Electric Power Commission of Ontario. The OCGP therefore set up Task Force Hydro, which submitted its first report "Hydro in Ontario: A Future Role and Place" in August 1972.

That report observed that Hydro's traditional mandate had been "power at cost"—satisfaction of peak demand at the lowest possible cost consistent with a high standard of reliability, financial soundness and independence. It noted that policies of promoting maximum consumption in order to realize economies of scale had been pursued, and suggested that there is some evidence that Hydro had priced electricity below its true socio-economic cost.

The recommendations of Task Force Hydro suggested that Hydro's mandate should be redefined in a number of respects, including recognition that growth of peak demand is not independent of pricing strategy. It also suggested that, as a gen-

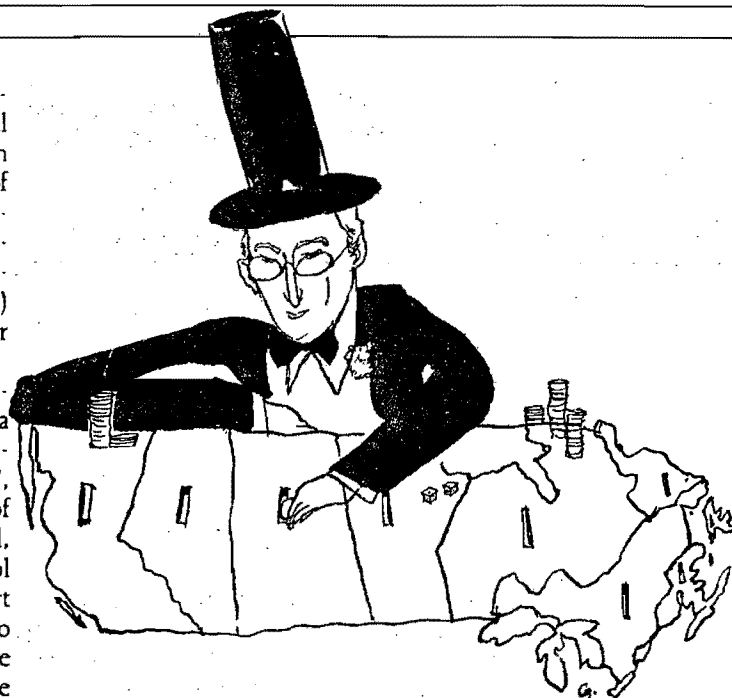
eral rule, additional costs incurred to meet environmental concerns should be reflected in electricity prices, while costs of meeting other imposed supplementary objectives of government (such as regional development or contra-cyclical policy) should not be built into power prices but borne by subsidy.

In response to these concerns, Hydro itself launched a study leading to a report, "Electrical Costing and Pricing", which espoused the objective of economic efficiency as a goal, and marginal cost pricing as a tool to realize that goal. That report was submitted to the Ontario government and referred to the Ontario Energy Board, with the result described above, namely that the Board, after extensive hearings and review, rejected both the proposal for pricing based on marginal costs and—more significantly for present purposes—the very idea of economic efficiency as an objective to be pursued by Ontario Hydro.

All this detail on marginal cost pricing may seem rather remote from the subject of this note, but it is not. It illustrates both what sorts of considerations economists expect price mechanisms and market tests to reflect, and the difficulties which those charged with responsibility for establishing public policy have with the notion of economic efficiency in practice.

This is merely one example of a much more general phenomenon. The goal of an efficient economy does not seem to be heavily weighted in the individual actions of governments, despite the importance assigned to it in rhetoric.

There are many signs we can point to: the OECD Trade Pledge of 1974 (much honoured in the breach) committing member nations to resist the temptation to introduce trade restrictions in an attempt to insulate themselves from the "oil shock" of the day; the drive for de-regulation; the search for "positive adjustment strategies" to permit some adaptation of economic structure to changing realities rather than the fossilization of existing structures through growing government involvement; summit declarations pledging all-out efforts to restore productivity and competitive enterprise; the pleas for resistance to



the "new protectionism".

All of these rhetorical flourishes signal growing concern with what appears to be a growing problem, namely the tendency to play down considerations of economic efficiency relative to other more specific goals, and hence to play down or resist the relevance of market signals to specific government policy or program decisions.

#### *The New Social Policy*

A number of factors are working to alter the processes by which economic policy is formed. First, broader social goals increasingly dominate economic considerations, calling for measures which protect and insulate people and enterprises from the misfortunes of the market and even from the pressures for mobility, adjustment and adaptation to which market signals might otherwise lead.

It used to be argued that one should separate the production questions from the distribution questions, running an efficient economy to ensure maximum output, and then redistributing that output to ensure maximum welfare. The argument has a long and honourable tradition in the economic literature dealing with the individual in a market economy; when social policy is confined to transfer programs to alleviate poverty, it still holds. In the *Scandinavian Journal of Economics* for 1979, Hyland and Zeckhauser of Harvard University set out an

elegant, modern version of the argument under the title "Distributional objectives should affect taxes but not program choice or design".

The separation of economic and social policy was thought to be not only possible but desirable because economic policy could be directed toward the maximum feasible menu of goods and services, while appropriate redistribution permitted the socially preferred selection of outcomes from that menu and achieved the desired balance of equity.

But as a progressively richer community develops growing concerns as to who works where, and under what conditions, the distribution of

production activity, and individual opportunities for participation in production, and production decisions, become less a matter of indifference for social policy. Moreover, the appropriate redistributions of income and wealth seem seldom to occur. The result is that both politicians and analysts go over to the practice of taking their redistribution where they can, evaluating public programs not so much on their resource allocation consequences as on their distributional impacts—the balance of winners and losers.

Thus when social policy is directed not at transfer programs but at the creation of jobs in the face of market signals, or the cushioning of individuals in the face of unanticipated economic change or misfortune—when individual welfare is thought to depend on not being forced to move in search of a job, for example—then the separation of economic policy from social policy is not feasible. It may still be pursued for administrative reasons; but formidable difficulties arise, as will be observed below.

Associated with this shift of emphasis in social policy are growing forces to centralize economic decisions, to refuse to delegate to a market mechanism decisions in which social and cultural values appear mixed with problems of resource allocation.

These forces seem to flow from growing challenge to concepts of property rights and title to resources. They flow from increasing skepticism about the role of pri-

ces as indicators of social values for resource allocation purposes. They flow from refusal to accept prices determined in exchange as legitimate outcomes of an objective and impartial process; prices for goods and services, especially natural resources and labour services, increasingly are seen as outcomes of bargaining, negotiation, or conflict.

All of this drives into the government arena explicit consideration of problems which previously were left to be sorted out by individual economic agents and impersonal market mechanisms. Government action is expected to alter the structure of transactions toward more favourable patterns of primary incomes or more acceptable participation in control of resources. Government action is expected to offset the adverse shocks arising from economic events. Government programs are expected to insulate economic agents from the consequences of changing economic circumstances.

Thus the emerging social contract seems incompatible with market mechanisms for resource allocation and income distribution. Market signals for the allocation of resources and the planning of investment (or the "harvesting" of renewable or non-renewable resources) may point in directions which are increasingly thought to be unacceptable on social grounds by an informed, articulate, and politically active community.

If this is true, then considerations of social policy cannot be separated from economic policy, and appeal to the "bottom line"—either commercially determined or estimated through a social benefit/cost analysis—will have little significance in the councils of the government. Moreover, resource allocation decisions cannot then be left to the market. Cabinet selection of winners and losers becomes inevitable, and subsidy of the losers until they are winners becomes likely.

In brief, this shift in outlook can perhaps best be described by referring to the transition to the "new social policy". Traditional concerns with transfer programs, designed to offset the outcomes of economic processes based upon unfettered market transactions and existing endowments of resources (hu-

man, physical, and financial), have given way to programs designed to alter that initial distribution.

Social policy now finds expression in programs designed to raise wages and alter relative prices; to relocate activities so as to insulate people from the need to move or switch jobs; to maintain employment through subsidies to ailing firms and "lame ducks".

Social policy designed not to alleviate poverty through tax and transfer mechanisms but to attack inequality through alteration of primary incomes and changes in relative endowments and opportunities is, inevitably, social policy which must dominate economic considerations, not simply represent a distribution of the surplus available from economic activity.

#### Process Is All

There is a growing literature which suggests that really the process is all that matters. In public administration, the literature of the sixties, filled with formulae, matrices, and algorithms describing how complex decisions should be made in government, has given way to the literature of the seventies, describing how decisions are made.

The wave of normative optimism has given way to the wash of descriptive pessimism—"positive" theory which concludes, in the words of Bruno Frey, that "government and the public bureaucracy have goals of their own that they pursue, . . . they are not interested in furthering the public interest or social welfare". Implementation of public policies derived from a rational attempt to pursue maximum social welfare is, Frey says, "not accepted by prac-

tical policymakers" as it is not "in their interest to behave this way".

There has been quite an outpouring of such material in Canada, beginning with more academic pieces by Albert Breton, for example, and followed by several eyewitness accounts by those who were there in the early seventies—Hartle, Kroecker, now French—setting out the more realistic, possibly disillusioned view of how Ottawa decides. The implication is that analysis—at least internal to the system—is not to much purpose.

Even if the expenditure process is riddled with such pressures, one might have hoped that the heart of the economic policy process—the formation of tax policy—responds to more "professional" dictates aimed at ensuring overall rationality in the balance of revenues and expenditures. Unfortunately even this fond hope is called into question with the recent book on Canadian federal tax policy in the early seventies by David Good, who was not actually there at the time but who based his Berkeley dissertation and subsequent book on interviews with those who were.

A related idea, in some ways a consequence of the suggestion that there is a limited role for analysis in the policy process, is the suggestion that an outcome is "just" if it is the result of a "just" process. The political scientist can argue that his faith in the workings of the (ideal) political process is exactly analogous to the economist's faith in the workings of the (ideal) market process.

In principle, economic theory can demonstrate that the outcomes generated by competitive markets have some features of optimality or economic efficiency about them, and that an outcome which is not a competitive equilibrium could be improved for some while leaving no one worse off. Thus, a basic test of the outcome, independent of the process which generated it, exists, in principle.

But in fact, in the world in which we live, economists cannot demonstrate conclusively either that the results generated by market mechanisms are efficient, or that correcting an existing allocation of resources toward a competitive market equilibrium will improve matters. So adherence to economic principles comes down to faith in the process of market competition, on the grounds that its major feature, non-coercive voluntary exchange based on price signals, is likely to serve best the myriad individuals

**"representations based on the criterion of economic efficiency are no longer very persuasive".**

who make up an economy and a community. People at least are free to be the judge of their own welfare.

The economic and political principles are thus hard to distinguish: if a political process works well—if it is democratic and takes individual preferences into account—then the outcome is judged good. Alternatively, if market power is not a problem, and prices signal values and opportunity costs reasonably adequately—then the outcome is judged good.

Scott Gordon, in a reflective review in the *Journal of Political Economy* (1975), has drawn attention to what he calls "The New Contractarians". Reviewing three influential works of Rawls, Nozick, and Buchanan, Gordon points to the contrast of their "procedural" principle of ethics (the good is that which emerges from the proper procedure) with the "consequential" principle he considers to be the dominant ethic of the present day: that act or process is good which yields good consequences independently demonstrated to be so.

Gordon observes that the former line of thought leaves us in the end with only the test of proper procedure. A social structure is based on myriad small acts of contracting, but this does not mean that it is based on one grand social contract which establishes a procedural test for fairness, justice, and equity. "End-state" tests for desirable outcomes are unavoidable, he argues, even if it is not clear what are the appropriate tests.

But Gordon is swimming against the tide.

#### *The Impotence of Economics?*

So a number of developments have led to the apparent decline in the importance attached to the goal of economic efficiency and the appeal to market realities as guides to action. There is the move toward the wider view of social welfare which demands that the government intervene in the economy to affect primary incomes and protect the social goals of individuals. There is the burgeoning literature insisting that the process of policy decision in government is so bound up in games and bureaucratic tangles that economic rationality is a fool's dream. And there is the philosophical argument that the test of social action must be found in the form rather than the substance—that is to say, in the procedure rather than the outcome.

## "the Auditor-General hovering over the action to swoop down on the wounded after the battle"

Small wonder that the economist and systems analyst feel themselves outflanked again by the lawyer and accountant who can fall back on the professional guilds with their "generally accepted" procedures. And small wonder that the economist in turn falls back on the argument that the information generated by market tests is at least a more sensitive indicator of individual preferences and opportunity costs than are the mechanisms of the political process. But this is not a very persuasive argument in Ottawa.

There is a somewhat different strand in the web of ideas which have altered the nature of economic policy formation, namely the growing influence of a school of thought—the so-called "rational expectations" school—which holds that in any case active government policy can do nothing to improve overall economic performance. A straightforward statement of this position—which is espoused by some of the most incisive theoretical economists active in the U.S.—can be found in the most recent volume of the Carnegie-Rochester conference series, *Policies for Employment, Prices and Exchange Rates*, in the critique by Robert Lucas of the "McCracken Report" to the OECD.

The basic idea behind this concern is simple. In a 1969 paper attempting to explain to control engineers why policy problems in economics are different from optimizing problems in aerospace engineering, I point to the fact that "...conscious decision-making by components of the system will result in responses to control which act to cushion the effect, to insulate each component as much as possible from the control. The effectiveness of control may be reduced, therefore, and the controllability

of the system may itself come into question".

Over the last ten years this concern, coupled with recognition that individual economic agents not only respond to, but learn to anticipate and thus offset, government policy moves, has led to much speculation about the general impotence of macroeconomic policy. Rejection of "fine-tuning" has in some views been extended to rejection of any discretionary stabilization policy.

An exchange in *Canadian Public Policy* (1975) between Ian MacDonald (of York University) and Gideon Rosenbluth (of UBC) on the efficacy (or lack of it) of macroeconomic policy, bears on the same issue, with the provincial governments the culprits. MacDonald suggested that the growing discretion resting with the provinces to take action which would effectively offset federal attempts at stabilizing economic policy meant, in effect, that federal economic policy was largely impotent. Rosenbluth's response suggested that this development meant merely that the federal government must incorporate models of provincial fiscal behaviour into the description of the stabilization problem it faces. In this process, however, the provinces might not stand idly by. All the ABC's of politics—anticipations, bluffs, counter-bluffs—might then cascade into a very complex policy game.

A significant subsidiary theme here is the general difficulty of finding reliable indicators of economic performance. It is commonplace now, for example, to argue that unemployment numbers do not mean what they say. The Senate Committee on National Finances, in its report on *Growth, Employment, and Price Stability* asserts that "For some time, it has been recognized that the performance of the Canadian economy has been unsatisfactory. Growth has been too slow and hesitant, and unemployment and inflation have been too high".

This report was published in 1971 and must have been referring to the golden sixties, not the turbulent seventies. When the indicators of performance are so little linked to the tangible circumstances of individuals, debate about appropriate economic policy seems doomed to be largely a doctrinal dispute or a religious exercise.

Faced with all the above develop-

ments, it would be a brave analyst indeed who could approach the formation of economic policy with confidence. The appropriate model would have to take full account of all the hesitations, mis-steps, and distortions of the implementation game. It would have to recognize that other players in macroeconomic policy might independently or in response to federal initiatives take action which would offset those initiatives. It would have to recognize that the individual economic agents in the system might both anticipate and take action to insulate themselves against government initiatives to such an extent that any macroeconomic policy initiatives would be futile. And it would have to recognize the many different actors and diverse views in the policy formation process itself.

---

#### Where Does All This Take Us?

This background points to some substantial shifts in all three broad classes of economic policy responsibilities—stabilization policy, redistribution policy, and resource allocation policy.

As to the first, academic and practical pressures have resulted in an enduring shift from active discretionary policies towards guidelines and "gradualism". Although the process may not have altered significantly, as will be discussed below, the perceived room for action has narrowed considerably.

On redistribution policy, initiatives arising outside the traditional budget process suggest greater possibilities to use the tax system for purposes of social policy, and indeed to integrate tax-transfer mechanisms to a substantial degree. Perhaps even more significant, however, is the tendency described above to see social policy everywhere, in all programs and in all departmental proposals. To a major extent, this development, rather than having the effect of bringing the Department of Finance more into social policy questions, is having the effect of bringing distributional impacts of taxes more into the social policy domain.

Responsibilities for resource allocation decisions are the area of the major changes. Strong forces exist to bring forward for Cabinet debate decisions which previously might have been left to the market or handled in the field on the basis of straightforward economic criteria. At the same time, conventional criteria for appraisal of program proposals—criteria based ulti-

mately on notions of economic efficiency—are increasingly called into question.

Of course, all these issues are dominated to a great extent by the more pressing realities of a world in recession, as liquid balances pile up in OPEC countries, and a nation in some disarray as oil rents pile up in Western Canada. Concerns for social goals and sheer self-preservation lead Western nations toward a new protectionism; so do similar provincial concerns lead to growing barriers to free movement of capital, labour, goods, services, and people. Pressures on the liberal trading system of an integrated world economy are paralleled in pressures on the Canadian common market.

And the constraints arising from current account deficits in the balance of payments are reflected in pressures on the government budget. As in the memorable D.H. Lawrence story, "The Rocking Horse Winner" (from *The Lovely Lady*, 1933), the very walls in Ottawa these days are whispering in ever more frenzied fashion: "There must be more money. There must be more money". Who plays the role of the lovely lady unable to restrain expenditures is unclear, and whether this government also is condemned to ride its hobby horse to its death in search of a winner remains to be seen. But certainly some of the more cherished principles of public finance appear likely to take a beating in search of more revenue.

Thus, we might expect current economic circumstances and current thinking to lead to a posture where the Department of Finance retains responsibility for a stabilization policy in which little discretion is seen, and even less is thought desirable. Monetary targets, a "top-down" ceiling on the share of GNP flowing through the federal government sector and hence on the growth rate of expenditures, and a perceived need to reduce the federal deficit, together pretty well define the settings for the traditional "big levers" of macroeconomic policy. Guidelines as to wage and price increases seem to be hovering only slightly in the background.

What is somewhat striking, by contrast with the posture only eighteen months ago, is the apparently resigned acceptance by the government of its inability to make any significant dent in the growth of government expenditures, and hence acceptance of the need to make all the yards on the tax side.

One can only hope that the resulting tax increases will be legislated honestly rather than slipped in through the covert expedient of removing the provisions for indexing of the personal income tax.

In this situation, the above arguments imply that influence must shift from the traditional economic ministries—Finance and Treasury Board—toward social agencies and program departments. Justification or criticism of departmental proposals rests more on *ad hoc* considerations than on criteria of economic efficiency, whether expressed in terms of market signals and actual commercial viability, or in terms of benefit/cost analysis and effectiveness evaluation. The lack of persuasive economic criteria for appraisal of program proposals strengthens the positions of spending departments relative to Finance and Treasury Board.

This shift of influence persists even where "top-down" budgeting forces expenditure limits. When the choices among programs are made on the basis of *ad hoc* bargaining amongst Ministers, rather than on more traditional economic analysis, the purveyors of that analysis are inevitably less relevant to the outcome, no matter how fully they are represented at the table.

In fact, this development impinges more strongly on the Treasury Board secretariat than it does on the Department of Finance.

Since the splitting of the Treasury Board secretariat from Finance, it has never been fully clear to what extent the secretariat (which was to be the guardian of the expenditure total) was also to be the spokesman for economic efficiency and effectiveness in resource allocation. But while Finance is not substantially challenged in its stabilization role, the program branch of the Treasury Board secretariat has little left but a mechanical administrative role if its responsibilities for the composition of expenditures are eroded. That this is happening seems apparent from the following description of the current process.

---

#### Who is Minding the Store?

If economic efficiency is not the paramount goal, then the traditional role of Finance as the "court of last review" in economic matters, or the "internal opposition" and skeptical critic for the proposals of all the other agencies, is not a paramount role. The criteria by which programs should be

appraised or criticized are less clear; and the likely judgement of the market is in any case less significant to the interdepartmental debate.

Recent personnel shifts within Finance seem consistent with this shift in emphasis. The temptation is overwhelming to ask whether the switch from Crosbie-Reuber to MacEachen-Stewart has led to any observable change in either the role played or the objectives pursued by the Department of Finance in the formation of economic policy.

This switch—or indeed, going back further to a previous Liberal administration, the switch from Turner-Reisman to the present team—represents a move from a Minister and Deputy who “believe in the market” to a view which is far less sure of the market, either its long-term direction or its short-term value. Yet little shift in the Department’s activities due to that transition is evident from the outside.

Possibly it is the labels and the placement of the chairs around the table which dictate the roles played. “Where you stand depends on where you sit.” Or possibly, there are no degrees of freedom, objective circumstances being such that only one economic policy position can be considered feasible, regardless of the personalities or philosophies involved. Or perhaps we simply need to look more deeply to see that, despite short-term constraints on policy, and any general inertia in the roles played by less senior Finance officials around the various tables, longer-term directions have altered.

It certainly seems true that the role of the price mechanism as an allocation device is less valued under the current management. And the intensity of the deregulation drive seems curiously muted these days. One hears not so much about reduced regulation as about “revitalized” regulation. Further from Finance, though not inconsistent with the above impressions, is the suspicion that “freedom of information” legislation and “sunset” provisions and “parliamentary scrutiny” of departmental evaluations of government programs” will all die with the Cabinet Committee on Economy in Government, even though all were initiatives of the previous Liberal administration.

Perhaps, therefore, it could be argued that the present philosophy in Finance is part of a general shift of the whole government back toward the more interventionist pos-

**“policy decision in government is so bound up in games and bureaucratic tangles that economic rationality is a fool’s dream”**

ture which it seemed to be tempering slightly in the late seventies. Those who find religion late often abandon it soon. It would be interesting to hear an inside view on some of these speculations.

Even if Finance is continuing to play its role as defender of the long-term and spokesman for the proposition that the best guarantee of prosperity for our grandchildren is the maintenance of a productive, dynamic economy, the indications are that representations based on the criterion of economic efficiency are no longer very persuasive. On the resource allocation side, this criterion and the dominating influence of the Department of Finance seem no longer to provide the unifying force they once did.

If not Finance, who is providing the reasoned oversight of the system, and fitting individual departmental proposals into an overall strategy, submitting each proposal to skeptical scrutiny and appraising its consistency with some established policy direction?

The answer is a little more complex now than in the past. With an extended PCO (Privy Council Office) involvement, Ministries of State for Economic Development and for Social Development, Treasury Board still operating (not to mention a Controller-General to express views on the appraisal of program effectiveness, and the Auditor-General hovering over the action to swoop down on the wounded after the battle), it becomes a little hard to sort out all the central agency players. Indeed, although it may be a little uncharitable to say so, some think that there are rather too many central agency players in the present game.

It appears however, that on the resource allocation side, the process is not a great deal different from that envisaged in

the expenditure management system outlined in the budget papers last December. That system has already been described in detail elsewhere, and only a few features will be sketched here.

The expenditure budgetary process is intended to begin much as before, with a possible background paper prepared by the Department of Finance on “emerging economic issues” followed by a more concrete medium-term document on “the fiscal outlook”, both presented by the Minister of Finance in the priorities and planning committee of Cabinet, and in turn followed by a proposed “fiscal framework” for the fiscal year fifteen months away. This fiscal framework is based on a projection by Finance of likely revenue growth and a projection by Treasury Board secretariat of anticipated growth of expenditures for existing or committed programs.

Modifications to these estimates to reflect the tax changes, borrowing possibilities, and program initiatives appropriate to the anticipated state of the economy eighteen to twenty-four months ahead determine, as usual, the appropriate balance of revenues and expenditures, and thus the overall “fiscal elbow room”.

What is new is that as part of this process the Minister of Finance (on the basis of what revelation one does not know) proposes to priorities and planning committee the appropriate decomposition of overall expenditure into policy “envelopes” to be allocated by the separate policy committees of Cabinet. Since all the chairmen of policy committees are members of priorities and planning, some indication of the relative priorities assigned to initiatives within policy sectors presumably emerges from the discussion at this time.

As described in Mr. Crosbie’s December budget papers, each policy committee is charged with responsibility to review existing and proposed programs which fall within its policy area, in order to ensure that expenditures remain within the established allocations. Approval of new programs requires that the new money be found by reduction of expenditures on other existing programs within the envelope.

In this system, for example, the Cabinet committee on economic development assumes responsibility for expenditures and activities relating to job creation and employment services, labour, regional development, science and technology and

industrial programs, while the Cabinet committee on social and native affairs assumes responsibility for financial contributions to unemployment insurance, environment, health and social service programs (including block financing of provincially delivered services) and justice.

In Mr. Clark's government, the "inner Cabinet" was to take responsibility for fiscal arrangements or revenue sharing; presumably this now rests with priorities and planning committee. On paper, this decomposition of the government's expenditure program into separate groups, with prescribed expenditure limits to be independently managed, seems inevitably to lead to less, rather than more, joint consideration of the interdependent social and economic concerns discussed above.

Thus, the major difference in the handling of departmental program proposals is that Ministers in the appropriate policy committee, rather than approving the proposal in principle and handing responsibility for funding off to Treasury Board, must face personally the responsibility to weigh the merits of the proposal against the programs which must be sacrificed to make way for it.

In the current process two "bureaucratic" features are significant. First each Cabinet committee has its shadow committee of deputy ministers which meets weekly to "filter", coordinate, and force coherence upon, all departmental submissions. Particularly in the case of the two big envelopes, economic development and social and native affairs, one hears that this process is working smoothly.

Second, in the policy committees all Ministers, not simply the chairperson, receive the "assessment notes" prepared by the secretariat as an analysis of the Cabinet document under consideration. While each Minister may also have a note prepared by his or her own department, the importance of all working from the same basic assessment of the proposal is obvious.

The basic presentation of the case having been reviewed and presumably agreed upon by the shadow committee of deputies, and the proposal then having been considered and approved by the Cabinet committee in light of the overall state of its spending envelope, the document presumably passes to Treasury Board not for consideration in principle or in respect of resource allocation, but on housekeeping matters—detailed allocation of man-years, contract administra-

tion, and the like. In this respect, the Lambert Commission proposals for transformation of Treasury Board into management board seem largely to have been realized.

The obvious difficulty is also potentially the most serious. Where programs in one envelope have significant impacts on the attainment of objectives in other envelopes, some coordination is essential. A reasonable outcome could occur only by sheer accident otherwise. But no machinery exists within an envelope system to handle these inter-committee spillovers, short of going back to the priorities and planning committee. In particular, although the Privy Council Office itself may assume responsibility for such spillovers, it seems clear that the handling of job creation programs in the economic development envelope can hardly be separated from general social policy concerns of provision for unemployment insurance, for example.

Several analytical and procedural reservations spring to mind in considering this system of splitting into components the overall problem of establishing an effective and coordinated expenditure budget. But for present purposes, the significant point is that it may establish effective expenditure limits without assuring effective expenditures—or at least, without bringing to bear conventional criteria of economic efficiency in any substantial way.

#### Conclusions

In the last issue of this magazine, Irving Brecher suggested that "the time has come for Canada's economic researchers to confront the totality of the policy process." That, of course, is precisely what schools of public administration are all about.

Indeed, the present article is attempting to carry an analysis at three levels: first, the way changing views of economic policy affect the attitudes and criteria which participants in the policy process bring to their work; second, tracing some consequences of various procedural or "bureaucratic" changes in the formation of economic policy; third, dealing very briefly with a few substantive elements of that policy.

I leave the first level with what has been said so far. At the second level, the following conclusions might be suggested:

(1) The role of Finance in the formulation of macro-economic policy is functioning much as current wisdom might argue it

should. The Minister of Finance takes to priorities and planning committee the fiscal outlook and fiscal framework documents, setting out expenditure and revenue projections, proposing the appropriate balance, and thereby permitting the committee to establish the level of "fiscal elbow room" or, in the current situation, "fiscal belt-tightening".

On the basis of a document from the Minister of Finance, the committee establishes not just priorities for the new money, but the allocation of total expenditures over sectoral envelopes. To support all these activities and on-going current economic intelligence, Finance appears to retain its traditional primacy in analytical capacity.

(2) The most dramatic structural development might be the emergence of new "Treasury Boards", and the reduction of the old Treasury Board to a role not unlike that envisaged by the Lambert Commission for its management board, concerned with the administration and housekeeping within the public service.

(3) Some order is imposed on the flow of documents through these new Treasury Boards by virtue of the fact that each has its own shadow committee of deputy ministers. In the case of the two large envelopes—economic development and social development—these shadow committees are chaired by strong deputies and meet weekly. While Ministers always retain their right to bring any matter to the attention of their colleagues, their deputies have apparently found it expedient to ensure that documents are coordinated through referral to these shadow committees. Moreover, the Prime Minister appears prepared to insist that the sectoral committees deal with all proposals, rather than permitting "end runs" by which Ministers bring matters directly to Cabinet. Thus, while Mr. Clark may have formally instituted the expenditure management system, Mr. Trudeau may in fact have the experience and clout to make it work more tightly.

(4) Major reservations must attach to the links between social and economic policy as they affect the work place and industrial structure. Rick van Loon, in his article "Reforming Welfare in Canada" (*Public Policy*, Fall 1979) suggests that social policy is shaped by forces outside its domain—primarily by economic considerations. Here, it has been suggested that things may in fact work the other way around. But either way,



a major difficulty in any expenditure management system—and a major argument for devolution of program responsibilities to provincial and local governments—is the difficulty of establishing either analytically or politically the appropriate balance between the two.

These conclusions bear on the formation of economic policy. The arguments of this article also suggest a set of general principles around which an analytically coherent division of economic powers might be built. The ideas are not new, but they are consistent with the general trends outlined above.

The basic model is one in which the federal government defines what it means to be a Canadian, and manages basic interpersonal and interprovincial redistribution policies according to agreed general principles, while provincial (and local) governments assume responsibility for resource management and resource allocation decisions for which no agreed analytical criteria—as we have seen above—can exist.

Suitable administrative arrangements can assure regional (not necessarily provincial government) representation on agencies concerned with monetary policy and exchange rate management, as well as consultation on fiscal and debt management policy. Federal responsibility to underwrite and monitor adherence to the principles of a Canadian common market would provide a foundation for a national economy.

More specifically:

(1) The federal government is the natural focus for an integrated tax transfer mechanism which would deliver an income support/supplementation scheme—uniform, portable, universal, defining one aspect of what it means to be a Canadian.

(2) The federal government is the natural centre for a tax collection agreement based on uniform definitions, providing a basic guarantee of harmonization in taxation practices and protection from double taxation or inter-jurisdictional tax competition.

(3) The federal government is the natural guardian of the Canadian common market, acting to ensure observance of overriding principles of freedom of movement for people, goods, and services, and removal of any inter-provincial barriers to trade or competition.

(4) The federal government is the natural focus for negotiation of basic “program criteria” governing access to social services and other programs providing basic

“an enduring shift from active discretionary policies towards guidelines and ‘gradualism’.”

services to individuals.

(5) Within agreed program criteria, responsibility for all basic social services, regulatory activity, and resource allocation decisions relating to regional development, manpower and job creation, and resource management, can best be carried out by provincial and local governments.

(6) For the purpose of financing these activities, additional (equalized) tax points transferred to the provinces would be expected to cover federal obligations under present established program financing arrangements.

(7) Pricing of natural resources is best left as the responsibility of the provinces concerned, but with the understanding that some annualized equivalent of resource revenues would be fully counted in equalization calculations.

(8) The possibility of negative equalization payments would be introduced, with the effect of putting the present fiscal arrangements fully on a “net” basis. From being solely a federal program the fiscal arrangements would thus become in part an inter-provincial transfer scheme, based on the existing procedure of equalizing to national average standards.

(9) Administrative arrangements would ensure representatives from each province (not provincial government) on the boards of agencies such as the Bank of Canada; for example, regional offices of the Bank of Canada could be strengthened to provide a substantial source of regional economic intelligence comparable to the separate Reserve Banks of the Federal Reserve System in the United States.

(10) Consultation on fiscal policy and general economic policy could be assured through regular meetings of Finance Ministers and of First Ministers for the purpose.

(11) Federal and provincial governments would commit themselves to the

introduction of legislation embodying agreed principles of freedom of information, and legislative scrutiny of regular departmental evaluations of government programs.

The premise is that provinces would be willing to commit themselves to common basic principles governing interpersonal redistribution and a working common market, and the “have” provinces to commit themselves to contributing directly, in effect, to regional balance in the provision of public services—that is, to commit themselves, through negative equalization payments where appropriate, to a federally-managed inter-provincial transfer scheme.

The counterpart to these commitments would be jurisdiction, and adequate tax room, to handle resource management and resource allocation decisions, including regulatory responsibilities other than those inherent in the common market functions.

Even though both federal revenues and federal expenditures would presumably be smaller under this scheme, it can be argued that no other foundation for management of the national economy is necessary. The goal which is not explicitly taken into account is that of full regional balance in economic development. But provincial initiatives on their own behalf may not fall further short of that goal than do present programs.

In place of a grand centrally-planned industrial strategy, there would be provincial decisions more sensitive (one hopes) to local market conditions. In place of federal responsibility for the “new” social policy coupled with provincial responsibility for the “old,” there would be full responsibility at the provincial level within agreed general guidelines defining the nature of the underlying economic union. Providing the foundation for that economic union, there would be a federal government which does indeed establish what it means to be a Canadian, and can guarantee that what it means is the same across the country. Some fundamental guarantees of openness at all levels in the system would help to ensure greater responsiveness to popular control.

It cannot be claimed, obviously, that this is a fully-articulated or demonstrably practical program; a lot of computation would be necessary to put numerical flesh on such an analytical skeleton. But it is one view of the division of power to which the current literature on the formation of economic policy, taken seriously, might lead. ≡