Policy Signposts in Postwar Canada

REFLECTIONS OF A MARKET POPULIST

Thomas J. Courchene

IRPP
40 YEARS/ANS

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Foreword

For the past 40 years, the Institute for Research on Public Policy (IRPP) has helped shape Canada's most important conversations. Since its creation in April 1972, the Institute has led national debates on free trade and Canada-US relations, tax reform, Canadian federalism, child care and family policy, health care funding, national security, and Canadian Arctic sovereignty. Today, as we mark our 40th anniversary, we continue to provide sound analysis and critical thinking on pension reform, care for seniors, the economic and social integration of immigrants, and making our economy more competitive through productivity and innovation.

As part of our 40th anniversary celebrations, we are delighted to publish this important essay by one of Canada's most distinguished academics, IRPP Senior Scholar Thomas J. Courchene. A sweeping overview of the most significant milestones and turning points in Canadian public policy since the end of the Second World War, the essay covers the main challenges we have faced and continue to face relating to social and economic policy, natural resources and energy, Aboriginal issues, constitutional affairs, and federalism. More than a history lesson, the essay traces the evolution of these important debates, draws the links between them and, with an eye firmly on the horizon, points to where they might lead us in the future.

This essay is the culmination of the impressive and innovative body of work that Tom has produced since becoming our senior scholar in 1999. He served as the co-director of the multiyear Art of the State series, which took an in-depth look at issues as diverse as multilevel governance under globalization, North American integration, diversity and shared citizenship, and the future of Canada's North. A prolific writer, Tom has published no fewer than 20 IRPP studies and 30 *Policy Options* articles, breaking new policy ground on topics such as federalism and fiscal arrangements, Canada's place in the world, the development of human capital and the role of global cities. Here Tom shows us, in typical Courchene fashion, how seemingly distinct events and policy developments are interconnected, and why they matter to Canadians. In this sense, *Policy Signposts* is ideally suited to be our first publication in this IRPP anniversary year.

Graham Fox
President
Institute for Research on Public Policy

About the Author

Thomas J. Courchene was educated at the University of Saskatchewan (honours BA, 1962) and Princeton University (PhD, 1967). He is the Jarislowsky-Deutsch Professor of Economic and Financial Policy and a member of the Department of Economics, the School of Policy Studies and the Faculty of Law at Queen's University. He has been senior scholar at the IRPP since 1999. He is the editor/author of some 60 books and roughly 300 articles in academic publications on Canadian policy issues, including a four-volume series on Canadian monetary policy published by the C.D. Howe Institute. His 1994 book, *Social Canada in the Millennium*, was awarded the Doug Purvis Prize for the best Canadian economic policy contribution in 1994. His book *From Heartland to North American Region State: The Social, Fiscal and Federal Evolution of Ontario* (1998, with Colin Telmer) won the inaugural Donner Prize for the best book on Canadian public policy. His book, *A State of Minds: Toward a Human Capital Future for Canadians*, was published by the IRPP in 2001. Thomas Courchene was chair of the Ontario Economic Council from 1982 to 1985, was a senior fellow of the C.D. Howe Institute (1980-99), was a member of the Economic Council of Canada (1988-91), is a fellow of the Royal Society of Canada (elected 1981) and is a past president of the Canadian Economics Association (1991-92). He received honorary doctorates of laws (LLDs) from the University of Western Ontario (1997), the University of Saskatchewan (1999) and the University of Regina (2007). On the occasion of the 100th anniversary of the University of Saskatchewan, he was included in the 100 Alumni of Influence. Courchene was awarded the 1999 Canada Council Molson Prize for lifetime achievement in the social sciences and humanities. He was invested as an Officer of the Order of Canada in April 1999.

Acknowledgements

I am most grateful to Graham Fox and the Institute for Research on Public Policy for including this essay as part of the celebration of the Institute's 40th anniversary. The essay began in response to a request by my colleague Naomi Alboim to reflect on aspects of Canada's recent policy evolution as part of the Queen's University annual policy forum. A later version of the paper was presented at a Festschrift in honour of Charlie Beach. The present version owes a great deal to France St-Hilaire and Jeremy Leonard of IRPP for their careful reading and valuable suggestions and comments on earlier drafts. And I am most grateful for the many discussions with Jeremy in finalizing the essay. Responsibility for the views and interpretations that follow rests with me.

Policy Signposts in Postwar Canada: Reflections of a Market Populist

Thomas J. Courchene

The 40th anniversary of the Institute for Research on Public Policy seems an ideal occasion to reflect on the evolution of Canada's postwar public policy. Toward this end, this paper identifies the signposts or milestones that represent the key turning points in our policy history. In large measure the ensuing analysis is a selective distillation of my research as senior scholar at the IRPP, as Contributing Writer for the IRPP's *Policy Options* magazine and during the score of years I spent earlier as senior fellow at the C.D. Howe Institute. Hence, I had the great good fortune of receiving constant encouragement and professional guidance as well as ready access to high-profile publication venues as I studied a broad range of Canadian political economy and public policy issues, many of which have found their way into this paper.

In undertaking such an exercise, one would like to be as comprehensive as possible. However, it also makes sense to put some limit on the number of signposts. Choosing a baker's dozen is my way to walk the line between being reasonably comprehensive and at the same time being reasonably parsimonious. Having completed my list, I hope that others might replicate this model in their own areas of expertise. A series of policy (or perhaps theoretical) signposts relating to areas such as monetary policy, health care, social policy, tax policy or federal-provincial relations would be a valuable contribution to future scholarship as well as enhancing Canadians' understanding and appreciation of our fascinating public policy history.

As noted in the subtitle, my selection of signposts reflects a market populist approach, essentially a market perspective complemented by a belief in a generous social envelope. Other societal visions would lead to different choices, although I suspect some of the signposts would make everyone's list.

Although there are some unavoidable overlaps, the signposts are presented in chronological order. The first seven focus on the major turning points during what can be termed the era of American hegemony, roughly until the millennium. It is interesting to recall that with the collapse of the Soviet empire and the fall of the Berlin Wall, Francis Fukuyama confidently declared the “end of history,” by which he meant the triumph of democratic capitalism. Yet even as we celebrated the end of the Cold War, the world was in the throes of another epochal revolution; in this revolution, which I label the “informatics era,” Chinese-style state capitalism seems to be eclipsing Fukuyama’s democratic capitalism. The remaining five signposts are designed to capture key policy milestones in this new global order on still evolving issues that embody both challenges and opportunities for our federation.

In essence the postwar American era was a time when international economic integration proceeded apace with domestic socio-economic integration. This is in sharp contrast with the informatics era, when the challenge is to try to ensure that continuing international economic integration does not lead to domestic social disintegration.

Signpost 1: Embedded Liberalism and American Supremacy

The genius inherent in the postwar international and domestic economic orders lay in what John Ruggie has termed the “compromise of embedded liberalism” (1995, 67). Societies were asked to embrace the changes and dislocation attending liberalization and internationalization. In turn, liberalization and its effects were cushioned by the newly acquired economic and social policy roles of governments. As a result, the modern welfare state grew apace with international openness because the institutional framework embedded this openness within an activist domestic social democracy and an accommodating international regulatory system. Remarkably, it was the most open economies (Sweden and Denmark) that developed the most pervasive social programs. In contrast to the current reality, the compromise of embedded liberalism ensured that in this era international economic integration would not lead to domestic social disintegration. Indeed, embedded liberalism paved the way for a revolution of rising social expectations (even entitlements) on the part of citizens.

The major factor that led to American supremacy was that the US, unlike Europe and Japan, came out of the Second World War with its economy and infrastructure largely intact. Almost by default, America became the workshop of the world. In one of America’s finest hours, it embarked on the Marshall Plan, among other initiatives, to rebuild the war-ravaged economies, and it played a lead role in creating a new international institutional order: the World Bank, the International Monetary Fund and the General Agreement on Tariffs and Trade on the economic and trade side; and the United Nations and the North Atlantic Treaty Organization on the political and security side. The US also took the lead in a number of trade and economic initiatives, including the gold-exchange standard anchored to the greenback (and later the dollar standard itself) and the move to restore full currency convertibility and capital mobility across the developed nations. To be sure, these measures were also in America's self-interest since an expanding global economy was essential for the US to take full advantage of its privileged position as the uncontested economic superpower.

Indeed, the privileged position of the US in the early postwar period was such that even relatively unskilled Americans could aspire to middle-class status, because they were able to work with quantities of physical and financial capital that were simply not available in other countries. Moreover, the American economy was increasingly dynamic and innovative as a result of creating world-class universities and research institutes and of inviting the best and the brightest from the rest of the world to settle in the US. This innovation drove the productivity of all workers, regardless of skill level. For both of these reasons, American factory workers could command higher wages than similarly qualified workers elsewhere. The rising wages and incomes of these factory workers combined with falling prices for consumer goods arising from mass production meant that a majority of Americans were able to live the American Dream: the middle-class lifestyle. In hindsight, the Achilles' heel of the robust postwar US economy was that the middle and lower echelons of the labour force were not as skilled as their counterparts in Europe and Japan.

More generally, under US political and economic leadership, the postwar period saw unprecedented income growth across the globe, a doubling of the number of democratic governments and the successful management of the Cold War. As the world welcomed the third millennium, American exceptionalism seemed unassailable. With its greenback serving as the world's currency, America was the uncontested global superpower — economically, financially, militarily and, to Americans at least, morally. Among the keys to America's ability to scale what Yergin and Stanislaw (2002) refer to as the "commanding heights" were its individualist ethic, its liberal approach to markets and, above all, its inherent dynamism and penchant for innovation. Unfathomably, America's global economic supremacy is now contestable, indeed eminently so, for reasons examined later in this essay.

Postwar Canada obviously benefited enormously on the economic front from sharing a several-thousand-kilometre border with the world's economic superpower. And because the US market was so large we tended to focus our exports southward. This export penetration was intensified initially by the 1965 Canada-United States Automotive Products Agreement (the Auto Pact) and later by the Canada-US Free Trade Agreement (FTA) and the North American Free Trade Agreement (NAFTA). Moreover, American global leadership gave Canada a privileged position in international affairs, allowing us to "punch above our weight" and to advance issues of mutual interest. The most obvious and most important of these privileges was ascension to membership in the G7. Yet our close association with the US did not impinge on our ability to develop a social and political model at home reflecting our own character, nor did it keep us from marching to our own drummer internationally when our interests so dictated: for example, we did not follow the US into Vietnam or Iraq. Indeed, we successfully positioned ourselves as a middle power, no doubt helped along by the awarding of the 1957 Nobel Peace Prize to Lester B. Pearson for defusing the Suez Crisis and in the process branding Canada as the birthplace of peacekeeping.

Postwar embedded liberalism provided ample substance to Sir Wilfrid Laurier's claim that the twentieth century would belong to Canada.

Signpost 2: Quebec's Personal Income Tax and Canadian Federalism

Easily the most significant postwar development in the evolution of Canadian federalism was Quebec's introduction in 1954-55 of its own separate personal income tax (PIT) system. The triggering event was Ottawa's transfer of federal money directly to universities: an exercise of the federal spending power in what Quebec deemed to be an area of exclusive provincial jurisdiction. Premier Maurice Duplessis recognized that Quebec had no effective way of fiscally countering Ottawa's funding since the province had no ready access to a significant revenue source. In order to provide one, Duplessis drew from an interim recommendation of the ongoing Royal Commission of Inquiry on Constitutional Problems (Tremblay Commission) and introduced the Quebec PIT with a 15 percent tax rate. Ottawa was alarmed at this initiative. In particular, since the provinces have the constitutional authority to levy income taxes, the fear was that other provinces would follow Quebec's lead and enact their own PITs, which not only would undermine Ottawa's ability to manage the economy but also would surely fragment the internal common market as it related to taxation.

Ottawa reacted by providing tax abatements to the provinces — transfers of federal tax revenues to the provinces — from three sources: 10 percent of federal PIT revenues, 9 percent of federal corporate income taxes and 50 percent of succession duties. While this move served to remove the temptation for the other provinces to establish separate PITs, it generated another problem. Since these abatements were transferred to all provinces on a derivation basis (i.e., they were calculated on the basis of what the federal government actually collected in each province) and not on an equal per capita basis, this meant that the richer provinces would receive larger per capita abatements than the poorer ones.

To address these looming interprovincial revenue differentials, the government of Canada inaugurated the Equalization program as part of the 1957 federal-provincial fiscal arrangements. This initial version of Equalization ensured that all provinces would have per capita revenues from the three abatements equal to the per capita average of the two richest provinces (at that time Ontario and British Columbia, with the latter receiving an Equalization payment). Over time the Equalization program became the cornerstone of the system that enables all provinces to provide comparable public goods and services to all Canadians. So vital did it become that on the 25th anniversary of its inauguration the principle of equalization was enshrined in the *Constitution Act, 1982*.

Before this 1954-57 trio of policy initiatives (the Quebec PIT, the federal abatements and Equalization), the provinces had little fiscal flexibility to embark on major new programs.[1] Old Age Pensions and Unemployment Insurance, for example, although they fell under provincial jurisdiction, could not be undertaken by the provinces because they lacked the requisite fiscal capacity. In order to proceed, these responsibilities were transferred, via constitutional amendments, from provincial to federal jurisdiction, and as a result they are entirely financed, regulated and administered by Ottawa. After 1954-57, however, the provinces had acquired financial means (equalized tax point transfers and later the ability to increase the provincial component of the PIT), which meant that our defining social programs (hospital insurance, medicare, welfare, post-secondary education) ended up being jointly financed, but remained under provincial jurisdiction (that is provincially administered and regulated).

Without the Equalization Program, the poorer provinces would never have allowed the degree of income tax fragmentation that ultimately ensued. In this important sense the rich provinces also benefit from the operations of Equalization.

The result was that Canada became, arguably, the world's most decentralized federation. This is the sense in which operation of Canadian federalism was dramatically altered by Quebec's decision to mount its own personal income tax system.

Signpost 3: JFK's New Frontier, LBJ's Great Society and Pearson's Transformation of Social Canada

The early to middle 1960s were characterized by the ascendancy of social programs to policy centre stage. While embedded liberalism made this possible, the intellectual driver was the Keynesian revolution. In the US the years of the John F. Kennedy and Lyndon B. Johnson administrations were the heyday of Keynesian fiscal and social policy; government spending and regulation became the primary instruments for achieving social and economic goals. My most vivid memory of this period is of the economist Richard Musgrave, who had been working with Paul Samuelson and the Council of Economic Advisors on the Kennedy tax cut. He returned from Washington to our public finance graduate class at Princeton and excitedly announced that the proposed tax cut, from 90 percent to 72 percent for the top marginal rate, would actually increase tax revenues. This was my introduction to what we would later call the Laffer Curve.

Johnson's Great Society agenda (much of it inspired by Kennedy's New Frontier) was the more important initiative for the evolution of US social policy. It was an activist government

[1] The remainder of this paragraph draws from Forget (1984) and Courchene (2008).

agenda with the scope and sweep of Roosevelt's New Deal, albeit with different priorities. Major new programs were launched in health (Medicare and Medicaid), education, civil rights, urbanism, transportation and the war on poverty. Thousands of economists and other social scientists flocked to Washington over several summers and left with briefcases full of policy papers in areas where there were no respectable journals. Not surprisingly, the result was a blossoming of specialist policy journals in all of the Great Society areas and the beginning, for better or worse, of the discipline of economics taking on its modern role as the imperialist social science.

In roughly the same time frame, Lester Pearson's 1963-68 minority governments created the essence of social Canada. The achievements of the Pearson era were nothing short of astounding:[2]

- the Canada Pension Plan and the Quebec Pension Plan (CPP/QPP);
- the 1966 *Medical Care Act* (building on the Saskatchewan model[3]), which provided for federal cost-sharing with the provinces provided they adhered to the five medicare principles: universality, accessibility, comprehensiveness, portability and public administration;
- the Canada Assistance Plan (CAP), designed to finance a large part of the provincial welfare systems;
- the transfer of additional income tax points to the provinces;
- the Guaranteed Income Supplement (GIS);
- Canada Student Loans;
- the 1967 *Adult Occupational Training Act*;
- the introduction of the point system for immigration; and
- the introduction of the comprehensive Representative Tax System approach to Equalization in 1967.

All these were wrapped up, as it were, in the newly created Maple Leaf flag.

The necessary condition for Pearson's social agenda was to have Quebec on side. This occurred with the election of the Jean Lesage Liberals in 1960 and the launching of the *Révolution tranquille* (Quiet Revolution), which led to the secularization of Quebec society (e.g., the creation of ministries of education and health to replace the Catholic Church, which dominated these areas), to the nationalization of Hydro-Québec under the *Maîtres chez nous* slogan and more generally to the expansion of the Quebec government's role in

[2] The intellectual forerunner of Pearson's social agenda was Tom Kent's paper *Social Policy for Canada: Towards a Philosophy of Social Security*, presented at the Liberals' renowned 1960 Kingston Conference. Among Kent's 11 social priorities were medicare, hospital insurance, reworking Unemployment Insurance, training, regional development, urban renewal and housing. Kent helped implement this agenda as Pearson's behind-the-scenes leader and as Pearson's chief of staff. Amazingly, until his death at 89 in late 2011, he continued his role as one of Canada's leading public intellectuals from his position as adjunct professor at the Queen's School of Policy Studies.

[3] Although medicare was a centrepiece of the Liberal Party's 1960 Kingston policy conference, the legislation eventually brought in by the Pearson Liberals converted Saskatchewan's pathbreaking medicare system into a national program. I recognize that many readers would designate Saskatchewan's creative experimentation on the health front as an achievement in its own right rather than meshing it with the Pearson-era accomplishments on the socio-economic front.

the economic and social spheres that has come to be referred to as Quebec Inc. However, the linchpin of Pearson's social agenda was the fact that Lesage and his government were staunch believers in the Canadian federation; Lesage himself served as a cabinet minister in Louis St-Laurent's Liberal government and was willing to cooperate in the creation of social Canada. The relationship was a two-way street. On the one hand, one of the first initiatives of the Pearson government was the creation in 1963 of the Royal Commission on Bilingualism and Biculturalism, which eventually led to Prime Minister Pierre Trudeau's introduction of the 1969 *Official Languages Act*. On the other, Lesage's compromise proposal for contributory public pensions was accepted by Pearson and led to the CPP/QPP.[4]

Signpost 4: The Parti Québécois, the Bloc Québécois and Quebec Separatism

While Expo 67 allowed Quebec to showcase itself to the rest of Canada and to the world, it also provided a platform for President Charles de Gaulle's famous rallying cry from the ramparts of Montreal City Hall: "Vive le Québec libre." In the turbulent aftermath of this declaration, René Lévesque (earlier, the minister in the Lesage cabinet who led the nationalization of Hydro-Québec) launched the Mouvement Souveraineté-Association, which became the Parti Québécois (PQ) in 1968. After Lévesque assumed the premiership in 1976, the PQ legislated the *Charte de la langue française* (Bill 101), making French the official language and the language of work in the province. The separatism issue then dominated the march of Canadian politics for two decades:

- the 1980 referendum on Quebec sovereignty (rejected by a margin of 59.6 percent to 40.4 percent);
- Quebec's refusal to sign on to the *Constitution Act, 1982*;
- negotiation of the 1987 Meech Lake Accord by Prime Minister Brian Mulroney and the premiers;
- the failure of Meech in 1990, which led to the departure of Lucien Bouchard from the Mulroney cabinet;
- Bouchard's formation of the Bloc Québécois, which became Her Majesty's Loyal Opposition after the 1993 election;
- the launch in 1990 of Quebec's Bélanger-Campeau Commission on the Political and Constitutional Future of Quebec;[5]

[4] It has become commonplace to refer to Quebec as having opted out of the CPP in order to create the QPP. Likewise, we typically say that Quebec has opted out of the combined federal-provincial personal income tax. However, this is wrong: if a province operates a program that falls within its constitutional jurisdiction, it cannot be said to be opting out. Rather, what has happened is that the rest of Canada has decided to "opt in" to the federal program, very much in line with section 94 of the Constitution. Much political harm has been done by perennially referring to Quebec as opting out when the opposite is really the case.

[5] On a personal note, I appeared before the Bélanger-Campeau Commission, where I asserted, and still believe, that for Quebecers, Quebec will always be their nation and Canada will always be their state, whereas for the rest of us, Canada is generally viewed as the locus of both nation and state (Courchene 1991).

- the rise and fall of the Charlottetown Accord in 1992; and
- the razor's-edge defeat of the 1995 sovereignty referendum (rejected by a margin of 50.6 percent to 49.4 percent).

After the second referendum, the rest of Canada became more receptive to Quebec's desire for recognition of its special status in the federation. Leading the way here was the 1996 Calgary Declaration of the premiers (other than Quebec's), especially its article 5:

> In Canada's federal system, where respect for diversity and equality underlies unity, the unique character of Quebec society, including its French speaking majority, its culture and its tradition of civil law, is fundamental to the well being of Canada. Consequently, the legislature and Government of Quebec have a role to protect and develop the unique character of Quebec society within Canada.

For its part, Quebec also became more receptive to the rest of Canada, the best example being Quebec's joining the Annual Premiers' Conference and in the process converting it into the Council of the Federation in 2003. Ottawa under Prime Minister Paul Martin also joined in by granting special recognition of Quebec's specificity in the context of the 2004 Health Accord. The title of the appendix says it all: "Asymmetric Federalism That Respects Quebec's Jurisdiction." Prime Minister Stephen Harper went the remaining distance of effectively recognizing the Quebec National Assembly as the repository of Quebec nationhood, first through his commitment to "open federalism" (i.e., respect for the 1867 division of powers) and second, and much more importantly, by the formal recognition arising from the unanimous 2006 House of Commons proclamation that "the Québécois form a nation within a united Canada."

From my perspective, what is encouraging and appropriate is that the rest of Canada is accommodating Quebec in ways that are allowing Quebecers to create their own nation within the framework of the Canadian state.

Signpost 5: Patriation and the Charter: Empowering Citizens and First Peoples

The *Constitution Act, 1982* dramatically altered many features of the Canadian legal and political landscape. The key innovation was the Canadian Charter of Rights and Freedoms, which confirms or establishes fundamental societal freedoms and a host of citizen rights (democratic, equality, mobility, legal); recognizes existing Aboriginal rights, including rights for Métis peoples; enshrines principles relating to fiscal equalization; and promotes equality of well-being and opportunity for all Canadians. Arguably, since the Charter necessarily enhances the role of the courts as a player in Canadian governance, it can also be interpreted as a move in the checks-and-balances direction of the American system.

However, the more common view of the Charter was that envisioned by Alan Cairns (writing soon after the proposed text was introduced by the Trudeau government):

> At a more profound political level...[the Charter] was an attempt to enhance and extend the meaning of being Canadian and thus to strengthen identification with the national community... The resultant rights and freedoms were to be country-wide in scope, enforced by a national supreme court, and entrenched in a national constitution beyond the reach of fleeting legislative majorities at either level of government. The consequence, and one very clear purpose, was to set limits to the diversities of treatment of Canadian citizens by provincial governments, and thus to strengthen Canadian as against provincial identities. (1979, 354)

The role of the Charter in recognizing existing Aboriginal treaty rights merits further comment. Treaty rights as defined in section 25 of the Charter include "rights and freedoms that now exist by way of land claims agreements or may be so acquired." Although the historic James Bay and Northern Quebec Agreement (1975) preceded the Charter, there has been a dramatic increase in modern treaties since the Charter. For example, focusing only on the northern territories, the creation of Nunavut and the roughly 20 other modern treaties, including the 12 (soon to be 14) Yukon First Nations treaties as well as Inuit land claims agreements (such as the 2008 Nunavik Inuit agreement), are impressive achievements.

Nonetheless, and in spite of the Charter, Canada's approach to our First Peoples falls short in at least two areas. First, Canada seems not to be appropriately concerned whether the monies provided to individual bands end up providing public services to their members that are comparable to those given to citizens living elsewhere in Canada in similar circumstances. This is in part an accountability issue and in part an underfunding issue. The result is that Aboriginal citizens do not have the same rights and opportunities as other Canadian citizens. Second, when Aboriginal citizens live in cities (as roughly half do), they are often in limbo with respect to their rights. Section 91(24) of the Constitution states that Ottawa is responsible for "Indians, and Lands reserved for the Indians," but too often Ottawa interprets this as "Indians *on* Lands reserved for Indians." If the federal government were made responsible for the well-being of First Peoples no matter where they live, this could lead Ottawa to insist on meaningful accountability provisions to ensure not only that the reserves themselves are providing appropriate public services but also that Aboriginal people leaving reserves to join urban labour markets would get the same attention and services that Canada provides to immigrants, for example. The larger issue here is that Aboriginal Canadians are going to account for an increasing proportion of our labour force, so that it is in everyone's interests that they can meet this challenge. The point can be made differently: Canada must work toward ensuring that bestowing *collective* rights on Aboriginal peoples does not deny to them as *individuals* their rights and opportunities as Canadian citizens.

No discussion of Aboriginal rights should overlook the historic wrong that Canada visited on Aboriginal peoples by using residential schools to forcefully assimilate (i.e., erase the identity of) First Peoples. While all Canadians can and should applaud Canada's 2008 apology and the creation of the Truth and Reconciliation Commission of Canada, we have yet to come to grips with the pervasive social and economic disparities and discrimination that are still experienced by Canada's First Peoples.

Signpost 6: Immigration and Multiculturalism

Prime Minister Sir John A. Macdonald's 1879 National Policy was designed to create a Canada from sea to sea. The policy had three interrelated thrusts: protective tariffs, immigration and the settlement of the West, and railroad construction. Initially, the immigration component concentrated on bringing to Canada potential farmers from Britain, the US and northern Europe; later Canada sought immigrants from eastern and central Europe. During the Depression and the war years, immigration slowed markedly, except for family reunification. After the Second World War the declared purpose of immigration was to increase the country's population, but without changing the basic character of Canadian society.

However, in 1962 Canada abandoned this essentially all-white immigration policy. In 1967 we inaugurated the point system, which has shifted immigration selection policy toward economic qualifications, largely irrespective of colour, race and country of origin. European countries supplied 85 percent of immigrants in the 1950s; this proportion fell to just under 30 percent in the 1980s and further to 15 percent over the next 20 years. In 2005 roughly 53 percent of immigrants to Canada were from Asia and the Pacific Region, with the four largest source countries being, in order, China, India, the Philippines and Pakistan.

Quebec, after the Conquest in 1763, had to rely on high birth rates for its population growth — *la revanche du berceau* (the revenge of the cradle), as it has been dubbed — but the province made a sudden and dramatic transition to having the lowest Canadian birth rate after the Quiet Revolution of the 1960s, with the result that immigration became a priority. When the "three wise men" — Pierre Trudeau, Jean Marchand and Gérard Pelletier — were elected to Parliament in 1965 as part of the Liberal team, the most prominent among them at that time (Marchand) became the Minister of Citizenship and Immigration. Although immigration is one of only three concurrent powers in the Constitution (albeit with federal paramountcy), it was not until 1978, with the Cullen-Couture Agreement, that Quebec enacted its own point system and not until 1991 that it obtained control over immigration levels, the selection of immigrants and their integration, under the Canada-Quebec Accord.

Not surprisingly, the other provinces wanted these powers as well. The federal government's compromise was to create the Provincial Nominee Program, which exists in most provinces and brought 30,000 immigrants to Canada in 2009.[6] Concern still exists that immigration settlement funds are not allocated across provinces in an equitable manner; of even more concern is that recent immigrants are not performing as well in the labour markets as earlier cohorts. However, even here there is a good-news story:

[6] All the provinces except Ontario have an agreement with Ottawa that allows them to nominate immigrants who wish to settle in their province. The criteria for this program can vary across provinces. After being accepted under this program, potential immigrants still need to make a separate application to Citizenship and Immigration Canada, although the application is typically fast-tracked.

> Second-generation Canadians are more educated than those whose parents were born in Canada. They have made these gains not just because their immigrant parents are more highly educated and are able to pass on this advantage — something that highly educated Canadian parents are also able to do — but also because, even when their parents are less educated, they are more likely to move up the schooling ladder. These patterns do not seem to be associated with how much money immigrant parents earn, and they characterize the Canadian experience for those who went through the education system during the 1980s and 1990s, as well as for those who went through during the 1950s, 1960s and 1970s. (Corak 2008, 16)

Corak then provides evidence that "Canadian labour markets are flexible and merit based" so that immigrants will presumably be able to reap the benefits of their education.

The changing sources and faces of Canada's immigration on the one hand and the formal existence of policies related to bilingualism and biculturalism on the other have led to the promotion of multiculturalism. Indeed, in 1971 the federal government built on the 1969 report of the Royal Commission on Bilingualism and Biculturalism by developing a multicultural policy that incorporated programs to assist cultural groups, to promote interchange among cultural groups and to facilitate immigrants' integration by assisting them in learning at least one of the official languages. Pursuant to section 27 of the Canadian Charter of Rights and Freedoms — "This Charter shall be interpreted in a manner consistent with the preservation and enhancement of the multicultural heritage of Canadians" — Canada enacted the 1988 *Canadian Multiculturalism Act*.

One of the reasons why Canada has been successful with multiculturalism is that we have always integrated working-age immigrants into society via the labour force and rewarded them according to their individual skills. This comes rather naturally to common-law or individualist-capitalist countries like Canada, Australia and the US. By contrast, civil-law or communitarian-capitalist societies appear to have considerable problems with immigration, in part because inherent in civil law is the notion of a "people" or a community. Some civil-law nations are opposed to immigration (Japan), some tend to invite immigrants into their societies primarily as "guest workers" (Switzerland), and some accept them but then are unable or unwilling to integrate them geographically or societally (Germany, France and northern Europe). In October 2010, German chancellor Angela Merkel declared that German multiculturalism (*Multikulti*) was a failure.

Indeed, within Canada, civil-law Quebec also harbours considerable anxiety about immigration, and its policy of "interculturalism" emphasizes social integration, whereas the multiculturalism model in the rest of Canada emphasizes the promotion of diversity. However, it is much easier for the English-speaking common-law countries to integrate their immigrants socially and economically than it is for civil-law countries to do so, because English, the global language, is dominant in virtually all common-law countries and in almost none of the civil-law countries. So for persons emigrating to continental Europe, for example, the incentives for learning the local language (say, Dutch or Norwegian) are weaker than they would be for emigrants to the UK, where learning English opens many more doors.

Looking ahead to the 2020s, since all net growth in the Canadian labour force will have to come from immigration (even accounting for growth in the Aboriginal labour force), it is critical that we continue to strive to accommodate our diverse communities and develop a shared citizenship. But because Canada cannot rely on the various traditional approaches to social integration such as a common national culture, a common language and a common history, the path to developing a shared citizenship lies elsewhere. As Keith Banting, Leslie Seidle and I wrote in our conclusion to the IRPP volume *Belonging? Diversity, Recognition and Shared Citizenship in Canada*:

> Symbols of nationhood...cannot be the only glue holding the country together. In a bilingual multinational federal state, there are definite limits to our capacity to engage in nation-building enterprises. Hence our stress on three equalities [human rights and the justice system, socioeconomic equality, and political and civic participation] as the bedrock of shared citizenship. We build respect by respecting difference; we build tolerance by resisting discrimination; we build trust by being trustworthy; we build belonging by drawing people into the mainstream of civic and political life; we build solidarity by supporting all Canadians in need. Building shared citizenship is an ongoing task, especially in a diverse society, but there is good reason to hope that these fundamentals will sustain this distinctive Canadian project in the future. (682)[7]

Signpost 7: The Transformation of Canadian Economic Space: The FTA and NAFTA

In 1989, the year that the Canada-US Free Trade Agreement (FTA) came into effect, all provinces except Ontario and Newfoundland exported more to their sister provinces than they did to the US. And in the aggregate, interprovincial exports accounted for 22.5 percent of GDP, compared with 18.6 percent for exports to the US. By 2001, seven years after the North American Free Trade Agreement (NAFTA) came into effect, all provinces except Manitoba were exporting more to the US than to the rest of Canada. Interprovincial exports as a percentage of GDP had fallen to 19.7 percent, and exports to the US had more than doubled, to 37.6 percent.

These shifts represented a stunning transformation of Canada's economic space. Canada had progressively become less and less a single national economy and more and more an east-west series of north-south cross-border economies. Among the principal beneficiaries were the Maritime provinces, which returned to pursuing their traditional trade with New England that Sir John A.'s National Policy so abruptly disrupted. The new challenge in the immediate aftermath of the FTA was to ensure that pursuing east-west equity in our social

[7] Underpinning the first equality (human rights and the justice system) is section 15, the equality provision of the Charter of Rights and Freedoms. Section 15(1) reads: "Every individual is equal before and under the law and has the right to the equal protection and equal benefit of the law without discrimination and, in particular, without discrimination based on race, national or ethnic origin, colour, sex, age or mental or physical disability." And on this score, we need to heed the warning of Pearl Eliadis: "When multiculturalism is unhinged from equality, it tends to careen off in unpleasant and increasingly unacceptable directions, as it did in 2005 when Ontario nearly approved religious arbitration in family matters" (2007, 551).

union was compatible with the pursuit of north-south economic competitiveness. Among the many implications of the free trade agreements was their impact on our attitudes about foreign direct investment. Before the agreements, some US companies utilized foreign direct investment to leapfrog over high Canadian tariff walls and establish Canadian subsidiaries to sell only in the Canadian market. One result was that US foreign ownership became a political issue in some Canadian quarters. After the FTA and NAFTA, the very opposite has been true: we encouraged inward foreign investment and welcomed global companies locating in Canada in order to sell into NAFTA economic space.

The new economic geography was, by most indicators, a very comfortable niche for Canada, especially as long as the US remained the pre-eminent economic power. But today, as will be elaborated later, American manufacturing is being hollowed out and Canada's current challenge is to diversify this north-south trade in the direction of the emerging economies.

* * *

The seven signposts outlined so far are largely part of our public policy history, even though they continue to influence it. In the remainder of this paper, by contrast, the signposts are more forward looking, in that Canada will have to be fully engaged from now on with the challenges and opportunities that they present. Just as the first signpost detailed the economic and institutional framework for the era of American hegemony, the next signpost sets the framework for the new global era, the informatics era. Its origins were in the Reagan-Thatcher era, but its full implications have become fully apparent only since the turn of the millennium.

Signpost 8: The Informatics Era and Unfettered Capitalist Globalization

The major underpinnings of the informatics era are a transformative technology, as well as a transformative ideology. In terms of the former, the new general-purpose technology is built upon successive revolutions in microelectronics, software, computation, telecommunications and digital communication (Castells 2004), which have dramatically enhanced our capacity for, and access to, information processing and communications. At the heart of this technological revolution is the Internet, which is the basis for the network, the ubiquitous organizational form of the informatics era. Networks are located not in the "space of places" but in the "space of flows" (Castells 2004), so almost by definition they are unconstrained by national boundaries. It is this characteristic of networks that defines the information-era global economy, namely "an economy with the capacity to work as a unit in real time on a planetary scale" (Castells 1996, 92). In particular, networks are the key integrating instruments powering the rapid emergence of global supply chains or global value chains; indeed, global supply chains are networks.

Beyond all this there is the "social networking" phenomenon, which allows instantaneous global citizen communication — McLuhan's global village, as it were.[8] Former NBC News president Lawrence Grossman aptly captured this new reality: "Printing made us all readers. Xeroxing made us all publishers. Television made us all viewers. Digitization makes us all broadcasters" (cited in Friedman 1999, 45).

On the transformative ideology front, the reality was that the existing Keynesian model of capitalism was unable to harness the potential of the informatics era, so Keynesianism needed to be replaced. Enter US President Ronald Reagan and British Prime Minister Margaret Thatcher in the 1980s, with their mission to "recapitalize capitalism." They ushered in liberal economic policies that involved crushing organized labour and cutting taxes for the rich and corporations (the top US personal income tax rate fell from 70 percent to 28 percent under Reagan); that preached the wisdom of the Washington Consensus (liberalization, deregulation, privatization and free markets); and that in the process reversed the Keynesian policies that had held sway for a quarter century. As Castells noted: "A new orthodoxy was established throughout the world...unfettered capitalist globalization, spearheaded by the liberalization of financial markets...Under the new conditions, global capitalism recovered its dynamism, and increased profits, investment and economic growth" (2004, 16).

In contrast to the compromise of embedded liberalism, which allowed domestic socio-economic integration to proceed apace with increased international economic integration, under unfettered capitalist globalization the further dramatic increase in international economic integration may lead to domestic social disintegration and inequality, and nowhere more so than in the United States, as I have detailed in *Rekindling the American Dream* (Courchene 2011).

The informatics era has had an impact on income distribution more generally. In particular, a key dimension of the shift from an industrial to an informatics paradigm is that the informatics era privileges knowledge and human capital relative to physical and financial capital; or, as I wrote in 2001, it privileges mortarboards relative to boards and mortar. More generally, human capital is to the informatics revolution what physical capital was to the industrial revolution. Eventually, the increase in the returns to human capital will reconstitute the middle class along the skills and education spectrum. Lester Thurow offers the following truism with respect to the operations of unfettered capitalist globalization: "If capital is borrowable, raw materials are buyable and technology is copyable, what are you left with if you want to run a high-wage economy? Only skills; there isn't anything else." (1993, 5).

I made a similar argument in my 2001 book (*A State of Minds: Toward a Human Capital Future for Canadians*), in which I went so far as to offer a "mission statement" for twenty-first-century Canada: "Design a sustainable, socially inclusive and internationally

[8] The role of social media, especially in relation to the ongoing "Arab spring," would probably merit a signpost of its own were the focus on international public policy rather than Canadian public policy.

competitive infrastructure that ensures equal opportunity for all Canadians to develop, to enhance and to employ in Canada their skill and human capital, thereby enabling them to become full citizens in the information-era Canadian and global societies" (154).

The shorter-term impact of the informatics era engendered by the Reagan-Thatcher revolutions was to propel the US to its greatest political and economic achievements. Reagan's 1980s policies led to the longest US postwar boom, culminating with the fall of the Soviet bloc and the end of the Cold War. Bill Clinton's high-tech boom in the 1990s allowed the US to register the highest one-decade growth ever. But as the world welcomed the new millennium, we could not have imagined that the informatics era's next phase would be a spectacular global restructuring: the rise of China and the decline of the US.

Signpost 9: The Transformation of Global Economic Space

The rise of China as the global workshop

As an unfathomable 1.5 billion new workers entered the world economy with the rise of China, India and other emerging nations, the global labour market experienced a decline in wages that caught the West entirely by surprise. The new reality is that the BRIC nations (Brazil, Russia, India, China) have 45 percent of the world's labour supply, compared with 19 percent for the OECD members.

In the presence of global supply chains and unfettered capitalism, China found a most creative and effective way to leverage its wage advantage to emerge as the world's twenty-first-century workshop. Specifically, China realized that it lacked internal capital markets that could efficiently allocate domestic and foreign investments toward their most productive uses. Accordingly, in an economically brilliant and unprecedented initiative, China invited global capital markets and global enterprises to do this internal allocation for it.

Moreover, China also removed tariffs on imports destined as inputs to production, especially production for export. In other words, China's production was, at the outset, undertaken by international enterprises and driven by global prices and by international comparative advantage, all working in tandem with the inexpensive and seemingly inexhaustible Chinese labour force. The corresponding requirements imposed on these foreign enterprises were to link up with Chinese partners and share technology and industrial secrets with them. However, from the perspective of the foreign enterprises, the advantage of increased competitiveness in exporting to the rest of the world from China, and of gaining access to the world's fastest-growing domestic market, obviously outweighed the cost of these requirements.[9]

In order to provide these foreign enterprises with economic security and continued open access to foreign markets and, on the domestic Chinese side, to maintain international

[9] More recently corporations have become increasingly concerned about the required sharing of technology, industrial design and innovation with their Chinese partners.

competitiveness in pursuit of employing its hundreds of millions of potential workers, China pegged its yuan to the US dollar (at an undervalued rate) and began to accumulate enormous amounts of US-dollar foreign exchange. As a result, by 2008 the world's most populous country, with a per capita GDP of only US$3,500 (compared with $46,000 for the US, although the gap is closing quickly), became the world's largest exporter and second-largest economy. Now it has three of the four largest banks in the world and three of the five largest companies by market size.

China is only the most dramatic exemplar of what has come to be called "state capitalism," an organizational construct that integrates the powers of the state with the powers of capitalism. In contrast to Fukuyama's "end of history" prophecy, the *Economist* argues that the defining battle of the twenty-first century will be not between capitalism and socialism but between different versions of capitalism:

> State capitalism is on the march, overflowing with cash and emboldened by the crisis in the West. State companies make up 80% of the value of the stockmarket in China, 62% in Russia and 38% in Brazil. They accounted for one-third of the emerging world's foreign direct investment between 2003 and 2010 and an even higher proportion of its most spectacular acquisitions, as well as a growing proportion of the very largest firms. (2012, 4)

The *Economist* concludes: "The invisible hand of the market is giving way to the visible, and often authoritarian, hand of state capitalism" (5).

The decline of the American empire

In sharp contrast to its "commanding-heights" status as elaborated in signpost 1, America's role as the global superpower now seems eminently contestable. Indeed, in many circles the notion of American declinism — the unwinding of the American Dream — is making headway.[10] The symptoms are everywhere apparent: the US is dangerously overextended in its fiscal and trade deficits; unfettered capitalism with an individualist rather than a communitarian ethic has led to the massive offshoring of US manufacturing and has contributed in turn to the US becoming the most unequal society of the rich countries' club; and the lax financial regulatory environment is to blame for the mortgage debacle, the financial crisis and, ultimately, the still ongoing Great Recession.

American labour is more susceptible to outsourcing and offshoring than is continental European labour, in part because American middle-class workers are less skilled than, say, the German technologist middle class and in part because labour and its unions are typically on the boards of directors of European-based firms but not on US boards. This different attitude toward offshoring may result from the very different legal or constitutional frameworks that underpin their respective capitalist systems: Anglo-American, common-law capitalism tends almost by definition to be much more individualist in nature than the

[10] The points that follow are developed in more detail in Courchene (2011).

civil-law communitarian capitalism of continental Europe (Courchene 2011). This is clearly evident in the differing constitutional rhetorics: the individualist American rhetoric ("Life, liberty and the pursuit of happiness") versus, say, the communitarian French constitutional rhetoric ("Liberté, égalité, fraternité").

On the international front, US imports from China have risen from almost no trade in 1985 to $350 billion in 2010, while US exports to China were still less than $100 billion (figure 1). Essentially, this dramatic increase in imports from China results from the hollowing out of US manufacturing, the transfer of work and production to China and then the importation of the finished products back into the US. Walmart is the clear leader here. In 2004, more than 80 percent of its six thousand suppliers were located in China, accounting for 70 percent of the products sold at Walmart. Indeed, Walmart was China's fifth-largest "export market," ahead of Germany and Britain, and it accounted for 11 percent of US imports from China (AFL-CIO 2011).

Perhaps the most problematic aspect of all in the US-China "clash of the titans" is the potential for "uncoupling": the US is becoming more beholden to China, which finances America's fiscal profligacy, at the same time that China is becoming less dependent on the US market for its own economic well-being.

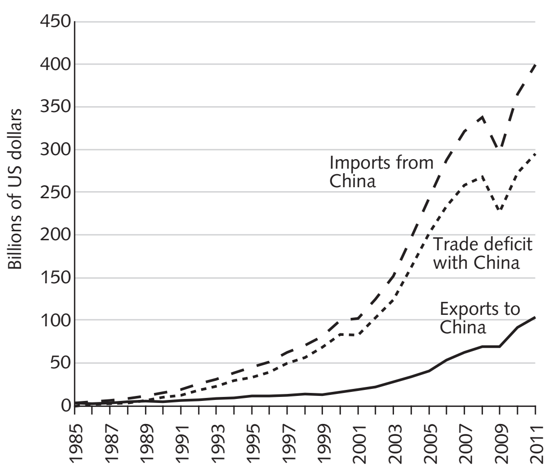
All in all, Nicolai Ouroussoff's 2005 observation rings even more true today: "America is an empire enthralled with its own power and unaware that it is fading."

Further complicating the US predicament is the nature of its political system. On this issue, the *Economist* (2010, 11) faults the US political system for being paralyzed, ungovernable, dysfunctional, too subject to filibuster, too subject as well to gerrymandering, and of course for being too influenced by moneyed interests/lobbyists, especially in the aftermath of the 2010 US Supreme Court decision (*Citizens United v. Federal Election Commission*), which threw open the corporate money doors in terms of electoral financing. In terms of the financing issue, some perceptive wag noted that the US has the best government that money can buy!

Nonetheless, it would be foolhardy to underestimate the ability of the US to rekindle its erstwhile supremacy, especially since America still remains the most dynamic and innovative global economy. As to how the US might right its socio-economic ship, I

FIGURE 1

US trade with China, 1985-2011



Source: US Bureau of the Census, foreign trade statistics.

accept Tom Friedman's perception of the problem, and therefore of the solution: "[America let its] five basic pillars of growth erode since the end of the cold war — education, infrastructure, immigration of high-I.Q. innovators and entrepreneurs, rules to incentivize risk-taking and start-ups, and government-funded research to spur science and technology" (2011, 14).

This transformation of global economic realities has been a mixed blessing for Canada. Obviously the rise of the populous BRIC nations and those on the Pacific rim have led to increased demand for Canada's natural resources. On the other hand, the decline of the US has left Canadian manufacturers wishing that they had not directed so much of their trade south of the border. The manner in which the new global economic order has reshuffled our domestic economic prospects (and indeed continues to do so) will be discussed in a later signpost.

Signpost 10: The Maple Leaf Miracles: Achieving Monetary, Fiscal and Financial Stability

Canada has earned the reputation of a macro manager par excellence in OECD circles for its performance in inflation control, fiscal prudence and financial integrity over more than 20 years and is arguably the best positioned among the industrialized nations (perhaps along with Australia) in terms of navigating the troubled economic and financial waters. The ability to isolate ourselves from the fiscal and financial turmoil that has enveloped the US and Europe is a remarkable achievement that results from creativity, innovation and prudential oversight.

The Bank of Canada and inflation targeting[11]

The Bank of Canada has clearly punched above its weight recently in terms of its reputation and influence in international banking circles.[12] However, Canada's leadership on monetary and financial matters is not new. One example is our experimentation with a floating exchange rate, temporarily in the 1950s and permanently from 1970 onward; its success arguably facilitated or at least informed the 1973 decision by the US and the global financial community to abandon the Bretton Woods system of fixed exchange rates and to embrace a floating exchange rate regime.

The move to flexible rates is a convenient starting point for focusing on the key role of the Bank in our recent macroeconomic successes. Once we ceased to peg the Canadian dollar to the US dollar the Bank needed to find an alternative anchor to serve as the centrepiece of the monetary policy framework. The initial choice was monetary targeting: controlling the rate of growth of a monetary indicator (specifically M1, the narrow definition of the money supply) in order to control, in turn, the growth of nominal

[11] This section draws from Charles Freedman's "Reflections on Three Decades at the Bank of Canada" (2004).
[12] For example, in November 2011 Bank of Canada Governor Mark Carney was appointed head of the Financial Stability Board, the international watchdog overseeing financial institution reform and global system stability.

GDP and inflation. While this was a major improvement on the earlier nebulous "credit conditions" approach to monetary policy, it nonetheless fell short of the mark, because the link between money growth and inflation turned out to be insufficiently stable to serve as the anchor of monetary policy.

Something different was needed. For a short period, the Bank targeted nominal income. Then Governor John Crow, in the 1988 Eric Hanson Memorial Lecture at the University of Alberta, advanced "price stability" as the appropriate long-term goal of monetary policy. With the 1991 agreement between the Bank and the government (the Department of Finance), Canada formally embraced "inflation targeting," with the target set at 2 percent within a band of 1 percent to 3 percent, a target range that persists to this day. The shared acceptance of the inflation target was critically important, since the Bank and Finance had earlier been adopting (implicitly, if not explicitly) different inflation targets. Inflation targeting is forward looking, aiming to influence medium-term trends rather than to correct month-to-month variations. Thus, if inflation appears to be headed for a rate outside the target range for a sustained period, the Bank will take action (normally by changing short-term interest rates) in order to bring it back into the range within 18 to 24 months.

The results of inflation targeting were dramatic. Running well above US inflation rates in 1991, Canadian rates fell below US rates in short order, and so did interest rates, thereby making a most important contribution — in economic stimulus as well as debt servicing costs — to Canada's successful deficit-taming exercise. Beyond this, monetary policy became predictable and transparent, and it certainly provided a stable monetary framework for Canada's private sector. Although New Zealand adopted inflation targeting a year before Canada did, the Bank of Canada has continued to innovate with respect to inflation targeting in ways that have benefited Canada as well as other countries.[13]

Taming the federal deficit: Canada as the fiscal virtuoso of the G7

After 17 consecutive budget deficits (peaking at $42 billion in 1993/94), Canada under Finance Minister Paul Martin achieved a federal budget surplus in fiscal year 1997/98, the first of a dozen or so consecutive surpluses. In the context of continuing deficits in the other G7 countries, the *Economist* labelled Canada the "fiscal virtuoso of the G7" and *Business Week* referred to Canada's fiscal performance as the "Maple Leaf Miracle." Simon Fraser University's Rick Harris has noted in several fora that a budget surplus has been referred to in G7 circles as a "Canadian fiscal value," presumably since the other six countries had no interest in running surpluses or no ability to do so.

[13] In the interest of full disclosure, I have been a frequent critic of Canadian monetary policy, admittedly with virtually no support from the policy community. Nonetheless, I salute the Bank's performance in implementing inflation targeting. My concern is that this policy pays insufficient attention to exchange-rate volatility.

A great many factors and forces facilitated the achievement of budget balance.[14] These were among the background and external factors in the mid-1990s that worked in Martin's favour:

- the Bank of Canada's policy shift toward price stability, leading to lower inflation and interest rates (and a fall of debt servicing charges);
- the appreciation of the US dollar, which enhanced Canadian competitiveness;
- the spilling over into Canada of the US high-tech boom;
- Moody's putting Canada on a credit watch, which helped Martin to bring his Liberal colleagues on side; and
- the fact that Martin had a free hand politically, since Preston Manning, leader of the opposition (at first de facto and later officially), would criticize any and all of Martin's policies for not moving faster and further toward fiscal balance.

To this litany one must add the important earlier initiatives of the Mulroney government that dramatically enhanced Canada's competitiveness and allowed us to reap the full benefits of the 1990s high-tech boom. These included the Canada-US FTA (and later NAFTA), the introduction of the export-import-neutral GST and the privatization of 23 Crown corporations including Air Canada, Petro-Canada and CN.

The cornerstone of Martin's 1995 budget was a series of deficit targets that would be achieved "come hell or high water." Within this framework, Martin rejigged the federal-provincial transfers to create the omnibus Canada Health and Social Transfer (CHST), then proceeded to pare it down by one-third (a cut of about $6 billion, although in later years Martin as prime minister largely reconstituted the CHST's original value). He also confiscated the annual surpluses of $5 billion to $6 billion in the Employment Insurance fund over these years. As a result of all these measures, Martin was able to achieve budget balance a year earlier than he had first announced. Overall, Canada's federal debt-to-GDP ratio fell from 68 percent in 1995/96 to under 40 percent in 2004/05. Martin also shored up Canada's contributory public pension plans by increasing CPP/QPP premiums as part of a pre-funding strategy. As a result the CPP is deemed to be actuarially sound over a 75-year horizon, another way in which Canada has dramatically outperformed its G7 partners.

Just as spectacular from an international perspective were the forecast cumulative surpluses of $330 billion over 1997/98 to 2004/05. Of this fiscal dividend, $50 billion went to pay down the debt, and $130 billion went toward personal and corporate tax cuts,[15] the Canada Child Tax Benefit, the health care accord of 2004, and increased spending on Equalization and a range of "new economy" areas such as infrastructure, daycare, scholarships, research and information technology.

[14] For a more detailed analysis, see Courchene (2002).

[15] Federal corporate tax rates fell from 28 percent to 21 percent in the Martin era and further to 15 percent in 2012 under Finance Minister James Flaherty. The Harper government also reduced the GST by 2 percentage points, as promised in the 2006 election platform.

Nonetheless, Canada could not avoid being sideswiped economically and fiscally by the 2008 US financial and fiscal collapse, and the deficit soared to a record $56 billion in 2009/10. Under Finance Minister James Flaherty, Canada is again leading the way among G7 countries, first with the large stimulus in the 2009 and 2010 budgets and more recently with the credible forecasts for a return to fiscal balance by fiscal year 2015/16 at the latest (well before any other G7 nation).

Avoiding financial collapse: Three cheers for Canada's regulators

Although Canada's fiscal position was significantly shaken by the recent global economic recession, Canada's financial sector, unlike that of Europe, largely escaped the contagion spread by the US debacle, except for the temporary financial turmoil associated with asset-based commercial paper (ABCP). The factors that allowed Canada to avoid the financial contagion are important to highlight, especially since contagion continues to plague many of our trading partners.

This fascinating financial saga began in the mid-1980s. Unlike our banks and insurance companies, which could go head-to-head with the best in the world at that time, our securities industry was woefully undercapitalized, thanks to very tight ownership restrictions. For example, US-based Salomon Brothers had more capital in the mid-1980s than the entire Canadian securities industry. In hopes of attracting some of the Toronto-based securities industry to Montreal, Quebec suddenly announced that it would abandon all ownership restrictions for securities firms based in Quebec. The next surprise came when one of the chartered banks expressed interest in establishing a securities company in Quebec. Ontario, which was the centre of Canada's securities industry, reacted immediately by also throwing wide open the ownership of securities firms domiciled in the province, and even permitting foreign ownership.

At this point Ottawa became very concerned, since it had intended to use wider ownership of the securities industry as an important bargaining chip in the ongoing free trade negotiations with the US. However, with the cat now out of the bag as it were, Ottawa requested that Ontario limit ownership to Canadians for a year before allowing foreign owners. Ontario agreed, and the rest is history: Canada's chartered banks had a field day. Bank of Nova Scotia acquired Scotia McLeod, RBC bought Dominion Securities, CIBC purchased Wood Gundy, BMO snapped up Nesbitt Burns and Banque Nationale took over Lévesque Beaubien. TD Bank established its own securities firm, which eventually morphed into TD Waterhouse. In other words, the banks took over the Canadian securities industry. Although these securities subsidiaries remain provincially regulated, they are owned by national enterprises so that they provide comparable services to Canadians no matter where they reside.

Also in the mid-1980s, Canada was coping with the failure of the Canadian Commercial Bank and the Northland Bank, our first bank failures since Home Bank in 1923. Drawing on the recommendations of the inquiry into these failures conducted by former Supreme Court justice Willard Z. Estey, Ottawa created the Office of the Superintendent of Financial Institutions (OSFI) in 1987 to ensure a coordinated approach to financial supervision and a modern regulatory framework for Canada's financial system. OSFI integrated the former Department of Insurance and the Office of the Inspector General of Banks, taking on the supervision and regulation of all federally chartered financial institutions. While regulation of the securities industry continues to rest with the provinces, the fact that the securities firms are subsidiaries of the banks allows OSFI to "see through" the connection to ensure that the behaviour of the securities firms does not endanger the financial integrity of the banks. The result is not only that our banks (including the securities industry subsidiaries) are required to have higher capital-asset ratios than US banks but, more importantly, that our securities firms are kept within a chartered bank culture, in contrast to the looser regulation of the US system. Indeed, Citibank abandoned its bank charter to become Citigroup in order to move its securities activities out from under banking regulation; the same transformation moved some of its activities into the largely unregulated hedge funds industry. Citigroup's massive mortgage losses necessitated a federal government bailout.

While the Canadian banks did suffer losses as a result of the ABCP fiasco, the relevant message is that our financial securities industry escaped the financial carnage that befell the US and other nations.

Overall, our combined financial system (fiscal, banking and securities) is easily among the most healthy in the world. Plaudits all around to our macroeconomic and financial policy managers!

Signpost 11: Natural Resources and the Restructuring of the Canadian Economy and Federation

By the time Alberta and Saskatchewan entered Confederation (1905), the convention of subsurface mineral rights being acquired along with the purchase of land had ended. In contrast to the practice in Ontario and Texas, for example, where royalties associated with the extraction of fossil fuels typically reside with private interests, in Saskatchewan and Alberta (and on provincial lands more generally) they accrue to the respective provincial Crowns.[16] Moreover, because of section 125 of the *Constitution Act, 1867* (which establishes that the federal Crown cannot tax the provincial Crown and vice versa) provincial royalties are off limits to the federal tax collector. This being the case, the discovery of oil near Leduc, Alberta, in 1947 effectively set the stage not only for a dramatic transformation of the Canadian economy and the rise of the West as an economic powerhouse but also for a

[16] By virtue of federal-provincial agreements reached in the 1980s with Nova Scotia and Newfoundland and Labrador, this is also the case for offshore energy revenues.

potentially equally dramatic geopolitical transformation of the Canadian federation, fiscally and politically.

That energy could play these transformative roles became apparent early on when crude oil prices doubled in 1973-74 because of the Yom Kippur War. Ottawa's reaction in the first instance was to keep the domestic price well below the world price. This resulted in a massive transfer of energy rents from the producing provinces to Canadian consumers. In addition, Ottawa levied a tax on exported oil equal to the difference between the domestic price and the world price, the proceeds of which went to subsidize the cost of energy to easterners, who relied on energy imports. In spite of these revenue grabs by Ottawa, the resulting royalty increases in the energy provinces were still such that Ontario qualified for Equalization from 1977 to 1982.[17] This turnabout led to the scrapping of the national-average (or ten-province) standard for Equalization, to be replaced by the five-province standard. The new formula ensured that Ontario would not qualify for Equalization by excluding energy-rich Alberta from the new standard.

The more than doubling of energy prices in 1979-80 triggered by the impending Iran-Iraq War rendered Canada's energy policies obsolete; Canada was so out of step that our energy price was only 40 percent of the world price. Ottawa's response was the 1980 National Energy Program (NEP), which included additional taxes on natural gas and on petroleum revenues, incentives to shift exploration from provincial lands to federal lands and two "nationalization" provisions: one gave Ottawa the right to a 25 percent interest in all petroleum developments on federal lands, and the other was the Canadian Ownership Charge, designed to increase public ownership of the energy sector. The NEP was seen as an unprecedented frontal attack on the energy patch and became permanently etched in the psyche of Alberta and Albertans.

It is likely that Ottawa's motivation for inserting section 92A into the *Constitution Act, 1982* was in part to make amends for the damage wrought by the NEP and in part to bring the energy patch on side in terms of the patriation of the Constitution. Section 92A enhances and extends the provinces' right to legislate exclusively in relation to the exploration, development and management of nonrenewable natural resources and forestry and the generation of electrical energy. Moreover, the provision grants the provinces the right to raise money by any mode or system of taxation in relation to these resource areas. To my knowledge no other federation has anywhere near such a powerful provincial-rights provision. In turn, no other federation is likely to be affected as much by resource-related changes of fortune.

This is a brief historical backdrop to the economic, fiscal and federal opportunities and challenges associated with the ongoing resource boom. Natural resources are immensely

[17] Ontario was prevented from actually receiving its Equalization payment because Ottawa passed the "personal income override" bill in 1981. The bill declared that a province cannot receive Equalization if its per capita personal income exceeds the national average in the current year and in the previous two years. While the language was general, it was intended to apply only to Ontario. It succeeded in doing so — and was applied retroactively.

important to Canada's future, yet the issues at play are complex and inter-related and a coherent natural resource policy has not yet been cast in stone. For all of these reasons, the discussion in this signpost will not only be longer than the others, but more normative in nature.

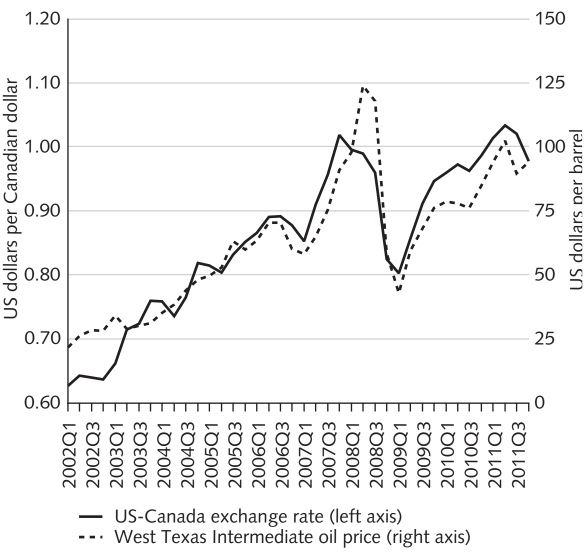
Resources in the new millennium

The seemingly endless demand for our resources associated with the economic ascendancy of populous China and India is a game-changer, a boom that will likely intensify as domestic and global economic activity recovers and as China and India begin to narrow the still-dramatic per capita income gap between themselves and the rich nations. The emerging response from influential policy leaders such as CIBC vice-chairman Jim Prentice is in the direction of a resource-based economic future or, in Prentice's phrase, a hydrocarbon and hydroelectric industrial strategy. This twinning of fossil energy with hydroelectricity would not only bring Manitoba and Quebec under the industrial strategy umbrella (joining the three westernmost provinces and Newfoundland and Labrador) but also integrate green hydro power with the less environmentally benign development of oil sands in order to make the overall strategy more saleable both at home and abroad.

There is another, less direct, but not less dramatic, impact of the resource boom on Canada's economic transformation. This is the absolute decline in manufacturing that has led to the descent of Ontario into the ranks of the have-not (Equalization-receiving) provinces; it is receiving Equalization payments of some $3 billion for 2012/13, about 20 percent of total Equalization. To be sure, some of the decline is the result of the hollowing out of manufacturing because of outsourcing and offshoring to China and other emerging economies. However, some is also due to the operations of the "Dutch disease," so named because Holland's export of North Sea gas and oil beginning in the 1960s eventually led to an appreciation of the guilder that ended up clobbering the Dutch manufacturing sector.

FIGURE 2

US-Canada exchange rate and crude-oil price, 2002Q1-2011Q4



Source: Bank of Canada; US Federal Reserve Bank of St. Louis, FRED data retrieval system.

Figure 2 reveals that the Dutch disease has also broken out in Canada. From roughly $20 per barrel in 2002, the price of oil soared to over $100 in 2008 (it even spiked briefly to $150 per barrel for a few days in mid-2008). Over the same time frame the loonie appreciated from under 70 cents US to roughly 105 cents, for an appreciation of about 50 percent, which clearly harmed our export competitiveness.[18] Hit hard by both US hollowing out and the Dutch disease, Ontario lost 20 percent of its manufacturing workforce between 2004 and 2008 (i.e., before the Great Recession); more than 300,000 manufacturing jobs have vanished in the past eight years. Not surprisingly, then, Ontario's growth rate has fallen short of the national average for each of the past nine years, essentially following the appreciation of the loonie. See box 1 for other countries' experiences with the Dutch disease.

Three comments on the economic challenges posed by volatile exchange rates are in order. The first is that we continually obsess about our poor productivity performance relative to that of the US, yet no one argues that this has anything to do with the exchange rate. This is puzzling since it is easy to build credible analytical models where exchange rate volatility reduces productivity (e.g., Harris 2002). In addition, Courchene and Harris (1999) argue that the great depreciation of the 1990s (from 90 to 70 US cents per loonie) resulted in a reduction of the capital/labour ratio for both physical and human capital, with obvious negative implications for Canadian productivity.

Second, the combination of an increased demand for our resources on the one hand and the operations of the Dutch disease on the other means that Canada will likely find itself at the upstream (i.e., raw material) end of global supply chains, whereas in the informatics era, high-value-added returns are likely to be at the downstream (final consumer) end. We must work toward creating a larger downstream presence, where the productivity payoff will be higher. In the interim it probably makes economic sense to make determined efforts to embed more value-added in our resources before exporting them.

Finally, I agree with those who maintain that major infrastructure needs (pipelines, transmission lines, physical plants) would be associated with the development of our resources, and these would provide important opportunities for Ontario and other provinces to become major suppliers. However, the caveat here is that while we are still afflicted by the Dutch disease, these opportunities may well end up being seized by American firms.

The ongoing natural resource boom and the decline in the manufacturing centre of the country have dramatically shifted Canada's economic centre of gravity away from its traditional locus in central Canada. Moreover, the ramifications of this transformation

[18] One of the presumed advantages of the FTA and NAFTA was that Canada's impressive social-economic attributes — medicare, a quality labour force, a continental-European-type social envelope, good public schools, safe neighbourhoods, etc. — would make our country a preferred location for foreign enterprises to access NAFTA economic space. However, the wide swings and volatility in the value of the loonie vis-à vis the greenback may have introduced a degree of economic risk or uncertainty that neutralizes our many trump cards. In other words, why locate in Canada to serve NAFTA economic space when the volatility of the loonie can jeopardize competitive access to 90 percent of your potential NAFTA market? Much better, the argument would go, to locate in the US and risk competitive access to the Canadian market. In this sense, Canada-US free trade has fallen short of the potential that would be achieved if firms locating in Canada to access continental markets could be confident of greater Canada-US exchange rate fixity.

Box 1
The Dutch disease around the world

In addition to its rise against the US dollar, the loonie has also appreciated with respect to the currencies of many of our other major trading partners. It is passing strange that a small open economy like Canada's should tolerate such volatility in its exchange rate (i.e., overshooting on both sides of the purchasing-power-parity equilibrium). This is not, in principle at least, an argument against our regime of flexible exchange rates. Rather the challenge arises because the Canadian-dollar currency area is far too small to accommodate at the same time a resource superpower and a world-class manufacturing sector (particularly when they are geographically relatively distinct). In short, Canada is too small economically to accommodate flexible exchange rates without succumbing to the Dutch disease.

How do other small open economies avoid the Dutch disease and, more generally, extreme exchange-rate volatility? The smaller Asian economies have typically pegged their exchange rates (in varying degrees) to the US dollar, which in recent years also means pegging their exchange rates to the Chinese yuan. The Europeans have of course created a common currency (but, as is painfully evident, not an effective monetary union) as a way to ensure a larger internal market. The approach of Norway, a unitary state, is to invest its huge energy-export-based sovereign wealth fund in international markets, thereby mitigating the tendency for the Norwegian krone to appreciate in the first place. This option is not really open to federal Canada, since resource royalties and revenues accrue to the provinces, not to Ottawa.

If there is a poster child for maintaining the Canadian status quo, it is certainly Australia, with its flexible exchange rate and successful resource-based economy, although concerns about the Dutch disease are mounting there as well. However, even though both Canada and Australia are federations, there are two key differences between the two countries. First, while Australian resource revenues do accrue to subnational governments rather than the national government, they are effectively shared with other subnational governments through the country's egalitarian equalization program. This means that the substantial degree of subnational fiscal inequities in Canada that have been triggered by rising resource revenues have no counterpart in Australia, so Canberra can devote these resource revenues toward macroeconomic goals, even along Norwegian lines should it wish. Second, Australia does not share a several-thousand-kilometre border and an integrated cross-border economic space with a country that is over 10 times its size and buys 80 percent of its exports.

Switzerland, long viewed as having the world's most stable and independent currency, has opted recently for intervention in the exchange market to ensure that the Swiss franc does not appreciate beyond (i.e., dip below) 1.20 francs per euro. This may be a relevant example for Canada. Switzerland is a small open country surrounded by a huge economic and currency union and very concerned about the possibility of an overvalued (appreciating) currency undermining its competitiveness. To be sure, Switzerland's challenge is not the Dutch disease per se: rather, the source of upward pressure on the Swiss franc appreciation is the imploding euro. Nonetheless, using the Swiss approach, Canada might let the loonie float freely, subject to some limit on the allowable appreciation, at which point the Bank of Canada would undertake initiatives to forestall further appreciation. This would provide a measure of security to foreign and Canadian investors alike when they are contemplating a Canadian location in order to sell into NAFTA economic space.

go well beyond the economic sphere to embrace both the fiscal and the social dimensions of the Canadian federation. I expect that a resource-based industrial strategy of some variety is inevitable. This being the case, the associated challenge is to ensure that it is less a largely *regional* economic strategy and more a *national* economic strategy that shares the benefits of a resource-based future with all Canadians.

Resources and interprovincial fiscal equity

Canadians have fully embraced the essence of section 36(2), the constitutional provision relating to Equalization, namely that no matter which province we choose to reside in, we should have access to "reasonably comparable levels of public services at reasonably comparable levels of taxation." The resource-related challenge here is straightforward: per capita revenues of the provinces rich in energy and other resources are already several thousand dollars higher, *after* Equalization, than those of the have-not provinces.

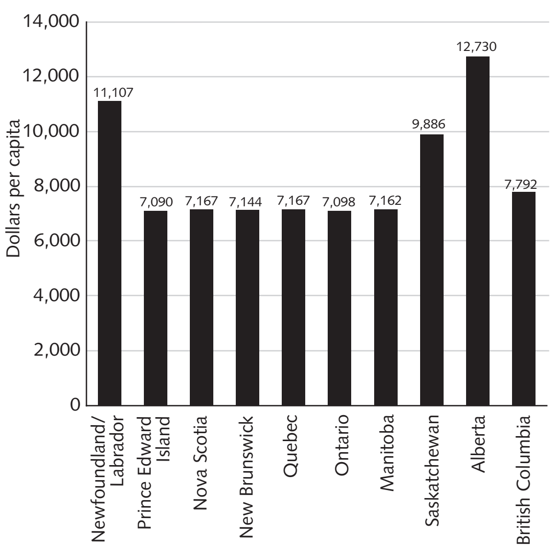
This is very evident from figure 3, which shows the per capita values of overall fiscal capacity as the sum of 1) the fiscal capacity measures obtained from the latest publicly available 2012/13 Equalization forecast, adjusted to include 100 percent of resource revenues; 2) the Equalization payments; and 3) the offset provision for Nova Scotia under the offshore agreement. Excluded are the equal per capita federal-provincial cash transfers, roughly $1,200 per capita, which by definition will not affect the per capita provincial differentials in the figure.

Were these differentials to persist, let alone grow, under a resource-based industrial strategy, the result would surely be the emergence of tax havens and/or superior public services in the resource-intensive provinces. Indeed, Alberta has already gone down the tax-haven road by utilizing its resource revenues to eliminate its provincial sales tax. The good news here is that the province did not decide to eliminate its corporate income tax instead, since this would surely have led to fiscal-induced relocation of corporate headquarters, which in turn would have led to countermeasures by other provinces and more generally to the fragmentation of Canada's internal economic and fiscal common market.

Could we not reduce these provincial fiscal differentials by simply ramping up Equalization payments? Unfortunately, this would be hugely expensive. Now that Ontario is a have-not province, the reality is that roughly 70 percent of our population resides in Equalization-receiving provinces. This means that, all else equal, every additional dollar of energy revenues brought into the Equalization formula would lead to an increase of 70 cents in Equalization payments! A related funding issue is often overlooked, namely, that Ottawa cannot

FIGURE 3

Post-equalization fiscal capacity,[1] 2012/13



Source: Author's calculations based on Department of Finance data.

1 Fiscal capacity includes 100 percent of resource royalties. Nova Scotia's total includes its offshore accord payment. Federal-provincial cash transfers (which are equal for all the provinces in per capita terms) are excluded.

constitutionally access provincial energy royalties, so that Equalization payments must come from Ottawa's consolidated revenue fund, the provincial shares of which are roughly in line with their population shares. Hence upwards of one-third of the cost of an increase in Equalization triggered by resource revenues will be borne by the taxpayers of Ontario.

Thus far, Canada's approach has been to ignore the provincial per capita differentials in fiscal capacity as shown in figure 3, most recently by linking the growth of total Equalization payments to growth in nominal GDP. In particular, we have avoided approaches that would allow Ottawa to share indirectly in provincial resource revenues (for example, by reducing the resource depletion allowance for federal corporate tax purposes or by redesigning the corporate tax along rent-taxation lines, as is being considered in other jurisdictions).

Resources, federalism and stewardship

A quite different approach to resource revenues may well have important implications for both the Dutch disease and interprovincial fiscal equity. In a most insightful *Policy Options* article, "Reversing the Curse: Starting with Energy," David Emerson writes:

> A longer-term, more disciplined approach to managing energy and resources is required. Natural resources are long-term assets that belong to generations of Canadians now and into the future. Government leaders and decision-makers have an implied custodial and stewardship responsibility to manage across the generations. In fiscal and economic terms, non-renewable energy and natural resources are long-life, fixed assets that, when sold and monetized, should be reinvested in ways that will benefit Canadians over the long term. Pretending that resource revenue is just another form of operating revenue, to be spent on current consumption of public services, is an abrogation of this responsibility. (2012, 53)

Among other things, this approach would seem to call for the energy provinces to create some version of the heritage fund, as Peter Lougheed did in Alberta. Indeed, there appears to be interest in Alberta in creating a new fund. Such sovereign (provincial) wealth funds might well be in the interests of all provinces. Not only could the fund be used to smooth out provincial revenues during boom and bust periods, but investing them in international markets, as Norway does, would moderate the impact of the Dutch disease. For the federation as a whole, depositing some of the resource revenues in wealth funds would mean that they would not be available for financing current public goods and services; in turn, they would not enter the Equalization formula nor would they be available for enticing the provinces to create tax havens. Only to the extent that these funds were eventually brought into current revenues would they enter the Equalization program.

Actually, this principle can be generalized. Revenues devoted to selected types of provincial infrastructure spending and to debt reduction in any province should also be considered for exclusion from the Equalization program since they would not go to the production of current provincial public goods and services. This would not only better align Equalization with its intended goal but would also promote an investment mentality in the provinces.

It is difficult to overstate the importance of the ongoing resource boom, its complexity and its impact on our federation. On the economic side, global economic forces are effectively inviting us to pursue a resource-intensive industrial strategy. For federalism and public policy, the challenge is to ensure that the resource boom will not trigger a degree of fiscal and economic inequality across provinces that would make the pursuit of such an industrial strategy difficult politically. While we are truly blessed as a nation to have generous endowments of natural resources, if we are not careful to ensure the continuation of the Pearsonian achievements on the societal front and if we do not seek creative policies to address the range of economic and federalism issues that will be in play, then the resource boom (and boon) may well begin to morph into the proverbial resource curse.

Finally, success in resource development cannot be an end in itself. Thomas Friedman notes that a recent OECD study found "a significant negative relationship between the money countries extract from natural resources and the knowledge and skills of their high school population" (2012). While Canada scores quite well in these comparisons, this finding nonetheless serves as a reminder that skills and human capital are essential for success in this informatics era. As we grapple in 2012 with how we ought to develop our resource endowments in order to secure our economic future, we need to continually remind ourselves that one of the dividends of an energy strategy has to be to develop and privilege our human resource potential — the minds of the Canadian state need to be focused on the state of Canadian minds. Ensuring that the energy bonanza will also serve this larger societal goal will go a long way to ensuring that an energy strategy becomes a national strategy.

Signpost 12: Canada's Remarkable Political Evolution: The West Is In!

In "The Collapse of the Laurentian Consensus" (2011a), John Ibbitson traces the westward shift of political power and values. Before this shift, the long-standing Laurentian consensus held sway:

> From the time of Confederation until quite recently, the direction of this country was determined by the political, academic, cultural, media and business elites in Toronto, Ottawa, Montreal and other cities along the St. Lawrence River or its watershed. On all of the great issues of the day, this Laurentian elite debated among themselves, reached a consensus and implemented that consensus. In short, they governed the country.

Heintzman notes that "the St. Lawrence River system always pointed into the heart of the continent as much as it did toward the Canadian west" (1994, 20), but the 1814 Treaty of Ghent (pursuant to the War of 1812) restored the pre-war (and current) Canada-US boundaries. This cut off the southern portion of the potential St. Lawrence economic hinterland, which represented a loss of trade that arguably served as an important catalyst for Confederation. With John A.'s National Policy of 1879, the "commercial empire of the St. Lawrence" blossomed, and Montreal became a transcontinental hub for transporting people in and staples out. While Montreal's star gradually faded relative to Toronto's, these two cities and their provinces had the population base to dominate Canadian economics and politics for a century and even beyond. As early as the Macdonald and Cartier cooperation at the Confederation conferences, this led to the "elite accommodation" model of Canadian governance.

Precise information on the operations of elite accommodation would be hard to come by. One can guess that Montreal got the headquarters for Air Canada and CN because Ontario got the Auto Pact, and so on. As suggested earlier, Quebec's cooperation in creating social Canada in the Pearson era probably led to the Bi and Bi Commission and perhaps as well to allowing Quebec control over immigration. On the political side, Canada's natural governing party rotated leaders (and typically prime ministers) between Quebecers and English Canadians (usually Ontarians). Whatever one might think of this governing model today, the reality is, as Ibbitson says and as readers will certainly agree, that the Laurentian Consensus left us with a wonderful country.

But the Laurentian Consensus was at least in part the author of its own demise. Quebec began to march to its own drummer, no doubt propelled forward by Trudeau's willingness to enact the *Constitution Act, 1982* without the support of Lévesque's Quebec. While this breakup spelled the end of the Laurentian Consensus, it did not spell the end of elite accommodation, as the Meech and Charlottetown Accords made clear. Nor did it prevent Ontario from exercising its electoral clout in determining the governing party, especially during the Chrétien years, when it delivered 98 of the 99 Ontario seats to the Liberals in the 1993 election, 100 of 103 in 1997, and 101 of 103 in 2000. However, the combination of the westward shift of economic activity and our open (colour- and country-blind) immigration policy served to populate the West with newcomers who, while wholly embracing their new country, did not share the values and sense of history that supported the "elite accommodation" model. With uncanny timing, Preston Manning launched the Reform Party of Canada in 1987, the year of the signing of the ill-fated Meech Lake Accord, arguably the most spectacular failure of the elite accommodation model.[19] It is instructive to recall Deborah Coyne's comment on elite accommodation before the 1987 joint House-Senate hearings on the Accord: "eleven men...around a table trading legislative, political and executive powers as if engaged in a gentlemanly game of poker." In dramatic contrast, Western-based Reform was a populist movement, even including a provision for popular recall of elected politicians. Reform was against government funding of bilingualism and multiculturalism and in favour of equality of the provinces and a triple-E senate (elected, equal by province and effective) — in other words, Reform was at the opposite end of the political spectrum from Canada's traditional governing model. Its rallying cry was "The West wants in."

[19] "Failure" refers not only to the demise of the Accord but also to the fact that it led directly to the creation of the Bloc Québécois, when Lucien Bouchard left the Mulroney cabinet in 1990 to found the movement. In the interest of full disclosure, I note that I was a strong supporter of the actual substance of Meech.

With the implosion of the Progressive Conservatives under Kim Campbell in the 1993 election (from 151 seats to 2 seats), the Reform Party emerged as the dominant right-wing party, with 52 seats. Preston Manning became the effective leader of the opposition to the Chrétien Liberals, although the Bloc Québécois was the Official Opposition. After the 1997 election, when Reform won 60 seats, Manning became leader of the Official Opposition.

However, Reform did not win a single seat east of Manitoba in 1997. The party realized that it had to embrace policies that appealed more to the centre of the country and in particular to Ontario, still almost entirely Liberal. Accordingly, Reform morphed into the Canadian Reform Conservative Alliance (usually called the Canadian Alliance) and in the process embraced a more centralist platform. Jean Chrétien called an early election in 2000 to take advantage of the organizational challenges facing the newly formed Canadian Alliance and won his third majority. It was this defeat that triggered the "unite the right" movement, the result of which was the merger of the Alliance and the Progressive Conservatives in 2003 to form the Conservative Party. Stephen Harper became its leader in a 2004 convention.

The Harper Conservatives held Prime Minister Paul Martin and the Liberals to a minority government that year, and Harper then ascended to the prime ministership with back-to-back minority government victories in the 2006 and 2008 elections. He finally achieved his majority in the 2011 election, with the NDP winning a rather astounding 103 seats and forming the Official Opposition, thanks in part to taking 59 of the 75 Quebec seats and in the process decimating the Bloc Québécois. For their part, the Liberals, Canada's traditional governing party, ended up with only 34 seats. All in all, a brilliant strategy on the part of Prime Minister Stephen Harper. The West is in!

This is totally new territory for postwar federal politics: a right-of-centre governing party with a left-of-centre official opposition and the centrist Liberals largely out of the picture. Although it is too early to assess where the Harper majority will take the country, the promise to withdraw direct federal funding for political parties, the emphasis on the military, the dismantling of the gun registry and the tabling of an omnibus crime bill all point to a fundamental shift in direction for Canada.

Harper has embraced what he has called "open federalism." This is a policy designed to respect the 1867 constitutional division of powers, which means that Ottawa will be focusing its attention on those areas that fall under federal jurisdiction. As noted earlier, this doctrine provided the framework that allowed Parliament to proclaim in 2006 that "the Québécois form a nation within a united Canada."

John Ibbitson has proffered an intriguing "open federalism" interpretation of recent events (2011b). Ottawa's announcement that the federal-provincial health transfers beyond 2017 will be indexed to GDP growth with a 3 percent minimum and that the provinces will be left on their own to rework medicare with few or no strings attached so as to live within this cash envelope represents an open-federalism-type, hands-off approach to areas of social policy under provincial jurisdiction. The quid pro quo, says Ibbitson, would be for Ottawa to increase its use of the federal powers under section 91, and especially over the macroeconomic and economic-union levers. The obvious candidate here, and a key federal priority, was to be the creation of a single national securities agency. A Supreme Court decision in December 2011 stopped Ottawa in its tracks on this file, but it is a safe bet that we have not seen the last of it.

More broadly, global city-regions have become the motors of growth in the new global order, and measures to build human capital (including early childhood development, training and immigration settlement) are emerging as the keys to economic success in the informatics era. So the new reality is that the policy areas that are increasingly vital to our socio-economic future — and that are therefore in the *national* interest — tend to fall within provincial jurisdiction. If Canada is to prosper in the face of this divide between national interest and provincial jurisdiction, aspects of open federalism must be rethought.

Signpost 13: Toward a New Northern Policy Universe

This final signpost highlights a looming policy opportunity and challenge: the future of the circumpolar Arctic and in particular the Canadian Arctic. Creative institutional and political arrangements have already been implemented in our northern territories, but there is much unfinished business, especially in resource devolution agreements. These domestic concerns are certain to interact with major circumpolar and international challenges on the horizon.

The Arctic's physical features are becoming unrecognizable. Not only is the Arctic ice melting from above, but with the warming arising from the albedo effect (water absorbs the sun's rays whereas ice reflects them), the ice is also melting from below. The resulting climate dynamics have many potential implications:

- Glaciers will melt much faster than expected, so eventually several additional areas of the globe will find themselves under water.
- The Arctic may become a well-travelled trade route (the distance from London to Yokohama over the northern route along the Russian shore is roughly half the distance through the Panama Canal), which will heighten concerns over both security issues and environmental risks.[20]
- Plants and animals from south of 60 will move north, while polar bears, ring seals and walruses may find it difficult to survive (Anderson 2009, chaps. 9 and 10).
- The disappearance of Arctic ice may trigger a race for resources. The US Geological Survey has described the Arctic as the largest unprospected area on earth, with an estimated 13 percent of the world's oil and 30 percent of the world's gas (Anderson 2009, 181).

[20] While the Northwest Passage may not become the preferred Europe-Asia route, it too will be much more travelled and will generate similar concerns.

- Both melting and burning tundra have the potential to release enough greenhouse gases to double the amount now in the atmosphere.

Above all, the Arctic is becoming a complex geopolitical arena with competing national claims over land, water and the seabed as well as resources of all types. Even the Chinese have one icebreaker in the Arctic, with another on the way. And enveloping all of the issues noted in the list above is the issue of Arctic sovereignty.

Important as these opportunities and challenges may be, the fundamental consideration is that the Arctic is the homeland of first Canadians: First Nations and the Inuit peoples. Moreover, there is a close relationship between management of the North and the living conditions of the people who live there: for example, Canada's claim to sovereignty over what we argue are "internal Arctic waters" owes a great deal to Inuit and First Nations occupancy and stewardship over the centuries. They are the "use it" in the "use it or lose it" slogan about sovereignty. But at a more fundamental level, as Canadian citizens they deserve our commitment to ensure their future well-being and that of their communities. This is a major challenge because in terms of far too many economic, social and health indicators, our northern peoples fare poorly.

Ottawa has been innovative in working with northern peoples to design accommodating institutional arrangements for governance, but one often hears that the Territorial Formula Financing (TFF) payments to the three territories are exorbitant. And at first glance they seem so: in fiscal year 2008/09 they amounted to $18,000 per capita for Yukon, close to $19,000 for the Northwest Territories (NWT) and a whopping $30,000 for Nunavut, whereas the largest per capita provincial Equalization payment is well under $3,000. However, if the territories had the same rights to resource revenues as the provinces, they would soon be able to increase their revenues to a level that would easily exceed their TFF payments — and, over time, by a large amount. Another way the territories are deprived of revenue is that fly-in workers at territorial resource enterprises file their taxes in the jurisdictions where they live on December 31, typically one of the provinces. Why could the territories not tax the fly-in workers on income earned there? Imposing the same tax filing requirements on the territories as on the provinces makes little sense unless the territories also have the same powers as the provinces (such as powers over resources).

A significant emerging problem that has the potential to stymie northern development is that there are at least 25 constitutionalized entities in the North (the 14 Yukon First Nations agreements, several more in the NWT, the four Inuit Land Claims Agreements and the three territories themselves). This is a recipe for the economic balkanization of the North. Small wonder that the Mackenzie Valley pipeline may fall by the wayside — there are too many players holding vetoes. What is needed is some version of an internal northern economic union that would allow freer movement of goods, labour and capital across these jurisdictions.

It is most encouraging that Canada appears eager to aggressively embrace the new geopolitics of the circumpolar Arctic. In 1996, the Ottawa Declaration created the Arctic Council, consisting of eight member states (Canada, Denmark, Finland, Iceland, Norway, Russia, Sweden and the US). Among the indigenous permanent participants are the Yukon-Alaska Gwich'in International Council and the Inuit Circumpolar Council.

The really good news here is that Prime Minister Harper has made the Arctic one of the priorities of his government. Apart from making frequent trips to the Arctic, Harper has committed several billion dollars to four key areas: sovereignty, environmental protection, economic and social development, and governance. To bolster Canadian sovereignty, Harper has commissioned up to eight Polar Class 5 patrol ships (capable of operating in up to one metre of ice) as well as the construction of a deep-water port allowing the patrol ships to resupply and refuel.

It should come as no surprise that Harper harbours a vision for the future of the Arctic that is expansive and optimistic: "Canadians see in our North an expression of our deepest aspirations: our sense of exploration, the beauty and the bounty of our land, and our limitless potential" (Canada 2007).

We in the south need to commit ourselves to work with northerners to ensure that this potential is achieved. As we note in the concluding paragraph of *Northern Exposure*, this means, *inter alia*, that we need to work collectively to address "the social, economic and governance changes that are essential to strengthen the peoples, powers and prospects of Canada's North," all while ensuring that this is consistent with their gaining greater control over their own destinies (Abele et al., 2008, 587).

Conclusion

These 13 signposts represent my choices for the key turning points in the evolution of Canadian public policy. Some of them have long become part of our nation's defining economic and social characteristics and thus are now part of Canada's public policy history. Others, like the last few, are driving our current and future policy challenges and choices.

There are potential issues that ought to have been signposts except for the fact that our leaders failed to implement them. The obvious candidate here is carbon pricing and management. In the IRPP's impressive *A Canadian Priorities Agenda* (Leonard, Ragan, and St-Hilaire 2007), carbon pricing and the environment more generally topped the list as Canada's most pressing and most important policy priority. The academy has come through with creative proposals that take into account what ought to be a key Canadian concern. Some provinces have introduced cap-and-trade and carbon-tax regimes, and half of them have even been willing to embrace a cross-border carbon management system with selected US states. But without Ottawa in the game, the provinces do not have the constitutional power to ensure that their programs are export-import neutral, nor can they make their pricing regimes efficient on a pan-Canadian level. In the meantime, other nations with very different economies and priorities are driving the carbon management agenda. It is time for Ottawa to seize the moment and become a player.

Finally, I want to return to the two global paradigms that have held sway in the post war period. We succeeded brilliantly under American hegemony. Indeed, we were perennial leaders in the international rankings of the most livable nation on earth. A large part of this success was the result of drawing the best from the two dominant power centres, America and Europe. Specifically, we were able to marry the dynamism of the American economic model with the communitarianism of the Continental European social model.

As the informatics era evolves, with the rise of China and the other BRICs, on the one hand, and the declining fortunes of the US, on the other, we are forced to wrestle with the whole host of transformations elaborated above. Yet we are not starting anew, because we can fall back on the trump cards that in the past enabled us to master the global order. Our macroeconomic parameters (fiscal, monetary and financial) are second to none. We are engaged across the globe in negotiating free trade agreements and our immigration and multicultural policies have generated a multilingual and multicultural society that will help us close deals after our bureaucrats open the doors. Our contributory public pension system is sustainable and both levels of government are hard at work age-proofing our social programs. And above all the world needs our bountiful resources, which — if we follow the precepts proffered under signpost 11 — will become the springboard for a national rather than simply a regional economic strategy that will provide opportunities for Canadians to develop the essential skills and human capital to succeed in the informatics era without saddling them with unsustainable debt burdens.

Most of all I look forward with a sense of excitement and confidence as Canada and Canadians work together to develop future signposts en route to excelling in the informatics-era economy and society.

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