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GETTING ON THE ROAD TO A POST-COVID ECONOMIC RECOVERY

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PRINCIPLES FOR A RETURN TO WORK AND PROSPERITY

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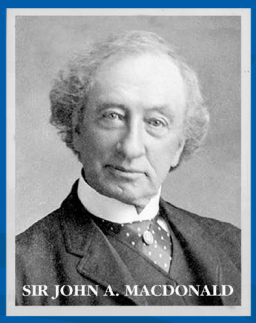

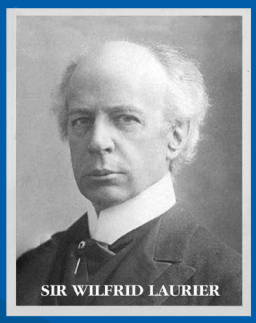

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Executive Summary

With hundreds of billions of dollars of deficit spending, millions thrown out of work, and a massive loss of business revenue and investment wealth, Canada faces a dark economic future. Lockdown measures will gradually be lifted, economic activity will resume, and some day the pandemic will end. But the bill will be staggering. Decisions made in the next weeks and months will determine the trajectory of Canada's economic recovery.

This collection of essays by some of Canada's leading thinkers on economics, public policy and governance offers some important principles and ideas to guide policy-makers as they face these tough decisions.

Things may be worse than we think. As MLI Senior Fellow **Philip Cross** explains, "The failure of economists to understand how fast and severely the economy is contracting implies that government spending will increase much more than anticipated, while simultaneously the loss of revenue is being under-estimated." He recommends that the federal government should **start thinking about the post-COVID recovery now**. He advises us to be "wary of schemes hatched in the civil service to permanently expand government program spending during a crisis." And Cross urges policy-makers to continue to avoid the mistakes of the 2008-09 financial crisis, "where rescue packages for banks and quantitative easing favoured the wealthy and helped to widen income inequality, especially in the US and Europe."

In his essay, MLI Distinguished Fellow **Jack Mintz** echoes Cross's concern about the long-term expansion of government spending and control over the economy. He calls for the federal government to **focus on getting people back to work, not sweeping, costly new programs like a guaranteed income**.

As MLI Distinguished Fellow **Donald Savoie** points out in his essay, our already **ballooning federal government will have to take some harsh**

medicine for its COVID-19 hangover. And unlike in the 1990s-era deficit cutting exercises, downloading cost cutting to the provinces will be much more difficult this time.

And finally, in a pair of essays, MLI Senior Fellow **Ken Coates** points to the importance of a private sector-led recovery that includes Western Canada. He urges the federal government to **stop the economic self-harm and revive the Canadian energy sector**, and argues that **climate change priorities need to be adjusted** to reflect the reality of suffering Canadian individuals and businesses, and the need to prioritize a return to prosperity for Canadians.

Sommaire

Au vu des centaines de milliards de dépenses imputées au compte des déficits, des millions de pertes d'emploi et de la destruction massive de revenu et de capital d'investissent, le Canada risque d'être confronté à un avenir économique sombre. Les mesures de confinement seront progressivement levées, l'activité économique reprendra et la pandémie finira par se résorber. Toutefois, le montant de la facture dépassera l'entendement. Les décisions prises au cours des prochaines semaines et des prochains mois dicteront la trajectoire de la reprise au Canada.

Cette collection d'essais sur l'économie, les politiques publiques et la gouvernance publiés par certains des plus éminents penseurs canadiens présente les principes et les idées clés pouvant orienter les décideurs dans leurs difficiles prises de décisions.

La situation pourrait être pire que nous ne le pensons. Comme l'explique **Philip Cross**, *Senior Fellow* de l'Institut Macdonald Laurier, « Le fait que les économistes n'aient pas compris à quel point le recul de l'économie serait précipité et prononcé laisse supposer que les dépenses publiques augmenteront beaucoup plus que prévu et qu'en parallèle, les pertes de revenus seront sous-estimées. Il recommande au gouvernement fédéral **d'amorcer une réflexion sur la reprise post-Covid**. Il nous invite à demeurer prudents et vigilants au regard des stratagèmes concoctés par les fonctionnaires pour augmenter durablement les dépenses de programmes du gouvernement en temps de crise. Enfin, il exhorte les décideurs politiques à demeurer à l'abri des erreurs commises lors de la crise financière de 2008-2009, les plans de sauvetage des banques et le recours à l'assouplissement quantitatif ayant opéré de manière à favoriser les riches et à creuser l'inégalité des revenus, en particulier aux États-Unis et en Europe ».

Dans son essai, **Jack Mintz**, *Distinguished Fellow* de l'Institut Macdonald Laurier, se fait l'écho de monsieur Cross quant au problème posé par l'augmentation durable des dépenses publiques et le contrôle sur l'économie. Il demande au gouvernement fédéral de **concentrer ses efforts à remettre les gens au travail, et non à mettre en place de nouveaux programmes vastes et coûteux, notamment un programme de revenu garanti**.

Comme **Donald Savoie**, *Distinguished Fellow* du même institut, le souligne dans son essai, notre **gouvernement fédéral, déjà énorme, devra prendre des remèdes d'éléphant pour endiguer les incidences de la Covid-19**. Toutefois, contrairement aux exercices de réduction du déficit des années 1990, cette fois, il sera beaucoup plus difficile balayer les coûts dans la cour des provinces.

Enfin, dans deux autres essais, le *Senior Fellow* ***Ken Coates*** souligne l'importance d'une reprise menée par le secteur privé qui comprend l'Ouest canadien. Il incite le gouvernement fédéral à **mettre fin à l'autodestruction économique et à relancer le secteur canadien de l'énergie**. Il arguë que les **priorités en matière de changements climatiques devront prendre en compte** la difficile réalité des particuliers et des entreprises et la nécessité d'un retour à la prospérité pour les Canadiens.

Start thinking about the post-COVID economic recovery now

Philip Cross

We are living through the fastest-moving crisis of our time, surpassing previous shocks such as the 1998 Ice Storm, the 9/11 terrorist attacks and the Great Financial Crisis of 2008. It is worth recalling these shocks themselves were unprecedented, yet we found the resources, wisdom and strength to overcome each of them.

The federal government is increasing spending at the fastest rate in its history. This is arguably an appropriate and largely unavoidable response

to the massive disruption of our economy. Canadian households and businesses need quick access to funds if they are going to survive financially until the suspension of normal economic activity ends.

Yet the imperatives of dealing with the current crisis cannot totally blind us to their long-term effects. It is not widely appreciated that macroeconomic policies to buttress demand in the short-run are harmful to potential growth in the long-run. We can already see this playing out in the response to the current crisis.

Canada entered this crisis in an already vulnerable state due to excessive accumulation of debt over the past decade by all sectors of the economy. Our highly cyclical economy and past experience with unexpected shocks should have bred a more cautious approach to savings and borrowing. The federal government's debt is already exploding. Some estimates see the federal deficit climbing as high as $400 billion.

But projections are unlikely to prove very accurate. Economic forecasts are made using abstract models that do not incorporate knowledge of local conditions and they routinely underestimate the impact of events such as the 2008 financial crisis or the coronavirus today. This fallibility is seen in unemployment insurance claims in the US; in early April, economists forecast an increase from 3.3 million to 5 million, but claims actually soared to 6.6 million. Worse yet, economists had expected US payrolls in March to fall by about 100,000; payrolls actually plunged by 701,000.

In Canada over March and April, three million Canadians officially lost their jobs, while another 2.5 million were not able to work at all or had much reduced hours. Overall, employment fell by 15.7 percent and hours worked by 27.7 percent. By early May, 7.8 million Canadians had turned to emergency income support from the federal government.

The failure of economists to understand how fast and severely the economy is contracting implies that government spending will increase much more than anticipated, while simultaneously the loss of revenue is being under-estimated.

Moreover, there will be other demands on the federal government. Low interest rates are making pension plans for employees increasingly problematic in the public sector. Notably, as recently as last December, the federal government raised its estimates of the federal debt substantially because it finally began to acknowledge that low rates of return on pension assets would force the government to subsidize federal pensions. The full amount of this subsidy has still to be publicly acknowledged and is rising as bond yields decline further.

Provincial government revenue losses are likely to be especially severe. They rely more on sales taxes which are suffering from unexpectedly sharp declines in the usually-stable services sector, even as the provinces bear the brunt of soaring health care costs. Undoubtedly, this will lead to even more demands on the federal government.

Soaring government debt adds to the massive bill we are passing to future generations. We know that government debt was already poised for steep increases as our aging population puts increasing demands on our pension and health care systems. Generational conflict was already being fuelled by the policy of low interest rates, which are now approaching their zero-lower bound. Low interest rates have already helped push housing prices out of the reach of many young adults in Toronto, Vancouver, and elsewhere.

> *"Hopefully we will not often hear the slogan 'never let a crisis go to waste.'*

There are other impacts on young people from actions taken to combat the virus. Suspending classes, likely for the rest of this school year and possibly beyond, will harm learning as home instruction is unlikely to be as good. Meanwhile, about 250,000 university students are about to graduate and enter a labour market that has dried-up overnight. There is substantial research indicating that cohorts that enter into the labour market during recessions suffer a lifelong loss of earnings that is never fully recouped.

Hopefully, we will not often hear the slogan "never let a crisis go to waste." History is littered with examples of rash decisions made during a crisis that aggravated the problem in the long-term. Many decisions made following the 9/11 attacks come to mind, particularly the Iraq War. In Canada, invoking the *War Measures Act* in response to an imagined FLQ insurrection was a blatant mistake.

The same is true of economic crises. The federal government used the stagflation of the 1970s to intervene in the economy on a vast scale, culminating in wage and price controls and the National Energy Program, both of which are now completely discredited. More recently, the Ontario government adopted the *Green Energy Act* in response to the Great Recession,

a misguided foray into industrial policy that resulted in a doubling of electricity rates, ballooning government deficits and chronically slow growth. It is worrisome that today, some of the architects of that policy are advising the federal government.

Parliament should be wary of schemes hatched in the civil service to permanently expand government program spending during a crisis. One study of social policy concluded that the rapid expansion of the welfare state in the 1950s was not a response to public demand but played on widespread fears of a return to Depression after World War II ended. Their "genesis, formulation, justification, and, of course, implementation all occurred within the state and as a result were the handiwork of key policy actors."[1] The frenzy of a crisis atmosphere makes it seem worth taking risks with both state power and public money, although once a government program begins it is hard to end (one example of how permanent a temporary government program can be is the US Congress raising pensions in 1958 for Civil War widows, nearly 100 years after the war ended).

Canadians want a return to their normal lives as quickly as possible, not a permanent expansion of government spending programs. Already it may be hard to roll back higher tax credits for low incomes, while the drums are beating in some quarters to convert the $2000 Canada Emergency Response Benefit grant into a permanent Guaranteed Annual Income for all. As soon as possible, we want to restore the efficient allocation of credit to the private sector, not fund massive government deficits.

So far, we are not repeating one lingering problem from the 2008-2009 crisis, where rescue packages for banks and quantitative easing favoured the wealthy and helped to widen income inequality, especially in the US and Europe. The policies currently adopted in response to the pandemic have been targeted more at those parts of the working class and small businesses bearing the brunt of the downturn. Hopefully, this will help avert the worst of the last decade's divisive and futile debate over distributional issues. That may be one blessing coming out of this crisis.

Philip Cross *is a Munk Senior Fellow at the Macdonald-Laurier Institute. He spent 36 years at Statistics Canada specializing in macroeconomics.*

[1] Bryden, P.E. 1997. *Planners and Politicians: Liberal Politics and Social Policy 1957-1968*. Montreal and Kingston: McGill-Queen's University Press, xvii.

Focus on getting people back to work, not sweeping, costly new programs like guaranteed income

Jack Mintz

Canada's COVID-19 economic coma provides a new, grand experiment to understand the implications of a guaranteed basic income on the willingness to work. Numerous advocates of a guaranteed basic income are now calling for the enhanced benefits currently deployed as an emergency measure, to extend past the crisis in the form of a guaranteed income.

It was wise for governments to rush out financial support as quickly as possible in wake of this severe downturn as businesses closed down.

However, on a permanent basis, a guaranteed minimum income, despite having some good features as explained below, would be inferior to an enhanced wage subsidy program to encourage people to work.

During the pandemic, the federal government crafted two types of temporary support programs. The Canada Emergency Response Benefit (CERB) provides a taxable $500 per week for 16 weeks for people laid off from work, equivalent to a $14 per hour wage. Of course, for half-time work, the CERB is equivalent to a $28 per hour wage.

The federal post-secondary student package provides another $1250 per month for four months. Many complaints were made that this would simply encourage students to slumber on hammocks during the summer rather than work even if some jobs become available. Some post-graduates would have been able to combine this payment with the CERB, resulting in a pretty lucrative income not to work for several months. The federal government is now implementing some less-than-clear measures to eliminate the disincentive to work under this program.

Although jobs are disappearing in wake of economic stay-at-home orders, not all industries are contracting. As related to me by one of the technology companies, they have some new job opportunities that they have been trying to fulfil. However, as soon as the CERB came out, the applicant pool began to disappear. This is not the only case I heard of – many other employers in a similar circumstance started to tell similar stories. Time will tell whether these anecdotal stories are supported by the data.

Before this pandemic, Facebook's Mark Zuckerberg along with some other captains of Silicon Valley industry last year called for a guaranteed basic income to help workers displaced by the adoption of artificial intelligence, digital processes and robotics. This is not what the history of innovation tells us. Undoubtedly, new technology displaces jobs, but innovation also leads to lower costs and new products, expanding jobs as production rises. Most economic studies have found that net employment increases with innovation over time.

The most challenging issue is trying to shift laid off workers into new occupations rather than leaving them idle. A basic guaranteed income can interfere with these dynamic processes if people do not seek retraining and new opportunities.

The better argument in favour of a guaranteed income is to reduce poverty. The complex assortment of social assistance programs, pensions, housing subsidies, unemployment insurance, targeted benefits and other low-income supports result in an inefficient delivery, high marginal tax rates and

costly administration. Surely there must be a simpler way of designing support programs for those in need, under a single stipend.

The idea of a guaranteed income is far from new. In 1516, Thomas More proposed a basic income to reduce robbery, but it was his friend, Johannes Vives, who first proposed a guaranteed income to reduce poverty a decade later. University of Chicago economist and Nobel laureate Milton Friedman made the most revolutionary proposal in 1962, recommending a "negative income tax" as a radical simplification of the welfare state and tax system. Under his scheme, a grant would be provided to each household financed by a flat income tax on personal income, without exemptions or tax credits. Those on the left might prefer a progressive rate schedule but they found Friedman's guaranteed income as a replacement for welfare programs appealing.

> *Federal, provincial and local governments fund over $160 billion in social benefit programs.*

So how would Friedman's proposal apply to Canada today? Based on 2018 data, federal, provincial and local governments fund over $160 billion in social benefit programs – roughly $12,000 per household (an average household has 2.5 members). Although our income tax is based on individual earnings, I shall start with a family income approach to the guaranteed income similar to the existing income-tested benefit and refundable tax credit programs.

So we could cancel various social-benefit programs such as social assistance, free dental care and drugs, old age security, child benefits, and employment insurance by replacing them with a refundable negative tax credit of $12,000 per household (even those with incomes below that would thus get a refund to top them up to $12,000). One could also throw in Medicare, making it private, which is a fear some have if we took a very broad approach to implementing a guaranteed income plan.

The flat income tax required to pay for it – one covering not only the minimum grant but also the remainder of government expenditures net of other taxes (corporate, sales and excise, property and other) would

be about $14,000 per household – would need to be levied at a rate of 29 percent. These calculations do not take into account any savings in administrative costs with the cancellation of various welfare programs.

But if we're alleviating poverty, $12,000 seems below the poverty line for the average household of 2.5 people who have no other income. For what poverty activists consider a "living wage" of $15 per hour – which I will take as an annual payment of $30,000 per household (with either one or two adults) – the flat income tax rate would need to rise to 49 percent to balance the books. These personal income tax payments would come to $590 billion, enough to cover $420 billion minimum-income payments (at about a fifth of GDP) and the rest of the public expenditure.

As appealing as it seems, Friedman's negative income tax is not so simple to implement. Obviously, minimum payments would need to recognize different households' characteristics. Single individuals would get less than those families with multiple adults and children. Households with a disabled parent or child should be given more to cover additional costs. Those temporarily out of work, after earning a higher income, might need replacement income that would be significantly above the minimum payment. So, once we start differentiating people by their needs, we get back too many current programs – and the bureaucracy – to determine eligibility for various benefit payments.

> *The idea of just giving out cash to relieve poverty also raises eyebrows for many voters who pay tax on their earnings from work.*

Nor is it clear voters would support the elimination of tuition tax credits, property tax and rent credits, pension and RRSP deductions, age credits, refundable GST tax credits and other targeted relief measures, which all play a role in social policy. And if voters dislike a flat rate, a much higher marginal tax rate would be needed than 49 percent to make up for special preferences. But such high marginal tax rates would discourage work, saving and risk-taking, ultimately eroding the ability for an economy to sustain a guaranteed income.

The idea of just giving out cash to relieve poverty also raises eyebrows for many voters who have to pay tax on their earnings from work. And there's

the unknown labour-supply effect: how many recipients might choose to stay at home, receiving $30,000 cheques, rather than work? That's why many economists concerned about the working poor prefer wage subsidies instead of just handing cash to otherwise able workers. And cash alone isn't a panacea for helping all low-income families: we would still need professionals to support those with mental or other health issues, social problems or who lack the basic skills to contend with daily life.

As we begin to recover from this pandemic, the last form of intervention we need is to discourage people from pursuing new opportunities and jobs that will eventually become available. That is a lesson so far from the grand experiment we had to adopt in a hurry to help many people survive a severe recession. While necessary in the short-term, if the federal government were to heed calls to continue this policy on a permanent basis it could disrupt recovery for years to come.

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Stop the economic self-harm and revive the Canadian energy sector

Ken Coates

Governments, and Canadians, are working extremely hard to protect citizens from a pandemic of frightening proportions. Appropriately, governments' priority has been getting money into the hands of the unemployed and of businesses facing financial ruin due to lockdown measures. Governments have so far done reasonably well at keeping people in their homes, covering essential needs, and supporting the health care system against an enemy of unknown power and impact. Yet the economic and social costs have been enormous.

While the nation's attentions are focused on the immediate crisis, actions taken in the early months of the pandemic will have long-term consequences for this country. Deficit spending in early 2020 will become long-term debt for the 2020s and likely beyond. Income redistribution programs launched to address immediate and urgent crises could, if opportunistic social engineers have their way, become permanent fixtures in the Canadian policy landscape, with unpredictable long-term financial implications.

If we are to recover as quickly as possible from the massive economic harm caused by pandemic lockdown measures, it is the private sector that will need to lead the way to create employment opportunities, wealth and economic growth. And given its outsized importance to Canada's economy and the prosperity of Western Canada in particular, the survival of the oil and gas sector is vital.

The Government of Canada continues to consult with industry organizations and provincial governments on a rescue plans for the Western oil and gas sector; the fact that work continues on the TransMountain pipeline and the Coastal Gaslink pipeline augers well for the medium-term prospects for the energy sector. There is no doubt of the need for urgent action. Hundreds of thousands of oil and gas workers have lost their jobs. Alberta Central has forecast the loss of 25,000 Alberta jobs in 2020 alone, on top of a three-year-long skid that hammered employment in the sector. Hundreds of companies report that they are on the verge of closing or have sharply reduced employment and operations to stay solvent. Government revenues have tanked, putting provincial public services in Alberta and Saskatchewan at serious risk.

In February 2020, a month before the COVID-19 pandemic hit, Alberta forecast a $6.8 billion deficit, a number that is ballooning through the first moths of the crisis and will certainly more than triple. Non-renewable resource revenues in Alberta had already fallen from almost $9 billion in 2014-2015 to less than $5.5 billion in 2018-2019.

Major companies have been pulling out of Western Canada, cancelling or delaying major projects or downsizing their Canadian operations. Teck Resources' massive Frontier oil sands project was pulled from consideration just before the federal cabinet was to rule on its applications; Murphy Oil closed it Calgary office with a loss of 110 jobs, joining firms like Nine Energy which moved out in 2019.

Major initiatives remain cancelled or stalled, including the slow-moving pipeline projects, and numerous large LNG projects. Billions of dollars in investment have already been lost, with obvious implications for regional businesses and employment.

The Liberal Cabinet's half-hearted support for major infrastructure projects has kept much of Canada's energy supplies land-locked and, as a consequence, unable to command world prices. Exacerbating the domestic situation, in a tragically ill-timed move this spring, Saudi Arabia responded to Russia's refusal to cut oil production by flooding the international market, resulting in a fall in the price by two-thirds in less than a month. In mid-April, the two rogue countries agreed to withdraw 10 million barrels a day from the market, which improved prices somewhat.

And so, the industry-wide crisis is complicated by a pre-existing decline in the sector over the past few years that has been substantially policy-induced, driven by Ottawa's reluctance to embrace the sector whole-heartedly, its preference for climate change action that disproportionately impacts the industry, and an inexorably tightening administrative and regulatory environment. To this point, the government has not provided a clear and unequivocal statement of support for the oil and gas industry.

"The government has not provided a clear and unequivocal statement of support for the oil and gas industry.

The complications go further. Since their election in 2015, the federal government has brought in legislation to ban oil and gas exploration in the Arctic, blocked efforts to ship oil out of Northwest British Columbia ports (Bill C-48) and expanded the geographic and conceptual range of regulatory oversight in a manner that will likely add considerable time and difficulty to the environmental assessments of proposed resource developments (Bill C-69). The Canadian mining sector found the legislation workable, but the oil and gas sector saw it as extremely problematic, as do many Indigenous communities that depend on energy revenues and employment in the sector.

In December 2019, the government announced plans to reintroduce legislation to implement the *United Nations Declaration on the Rights of Indigenous Peoples* (UNDRIP) as Canadian law, following the death of private member's Bill C-262 in the Senate. The latter legislation, which contained valuable elements of pathways to reconciliation with Indigenous peoples, had many substantial implications for the natural resource economy and for relations with Indigenous peoples and should not have

proceeded. No less an authority than the Indian Resource Council, representing some 130 First Nations, has asked the government not to move too fast on UNDRIP to avoid further problems in the energy sector at a time of general industry uncertainty. While the extractive industry and most Canadians support most elements of UNDRIP, great care must be taken not to negatively impact the regime of consultation and accommodation with Indigenous communities that has developed over the last few decades in Canada.

Although the Liberal government has hinted at a softening of its energy stance in recent weeks, the stronger support for an aggressive climate change agenda has relegated the industry to the second or third tier in terms of government support. Western Canadians have had access to national programs for the unemployed and businesses at risk, in the amount of $1.6 billion, mostly in loans, to assist business peoples, and $1.7 billion to address the problem of cleaning up the "orphan" wells in Western Canada. The government has made some contributions, including funding for the cleanup of old wells, wage subsidies and access to inexpensive loans, but Western patience is wearing thin as they await signs of real commitment to the sector.

The oil and gas industry – including research, exploration, development, processing, shipping and site remediation – is a major contributor to the Canadian economy. In Western Canada, the sector is vital to employment, business and overall well-being. There is recognition that global energy demand, post-pandemic, will continue to be strong for several more decades, even as the shift to renewable energy supplies accelerates.

If Canada continues along a path of economic self-harm, it would be almost alone among energy-producing nations. Canada's approach is odd in this regard; Eastern Canada imports almost $19 billion a year in foreign oil, almost two-thirds from the United States. In an ironic twist that has attracted little attention, New Brunswick's Irving Oil recently got permission to ship Western Canadian oil through the Panama Canal to the Saint John refinery, a move that the construction of the now-cancelled Energy East pipeline would have made unnecessary. So much for the environmental benefits of scrapping pipeline projects. Ironically, the best chance the country probably has to expand renewable energy likely rests with the revenues produced by a vibrant oil and gas industry, which governments and enterprising industry could allocate to the nation's energy transition. Energy hypocrisy abounds.

In the next few months, the Government of Canada will make decisions on the energy sector of decades-long importance to the country. If infrastructure projects proceed, new projects are authorized, and regulatory over-

reach slowed, the energy industry could lead and support the revitalization of the Canadian economy. The rebound may take time, as energy demand is tied directly to the strength of the global economy and lingering effects of the 2020 Russia-Saudi Arabia oil and gas market manipulation, but the impact could be – will be – considerable.

If the government continues with its go-fast approach on UNDRIP and other regulatory measures, acquiesces to project delays that will slow or kill infrastructure projects, and holds back on support for the oil and gas sector, the crises of 2020 will be only the beginning of a sharp decline in the regional and national economies. Alberta's economy, already reeling from the problems of recent years, will collapse. Even more workers will lose their jobs, more businesses will close, energy-dependent communities will contract, and the crisis will have ripple effects across the Canadian economy.

In the short-term, Canadians have a simple decision: support the oil and gas industry or shut it down. Half measures are unlikely to satisfy defenders of the sector and the multi-billion-dollar investors needed to keep the industry strong, or those who oppose Canadian oil and gas regardless of the immense harm to the economy or to the many people who are dependant on Canadian energy for their prosperity and their livelihoods.

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Ballooning federal government will have to take some harsh medicine for its COVID-19 hangover

Donald Savoie

Governments will soon be dealing with a COVID-19 hangover. The day when governments come up for air, they will see that their budgets are a wreck – revenues are collapsing while expenditures are growing through the roof.

Government debt as a percentage of GDP is fast approaching mid-1990s levels when, it will be recalled, Ottawa launched an ambitious program-re-

view exercise that generated sweeping spending cuts. There is, however, an important difference this time. In the mid-1990s, baby boomers were in the prime of their careers and highly productive. Today, Canada has a fast-aging and less productive population that is putting more pressure on our health care facilities and generating more demands on expenditure budgets.

Ottawa has led the way in coming up with measures to attenuate the sting of economic misfortunes flowing from the COVID-19 economic shutdown. The federal government will also have to show the way in redefining the role of government, starting with its own.

> *Public servants deal with public resources and have no constitutional mandate to take risks.*

There is a consensus emerging that federal public servants need to learn to take risks to help in redefining the role of government, and better managing the difficult economic challenges brought on by the response to COVID-19. Indeed, even a number of former federal public servants are now making this call, including recently a former clerk of the Privy Council and former Treasury Board Secretary.

However, this idea is fraught with danger – public servants deal with public resources and have no constitutional mandate to take risks. If we should ask them to take risks, then we will need to overhaul accountability requirements and take a fresh look at the growing number of oversight bodies always at the ready to provide fuel for the blame game.

If public servants are expected to take risks, they will also be expected to take responsibility before Parliament when things go off the rails. It would also allow politicians to take credit when things go well and point fingers at public servants when things go bad, thus turning career officials into political actors. That would spell the end of a professional career civil service.

Politicians on the government side will need to strike all key decisions and assume the risks in the post-COVID-19 world. The mid-1990s program review exercise undertaken by the Chrétien government offers few lessons learned for what lies ahead. A good chunk of the cuts then came from transfer payments to the provinces and regional programs. It only takes a moment's reflection to appreciate why it is easier politically for federal

politicians to download cuts to provincial governments and why, at least from an Ottawa perspective, it makes sense to cut into regional programs.

But there is a price to pay. Canada now has the highest level of sub-national debt in the world. I suspect that if Ottawa had told the provinces in the 1960s that the federal share of funding Medicare would in time go from about 50 percent to 24 percent, most provincial governments would have told Ottawa, "no thanks!" Given that the fiscal burden that medical care places on provincial governments will only become more demanding due to the country's fast-aging population, not to mention the impact of the coronavirus pandemic on provincial health systems, Ottawa has no room left to cut its share of funding for Medicare. If it does, it will surely be the end of Medicare.

"Ottawa has no room left to cut its share of funding for Medicare. If it does, it will surely be the end of Medicare.

And Medicare is hardly the only case where the federal government enticed the provinces to enter a policy field – see numerous examples in education and economic development – only to cut and run a few years later, leaving provincial governments holding the bag. This time Ottawa will need to look to its own activities to make spending cuts. These decisions belong to politicians – no one else – and they will discover that unveiling cuts requires spending political capital.

This is not to suggest that the federal public servants can wash their hands of the tough task ahead. They play an important advisory role. They are responsible for managing government operations and they have a lot to answer for.

The federal public service, notably the Ottawa component, has done very well through several program review exercises. It has grown substantially in size for reasons that have never been clear. In 2000 the size of the federal public service was 211,975 employees, and in 2019 it was 287,978. This rapid growth has occurred despite the fact that it is the provinces that deliver labour-intensive public services such as health care,

education and social services, and despite an ambitious program review launched by Stephen Harper's government that sought to reduce the size of the public service.

I would invite readers to take a look at the many levels of management in all departments in Ottawa. The public service has also proven incapable of dealing with non-performers. It remains that when asked to take on new activities, they invariably ask for new resources rather than look at re allocating existing resources.

Many Canadians believe that cuts can be made to the overhead cost of government while having a minimum impact on their communities.

To be sure, the impact of COVID-19 is not limited to the private sector. Politicians will need to strike very difficult decisions and sell them to Canadians. Federal public servants should not be expected to take risks but they should be expected to come to terms with the fact that the overhead cost of the federal government is out of whack with what is required to deliver the necessary programs and services to Canadians.

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Climate change priorities need to be adjusted

Ken Coates

The government of Prime Minister Justin Trudeau has been openly committed to climate change policies since it was elected in October 2015. Since that time, the Liberal government has moved in fits and starts along a path suggested by the 2015 Paris Accord.

The high-profile carbon tax, expanded from $20 to $30 per tonne on April 1 2020, adding about 2.5 cents/litre and occurring at a time when collapsing prices at the gas pump rendered it economically irrelevant and while millions of Canadians were being thrown out of work and businesses are struggling to survive. The tax hike appears to have had little impact on

consumption while driving rural and farm frustration with what is seen as an unfair imposition. (Gas prices in Saskatchewan area, as of May 2020, are below 80 cents a litre, down from over $1 a litre in November 2019. The decision to expand the tax was unwise and unnecessary, but it is the kind of political judgment that goes substantially unexamined and uncriticized during times of national crisis.) The government of Canada has doubled down on the approach of linking government support to sustainability goals by announcing requirements that large businesses seeking access to government-supported credit have to report regularly on their sustainability progress.

Two things are quite evident about Canadians. The country supports action on climate change – provided it is done fairly and that the direct costs do not bite too deeply on individual or national well-being. Second, Canadians are deeply worried, mid-pandemic, about their lives, livelihoods and standard of living.

There is little evidence that there is national support for dramatic and risky changes in the national economy; instead, the deep hope that one feels across the country is the economy will return to "normal" in fairly short order.

Over its first term in office, the Canadian government tied its climate change agenda to efforts to constrain the oil and gas sector. Ottawa avoided dramatic actions but favoured regulatory controls on the sector. What the government has not done, beyond the carbon tax, was spread the costs of its climate change plan across the country. And as the Prime Minister has said repeatedly, the direct cost to individuals and families of the carbon tax is offset by equivalent or larger government cheques. This means industry, farmers and rural residents are playing disproportionately for the costs of the carbon tax while urban dwellers, already beneficiaries of massive subsidies for major transit projects, receive a rebate. All told, the cost of the Liberal government's climate agenda fell disproportionately on Western Canada, on the energy industry and on rural businesses.

Imagine, for second, the national reaction if Ottawa had knocked out the underpinnings of the national automobile industry, on the grounds that the manufacture and use of automobiles made large contributions to carbon emissions, or if the government had ordered a sharp reduction in the allowable heating and cooling of homes, public buildings and private businesses on the same basis. Consider the reaction in Quebec if the four Western Canadian provinces demanded that the federal government pull all financial support and expand regulatory control over the aeronautics and pharmaceutical industries, to say nothing of Bombardier and SNC-Lavalin. The reaction to such measures, each of which would have had a

nation-wide impact on carbon production, would have been loud, boisterous and politically unsustainable.

The main point is simple. If the government's objective is to reduce Canadian emissions, it can focus on the production side (oil and gas) or on consumption (transportation, home heating, manufacturing and the like). In the long run, the effort will require a combination of all opportunities to reduce emissions and a sharing of the burden across the country. Singling out the Alberta energy sector while ignoring offshore oil production in Newfoundland, cement plants in Quebec, or the energy footprint of massive urban developments is disingenuous at best and mean-spirited at worst. Moreover, it leaves the impression that the country's climate change aspirations can be met solely through an assault on the Alberta oil sands, which is not remotely true.

> *"The cost of the Liberal government's climate agenda fell disproportionately on Western Canada.*

It is destructive of national good will when the Premier of Quebec feels comfortable making gratuitous attacks on the Canadian energy industry while importing and processing in his province millions of barrels of foreign-produced oil.

Mid-pandemic, an unexpected political convergence has turned up the rhetoric on the topic. Bloc Québécois leader Yves-François Blanchet joined with outgoing Green Party leader Elizabeth May in declaring Alberta's oil sands "dead," suggesting that this is an acceptable outcome for the country as a whole. Their commentary is economically tone-deaf and destructive of national unity. Canada will be using oil and gas and related products for decades to come. The only realistic path forward is to recognize the Canadian-produced oil and gas will remain a major part of Canada's energy supply and that the energy sector is an integral part of the climate change planning process, not opponents of the search for an effective transition to a more sustainable economy.

Imposing national penalties on selected people outside the mainstream – and Alberta and Saskatchewan are clearly outsiders in national politics

– is an easy way to make policy progress. The backlash is limited and can often be contained politically to the affected region. What Canadians have missed to date is that an aggressive climate change plan that focuses on oil and gas production will have truly national consequences. Government revenues will tank, as they have already in Alberta and Saskatchewan, employment will crater, scores of businesses will close and hundreds of small communities in the West will experience excruciating dislocations. In an age of promised transparency, this is not a story that has been shared nationally.

A stark reality is staring the country in the face. Current Canadian policy will undermine and devastate the Western Canadian oil and gas sector. Should this happen, the current pandemic-related economic downturn will plunge further – and will last longer – with government lacking the financial resources to support a sustained recovery or to pay for a substantial and effective climate change plan. The Liberal government is politically devoted to its climate change agenda, even though current plans will have little impact on the global carbon footnote and will get little notice outside of Canada. Even Greta Thunberg will not be overly impressed.

Seldom, if ever, in Canadian history has so much been risked economically for such a limited return.

Canada requires a climate change agenda, just not the one that it is currently following. There will be no immediate transition to a renewables-based economy, however much proponents of the so-called Green Economy might like it. This is even more true internationally, where East and South Asia have substantial needs for oil and gas for decades to come, as the International Panel on Climate Change has confirmed. Canadian oil and gas, produced under strict environmental and social guidelines, is a vital part of the Canadian and the global energy mix and will be so for years to come. This country and the world at large will require a steady supply of oil and gas for at least three decades while alternate energy projects come online. The Canadian goal should be to create an energy plan for a huge, sub-Arctic country that has to come with a widely dispersed population and extremely cold weather. It is a fantasy to think that Canadian energy consumption will decline in parallel with those in more temperate climates.

In the current environment, Canada should prioritize new systems, particularly small modular nuclear reactors and community-sized energy plants, including geo-thermal, run of the river, wind and solar power. It should maintain the use of oil and gas where it is more logical and financially realistic to do so. Coal is clearly on the way out, certainly in North America. Canadian oil and gas could play a major international role in providing a steady and competitively priced supply that will allow China, Indian and

other countries to move off coal and to cleaner oil and gas. A robust and financially successful oil and gas sector, one with demonstrated achievements in reducing its carbon footprint, is part of a national climate change plan, and not the enemy of it.

The crisis has forced an unprecedented expansion in the scale of government spending and, therefore, the role of government in the economic life of the nation. Canadians find themselves facing an existential question in the coming months. Does the country believe that a subsidy-based, government-driven economy is in the best interests of the country, or do they want to put their confidence in a re-invigorated market economy?

The next few months matter greatly. The immediate challenges are monumental. But how governments invest their stimulus spending, regulate the economy and resource development, and plan for a realistic and effective climate change strategy that plays to Canada's strengths, will determine the fate of the Canadian economy for generations.

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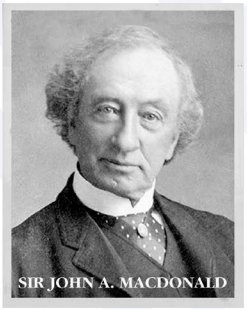
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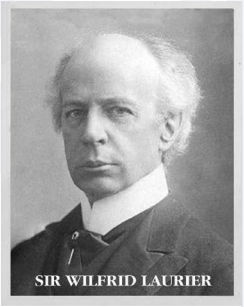
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