



True North in
Canadian public policy

A MANDATE FOR CANADA



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In advance of the 2019 federal election, MLI has released a new series designed to offer practical public policy recommendations for the post-election government. Titled “**A Mandate for Canada**,” this series of short analyses will cover a range of pressing issues that any incoming government will need to address, including Indigenous affairs, foreign and security issues, and economic and fiscal policy.

The Unfolding Debate: Public Policy, Politics and the 2019 Federal Election

Sean Speer

Introduction

We are at a critical juncture for our federal politics. Parliament broke for summer in the past 10 days or so. It will not return until after the election in October. We are now in effect into the unofficial campaign - one that will be punctuated by a wide range of issues, including climate change, competitiveness, public finances, health care, and so on. In this short commentary, I'll aim to contextualize the federal election campaign, the policy issues that will animate it, and what it means for businesses, workers, and the Canadian economy.

This analysis derives from a speech to the Vinyl Institute of Canada's annual general meeting in July 2019. It's not meant to be a comprehensive review of the policy issues that may animate the upcoming federal campaign or an evaluation of the political fortunes of the different political parties. Instead it is an exercise in political economy. It reflects my assessment of the intersection between policy and politics on some key public issues and the potential implications in the context of the election. Think of it as one policy observer's good-faith attempt to provide a political economy analysis for parliamentarians, the media, and ordinary Canadians.

The author of this document has worked independently and is solely responsible for the views presented here. The opinions are not necessarily those of the Macdonald-Laurier Institute, its Directors or Supporters.

Macroeconomy

It's worth starting with the macroeconomic picture on the eve of the election. Canadian voters are going to hear competing narratives about the state of our economy. The government will argue that Canada's economy has performed well:

- It will talk about significant job growth, including 106,500 new jobs in April (Canadian Press 2019).
- It will talk about positive wage growth in 2017 and 2018 (Canada 2019a).
- And it will talk about how Canada's GDP growth has led or been second among G7 countries for the past two years (Canada 2019b).

The opposition will set out a different economic narrative:

- It will talk about how growth is slowing and is projected to reach only 1.6 percent annually in the next two years (Canada 2019a).
- It will talk about stagnant or declining business investment – particularly foreign direct investment – for most of the past four years (Argitis 2018).
- And it will talk about how our labour market performance is uneven, including persistently high unemployment in our oil-producing provinces and the role that government policy has played in hastening a “job crisis” (Clancy and Graney 2019).

The truth is that both narratives are generally true. How people respond to these different narratives may be a reflection of where they live and what industry they're in.

The challenge for the government is that while much of the aggregate economic data affirms their story, the disaggregated picture is more complicated. Toronto and Vancouver have performed well. They've been responsible for a disproportionate share of net new job creation in the country for the past few years. Other places, such as Calgary, which now has the highest unemployment rate among the 33 Census Metropolitan Areas, have struggled (Fletcher 2019). This juxtaposition also applies to different sectors. Employment in services has steadily grown, for instance, while employment in manufacturing has lagged (Canadian Press 2019). To an extent we're observing two or even more economic stories in Canada.

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This applies here to Ontario. The Fraser Institute, for instance, has written about the “five solitudes of Ontario” (Eisen and Emes 2016). The regional disparities here in the province are illustrative of the growing economic unevenness based on place. It isn't unique to Ontario but the province can provide a window into this economic phenomenon elsewhere in the country

- Total employment in Ontario outside the Greater Golden Horseshoe has barely recovered to pre-recession levels.
- Employment rates and labour force participation rates have been much lower in Eastern, Northern, and Southwestern Ontario than in Ottawa and the Greater Golden Horseshoe in recent years.

- And the economic dependency ratio in Eastern, Northern, and Southwestern Ontario has also been consistently higher than the provincial average.

This doesn't even account for the uneven economic conditions for different Canadians. The top-line data on Canada's labour market is self-evidently positive. But the experiences of different cohorts – namely, working-age men and women without post-secondary qualifications – is much more challenging. The risk for the government, then, is that a triumphalist tone on our macroeconomic performance will sound disconnected for large swathes of the province and the country. It will need to balance its message about overall progress and regional or local challenges or the opposition narrative on the economy will ultimately win out.

Public Finances

People will know that the Trudeau government came to office on a clear commitment to run budgetary deficits of \$10 billion for three years and return to surplus this year. That promise is still awkwardly in Minister Morneau's mandate letter on the Prime Minister's website (Canada 2015). The government's mandate tracker describes this promise as “not being pursued” (Canada 2019c). Readers will know that it wasn't long after the election that this promise was abandoned. The deficit has consistently been about twice as high as promised. The three-year duration has been replaced by an indeterminate timeframe.

There are two main problems with the government's fiscal policy. The first is that we're probably on the backside of the business cycle. Historically we've tended to have economic downturns every eight to 10 years. Budgetary deficits at 3 percent growth invariably mean higher deficits when growth turns negative.

According to the Fraser Institute:

- If we experienced something like the 1991/92 recession, the deficit would jump from \$14 billion to \$43 billion.
- If we experienced a more marked slowdown like 2000/01, it would jump to \$48 billion.
- And if we experienced a recession of the magnitude of 2008/09, the annual deficit would hit \$120 billion (Clemens, Palacios, and Veldhuis 2018).

Importantly, these estimates don't account for any incremental stimulus spending. They're just a function of the recessionary effects on revenues and automatic spending such as Employment Insurance.

The point is that deficit spending in good times makes it more challenging and costly when circumstances change. And, at some point, the good times are going to end.

My second objection to the government's fiscal policy focuses on the utility of much of its new spending. The government has increased spending by 20 percent in its first three years in office. This outstrips typical benchmarks such as economic growth, inflation growth, or population growth. In fact, it's one of the largest sustained increases in government spending since the early 1970s, and one of the largest outside of a recession or wartime in Canada's history (Fuss, Poschmann, and Palacios 2019).

The government likes to characterize its spending growth as being driven by large-scale increases in infrastructure spending. But the truth is that infrastructure spending – particularly on productive infrastructure – has played a small role (Speer 2018a). Most of its new spending has just been run-of-the-mill government largesse that, in my view, is hard to justify, especially since it has caused borrowing costs to go up for the first time in several years (Speer 2019a). This is an important point: Ottawa argues that its deficits are small and manageable,

which is, of course, true. But it's not a good sign that the share of government revenue dedicated to servicing our public debt is rising.

My biggest concern is that our fiscal policy debate is rooted in abstraction. The Left argues in favour of higher government spending in the abstract. But this isn't about whether certain expenditures are good or nice. We have to judge it against the costs of extracting resources out of the private economy or the government's borrowing costs. And I would contend that if we use this test, arguably not much of Ottawa's new spending would survive.

The Right, by contrast, tends to make arguments against deficits in the abstract. I think they need to make the case in a much more honest and direct way. There's an onus to set out what we think the government should do, what we think the government shouldn't do, and a transition plan to get there.

Regrettably neither side of the political argument is likely to change how they think or talk about fiscal policy in the forthcoming campaign. The result is we'll get a hyper-politicized debate in which the Left claims that anything less than the current level of public spending amounts to radical "austerity" and the Right argues that we're facing a fiscal "crisis." And Canadians will be left no more informed about the real differences between the political parties and what it means for them.

In fact, I think it may be even worse than that. The cynic in me thinks that the government's deficit isn't a function of ideological preferences. It's actually a deliberate political choice to box in the Conservative Party. A persuasive argument can be made that the government could have balanced the budget if it wanted to due to strong revenue growth. It has effectively manufactured a deficit in order to accuse the Conservative Party of an austerity agenda. It's what political people call a "wedge." I've personally called it "weaponizing" deficit spending (Speer 2019b).

Think of it this way. The Conservative Party now faces a trilemma. One: It can run on balancing the budget. Two: It can run on new spending promises or tax cuts that resonate with voters. Three: It can avoid running on spending cuts. But it can only have two of the three. And on number three, while the deficit may be small relative to the size of the economy, closing the fiscal gap in the next mandate would still involve reducing planned spending by 3.4 percent.

One can already hear the Prime Minister and Mr. Morneau condemning such a plan as cold-hearted, mean-spirited, or worse. It's precisely the type of campaign that the government wants to run. We now know that Mr. Scheer and the Conservatives have therefore chosen number three. They won't commit to balancing the budget for at least five years. The upshot is that the two major parties now basically agree on deficit spending and so while public finances ought to be an issue in the campaign, I suspect they won't be.

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Climate Change

Another issue that we've heard a lot about is climate policy. The media and others have come to characterize it as the source of major differentiation and thus a likely campaign issue. Yet I think this is a bit overblown. Both major parties have agreed that we ought to aim for meeting our Paris Agreement targets. They've also agreed that achieving this goal will require a mix of different policies. These questions are not in dispute. Where they disagree is that the current government's policy mix involves a broad-based carbon tax. The Conservative Party opposes the adoption of a carbon tax on consumers.

Is this an intractable difference? Not really, in my view. There are two main problems with the narrative that this issue is a major source of differentiation.

The first is that the government's carbon tax is small and, notwithstanding the rhetoric, plays a limited role in its projected emission reductions. In fact, according to climate policy expert Mark Jaccard (2018), the federal carbon tax will be responsible for roughly 15 percent of Ottawa's climate plan's emission reductions. That figure will probably end up being even lower given that Minister McKenna has indicated that the government has no plan to raise the carbon tax beyond \$50 per tonne (Beer 2019). So when one drills down into the numbers, the parties are essentially arguing over less than 15 percent of the overall policy mix. Put differently: the political class agrees on what amounts to more than 85 percent of climate policy.

The second point is that while the Conservative Party is opposed to the consumer carbon tax, it has basically endorsed a carbon levy on industrial emitters. In fact, recently Mr. Scheer conceded that his plan would function, at least theoretically, like a tax on those businesses that emit more than 40 kilotonnes per year (Aiello 2019). He just doesn't want it to extend to a direct tax on consumers. So, again, for all of the rhetoric about carbon taxes, we're essentially fighting over the tax base and how the levy is designed. The parties want us to believe that there's a much wider gulf between them than there is. The real story here isn't policy divergence but the extent to which we're seeing policy convergence on climate change.

We basically agree on some combination of regulations, subsidies, and levies as part of an aspiration to meet the Paris targets. We basically agree that the levies ought to apply to large-scale emitters. We disagree on the margins about how widely the levies apply across the economy and how they function. That's essentially it. And, for that reason, I cannot imagine that climate policy will ultimately drive the election debate.

Pharmacare

Let me next address pharmacare. This may actually be the subject of real differentiation. We can anticipate the Liberal Party will run on a version of single-payer pharmacare as recommended by the Hoskins Panel. The Conservative Party is unlikely to match this commitment. The only question, it seems to me, is whether it puts forward an alternative proposal to address those who are uninsured or under-insured.

I believe it should. The case for single-payer pharmacare is, in my view, quite weak. Even according to the Hoskins Panel, the vast majority of Canadians have drug coverage through an employer, an individual plan, or the government. Roughly 3.5 million don't have insurance. Another roughly 3 million are under-insured.

Who are these people? The truth is we know quite a lot about them. A large share is neither poor nor old. They're also unlikely to live in a rural or remote community. Otherwise they would be covered by provincial programs, such as Ontario's Trillium Drug Program, which target low-income households, seniors, or rural residents. They don't have private drug coverage through an employer, a spouse, or as an individual. This presumably means that they are unattached or work for small firms or are involved in non-standard employment such as "gig" economy, non-profit work, or self-employment.

My research in fact estimates that 2.8 million (or roughly 80 percent) of the uninsured cohort actually fall into the self-employed category (Speer 2019c). And it's not even accurate to refer to this self-employed group as uninsured. These people have ostensibly chosen to self-insure based on a cost/benefit analysis of obtaining insurance relative to paying out of pocket for drugs. These characteristics mean that this cohort is generally working-age and earning income that exceeds the means-testing thresholds for public programs. It also means that these people aren't victims of an unfair system but rather mostly are rational actors who've made reasonable judgments based on age, costs, and health status.

Now, of course, this doesn't mean policy-makers shouldn't concern themselves with this group. But it might change how we think about the role of government and public policy.

Basically the Hoskins Panel's claim that there are "significant gaps in coverage and access" is both qualitatively and quantitatively less significant than it would have us believe. The truth is we may only be talking about roughly three-quarters of a million people or so who have access to neither private nor public plans and face limitations to obtaining drug coverage through an employer or on their own.

This matters, of course, because the significance of the purported gap is key to the panel's appeal to Canadians' fairness and its justification for sweeping reforms to the current drug insurance model. If the gap isn't that big and the people affected aren't vulnerable - in fact, a considerable share have deliberately chosen not to obtain drug insurance - then, it seems to me, the whole fairness argument collapses under the weight of its own evidence. And, in turn, it becomes more and more difficult to justify blowing up the current model to better accommodate a population roughly the size of Mississauga.

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What about the politics?

I'm also skeptical. Disrupting drug coverage for 80 or 90 percent of the population to target a small share of Canadians is a risky proposition. The better solution, in my view, is to build on the current mix of public and private insurance and target those who are currently left behind. This approach would leave the current model intact for the vast majority of Canadians and instead focus on those for whom the current model isn't working.

I've written about different such models including redesigning the Medical Expense Tax Credit to better help people obtain private drug coverage (Speer 2018b). But I won't go into the details here. My main point is that this could emerge as a significant political issue if the Liberals run on radical reforms to the current model and the Conservatives propose something more targeted.

Education, Populism, and the Future of Work

I've detailed some of the specific policy issues that may animate the election campaign. But there is a bigger structural issue that will be behind-the-scenes of the campaign and our politics over the long-term. This concerns the economic and social forces that are contributing to political disruption in Western societies. President Trump's election is, of course, the most significant example of this trend. But the truth is we're observing it

across many countries. And we need to better discern whether we can anticipate it here and what we can do to mitigate it.

There are various arguments and explanations ranging from trade to immigration to xenophobia and so on. Yet the single most important determinant of those who voted for Trump and for Brexit is education level. Those without university or college degrees are most vulnerable to the twin forces of Chinese import penetration and technology-induced dislocation. It's this cohort who rightly recognizes that its economic prospects are narrowing (Speer 2018c).

We increasingly have an economy that's producing bifurcated opportunities. The economy is producing new and dynamic opportunities for those with the right set of aptitudes, credentials, and skills. But we are witnessing narrowing opportunities – particularly stable, well-compensated ones – for those without them. A range of scholars have come to refer to these trends as “skill-biased” change. As a result, those without post-secondary education or who are working in manual labour are facing heightened risks of technology-induced dislocation and increased competition from low-cost imports. In turn, there are fewer opportunities for these people to find stable employment, earn a decent living, and provide for themselves and their families.

What do these trends mean for Canada?

It requires that we drill down into top-line data on our labour market performance. A superficial focus on aggregated outcomes risks missing the concentrated challenges that rose to the surface in the 2016 presidential cycle. The truth is Canada's strong labour market performance in recent years conceals significant differentiation among regions, genders, and working-age Canadians with different educational attainment.

The challenges are most acute for working-age men without post-secondary qualifications whose labour market outcomes outside of the oil-producing provinces have resembled some of the poor outcomes observed in parts of the United States. This cohort seems to be facing a series of secular headwinds that threaten their inclusion in broader labour market gains.

Much of Canada's labour market strength (including general employment, full-time employment growth, labour force participation, and income growth) has been driven by women with post-secondary qualifications. They have outperformed men with post-secondary experience and degrees and markedly outperformed non-educated men and women for the past 20 to 30 years. We cannot afford to neglect the experiences of this cohort. Approximately 36 percent of Canadians do not have university or college qualifications or have completed an apprenticeship. This amounts to about 6.7 million Canadians aged 25 to 64 – roughly the equivalent of the combined populations of Manitoba, Saskatchewan, and Alberta (Statistics Canada 2016).

Think about it this way: roughly one-third of working-age Canadians do not have post-secondary qualifications and even according to data for younger cohorts, this isn't likely to change significantly in the future. The upshot is our politics and policy must place a much greater focus on supporting those who don't choose the post-secondary path. The case for putting this cohort closer to the centre of our politics is both a hedge against political populism and substantively the right thing to do given its economic vulnerabilities.

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Yet I would argue that this is the least represented group in our politics and public policy. We spend a lot of time thinking about political representation among women, Indigenous peoples, and so on. This is important, of course. But we rarely consider the political representativeness of those without post-secondary qualifications.

The fact is most elected officials and senior public servants have post-secondary degrees and tend to think about the economy and labour market through the lens of post-secondary education. This is one of the reasons that we spend billions of dollars per year on grants, tax subsidies, and so on, for those who choose to attend university or college, and virtually nothing for those who leave high school and enter the work force. Our public policy framework essentially signals to these people that, unlike their peers who choose a post-secondary path, we have no collective interest in their success. In fact, the types of work that this cohort tends to do is regularly subject to punishing mandates and regulatory impositions.

Think of the natural resource sector, for instance. We seem to be imposing new and additional burdens on the sector without careful consideration of the potential economic, political, and social costs including the erosion of an outlet for working-class opportunity. Harming the one sector that has been such a major source of employment for those without post-secondary qualifications is something we could seriously come to regret. Yet that's what is happening. Just consider the trade-offs that Ottawa is implicitly choosing between its environmental objectives and the energy sector.

Stringent climate change abatement policies may have a marginal effect on emissions but could seriously undermine employment for people without post-secondary education. Analysis of the distributional effects of environmental policy needs to go beyond region, sector, or income level, and consider the limits of employment substitution for workers without post-secondary qualifications. That the natural resource sector has played a key role in sustaining Canada's middle class ought to be a key consideration when policy-makers grapple with these trade-offs (Milligan 2018). It's certainly not clear that this is happening.

Bill C-69's inclusion of new requirements that energy projects are considered based on their overall climate effects is a concrete example. We know that the principal climate effects of energy projects are related to transportation and individual consumption. The extractive process itself is only one part of the overall emissions picture. It seems highly unfair and counterproductive therefore for energy projects that will provide significant employment to assume full, economy-wide responsibility for upstream and downstream emissions.

Why would we ask oil sands workers to bear a disproportionate share of the economic brunt? It seems to me it amounts to a regressive subsidy from non-educated workers in Alberta's energy sector to educated workers in other parts of the country.

This isn't a call for climate inaction. But it should mean that our analysis of policy trade-offs drills down into the aggregate effects and understands how they will affect the employment prospects for people with different educational backgrounds and skill sets. The present debate about the household distribution of the federal carbon tax proposal (including its accompanying rebates) doesn't fully capture this dynamic. It can be both true that most households are, in net terms, better off and working-class households are subjected to greater risk because of diminished opportunities in the natural resources sector.



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We need to rebalance our policy and politics to better focus on interests of working-age Canadians without post-secondary qualifications. And the upcoming election campaign is a good place to start.

Conclusion

There will no doubt be various other issues that are part of the 2019 campaign. Election campaigns are after all often marked by topics that were difficult to anticipate. Few could have guessed, for instance, that Syrian refugees would loom so large in 2015. And there are growing signs that the Canada-China relationship could loom large this time around (Young 2019).

Still, based on public polling, including a recent Abacus Data poll (Anderson and Coletto 2019), and my assessment of the pending campaign, the issues and accompanying analysis in this commentary provide a good primer on how policy and politics may intersect in the coming months and what it means for Canada and Canadians.

About the Author



Sean Speer is a Munk Senior Fellow at the Macdonald-Laurier Institute. He previously served in different roles for the federal government including as senior economic advisor to the Prime Minister and director of policy to the Minister of Finance. He has been cited by *The Hill Times* as one of the most influential people in government and by *Embassy Magazine* as one of the top 80 people influencing Canadian foreign policy. He has written extensively about federal policy issues, including personal income taxes, government spending, social mobility, and economic competitiveness. His articles have appeared in every major national and regional newspaper in Canada (including the *Globe and Mail* and *National Post*) as well as prominent US-based publications (including *Forbes* and *The American*). Sean holds an MA in History from Carleton University and has studied economic history as a PhD candidate at Queen's University.

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The Institute undertakes an impressive program of thought leadership on public policy. Some of the issues we have tackled recently include:

- Aboriginal people and the management of our natural resources;
- Making Canada's justice system more fair and efficient;
- Defending Canada's innovators and creators;
- Controlling government debt at all levels;
- Advancing Canada's interests abroad;
- Ottawa's regulation of foreign investment; and
- How to fix Canadian health care.



True North in
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What people are saying about the Macdonald-Laurier Institute

In five short years, the institute has established itself as a steady source of high-quality research and thoughtful policy analysis here in our nation's capital. Inspired by Canada's deep-rooted intellectual tradition of ordered liberty – as exemplified by Macdonald and Laurier – the institute is making unique contributions to federal public policy and discourse. Please accept my best wishes for a memorable anniversary celebration and continued success.

THE RIGHT HONOURABLE STEPHEN HARPER

The Macdonald-Laurier Institute is an important source of fact and opinion for so many, including me. Everything they tackle is accomplished in great depth and furthers the public policy debate in Canada. Happy Anniversary, this is but the beginning.

THE RIGHT HONOURABLE PAUL MARTIN

In its mere five years of existence, the Macdonald-Laurier Institute, under the erudite Brian Lee Crowley's vibrant leadership, has, through its various publications and public events, forged a reputation for brilliance and originality in areas of vital concern to Canadians: from all aspects of the economy to health care reform, aboriginal affairs, justice, and national security.

BARBARA KAY, NATIONAL POST COLUMNIST

Intelligent and informed debate contributes to a stronger, healthier and more competitive Canadian society. In five short years the Macdonald-Laurier Institute has emerged as a significant and respected voice in the shaping of public policy. On a wide range of issues important to our country's future, Brian Lee Crowley and his team are making a difference.

JOHN MANLEY, CEO COUNCIL
