

“The Top Public Policy Challenges Facing Canada Today”

Notes for a talk by AIMS President Brian Lee Crowley

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Ladies and Gentlemen,

I have been asked to talk to you about what I see as the greatest public policy challenges facing the country. I am going to concentrate my remarks on two areas with infinite ramifications:

1. Our relationship with the United States
2. Demographic change and its impact on three key policy areas: social welfare, politics and immigration

You may notice, if I have time to get anywhere with my remarks, that there is a surprising extent to which these seemingly disparate policy fields are in fact deeply intertwined in complex and perhaps unexpected ways.

### **Relations with America**

All of the world that has hitched on to the powerful trend toward trade liberalisation has enjoyed unparalleled growth, while those who have remain aloof have withered. Compare the Taiwans, the Hong Kongs, the South Koreas, the Singapores, with the Cubas, the Burmas and the North Koreas. Compare the Brazil or India or Ireland of today with the same country a mere 10 or 15 years ago. Wherever trade has been allowed to work its magic, it has grown faster than national economies.

Trade between Canada and the US is the largest in the world, CAD\$2-billion dollars worth of trade every single day of the year. Over 300,000 trucks enter Maine alone from Canada every year, about a 50% increase in only 5 years. It was realities like this that drove our two countries to conclude a new reciprocity agreement for a new century, the FTA, giving us both the tools to manage that huge trading relationship more intelligently and thoughtfully.

And it helps to remember why freer trade is such a powerful force for growth. Of course it does help to keep inflation low and keep our industries under pressure to be competitive, but that's not its primary strength. That primary strength is that it forces everybody to specialise in what they do best.

## **Specialisation is the key.**

That's why the United States is such a powerhouse in the entertainment industry, or in software, or in defence technology. That's why Montreal is doing so well in aerospace and biotechnology, New Brunswick is a world leader in the nexus between telephony and information technology, and Nova Scotia is a world centre for ocean industries.

That's also why the textile and shoe and furniture and steel and shipbuilding industries that used to be such a feature of my region have long since fled to other places where people do them better than we do.

Free trade relentlessly presses us to discover what we're good at and to put all our productive efforts there because that's what most benefits us and our customers around the world. And what we're good at is a constantly moving target, as producers all over the world jockey to gain a competitive advantage in every field.

So the key to economic success lies in identifying your main strengths, and not holding on to the past. And it is a great strength for Canada that our trading relationship with the US forces us to benchmark ourselves against the most productive society in the world.

But remember that free trade isn't only about specialisation. In particular, trade is about greater competition, which weakens the power of vested interests. It is about greater opportunity for millions rather than privileges for the few. That is why the vested interests will always try to use politics to frustrate competition and free trade, because these two forces move power into the hands of those who are most adept at satisfying consumers. These are not at all the same people as those who wield significant political power. And even before September 11th, the forces of politics have been rallying against the forces of free trade. The balance is less decisively in favour of free trade than at any time I can recall since the 1980s. And for anyone who has looked at the US farm bill or the steel protectionism or the US attitude at the Doha trade round, it is clear that political forces hostile to freer trade are more powerful in the Washington political establishment than they have been for decades.

To these already powerful trends has been added the devastating effects of 11 Sept. America already has a powerful isolationist streak – to that has now been added the concrete proof, to their eyes, that the world is a dangerous and dark place, and one where friends are few and far between. Americans have developed an admirable sense of solidarity in the wake of the attacks, but that solidarity comes at the price of considering everyone else a potential threat. This changes fundamentally the atmosphere that prevailed before 11 September for Canada-US relations and particularly the deepening of our economic relations. Where before all thoughts were turned to how to make the barriers at the border disappear, suddenly Americans are thinking of reinforcing the wall that separates them from the dark world to which I have already alluded.

11 September has driven home to Washington how the institutions of a free society can be turned into weapons to be used against them. Relatively open borders are one of those

institutions. Whether terrorists came in from Canada last time or not, our border is an area of vulnerability that Americans will manage in order to maximize their own security.

The impact isn't just on the immediate movement of goods. Every delay and border hassle doesn't just raise costs for existing businesses. It makes potential new investors question investing in Canada when access to our chief market may be subject to unpredictable political risk in the form of strict border controls.

Crude nationalists always present free trade with the US as a loss of Canadian sovereignty. What they forget is that the Americans have sovereignty too and can use it in ways that are deeply damaging to us. Free trade is often a delicate balancing of a loss of our own freedom of action in exchange for the Americans accepting the same. It has always been in our interest to attract America into rules-based relationships like the NAFTA and multilateral organisations like the WTO and the UN because both strategies allow us to create constraints on what would otherwise be a relationship based solely on power, and hence one where America would hold all the cards.

The stakes at the border now are as high as they have ever been for Canadians. In my view our top challenge is to make absolutely clear to the Americans that we are a trustworthy partner who is ready to work with them to create a well-policed continental perimeter within which we can all feel as safe as possible. Then we can get on with the business of dismantling the barriers to the movement of goods and services between our two nations on which our mutual prosperity depends. This wall doesn't have to be loveable, just liveable.

Now the post-September 11th world presents us with both opportunities and challenges in this context. Canadians seem not really to grasp, how the mass murder of that date changed the world view of Americans and their government. America may be the great commercial republic, but there is no doubt in my mind that in America today, security trumps trade and prosperity every time. That, of course, is the message of the creation of the Department of Homeland Security, the single biggest shake-up of the structure of Washington in several generations. Emblematic of the change is the fact that Customs, which I believe used to be under the Treasury, and was therefore primarily an agency preoccupied by trade and economics, is now under Homeland Security, an agency obsessed by security.

Of course many of us in Canada hope and believe that this represents an opportunity for us to move to a new stage of deepening and broadening our relationship, and indeed many of us, including Canada's former ambassador to the US, Allan Gottlieb, have spoken of the idea of a new Grand Bargain, a NAFTA plus, in which we would trade better and closer security ties for improved access to US markets, including even, perhaps, almost free movement of people.

But the problem with the trade-off that is envisaged here is that our bargaining power is a wasting asset. With each passing day, America makes more and more of the decisions about how it will respond to the darker more threatening world it now sees, and Canada

has been, to put it charitably, ambiguous and confusing about where it wants to go. On the one hand there has been the excellent Smart Border Accord, and practical things like the presence in Halifax, Montreal and Vancouver of US customs inspectors helping to ensure that containers are properly inspected. Ultimately I hope that this is the precursor to a continental perimeter border where the two countries negotiate mutually acceptable standards for goods and persons entering the continent, and once let in by one country, they then move without let or hindrance throughout the continent.

But how can we reconcile that hope with Canada's offensive behaviour toward the Americans in the run-up to the recent Iraqi military action? The message sent by our politicians, and, I am sad to say, a distressingly large segment of the population, was that Americans were not our friends, but nasty bullies to be derided, mocked and harried. Canadians seem not to have realised that, to US eyes, there is no nice neat, clear dividing line between the "War on Terrorism" which we continue to support, and the war against Saddam. Recent moves to bolster Canada's contribution to its own defence, thus reducing slightly its status as an egregious free rider in defence matters, as well as the mooted Canadian agreement to participate in the star wars initiative, are welcome steps, but only time will tell whether they are enough, and as I have already said, time may be one thing we have precious little of to remain on the right side of the security cordon the US is building up with every passing day.

It is, of course, right to say that the US benefits from open borders with Canada too, but Canadians are far too optimistic about what that means. Canadians can never afford to forget that our relationship is fundamentally an asymmetrical one. Yes, we are the US's largest trading partner (and the largest trading partner for 38 states), but China and Mexico are growing more rapidly. More importantly, while we export 40% of our GDP (and 50% of our private sector production), and virtually the totality of that goes to the US, the US only exports about 11% of its GDP, and does so to a more diversified range of countries. It is extremely hard to get the US government even to focus on problems in the US-Canada relationship. And when we have gone out of our way to be disobliging on the Iraq issue in such an egregious way, the US can do us tremendous damage simply by their indifference, by being too busy to notice that there are problems. Yes, they will be quick to take action to protect and defend US interests, but in my view they will be rather less quick to try and accommodate Canada's concerns. And while we usually have been there for the US, we cannot simply blithely assume that therefore nothing we do can damage what has hitherto been an extremely positive relationship.

I am not saying that there is no alternative to repairing, broadening and deepening our relationship with America. Of course there are choices. But all of the others are ultimately inferior to this one. There are complementary measures, but no substitutes.

When the dispute about Iraq is over, we will again want to make common cause with the Americans at other times and in other circumstances, just as we do today in the war on terrorism, in rebuilding Afghanistan and Kosovo and in the defence of North America. They are our friends and allies, not because circumstance forces that relationship on us,

but first and foremost because we are very much alike and we believe that that is the right way for us to be.

### **Demographic change**

There can be little doubt that we are going through very significant population change. Not only does this have major implications for our future productivity and labour force, but it affects social welfare programmes and immigration as well. And the significance of our population changes is magnified by being next door to the United States, a country that will not undergo the same kind of aging that we will. In fact almost alone among industrialised countries, the US is going to continue to be a relatively young country with very high productivity and high labour force participation rates. This will likely create significant pressure for Canada to reform a series of social programmes, or else the country risks a widening of the productivity and prosperity gap with which we are all familiar.

Now the population isn't going to shrink. Between now and 2036 we are projected to grow to just over 40 million, but the rate of increase is going to shrink significantly, from 6% every five years in the late 90s, to only 2% every five years in the first half of the 2030s. But the change will be most visible in the aging of the population: in 1996, nearly 27% of the population was under 20. In 2036, a mere 20% will be under 20. In 1996, Only 12% of the population was over 65. By 2036, it will have doubled, to 24.5%. And over the last 25 years, people over age 55 have been working less and less. In 1976, 48% of men over 55 were in the labour force. By 1996, it was down to 33%. Women over 55 peaked in the labour force in 1981 at only 18.4%; by 1996 it was down to less than 17%. The labour force in 2036 will be 45% of the total population, down from 51% 40 years earlier.

Now these trends do pose challenges in terms of labour availability, although it is easy to exaggerate their importance, to make a "crisis" out of a problem. First of all, the total number of workers is not the only determinant of the supply of labour, or of the ability to get work done. For example, if the same number of people work more hours, if people hold multiple jobs, if people end up retiring later rather than earlier, more work gets done. Capital can be substituted for labour. In fact, the labour shortages of the 1990s in the US themselves had a tremendous impact on the labour participation rate. Because workers were more and more valuable, employers sought them out more and more aggressively. Every nook and cranny of the population was scoured for potential workers who could be enticed into the work force. Employment among seniors, for example, increased substantially, as people were offered conditions that were sufficiently attractive to entice them out of retirement.

A labour shortage is a worker's best friend. Employers were so desperate to find people that they began to devise strategies to allow them to put, for example, illiterate workers to work. That is why the fast food industry, to take but one example, began to design cash registers using only pictograms, not words and numbers, so that workers who could not read could nevertheless operate some fairly sophisticated machinery. For all these

reasons, I believe that there is far more flexibility in labour force availability than a simple analysis looking at population numbers will reveal.

If we are to meet the challenge of American productivity, we are going to have to put a lot more people to work at higher levels of productivity. Those extra workers are going to have to come from three key sources: older workers who today would not be working, people trapped on welfare benefits of various descriptions, and immigrants. Each one represents some challenges that I want to speak to. I think that Bill Robson is going to speak about some of the problems represented by the aging population, so maybe I'll leave that field to him. Let me talk, then, about welfare reform, followed by some observations on the interplay between demographic change and politics. I will wind up with some comments on immigration, if I have time.

### **Welfare reform**

The key to reducing poverty is work, not welfare.

There is not a huge underclass in Canada trapped permanently on low incomes. On the contrary, there is huge turnover from year to year: somewhere between a third and a half of the people in the bottom fifth (quintile) of income earners one year are not there the next, not because they have starved to death, but because their income has risen. And StatsCan's numbers are quite clear about what makes the difference between falling into poverty and escaping it: the best and most common route out is more family members working more hours. Hard work and a buoyant labour market do make the difference.

Now Thomas Sowell, a distinguished black economist at the Hoover Institution at Stanford University in California, has deepened our understanding of the relationship between work and poverty even further. His figures, of course, look at the US situation and, while I haven't seen the comparable numbers for Canada, I expect that they are substantially similar. In a recent article, Sowell points out that while there are more than 19 million people working in households with incomes in the top 20 percent in the United States, there are fewer than 8 million people working in households in the bottom 20 percent. Among households in the bottom 20 percent, there are more than 13 million people who do not work at all. So unless you're prepared to argue that it is unfair that work be rewarded, these huge differences in numbers of household members working go a very long way to explaining income differences between the so-called "rich" and those at the bottom of the income scale.

Just how much income do you need to get into the top 20 percent of income earners in the US? Household income of \$85,000. That's two adults working at lower-middle class salaries. And remember that many of the people in this group will have been in the bottom 20 percent of income earners at another point in their lives. Far from it being the rich are rich and the poor are poor and never the twain shall meet, there is massive movement among income classes and for most people being on low-income is not a permanent condition but a normal way-station in life.

Work is still the best most effective antidote to poverty. And contrary to what many people might think, the main obstacle to improving conditions for those on low-incomes is not the absence of jobs. On the contrary, industries around Atlantic Canada and Canada more generally, are getting increasingly exercised about looming labour shortages, and most employers tell pollsters they have real difficulty finding workers. No, it's poorly designed social programs, both federal and provincial, that remain the biggest obstacle to helping people get back into the labour force and out of poverty.

I won't repeat here what I said to this group two years ago, but I commend to you again my comments on the cultural dimension of poverty and the very significant constraints that puts on government's ability to use spending programmes to combat pathological poverty, as opposed to what we might call conjunctural poverty. For those of you who wish to refresh your memories on what I said at that time, the text is available on-line in the commentary section of our website.

### **Demographics and politics**

I want now to turn briefly to the effects of demographic change on politics. It is not just the age structure of the population that is changing, but also their geographical distribution, and this is closely linked to a series of social, regional and, ultimately, political conflicts. I don't have time for details, so here are a few facts to feed your imagination.

The cities and metropolitan areas will continue to be the motors of economic growth, in part because they are where people want to live, and in part because technology allows people more freedom to follow those desires. They will attract virtually all immigrants and young people.

Rural areas are going to lose population, and quickly, and their population will be changed as the urban values of retired Boomers looking for a country idyll come to carry more weight. The country's demographic centre will continue to shift resolutely westward.

But our political institutions are struggling to keep up and, by and large, are failing to do so effectively. In 2036, to take just one example, Atlantic Canada will have less than 6% of the national population, but 10% of the parliamentary seats, nearly double their share justified by representation by population. Similar effects will be observed in Québec, Saskatchewan and Manitoba. This means that political reality will continue to favour the regions most resistant to change and innovation. Even within provinces, the distribution of parliamentary seats continues to favour rural areas heavily at the expense of cities for reasons that may have made sense in the 19th century, but not in the 21st.

But let me remind you of what I said at the outset about prosperity based on free trade — that it depends on a constant commitment to innovation and specialisation. So the effects of our demographic shifts is actually to make relatively more powerful those parts of the country that benefit least, in their eyes, from change, while refusing to grant the more

dynamic areas of the country a political weight commensurate with their economic contribution.

Think about where opposition to regional development, social programme and education reform, bank mergers, telecommunications restructuring, etc., are strongest. Note too that the areas of greatest under-representation are also the areas of the greatest strength for the Alliance (BC and Alberta), while the areas of greatest over-representation tend to be dominated by the Liberal Party, and may even confer on it its parliamentary majority. Political power and economic power are going to be painfully unsynchronised and we have not yet come up with the right solutions.

## **Immigration**

There are two main issues with respect to immigration that will repay some reflection. One is the problem of assimilation of immigrants increasingly arriving from parts of the world that are regarded, in the context of the war on terrorism, Iraq, the Arab-Israeli conflict and a host of other factors, as dangerous places. The other is the fact that Canadian authorities now control the selection of a minority of the immigrants arriving in this country.

On the first point, Canada today is very reminiscent of Europe before September 11th — see how that date keeps coming up again and again? Elites regard any discussion of immigration as an offence against good taste and liberal values.

But what happened after September 11th was that those same liberal sensibilities, sensibilities that I share, were shocked and outraged by the reaction of many of the newcomers in their midst. A major factor in the rise of Pym Fortuyn in Holland was polling that showed that 40% of the country's growing Muslim population were not prepared to condemn the attack on the World Trade Centre.

Britons were shocked to discover that two British Muslims had gone to Israel as suicide bombers. More and more Western societies are discovering, according to *The Economist*, "...what ordinary citizens had long believed, but not dared to say: that many of their immigrant neighbours do not share" many basic Western values.

At last, not just were the long-term effects of immigration openly on the agenda but it was permissible to be open about them; in particular, to admit that they would not go away again if the plebs would put aside the racial and other prejudices which the better-educated, suburban-dwelling, liberal elite wouldn't dream of sharing. Fortuyn was shot dead a year ago; his party was soon in chaos. But the veil that decency and good-will had cast over discussion of such questions had been decisively torn away. (*The Economist*, May 10th, 2003, p. 22)

I believe that Canadians are going to be shocked too when the extent to which we, as a country bordering on the US and with relatively easy access to our neighbour, are used as a base for terrorism by extreme groups is revealed, along with the extent of sympathy

among some population groups for terrorist activity, and particularly some immigrant groups.

Combine this with the fact that Canada has essentially lost the ability to determine who comes to this country, and we face a perilous time; it is only a minority of immigrants who now are chosen on rational criteria by Canadian authorities for the benefit of Canadian society. The bulk of immigrants now comes in under either the family reunification or the refugee class, meaning that they are essentially self-selecting, often allowing undocumented and unqualified refugee claimants to jump the queue. Our refugee determination process is the laughingstock of the world – we accept a far higher proportion of applicants than almost any other rich nation, and accept them from improbable places like Norway!

One consequence is that immigration is no longer the unqualified economic benefit that it once was — immigrants aren't even any younger than Canadians on average, and therefore make no contribution to meeting the aging problem that we face.

As the War on Terrorism gathers steam — and I believe that we are seeing the beginning of what promises to be a protracted battle of attrition between the forces of Western liberalism and freedom and the dark forces of Islamic extremism — the chances of major terrorist events in the US and, God Forbid, Canada, are increasing, as is the possibility of a major Canadian connection to future US attacks. Iraq aside, we are combatants in this war. We are a target. This is a border issue with the US, and I believe that increasingly it will be a domestic political issue here in Canada.