

across the country. As coalitions of regional interests, the parties would need to formulate policies with broad national appeal. Their caucuses -- and the cabinet of the party in power -- would be arenas in which regional (and other) compromises would be hammered out. This model no longer corresponds to reality.

Regional interests today seek their expression less through federal parties -- or even through third parties -- and more through provincial governments; the federal-provincial conference has replaced caucus and cabinet as the primary bargaining arena.

Party failure is accentuated by the Canadian electoral system, which greatly exaggerates the regional imbalance in party support. As Table 1 shows, the discrepancies in national party support across the country are much more dramatic at the level of seats than in votes. The electoral system greatly exaggerates regionalism in an already regionalized society by denying to certain regions representation in the governing party and caucus. Given that so much power is concentrated in the cabinet, the lack of an effective voice here is likely to render policy-making less sensitive to regions that are under-represented. Tables 2 and 3 underline the dimensions of this problem. This failure of the party and electoral system, especially when it leads to long-term exclusion of regions or provinces from power in Ottawa, profoundly weakens the integrative and nation-building impulse and has contributed to the character of Canadian politics whereby relations take place between strong governments rather than within central institutions.

Nor does the cabinet, bound by the norms of solidarity and unity, allow ministers to act as effective regional spokesmen. To the extent that ministers operate in a federal government, their priorities and perceptions are gradually shaped to a national perspective. The complexity of policy forces ministers to play the role of policy manager to the detriment of that of regional spokesman.

Parliament fails to provide an effective arena of adjustment between national and provincial interests. David Bercuson has noted that "since the House of Commons is elected on the basis of population only it will reflect the interests of the most populous part of the country."⁶

Party discipline, too, prevents regional caucuses of MP's from crossing party lines in order to form new ones. In the Canadian situation, the Senate has little policy-making significance and even less of a function in the relations between federal

6 David J. Bercuson, "Elected Senate," Brief to the Task Force on National Unity, Calgary (November 17, 1977).

and provincial governments. Accommodation in Canada has come to take place not within governments but between governments and this has important consequences for the extent to which federal institutions can be said to act as arenas for the adjustment of regional interests.

In Canada today, the form of the federal system precludes effective provincial voice in determining the structure and function of national political institutions. In turn, the way these institutions operate denies the provincial governments and interests sufficient influence in setting national priorities. In this context, it becomes clear why a growing sense of remoteness and alienation from the central government runs through much of what has been said at the task force hearings and various symposia that have been held in the last two years.

This analysis suggests that any country-building strategy for overcoming the threat to the current federal system must focus heavily on restoring Ottawa's ability to represent and reconcile within itself Canada's regional diversity. Restoration of its representative ability is a prerequisite for policy leadership. Several proposals along these lines have been suggested. They include changing the electoral system to create a more proportional system, restructuring the civil service on regional and ethnic lines, strengthening the regional role of the Senate, and reforming the House of Commons in the direction of the American congressional system, which gives members greater latitude to pursue local interests.

But it is unlikely that provincial governments will soon give up the role they have acquired, however representative Ottawa becomes. Quebec nation-builders would find nothing to please them in such a revamped federalism; indeed, the independentist movement has grown dramatically at the same time as Ottawa's sensitivity to Quebec's interests in both policy and representation terms has grown.

In Canada, we are past the stage when one level of government can seek to unilaterally develop policies for renewing the federal system. The breakdown of intergovernmental bargaining mechanisms, under the weight of shared responsibility, political interest, and major economic, social, and cultural problems, has put a strain on the constitutional arrangements of Confederation and made all the more pressing a concentrated effort at "renewal." Given the many linguistic, cultural, religious, geographic, and economic cleavages in Canada, the country-building interests must seek to reconcile these through joint effort with the forces that give political expression to this diversity.

Province-Building

The province-building drive is fuelled by grievances and frustration at unfair federal policies and unrepresentative national institutions, but it is much more than this. It is based on a strong sense of regional community and identity backed by the wealth of provincially owned resources and driven by the desire of provincial societies to develop unhindered according to their own needs and priorities.

Provincial governments provide a strong institutional expression to this impulse. Most important new activities of government have developed in the area of provincial jurisdiction. With the progressive decentralizing of taxing powers and the wealth of natural resources, the provinces have developed a significant fiscal clout and have become larger, more aggressive, and effective. The strength of the province-building drive is a reality of the Canadian political scene. It has arisen over the years in response to specific economic, governmental/institutional, and cultural conditions. The current crisis in Canada, and a great many of the problems of governing the country, stem from the inability of the current federal system to accommodate this reality.

The province-building drive was not always strong. Writing in 1940, Alexander Brady argued that "the socio-economic forces of modern industrialism tend to quicken the pace from federation to legislative union."⁷ Professor J. A. Corry felt that an interdependent economy with nationally oriented big business, big labour, and other national associations would inexorably drive Canadian federalism in a centralist direction.⁸ Economic realities in an age of nascent monopoly capitalism, it was argued, would lead to integration at the level of politics, economics, and culture. Certainly this has been the case in the United States and Germany. It has been less evident in Australia. The explanation of the rise of provincial strength is to be found in the particular pattern of industrialization fostered by the federal government's reconstruction policies -- that is, in the institutional provisions of the Canadian federal system and in the inability of federal fiscal and monetary policies to sustain full employment beyond 1957 through the maintenance of appropriate levels of aggregate demand.

7 E. R. Black and Allan Cairns, cited in "A Different Perspective on Canadian Federalism," in *Canadian Public Administration*, vol. 9, no. 1, p. 38 (March, 1966).

8 *Ibid.*, p. 38.

Table 1
 Ratio of Percentage of Seats
 to Percentage of Votes, Canada, 1974

	Political Party			
	LIBERAL	PC	NDP	OTHER
Canada	1.24	1.02	0.39	0.76
Newfoundland	1.22	0.98	0/9.5**	0/02
Nova Scotia	0.45	1.53	0.81	0/0.5
Prince Edward Island	0.54	1.52	0/4.6	0/0.1
New Brunswick	1.27	0.91	0/8.7	1.23
Quebec	1.50	0.19	0/6.6	0.82
Ontario	1.39	0.81	0.48	0/0.7
Manitoba	0.56	1.45	0.65	0/15
Saskatchewan	0.75	1.09	0.49	0/1.3
Alberta	0/24.8	1.63	0/9.3	0/4.9
British Columbia	1.04	1.35	0.38	0/1.7

SOURCE W. P. Irvine, "Does Canada Need a New Electoral System?", Unpublished Mss., 1978, p. 7. Entries of the form 0/x.y indicate no seats. The x.y indicates per cent of the vote in that province received by the party.

Table 2
 Proportion of Seats Held by Each Province
 in Governing Party, 1957-74

	Proportion of Seats in Parliament	1957 PC Minority	1958 PC Majority	1962 PC Minority	1963 Lib. Minority	1965 Lib. Minority	1968 Lib. Majority	1972 Lib. Minority	1974 Lib. Majority
Newfoundland	2.6	1.8	0.9	0.9	5.4	5.3	0.6	2.8	2.8
Nova Scotia	4.5	8.9	5.8	7.8	3.9	1.5	0.6	0.9	1.4
Prince Edward Island	1.5	3.6	1.9	3.4	1.6	0	0	0.9	0.7
New Brunswick	3.8	4.4	3.4	3.4	4.7	4.6	3.2	4.6	4.3
Quebec	28.3	8.0	24.0	12.1	36.4	43.0	36.0	51.3	42.6
Ontario	32.0	54.5	32.2	30.2	40.3	39.0	41.0	33.0	39.0
Manitoba	5.3	7.1	6.7	9.5	1.6	0.8	3.2	1.8	1.4
Saskatchewan	6.4	2.7	7.7	13.8	0	0	1.3	0.9	2.1
Alberta	6.4	2.7	8.2	12.9	0.8	0	2.6	0	0
British Columbia	8.3	6.3	8.7	5.2	5.4	5.3	10.3	3.7	5.7
Total Number of Seats		112	208	116	129	131	155	109	141
Total Number of Seats in House of Commons		265	265	265	265	265	264	264	264

SOURCE Calculated from election results, various sources.

Table 3
 Proportion of Seats Held by Each Province in
 Caucus of Official Opposition, 1957-74

	Proportion of Total							
	1957 Lib.	1958 Lib.	1962 Lib.	1963 PC.	1965 PC.	1968 PC.	1972 PC.	1974 PC.
Newfoundland	4.6	10.2	6.0	0	0	8.3	3.7	3.2
Nova Scotia	1.9	0	2.0	7.4	10.3	13.9	9.3	8.4
Prince Edward Island	0	0	0	2.1	4.1	5.6	2.8	3.2
New Brunswick	4.8	6.1	6.0	4.2	4.1	6.9	4.7	3.2
Quebec	59.0	51.0	35.0	8.4	8.2	5.6	1.9	3.2
Ontario	20.0	30.6	44.0	28.4	25.8	23.6	37.4	26.3
Manitoba	1.0	0	1.0	10.5	10.3	6.9	7.5	9.5
Saskatchewan	3.8	0	1.0	17.9	17.5	6.9	6.5	8.4
Alberta	0.9	0	0	14.7	15.5	20.8	17.8	20.0
British Columbia	1.9	0	4.0	4.2	3.1	0	7.5	13.7
Total Number of Seats	105	49	100	95	97	72	107	95

SOURCE Election results, various sources.

Writing in 1966, Black and Cairns attributed "the continuing power and influence of the provincial governments in Canadian federalism to the importance of their considerable economic functions."⁹ That certain tasks, unimportant when placed under provincial jurisdiction in the BNA Act in 1867, had become, by the mid-20th century, considerable is largely due to the changes that had occurred in the process of industrialization.

American investment¹⁰ in the resource industry prompted provincially based growth and was the prime mover in the considerable expansion of the economic functions of the provincial governments. The need to provide infrastructural necessities for rapid development prompted government participation in public utilities, railways, highways, and in research and technological development, complementary to that imported from the United States. This resulted in a shift in the weight of technical competence, assertiveness, and activism as the provincial governments came to deal more and more with situations and activities specific to their provinces alone, as with natural gas and oil in Alberta, potash in Saskatchewan, and lumbering and timber in British Columbia.

The United States ownership of Canadian industry sets up particular trading linkages between the United States and Canadian economies and results in the north-south integration of provincial economies to U.S. markets. The weakening of the ties between the provinces and Ottawa and obversely the strengthening of the provinces, is in part a function of the fragmentation of the Canadian economy and a reason for the persistence of regionalism in Canada. In addition, the most rapid expansion of government activities in the post-war period took place in areas where the provinces had primary constitutional responsibility -- health-care, education, and public welfare. While Ottawa became heavily involved in all areas, through hospital insurance, medicare, grants for vocational and post-secondary education, and sharing of the welfare burden, it was the provinces that directly provided the services and obtained the political credit.

Industrial developments in turn affected the institutional character of provincial government. In the pursuit of specific development plans unrelated to the national interest and not

9 *Ibid.*, p. 38.

10 Two books by H. G. J. Aitken *The American Economic Impact Upon Canada* and *American Capital and Canadian Resources* provide much valuable data on the form of the American presence in Canada. See also, Wallace Clement *Continental Corporate Power: Economic Linkages between Canada and the United States* (Toronto: McClelland & Stewart, 1977), pp. 80-85.

integrated with other provinces, the institutions and structures of the provincial governments grew substantially in the post-war period. The number of employees in provincial employment increased 81 per cent between 1959 and 1971. If local government growth is included, the figure reaches 104.2 per cent.¹¹

The growth of provincial governments is further reflected in the substantial shifts in the fiscal balance between the provinces and Ottawa, which began immediately following the Second World War and have continued to the present. Provincial expenditures on goods and services rose to 8.1 per cent of the GNP from 5.8 per cent in the 1955-65 decade and to 12.4 per cent in 1976. Correspondingly, federal expenditures in the same area fell from 9.3 per cent in 1946, to 8.3 in 1955, to 5.1 in 1966, and have stayed roughly the same in the last decade.¹² Federal taxes declined as a percentage of the total collected from 77 per cent in 1946 to 71 per cent in 1955, to 58 per cent and 53 per cent respectively, in 1965 and 1976. Provincial taxes, on the other hand, have climbed from a post-war low of 13 per cent of total taxes collected in 1946, to 15 per cent in 1955, to 27 per cent in 1965, and to 31 per cent in 1976.¹³ Conditional and unconditional transfer payments to governments, which E. R. Black suggests have been the most realistic indication of the political strength of the provinces within the federation¹⁴ increased from \$465 million in 1955, to \$1,379 million in 1965, and to \$8,342 million in 1976.¹⁵ Moreover, in recent years, the proportion of this aid in unconditional payments has grown rapidly relative to the proportion in the form of conditional grants, further weakening central control over provincial priorities.

While these general factors give some indication of the changes involved in the growing province-building drive, the specific elements of the impulse varied substantially across Canada. Substantial inflows of foreign investment to the resource sectors

11 D. Cameron, in J. P. Meekison, ed., *Canadian Federalism* (3rd. ed.) (Agincourt, Ontario: Methuen, 1977), p. 314.

12 *The National Finances 1977-78* (Toronto: The Canadian Tax Foundation, 1978), Table 2-10, p. 22.

13 *Ibid.*, Table 2-5, p. 17 (our calculations).

14 E. R. Black, *Divided Loyalties* (Montreal: McGill-Queen's University Press, 1975), p. 87.

15 *The National Finances, 1977-78*, Canadian Tax Foundation, Table 2-7, p. 19.

of the western provinces provided the original impetus for the expanding economic functions of the provincial governments. In the Atlantic provinces, that impetus came from the federal government and transfer payments in the form of unemployment insurance, children's allowances, and old age pensions, augmented by federal cost-sharing agreements in the 1950s and, after 1957, by equalization payments and DREE grants, which alleviated the worst poverty in the Atlantic region and which strengthened social institutions. However, T. W. Acheson argues, "In the course of achieving these gains, the Maritime provinces were transformed into client states of the federal government."¹⁶ If the West's aspirations were based on the confidence engendered by new wealth, the Atlantic provinces demonstrate the frustrations of dependency.

Furthermore, the difficulties surrounding any attempt to amend the constitution and the particular way in which the constitution has been interpreted by the JCPC greatly eroded the centralist bias of the BNA Act. The proportionate strength of the central Canadian provinces gave to Ontario and Quebec the necessary leverage to resist any attempt by the federal government to legitimize and consolidate in law certain centralizing measures, even when there existed major public support for them.

Thirdly, the growth of provincial governments and the maturation of provincial societies is related to the attenuation of federal dominance and the loss of legitimacy that the federal government suffered as a result of the inability of its institutions and policies to provide appropriate levels of aggregate demand and thus ensure full employment, growth, and the alleviation of regional disparities. Rather than argue, as Paul Phillips does, "that the Canadian government has lost the policy tools to attack the problem of regional disparity,"¹⁷ one could seriously doubt that it ever had them. Under the Keynesian policies of the Reconstruction Proposals, the major tools of the federal government were the generalized use of fiscal and monetary policy. It is doubtful that generalized fiscal and monetary policies can be useful when applied to an already regionally specialized economy but, when the economy is largely foreign-controlled and dependent on foreign markets, fiscal and monetary tools are even less effective.

The centralist argument of Phillips states that "without the active participation of the federal government the hinterland regions are unable to combat the economic forces that produce and

16 T. W. Acheson, "The Maritimes and Empire Canada," in D. J. Bercuson, ed., *Canada and the Burden of Unity* (Toronto: Macmillan, 1977), p. 105.

17 Paul Phillips, "National Policy, Continental Economics, and National Disintegration," in Bercuson, *Canada and the Burden of Unity* (Toronto: Macmillan, 1977), p. 20.

reinforce these disparities." ¹⁸ However, it must be recognized before anything else, that it is precisely because the federal policies have been unable to combat the economic forces that produce and reinforce disparities that provincial governments have had to take independent action to protect what they believe to be their legitimate interests.

The growth of provincial priorities and strength has led to increasing conflict with the country-building character of federal government activities. The inability or perceived unwillingness of the federal government to develop national policies that appear to benefit the western and Atlantic regions is a fundamental source of grievance in the provinces. National transportation policies, federal resource policies as they affect Alberta oil, Saskatchewan potash and uranium, and Labrador hydroelectric power, agricultural, and fisheries policy all promote criticism from the various provincial governments. Yet a listing of regional grievances -- and there are many -- almost suggests that no one benefits from Confederation. In fact, it is extraordinarily difficult to measure with any precision how the benefits and costs are distributed; the debate surrounding Quebec's presentation of its "economic accounts" illustrates the problem. Politically, it is the *perceptions* that are most important in the immediate case.

Perceptions of grievances enunciated by provincial governments fall into three interrelated categories. Economic grievances revolve around general federal policies and attitudes that appear "by the very nature of Confederation to be directed in a central Canadian way." In Alberta's view, the classic case is Petrosar. No distinction, however, seems to be made between the vagaries of the market economy and the policies of the federal government.¹⁹ Economic grievances help to shape political attitudes and therefore are important, but often they are not based on an objective analysis of the facts.

The second category is policy grievances that refer to policies of the federal government that are seen to be unfair. Generally, these result from Ottawa's pursuit of a unilaterally defined national interest and in places from its intrusion into areas of provincial jurisdiction. The deductibility of resource royalties

18 *Ibid.*, p. 20.

19 For an illuminating if somewhat classical, discussion of western economic grievances see, Kenneth Norrie, "Some Comments on Prairie Economic Alienation," in Meekison, *Canadian Federalism*, 3rd. ed., p. 325.

from federal corporate income tax, various two-price systems, and transportation policies that discriminate against certain modes of transport come under this heading.

The third category relates to structural problems of the Canadian federal system. Under-representation in national political institutions, inadequate representation and input into federal regulatory boards, inadequate consultative mechanisms, problems relating to appointments to the Supreme Court, and problems of the constitution all reflect the confused political situation. The suffocation and frustration that Alberta, Quebec, and the other provinces feel in attaining full partnership in Confederation stems largely from the inability of the federal system to accommodate an effective provincial role in the decision-making process.

Province-building has not generated such clear-cut programs for change as has the Quebec nation-building drive. This is partly because the provinces themselves are so much more diverse in their needs and interests and partly because provincial identities and grievances, though strengthening, are weaker than those in Quebec.

Yet the province-building impulse does imply some major changes. Some of these have already been occurring in the growth of provincial fiscal power, and in the dramatic move away from shared-cost programs as seen in the abandoning of the shared-cost device in hospital and medical care, aid to post-secondary education, and more recently, social services. All are being replaced by tax transfers and unrestricted cash transfers.

Province-builders seek several other things. First is greater autonomy and fiscal resources in a variety of areas. The clash is sharpest in the area of economic development and regulation in which, as they seek to promote their own development, provincial policies come up against federal policies and against the jurisdiction of the federal government over interprovincial trade and other matters. Second, province-builders seek to limit Ottawa's ability to "intrude" on their interests through use of its constitutional power to spend, or under the "Peace, Order and Good Government" clause. Such powers, they argue, should be either abolished or subjected to clear-cut provincial veto.

Finally, the provinces demand a much greater say in the exercise of federal powers that have major impact on them -- for example, in transportation, foreign trade policy, the activities of federal regulatory agencies, and the like. Such policies, it is argued, should be made jointly by the federal and provincial governments acting together rather than by Ottawa alone. Indeed, given the current distribution of constitutional and fiscal powers, it may be argued that broad policies can *only* be made jointly, since no single government possesses full authority.

More broadly, the province-building drive implies that, to the extent there *is* a national interest, it is the sum or resultant of a group of provincial interests. Moreover, it assumes that these provincial interests cannot be fully understood or promoted by Ottawa or by federal parties. The provinces are the legitimate spokesmen. Pushed to its extreme, this suggests a movement towards a confederal pattern of decision-making in which the federal government has only limited authority on its own.

Quebec Nation-Building

Quebec is the central focus of the contemporary political crisis in Canada. Important as they are, neither the other regional grievances nor the general administrative problems of the federal system actually call into question the basic political arrangements of Canadian federalism. "Solutions" that fail to address the related questions of the relations between French and English speakers and between Quebec and the other governments are irrelevant. It was the election in 1976 of the Parti Québécois, which was committed to establishing political sovereignty in Quebec, that precipitated the present constitutional crisis. Whatever the precise reasons for this victory -- and they are many -- the presence of an independentist government in Quebec radically transformed the debate.²⁰

But the crisis did not begin with this election; nor would it end with a PQ defeat. Ethnic tensions have been a central preoccupation of Canadian politics. More recently, every Quebec government since 1960 has pressed for more or less fundamental changes in the operation of the federal system. It was this pressure from Quebec that triggered the extensive constitutional review between 1968 and 1971; similarly, it was the inability or unwillingness of other governments to meet these goals that led to failure. During the same period, there were two types of federal response.²¹ On one hand, increased equalization and tax-sharing strengthened all provinces as measures such as the "opting out" legislation of 1964 and the establishment of a separate

20 This section owes much to the analyses presented in Richard Simeon, ed., *Must Canada Fail?* (Montreal: McGill-Queen's University Press, 1977) esp. James de Wilde, "The Parti Québécois in Power." A convenient summary of recent developments in Quebec is found in André Bernard, *What Does Quebec Want?* (Toronto: James Lorimer and Co., 1978).

21 For a brief account of these negotiations, see Richard Simeon, *Federal-Provincial Diplomacy* (Toronto: University of Toronto Press, 1972), Ch. 5. For a more detailed account, see Secretariat of the Constitutional Conference, *The Constitutional Review* (Ottawa, 1974).

Quebec pension plan were moving towards a *de facto* -- if not constitutional -- special status for Quebec. On the other hand -- and increasingly after 1968 -- Ottawa sought to better represent French-Canadians at the centre through a variety of policies, such as the Official Languages Act. The differences between the two strategies reflect a number of competing perspectives that have not yet been resolved. Is the conflict between French-speaking Canadians and English-speaking Canadians, or between Quebec and Ottawa and the other provincial governments? Is the redress of grievances to take place primarily at the level of language policy and, if so, is it to follow the principle of national bilingualism, or of territorial unilingualism? Is the stress on individual or on collective solutions?

There are many ways to look at the relations between French- and English-Canadians; and the choice of analysis and even terminology (Quebec-Canada or Francophone-anglophone) is intimately related to the solutions proposed.

One might begin by locating the conflict within the simple difference between two languages and cultures by arguing that the fact of linguistic and cultural difference in itself can generate conflict. Alleged cultural differences between French- and English-Canadians have generated a large literature, yet they remain elusive. In any case, their relevance to political conflict is unclear at best. Indeed, it may well be argued that cultural *convergence*, rather than difference, increases conflict. Thus, the process of modernization and its accompanying ideological and value changes in Quebec, it may be argued, represents a growing similarity between French- and English-Canadians -- a similarity that increases both contact and conflict because now both groups are in competition for the same things, such as posts in the corporate or bureaucratic structure. So long as Quebec culture was seen to be rural, anti-industrial, and anti-*étatiste*, little contact was necessary. "Two solitudes," by definition, seldom fight.

More important, linguistic and cultural differences become politically relevant only when they are associated with clear differences in other political-economic interests. Thus, we need to examine the grievances or disadvantages faced by French-Canadians in the Canadian system.

First are economic grievances.²² Per capita income in Quebec has historically lagged behind that in Ontario. Even within

22 For a summary of the findings of the Royal Commission on bilingualism on these points, see Hugh R. Innis, *Bilingualism and Biculturalism* (Toronto: McClelland and Stewart, 1973). See also Bernard, Ch. 2. A careful analysis of the economic data is also found in *Living Together: A Study of Regional Disparities* (Ottawa: Economic Council of Canada, 1977).

Quebec, the average income of French-speaking Canadians is below that of virtually all other ethnic groups in the province.²³ Unemployment rates are historically above the average. English-speaking Quebecers are greatly over-represented in the upper-income levels and under-represented at the bottom.

These gross differences are related to the structure of ownership of Quebec industry. The most profitable and productive sectors of Quebec industry are owned by foreign or Anglo-Canadian interests. While "foreign ownership" is an important issue in English-Canada, too, the linking of language with foreign ownership in Quebec gives the question much more edge. The ownership structure is also related to the employment structure. English-Canadians predominate in the upper management echelons; the relatively few French-Canadians at these levels must often work in English. More generally, within the Canadian system, French-Canadians make up only a small proportion of the "economic elite," as studies by John Porter and Wallace Clement demonstrate.²⁴

Increased education, together with recent political pressures in Quebec, have eroded the differences somewhat. Nevertheless, the visibility of the concentration of economic power in Quebec in the hands of a minority ethnic group is a powerful stimulus to nationalist feeling. It underlies the linguistic policies of successive Quebec governments. It helps account for the recent emphasis by Quebec governments on economic planning and state-sponsored enterprise. And it contributes to the desire for more political autonomy.

Within the national political system, French-Canadians have also been disadvantaged.

First has been the denial of French-language education and other government services in the other provinces. Anti-French policies in Ontario, Manitoba, and other provinces at the turn of the century²⁵ may be an important reason why French-Canadians remained highly concentrated within Quebec and, to a lesser extent, in bordering areas of Ontario and New Brunswick. More recently, French-language rights have been significantly extended in New Brunswick and, to a lesser extent, in Ontario. Recent federal policies, including constitutional proposals in 1968 and 1978, have tried to encourage provinces to extend French-language rights.²⁶

23 Bernard, p. 59.

24 Wallace Clement, *The Canadian Corporate Elite* (Toronto: McClelland and Stewart, 1975), pp. 233-237.

25 For a list of such actions, see Bernard, p. 27.

26 For a full statement of current federal language policy, see *A National Understanding*. A statement of the Government of Canada on the official languages policy (Ottawa: 1977).

Their success has been limited. On the one hand, English-Canadians have strongly resisted such developments. On the other hand, it may be argued that even very clear government policies are powerless in the face of the massive economic and cultural pressures leading to the assimilation of francophones outside Quebec. The result is that the assimilation proceeds apace, lending strength to the assertion that only in Quebec, where French-Canadians constitute a critical mass, where they are fully supported by an elaborate network of public and private institutions, and where they have the unqualified support of government, can francophone culture be protected.²⁷

Within the federal government, the picture is more complex. In Parliament, French-Canadian representation has been proportionate to numbers. Indeed, the historic Liberal dominance has meant that, in purely numerical terms, French-Canadians have been over-represented in the government party. But many qualifications must be added.

Given the current party system, this representation is fragile; it is to a large extent dependent on continued Liberal pre-eminence. Even if representation is proportionate, French-Canadians necessarily remain a minority at the centre. So long as the primary issues of political debate do not pit French-against English-Canadians -- and, in most cases, they have not done so -- this does not pose severe problems. However, Canadian history does offer several examples, such as the Riel crisis, the conscription crises of the First and Second World Wars, and, more recently, the issue of bilingualism in air traffic control, where issues directly paralleled linguistic lines. If most issues did so, or were believed to do so, the survival of Confederation would be highly problematic.

Proportionate representation in the House of Commons has not prevented under-representation in other political institutions. Historically, cabinet ministers from Quebec have tended to hold posts of lesser importance: only very recently, for example, has a French-Canadian been Minister of Finance. More important has

27 The best discussion of the situation of French-speaking Canadians outside Quebec remains Richard Joy, *Languages in Conflict*, Carleton Library ed. (Toronto: McClelland and Stewart, 1972). For a persuasive argument that these demographic facts render national bilingualism policies ineffective and irrelevant to the central need to maintain French dominance in Quebec, see Hubert Guindon, "The Modernization of Quebec and the Legitimacy of the Canadian State," in Daniel Glenday et al., ed., *Modernization and the Canadian State* (Toronto: Macmillan of Canada, 1978) pp. 212-246.

been under-representation within the bureaucracy,²⁸ a fact of increasing importance as the size and influence of the bureaucracy itself has grown. Thus, French-Canadians were under-represented within the civil service and armed forces and tended to be concentrated at the lower levels. Indeed, in the upper ranks of the civil service, and especially in the ministries that were the architects of the Keynesian welfare state, Canada has had an essentially anglophone civil service. Those few francophones with it usually had to work in English.²⁹ This had three kinds of effect; the direct effect of barring francophones from an increasingly important avenue of employment, and the indirect effects of limiting the bureaucracy's ability to serve French-speaking clients and of giving short shrift to francophone values in policy formation.

In recent years, under-representation in the cabinet and the civil service has been reversed. The Office of the Commissioner of Official Languages was created; minority language services were extended through bilingual districts; a massive language training program was aimed at increasing the bilingual capacities of both French and English speakers. Major efforts were made to increase the number of French-Canadians in the civil service and to enable them to work in their own language. Between 1967 and 1976, the proportion of French speakers in the federal bureaucracy rose from 12 to 26 per cent. Between 1966 and 1976, the proportion in the officer category doubled from 10 to 19 per cent.³⁰ Nevertheless, these programs have provoked tensions among anglophone civil servants. The effectiveness of the language training schemes has been questioned and, despite its more bilingual public face, most of the civil service remains English.

More important, it is argued that federal policy formation has failed Quebec and French-Canadians. Earlier studies, such as the Tremblay Report of 1960, criticized federal policy primarily on the grounds that it infringed Quebec autonomy and that it embodied values and aspirations at odds with traditional values in Quebec. The autonomy theme has, of course, remained but critiques of federal policies by the PQ and others have shifted. They form an important part of the Parti Québécois indictment of federalism and have been echoed by many other Quebec spokesmen.

28 See Richard Van Loon, "The Structure and Membership of the Canadian Cabinet." Report prepared for the Royal Commission on Bilingualism and Biculturalism, 1966, pp. 56-57.

29 None of the Deputy Ministers holding office in 1944-5 was a French-speaking Canadian. See R. V. Wilson and W. A. Mullins, "Representative Bureaucracy: Linguistic Ethnic Aspects in Canadian Public Policy." Paper presented at Conference on Political Change in Canada, Saskatoon.

30 Bernard, p. 64.

First, it is argued that the federal government drains resources from Quebec by taking more out in taxes than it returns in federal spending. The bases for such analyses remain highly controversial, but most agree that, following a long period of deficit, federal taxing and spending do redistribute some resources to Quebec from other parts of the country. Quebec spokesmen argue, however, that this surplus is accounted for mainly by income maintenance programs that do little to promote economic development. They also argue that federal development spending (DREE) has not been oriented to their perception of Quebec's needs.

It is also felt that basic structural policies benefit Ontario and hurt the weak areas of the economy. The St. Lawrence Seaway diverted trade from Montreal to the Great Lakes. Agricultural, transportation, and other policies are oriented more to Ontario than to Quebec, and so on.

The Quebec nation-building impulse derives from other sources as well. Redress of grievances and under-representation would not eliminate the drive for autonomy and self-determination within the province itself. To focus on grievances is to ignore that autonomy may be sought for its own sake or that a highly self-conscious people, united by a common language, a common historical experience, an elaborate network of social institutions, and with institutional resources provided by control over a provincial government, might wish to achieve sovereignty and so become a complete "nation-state."

Only recently has Quebec nationalism generated the demand for independence and sovereignty. Duplessis and the Union Nationale government resisted federal incursions in the social field and jealously guarded the province's tax resources but were content to leave economic power in federal hands. The government of Jean Lesage focused on expanding provincial tax shares in responding to federal initiatives, such as the Canada Pension Plan, with its own programs and in seeking freedom from federal controls through cost-sharing programs. Under the slogan "égalité où indépendance," the 1965 Union Nationale government expanded the cultural and foreign roles of the Quebec government and called for fundamental constitutional revision that would recognize the existence in Canada of two distinct nations. In the late 1960s, attention shifted somewhat to language policies, motivated partly by the sense of threat to francophone majority status in Montreal and partly by the desire to attack more directly the barriers to francophones in the private sector.³¹

31 Guindon, *op. cit.*

Under Robert Bourassa's Liberal government, the emphasis shifted to a greater Quebec role in social policy and to the demand for "cultural sovereignty." The trend since 1960 is clear. Each government has sought major change in the federal system and in each case this has *not* taken the form of a demand for increased French language rights across the country or for more power for French-Canadians in Ottawa. All have argued instead for greater authority centred in the Quebec government, the principal political voice of and spokesmen for francophone interests.

The process of industrialization in Quebec throughout the 1950s brought to the fore of events an organized, militant, urban working class and a new technologically based middle class. "Nationalist developments," such as Hydro Quebec and other state-run enterprises, are seen by analysts like Albert Breton to result from the desire of the new middle class to create for itself managerial, professional, and technical positions, which they had been unable to attain in the anglophone milieu.³² Thus, the new middle class is seen both as the creature and creator of the expansionist Quebec state.

As the state attempts to organize the interests of the new middle class, it undergoes an expansion. In Quebec's case, much of the public sector growth represented a "catching up" with other jurisdictions. The expansion requires massive resources and, more importantly, policy levers that Ottawa influences or controls. Competition, then, develops between federal and provincial governments for the allegiance and support of the general population -- each level feeling it can deliver what the population wants.

As the one instrument that could be turned to this purpose, the Quebec state apparatus has become a device for preserving Quebec's cultural identity and for asserting control over its own economic life. Federalism, it was asserted, placed far too many constraints on Quebec's ability to reach these goals.

32 Albert Breton, "The Economics of Nationalism," *Journal of Political Economy* 72 (1964), pp. 376-86. For related analysis, see Guindon, "Social Interest, Social Class and Quebec's Bureaucratic Revolution," *Queen's Quarterly* 71 (1964), pp. 150-62; and Charles Taylor, "Nationalism and the Political Intelligentsia," *Queen's Quarterly* 72 (1965). Breton's argument has an important twist: the middle class expansionism works to the disadvantage of working class interests in Quebec, because it leads to inefficient allocation of resources. This assumes, of course, that the previous allocation was efficient. In any case, notes must be taken of the broad penetration of separatist ideas in all Quebec milieux, though it does remain strongest among the younger, more educated and more urban elements.

In the process of modernization, the cultural and economic spheres have become fused. Economic control is seen as necessary for cultural control. The demands of the Parti Québécois for sovereignty and autonomy are in line with the development of past demands and consistent with the integration of cultural, economic, and political forces in the modern state.

None of this should imply that the Quebec population is united behind the drive for independence. As the variability of the polls concerning support for independence shows, much of the population supports continued federation, and many other are undecided. The same remains true of important interest groups, most notably the labour movement. The internal political debate is intense; its outcome is uncertain.

Several contending groups have emerged. The committed federalists, among whom Prime Minister Trudeau remains the primary spokesman, have a fundamental distrust of ethnically based nationalism and instead place reliance in valuation of individual rights. For these reasons, Quebec separatism is seen as dangerous. Humanist values are far better preserved in a multilingual and multicultural state. French-Canadians must look beyond their province to play a role in the larger country. Accordingly, English-Canadians too must be more willing to accept the rights of French-Canadians to live with their own language throughout Canada. Moreover, there must be a fundamental distinction between linguistic group and provincial government. Reform implies the promotion of individual French-Canadian interests everywhere, not the strengthening of the government of Quebec. Indeed, the fundamental objection to any form of special status is that, in so weakening the links between Ottawa and Quebec citizens, it becomes a snowball whose only logical stopping place is complete independence. It is this viewpoint that separates the Trudeau federalists from most other Quebec federalist political spokesmen. While prepared to work towards a "renewed federalism," this group argues for strengthening of minority language rights and for ensuring full francophone participation in national institutions. This has been the direction of federal policy in recent years and it underlies the recent constitutional proposals of the federal government.

The third-option federalists, perhaps best represented today by Liberal leader Claude Ryan,³³ remain committed to a federal system, partly for the same principled reasons, such as commitment to a bilingual Canada, that animate the first group. They also tend to argue for federalism on the grounds of expediency -- best

33 For recent statements of Ryan's views, see Claude Ryan *Une Société Stable* (Montreal, Editions Héritage, 1978).

summarized in former Premier Robert Bourassa's phrase "profitable federalism." In this view, Quebec benefits from the larger Canadian market, from redistributive federal policies, and from the political strength of a larger unit. An independent Quebec might suffer economically and would, in any case, be at least as vulnerable as it is now to outside economic forces. This group tends to differ somewhat from the present language policy; while strongly supporting the need for the federal government to be fully bilingual, it tends to be more accepting of a territorial strategy elsewhere, in which the position of the French language is strengthened within Quebec. But, most fundamentally, the third-option federalists adopt a conception of Canada as a binational state, in which Quebec is and must be the primary political voice of Quebecers. Hence, it requires legislative and fiscal powers that are not required by the other provinces, which lack this national role. From this flow the general arguments for some form of special status.

The independentists include the PQ party, which takes the view that Canada is binational and that Quebec must have full sovereignty. Federalism is rejected for several reasons. It is a mask for continued centralization. It treats Quebec as merely one among ten provinces. The unnatural joining of two nations within a single political system is responsible for continual conflict and bitterness, which frustrates both French and English Canadians. Far better, they argue, to cut the ties and allow each majority to act alone. Yet, continued interdependence is accepted, so that economic association is expected to follow.

All three positions offer a challenge to English-Canadians and to Canadian political institutions. The last two orientations may be called Quebec nation-building strategies. As with province-building elsewhere, they depend crucially not only on the territorial concentration of the linguistic group but also on the existence of the political institution of the provincial government, which has provided the resources for the growth of nation-building and the focus for loyalty and support. It is hard to conceive of successful modifications to the federal system that do not recognize and respond to the nation-building drive.

Conclusion

The political crisis of Canadian federalism thus comes down to a clash between rival governments, each tending to speak for one of the three drives we have surveyed: for national leadership, for greater provincial control, or for a special role for Quebec as the political expression of a distinct national community. Each of these drives leads governments to act in virtually all policy areas and to use aggressively the policy tools available to it. Each "intrudes" on the other. The drives also suggest that each government has quite distinct policy priorities, which are often, though not always, in conflict.

This rival community-building activity is one prime reason for the increased overlapping of federal and provincial responsibilities. It is reinforced by the vagueness or obsolescence of the powers set out in the British North America Act. These categories neither reflect accurately the role of contemporary government in Canada nor provide strict rules delimiting the responsibilities at each level. Overlapping is also reinforced by the character of modern policy itself, since all policy domains are now so interconnected, and by the competition of all governments to respond to changing citizen demands.

The result of this interpenetration of federal and provincial policies is a high degree of interdependence and much opportunity for mutual frustration. Policy activities are so shared that "national" policies in fields from economic policy to culture can only result from the activities of both levels of government. Paradoxically, however, this *policy* interpenetration is not accompanied by *political* integration. That is, there are sharp discontinuities between politics at the two levels: provincial voting patterns differ from federal voting patterns; provincial parties have few ideological or organizational links with federal parties; and there is little movement of political leaders from one level to another. All this helps to explain the continued conflict and why intergovernmental relations are conducted largely at the executive level, reminiscent, indeed, of *international* relations.

Quite outside the constitution, a huge network of intergovernmental relationships and techniques have grown up in relation to these realities. Shared-cost programs, administrative delegation, and five-year fiscal arrangements are some of the instruments of joint activity. Hundreds of federal-provincial conferences are held each year, ranging from the set-piece, increasingly televised First Ministers Conferences to a myriad of ministerial meetings and to both multilateral and bilateral officials' meetings. In fields such as energy and education, Councils of Ministers have been created with small secretariats. A joint body, the Canadian Intergovernmental Conference Secretariat, has been created to administer the many meetings. The federal and several provincial governments have responded internally to the heightened priority of intergovernmental affairs through the creation of cabinet committees and new central-control agencies or ministries. As a counterweight to federal-provincial meetings, there has been a considerable growth of interprovincial meetings, with the annual Premiers' Conference now being an important forum for the elaboration of joint provincial positions. Regional groupings of Premiers in the West and the Atlantic provinces have grown in importance. On several issues, including the fiscal arrangements in 1975-76 and the debate on patriation and amendment in 1975-76,

the provinces, acting together, generated common fronts. Increasingly, the processes tend to be politicized and to move inter-governmental relations to the summit of the political system, where political competition and conflicting general strategies become most evident.

Extensive as this process is, and successful as it has been in many fields, it suffers from severe weaknesses. It is largely secret. It is sporadic. It has few firm procedures or decision rules. It cannot guarantee co-operative action. The inadequacies of the machinery and the degree of interpenetration create three kinds of frustration: the federal government is frustrated in its attempts to plan overall national development and to operate the tools of Keynesian fiscal policy. Province-builders often feel frustrated in their own planning by the constraints imposed by the federal system. And citizens are often frustrated by the lack of accountability, delay, uncertainty, and inconsistency engendered by intergovernmental conflict. Business groups are often frustrated by provincial barriers to the Canadian common market, by conflicting norms on such matters as consumer protection, and the like. Labour, too, is frustrated by variations in labour policy and by the inability of Ottawa to engage in national planning.

All this suggests that the primary agenda for constitutional discussion should focus on the relationship between governments, and this leads to a focus on the division of powers and on the machinery of intergovernmental relations.

The first goal of a search for a new division of powers might be to reduce entanglement and the potential for mutual frustration by redefining governmental powers in such a way that each is responsible for a given list of functions that it can carry out without reference to other governments. This "watertight compartments" view, however, seems unrealistic. In no modern federal system does it obtain; everywhere the pattern is one of mutual interpenetration. The character of modern policy, the undifferentiated demands of citizens, and most important, the community-building aspirations of governments render this strategy impossible in Canada. Much disentanglement is, no doubt, possible, as the ending of several major shared-cost programs recently attests, but the prospects are limited. Many, if not most, of the fundamental activities of the modern world can only be carried out through a process of collaborative or joint decision-making. Existing mechanisms for such collaboration are far too underdeveloped and the search for institutional change must focus on improving it.

Nor is it possible through the division of powers to meet fully the goals of any one of the three drives. Massive decentralization, increased centralization, and special powers for Quebec all have strong supporters and strong opponents. Some

flexibility is possible, but it seems more likely to come about through a greater range of concurrent activities, through provisions for delegation of power, and through various opting-out strategies than it does through a move back to watertight compartments.

Whether it is possible to design new machinery for intergovernmental relations, which would maximize the incentive for harmony and agreement and which would maximize the chances for public accountability, is unclear, but several means have been suggested recently.³⁴

Thus, while underlying factors of ethnic, economic, cultural, and historical diversity are crucial for understanding the Canadian political crisis, they are all manifested through governments. Reform of the Canadian system, therefore, while no doubt helped by stress on common symbols, values, and the like must concentrate on governments and on their capacities to develop policies in which the dynamic balance between national and regional forces is able to evolve continually. This search must focus first on the representative and integrative capacity of the federal government itself; second, and more important, it must focus on the relationship between it and the provincial governments.

Population factors alone make it hard for Ottawa to be fully representative. Under a system of majority rule, inevitably, the numbers in central Canada can defeat the numbers on the periphery, and the numbers of English-Canadians can defeat the French-Canadians. So long as political cleavages in Canada tend to pit English against French, or centre versus periphery, that is a problem impossible to reconcile.

34 Among them are: *Towards a New Canada*, Report of the Committee on the Constitution, the Canadian Bar Association (The Canadian Bar Foundation, 1978); David Elton, F. C. Engelman, Peter McCormick, *Alternatives: Towards the Development of An Effective Federal System for Canada* (Calgary: Canada West Foundation 1978); Richard Simeon, *Statement to the Joint Committee of the Senate and House of Commons on the Constitution, 13 September 1978*, Ontario Advisory Committee on Confederation, First Report (Toronto, April 1978); and *What is British Columbia's Position on the Constitution of Canada* (Victoria, 1976).

Comments by S. Roberts, President, Canada-West
Foundation, Calgary

Evenson's and Simeon's paper on "The Roots of Discontent" is analytically perceptive and an excellent general description of the very real malaise currently affecting our nation. It is a great shame that so many provincial premiers ignore the kind of information that is available in a paper such as this. I hope my elaboration of one or two points will stimulate further discussion.

First of all, our current crisis is most definitely one of government institutions. We can discuss any number of economic problems but we cannot ignore the faults of the Canadian federal system. Western discontent with this system is not limited to government people and academics; it is also rife amongst the masses. Westerners feel that they are alienated, and it matters little whether their feelings are based on fact or only on what they perceive to be fact. If the discontent is there, it can only be harmful to the nation. Evenson and Simeon concentrate on the Quebec - Canada crisis, but discontent is just as great in Western Canada and in the Atlantic Provinces, for that matter, as it is in Quebec. Accordingly, we would appear to be in the midst of a Region - Canada crisis. Western Canadians have their own particular perspective on many of the issues raised by our current national dilemma.

They are primarily concerned with more effective regional representation in the central government. To this end, they are not afraid to talk of a "new deal" or even of a new constitution that would allow them greater political clout at the national level. As Evenson and Simeon have noted, such cries for proportional representation become louder as polarization increases. They are now particularly loud because it is clear that, if another Liberal government is elected, there will be virtually no Liberals in Western Canada. Conversely, there will be very few Conservatives in Quebec. Aside from increased representation in the House of Commons and in a new, reformed Senate, it is also vitally important that Westerners have greater representation on all relevant regulatory agencies. These are of special significance to the people of Western Canada.

It is interesting to note that Western Canadians do not want the provincial governments running Canada; they do not believe in small - "c" Confederation. If you look at the provincial voting patterns in British Columbia, for example, you will note that there is a strong Social Credit - NDP polarization, while neither party has a particularly strong representation in the federal House. Western

voters want to elect provincial governments to run the provinces and, independently of this, a federal government with a strong regional component to run the nation.

Evenson and Simeon speak of country-building, province-building and Quebec nation-building. They could, perhaps, have looked more closely at government-building because this has been a major preoccupation at both the federal and provincial levels for the past twenty years. By and large, Western Canadians are thoroughly annoyed with big government because it is so insensitive to peoples' needs. Integral weaknesses in government structure are only magnified by expansion.

There are many peculiar ironies in the western response to the issues of the day. Westerners are opposed to bilingualism, but they demand french language training for their children; they favour unity, but oppose the price-tag that might accompany it; they demand control over their own natural resources and the funds which accrue from them, yet participate willingly in equalization payments to other parts of the country; they consider the Supreme Court to be made up of fine, impartial judges who regularly rule improperly and irregularly on constitutional matters in favour of the central government; and, finally, they're incensed at their poor representation in Cabinet, and mad at Jack Horner for changing sides. These are the paradoxical statements that emerge from meetings of the Canada-West Foundation in every part of Western Canada.

Evenson and Simeon state: "it is impossible to divorce changes in central institutions from the crucial question of the division of powers." I must disagree and suggest that Ottawa can begin to eradicate the roots of discontent by putting its own house in order without provincial government approval. A reformed House of Commons could allow for more regional input and proportional representation as well. It is the emending formula which cannot be divorced from the division of powers, and the November "First Ministers' Conference" ground to a halt over this very issue.

As the party system is failing, the Senate watchdog impotent, and the nation increasingly difficult to govern, it is time for the Federal Government to move on to unilateral reform of the House of Commons. There must be some kind of accomodation that will give Westerners a greater say in the Parliament of Canada. I shall frame my conclusion in the form of a gentle warning. There is an ambivalent mood in the West today. While committed to the ideal of one Canada, Westerners are also taking a pragmatic and somewhat envious look at Quebec's success in obtaining the things she holds dear. Western Canadians too are taking a long, hard look at their future.

WESTERN ECONOMIC GRIEVANCES:

AN OVERVIEW WITH SPECIAL
REFERENCE TO FREIGHT RATES

by

Kenneth H. Norrie*

University of Alberta

* I gratefully acknowledge comments by Dave Gillen and the research assistance of Yolanda Van Wachem. The usual disclaimer applies.

INTRODUCTION

The current preoccupation with the economics of Confederation stems from the election of the Parti Québécois government, and the publicity surrounding its claim that that province is a net loser under the present fiscal arrangements. Regional economic grievances are not unique to Quebec of course, nor have they been restricted to the balance sheet of federal taxation revenue versus expenditure by geographical area. It seems to have taken the emergence of the Parti Québécois though to create a climate in which the entire economic and political basis of Confederation is open to discussion. Topics that were unthinkable a few years ago have become the stuff of current research and debate.¹

The Prairie Provinces² have always contended that Confederation, the national policy and most of the subsequent economic policies were designed by and for central Canada. Decades-old grievances over tariffs and freight rates have been supplemented more recently by disputes over resource taxation and industrial development strategies. Their dissatisfactions have been repeatedly expressed through submissions to Royal Commissions, through the election of strong provincial governments and the rejection of government candidates in federal elections, via federal-provincial conferences more recently, and most notably during the special Western Economic Opportunities Conference in Calgary in July, 1973. Ironically enough however, it has taken the threat of secession by one of the provinces the West has long considered to be favoured economically by Confederation for these claims to be viewed seriously. The so-called western viewpoint now makes a regular appearance in discussions of national economic concerns.³

Western economic grievances⁴ must be viewed in light of the two main goals of the region's political and economic leaders to be properly understood.⁵ The first concern is with maximizing the level of real per capita income from the existing economic base of the region. In the context of federal-provincial relations this means western opposition to federal policies that are construed as restricting the generation of income from these sectors, or its retention regionally, and to those that increase the cost of goods and services to residents. The other goal is a desire for greater economic diversification, meaning essentially expanding the industrial base of the region. In this regard, there is a belief that federal economic strategies are, and always have been, deliberately designed to develop Ontario and Quebec based on the resources of the outlying regions. The presumption is that with more neutral federal economic policies the industrial, financial, and commercial activities of the country would be more widely diffused among the regions. Natural disadvantages in these respects are sometimes recognized, but the belief persists that the western provinces are more dependent upon raw material exports than they otherwise would be because of the century-old Canadian development strategy.⁶

The present paper is an attempt to analyse these two general areas of concern.⁷ It is useful to adopt a criterion employed in an earlier paper.⁷ The term regional economic discrimination is reserved for demonstrated economic losses emanating from distortions initiated or tolerated by the federal government. In other words, the actual allocation of resources given the particular policy in question must be shown to be inferior from a western standpoint to an hypothetical one predicted to result from a more neutral policy environment. This criterion is specifically intended to exclude allegations of economic discrimination that stem in fact from the inevitable position of a small, geographically remote natural resource based economy within a larger industrial North America.

The paper cited in the previous paragraph argued that many of the western economic grievances are precisely of this latter type. Examples given were the general lack of secondary industry in the region (as distinct from a few specific industries), the fact that transport charges on both exports and imports are borne locally (and would be even with a perfectly competitive transport system), the lending policies of commercial banks, and the regional impact of tight monetary policies. In each of these cases, the grievance is more properly directed at the inevitable operation of a market economy where geographical distances are great, and in which regions are vastly different in size and proximity to other industrial areas of the world.

The other type of western economic complaint distinguished was distortions in the economy, caused by the federal government or at least tolerated by it, which have possible regionally discriminatory effects. Instances such as these qualify as grievances because the source of the dispute lies with the federal government, and because recourse lies in lobbying to have the distortions removed. Examples of this sort are western grievances over tariffs, freight rates and federal taxation of natural resource rents. Before it can be concluded that the West can and should press for changes in these areas, however, two additional criteria need to be satisfied. It must be shown first of all that the assertions are valid, and that the alleged losses are significant ones. In addition, it should be clear that the changes proposed would unambiguously benefit the residents of the region. A slightly less restrictive version of this would be that any changes involving income redistributions within the region should be ones that can be condoned through the usual political process. The remainder of this paper discusses each of these areas in turn, with a special empirical effort being devoted to allegations concerning freight rates.

TARIFFS

Western complaints about tariffs stem from the recognition that they operate to redistribute income from the western provinces and the Maritimes to central Canada. All Canadians pay the costs of the tariffs in the form of higher prices on protected goods, but the benefits are distributed unequally due to the concentration of industry in Quebec and Ontario. The question though is whether or how this can be construed as a legitimate regional burden. The main impact of the tariff is to create a larger number of industrial jobs within Canada than would otherwise exist, with the bulk of these accruing to Ontario and Quebec. The regional impact of the tariff then is essentially that persons living outside the industrial heartland pay a share of this excess wage bill through higher prices but receive a disproportionately small percentage of the jobs.

The usual recourse to this is to argue that there are no formal barriers to labour mobility within the country, so there is nothing to prevent workers of all areas from migrating to the industrial centres to take these jobs.⁸ But this assumption of costless adjustment of factors is not tenable. Land and natural resources are not mobile by definition, so owners of these factors will have their incomes reduced below those potentially available, as Mackintosh recognized long ago.⁹ Recent work in the economics of migration or job search has highlighted the importance of adjustment costs. Unless a factor has some degree of market power, which is unusual, it bears the full brunt of these costs.

An analogy can be drawn to the literature dealing with the reallocation of income between capital and labour due to tariffs or minimum wage legislation, between black and white or male and female due to discriminatory hiring practices, among income classes due to publicly funded education and so forth. The presumption in these cases is that one is dealing with mutually exclusive groups and perfect immobility; the full burden must be borne because there is no way of avoiding it. But if this is generally accepted as the basis of an interesting economic problem, then so is any policy such as tariffs that demonstrably shifts the costs of adjustment to a specific, identifiable subset of the population. It thus seems worthwhile to attempt to specify and estimate the exact regional effects of the Canadian tariff, as has been done in some recent studies.¹⁰ Space limitation preclude any additional estimates here.

A related concern is the belief that western-based resource industries face a negative effective rate of protection because there are duties on inputs but not outputs. This means that value added in these sectors is less than it would be under free trade, implying in turn lower payments to labour, to capital or to the owners of specialized resources. In each case the result is a reduction in the aggregate income generated from the existing economic base of

the region. In practice, though, the effective rate of protection is rarely significantly negative¹¹, so it is unclear how significant a point this really is.

Yet another contention is that the existence of the tariffs adds to the transport costs paid by westerners. The Canadian tariff ensures that deliveries of many manufactured consumer goods are from Quebec and Ontario, with the significant distances and therefore transport costs added on. In the absence of these barriers, it is argued, the west could purchase these products from geographically more proximate areas of the U.S. or even from Japan and face a lower total freight bill. It should be noted that this argument is made independently of claims that actual freight rates are discriminatory; it is a point about distance alone. This point is almost certainly correct to some extent, although to measure the size of the loss would be a nearly impossible task.

A final specific claim with respect to Canadian commercial policy is that the federal government has been lax in attempting to negotiate reciprocal trade arrangements with the U.S. and other countries for products that would benefit the west primarily. The American tariffs on petrochemical products are one example of a perceived barrier to the expansion of petrochemical capacity in the West. American and Japanese duties on processed products of agriculture, forests and mines are other examples. The federal role in securing the Autopact or the Defence Sharing Agreement is usually mentioned by way of contrast. Western interest in this area is evidenced by the very active role they have taken in shaping Canada's position in recent GATT negotiations. It is important to realize, though, that the real targets in these cases are foreign tariff structures and all the interest groups behind them rather than the Canadian tariff structure *per se*.

FEDERAL TAXATION AND EXPENDITURES

The reference in this section is to the so-called "balance sheet" question, made current recently by the Quebec-Ottawa dispute. There has long been a presumption in the western provinces, particularly in Alberta and B.C. that they contribute significantly more in taxes to the federal government than they receive back as government services and income transfers. In fact, the second volume of the "Costs of Confederation to Alberta" studies attempted to measure the size of this income transference via the tax system, and found it to be significant.¹² It is also the issue that is emphasized by nearly all of the variety of western independence parties currently campaigning in the region.

On this question though, it is important to define clearly what is at issue. Some provinces obviously will pay more in federal taxes than they get back in the way of services, and others less, simply because of disparities in regional incomes, the progressive

nature of the personal income tax and the goal of uniformity of government services across the country. Furthermore, if the idea of progressivity in taxation is accepted, then this is in fact how it should be. It is unclear what it means to say that Alberta or B.C. bear a burden in this respect. To argue that each province should be exactly in balance in this respect is to deny the principle of progressive taxation applied to Canadians as a whole.

This question is an interesting issue, though, for a provincial or regional jurisdiction contemplating political independence. For then there is a need to examine the tax base of the region under a variety of assumptions about dynamic effects to see if it could support an equivalent level of government services once independent. It would be equally interesting if it were discovered that the poorer regions of the country were the ones in a deficit position. But merely to show that residents of B.C. or Alberta or Ontario are in total taxed relatively more heavily really only amounts to confirming that there is in fact some progressivity in the Canadian tax system.

The argument could be made, however, that the above arguments are valid in the case of taxation of incomes that have accrued to companies and individuals, but not to federal interception of resource revenues that would otherwise have gone to provincial governments in the first instance. The western position along these lines has been stated rather succinctly by two leading political figures.¹³ The BNA Act divides powers and responsibilities into areas of exclusive federal concern, those solely in the domain of the provinces, and those such as agriculture that are shared between the two levels. Areas assigned to the provinces are unassailable, except in cases of true emergency and then only by act of Parliament. The authority given to the provinces under the BNA Act to own and manage the development of land and natural resources is one such example of an exclusive provincial prerogative. Thus, in the absence of a clearly recognized national emergency the federal government has no constitutional right to implement any special kind of taxes or regulatory provisions for these sectors.

These are the grounds on which the western premiers have opposed the federal export tax on crude oil, the 1974 budget decision to disallow royalty payments to provinces as a tax deduction for resource companies, and Ottawa's active intervention against Saskatchewan in challenges to the province's oil and potash policies. In each case, the actions are seen as unwarranted and grossly discriminatory. They ask why there was no similar export tax on hydroelectric power transmitted to the U.S. or on shipments of timber, gold, or nickel. The fact that the energy royalties have been designated to aid in the industrial diversification of the province in the case of Alberta, or in the repatriation of the potash industry in Saskatchewan, makes the federal actions doubly onerous. Ottawa is not only seen as taking an unfair share

of provincial resource revenues, but also is seriously impeding what may well be the West's last chance at achieving the elusive economic diversification.

To assess these claims requires resolving which level of government has the right to control and regulate the natural resource industries and act as the initial collector of the resource rents, and how much if any of these rents should be redistributed to other jurisdictions within Canada. The hitherto most complete attempt to examine these issues is by Anthony Scott.¹⁴ He first examines what he calls institutional criteria - constitutional law, the province as landlord, and the notion of an optimal size of income redistribution jurisdiction - and finds no clear criteria as to how the resource revenues should be allocated. A second criterion, dubbed allocational factors, does not yield any firmer conclusions. He concludes by suggesting a division of revenues according to the share of special services provided by the respective governments, with the federal government also collecting a share in preparation for the interprovincial population movements that will likely result from exhaustion. In a similar kind of review Helliwell concurs that "nothing is 'right' when it comes to political division of authority and revenues."¹⁵

Any estimate of the size of the burden borne by the western provinces with respect to resource taxation depends crucially on what is viewed as "proper" allocation of economic rent. If the producing provinces are assumed to have exclusive rights, then the simplest estimate of provincial government revenues foregone from oil and gas is equal to the current production rate times the difference between world and domestic prices times the relevant marginal royalty rate. The companies' share of foregone income (equal to one minus the royalty rate) can then be allocated among provinces according to the distribution of shares. A calculation of this sort shows that income foregone by the province itself or by its share-holding residents in 1974/75 was equal to \$310 million in the case of Saskatchewan, and \$2,309 million for Alberta.¹⁶ If the benefit the provinces' residents derive as consumers of lower-priced fuels is taken into account these figures drop to \$214 million and \$2,129 million, respectively. The net figure for Manitoba is a gain of \$63.6 million.

These calculations could be refined in several ways. A similar exercise for a later year would yield a smaller figure for instance, since domestic oil and gas prices have been gradually approaching world prices by federal-provincial agreement.¹⁷ The implicit assumption of a perfectly inelastic demand curve for fuels is almost certainly unrealistic.¹⁸ The view that at least some portion of the resource rents properly belong to the nation as a whole could be accommodated by reducing the figures by an appropriate amount.¹⁹ The historic pattern of preferential tax treatment of the industry could be taken into account, since this certainly increased the amount the provinces collected in the form of exploration and development rights.

Finally, it might be argued that current royalty rates in the producing provinces are a direct consequence of early federal initiatives in the area and that, in the absence of this demonstration effect by Ottawa, Alberta and Saskatchewan would never have revamped their taxation efforts in the manner they did. All these adjustments would reduce the estimates of the interprovincial income transfers.

In total, though, the issue of resource taxation does seem to be a legitimate area for provincial concern. The federal government has clearly collected a significant amount of the economic rent from the oil and gas industry and redistributed it to residents of other provinces. While there may not be a clear constitutional prohibition against this, it certainly does contravene the understanding the provinces have of the position of natural resources in the BNA Act. Alberta and Saskatchewan are also entitled to ask, as they do, why just their resource industries have been singled out for this special treatment. The fact that the economic rents were obvious and large and administratively rather easy to tax may explain the phenomenon, but it does not justify it.

FREIGHT RATES

This is perhaps the longest-standing issue of western alienation, stretching back to pre-CPR days. In the early years, western concern was focused mainly on the level of rates on grain exports. But as the economies have matured and developed, the criticism has become more comprehensive and sophisticated. The target at present is the National Transportation Act of 1967, with its near exclusive reliance on competition to set rail freight rates. Aside from a minimum charge equal to average variable costs, a maximum one for captive shippers, and the retention of the statutory grain provisions, the market was to be relied upon as the best judge of what rail tariffs should be.

The West's position as regards the implications of this system can be summarized as follows. The widely recognized joint and common product nature of railway operations makes it difficult or impossible to identify costs uniquely with each of the services provided. This means that the companies price so as to maximize the profits of the operation as a whole, with individual commodities often moving at rates at or near average variable costs and others at well above average total costs. Given the high ratio of fixed to variable costs in railroads, the consequent variation in rates can be quite large.

A discriminating monopolist faced with this situation will maximize profits by charging what the market will bear or, in other words, according to the price elasticity of demand for transportation services. Goods with no alternatives to rail transport will pay rates substantially in excess of average total costs,

making up for the portion of fixed costs lost on rate-sensitive traffic moving at less than total cost. The National Transportation Act, relying as it does on intermodal competition to set rates in all but a few instances, creates and sanctions such discriminatory pricing by the railroads.

The western provinces feel that they inevitably have relatively inelastic demands for transportation services because of the lack of competing water transport, the high-bulk, low-value nature of their exports and the long distances involved in the import and even intraregional movement of goods. These latter factors are thought to restrict the competitive ability of trucking. As a result the region views itself as bearing a disproportionate share of railway fixed costs at the expense of real incomes of the region's residents. In addition, this value of service pricing together with statutory rate limitations on some agricultural products results in a structure of rates over commodities that actively discourages further processing within the region.

The specific complaints are five in number. It is held first that rates on the export of raw materials are significantly lower than those for processed products, creating an incentive to export the former rather than the latter and thus destroying otherwise natural industries for the West. Examples most often cited are the rates on feed grains as opposed to livestock and meat products, and those on rapeseed versus rapeseed oil and meal products. A second charge is that the West does not receive the same kind of zone or blanket rates on incoming goods that the East does. Smaller centres pay additional rates to those charged to the main cities, thereby discouraging the decentralization of economic activity within each of the provinces that is a major goal of all prairie governments. Thirdly, the rates on goods shipped to the provinces are said to be higher than those for the same product shipped the greater geographical distance to Vancouver. This is the familiar long-short-haul discrimination, and results from the railways' need to compete with ocean delivered supplies from other countries to B.C. The most common examples here are steel and canned goods. The higher prices reduce real incomes in the West and also inhibit the establishment of western wholesaling and distribution centres on the prairies. The fourth allegation is that rates on westbound manufactured goods are lower than those on eastbound ones, compounding western difficulties in competing with eastern producers in both local and central Canadian markets. Finally, it is argued that the horizontal rate increases of recent years, whereby a constant percentage increase has been applied to all rates, has increased the absolute rate spread, and thus exacerbated the above problem.

The West has proposed to replace the present value of service scheme with one based as closely as possible on the actual

costs incurred in providing individual railway services. To this end Alberta has designed and lobbied for the so-called Equitable Pricing Policy,²⁰ while Manitoba has suggested an alternative method dubbed the Destination Rate Level Technique.²¹ There has been an understandable unwillingness to see the Statutory Grain rates be abolished, however, at least until an alternative form of compensation can be agreed upon.

Western claims about the divergence between rates charged and costs incurred by the railroads cannot be investigated directly, due to the absence of any reliable cost data. One recourse is to try and infer what the structure of rates would be under the assumption that the companies practise discriminatory pricing efficiently. These predictions can then be checked against actual freight revenue data together with any information on variables likely to reflect cost differences over commodity movements. This procedure is less precise of course, but is about all that can be done with present data availabilities.

SOME THEORETICAL CONSIDERATIONS

The sensitivity of any given commodity movement to the level of railway freight rates depends on two separate factors. The first, and the one stressed by western spokesmen, is the presence of competing transport modes. Water transport can be an effective competitor to rail for bulky, low-value products moving long distances, at least in season and where speed is not essential. For higher-value, lower-bulk items moving shorter distances, trucking is a main competitor. In addition there is competition from airlines, pipelines and the like for more specialized product movements. But there is another important determinant of demand elasticity that is often overlooked in western submissions. Unreasonably high freight rates on products with no alternative mode available can force the industry out of business, with the railroad losing the traffic entirely. If they have excess capacity and the rate they can charge covers some of the fixed costs, then it is obviously to their advantage to price appropriately to ensure the industry survives. Thus even where railroads are the only feasible mode, this product competition as it is known can bring about rates at or below actual total costs.

There are two factors that determine how much of a freight rate any specific industry can absorb without forcing it to shut down. The first is the price elasticity of demand for the product itself. The more inelastic this is, the more the industry will be able to shift forward any transport charge, and thus the less is the effect on producer prices. Conversely, a highly elastic demand curve means that the producer will bear the brunt of the transport charges. For a producer or industry in this latter situation the ability to bear a transport charge depends on the margin between the given world price and the average production cost. Producers

with highly elastic supply curves with intercepts at or slightly below the world price would not be able to bear very large transport costs, for example. On the other hand very profitable ones would be able to absorb the freight charges, and industries with relatively vertical supply curves would accept additional transport charges without reducing output significantly.

It is clear that there is a general lack of intermodal competition in western Canada. One ocean port, isolated and icebound for most of the year, provides no competition to the railways. In addition, most of the products shipped out of the region are low-value, high-bulk raw materials for which trucking costs would be prohibitive. The higher-valued manufactured imports from eastern Canada and abroad generally move at such great distances that trucks again cannot compete, although their disadvantage is apparently becoming less significant over time. The only area where the effects of intermodal competition should be discernable is in intraregional commodity movements of high value goods, where the shorter distances make trucks a viable competitor.

Product characteristics are relevant, though, in setting rates on western products, and the pattern that one would predict on these grounds is exactly opposite to what the West describes the current one to be. One example is the contention that freight rates on raw materials are generally lower than those on processed goods. Both would move by rail if at all due to their bulk and the distances involved. In addition, one can safely assume that external demand for both categories was highly elastic, given the small share Prairie producers have or would have in world markets. Thus there is little or no opportunity to shift freight charges forward in either case. Any exceptions to this would be more likely in raw materials rather than processed products, Saskatchewan potash being one example perhaps. Thus any difference here would point to higher rates on raw materials.

The ability of producers to bear a price decrease is different, though. Manufacturing and processing plants on the Prairies are necessarily small, marginal concerns operating on the fringe of the larger North American Industrial heartland. The margin between average costs and world prices is generally rather small. In addition, they are typically price takers for capital and labour and purchased inputs, given their relatively small size and the geographical mobility of factors, so any move towards reducing output would have little or no impact on factor prices and thus unit costs.

Natural resource industries, on the other hand, have a unique and immobile factor of production in addition to capital and labour. The return to the latter factors may be immutable in the face of factor mobility, but that to land or to the resource site is not, so long as any Ricardian rent is being earned. In other words,

the presence of specific factors of production gives the raw materials industries a much more inelastic supply curve than the processing industries. A lower price at the farm gate or mine site is reflected backwards into a lower capitalized value for land or for the exploration rights. Only units at the margin will be squeezed out, leaving intramarginal ones still operating. A discriminating monopolist will recognize this and will attempt to extract some of this economic rent.

In the absence of any regulatory distortions, then, such as statutory rates on export and feed grains, one would expect any divergence between freight rates and costs to be greater for raw materials than for processed products, rather than the reverse as is alleged. This is the first case then where the theoretical prediction is at variance with the western position.

The same basic point applies to the claim that manufactured goods move more cheaply from east to west than vice versa. The elasticity of demand for western manufactured products in eastern and world markets is likely very high given the easy availability of substitutes. In addition, the marginal nature of most western manufacturing industries suggests there would be little room to absorb transport charges at the producer's end. Thus if the traffic is to move at all, the railways would have to provide relatively lower rates, not higher ones, as is advocated.

Commodities shipped east to west would likely be put into two separate categories by railways. Manufactured goods not produced in the West would move at quite high rates, given the relatively inelastic demand for them in the region due to the absence of easily available substitutes. Thus western prices of these products would be higher than under a cost of service freight rate system. For commodities that are produced locally, the railway would have to compare the relative competitiveness of eastern and western firms. Goods where the East had an apparently strong competitive advantage could move at relatively high rates and still compete in the West with western products, while for the more footloose type of products, the reverse is true. In general, though, one would expect the average rate on manufactured products to be higher from east to west, and not vice versa, as is argued.

The presence of long-, short-haul discrimination is, in fact, an example of the application of the above principles by the railroads. Rates are higher to the Prairies than to B.C. for some commodities because of the absence in the former region of competing suppliers able to produce these products within the region or land them there cheaply by competing modes. The alternative to high-priced Ontario steel in B.C. is Japanese products landed by sea. In the Prairies the local producers cannot offer the quantities and varieties necessary, so it must be shipped in by rail regardless. The same is true for canned goods, with the B.C. alternatives being ocean shipments of Australian and California products.

A COMPARISON OF FREIGHT RATES BY REGION

The actual pattern of freight charges can be seen by examining the Waybill publications published by the Canadian Transport Commission (CTC).²² Table 1 gives a matrix of revenue per ton-mile earned by the railroads for each of the five rate classes by region. The first category, class rates, is an effective ceiling rate for any good moving anywhere in Canada. In 1976 only 0.46 per cent of the total ton-miles moved came under this rate. Commodity non-competitive rates, or normal rates as the railways prefer to call them, cover cases where the railroad is the only feasible shipper but where the rate must be set so as to allow the commodity to compete in Canadian and world markets. Commodity competing rates are ones set in competition with other potential carriers. Agreed charges are an explicit contractual arrangement between the carriers and the shippers whereby a fixed rate is given in exchange for a specified volume of traffic moved during the contract period. Statutory grain rates are the ones from the 1925 agreement covering maximum rates on export grains.

Even at this very broad level of aggregation there are several interesting observations to be made. In the first place, the over-all incidence of freight rates on the western economies is apparently relatively low. In 1976, some 36.75 per cent of originating traffic from the West was statutory grain (Table 2) which moved at the very low rate of 0.50 cents per ton-mile. Another 33.34 per cent moved in the commodity non-competing class, at rates which are among the lowest of the entire table. Thus about 70 per cent of all traffic shipped from the western region is moved at the lowest rate categories. Assuming as is likely that the transport costs are borne by the producers in these cases, this seems to indicate that there is no large burden on these incomes.

It must be stressed, though, that this does not demonstrate that there is no discriminatory pricing being practiced on these commodities. The rate on statutory grains is well below even average variable costs, as the Snavely Commission has recently shown.²³ But in the commodity non-competing class it could be that unit costs are unusually low and that even the low rates per ton-mile shown are in excess of what a true cost of service rate would be. Given that this category involves such things as unit coal trains, and that the average distances travelled by western products are greater, it is quite possible that costs are in fact lower. What Table 1 does indicate then is how much lower these costs would have to be for the thesis to be correct. It also demonstrates that for the bulk of the commodities moving out of the Prairies the average freight rate for non-competing commodities is well below that charged on the movement of all other commodities in Canada.

A second feature is that the rates on western products shipped under the commodity non-competing category are the lowest of all the groupings for each of the three destinations, excluding statu-

tory grains as a special case. This is the case in spite of the fact that the average distance travelled is less in two of the routes and only slightly higher for internal movements. This illustrates the danger of regarding these as non-competitive and of suggesting that the lack of a competing mode of traffic necessarily implies excessive charges by the railroads. Carriers have apparently responded to the competition faced by these products in external markets by providing rates that are low in comparison with traffic moving under supposedly more competitive categories. Again, though, the point has to be stressed that in the absence of good cost information, it cannot be concluded that these rates are not in excess of total costs incurred in moving the products. The data only illustrate that the magnitude of the cost differential between products moving under this classification and those under other ones would have to be substantial for this to be true.²⁴

Some further interesting patterns emerge from a look at specific geographical pairings. The commodity competing group²⁵ includes most of the manufactured products shipped by rail. Within this category eastern internal shipments move at cheaper rates than western ones in spite of shorter average hauls, which is consistent with the relative lack of intermodal competition in the latter region. But when the east-to-west rates are compared with the west to east ones the pattern is reversed. Western producers of products shipped under this classification apparently have access to eastern markets at rates lower than their eastern counterparts do to markets in the West. This is consistent with the theoretical analysis above, but runs exactly counter to the stated Prairie position. The assertion is strengthened by the fact that the east-to-west rate is higher than the west-to-east one in all four categories reported, with the average hauls about equal in all cases. The comparative figures for agreed charges are especially interesting since it is often argued that the much larger size and influence of eastern industries allows them to negotiate better rates with the carriers. In this respect too, it is interesting to note that the average revenue per ton-mile from agreed charges within regions is lowest in the West, although the much longer average length of haul probably accounts for this.

The conclusions to this point though are subject to qualification as noted, because of the very high level of aggregation and the absence of any specific reference to costs. It is possible to circumvent the former problem somewhat by looking at a second set of commodity flow data published by the CTC.²⁶ Data for province-by-province flows for seven basic commodity groups are summarized in Tables 3 through 7. The commodity group of most interest in light of western concerns is manufacturing and miscellaneous. The lowest rates for originating manufactured goods are those shipped from the four western provinces, with those from the Maritimes following closely, and the rates from Quebec and Ontario being substantially higher. On the other hand, the rates on manufactured goods coming into the three Prairie provinces are substantially higher

than those for Quebec, Ontario, and B.C. The Prairies thus appear to get relatively favourable rates on manufactured goods they export but residents pay disproportionately higher rates and thus prices on processed imported goods. Again this is consistent both with what was expected on theoretical grounds and with the conclusions drawn from the aggregate data above but it runs counter to one of the main western freight rate grievances.

The situation as regards raw material movements is mixed. The rates on products of forests tend to be a little higher for the three prairie provinces, both in and out. The other products vary substantially, with some of the western figures being lower than the Ontario and Quebec ones and others higher. Even within the Prairies there is considerable variation. There is no obvious tendency for rates on raw materials to be consistently lower than those on manufactured products. But this needs to be checked further at a greater level of disaggregation and with some attempt to account for cost differentials.

A final step at this level of aggregation is to look at specific province-to-province flows. Table 5 gives the revenue per ton-mile for shipments within each of the provinces. The rates for manufactured goods for the three prairie jurisdictions are at or slightly below that for Ontario, and slightly above that for Quebec. Apparently there is sufficient truck competition for these shorter hauls of higher-valued products. Again, the charges on forest products are a little higher relative to those for Ontario and Quebec, with the others exhibiting great variation.

Tables 6 and 7 give the average revenue per ton-mile earned on flows between the three Prairie provinces and Ontario and Quebec respectively. Once more it will be noted that the rates on manufactured goods from any of the three provinces are substantially less than those for products moving in the reverse direction. In many cases they are less than half those on products coming in. Even further, the fee per ton-mile is less for all three provinces on shipments into Ontario (Quebec) than it is from Quebec (Ontario). They also have a substantial advantage over the two central Canadian provinces when it comes to shipments into the Maritimes. In the last two cases, though, part of the difference is undoubtedly due to the longer average haul. Once again there is a possibility that the degree of aggregation is too large, camouflaging the commodity mix, and that there are substantial cost differences involved in carrying the different types of processed products. But as stated above, these differences would have to be substantial to offset the figures shown in these tables.

It is possible to take the analysis to an even greater degree of commodity disaggregation although it means reverting back to the three geographical zones. The Waybill publication underlying Table 1 gives freight rate data on a great number of commodity movements among the three zones. Of these, 60 specific commodities

are reported as having moved both east to west and west to east in 1976. Table 8 reports that only 19, or less than one third, had rates per ton-mile greater from west to east than vice versa. Even more interesting, though, is the distribution over the main commodity groups. Nearly all of the raw materials are more expensive to move east. In the cases of fabricated materials and end products however, the proportions are much lower. Even at this quite detailed level of disaggregation then, there is still no convincing evidence that there is a freight rate per ton-mile disadvantage facing western-based processing industries.

As a final disaggregation, unpublished data on province-by-province flows of the 69 commodities comprising the seven main groups in Tables 3-7 were obtained from the Traffic and Tariffs Branch of the CTC. With this data, it was possible to compare rates on shipments between each of the three provinces and Quebec and Ontario. There were seven manufactured goods that moved both ways between Alberta and Ontario, and four between Alberta and Quebec. In every case, the rate was lower on the west-to-east haul, often significantly so. The same was true for Saskatchewan for all five of the two-way movements. There were 13 such pairings for Manitoba, of which only one exhibited a higher west-to-east rate. The above conclusions apparently survive even this level of disaggregation.

The few studies that have been done on individual commodities can be consulted as yet another check on the conclusions that have emerged from the above data. One such effort is the attempt by Gainer, Drugge and Knowles to assess the impact of transport rates on the competitive advantage of Edmonton industrial chemical firms.²⁷ Their objectives were to determine whether these charges acted as a barrier to marketing primary outputs or further processed ones and whether there was a differential in rates on raw versus processed petrochemical products such as to prevent integrated operations in western Canada. For primary products they found the rates obtained by the industry in Edmonton to be "relatively favourable." With one exception the charges (cents/cwt) on products eastbound were significantly less than both those on the same products west-bound and the equivalent U.S. rate. For processed products of polyethylene and cellulose acetate, "... the rates obtainable by Edmonton based firms are favourable compared with west-bound Canadian rates, and are even more favourable when compared with U.S. rates." For further processing of the basic petrochemical products into final products they find that other location factors such as low-cost labour, market access and uniform pricing across the country dominate any transportation effect. At this very specific commodity level then, and for products that are among the most obvious ones for western industrialization to be based on, it must be concluded that there is no support for the thesis that discriminatory freight rates are

preventing or stunting the development.

The two cases most often cited to back the contention that freight rate structure promotes the export of raw materials rather than finished products are rapeseed versus rapeseed products and feedgrains versus meat products. In both cases, there is a distortion due to the low statutory rates applicable to grain whereas the processed products must pay a more normal, higher one. Popular discussions of the cases, however, make it appear that these differential charges actually result in a movement of rapeseed to central Canada for crushing there, or a shipment of western feed grains to eastern feedlots. In both cases, the actual market situation is much more complex.

There is no eastward movement of rapeseed as it cannot compete with soybeans produced in Ontario and Quebec or imported (duty free) from the U.S.²⁸ Instead, the grain is either purchased locally by the crushing plants or exported via Vancouver. Rapeseed oil and meal however are delivered to Central Canada in competition with soyoil and soybean meal. The farm price for rapeseed then is the Vancouver export price (set by the Winnipeg Commodity Exchange futures price which is in turn set in relation to the market for soybean futures in Chicago) less the statutory grain rates and handling charges. The plant price for oil and meal on the other hand is the Ontario and Quebec price (set in competition with the prices of soyoil and soybean meal which in turn are set with reference to the Chicago futures market) less normal freight and other charges. The essence of the problem, then, is that the low statutory rates on rapeseed exports through Vancouver are responsible for an artificially high price for rapeseed on the Prairies. But it must be noted that even without this distortion, the different distances shipped for rapeseed as opposed to its products would ensure that transportation factors weighed more heavily on the latter industry.

A removal of the statutory rates on the movement of rapeseed to Vancouver would reduce the farm-gate price of the grain by an equivalent amount. This would reduce input costs to western crushing plants, allowing them either to increase their profits in existing output or to reduce the prices of oil and meal and thereby increase their ability to compete with soybean products in eastern Canada. A careful study of this particular market would have to be made before it could be determined which of the above reactions would dominate. It is quite possible that some expansion of rape crushing capacity in western Canada would result and, in this sense, the claims that freight rate distortions prejudice industrial development are likely valid.

It must be noted, however, that this gain would come at the expense of rapeseed growers. They could offset the potential income loss to some extent by switching to other crops, but they would necessarily be worse off in the final analysis. Since the

production of rapeseed is concentrated in certain areas of the Prairies the loss would not even be spread over the farm sector generally; instead it would be borne by an identifiable, small subset of the population. This trade-off relationship must be kept firmly in mind, then, when changes of this sort are proposed. The same result could be achieved by reducing the rate on the movement of finished products to a level comparable with the statutory one, of course. But advocating this, while understandable, would be equivalent to asking for an additional subsidy (since no one has argued that the eastbound rates on oil and meal exceed costs) rather than complaining about an extant distortion.

The feed grains dispute is of a similar nature.²⁹ Eastern feed-lots use corn rather than grain as a basic input, so it is not the case that the Feed Grains Assistance Act is diverting western feed to the East instead of beef.³⁰ Rather, the western meatpacker has to compete with his eastern counterpart on the basis of landed price, recognizing that the products are not perfect substitutes. Western feed grains are shipped east, though, to feed hogs and poultry, a trade made possible by the subsidy given to the movement of this grain. This market opportunity thereby raises the farm price of feed grains beyond what it would be under more normal rates, which in turn increases the operating costs of western feedlots. Removal of the freight subsidy³¹ would lower these input prices by an equivalent amount, again implying higher profits and/or lower prices for western products in the East, and thus an expansion of their market share.

As with the rapeseed crushing dispute then, there is reason to believe that these distortions in the freight rate structure may be hindering the development of the meatpacking industry in the West by an undetermined amount. But again, a removal of the distortion implies lower incomes for those farmers producing these products. The trade-off is largely an internal one within the region, rather than between regions, as is sometimes alleged.

The special study commissioned to assess the impacts of the two freight rate proposals put forth by Alberta and Manitoba came to much the same conclusions as have been drawn from the data and literature surveyed here.³² The authors took a sample of important goods-producing industries and asked what the impact would be of replacing extant freight charges on inputs and outputs with those implied by both the EPP and DRL cost of service schemes. The conclusion is worth quoting.³³

Under both EPP and DRL there is no apparent consistent net benefit pattern favouring any particular region. As a consequence, there are, in the final analysis, no significant regional differences. If anything, there is a tendency to benefit regions on the basis of the existing degree of concentration of particular industries which, in the short run, reinforces the status quo.

The results to this point do not support the main western contentions regarding the discriminatory impacts of the present freight rate system. The general incidence of rates is low on goods exported from the Prairies, suggesting they do not bear an unusually large portion of railway fixed costs. There is no obvious bias in export rates on raw versus semi-processed or processed products, except in the cases of rapeseed and feedgrains, and only here because of statutory rates that favour western farmers. Finally, charges on manufactured goods are higher on regional imports than on exports, implying relatively good access for western producers to eastern markets and a form of natural protection for industries servicing the local market. These conclusions were the ones predicted by the theoretical analysis developed at the beginning of the section and were not rejected at any of the various disaggregations employed in the discussion.

A SIMPLE STATISTICAL MODEL OF RAILWAY PRICING

In each of the above cases, the simple average revenue per ton-mile figures were used, with only casual attempts to allow for possible cost differences among commodities shipped or regions served. The above results would naturally be more convincing if the variation in freight rates due to cost factors could be separated out more rigorously. To this end an equation of the form³⁴

$$1) \quad \log R = a + b \log D + c \log W + d \log N + e$$

was estimated using the commodity flow data underlying Tables 3 to 7. R is the reported revenue per ton-mile for any commodity shipped from one province to another; D is the average distance travelled; W is the average weight per car; N is the number of carloads and e is the residual or error term. The regression was run for all commodity movements grouped together, and then separately for each of the classes reported in the earlier tables. Statutory grains are omitted in each instance, of course.

These variables are an admittedly crude attempt to proxy railway operating costs. Rates per ton-mile should drop as average haul increases because of terminal charges. But for longer hauls, trucking is less competitive, so the railroads might have some leeway here to increase rates above costs. Again, heavier cars should move more cheaply. But this could also be a proxy for the high-bulk, low-value traffic on which railroads have a natural monopoly. The number of cars is meant to be a proxy for the presence of any kind of specialized handling or loading facilities that might reduce terminal costs. It might have been useful to be able to account for any specialized equipment such as refrigerator cars, but the data were not available, nor would they be very meaningful with the level of aggregation employed here.

Three dummy variables were developed in an attempt to test

for the presence and direction of bias in the pricing of western products. DT in Table 9 takes a value of 1 for commodities moved into Manitoba, Saskatchewan or Alberta and 0 otherwise. DF is the same for commodities shipped from the region to other provinces, while DI represents commodities moving within the Prairies. A non-zero value for any of these dummies would mean that the freight rate per ton-mile on the product in question was significantly different from that prevailing in the rest of the country, after allowing for any cost differences due to length of haul, average car weight and number of cars.

The coefficient for length of haul is always negative and highly significant. If there is any discriminatory pricing in long-haul shipments it is swamped by the cost saving due to the spread of terminal costs over longer distances. Heavier cars also move at cheaper rates per ton-mile, so the same comment applies here. The number of carloads has a slight negative effect on average rates, if anything at all. The dummy variables are of special interest though. For all traffic grouped together, there is a statistically significant extra charge added to commodities moving into the Prairies, but none on goods exported or moving internally. This is consistent with the theoretical and empirical results obtained above.

There are some interesting variations over commodities. Agricultural and mineral products, live animals, and piggyback apparently are carried into the Prairies at rates not significantly different from those for the country as a whole, once cost factors are accounted for. Forest products and especially manufactured goods on the other hand move in at a premium rate. As expected then it is on the shipment of high-value processed products into the West that the railroads are charging relatively high rates. In terms of shipments out of the region, products of mines, piggyback and most notably manufactured goods are not priced differently from that for the country as a whole. In other words, there is no evidence that processed exports from the three prairie provinces are treated differently in any way from other similar shipments in other parts of the nation, once these three cost factors are held constant. There is typically a lower rate for agricultural and forestry products and a higher one for live animals. For internal movements the dummies for agricultural products and mining products are not different from zero. Forest products and piggyback move slightly cheaper apparently, while live animals and manufactured products attract a surcharge.

These statistical results should not be treated as anything other than the crude tests they are. There is first of all the ambiguity surrounding the appropriateness of the cost proxies used as discussed above. In addition, the independent variables have a considerable range of variation, leading one to suspect heteroskedasticity and thus inefficient estimates. But the conclusions they suggest are consistent with both the theoretical predictions and the earlier empirical efforts. Together then, these investi-

gations imply that the western claims about the bias in the structure of freight rates are misinformed. There is a regional burden evident, but it takes the form of relatively high rates on manufactured goods brought into the region, leading to higher prices for consumers and hence lower real incomes. Neither of the general allegations about the distorting effect of rates on raw materials versus processing activities in the West appears to be valid, statutory grain rates excepted.

CONCLUSION

Two principle conclusions emerge from the above discussion. The first is that the real income generated and retained within the West from the existing resource base is significantly reduced by federal economic policies. This is most obvious in the case of energy taxes and to a much lesser extent by the tariffs and inflated freight rates on incoming goods. It is important to note here though that the loss on energy exports has only existed since 1973, that there was a net subsidy of the industry before this under the National Oil Policy, and that the current transfer will end when Canadian oil prices reach world levels. The second is that there is no apparent evidence that the industrial structure of the region is significantly adversely affected by the current mix of federal policies, railway freight rates included. The possible exceptions to this - rapeseed crushing and meat packing - contain a large element of intraregional income redistribution within them, making it difficult to judge them unambiguously. These two conclusions together, then, imply that under the more neutral policy environment that is often envisaged by western spokesmen the region would almost certainly remain a resource hinterland, albeit a wealthier one. This statement applies most directly to Alberta and least to Manitoba, since the latter province has the bulk of tariff-protected Prairie manufacturing and bears none of the energy-tax burden.

The obvious question then is what position the western provinces should take in their negotiations with the federal government. One strategy would be to demand to be left alone as far as is possible. The federal government would end its discriminatory taxation of western resource industries and turn over its regulatory powers to the provinces. They would thereby have the maximum possible latitude to nurture and structure their own economic development. This is the option favoured by Alberta for obvious reasons, but it has its adherents in Saskatchewan as well. It is, however, much more optimistic about the chances of promoting an eventual self-sustaining industrial sector than the above analysis would suggest.

An alternative would be for the West to acknowledge that it faces a natural disadvantage as regards attracting secondary industry, for the federal government to accept the legitimacy of western economic goals in this regard, and for the two to then

attempt to come up with mutually satisfactory policies. The justification for such an approach could be developed along the following lines. Canadian regions, or provinces, are and always have been legitimate political entities in their own right. This is obvious and generally accepted in the case of Quebec, but it is just as valid for the other groupings as well. Accordingly, a resident of any region has the right to expect a standard of living as high and as stable as that in any other area. Some parts of the country, such as the industrial heartland of Central Canada, are naturally favoured in these respects. But others are not, meaning that the federal government has a duty to develop economic policies to help offset these natural disadvantages as far as possible. To date however, and for a variety of reasons, the federal government has been unwilling to accept this responsibility. Regional dissatisfaction in this case would be directed against the lack of any significant positive action by Ottawa.

Many of the western grievances are already in this form in fact. The belief in the right to keep the Statutory Grain Rates, or to be compensated if they are removed in the interests of increasing railway efficiency, is one example of this. Another is the demand for preferential treatment by the Export Development Agency or on western bids for federal contracts. Subsidized grain rates are viewed as the result of a basic political understanding at the time of prairie settlement, one that is as inviolable as language rights in Quebec. The other example plainly recognizes that distance creates a natural disadvantage and, in effect, asks that this be ignored.

Future western efforts would first be devoted to formulating economic development goals and demonstrating that they have the support of the provinces' populations. Then they would have to convince the federal government and the rest of the country of their right to the kinds of concessions that will be needed to overcome their natural economic disadvantages in the industrial sphere. These arguments could be based on historical or political grounds, on the infant industry thesis in the case of some Alberta sectors perhaps, or simply through exercising bargaining power.³⁴ In this way at least, the fact and political basis of province building³⁵ will be discussed and debated both within and among the various regions, something that has not occurred formally to date. Like Quebec, each region will have to decide whether the existing institutional arrangements or some variation of them are sufficient to achieve their goals. As in the Quebec case too, the other regions will at the same time have to determine whether the conditions demanded are worth it.

FOOTNOTES

1. See for example the recent contribution by D. Usher "The English Response to the Prospect of the Separation of Quebec" Canadian Public Policy IV:1 (Winter, 1978) 57-70 and the comments by D.L. Emerson and D. Latouche immediately following.
2. The present paper will consider the three provinces of Manitoba, Saskatchewan and Alberta only. While British Columbia is sometimes included as part of the same region, most notably at the Western Economic Opportunities Conference in 1973, many of the issues to be dealt with below affect BC somewhat differently. Discussing this province specifically in each instance would have increased the paper beyond its permissible length.
3. In addition to the present volume see W.J. Blackman "A Western Canadian Perspective on the Economics of Confederation" Canadian Public Policy III: 4 (Autumn, 1977) 414-430, and K.H. Norrie "Natural Resources; Economic Development and Canada-US Relations: A Western Canadian Perspective" forthcoming in C.D. Howe Institute Natural Resources and Canada-US Relations. In current policy symposiums the Quebec and Western views are usually requested. One cynical inference is that this leaves the Ontario point of view as being equated with the federal one, and the Maritimes ignored completely.
4. For a summary discussion of the western positions see Western Premiers "Capital Financing and Regional Financial Institutions", "Transportation", "Agriculture" and "Industrial Development Opportunities" (Submissions to the Western Economic Opportunity Conference, Calgary, July 24-26, 1973).
5. This argument is developed at greater length in K.H. Norrie "Natural Resource, Economic Development..."
6. The official western position is given in Western Premiers "Capital Financing and Regional Financial Institutions". Typical western academic statements to this effect can be found in W.J. Blackman "A Western Canadian Perspective...." or D.J. Bercuson "Canada's Burden of Unity: An Introduction" in D.J. Bercuson (ed.) Canada and the Burden of Unity (Toronto, 1977).
1-18. See also D.V. Smiley "The Political Context of Resource Development in Canada" in A. Scott (ed.) Natural Resource Revenues: A Test of Federalism (Vancouver, 1976) 61-72.
7. K.H. Norrie "Some Comments on Prairie Economic Alienation" Canadian Public Policy II:2 (Spring, 1976) 211-224.
8. See J.H. Dales "Introduction to the Carleton Library Edition" of W.A. Mackintosh The Economic Background of Dominion-Provincial Relations (Toronto, 1964) 6.

9. W.A. Mackintosh The Economic Background.
10. See T.L. Powrie "Regional Effects of the Canadian Tariff" (Unpublished paper, University of Alberta, 1967); H.M. Pinchin "The Regional Impact of the Canadian Tariff (Economic Council of Canada Background Paper, Ottawa, 1977); Ontario Treasury "Interprovincial Trade Flows, Employment, and the Tariff in Canada" (Supplementary Material to the 1977 Ontario Budget) as well as the contributions by T. Hazledine and L. Auer in the present volume.
11. See B.W. Wilkinson and K. Norrie Effective Protection and the Return to Capital (Economic Council of Canada Special Study, 1975).
12. M.J. Hollinshead and W. Blackman "The Cost of Confederation: An Analysis of Costs to Alberta" Part II (Independent Alberta Association, 1975).
13. See M. Leitch "The Constitutional Position of Natural Resources" and Premier Allan Blakeney "Resources, the Constitution and Canadian Federalism" both in J. Peter Meekison (ed.) Canadian Federalism: Myth or Reality (Toronto, 1977) 170-178 and 179-187.
14. A. Scott "Who Should Get Natural Resource Revenues?" in A. Scott (ed) Natural Resource Revenues.... 1-51.
15. J. Helliwell "Overlapping Federal and Provincial Claims on Mineral Revenues" in M. Crommelin and A.R. Thompson (eds.) Mineral Leasing as an Instrument of Public Policy (Vancouver, 1977) 182-199.
16. Available on request from the Economic Council of Canada, tables in unpublished mimeograph of A. Glynn.
17. A similar calculation done for the years prior to 1973 would show a net gain for Alberta and Saskatchewan of course, since the National Oil Policy acted to raise prices in Ontario above the landed price of offshore crude.
18. M.A. Fuss "The Demand for Energy in Canadian Manufacturing" Journal of Econometrics 5 (1977) 89-116 and M. Denny, J.D. May and C. Pinto "The demand for Energy in Canadian Manufacturing: Prologue to an Energy Policy" Canadian Journal of Economics 11, No. 2 (May, 1978) 300-313.
19. See for example W.D. Gainer and T.L. Powrie "Public Revenue From Canadian Crude Petroleum Production" Canadian Public Policy I: 1 (Winter, 1975) 1-12 where it is argued "... that the federal share of provincial resource revenues should be the same as it would be if those revenues accrued to the private sector and were taxed accordingly". The sudden and large accrual of these revenues by Alberta has created havoc with the old equalization payments

- formula. See T.J. Courchene "Equalization Payments and Energy Royalties" in A. Scott (ed.) Natural Resource Revenues.... 73-107 for a discussion of this.
20. Transport Research and Development Division, Department of Industry and Commerce, Government of Alberta "The Equitable Pricing Policy: A New Method of Railway Rate Making" (Edmonton, 1973).
 21. Government of Manitoba "Destination Rate Principle" (no date).
 22. Canadian Transport Commission Waybill Analysis: Carload All-Rail Traffic
 23. The Commission on the Costs of Transporting Grain by Rail Report Volume 1 (October, 1976).
 24. If the railroads were making a large profit on these rates they must be losing on some of the other ones, given the relatively low rate of return to railway operations. This would imply that the costs of these other movements were higher than the rates shown, making the implied cost differential even greater than what first appears.
 25. CN and CP Rail Railway Freight Rates: A Source Handbook.
 26. Canadian Transport Commission Commodity Flow Analysis: Canadian Carload All-Rail Traffic
 27. W.D. Gainer, S.E. Drugge and R.A. Knowles "Economic Analysis of the Effects of Transport Rates on Products of the Industrial Chemical and Meatpacking Industry With Special Reference to Edmonton" (University of Alberta, June, 1973).
 28. P.R. Perkins "An Economic Review of Western Canada's Rapeseed Processing Industry" (November, 1976) provides extensive discussion of the rapeseed case.
 29. See J. Heads "Transportation Factors and the Canadian Livestock and Meat Industries" in R.M.A. Lyons and E.W. Trychniewicz (eds.) Freight Rates and the Marketing of Canadian Agricultural Products (Occasional Series No. 8, Department of Agricultural Economics and Farm Management, University of Manitoba, 1977) 81-94.
 30. Heads ("Transportation Factors....") argues that freight rates appear to have little impact on the location of cattle production and slaughtering. Freight charges from West to East are greatest for a feeder steer plus the grain to feed it, next highest for a slaughter steer, and cheapest for sending a beef carcass and by-products. He has no explanation for the large shipments of feeder steers from Western Canada though.

31. Much of the previous subsidy has already been removed in the changes to the Feed Freight Assistance Programme that came into effect in August, 1976. Rates of assistance to Ontario and western Quebec of less than \$6 per ton were removed, and subsidy rates to BC reduced by \$4 per ton (Heads "Transportation Factors....").

32. P.S. Ross and Partners et.al. "Two Proposals For Rail Freight Pricing: Assessment of Their Prospective Impact" (A Report to the Federal-Provincial Committee on Western Transportation, 1974).

33. Ibid, p. 5-37.

34. See John Heads "Allegations of Rail Freight Rate Disparities in the Canadian Prairie Provinces Since the 1967 National Transportation Act" Transportation Research Forum 197 379-386 and T.D. Heaver and T.M. Oum "A Statistical Analysis of the Canadian Railway Rate Structure" Transportation Research Forum 197 571-578 for similar statistical exercises. The results obtained in both these studies are consistent with the ones reported here.

35. As an example, it is not at all unreasonable to demand concessions on freight rates in return for agreeing to hold oil and gas prices below world levels. This is especially true of the recent federal proposal to postpone an already-agreed-to price increase for oil in January, 1979 and to change the natural gas pricing agreement.

36. See J. Evenson and R. Simeon "The Roots of Discontent" (mimeographed, Institute for Intergovernmental Relations, Queen's University, May, 1978) for a discussion of province building.

TABLE 1

Average Revenue Per Ton-Mile by Rate Category and by Region, 1976
(Cents)

	<u>Class</u> <u>Rates</u>	<u>Commodity</u> <u>Non-Competing</u>	<u>Commodity</u> <u>Competing</u>	<u>Agreed</u> <u>Charges</u>	<u>Statutory</u> <u>Grain</u>
Maritimes to Maritimes	9.69	4.02	3.93	5.23	-
East to East	20.68	2.87	2.79	3.15	-
West to West	10.01	1.81	3.13	3.10	0.50
East to Maritimes	6.74	1.80	2.66	3.97	-
Maritimes to East	4.68	2.50	2.20	2.38	-
Maritimes to West	7.88	1.28	2.06	3.51	-
West to Maritimes	-	1.58	2.25	2.95	-
East to West	11.30	2.13	3.23	4.01	-
West to East	10.57	1.83	2.32	2.69	-

Source Canadian Transport Commission Waybill Analysis:
Carload All-Rail Traffic 1976

TABLE 2

Percentage Distribution of Ton-Miles Originating in Western Region, by Destination and Rate Group, 1976

(Per cent)

<u>West to</u>	<u>Class Rates</u>	<u>Commodity Non-Competing</u>	<u>Commodity Competing</u>	<u>Agreed Charges</u>	<u>Statutory Grain</u>
Maritimes	-	0.29	1.41	0.19	-
East	0.02	2.46	13.91	1.41	-
West	0.04	30.59	11.16	1.76	36.75
Total	0.06	33.34	26.48	3.36	36.75

Source As for Table 1.

TABLE 3

Average Revenue Per Ton-Mile by Commodity Group for Originating Traffic, 1976

(Cents)

	Statutory	Products of	Animals and	Products of	Products of	Manufacturing	Piggy-
	Grain	Agriculture	Products	Mines	Forests	and Misc.	Back
Maritimes	-	3.05	2.26	2.66	4.25	3.08	3.48
Quebec	-	3.28	2.51	2.27	2.19	3.46	3.87
Ontario	1.30	1.58	4.56	2.27	2.62	3.98	3.54
Manitoba	0.64	1.89	5.27	2.29	2.78	2.88	2.59
Saskatchewan	0.48	2.24	6.12	1.46	3.57	2.10	2.66
Alberta	0.49	1.90	4.56	1.41	2.44	2.80	2.29
BC	1.15	4.19	5.74	1.36	2.26	2.79	2.58

Source Canadian Transport Commission Commodity Flow Analysis: Canadian
Carload All-Rail Traffic 1976

TABLE 4

Average Revenue Per Ton-Mile by Commodity Group by Destination, 1976
(Cents)

	<u>Grains</u>	<u>Products of Agriculture</u>	<u>Animals and Products</u>	<u>Mines</u>	<u>Products of Forests</u>	<u>Manufacturing and Misc.</u>	<u>Piggy-back</u>
Maritimes	1.07	1.12	4.88	2.71	2.78	3.94	5.90
Quebec	1.31	2.27	4.59	1.83	2.03	3.19	2.99
Ontario	0.50	2.98	5.84	2.20	2.10	2.80	2.61
Manitoba	0.47	2.97	4.51	2.73	2.75	3.87	2.98
Saskatchewan	-	3.33	4.27	2.16	3.16	4.09	3.82
Alberta	-	3.76	5.07	1.60	2.88	4.00	3.30
BC	0.48	2.16	2.57	1.32	2.97	2.96	3.20

Source As for Table 3.

TABLE 5

Average Revenue Per Ton-Mile by Commodity Group for Traffic Within Region, 1976

(Cents)

	Statutory Grain	Products of Agriculture	Products of Animals and Products	Mines	Products of Forests	Manufacturing and Misc.	Piggy- back
Maritimes	-	6.09	10.30	3.29	4.32	4.10	10.28
Quebec	-	6.02	4.55	3.08	2.21	3.39	6.55
Ontario	1.45	5.24	10.39	2.57	2.60	3.98	2.84
Manitoba	0.51	6.03	6.13	3.47	2.71	3.90	4.73
Saskatchewan	-	3.77	8.94	3.22	4.73	3.77	4.63
Alberta	-	4.45	6.58	2.96	3.12	3.76	4.75
BC	1.35	6.24	3.86	1.37	2.97	2.87	3.20

Source As for Table 3.

TABLE 6

Average Revenue Per Ton-Mile by Commodity Group for Flows Between Prairies and Ontario, 1976
(Cents)

	Statutory Grains	Products of Agriculture	Animals and Products	Mines	Products of Forests	Manufacturing and Misc.	Piggy- back
Ontario to Manitoba	-	4.60	4.31	2.44	4.07	4.22	3.00
Manitoba to Ontario	0.61	2.32	6.56	2.43	2.30	2.30	2.23
Ontario to Sask.	-	4.77	4.70	2.12	4.83	4.62	4.01
Sask. to Ontario	0.48	2.13	7.26	2.04	2.31	2.03	2.34
Ontario to Alberta	-	4.79	5.39	1.44	3.00	4.17	3.30
Alberta to Ontario	0.42	1.66	5.62	1.37	2.32	2.23	2.08
Quebec to Ontario	-	8.02	4.68	2.03	1.88	2.78	4.67
Maritimes to Ontario	-	2.04	1.75	2.67	2.96	2.16	2.42

Source As for Table 3

TABLE 7

Average Revenue Per Ton-Mile by Commodity Group for Flows Between Prairies and Quebec, 1976

(Cents)

	<u>Grain</u>	<u>Statutory</u> <u>Agriculture</u>	<u>Products of</u> <u>Animals and</u> <u>Products</u>	<u>Mines</u>	<u>Products of</u> <u>Forests</u>	<u>Manufacturing</u> <u>and Misc.</u>	<u>Piggy-</u> <u>back</u>
Quebec to Manitoba	-	3.90	4.07	2.81	4.06	4.40	3.19
Manitoba to Quebec	1.50	1.52	4.72	1.30	2.11	1.81	2.21
Quebec to Sask.	-	4.32	-	1.54	3.28	3.93	4.39
Sask. to Quebec	1.27	1.03	4.89	1.83	2.33	1.59	2.01
Quebec to Alberta	-	3.87	3.61	1.19	3.07	3.93	3.56
Alberta to Quebec	1.09	1.03	4.50	1.52	2.12	1.94	2.18
Ontario to Quebec	1.32	2.90	7.47	1.75	2.49	4.05	4.67
Maritimes to Quebec	-	2.30	2.41	1.57	3.44	2.80	3.20

Source As for Table 3

Comparison of Average Revenue Per Ton-Mile by Detailed Commodity Group
for Goods Moving Between Eastern and Western Zones, 1976

<u>General Group</u>	Number of Commodities Moving <u>Both Directions</u>	Number for Which Rate West to East <u>Exceeds That East to West</u>
Live Animals	1	1
Food, Feed, Beverages and Tobacco	7	3
Crude Materials, Inedible	5	3
Fabricated Materials, Inedible	23	6
End Products, Inedible	17	3
Special	7	3
Total	60	19

Source As for Table 1.

TABLE 9

Regression Coefficients by Variable and Commodity Group From Equation 1

	Products of Agriculture	Animals and Products	Mines	Products of Forests	Manufacturing and Misc.	Piggy- back	All Commodities
Constant	8.73 (7.27)	5.41 (3.65)	4.60 (8.49)	5.85 (11.38)	4.34 (5.88)	5.23 (7.99)	5.23 (17.65)
D	-0.55 (-7.41)	-0.40 (-3.03)	-0.39 (-8.79)	-0.31 (-11.69)	-0.22 (-4.28)	-0.17 (-2.72)	-0.31 (-10.22)
W	-0.75 (-3.67)	-0.38 (-1.72)	-0.14 (-1.45)	-0.62 (-6.21)	-0.50 (-5.68)	-0.76 (-4.20)	-0.48 (-12.85)
N	-0.17 (-4.17)	-0.04 (-0.53)	-0.11 (-5.69)	-0.06 (-6.35)	0.01 (0.23)	-0.07 (-3.08)	-0.05 (-4.69)
DT	0.01 (0.04)	0.29 (0.57)	-0.01 (-0.08)	0.16 (3.21)	0.22 (3.55)	-0.05 (-0.49)	0.17 (2.73)
DF	-0.42 (-3.04)	0.61 (2.43)	0.08 (1.04)	-0.11 (-2.05)	-0.02 (-0.24)	-0.08 (-0.71)	-0.02 (-0.28)
DI	-0.12 (-0.82)	0.17 (0.58)	0.03 (0.36)	-0.07 (-1.26)	0.15 (1.85)	-0.25 (-2.02)	-0.02 (-0.38)
R ²	0.81	0.34	0.78	0.86	0.79	0.50	0.52

Figures in brackets are t statistics. All variables except the dummies are natural logs.

Comments by H.C. Eastman, Vice-President, Research Planning,
University of Toronto

Professor Norrie has written an exceptionally clear analysis of the three economic policies which are thought to impede the economic growth of the Prairie Provinces. These are the tariff, the pricing and taxation of natural resources and the structure of freight rates. I agree with Professor Norrie's position on these policies but will take this opportunity to make some further remarks.

There is always a tendency to discuss the tariff as if it affected regions rather than the income of the owners of particular factors of production. Professor Norrie, on the other hand, stresses how the tariff increases the demand for labour and hence either the wages or the size of the industrial labour force chiefly in Central Canada. The tariff also depresses the price of agricultural land by raising the costs of agricultural production. Insofar as the tariff raises real wages, however, these increased wages are as beneficial to the West as they are to other parts of the country. The regional incidence must be due to the larger proportion of income stemming from land ownership in the West.

Any discussion of regionalism must consider the costs of adjustment, and Professor Norrie rightly protests against the "assumption of costless adjustment of factors." However, problems of adjustment must be addressed within the context of time and change. There are those who would relate Canadian tariff and freight rate policies to costs of adjustment by virtue of the great labour migrations from the Prairies to the industrial centres. Since the tariff and the structure of freight rates have had an unvarying effect on the West for the past hundred years, these labour movements must be related to differential rates of growth in Canada, and they would probably have occurred over time at any tariff level. Regional attempts to link the tariff to adjustment costs founder once and for all upon the fact that tariff removal would cause changes in the interregional demand for factors and would, in fact, cause costs of adjustment. These costs would involve increases in the property income of the assets of owners of natural resources. Arguments based on costs of adjustment are largely ideological in this context.

Professor Norrie acknowledges that there are no *a priori* rules for a just distribution of income. Interregional distribution is acceptable when executed on the basis of individual decisions made when conditions have been stable and factor movements large. Tariff

and freight rate policies have not changed greatly during the past century and the men who developed the West made their decisions about resource ownership within the context of these policies. Subsequent sales and purchases, many interregional, have been made within this same context, so Prairie prices and rates of return do not necessarily differ from those of the East. This provides a basis for acceptable income distribution.

A major policy change would therefore result in a windfall gain or loss for the resource owner which would have little to do with justice. It would have as much political as economic significance. Sudden major changes in actual or expected income, like the recent change in the price of oil, are much harder to handle. There is a temptation to scramble over the rents, and the pressure on established policies is only resolved by political bargaining. The concept of justice is ideologically powerful, but difficult to translate into practical solutions.

Professor Norrie analyses the structure of freight rates from two points of view, that of the railways which have to make a profit and that of representative western spokesmen who claim that these rates have hindered the industrial development of the West. The search for profit should lead the railways to charge high freight rates relative to costs for raw materials because such agricultural and mineral products yield rents to primary factors. They have relatively low elasticities of supply, and the rents can be transferred from resource owner to railways in order to cover fixed costs. Western manufacturing establishments, on the other hand, are marginal and could not export with high freight rates. Thus, the outbound freight rates for manufacturers are relatively close to variable costs. The height of export freight rates for manufacturing would be less than import rates because inbound high freight rates raise railway revenues and the high prices are passed on to the prairie consumer and to the import-competing prairie manufacturer.

The representative prairie spokesmen are not concerned about the relationship of freight rates to the costs of transporting different goods but about the effect of these rates on the location of manufacturing, especially the further processing of western raw materials. They believe that, in fact, freight rates are low for raw materials relative to manufactured goods, that this inhibits the export of finished products, encourages the export of raw materials and induces manufacturing elsewhere. Is it possible for rational railway pricing to inhibit Prairie development in this way? Freight charges on raw materials could be high relative to cost compared to manufactured goods and still be low relative to rates for manufactured

goods produced from that quantity of raw materials after taking into account the loss of weight from processing. Thus, it would be possible to have higher railway profits from the transportation of raw materials than from the transportation of manufactured goods, yet still to have locational disadvantages for western processors -- disadvantages that would only be rectified by lower freight rates on exports of manufactured goods.

Professor Norrie shows that the structure of rates is principally determined by product competition rather than by intermodal competition. Therefore, except for statutory rates, there is no consistent tendency for rates on raw materials to be lower than those on manufactured goods, which accords with his rational rate model.

Lacking information on the weight loss from the processing of raw materials, it is impossible to reject or confirm the hypothetical Western hypothesis. However, the freight rates on raw materials (except under statutory rates) do not fall far below those on manufactured goods, and it is therefore unlikely that these rates are biased against Prairie manufacturing. This work undercuts the traditional Prairie complaints against the structure of freight rates. In any case, a policy dilemma follows from the fact that a readjustment of rates to favour Western manufacturing would adversely affect non-manufacturing interests immediately and only later, and conjecturally, improve the position of manufacturing interests.

Professor Norrie's paper confirms that pricing, when unrelated to costs, can generate internecine quarrels as well as inefficiency. G.A. Elliott has deplored Canadian distributional policies because they take a nickel out of each person's pocket and give it to his neighbour. The redistribution is small, but its costs are high. Professor Norrie has demonstrated that freight rate structures take fewer nickels out of western pockets than has been widely supposed. A greater understanding of such policy-induced distortions will lead to more rational pricing policies and these in turn might well lead to a tempering of interregional quarrels, reduced lobbying and greater efficiency in both production and consumption.

PUBLIC POLICY AND CANADIAN FEDERALISM:
WHAT IS AT STAKE IN CONSTITUTIONAL CHANGE

by

Peter M. Leslie

Department of Political Studies
Queen's University

*I am grateful to Richard Simeon and James de Wilde
for comments on an earlier draft of this essay.

INTRODUCTION

Proposals for a new type of federation in Canada, or for some limited form of economic association between Canada's successor-states, are now the subject of sustained public debate. Few participants in the debate, however, have seriously attempted to ask themselves: what relationship is there between constitutional forms and the substance of public policy? Whose interests are at stake in constitutional change, and in what ways? These questions are the subject of this essay.

WHY THE CONSTITUTION MATTERS, AND TO WHOM

We begin with a survey of opinion on the presumed impact, in terms of public policy, of unspecified changes in the constitution. For this purpose we employ a six-point "impact scale" that ranks opinion according to the magnitude of anticipated policy consequences if the Canadian federation is restructured or dissolved. For each point in the scale, we deduce what sort of interests have an apparent stake in the outcome of the constitutional issue. A description of the points on the impact scale ensues.

Level One -- At the bottom end is the opinion that even after fundamental constitutional change, political processes would churn out very much the same policies as before. The structural framework in which those processes are acted out is held to be irrelevant to the policy outputs. In other words, the anticipated policy impact of redesigning the Canadian federation or of "letting Quebec go" would be negligible.

This view may be widespread. One should beware of drawing inferences on this subject from survey data on a less specific question, but it is nonetheless significant that in January, 1977, some 22 per cent of Canadians thought that if Quebec left Confederation, the consequences for the future of the rest of the country would be "not very serious." (Fletcher, 1977, p.36). It is likely that many people think that the sparring between governments on the constitutional question reflects institutional rivalries and personal ambitions, and nothing else. It is easy, even if logically unwarranted, to extend this supposition and to suggest that the only things at stake in constitutional change are the careers and the self-esteem of those who run the machinery of government -- the politicians and bureaucrats.

Level Two -- Next on the scale is a position that still regards the policy impact of constitutional change as negligible, but takes account of possible changes in the costs incurred in running the public sector as its structure is modified.

At the political level, opinion to this effect is implicit in the demand, especially put forward by Ontario, for the "disentanglement" of federal and provincial powers. It is thought irritating and wasteful of resources that the federal and the provincial governments should both be involved in the same policy area. Bureaucrats must spend a lot of time co-ordinating their activities; inefficient programs are implemented because a subsidy is available or because one government's policy options are restricted by policies decreed elsewhere; negative by-products of one government's activities must be neutralized or undone, etc.

There is also an academic literature that treats the costs of government as a function of governmental structure, especially the allocation of functions between jurisdictions. The most elaborate exposition of this idea is contained in a recent book by Albert Breton and Anthony Scott, The Economic Constitution of Federal States (1978). Although Scott (1977, p.262) states that, "... the permanent assignment of powers and responsibilities to the various levels of governments ... may have a most profound impact on what is actually done," there is much in the book to suggest that the impact of constitutional change will be negligible except in that it may impose or reduce costs, the incidence of which may be difficult to identify. Indeed, the book deals with the distribution of powers within federal (and other) states entirely on the basis of the "organizational costs" incurred in one or another assignment of functions to various levels of government. Interestingly, they do not rely on economies-of-scale considerations in the production of public goods. On the contrary, they reject such considerations (pp. 39-41) because they argue that economies of scale can be achieved irrespective of the size of the consuming unit. Thus, to take an example from Scott (1977), a small state can take advantage of economies of scale in providing defence services by joining a military alliance. In consequence, when economies-of-scale considerations apply, Breton and Scott take account of them by positing that organizational costs will be incurred in minimizing production costs. Organizational costs are subdivided into four categories:

- administration: setting up the apparatus of government, obtaining information, law enforcement, etc.;
- co-ordination, as in reaching agreements with other governments to take advantage of economies of scale, and in expending resources in negotiating compensation for spill-over effects of public and private activities from one jurisdiction to another;

- signalling, or the costs incurred by citizens in making their preferences known to governments; and,
- mobility, or the costs incurred by citizens who dislike the bundle of policies implemented within the jurisdiction within which they live, and who respond by moving elsewhere.

The basic proposition expounded in the book is that the assignment of functions to various levels of government in a federal state approximates that assignment of functions which minimizes aggregate organizational costs -- those incurred in administration, co-ordination, signalling and mobility.

Breton and Scott must make allowances for differences between jurisdictions, either in policy outputs or in the costs of providing public services; otherwise they could not consider citizens' expenditures on mobility as one type of organizational cost to be set against administration and so forth. Apart from this, however, the whole tenor of their argument rests on the assumption of undifferentiated policy outputs: how many letters to the editor, how many protest marches, and so forth -- that is, how much signalling effort -- is required before the politicians will supply what is wanted? How many hours meeting-time between officials will be necessary to co-ordinate the policies of different governments, as if they were made by a central government? How many hours of bureaucratic time are needed under this assignment of functions compared with that one, in order to provide a given level of service? Asking questions such as these requires one to discount or ignore changes in policy as the assignment of governmental functions is (mentally) shifted around. Except in the case of mobility costs, only by imagining a standard set of outputs can one make sense of the organizational-costs type of argument.

If, then, thinking of the impact of constitutional change in the terms presented to us by Breton and Scott, we consider whose interests are at stake in constitutional change, we have virtually nothing to go on. We are led to consider an undifferentiated public interest summed up in least-cost considerations of running a public sector -- the costs of administration and co-ordination being borne by taxpayers (and therefore corresponding to the general incidence of taxation), and the costs of signalling and mobility probably being borne disproportionately by minorities who dislike what their governments are doing or find public services inadequate or too expensive. If we ask, what is at stake in constitutional change, the answer must be, "the public interest -- with a dollar sign."

Level Three -- At one higher level on our "impact scale" is an opinion that is most commonly found in the speeches of provincial politicians who favour the selective decentralization of legislative powers, and who present the consequences of such a move as entirely benign as far as regions other than their own

are concerned. This is the view that argues that decentralization permits the differentiation of policy outputs, so that in the aggregate policy is more sensitive to regional needs and to the values, moods and preferences of provincial electorates. Mathematics is apparently on the side of the decentralists in this. Scott (1977, p.268) tells us that it can be mathematically demonstrated that, "... if a nation that is divided among majority and minority parties (or interest groups) is cut up at random into small territorial jurisdictions, the total number of citizens who must suffer as minorities from the policies of majorities will decline; that is, the number of people who are in agreement with government decisions will increase." A negative way of making the same point (in the Canadian context) is that if Ottawa's powers were reduced, it would no longer find so many opportunities to impose uniform policies across the country in the mistaken thought that they would solve diverse problems; that no longer could Ottawa respond to an Ontario problem with a policy which would aggravate a different problem in New Brunswick which the federal politicians (or bureaucrats) hadn't even heard of.

This assessment of the impact of constitutional change is hugely important in the present Canadian context because it is the basis of the Parti Québécois' program of sovereignty-association. Quebec would like, because of its distinctive culture, (says the P.Q. and many others in Quebec, too), to do many things of no interest to the rest of Canada, or to deal with the standard problems of an industrial society in a distinctive way. It is acknowledged, however, that the rest of Canada does have an interest in maintaining economic ties, and that is the point of economic association: thus Quebec's political independence presents no threat to the rest of the country; the P.Q. is not trying to break up Canada, etc. Or listen to Premier Lougheed (1977):

In short, the economic centre of gravity is shifting west. It will continue to do so, but I am aware - as you are - that it neither will nor should shift too far, if we are going to maintain and sustain a strong nation. Frankly though, we can shift quite a way before we reach that point. In my view, without doubt, such a shift is good for Canada. As the regions strengthen, the country strengthens. This is not any exclusive club for Albertans; everybody is welcome, each in his own way and I just urge you, wherever you are, whatever activity, to come aboard.

To sum up this opinion: the interests at stake in all but the most radical forms of constitutional change, are regional in the first instance. But since all regions stand to benefit from decentralization, the national interest too (as an aggregate of regional interests) is served.

Level Four -- We now come to the opinion that recognizes regionally differentiated consequences of constitutional change. It is argued that a redistribution of powers, including powers

that may be used to swell the public purse (taxing powers, ownership of resources, etc.) would shift the costs of providing public services between provinces (regions). In the case of decentralization, provinces that lost revenue might not only have to raise taxes, but might find it difficult to maintain the same standard of services that the richer provinces provide. Sometimes this is presented as a distinct advantage: provincial governments would cut out wasteful expenditures on vain programs of economic development, when the resources to be developed are elsewhere; lavish social services and income maintenance schemes would no longer hold back emigration from declining regions, etc. Against these arguments, and far more commonly heard, are considerations of equity which suggest the desirability of comparable levels of public services in all regions, without undue levels of taxation.

Here, as is already evident, the interests at stake are presented in regional terms, although there are also suggestions that non-regional interests may be affected -- interests defined by income level and occupation.

Level Five -- At the next notch on our impact scale we find the opinion that a change in constitutional arrangements may raise or lower the level of government services, quite apart from the issue of regional variations in quality, and in cost, of services. It is sometimes argued that federalism makes for "big government," not just in the sense that there are many bureaucrats duplicating each others' work (if not actually undoing it), but in the sense that two levels of government will compete with each other to provide services, and the result will be a larger public sector than a unitary state over the same territory would create. So far as I know, however plausible the argument, there is no empirical support for this view. On the other hand, a contrary position has been presented by Harold L. Wilensky in The Welfare State and Equality (1975). This book is a contribution to the literature that looks for correlations between certain features of policy (such as levels of state expenditure on social welfare) and other variables. The literature finds, in general, that policy outputs correlate reasonably well with social characteristics like per capita income and age of population and scarcely or not at all with political structures (such as representativeness of institutions), official or prevalent ideology, or type of economic system. One of the principal conclusions of the literature is that institutions do not seem to matter very much. Wilensky, however, discovered that the one institutional characteristic that might be inferred to have some significance for levels of expenditure on social welfare is the degree of centralization of the regime. He calculated state welfare expenditures as a percentage of gross national product in 22 industrialized countries, and discovered that, "Of the top nine welfare-state leaders ... six are clearly among the nine most centralized governments ... [while] of the seven countries ranked lowest in social security [all of them federal]

four are among the least centralized;" of the remaining three, one was ambiguous as regards centralization, and two had high levels of military expenditure which presumably restricted their capacity to use state resources for welfare purposes. (Wilensky, 1975, p.52).

Wilensky's evidence about the relationship between centralization of the regime and levels of social security services can scarcely be taken as conclusive, but the enquiry itself does suggest a different and rather more significant relationship between federalism and public policy than do lower points on our impact scale. This is the first suggestion in our discussion of the relationship between constitutional forms and policy outputs that structural factors as such, as well as the availability of financial resources, may have an impact on what governments do. There is also a difference in terms of the groups affected by constitutional forms. If "big government" is generally more favourable to the less wealthy (because of transfer payments and because of public services disproportionately paid for by the middle and upper income groups) class interests rather than, or as well as, regional ones can be seen to be implicated in constitutional questions.

Level Six -- Finally, we come to the suggestion that as a result of constitutional change, governments may aim for new or different objectives, may abandon or trim down old ones, and/or may become more -- or rather less -- effective in achieving specific objectives than was formerly the case. It is not just a question of levels of public services, but of potential changes in the whole range of government activity. We are reminded in the present context, that the original purpose of creating the Canadian federation was to provide for the physical security of the colonies in British North America, to affirm and achieve distinctive social values ("Toryism," as Gad Horowitz would have it, symbolized in the affirmation of the British connection; and, in French Canada, Catholicism), and to develop the northern half of the continent as an extension in time and space of "the commercial empire of the St. Lawrence." (Creighton, 1935). Whether such purposes persist, whether they are replaced or supplemented by others, and who are the champions of such purposes, are the questions that most fundamentally underlie the Canadian crisis. Insofar as there is a relationship between national purposes and constitutional structures, those purposes and the capacity of Canadians to realize them through the agency of government are fundamental to our present concerns with constitutional matters.

It is evident, though, that there is no undifferentiated "national interest" in these questions. A diverse population affirms diverse purposes. The issues at hand are quintessentially political, and it is one of the defining characteristics of a political situation that some people want to secure objec-

tives that others resist. Both groups of protagonists seek to employ potentially coercive instruments -- the state -- to accomplish their purposes. There is, at least in the abstract, no way of knowing whether the groups involved are territorially concentrated or dispersed. That is, we cannot know without empirical enquiry whether the interests at stake in constitutional change are regional or not.

We have so far been concerned to identify various opinions on the relationship between constitutional forms, the substance of public policy, and the interests apparently at stake in constitutional change. We have provided an exposition of these opinions on the basis of a rank ordering, which sees an increasingly close relationship between structural factors and policy outputs, and which correspondingly perceives increasingly large stakes in constitutional questions. A summary of our impact scale in tabular form may be useful: --

PRESUMED IMPACT OF CONSTITUTION ON POLICY OUTPUTS	INTERESTS APPARENTLY AT STAKE
1. Negligible: The constitutional debate in Canada reflects institutional rivalries and nothing else.	The careers of politicians and bureaucrats.
2. Negligible as far as policy outputs themselves are concerned, although the costs of government are affected by structural factors.	An undifferentiated "public interest"; or alternatively, taxpayers (for administration and co-ordination costs) and citizens (for signalling and mobility costs).
3. Differentiation of policy outputs between regions; the federal government no longer acts in ignorance of local needs.	Regional interests; all regions stand to benefit from decentralization; therefore, in the aggregate, the national interest.
4. Costs of providing public services may be raised/lowered in each region individually; possible variations in level or quality of services by region.	Regional interests; standards of services may go up/down; interregional shifts in costs of services; possible impact on interregional migration.
5. Raise or lower level of public services, apart from regional variations.	Class (?)

- | | |
|---|---|
| <p>6. Governments may aim for new or different objectives, may abandon old objectives; may become more/less effective in achieving specific purposes.</p> | <p>Regional (in the sense of incompatibility of regional objectives) and non-regional (i.e., interests within each region, or within some regions).</p> |
|---|---|

It may be objected that rather than having a scale or a rank-ordering of opinions, we have merely identified several different ways in which a constitution may affect policy and hence have an impact on the interests of various groups of people. We have; but each category absorbs the one(s) below it. For example, a person who is concerned about the constitutional question because he thinks constitutional change might lead to variations in the quality of public services in the various regions would have no difficulty in acknowledging that amendments to the constitution might well also affect the careers of politicians and bureaucrats, might raise or lower the costs of government in the aggregate, and might affect the sensitivity of government to the needs of the various regions.

What I consider of critical importance is not the logical compatibility or incompatibility of the categories, but the fact that the more one focuses on the lower end of the scale, the easier it is to lose sight of the upper end, and thus to fail to perceive what is ultimately or potentially at stake in constitutional change. In particular, the more we argue about issues such as the costs of running the apparatus of government -- important though this issue is -- the more likely it is that other issues, perhaps of an even more fundamental character, will be neglected.

For this reason the remainder of this essay deals with the selection of governmental purposes and the effectiveness of governments in achieving them on behalf of the population or identifiable interests within it. Justice can only be done this complex and demanding subject by empirical work, and a great deal of it. It will be necessary, as time permits, to survey large areas of government activity at all levels in Canada, and to try to see what impact the present federal system has had on the selection of aims and the success governments have had in carrying through with them. Each of the proposals for changing the Canadian Constitution should be examined on the same basis. Although, obviously, none of these ambitions can be realized in this essay, the essay does attempt to explore in a relatively abstract way the arguments linking constitution, public policy, and the satisfaction of specific political interests and the neglect of others; to raise some questions about what those interests are (that is, what cleavages are politically salient); and to enquire into the compatibility

of political interests, or opposition between them, when the cleavages are regional.

CONSTITUTIONAL ROADBLOCKS TO EFFECTIVE POLICY MAKING

The initiative in the Canadian constitutional debate during the 1960s and 1970s has been taken by decentralists. They have hymned the potential achievements of more powerful provincial governments, rather than sounding the harsh notes of regional discord. The other main group of would-be constitutional reformers are those who find the present system messy and inefficient, and would like a return to a more classical form of federalism; they speak of the irritations caused by Ottawa's meddling in matters in which it has no business. In view of the arguments used to support reform, public attention has been directed mainly to the issues that appear at the lower end of our policy impact scale. This was not at all the case during the 1930s, when commentary on constitutional matters focused very largely on structural obstacles to the implementation of desired policies.

One result of the distress inflicted upon so many Canadians by the Great Depression was an outpouring of demands for an expansion of government activity in the fields of welfare and of regulation of the economy. However, the federal government's belated response to these demands, a series of legislative measures generally described as "Bennett's New Deal," was largely declared *ultra vires* by the Judicial Committee of the (British) Privy Council. This series of court decisions made many reform-minded persons desperately conscious of the obstacles to effective government action in certain areas under the Canadian constitution.

Unemployment insurance and market regulation illustrate the problem. The establishment of an unemployment insurance scheme was impractical at the provincial level but was nonetheless, if based on compulsory contributions to a special fund, outside federal competence. Neither level of government could do what many people believed necessary. This particular problem was resolved by constitutional amendment in 1941. Similarly, the establishment of compulsory marketing schemes and output quotas for natural products was declared *ultra vires* by the Parliament of Canada but could not be done by the provinces because they could not control the movement of produce across their boundaries. The obstacles to accomplishing the aims of the successfully impugned Natural Products Marketing Act (1934) were partially overcome by 1949 federal legislation which delegated certain powers to provincial marketing boards.

During the 1930s, however, these issues seemed intractable, a fact that convinced almost a whole generation of legal

scholars and others concerned with public life that federalism was outmoded. At a minimum, they believed, Canada would have to drastically revise the division of powers enshrined in the British North America Act, producing a much more centralized sort of federalism. In short, the relationship between federalism and the substance of public policy was widely acknowledged and gave rise to animated political debate as well as to acrimonious charges levelled against the British judicial authorities who allegedly had so little understanding of Canada's needs and whose judgments accordingly made bad law.

Enquiry into the constitutional discontents of the 1930s reveals that the problems identified at that time related to legislative competence and to the uneven distribution of financial resources among the provinces. Since the onset of World War II, however, a mixture of constitutional change, legislative and administrative adaptations, and fiscal measures have served to reduce the salience of these problems. Canadians seem to have learned how to work the federal constitution which so many of them thought, during the 1930s, to be unworkable -- at least in the context of an industrialized society and an international economic order dominated by the major powers. While this has been a matter for satisfaction if not self-congratulation for many, the changes in policy-making processes within a largely unchanged Constitutional Act have not occurred without raising resentment and apprehension in several parts of the country, especially in Quebec, Alberta, and British Columbia.

If changes in the distribution of powers and even more in the working relationship between levels of government in Canada have minimized the constitutional problems that were so acutely felt during the 1930s, they have left untouched more directly political discontents. Reform-minded persons of the Depression era were struck by the near-unanimity of opinion supporting at least some of the ventures being proposed (for example, each of the nine provinces had passed legislation complementary to the federal Natural Products Marketing Act, so that this neatly dovetailed body of legislation could accomplish agreed purposes); the apparent inadaptability of the constitution was all the more obvious and galling. On the other hand, federal monetary and commercial policies designed to counter the Depression were far from neutral as between regions; they had a demonstrably adverse impact on the primary sectors of the economy and therefore on the non-industrialized regions, especially the prairies. The policies of the early 1930s were a reaffirmation, almost with a vengeance, of the national policies of the latter nineteenth century, as the analysis of the Rowell-Sirois Report (Canada, 1940) demonstrated. Those policies, with their unequal regional incidence, reflected the preferences of those segments of the Canadian political community whose resources of wealth and numbers ensured them a guiding hand over major political decisions. That is to say, policy was shaped by

pressures and constraints emanating from a particular political community. Then as now political forces, filtered through representative and decision-making institutions, had and have their impact upon the chief decision-makers of the time. The composition of the Canadian political community, however, has changed and decision-making processes at the centre are increasingly subjected to constraints and impulses emanating from provincial governments, giving new salience to many long-standing political disputes within the Canadian federation, and generating new subjects of controversy. The relationship between these controversies and Canada's constitutional structure are explored in the next section.

POLICY AND THE CONSTITUTION: SELECTING POLICY

Consider a recently touted policy objective. In 1973 the premiers of four western provinces declared that the single most potent factor holding back the industrialization of the West was poor transportation. Effective competition between carriers, they thought, would improve services and would reduce rates. To achieve the desired competition they proposed that the federal government take over all railway beds and operate them as public utilities. This done, the railbeds would become steel-ribbon highways accessible to any licensed carrier.

There was no doubt about the legislative competence of the federal Parliament to do this. The project would be expensive but if the incentives were judged compelling, the financial resources could presumably be found. The question boiled down to this: did the western premiers represent a political force powerful enough to elicit a "yes" from Ottawa? This is the standard form of a political question. Indeed, whenever a proposal gets on the political agenda, the question inevitably arises: can an eager government get away with it? Or alternatively: can a reluctant government be prodded into getting on with it -- and by whom?

Our problem is to know whether the constitution has a bearing on the answers to these questions. There are two major reasons for thinking that it does. They are:

- the constitution selects the political community relevant to policy making in each subject area; and
- it structures the key representative and decision-making institutions.

What is the relevant political community?

The effects of constitutional change, as discussed in this section, are similar to those flowing from a gerrymander of electoral districts.

Gerrymandering is the art of redrawing the electoral map for partisan advantage. It is a way of tampering with the system of representation; besides boosting temporarily the fortunes of a party, it makes some interests relatively more powerful while rendering others less so. In part this occurs by overrepresenting some regions or areas. More subtly, it is accomplished by creating constituencies such that seats won by the opposition are taken by overwhelming majorities, whereas government seats are typically won with narrower majorities or pluralities. One consequence is that for a given percentage of the popular vote, the governing party (the one doing the gerrymander) gets the largest possible number of seats in the legislature. Another consequence more germane to the present discussion is that a gerrymander may also affect the substance of policy because it necessarily alters the constellation of political forces in the system.

Reallocating governmental powers in a federation has effects similar to those produced by a gerrymander, though in amending a federal constitution the element of partisan advantage may be incidental. In both cases, for at least some areas of government activity, a new or modified set of political forces is brought into play. To put it another way: the constituencies relevant to policy-making processes are at least partially re-defined. But whereas with a gerrymander, this result flows from relocating territorial boundaries, in the case of a constitutional reallocation of powers it is accomplished by moving functional boundaries instead. A federal responsibility becomes provincial, or vice-versa; policy-making responds to, or is ultimately controlled by, a new electorate. In slightly broader terms -- broader, because not all political pressures are electoral -- a different political community is now the relevant one.

Take the case of the railway beds. In Canada at present it is the federal government that regulates the railways and that might (if it wished) assume ownership of some or all of their assets. Under a new constitution, however, these powers could conceivably be transferred to the provincial governments. Suppose this happened. We do not know whether the western premiers, who had found nationalization attractive if undertaken by the Government of Canada, would have sufficient incentive to take this step themselves. After all, they would have to foot the bill or to risk some form of retaliation if they expropriated

assets without "adequate" compensation. Possibly the provinces, with governments of various ideological hue and with widely disparate financial resources, would each adopt a distinctive policy. No longer would there be (for this particular decision) national politicians responding to or constrained by the Canadian political community; those in charge would be provincial cabinet ministers hoping for a renewal of their mandates from a variety of provincial electorates.

To generalize, one may observe that Canada contains several political communities and that each corresponds to, or provides the context for, a distinctive set of political processes. Those decisions that are taken provincially implicate primarily the various provincial political communities. In federal decisions, where political processes at the centre are involved, the relevant political community is the Canadian one. (Well, it's not quite as neat as that: governments lobby and negotiate with each other.) Finally, there are some decisions that are jointly taken: policy emerges through various modes of interaction between governments, and both the Canadian and the several provincial political communities figure in such decisions.

If we posit some particular political objective, favoured by some people and opposed by some others, we may presume that it makes quite a difference whether that particular issue is to be resolved through one set of political processes rather than through another. The most obvious reason for this is that a minority interest in a large political community may well be a majority interest in a small one. For example, as is often said, Quebec is the only part of Canada where francophones are in the majority. This, however, is only the most frequently mentioned case of a very common phenomenon, namely, the regional concentration of a politically significant grouping. To take other examples, fishermen and fish-processing workers carry a political weight in Newfoundland that they do in no other province; and the same is true of cattlemen in Alberta, of Acadians in New Brunswick, and (perhaps) of socialists in Saskatchewan. None of these groupings can hope to wield the influence in federal politics that they apparently do within their own province. In consequence:

- (1) It is evident that some initiatives are likely to be undertaken only at the provincial level and within certain provinces. It was this consideration that caused P.E. Trudeau, at the time when he described himself as a socialist, to reject the centralist constitutional preferences of the CCF and to argue: "Federalism must be welcomed as a valuable tool which permits dynamic parties to plant socialist governments in certain provinces, from which the seed of radicalism can slowly spread." (1961, p.127).

The tacit supposition here -- perhaps it was really an unexamined premise -- is that uniform action across the country is not necessary for effective implementation of policy.

- (2) In cases where the realization of policy objectives requires concerted action by both levels of government, a decentralized form of federalism may discourage new governmental initiatives or cause their failure. The same point applies, perhaps with more force, when objectives must be realized by interprovincial co-operation, without federal participation. This is so because a federal initiative may be backed up with financial inducements, or simply have a "demonstration effect" serving to nudge the provinces into line.

-- For example, it is said that housing costs could be reduced if building codes were more uniform; greater use could be made of modular construction (prefabricated segments of houses). But the provinces would have to agree on the common standards. What uniformity there is now is provided by the national building code; it is important partly because of its application to construction financed by the Central Mortgage and Housing Corporation, and partly because it provides a model for the provinces to emulate (or such was the fond hope of its originators.)

-- A much more serious case is that of intergovernmental fiscal transfers, particularly the equalization payments. It has been said that these could be implemented by interprovincial agreement rather than through an Ottawa-designed and implemented program; and so they could -- technically. But the prospect of political agreement seems remote.

-- One final example: controls on the production of milk for industrial purposes now are imposed by the Canadian Dairy Commission; if it lacked its present powers, all major milk-producing provinces would have to agree to impose controls within the province, and to allocate the desired volume of Canadian production between them. Since special benefits would accrue to a province that refused to co-operate with the others in such a plan, such agreement would probably be difficult to achieve.

- (3) Where federal powers are sufficient to permit unilateral action, policies that favour those groups that can exercise an effective voice in Ottawa will presumably be adopted. This may be to the detriment of groups that are very strong at the provincial level (though not in all

provinces). Under a centralized constitution, then, groups that are powerful at the centre may be able to overwhelm objections from groups that, under a more decentralized constitution, would be politically untouchable. This is so whether or not a consistent policy is required, by the nature of the task, in all parts of the country.

The last of these observations invites a certain cynicism. I have suggested that some projects for governmental action are more likely to be adopted under a centralized form of government. Does this, stripped of its verbal varnish, simply mean that in a large political community local interests can be overridden with impunity? Certainly no amount of sophistry can alter the fact that a majority interest in a small political community may be a minority interest in a larger one. And this may be a way of saying that political centralization subordinates the interests of some regions to those of other regions. The imagery for evoking this relationship is rich and varied: metropolis drains hinterland, centre exploits periphery, the manufacturing and financial "heartland" coerces the primary-producing regions into an unequal trading partnership. In such imagery, centralization is equated with deliberate domination or with simple insensitivity to local and regional interests, whether these are of an economic or cultural nature.

Are we then simply discussing the constitutional arrangements that will enable some regions (or a single region) to dominate the others? Not quite. It depends whether the interests at stake in constitutional change are regional ones. And when they are, it depends on whether the interests or goals of each region tend to complement each other or are mutually incompatible. If the latter, then any one region's gain is another's loss, and the rationale for a free association of provinces is destroyed.

Are the interests regional or not?

Transportation and tariffs have, for almost a century, been regarded as policies working to the advantage of central Canada and to the detriment of the West and the Maritimes. The interests at stake have been regarded as regional ones. By contrast, in the case of labour policy the groups most directly involved appear to be those of occupation or class. And similarly with social security policy: social insurance programs and income maintenance schemes have differential impacts on groupings defined by income, age and sex. However, the characterization of each of these policy areas as "regional" or "non-regional" (as the case may be) may be challenged and it frequently is. This is not surprising as in almost every policy area, it is very difficult to sort out the regional and the non-regional aspects.

The western premiers' proposal to nationalize the railbeds was politically astute, even if not particularly inventive, because it dealt with transportation policy in a way that avoided controversy between the agricultural and the non-farm interests within their own region. The nub of Canada's problem in rail transport is to find a way of bearing the overhead costs of the system. The Crowsnest Pass rates for carrying grain, established by law in 1897 and since then maintained at that level, prevent the grain traffic from contributing to maintenance and other fixed costs. Rates on some other products are kept down by competition, as in the instance of transporting steel from Hamilton to Vancouver. In still other cases, although the only practicable mode of transport is by rail, high transportation costs would price the product out of its market: then the shipper and the railways negotiate "agreed charges," which may be as low as the railway's marginal costs. Thus a large part of the traffic -- grain alone accounts for about a quarter of the ton-mile total -- can carry only a small proportion of total overhead. The railways have tried to compensate by charging higher rates per ton-mile on goods for which there is no competing mode of transport (such as steel to a non-port city like Calgary) and on high-value goods for which the rates are not held down by regulation or by market considerations. One result has been that the transportation of industrial products to and from the prairie region has been expensive, whereas charges for transporting raw materials and unprocessed goods have been low (lower, in the case of grain, than in the United States). Hence the claim that transportation policy has held back the industrialization of the prairies and, together with the tariff, has increased the cost of consumption goods in that region.

If this analysis is correct, then one solution would be to eliminate the favourable rates for the products of primary industry, including farming. This could be done by deregulating the grain traffic and perhaps by provincial subsidy for the carriage of other low-value high-bulk goods (resource products, from which the provinces draw a royalty). This part of the business could then shoulder a reasonable share of the overhead, and rates on the more highly processed goods could drop. If one advocated this, however, it would pit the interests of the prairie farmer against other interests within the region*, a definition of the issue that would be clear suicide for any prairie premier. The solution? To pose the problem in regional terms by proposing public ownership of the railbeds, which, of course, implies a large federal subsidy. Now, let the reader decide: is or is not transportation an area where the relevant political cleavages are regional? Surely it depends on the solution envisaged, and not only the problem itself.

*I am grateful to Gail Hogarth who first brought this argument to my attention.

Further: if in the context of the present Canadian federation, the cleavages are judged to be regional, would they still be regional in the context of a Canadian common market in which (we say for the sake of argument) central institutions have slender financial resources and perhaps also lack the constitutional power to take over the railways or even to regulate their activities? The way we conceive the problem may depend not only on what that problem is and how we think it might be solved, but also on what machinery, as established by a constitution, is available to do the job.

Labour policy and social security policy too may be described both in regional and in non-regional terms. It is quite correctly pointed out that in both policy areas class interests are at stake -- not to mention distinctions of occupation, age, education, and so forth.

Nonetheless, labour policy also inevitably reflects a culture. For example, it speaks volumes about prevalent conceptions of the social order that the official program of the Parti Québécois envisages the compulsory unionization of all employees. (Murray, 1976, p.94). The PQ also proposes collective agreements to cover entire industries, a form of industrial relations that has existed since 1968 in Quebec's construction sector. In this sector, region-wide agreements are extended by government decree to cover non-unionized workers; the agreements extended in this way are also binding on firms that are not members of the relevant employers' associations.

In the area of social security, or more broadly of bien-être social, Quebec governments have for decades insisted upon full autonomy. Only on the basis of such autonomy can Quebec devise its own institutions for providing social services and otherwise implementing policy in this field. In other words, Quebec governments, conscious that institutions inevitably embody and express a culture, have insisted that the culture reflected in Quebec institutions should be French Canadian or Québécois. As a minority, French-Canadians have been more conscious than the English-speaking people on this continent that the institutions of any society reflect a distinctive perception of social structure, of the extent and nature of social conflict, and of appropriate responses to conflict. In so doing they are likely to be typical of and unique to the culture. Indeed, it is in this sense that Quebec's particular concerns in constitutional matters are properly summed up as "cultural." The issues that involve class conflict in Ontario and Nova Scotia need not be thought to do so in Quebec in quite the same way. To ignore such differences in outlook is to demonstrate, precisely, one's insensitivity to a viewpoint properly described as regional --

though in this case, involving a regional culture rather than a regional economic interest.

In other words, if it is a mistake to disregard cleavages within regions, it is equally unwarranted to assume that conflicts that seem non-regional from one cultural or ideological standpoint will be universally so perceived. It is an error to suppose that considerations of efficiency and effectiveness alone can satisfactorily determine the appropriate allocation or reallocation of powers between levels of government. It is also important to explore how people and groups perceive their needs and how they define (if the word is not too precise) their aspirations. It is not, I think, adequate simply to ask how certain technical problems involved in policy formation can be solved in accordance with a set of values and preconceptions supplied by the observer. An essentially political judgment is necessary to appreciate both the regional and the non-regional element in controversial questions.

Are regional interests compatible?

If one region is said to dominate or exploit another, this can be so only by virtue of there being regional interests at stake. As I have just argued, many issues do involve a regional aspect without properly being described in exclusively regional terms. Let us now, however, set aside these complexities and presume a regional aspect in political controversies whose outcome is likely to be affected by constitutional arrangements. In these cases, does enquiry into the selection of policy objectives resolve itself into the study of regional domination?

Obviously it does, if each issue is taken singly. But there is no warrant to do this and on the whole, people seem to be mainly concerned with the cumulative impact of a large number of political decisions.

A political community exists to realize certain purposes that its members can achieve only in common. Those purposes may relate to material welfare; for example, they may be to increase aggregate levels of production, to assure income security for individuals and families, or to provide various social services such as health care. Additionally, they may have to do with physical security (defence, domestic peace), or with the development and flourishing of a culture. The definition of purposes in each of these areas will predictably arouse controversy, as will the inevitable trade-offs between them. The same is true of the distribution of private goods and of deciding who will bear the costs of public services.

As we have noted, opinions on all these questions may vary by region; in some cases it may even be possible to assign a monetary value to various regionally defined interests. But whether the interests are tangible or otherwise is of no consequence: the existence of regional cleavages within a political community implies a form of bargaining between regions. In other words, we have a political process that trades off advantages and disadvantages within each aspect of governmental activity -- especially the economic -- or between economic, security-related, and cultural purposes.*

Within any state there is an understanding, constitutionally expressed as the capacity to make laws, that such political processes will result in decisions that are binding upon all members of the political community. Naturally, this limits the individual's capacity to pursue his own interests, a paradoxical situation if one holds that political authority derives from the people and that civil society consists of a free association of individuals. One solution to the paradox has been the fiction of a social contract, according to which individuals give up some of their own freedom of action in return for the larger benefits to be derived from an ordered society: physical security, material welfare, and so forth. In federal states a "federal bargain," fictitious or otherwise, accomplishes the same purposes as an imaginary social contract: on the supposition that there is mutual benefit to be reaped from creating a political authority with the capacity to make decisions binding upon the constituent units, it provides the rationale for a free association of provinces or states for certain defined purposes.

There are *a priori* grounds that establish the potentially for mutual benefit from federation, although empirical work is necessary to know whether in any particular instance such potentiality is realized. Mutual benefit in the economic sphere may derive from any of the following:

- The establishment of an integrated economy, permitting regional specialization in production and creating economies of scale -- hence augmenting aggregate production.
- The creation of economies of scale in the provision of public services.

* For example, a net disadvantage in material welfare may be over-balanced by cultural gain or by greater physical security. On the other hand, a negative assessment in any one area, implying a tangible or intangible cost of the region's inclusion in the broader political community, may be compounded by disadvantages in the other areas as well: thus to a cultural "price" of political union may be added an estimated economic loss.

- Compensating for positive or negative neighbourhood effects (or externalities) of economic activity.
- The optimal allocation of resources in the society, especially to the production of public goods such as defence.
- The implementation of effective policies of economic stabilization: monetary management and fiscal policy.
- Acquiring enough economic power, and perhaps military strength, to bargain effectively in the international arena, e.g. trade negotiations.

In my opinion it is imaginable but quite unlikely that the same range of benefits could be secured by interprovincial or inter-state negotiation, the results of which may (in some cases) take the form of a treaty. This is a point of capital importance, though we cannot afford the time to explore it now. Suffice it to say that it is a serious intellectual and practical problem to know what powers must be exercised by some central authority to achieve any substantial degree of economic integration. The choice may end up being between a political process that is highly bureaucratic, with major decisions taken by elites over whom there are few or only ineffective political controls, or a political process that operates more openly and in which governmental powers are exercised by agencies responsible to a directly elected assembly.

The potential economic benefits of federation, or of some other institutional solution to the problem of running an integrated economy, have been identified only in abstract terms. Merely drawing up a list of potential benefits does not ensure that they apply to Canada such that all regions do actually end up better off. On the contrary, for any one region or province the economic benefits of federation may be outweighed by foregone advantages that would accrue to it from (hypothetical) alternative arrangements with other political and economic entities: the United States, the European Economic Community, and Japan. This must remain a matter for speculation. In addition, although defence considerations do not appear to bulk large in determining each region's advantages/disadvantages from Confederation, cultural concerns evidently do so. Confederation may provide cultural advantages if Canadian values differ in any degree from values in the United States. Moreover, Quebec stands to gain a special advantage if, by being part of Canada, it can endow itself with a better economic and institutional base for withstanding the assimilationist pressures entailed by its being in a tiny minority position on the North American continent.

Whether or not these potential advantages of federal union are realized depends in part upon adventitious circumstances such as the compatibility or incompatibility of regional cultures, in part upon immutable underlying conditions (such as resource endowments by region, technological changes that make certain resources of great strategic importance or that render them superfluous, climatic variations, and locational advantages of particular cities and regions), and in part upon the design of political machinery. The last of these groups of factors points to one further aspect of the constitutional question in Canada.

The Structure of Representative and Decision Making Institutions

Many people insist that the nub of Canada's constitutional problems lies with the distribution of powers and that it is irrelevant to start changing the design of parliamentary institutions, modifying the composition and role of the Supreme Court, and entrenching a charter of human rights in the constitution. This seems to me an exaggeration, since the last two of these items have to do ultimately with the definition of governmental powers; and the first of the three -- an issue that hitherto has focused largely on the reform, replacement, or abolition of the Senate -- potentially affects the selection of the policy objectives by the Government of Canada. Parliamentary institutions help to shape the everyday process of coalition-building in federal politics, and they consequently may be expected to have a bearing on the configuration of political forces within the system.

If regional interests are incompatible, no restructuring of policy-making processes can prevent a dominant-subordinate relationship from arising between regions. On the other hand, where the interests are in principle compatible, a region may still think that it is not obtaining its fair share of the benefits of federal political union. Indeed, representative and decision making institutions may be such that the region is consistently outvoted or its interests disregarded in the policy-making process. The feeling of being politically slighted or even overwhelmed is widespread in Canada today, particularly in the West. That is why the constitutional debate rightly concerns not only the extent and allocation of governmental powers and their distribution between jurisdictions, but the structure of political institutions at the centre: Supreme Court, electoral law, upper chamber, and regulatory agencies.

CONCLUSION

If we ask, what is at stake in constitutional change, a part of the answer necessarily refers to symbolic and emotive concerns. People do care a great deal what community they belong to. The individual's self-esteem and indeed the very idea of "self" are commonly affected by one's

identification with a collectivity or a whole network of social entities -- family, locality and nation. For those who feel most keenly the broadest of such attachments, the political options facing Canadians today reflect the emotional question: "What is my country?"

There is another dimension, however, to the choice between various political options, a dimension related to the performance of the functions of government. It is the latter concern that is the focus of this essay.

The argument presented here has attempted to show that changes in governmental powers -- their scope, and their distribution between jurisdictions -- is likely to have an impact on the substance of policy decisions. The same is true of changes in representative and decision-making institutions. Public debate, and some academic literature, has tended to minimize the impact of such structural factors both on political processes and the outputs that emerge from them. The argument presented here does not refute this position, but it does present what I hope is a plausible case to the contrary. To the extent that the issue can be resolved at all, only careful examination case by case of the relationship between federalism and public policy in Canada can do it.

One issue that is bound to remain in dispute is whether the interests at stake are primarily regional. Although federalism is frequently described as a form of government that reduces conflict between regions since it permits diversity in policy and keeps some potentially disruptive issues off the federal political agenda, it also may have a contrary effect -- that of exaggerating the regional character of some public issues. Issues that, in a unitary state, would not be thought of in regional terms may appear as disputes involving the regions. In this way provincial/state governments may be pitted against each other and against the centre.

No academic enquiry will significantly affect the way that public opinion defines political issues. Nevertheless, the right sort of work carefully conducted, may help in the resolution of political conflicts. If dissatisfaction arises because the central government is incapable of doing what is necessary to operate an integrated economy, then decentralization will only exacerbate the problem. It might be much better to adapt political institutions at the centre in order to render the federal political authorities more susceptible to political pressure from the neglected regions. Conversely, if basic regional interests are at stake and cannot effectively be accommodated within the federal political arena, decentralization may be called for.

In that case, the question arises whether the more powerful state/provincial governments will act in a way to prevent the achievement of purposes regarded, in other regions, as essential to their welfare. In Canadian terms, this thought boils down to the consideration that some provinces must rely upon the federal government to underwrite the risks inherent in having a resource-based economy, which is subject to wide, externally induced and unpredictable fluctuations. They are, or may become, dependent upon the fiscal transfers and the public services provided by the federal government; they pay some of the costs of national policies, and they need compensation in return. If the compensation cannot be provided by a weakened federal government, or by interprovincial agreement, then the rationale for a free association of provinces within the Canadian federation disappears.

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Comments by B. Bonin, Assistant Deputy Minister,
Ministry of Intergovernmental Affairs, Quebec.

What Peter Leslie calls *Impact Level One* consists of the belief that changes in the constitutional arrangement will not have serious consequences. The opinion of those who are convinced that the changes in question would have few consequences is apparently that "the structural framework in which these processes are acted out is irrelevant to the policy outputs." I find such a view difficult to accept. If I correctly understand the meaning that should be given to it, we must therefore conclude that the policy output is absolutely independent, for example, of a government's composition. It should not be difficult to find examples disproving this viewpoint, and I believe it would be wise to assume that constitutional changes would likely produce changes in the type of policies. The question then becomes: what changes?

Impact Level Two in Peter Leslie's classification involves the cost of governments. In a federal system, therefore, particular attention is naturally given to overlapping jurisdictions or intervention. It would be quite appropriate, in fact, to clarify this issue in the framework of Canadian federalism, with a view to reducing the costs of government. Moreover, even those federalist systems widely thought to be based on a clearer division of tasks do not appear to have avoided overlapping jurisdictions. Switzerland is one example. A survey was recently conducted on this question following a motion presented in 1972. In the introduction to the report, Répartition des tâches entre la Confédération et les Cantons: principes de l'Etat actuel, which followed this survey in 1977, we find the following passage:

The present distribution of tasks between the Confederation and the Cantons is characterized by an extraordinarily high degree of overlapping in federal and canton responsibilities. We are hard pressed to find another federated state in which the powers of the central government and those of the federated states are so greatly confused. This appears to be the result of two major causes. First, the federal level prefers to proceed by small steps; consequently, the jurisdictional rules adopted by the Confederation are often drafted in a detailed way. Second, the federal jurisdictions were established on the basis of varied principles. Over the decades, these rules have proliferated to the point that there now remains practically no field to which the Confederation does not have access. The Canton jurisdictions have simultaneously become "residual" jurisdictions which are always more difficult to define, and the Cantons therefore have less and less opportunity to exert their own authority.

(Unofficial translation)

It would be difficult to claim that the federal system automatically leads to a greater extension by governments into the activity of a society than a single-tier system (*Level Five* in Peter Leslie's classification): many other factors besides the political system itself must be taken into consideration. But any change that could help to make governments more responsible (the term *accountability* is perhaps preferable because it appears to carry less of a value judgement) can only be an improvement. If, through a different arrangement, we can obtain the same services at a lower cost, society can't help but benefit. Moreover, we must not lose sight of the fact that often what is called the "demand for government services" originates with politicians and civil servants who convince each other that the people need a given service and are actually demanding it. In other words, the supply of services may sometimes create its own demand.

Impact Levels Three and Four in Peter Leslie's classification are based on the conviction that "if Ottawa's powers were reduced, it would no longer find so many opportunities to impose uniform policies across the country in the mistaken thought that they would solve diverse problems." Thus, the question here is that of regional variations in the quality and cost of services.

This variation would not necessarily be harmful, and in reading current literature we quickly reach the conclusion that this ability of the central government to "impose uniform policies across the country" could well be, in large part, the origin of Canada's present problems. First, when Ottawa takes this stance, it is in effect deciding which concept of the quality of life will prevail in Canada's various regions. Second, once adopted, this reasoning will not tolerate many hitches. On the one hand, a large number of analysts and politicians will contest that the federal government is automatically better informed than the other levels to make this decision, while on the other hand, it appears to be difficult to reconcile this central decision with the intensity that is generally associated with Canadian regionalism. If this regionalism is in fact as deeply rooted in Canada as now believed, it must signify not only different capacities of different regions to provide a minimum level of services to the population, but also different tastes in different regions with respect to the "basket" of government goods and services desired.

Furthermore, federal policies uniformly applied across the country do not have the same effects in all regions: because original conditions vary, these policies may help the strong regions and harm the others, or at least prove insufficient to alter the major trends.

On the sole basis of work conducted by university economists or the Economic Council of Canada, it appears that Canada's trade policy has had, at best, barely favourable effects, and at worst, highly ambiguous effects on Quebec's economy; that transportation policy has sometimes served Quebec's interests well (air transportation), and sometimes poorly (rail transportation and particularly shipping); that energy policy was at first unfavourable to Quebec's interests, then more favourable; that agricultural policy has in some cases reaped substantial profits for Quebec farmers (dairy policy); that immigration policy has not had a very considerable economic impact but has raised cultural problems in Quebec; that some aspects of manpower policy cannot have very marked effects because the French-speaking population is not very mobile outside Quebec and would have difficulty in becoming mobile under any circumstances; etc.

Once Ottawa had considered all these sometimes contradictory effects and found that regional disparities still had not decreased as much as hoped, it resorted to DREE interventions. These interventions were then held up as a benefit of confederation even if, according to an Economic Council of Canada report, they were too limited to have a significant impact in Quebec on either the unemployment rate or income disparities.

We, in turn, have analysed the impact of federal policies on Quebec's economy in a greater number of fields. Inclusion of a greater number of policies in the analysis does not basically modify the diagnosis to which I have just made allusion; they may even reinforce it because the most favourable general conclusion that could probably be advanced would be that the effects of various federal policies end up counterbalancing each other. It is therefore appropriate to question more seriously the various impacts of so-called national policies on Canada's various regions.

In another line of thinking, Peter Leslie mentions the mutual economic advantages that are generally attributed to a federation and which he doubts could be obtained through a treaty or inter-provincial negotiations: 1) establishment of an integrated economy; 2) economies of scale in the provision of public services; 3) the compensation of "spillover effects"; 4) optimum distribution of resources in a society, particularly for the production of public goods such as defense; 5) effective stabilization policies; 6) the establishment of sufficient bargaining power at the international level.

Only further work would reveal to what extent these advantages are important. The question of whether they could not be obtained otherwise is an empirical one that would be difficult to answer *a priori*. But it already appears that the importance of these economic advantages should not be exaggerated, although they may indeed exist. First, an integrated economic territory can exist without the presence of a federal government and, in return, the existence of a federal government in Canada has not made the present Canadian common market immune from numerous imperfections. Moreover, although economies of scale in the provision of public services are even greater when the services provided are uniform throughout the entire country, this creates other types of problems which may run counter to regional interests. In any case, the governments provide little of the type of compensation on which the third advantage is based, and the true public goods referred to in the fourth are not very numerous. Finally, we expect to be able to rely on efficient stabilization policies. The results of the Lacroix and Rabeau report again appear to warn against exaggerating this aspect; these two authors demonstrate quite clearly that stabilization policies have experienced their share of problems in Canada despite the federal system and perhaps even in part because of this federal system (distribution of powers).

A large number of authors have stressed that the advantages of federalism are found outside the economic sphere. They may very well be correct.

ALTERNATIVE ELECTORAL SYSTEMS

by

William P. Irvine

Department of Political Studies

Queen's University

Many features of the Canadian political and constitutional system rest to a large extent on inheritance and tradition. One of the salutary effects of the November 1976 election in Quebec has been to force Canadians to take a second look at these institutions to see if any better justification is possible or to see if modifications might be desirable. In an imperfect world with people neither impartial nor ignorant of their own interests, political institutions raise as many questions of engineering as they do of morals. There is no uniquely and universally desirable constitutional division of power, method of court appointment, or electoral system. Rather, we must decide what we want to accomplish and marshal the best available knowledge as to how to bring about these ends.

In the past few years, all Canadians have felt a sharpening of the tension among three forces which Richard Simeon has characterized as "country-building, province-building, and Quebec nation-building." (Simeon, 1978). As the labels imply, these are thrusts, at both the mass and elite levels, aimed at extending the range of decision-making authority of federal or provincial governments. Each force has an affective component as well, with the last two forces distinguished by the intensity of that component. Though all provinces have special interests and grievances about their capacity to deal with these areas of interest, Quebec can add to this an especially strong sense of self-identity and self-assertion as an entity distinct from its neighbours.

Country-building, province-building and Quebec nation-building are tendencies that have coexisted throughout Canadian history, but have varied in relative force. Most recently, country-building was the dominant force after the Second World War. It began somewhat hesitantly during the Depression but found its major impetus in the mobilization of wealth, manpower and resources for combat. Though most of the war-time apparatus was dismantled after 1945, the initial momentum persisted for some fifteen years. A fear of post-war economic dislocation, coupled with a highly talented Ottawa civil service committed to Keynesian economic management and proud of its war-time accomplishments, sustained this thrust. At the popular level, total war always seems to generate support for new social organization and Canada after 1945 was no exception. That and the world-wide economic boom provided mass support for country-building, support that, to some extent, cut across cultural and regional divisions.

We now know that this was not an inexorable self-sustaining process. Province-building and Quebec nation-building tendencies were submerged but not eliminated during the 1950s. They have come to dominate the 1960s and 1970s under leaders whose education and major formative experiences came in the country-building decade.

It is clear that these forces are not yet spent and that the 1980s will probably afford them greater institutional recognition. Legal authority over matters such as communications, immigration and economic development will devolve to provinces on either an exclusive or a shared basis. Provinces may obtain a greater role in the formation of central government policy as well.

What will happen to the centre in Canadian politics is not now predictable. Theoretically, one could do away entirely with an independent central power. Canada could become a confederation in the strict sense with matters settled through multilateral negotiation. It is not necessarily the case that such a change would produce major redirections of Canadian policy. What is clear is that such a development would seriously violate many of the beliefs, assumptions and interests of the Canadian people - the same set of beliefs, assumptions and interests that have influenced and been influenced by the country-building process in the past. Among these are self-definitions as heirs of a country stretching from sea to sea, a liberalism implying equal standing before government, whether one stands as a consumer of services or as a voter, and an egalitarianism designed to make the liberalism more effective. (Irvine, 1977). Many of these beliefs and assumptions are spillovers of American political culture. As such, they affect English-speakers more than French-speakers, but the latter are certainly not immune to the moral claims implied in liberalism and egalitarianism. Policies now justified on these moral grounds could possibly be shown to be consistent with self-interest. On the basis of liberalism, we believe that Canadians must have a choice of cultural offerings insofar as these are publicly provided. Specifically, we believe that people ought to be able to choose the language of education for their children and the language and "height of brow" of media offerings. Though Quebec has now violated what would be defined as liberal educational policy, the leaders of the Parti Québécois themselves see this as a transitional measure. It is entirely possible that a separate Quebec would discover that its self-interest required it to maximize the facility of its population in the use of English - even to the point of broadening access to schools in which English was the language of instruction. Similarly, in the richer provinces in Canada, being taxed to provide equalization payments is now justified in terms of a basic egalitarianism. It is quite probable that it could be justified in terms of self-interest. The enhanced standard of living made possible in poorer provinces by equalization payments makes them better consumers of products than the richer provinces.

While such possibilities exist, one doubts that self-interest can justify as many things to as many people as can now be based

on a diffuse moral sense of community. However this may be, it is clear that the violation of these sensibilities would produce an intolerable short-run situation. In this short run, the response is likely to be punitive rather than self-interested. There will, as a result, be no basis for mutually beneficial policies or communitarian policies, and every likelihood of mutually destructive tendencies. For this reason, as well as for the dynamic quality generated by the coexistence of contrary social tendencies, it seems appropriate to try to rebuild central institutions and to attempt to reassert this particular thrust. It is still possible to establish the authority of a central government based directly on popular support, albeit one operating within narrower jurisdictional limits. Whether this rebuilding would be helped or hindered by a reform of the Canadian electoral system and consequent changes in the party system is the question to be asked in this paper.

The central government is a system of interacting parts. Still, it is both possible and analytically useful to distinguish between the input and output sides of this system. The growth of central authority requires development on both sides: there must be a growth both in the legitimacy and in the responsiveness of the central government. Legitimacy is a function of group representation, procedural quality, institutional resources, and capacity to manage conflict. A government will be supported, that is, will be seen as legitimate, to the extent that social groups feel that they are represented in it. Government can also benefit if it is linked to the popular will by fair and understandable mechanisms. Conversely, government will have less appeal where the link seems capricious or based on irrelevant considerations. A voting system that appeared to favour Mr. Brown over Mr. White because it discouraged voters from looking past the top of the ballot would be an example. By institutional resources, I mean the capacity to mobilize, channel and commit social forces directly. (Huntington, 1965, pp. 8-11). Representational capacity assumes that all social forces are at some remove from government which, in a passive way, affords access to some or all interests. A government with institutional capacity has direct social roots, through a political party, and benefits from support that is diffuse - not linked to specific actions of government. It also benefits to the extent that politically active elites work through the party that is committed to government rather than through social organizations committed only to their own self-interest. Finally, a government's authority is enhanced when its functioning is such as to cut across and blur major social divisions in the society. It is diminished if the governmental system contains incentives to mobilize social differences.

On the output side, governmental responsiveness is a function

of two things: the capacity of the government to make and change policy and to do so in a way satisfactory to contending social interests; and the opportunities afforded by government to individuals and groups for the redress of policy choices and administrative discretion where these are perceived as unsatisfactory. Given the systematic interrelationships, responsiveness in these two senses may be expected to enhance legitimacy, and legitimacy makes it easier for a government to mobilize the resources needed to produce satisfactory response.

On reflection, one realizes that these goods are not all mutually consistent, at least at the extremes. Institutionalization implies the capacity to schedule and manage the distribution of one's attention. Within a limited time frame, at least, this means that some interests will be ignored and there is always the danger that these could be completely ignored. A highly institutionalized government may, by virtue of its very strength, be limited in its capacity for representation and responsiveness. Similar reasoning suggests that a government could be so successful in blurring social forces that it leaves itself both directionless and devoid of the capacity to mobilize social support.

Other problems arise when one tries to engineer an increase in governmental authority. As we shall see shortly, the literature on electoral systems links different methods of casting and counting votes with all of these aspects of authority. Any particular electoral system will be linked positively in some respects, negatively with others. When we come to evaluate the evidence in the fourth section of this paper, it will be clear that many supposed effects are either weak or nonexistent. It will also be apparent that other things impinge on the working of government with sufficient force to nullify effects from the electoral system.

I am now working on a more detailed analysis of the relationship between types of electoral systems and the kinds of "goods" and "bads" that might be consequent on each. In this paper, I want to offer a very much abbreviated version of the larger work. I will consider only four electoral systems, and four broad classes of values: representativeness, party-building, policy-making capacity and capacity for redress. After a brief description of the four electoral systems in the next section of this paper, the third section will offer a design of a new electoral system for federal elections in Canada. The next section will argue that this design is preferable to the alternatives over the range of values considered. As will be clear, this does not mean that it is superior on each value, but that it involves a set of trade-offs that is preferable to the sets associated with the alternatives. In the longer work, I argue that this desirability remains even if one considers more electoral systems and more values, but I will not lengthen this paper by offering the grounds for this assertion.

As a final preliminary point, we should note that the link between an electoral system and government authority is provided by the fact that we live in a system of cabinet government, that cabinets are products of political parties, and that parties are conceived as organizations primarily interested in maximizing electoral success subject to certain policy constraints. In a formal sense, Canada is a parliamentary democracy and the authority of a parliament seems quite independent of the electoral system. Certainly all interests having a territorial base do find representation in parliament and would do so under all electoral systems. But parliament neither initiates nor disposes of public policy; that is done by cabinets and government parties. It is the authority that these can muster that is most relevant in exploring ways of rebuilding the central government. Given that cabinets and parties respond to electoral considerations, the electoral system seems a fruitful point of intervention. This paper seeks to discover the most promising form for that intervention.

TYPES OF ELECTORAL SYSTEM

Countries whose governments derive from British traditions generally have plurality electoral systems, though there have been experiments with other systems for local government and the English themselves have never felt that the Irish were to be trusted to operate a plurality electoral system. In any case, that is now the form used in Canada for federal and provincial elections. Elections take place in constituencies where a number of candidates seek to win a single seat in parliament. This seat is allocated to that candidate winning the largest number of votes. There is no requirement that that number exceed any specified percentage.

Elections in the Republic of Ireland and for the Australian Senate proceed according to a system of single transferable votes (to be referred to hereafter as STV). Three to five (rarely more) people are returned to parliament from each constituency. The number of candidates is quite large as major parties will nominate as many candidates as there are seats available for the constituency. Voters do not mark a cross for a single candidate, but indicate their relative preferences among candidates by marking a 1, 2, 3... etc. opposite the name of each candidate. To determine the winners under such a system, returning officers must establish a quota. There are a variety of formulae for doing this, but one is established by the country's electoral law. A common quota is the number of votes cast divided by one more than the number of seats to be filled in that constituency. First preferences are then tabulated. Any candidate receiving more than the quota is declared elected and his surplus votes (his actual vote minus the

quota) are redistributed according to the next available preference indicated. If there are more seats to be filled, the candidate with the fewest first preferences is dropped and his vote is reallocated according to the next available preferences indicated. This process goes on until all seats are filled.

A list electoral system also requires large constituencies. Indeed, in Israel and the Netherlands, the whole country forms one constituency. Constituencies return several members to parliament and parties nominate lists of candidates for each constituency. The number on the list usually equals the number of seats to be filled from that constituency. The list system probably has the most variants. In one form, the voter casts a single vote for a list. In other cases, he can indicate his relative preference among the candidates on a single list by rank-ordering them. In other cases, the voter can create a new list by writing down a rank-ordered set of candidates of his own. (This must be drawn from people already on the ballot.) Depending on the variant chosen, counting rules become more complicated. In the simplest case of a single vote for a party list, the number of votes is totalled for each party. Seats may be allocated by calculating a quota and using highest remainders or by a "highest average" method which involves successive application of a set of divisors. Without going into details, each party can count on receiving a number of seats closely corresponding to its proportion of the constituency vote and will fill those seats starting with the top of its constituency list.

The electoral system of the Federal Republic of Germany is a compromise between the plurality system and the list system and involves electing two types of parliamentarian: some who represent constituencies and others elected "at large." The proposal in the next section is a modification of this system, so I shall not take the time to describe it further here. I should stress, however, that what is described in the next section is not the West German electoral system.

A NEW ELECTORAL SYSTEM FOR CANADA

Future federal parliaments could be composed of two types of members: those representing constituencies as in the current system, and those who would represent provinces. The former would be elected as at present; the latter would be selected from lists of candidates prepared by the political parties for each province. The allocation of list seats to parties would be such that the overall composition of the parliament would reflect as closely as mathematically possible the distribution of votes among parties in each province. In developing the following example of how such a system might be constructed and might work, the total size of the

parliament and the balance between constituency and provincial representatives has been selected arbitrarily. These parameters do affect representativeness, but could be varied within substantial margins without too much loss. They also affect other values not considered in this paper: the cost of paying and pensioning MPs and the disappearance of an MP's seat.

There are practical difficulties in adapting the German system to Canada's small provinces or territories. If the decision were to allocate one-third of the seats proportionately and two-thirds as at present, very poor proportionality could be achieved in the Atlantic provinces or in the north. Prince Edward Island would have only one at large seat, Newfoundland only two, and the Yukon/Northwest Territories might have no at large seat. One could keep all the current constituencies and increase the size of the House of Commons by one-third to one-half, but this would create an unwieldy parliament without really improving proportionality at the provincial level. A possible compromise might be to increase the size of the House of Commons by one-quarter to 354 and reduce the number of directly electing constituencies by one-third to 188, thus increasing constituency size by 50%. This would still not allow proportionality for the North, though residents might be permitted to vote for the Alberta lists. The effect on other provinces would be as shown in Table 1.

Table 1

Distribution of Seats among Provinces for
a Mixed Proportionality Electoral System

Province	Current	New Direct	New List	Threshold
Newfoundland	7	5	4	. 10
Prince Edward Island	4	3	2	. 17
New Brunswick	10	7	5	. 08
Nova Scotia	11	7	7	. 07
Quebec	75	50	44	. 013
Ontario	95	63	56	. 011
Manitoba	14	9	9	. 05
Saskatchewan	14	9	9	. 05
Alberta	21	14	12	. 04
British Columbia	28	19	16	. 03
North	3	2	2	. 20
TOTAL	282	188	166	

The representation thresholds would be quite different from province to province. In Prince Edward Island, a party would have to have support from slightly more than one-sixth of the electorate to be assured of representation (though, of course, it might hope to get representation with something around 40% of the vote in one constituency). In Ontario and Quebec, by contrast, representation could be assured by virtually any serious group. The inequalities in thresholds could be reduced if it were possible to have an "Atlantic Provinces list" or a "Prairie plus North list." Drawing up such lists would produce considerable intraparty tension in allocating top places to different provinces. However, the tension might not be any more formidable (or unmanageable) than would be faced by the Ontario parties in allocating top spots among claimants from Toronto, the Niagara peninsula, or eastern or northern Ontario.

This proposed system has many similarities to the present one. As now, political parties would nominate candidates in each constituency they wished to contest. They would, in addition, establish provincial lists of candidates ranking these candidates from one to however many provincial representatives are allocated to that province. Each party would have a Quebec list of 44 names, a British Columbia list of 16, a Nova Scotia list of 7, and so on. The same people could appear as constituency candidates and provincial candidates.

For the voter, nothing would be changed except that his constituency would be larger. As at present, he would enter the voting booth with a ballot containing the names of all who wished to represent his constituency and who could qualify as candidates. Those nominated by recognized parties would have their affiliation indicated on the ballot. Voters would make a single cross opposite the name of the candidate they supported and deposit their ballot in the ballot box.

The candidate preferred by the largest number of voters in his constituency would be declared elected. Again, this represents no change from current practice. However, the votes for each party's constituency candidates would be totalled for each province. This is regularly done now, both by election night commentators and by the Chief Electoral Officer in his official report of election results.

Provincial representatives would be declared elected in such a way as to make the proportion of the total provincial seats won by any party approximate the proportion of provincial votes won by that party. To see how this could be done, let us suppose that the 1974 election had been fought under our proposal for the House of Commons used in our example. Let us also suppose that all voters had cast their ballots the same way they did in 1974 and

that the success rate for each party in the constituencies was the same as at that election. Consider now the following examples.

In 1974, the Liberal Party obtained 54% of the vote and 81% of the constituencies in Quebec. In our example, Quebec had 50 constituencies. With the same success rate, the Liberals would have captured 40 constituencies in our re-run of the 1974 election. Since Quebec would have a total of 94 members, the vote for the Liberal party would make it eligible for 51 members. Since it had already elected 40, the first 11 names on its provincial list would also be declared elected. If any person had already been declared elected for a constituency, allocation of the provincial seat would go down the list to a name not already elected.

The Progressive Conservative Party obtained 21% of the vote in Quebec in 1974 and would, under our proposal, be entitled to 20 members from Quebec. At the same success rate in the constituencies as in 1974, only about 2 Progressive Conservative candidates would win direct election. Therefore, the first 18 names on the Progressive Conservative list for Quebec would be declared elected (again, skipping over any person already declared elected). The New Democratic Party would be eligible for 7 Quebec members. Having elected none at the constituency level, the first seven names on their Quebec list would be returned to Parliament. The Social Credit Party obtained 17% of the vote in Quebec in 1974 and so would be entitled to 16 members. Eight Social Credit candidates might have captured constituencies, and the first eight names on their provincial list would also be elected as provincial representatives, provided those people were not already elected in constituencies.

How would our proposal work in Alberta? With the same assumptions made in the discussion for Quebec, and excluding the five percent of the vote which neither captured a seat nor concentrated on a single party, we get the following results. The Progressive Conservative Party would be entitled to 16 of the 26 seats in Alberta, the Liberal Party to 7 and the NDP to 3. If the PCs had swept all 14 constituencies, they would get two members from their list. The top 7 on the Liberal list and the top 3 on the NDP list would be elected. Note that some balances between constituency and provincial representation could not have accommodated the 1974 Alberta result. Were we to opt for one-third list seats and two-thirds constituency seats, Alberta would have 17 direct seats and 9 provincial seats. With the Progressive Conservative Party sweeping all 17 seats, and only nine to allocate, the Liberals would get 7 and the NDP 2. While a departure from strict proportionality, it would not be as serious as could have occurred under a plurality system.

WOULD WE BE ANY BETTER OFF?

STV, list systems and the West German hybrid are all proportional representation systems. Though they differ somewhat in how well they achieve proportionality, they may be considered as belonging to a single class when contrasted with plurality electoral systems on the values of representativeness and of policy-making capacity. With respect to capacity for redress, the hybrid might be grouped with the plurality system in a single class in contrast to STV and list electoral systems. In affecting parties as institutions, STV and plurality electoral systems are similar in weakening parties and may be contrasted with the list and hybrid systems which tend to strengthen parties and, within them, organizational leadership.

With respect to representativeness, proportional systems produce party caucuses that reflect, in size and geographical distribution, the electorate of the party. The plurality electoral system does not. It translates votes into seats in a capricious way, and in a way that exacerbates the divisions in the country. This emerges quite clearly if we examine the results of the last three elections as set out in Table 2. The inconsistencies of the system are evident where in different places, years, or as between different parties, the same proportion of seats can be won with very different proportions of the vote, or similar proportions of vote are rewarded with quite different proportions of seats. (For related studies, see Rae (1967), Cairns (1968) and Johnston and Ballantyne (1977).)

Apart from these issues, we find large blocs of voters in each province robbed of any representation at all. Even if we disregard as very unusual the case of Prince Edward Island in 1968, when 45% of the voters supported Liberal candidates without electing a single one of them, we still find one-fifth of British Columbia voters in that year supporting the Progressive Conservative Party without being able to elect a single Progressive Conservative Member of Parliament. Similarly, the 1972 and 1974 elections gave many the impression that Albertans had unanimously rejected the Liberal government. In fact, one-quarter of Albertans had supported that government, but that support was concealed by the electoral system. In recent elections, the New Democratic Party has failed to elect a member from Alberta, Quebec, New Brunswick, Prince Edward Island and Newfoundland yet there exist sizeable numbers of New Democrats in each of those provinces. In Nova Scotia in 1974, the New Democratic Party did discover the secret of electing an eastern member. It paid them to give up some of the support enjoyed in the preceding election in order to better concentrate the remainder. This is not the only instance where a party's vote has gone down, but its share of seats has increased. The Progressive Party has benefited from the same phenomenon in Saskatchewan.

Table 2

The Distribution of Votes and Seats among Parties
in Recent Canadian Elections, 1968 - 1974

Year and Province	Liberal		Progressive Conservative		New Democratic		Social Credit	
	%Votes	%Seats	%Votes	%Seats	%Votes	%Seats	%Votes	%Seats
1968								
Nfld	43	14	53	86	4	0		
PEI	45	0	52	100	3	0		
NS	38	9	55	91	7	0		
NB	44	50	50	50	5	0	1	0
Quebec	54	76	21	5	8	0	16	19
Ontario	47	73	32	19	21	8		
Manitoba	42	38	31	38	25	24		
Sask	27	15	37	38	36	46		
Alberta	36	21	50	79	9	0		
BC	42	70	19	0	33	30		
1972								
Nfld	45	43	49	57	5	0		
PEI	40	25	52	75	8	0		
NS	34	9	53	91	12	0		
NB	43	50	45	50	6	0	6	0
Quebec	49	76	17	3	6	0	24	21
Ontario	38	41	39	45	22	13		
Manitoba	31	15	42	62	26	23	1	0
Sask	25	8	37	54	36	38		
Alberta	25	0	58	100	13	0	5	0
BC	29	17	33	35	35	48	3	0
1974								
Nfld	47	57	44	43	10	0		
PEI	46	25	49	75	5	0		
NS	41	18	48	73	11	9		
NB	47	60	33	30	9	0	3	0
Quebec	54	81	21	4	7	0	17	15
Ontario	45	62	35	28	19	10		
Manitoba	27	15	48	69	24	15	1	0
Sask	31	23	36	61	32	15	1	0
Alberta	25	0	61	100	9	0	3	0
BC	33	35	42	56	23	9	1	0

With very few and very minor exceptions, our electoral system unduly rewards the party that is dominant in any province. It thus makes provinces appear more unanimous than they really are. Quebec voters are not solidly behind the Liberal Party: one in two votes for other parties. This reality is concealed at the parliamentary level where the Liberals gain more than three seats in every four. A similar effect has been observed for Alberta. These are only the most dramatic effects. The leading party in popular votes gets a bonus in parliamentary seats in all provinces. Thus, political parties have an incentive to concentrate campaigns on their areas of strength, further reinforcing their image as captives of one or two regions.

There is no general pattern in the way the electoral system treats the less popular parties in each province. In some cases, the second most popular party is the most seriously disadvantaged. Liberals in Nova Scotia and Prince Edward Island could testify to this on the basis of recent experience. So too could Progressive Conservatives in Quebec. In both 1968 and 1974 that party received the second highest popular vote in Quebec. In both of those years, it only received about one-quarter as many seats as the less popular Social Credit Party.

In the Canadian context, the working of the plurality system offends not only against fairness in an abstract way but also sharpens regional cleavages and alienation. It makes the West and Quebec seem single-minded in support of one political party. When the Liberals form the government, the West is only weakly represented and Quebecers play leading roles. However this situation might satisfy Quebecers in the short run, they can have no long-term confidence in the normal democratic process. They know that, if the Progressive Conservatives were to form a government, the likely consequence would not be a change of the French-Canadians in government but an exclusion of French-Canadians from government. Under a more proportional electoral system, such as the one suggested, national parties would have support in all provinces. Even if new provincialist parties were to arise, taking advantage of the lower initial barriers to entry in a proportional electoral system, it is hard to believe that the present national parties would lose all their support in some province or other.

While defenders of the present electoral system might concede that a change would enhance representativeness in party caucuses and so increase legitimacy, they would probably insist that a more proportional electoral system would render Canada ungovernable. By returning parliaments in which there was no majority party, the capacity of government to make and to change policy would be weakened and so, ultimately, would be the acceptability of the whole governmental system - in a word, legitimacy. They fear that a representative parliament would be subject to deadlock and delay:

unable to agree on a cabinet to support, unable to continue that support for four years, unable to pass laws or budgets wherever these were opposed by significant segments of the community. In the Canadian context, it could also be argued that a government that was more representative in both a territorial and a partisan sense would be unable to effectively defend the interests of the federal government vis-a-vis the provinces.

The evidence that would permit us to comment on these propositions is sadly lacking, since there are many specific factors that make it difficult to apply European experience and there has been little systematic study of the nine years of Canadian minority government since 1957. On the one hand, this means that we should not make too much of the instances that are regularly cited as showing the weakness of proportional electoral systems: Italy and Germany before the Fascist takeovers, IVth Republic France or Italy immediately after World War II. In all of those examples, there was at least one (sometimes more) major party committed to the overthrow of, or very radical change in, the political system. In the German and Italian cases, there was a limited history of democratic government as well. None of these conditions obtain in Canada, nor are they foreseeable. Similarly, in the 1960-69 period, Canada had lower inflation than most Western European countries, and government absorbed less of the GDP in 1971/72 than it did in most West European countries. However, Canada had much higher unemployment in the same period and a higher rate of expansion of the public economy than most European countries over the 1960-74 period. Especially when we recall that the 1960-69 period includes seven years of minority government, we cannot claim that the present electoral system is necessary to desirable economic performance. Indeed, the most relevant difference between Canada and Western Europe in this context is the relative weight of social democratic parties. (See Tufte (1978) and work there cited.)

It would be all the more difficult if new parties were also to arise. While there is no reason to believe that these would sweep away the present parties at precisely the moment when votes for those parties come to have some weight, it is possible that some strongly regionalist parties might emerge. If a nationalist party from Quebec were both large, and so extreme in its demands that it could not be included in a governing coalition, the Canadian situation would be even worse than at present. On the other hand, if such a party were willing to bargain, Quebec would find itself with a wider range of coalition options than it now has. A similar analysis could be made for a "Prairie" party.

Moreover, if there is a basis for a large (more than 1/3 of the electorate for example) new party in some province, the most that our present electoral system could do is to delay its full emergence for an election or two. Any new party with committed

support, at both the mass and elite levels, could eventually turn a plurality system to its own advantage. The rise of the Parti Québécois provides eloquent testimony.

The suggested trade-off between representativeness and decisiveness is thus far from established. Minority governments can occur under the present electoral rules. In any case, the evidence of their weak policy-making capacity is hardly overwhelming. Moreover, to the extent that majority governments are artificially generated by the electoral system, any advantage they might have in policy-making permits them to go beyond the limits of social consensus and generates opposition to the whole system. Decisiveness easily shades into blundering wrong-headedness. As between the values of representational capacity and policy-making capacity, strong evidence on the former, and ambiguity with respect to the latter suggests that one should opt for the system offering representation: a proportional electoral system. But which of the three should it be? To make this decision, we look at two other values: party building, and procedural quality.

Party-building contrasts the STV system with those proportional systems requiring party lists. In the absence of a list, the voter becomes decisive in determining who is to be elected, and his choice is not only between party representatives as in the plurality system but also among representatives of the same party. Party is weakened, therefore, because its own candidates are encouraged to compete against each other. While this competition can be benign or even positive in its consequences if it takes the form of constituency service or patronage, it can be unfortunate if it encourages candidates to depart from the party line in articulating local interests. In a five-man STV constituency in Saskatchewan, there would probably be two guaranteed PC seats and a third marginal one. There would, however, be five PC candidates and one could expect that each would vie with the others in opposition to the national party's language policy or even, perhaps, to its natural resources policy. The incentive is quite the opposite in a list system, at least insofar as the national leadership determines the ranking on the list. Since the top ranks are the crucial ones, the proper strategy for the aspiring politician is to mirror as closely as possible the policy line of those who establish the list.

Party-building also means that each party not only elects candidates in regions where it is now weak, but that it can offer political careers to candidates in those regions. The Progressive Conservative Party has always had good candidates in Quebec; it has less often had the same good candidate at two successive elections. Given the operation of the plurality electoral system, this is hardly surprising. However, an STV system would not be much better. At present levels of support, Liberals could only be assured of one seat for every five-man constituency on the Prairies. The same

would hold for the PCs in five-man Quebec constituencies. In each case, there would be five Liberals or five Progressive Conservatives competing for that seat. Even if they could, by some pact, all agree to abide by the party line, chance variation in vote magnitudes would interrupt political careers. It would certainly make it very difficult for a party leader to recruit a prestigious spokesman in Quebec or the Prairies with promises of a political career. This is precisely what could be offered under a list system for achieving proportionality. A party leader could offer the top list positions to those whom he expects to represent the party to some regional or linguistic group and vice versa. Those playing these broad linkage roles could be insulated from specifically local constituency concerns and from idiosyncrasies in local level election returns.

As between the two proportional systems using lists, the hybrid system has the greater capacity for redress simply because it does not use lists exclusively. In the example given, just over half would hold their seats directly on suffrage of a local electorate. The ratio could be made higher by changing the balance between direct and list seats. This personal responsibility gives individuals and groups someone to turn to for assistance. No doubt the quality of that assistance depends much on the personality of the candidate. No plurality voting system can insure this kind of responsiveness, particularly in safe seats. However, the norms of parliamentary life may compensate for, if they do not reinforce, the parliamentarian's degree of self-interest in being attentive to local needs. Moreover, any mixed system would contain fewer parliamentarians with job security than any list system. In this sense, the hybrid system marshalls more incentive for acting to seek redress of local grievances than would a straight list system.

CONCLUSION

The above analysis contains an implicit hierarchy of values and has proceeded largely by pair-wise comparisons - a voting system known to produce paradoxical results. Another analyst might offer an extended discussion of STV which, even on the above discussion, obviously has more substantial capacity for redress of local grievances. Some might prefer this to party-building. Insofar as constituencies under STV return no more than five members, the barriers to entry would also be higher than in other PR systems. The NDP would likely elect no more candidates in the Atlantic region than it does currently, and would have little or no success in Quebec or Alberta. The system would not, however, be more likely to produce majority government (whose value, let it be recalled, is not established). It would, instead, produce two more evenly matched minority parties and might complicate policy-making.

Insofar as one conceives the analysis of electoral systems as a policy recommendation to governments or advisory panels, it would be desirable to be able to make an overall comparison of all electoral systems. One would like to be able to weight the values at issue and to discount these by the probability that any given system does contribute to realizing that value, given existing and probable future distributions of preferences. Political science is not (not yet?) at a point to enable us to do this. My own reading of the evidence, with implicit weights and discount factors, suggests that a hybrid plurality/proportionality system (such as the one described in section III) would end up with the highest score on the ideal balance sheet.

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Comments by K.Z. Paltiel, Department of Political Science,
Carleton University

In his oral remarks Professor Irvine correctly stresses the problem of parties and their declining role in our political system, matters which receive less attention in his written paper. In his formal presentation Professor Irvine argues that our faulty electoral system is one of the principal reasons for the current crisis facing the central institutions of the government of Canada. The "first past the post" territorial electoral system, as Alan Cairns pointed out more than a decade ago, seriously misrepresents the will of the Canadian people in the way it translates votes into seats; it inflates the strength of the largest party, exaggerates the representation of parties with strong regional bases and penalizes parties with broad but diffuse pan-Canadian support. This benefits regionally-oriented third parties and penalizes the Liberals in the Prairie provinces and the Progressive-Conservatives in Quebec.

The results, Irvine says, are a crisis of authority in the central governing institutions and growing popular frustration arising from the failure of governing parties to respond with policies capable of conciliating contending social forces. A more representative electoral system, in his view, would enhance the legitimacy of the Federal Government and pave the way for more satisfactory public policies. This could be achieved by adopting an electoral system that would more truly reflect rather than distort Canadian opinion.

For a variety of reasons Irvine rejects the Single Transferable Vote scheme practised in Ireland and Australia as well as the Netherlands. Irvine proposes that Canada adopt a variant of the West German hybrid plurality--constituency *cum* list system. This would entail fewer territorial constituencies in each province whose Members of Parliament would be chosen by the present voting system plus a number of seats-at-large for each province which would be allocated amongst the parties according to their proportion of the total vote in the election of the constituency members; the seats-at-large would be distributed so that the total number of seats received by each party would not exceed their proportion of the total vote cast.

My comments on this proposal fall into two categories:

- (a) the soundness of the details of the proposal;
- (b) a critique of Irvine's claims that his scheme will cure the defects of the current electoral system.

1. Irvine's scheme does not eliminate the possibilities of gerrymandering; indeed, it puts a premium on such practices. How and by whom will the new constituency boundaries be drawn? The present system of distribution already contains grave distortions and biases-- a constituency's population may vary by 25% above or below the provincial quotient. The biases favour rural areas and areas of declining population; the greater the number of seats to be chosen territorially, the greater the bias will be and the greater the temptation to bias.

2. Who will nominate and determine the position of candidates to be chosen from the "list" as opposed to those nominated in the constituencies? Will this not set up a two or three-class system of candidates composed of those nominated only by the local constituency organizations, those whose names appear only on the provincial "list," and the "stars" who appear both in a constituency and high on the list? At one point Irvine speaks of the provincial party organizations choosing the "list" candidate, at another he speaks of the national leader performing this function. If it is to be the party, which will it be? The provincial party organization, the provincial-wing of the federal party, or a central party cabal? All the evidence from existing list systems indicates that the real political struggle in such regimes is over one's location on the party list, and real political power rests with those who are authorized to do the choosing and placing of the candidates. In what way will this contentious process, which is bound to undermine local party organizations, enhance or revivify the parties? Will it not rather encourage the trend towards centralization and the atrophy of party infrastructure?

3. Under Irvine's proposal a candidate rejected by constituency voters could nevertheless be declared "elected" provided that his name also appeared in a high position on a "list." Thus party leaders could frustrate the will of the electorate. Furthermore, a candidate who had received a smaller number of direct votes in a constituency could be sent to Parliament over another who was endorsed elsewhere by a greater number of voters but whose name had appeared on a list which would not be compensated.

4. In the light of the foregoing, if proportionality is the goal, then why not opt for a straightforward list system on a provincial basis, or a system of multi-member constituencies chosen through a proportional or preferential system? This multi-member system would avoid the contradictory anomalies of Irvine's version of the West German hybrid.

Irvine rightly dwells on the weakness of parties in Canada, on their subsistence as mere electoral instruments, on their failure as "representative" bodies and on the implications of this failure for policy responsiveness and legitimacy. But will his scheme cure these weaknesses?

1. A large number of Quebec Liberals in the House of Commons since the turn of the century has not produced policy outputs over time or promoted administrative structures with adequate French-Canadian representation, moves which, according to some, could have allayed the current discontent in Quebec. Likewise, there is still discontent in the Maritimes where party representation has been, over time, more or less proportional to popular support. Why, therefore, should a "mechanically" achieved greater representation of Liberals from the West or Conservatives from Quebec assure different policy outcomes in Ottawa? Policy outcomes are influenced by interest groups and a variety of other forces, such as the leadership selection process, which lie outside the electoral process.

2. Nothing in the proposal before us would alter the internal structuring of our parties. Indeed, the bias towards the centre and the party leader which has been strengthened by recent changes in the Canada Elections Act concerning the recognition of parties, the placing of the party name on the ballot and party financing would be further enhanced by giving the leadership control of the proposed "lists" of candidates. A concern for parties, which is ostensibly the goal of this proposal, should at least indicate how the rank-and-file and middle-range leadership can participate in the candidate selection process. The recent proceedings in Ottawa Centre, Rosedale and other Toronto Liberal Party nomination "contests," that is to say, the displacement of locally-chosen candidates by hand-picked nominees parachuted from the central party organizations, would be given legitimate sanction by the creation of a hybrid "list" system.

3. The Irvine proposal as presently constituted, when coupled with the laws concerning the "recognition" of parties, would simply reinforce the existing, institutionalised and incumbent parties as a group. It would further impede the appearance of independents and grossly inhibit the emergence of "new parties." In this way our party system would be rendered less representative and less responsive to regional, sectional and social demands. Since the end of the First World War, it has been the rebellion of the regions as expressed by "new" and "third" parties which has prompted most of the innovation within our political system. Only in the face of the threat from these maverick groups have our established parties begun

to face up to pressing regional and social demands. Professor Irvine's proposal appears to thwart the future emergence of such yeasty and innovation-producing groups. As such it appears to me to be counter-productive in its attempt to restore "country-building" processes.

ECONOMIC STABILIZATION AND THE REGIONS:

THE DILEMMA IN CANADA

by

Y. Rabeau and R. Lacroix

Department of Economics

University of Montreal

PREFACE

Canada is now going through one of the most crucial periods in its history. The most serious economic crisis since the Great Depression has occurred at the same time as the most dangerous political crisis in Canadian history. Confederation is being questioned more each day, and while Quebec is the most direct critic, many other provinces are having considerable doubts about the distribution of power and jurisdictions as well as about the federal government's past use of the powers it has held or gradually accumulated.

The problem of regional economic disparities is a prime factor in these doubts. The poorest provinces ask, for example, why regional differences in unemployment and income have remained high. It is felt that income redistribution policies between regions and individuals through various forms of transfer payments have merely redistributed demand among the regions without redistributing employment. This would explain why some provinces are living increasingly off federal transfers and why this situation is accepted by the rich provinces, since these transfers allow the recipients to purchase products from the rich provinces. *Past economic policies have not allowed the poor provinces to become self-developing. To survive, they must rely on an uninterrupted flow of outside transfers. We must, therefore, question policies based solely on redistribution of demand as a means of reducing, and eventually eliminating, regional disparities.*

It is in this perspective that this study on regional economic stabilization must be viewed.

INTRODUCTION

While we have no intention of reopening the debate between Keynesians and monetarists, we agree with the neo-Keynesians that, while stabilization of the economy is definitely a difficult and delicate operation, it is, nonetheless, possible. While all economists now admit that "fine tuning" is not possible, the same cannot be said of the reduction of cyclical effects through appropriate budget policies.

This introduction will examine the two facets of budget policy -- expenditure and revenue -- in an attempt to provide a detailed profile of the characteristics a spending or tax program should have for maximum effectiveness as a stabilization instrument in a homogeneous economic context and in Canada's particular geopolitical context.

1 Public Spending

Through its direct effect on aggregate demand, a change in government expenditure is the form of intervention with the greatest and quickest impact on the level of economic activity and employment. However, to remain a true stabilization instrument, this type of spending must, above all, be flexible enough to increase or decrease substantially over relatively short periods of time. Unfortunately, a large proportion of public spending is easily increased, but not so easily curtailed.

In fact, it can even be argued that some expenditures, long considered non-recurrent, have created expectations such that it has become practically impossible to reduce them, unless we accept serious social tensions. If we therefore wish to prevent special government spending programs with contracyclical purposes from further increasing the relative size of government, we must first ensure that they are *non-recurrent*.

Moreover, if we wish to concentrate the impact of this spending within a short period, it must be implemented with an absolute minimum of delay. Finally, although it may appear paradoxical at first glance, this spending must not be inflationary. Recession does not equally affect all sectors of the economy and we must prevent the recovery policy from creating inflationary pressures in some sectors.

2 Fiscal Policy

Three major categories of taxes provide most of the government's revenue, and are generally considered as potential stabilization instruments.

Personal Income Tax Various studies indicate that the marginal propensity to consume for additional income from temporary variations in personal income tax is lower than the marginal propensity to

consume for permanent income. Moreover, we must remember that at the trough of a serious recession, consumers may worry about temporary cash-flow problems that a lay-off would cause, and are, therefore, more inclined to save all temporary income. Thus, in view of the considerable uncertainty existing over the impact on consumption of a variation in personal income tax, its utilization as a stabilization instrument appears very imprudent, at least during recessions.

Corporate Income Tax The effect on the economy of a change in corporate taxes -- modification of taxes on profits, variation of investment credits, changes to various depreciation formulas -- appears to be even more uncertain than that of a change in personal income tax. Michael K. Evans (1969) best summed up the various opinions on the issue: "It would (...) seem that the corporate income tax rate should be decided more on equity grounds or as a means of balancing the budget than as a method of regulating GNP."

Indirect Taxes Except for the jurisdictional problems that may arise in Canada, the use of indirect taxes as a stabilization instrument may be of some worth in particular situations. The impact of a temporary variation in the sales tax, for example, is double: it first leads to a change in the real income of individuals and then, over time, shifts their consumption pattern. This measure may also be selectively applied to only certain categories of goods whose national output content is high. While a sales tax cut is recommended in periods of recession and, particularly, of stagflation (since it stimulates demand while temporarily reducing inflationary pressure), any increase in the sales tax in a period of inflation is unadvisable since it pushes even higher.

3 The Particular Case of Canada

The preceding discussion of the effectiveness of stabilization instruments is based on the assumption that they are applied to homogeneous and particularly punctiform economies. However, the Canadian geopolitical reality differs greatly from this ideal world. Each major region has its own climate, its own resource and factor endowment, and its own commercial relations that cause it to react in a particular way to the business cycle.

A recent study by the Economic Council of Canada found, for example, that "an increase of 2 percentage points in the Canadian unemployment rate is typically accompanied by an increase of roughly 3.7 points in the Atlantic Region, 2.6 points in Quebec, 1.3 points in Ontario, 1.7 points in the Prairie Region, and 1.9 points in British Columbia.¹

¹ Economic Council of Canada, *Living Together*, p.49.

This casts doubt on the effectiveness of stabilization policies that are applied at the same time and to the same extent in all regions of the country. It has long been claimed in Canada that we cannot regionalize economic policies but only structural policies. In other words, stabilization is carried out at the national level, while development can be conducted on a regional basis.

Yet, the differentiation in the utilization of stabilization instruments by region raises major problems if we use public spending. However, in Canada account must be made for the distribution of jurisdictions: we will see later that those expenditures most likely to be used for stabilization purposes fall, in large part, under provincial or municipal jurisdiction, while the responsibility for stabilization and the means for financing it form part of the federal jurisdiction.

1 LEVELS OF GOVERNMENT AND STABILIZATION INSTRUMENTS

An analysis of the past growth of revenue and expenditure at the various levels of Canadian government from 1950 to the present, will reveal which level of government has the most effective stabilization tools.

This overview will also make it possible to evaluate the fiscal performance of these governments by determining in particular whether they actually used the various stabilization instruments at their disposition.

1.1 The Federal Government's Instruments

Our analysis reveals that approximately 96 per cent of all federal government expenditures are not suitable for stabilization purposes.

The tests that we conducted indicate that spending on goods and services by the federal government (23.1 per cent of total expenditure in 1975) is, in large part, recurrent. Transfer payments to individuals (30.9 per cent of total expenditure) and interest payments on public debt (10.3 per cent) are also recurrent. Finally, transfers by the central government to other levels of government (21.3 per cent) can be considered to serve primarily to finance current expenditures and are, therefore, unsuited to stabilization. As a result, the federal administration's ability to stabilize the economy through its expenditures appears to be very limited.

Among the non-recurrent expenditures, only those for gross fixed capital formation (GFCF) could be used for stabilization purposes by the federal government. However, these expenditures represent only a very small share (3.1 per cent) of the federal government's budget and a minor proportion (slightly over 15 per cent) of total public GFCF in Canada. The federal government GFCF represents practically a negligible proportion of GNP and its fiscal lever effect would thus be very limited.

Consequently, the federal government's ability to intervene is based more on income than on expenditure. We have seen that the utilization of taxation as a means of stabilization is not necessarily very effective. Households and businessmen do not automatically spend a temporary increase in their disposable income and, even if they do, this often occurs too long afterwards to be effective. Thus, the federal government is faced with a dilemma in terms of the management of its stabilization policies in Canada. It has the extensive financial resources but its means of intervention are among the least effective for stabilization.

A short summary of the difficulties the federal government has experienced since 1950 in the use of public expenditure for stabilization purposes will provide a clearer picture of Ottawa's dilemma:

- With respect to fixed capital formation expenditures, the distribution of jurisdictions in Canada does not particularly favour increased federal intervention. Even when it did succeed in moving into this spending sector, the federal government was unable to inject amounts of any significance on an annual basis.
- In any case, it proved difficult to control the growth of federal spending because of its highly recurrent nature. In 1968, despite a promise to exert tight control over spending in an attempt to stop inflation, federal government expenditure continued to grow at 11 per cent, while the growth of GNP did not exceed 9 per cent.
- To stabilize the economy, the central government is reduced to using expenditures that, by their very nature, are unsuited to this purpose. In particular, it has often used transfer payments to individuals and provinces.
- On occasion, the federal government has resorted to the spending power of lower government levels to stimulate the economy through expenditure. In 1970, for example, it financed provincial and municipal spending on infrastructure, whose multiplier effect is known to be large.
- The federal government has attempted to circumvent its fiscal dilemma at the start of the 1971 expansion by launching special job-creation programs -- Opportunities For Youth, Local Initiatives Program -- that have rapidly become recurrent. In May 1972, Opportunities For Youth was renewed while gross national demand was growing at a rate of 11 per cent annually. Similarly, in the following year when the Canadian economy reached a peak of expansion, Opportunities For Youth and Local Initiatives Programs were renewed. These expenditures

eventually helped to increase the government's size in relation to GNP and thus no longer met the basic criteria for stabilization expenditures.

1.2 The Provincial and Municipal Governments' Instruments

In the case of the provinces, if we accept the findings of our research on recurrent expenditures that part of the spending on goods and services other than wages is sufficiently flexible to be used for stabilization, this could supplement the part of gross fixed capital formation (GFCF) suited to contracyclical use.

Since GFCF already accounts for slightly over 7 per cent of the provincial budgets, the amount of provincial government expenditure that could be applied to stabilization can be estimated at over 10 per cent. Therefore, the provinces clearly have greater spending flexibility than the federal government (approximately 4 per cent). If, for example, the provinces made a 25 per cent increase in their non-recurrent expenditures, approximately 1 billion dollars would be injected into the Canadian economy on the basis of 1977 data. A similar increase by the federal government in the same year would only have produced an injection of about \$400 million. Moreover, as shown by a special study that we conducted for Quebec, the labour content of provincial spending is likely to be greater than that of federal spending.

Municipal governments, as immediate providers of services, devoted 74 per cent of their 1975 budget to the purchase of goods and services. Of this amount, 20 per cent went to the purchase of goods and services other than civil servants' wages. Their GFCF expenditures represented 17.2 per cent of total expenditure and almost 40 per cent of total public GFCF in Canada. We believe that the pattern of municipal GFCF over time could be changed if the provinces decided to co-ordinate this spending and use part of it for stabilization. For example, if we assume that 30 per cent of municipal spending could be accelerated or delayed relative to the cycle, approximately \$825 million, based on 1977 data, would thus be available for stabilization.

We have now found about \$2 billion that could be used for stabilization purposes at the lower levels of government, while the federal government's power of intervention would be only about \$400 million. It should be stressed here that capital expenditures exclude investments by parapublic corporations, part of the education sector and the hospital sector.

Finally, a survey of federal spending in Quebec indicates that the proportion likely to be used for stabilization purposes is relatively smaller than in the other provinces. Federal expenditure on goods and services averages only 15 per cent of total government expenditure in Quebec, compared with 27 per cent at the national level. When wages are excluded, this proportion rises to over 20 per cent, but still remains far below the national

average of approximately 35 per cent. The average share of federal GFCF spending, even after a clear upward trend in the 1960s, still remains clearly below the 15 per cent level observed nationally. Ottawa's spending flexibility, already very limited in all Canadian provinces, is even more severely restricted in Quebec.

1.3 The Performance of the Federal Government

Now that we have identified the types of expenditure or revenue at all three levels of government that could effectively be used for stabilizing the economy, we must determine whether they were actually used and achieved good results over the period analysed, 1950-75. Table 1.1 summarizes our conclusions.

It is evident from our analysis that the orientation of the federal government's fiscal policy has not always met the needs of the Canadian economy. The 1960 and 1969 anti-inflation measures are the most conspicuous major errors.

The 1959-61 period was dominated by fear of the appearance of inflationary pressures in Canada. This crusade against inflation had adverse effects on the entire Canadian economy, since the cycle had already begun to slow in 1960 and the inflation rate had fallen from 2.6 per cent in 1958 to 1.2 per cent in 1959. The already adverse effects of this policy at the national level were even greater in Quebec. While the unemployment rate exceeded 9 per cent in 1960 and 1961, the inflation rate did not exceed 1 per cent for this period. The obvious conclusion is that a national policy that is harmful throughout Canada has even more serious consequences in a region where the participation rate is below the national average and the effects of the recession (in terms of the magnitude and length) are generally greater than at the national level.

The same error was repeated in 1969 when the federal government began a new crusade against inflation through three successive tax hikes. At the time, Quebec was experiencing a serious slowdown of investment and the federal policies thus exacerbated the particular problems of the Quebec economy.

The lack of adaptation between federal fiscal policy and Quebec's stabilization needs consequently arose not only from the lack of a regionalized stabilization policy, but also particularly from its poor orientation at the macroeconomic level. In fact, the periods when federal government action was particularly harmful for Quebec also correspond to those when the stabilization policy was clearly misdirected for the nation as a whole.

The existence of a regional stabilization mechanism would have made it possible, in the first place, to better adapt the federal government's policy to Quebec's needs. When the policy was not sufficiently expansionist, a regionalization mechanism would have ensured an injection of sufficient fiscal stimulants to allow Quebec to operate closer to its potential or to benefit more rapidly from the effects of a recovery.

Table 1.1
Effectiveness of Various Fiscal Policies
in Terms of Stabilization¹

	Federal					Provincial				
	(1)	(2)	(3)	(4)	(5)	(1)	(2)	(3)	(4)	(5)
A. Expenditures										
Wages	TR	NO	Occasion- ally (EG: 1969)	NE	D	TR	NO	NO	NE	D
Other Goods and Services	AR	Periodic- ally	NO	PE	D (1952-65) N (1966-71) D (1972-76)	AR	Periodic- ally	NO	PE	D (1952-65) S (1966-71) N (1972-76)
Transfers to Individuals	AR	NO	YES	PE ²	S	AR	NO	YES	PE	S
Equipment Subsidies	TPR	NO	NO	NE	N	TPR	NO	NO	NE	N
GFCF ³	PR	YES	Periodic- ally	PE	S (1952-65) D (1966-71) N (1972-76)	PR	YES	Periodic- ally	TE	D (1952-71) N (1972-76)
B. Revenue⁴										
1. Autonomous										
Direct Taxes										
Personal	-	YES	YES	PE	S	-	YES	YES	PE	S
On Profits	-	YES	YES	NE	S	-	YES	YES	NE	S
Indirect Taxes	-	YES	YES	AE	S	-	YES	YES	E	S
2. Current Transfers from Other Levels of Public Administration	-	-	-	-	-	PR	YES	NO	NE	N

1 Column 1 indicates whether the category of expenditure considered is: highly recurrent (TR), fairly recurrent (AR), fairly non-recurrent (PR) or very non-recurrent (TPR). This classification is based on the results of recurrence tests. The second column indicates whether the instrument (expenditure or income) can be utilized for purposes of stabilization. Column 3 asks the question, "Was this instrument regularly used for purposes of stabilization?" Column 4 indicates whether the instrument can be used for stabilization purposes effectively (E), fairly effectively (AE), not very effectively (PE) or ineffectively (NE). Finally, the last column summarizes the effect of using this instrument in the past on the economy; there are three possibilities here: the instrument may have a stabilizing or countercyclical effect (S), destabilizing or procyclical (D), or neutral or undetermined (N).

2 The handling of transfers to individuals in a discretionary way cannot be effective for purposes of stabilization because of the tendency of these modifications to become permanent. On the other hand, we do not deny that as an automatic stabilizer these expenditures play a very effective role at the federal level.

3 The only case in which the municipal sector in co-ordination with the provincial sector was able to use its spending for stabilization is that of GFCF. As indicated in the text, however, this type of expenditure has an undetermined behaviour at the national level.

4 In view of our analysis, the recurrence test is useless for revenue (the test was conducted, however, for transfers to the provinces from the federal government, since this is a federal expenditure).

Secondly, a body responsible for the regionalization of tax policy would have been able to inform federal authorities and draw their attention to the economic situation in Quebec -- and the other provinces -- at the moment when the latter intended to introduce restrictive measures. Such an agency could also have warned of the disastrous consequences of the federal anti-inflation policies on a regional economy where no true inflationary pressures existed and where the participation rate was already well below the national average.

Such intervention would have been able to modify the orientation of Canadian policy or at least reduce an anti-inflation policy's adverse effects if it had still been applied by Ottawa.

Our analysis also shows that, while the federal government did not technically regionalize its fiscal policy, it nonetheless showed a real concern for regional disparity problems in the management of its fiscal policy. But the means of intervention proposed to compensate for these disparities -- for example, the declared intention of using DREE programs to lessen the harmful effects of the national policy at the regional level -- did not make it possible to regionalize the effects of the stabilization policy.

1.4 The Quebec Government's Performance

Our analysis also reveals that the Quebec government never used the major fiscal lever at its disposition to support the federal stabilization policies or, in some cases, to lessen the adverse effects of these federal policies. The provincial authorities have, upon occasion, mentioned the possibility of using their taxing power to stabilize the regional economy but have never actually done so. The orientation of Quebec's fiscal policy since the early 1950s has often been procyclical and sometimes has even reinforced the harmful effects of the federal policy. In 1969, for example, when the province reached the trough of a recession and the federal government began its crusade against inflation, the Quebec government took no step to stimulate its economy and even exerted a slightly deflationary action through a cut in its budget deficit.

However, the 1975 recession constitutes an interesting experience for Quebec because it allows us to complete our conclusions on the postwar fiscal policies. This experience indicates first, that regionalized fiscal policy could effectively help to stabilize the economy of a province such as Quebec; second, that the utilization of expenditure on public infrastructure, while effective in stabilizing the economy, raises the problem of bottlenecks whose inflationary effects may be aggravated by provincial labour legislation.

When Canada was experiencing one of the most severe postwar recessions, the moderately expansionist fiscal policy of the federal government in 1975 was combined with a strong growth of public

infrastructure spending in Quebec. While the gap between unemployment rates in Quebec and the rest of Canada widens during a recession -- in direct proportion to the seriousness of the recession -- this large increase in public spending resulted in the participation rate disparity registered in 1974 remaining steady in 1975. The growth rate of employment in Quebec in 1975 was roughly the same as that in the rest of Canada. This fairly exceptional behaviour of the cycle in Quebec tends to illustrate to what extent a regional stabilization policy can be effective.

We must remember, however, that this was not the result of policy co-ordination between the three levels of government, but rather coincidence. In previous years, the three levels of government had begun various public infrastructure projects that, by 1975, had strongly stimulated activity in the construction sector and, indirectly, in the entire Quebec economy.

Unfortunately, the infrastructure expenditures for the Olympic Games created considerable inflationary pressures. The fact that the project imposed delivery of the infrastructure by a precise date, plus the characteristics of the decree system used in the Quebec construction industry, created a twofold monopoly situation in this sector. One buyer -- the organizing committee and, therefore, indirectly, the provincial government -- and one supplier -- the construction unions -- confronted each other over the renewal of a collective agreement that, through the decree system, would apply to all workers in the sector for a period of three years, extending well beyond the closing of the Olympic site.

In 1976-77 these escalating construction costs began to hit the Quebec economy -- the growth of these costs has been partially responsible for the slowing of investment in Quebec since 1975. Moreover, the extensive borrowing that the Quebec government was forced to undertake in 1975-76 to finance the Olympic games reduced the province's borrowing power at a time when the Quebec economy still needed fiscal stimulus.

1.5 A Few Important Principles

Quebec's experience in 1975 reveals a few principles that should be followed in managing a regionalized fiscal policy:

- Close co-ordination between the three levels of government is essential in the utilization of GFCF expenditures in order to avoid bottlenecks in certain subsectors of the construction industry.
- The use of an infrastructure spending policy as a means of stabilization would require changes to provincial labour laws; a change to mechanisms such as the Construction Decree System appears essential in order to apply a stabilization policy through GFCF. For example, the use of *ad hoc* contracts for

particular projects with construction workers allocated to this project could be one way during a recession of avoiding excessive pressure on wages in the construction sector;

- When provincial and municipal capital expenditures increase, the provincial government should have access to a special source of financing so as not to affect its normal flexibility in financial markets following the stabilization measures.
- Finally, a major increase in public infrastructure expenditures for purposes of regional economic stabilization raises the problem of the social return on public investment projects. There can be no justification for stabilizing the economy with projects that do not contribute to the development of the economy's productive capacity. We cannot afford to stabilize the regional economy at any price by digging holes as suggested by Keynes. What is needed is a cost/benefit analysis conducted on a continuing basis by the three levels of government so as to develop a series of projects that could be undertaken during periods of economic slowdown.

2 ECONOMIC STABILIZATION AND REGIONAL DISPARITIES

Doubt has long been expressed over the effectiveness of stabilization intervention at the regional level even if public spending, apparently the most effective instrument, were used. In particular, it has been argued that the flight of funds would be too large for an increase in public expenditure during a recession to have a significant effect on regional employment.

However, studies of interregional flows in Canada in recent years have tended to disprove these doubts over the efficiency of regional stabilization policies. It has been demonstrated, in particular, that the results of a regional stabilization policy are highly dependent on the nature of the expenditure injected into a regional economy. If, for example, we increase transfer payments to households rather than public GFCF, the regional multipliers drop significantly.

Moreover, government expenditures in any given region generally have a larger multiplier effect when the labour content is high and the required supplies, equipment, materials, etc. are, for the most part, locally made. A special chapter attempts to evaluate the relative effectiveness of the different government levels in stabilizing the economy and to determine what type of intervention is most effective for each individual government.

2.1 Relative Effectiveness of Various Budget Measures

We have attempted to evaluate, through an input-output table based on 1977 labour market data, the amount of expenditures (or tax cuts) that government should inject into the Quebec economy to reduce the provincial unemployment rate by one percentage point during the fiscal stimulus's first period of economic impact.

The effectiveness of a fiscal measure was measured in man-years of employment created by the treasury expenditures, with account taken of the fiscal receipts generated by direct and indirect purchases of goods and services.

The reduction by one percentage point of the 1977 unemployment rate in Quebec would have required the creation of 37,000 jobs. We, therefore, computed the amount of public funds that would have had to be injected into the economy to create this number of jobs during the first initial impact period. The results are presented in *Table 2.1*.

These show that expenditure on goods and services is more effective than that on GFCF in creating jobs in the initial period. Except for the federal government, the amount of expenditure on goods and services required to reduce the unemployment rate by one percentage point is less than the amount of GFCF required. The former is a more effective stimulant, primarily because of the very low import content and the important role of wages in these expenditures. It should be noted, however, that this type of expenditure, with a high wage content, does not meet our criteria of non-recurrence and would thus contribute over the long run to an increase in the government's share of the economy.

Expenditures on goods and services are most effective at the provincial level in stimulating employment, followed by the municipal, and finally the federal, levels. The net cost to the provincial treasury over the initial period would be 88 per cent of the original cost, so that the 37,000 jobs would have cost the province \$700 million. To obtain the same impact on employment, municipalities as a whole would have had to spend some \$300 million more. The federal government in turn would have had to spend almost double the expenditures incurred by the provincial government to obtain the same impact on employment.

The ranking obtained for the effectiveness of *fixed capital formation expenditures* by levels of government remains the same. However, the differences between the amounts that must be spent by the various levels are substantially smaller. To create the same number of jobs, the federal and municipal administrations would have had to spend \$214 million and \$37 million more, respectively, than the provincial government. We can thus say that municipal spending is, for all practical purposes, as effective as provincial spending in stimulating the economy. The advanced technology of federal fixed assets results in a 22 per cent import content of the amount injected, while the same coefficient is about 16 per cent for provincial and municipal administrations. This, essentially, is why the federal government must spend more to obtain the same result.

Finally, we must note that the net cost of the expenditure of the federal government, taking into account the receipts generated in Quebec and the other provinces and the ensuing drop in transfer

Table 2.1
 Fiscal Measures Required to Create 37,000 Jobs (Man-Years) in Quebec
 (Based on 1977 Data)

Nature of the Measure	Income created by the injection		Expressed as a percentage of the initial injection	Final receipts Fed. Prov.	Net cost to the treasury Fed. Prov.
	Wages	Other Total			
	(\$ millions)			(\$ millions)	
1. Injection (Expenditure)					
A. Current Expenditures					
Federal	1,370	822	1,329	192	978 (71%)
Quebec	787.2	314.9	747.9	87	700 (88%)
Municipal	1,088	511.3	957.3	123	
B. Gross Fixed Capital Formation					
Federal	1,370	561.7	438	999.7	278
Quebec	1,156	566.4	358.3	924.7	130
Municipal	1,193	584.6	381.8	966.4	15.6
2. Tax Cut (transferred to households)					
Hypothesis A: Additional savings by households on temporary income -- 10 per cent	1,522				1,134 (74%)
Hypothesis B: Additional savings by households on temporary income -- 50 per cent	2,740	342.5	452.1	794.6	171
					2,549 (93%)

1 Takes into account the reduction in unemployment insurance and equalization payments.

payments, is less than the net cost to the provincial government, despite the fact that the federal expenditures are less effective, in the Keynesian sense, in creating jobs. This fact leads some people to suggest *a combination of expenditures at all three levels of government*, so as to minimize the net combined cost for treasuries involved. For example, if we assume that the capital expenditures are made entirely by the provincial government (or even in part by municipalities), and that the central government assumes 50 per cent of the financing of these projects, the net cost of the fiscal measure over the first period would be about \$890 million for the federal and provincial treasuries involved, a saving of \$135 million over the net cost of the provincial government acting alone.

The results of our analysis indicate that a *tax cut* is clearly less effective than an increase in public spending. Under the most favourable assumption -- that a tax cut would be spent in the same way as the households generally spend transfer payments -- the required tax cut is just as large as the injection of federal public expenditure required to create 37,000 jobs. This result is explained by the high import content of household expenditures: over 27 per cent terminates in other provinces or countries. If we assume that, *ceteris paribus*, consumers save an extra 10 per cent of their temporary income, the tax cut required to obtain the same result rises from \$1.3 billion to \$1.52 billion. Finally, if we assume that consumers save 50 per cent of their temporary income from the tax cut -- not an unrealistic hypothesis -- the necessary injection would then be \$2.5 billion, or more than double the federal expenditure necessary to obtain the same result.

Finally, the problems raised by consumer behaviour following the temporary drop in taxes serve as a reminder that the management of a regional stabilization policy should ideally take into account the interregional effects and be applied in the perspective of general equilibrium at the national level. If we wish, for example, to stimulate Quebec's economy without immediately exerting additional pressures on the Ontario economy, a tax cut obviously will not be the appropriate instrument to achieve this. Flights of funds to Ontario in the initial period could climb to more than a third of the fiscal stimulus, and would thus be capable of creating inflationary pressure in that province. On the other hand, an injection of public funds would limit a larger share of the effects to the designated province and flights would only occur in precise sectors and, even then, generally outside Canada.

2.2 The Causes of Unemployment Disparities in Quebec

Of the various regional disparities, we have retained the unemployment rate for two reasons. First, it is the most important aspect of the economic stabilization problem and the one felt most by the population of the underprivileged regions. Moreover, the unemployment disparity is one cause of a large disparity in income, which, in turn, determines a large number of other disparities.

Two traits characterize Quebec's unemployment compared with Ontario's or Canada's: the unemployment rate is always higher in Quebec than Ontario and the spread between the two rates varies over the business cycle. The persistent disparity in unemployment rates between the two neighbouring provinces is the result of two factors:

- a difference in the seasonal unemployment rate;
- and a gap that could be qualified as "structural," due in part to rigidities in wage determination (often found only in Quebec), and to an obvious lack of mobility in Quebec's labour force.

The authors generally agree that the difference in the seasonal unemployment rate accounts for half a percentage point out of the three-point disparity in aggregate unemployment between Quebec and Ontario.

In turn, wage flexibility is largely offset by particular labour market conditions occurring only in Quebec. In fact, various regulations are unique to Quebec. Of particular interest are the decree system for collective agreements that affects an average of over 200,000 employees, labour relations in the construction industry, terms of application of the minimum wage act and a collective bargaining system in the public and parapublic sectors unlike any other in Canada. All these unique regulations in Quebec have combined simultaneously or at various moments to reduce the efficiency of the labour market and prevent wages from reflecting real labour market conditions in the province.

It should also be remembered that Quebec, like other regions of Canada, is evolving within a country -- a continent, even -- in which some factors prevent wages from truly reflecting regional labour market and productivity conditions. Some examples are the wage policy of the federal government, Crown corporations and major national and U.S. firms that often provide practically identical working conditions for all employees regardless of their region of employment. In this same vein, we could also mention union demands for wage parity across the country and, in some cases, between Canada and the United States.

Faced with this relative wage rigidity between regions, we can now count only on worker mobility to lessen regional unemployment disparities. But here the second unique aspect enters the picture: Quebec's population is still 61 per cent unilingual francophone, and the province, therefore, has a culture, religion, and even history that are different from those of the majority in the rest of Canada. It follows that the personal cost of mobility within Canada for most Québécois is considerably higher than for other Canadians. To this add a very generous federal unemployment insurance policy that further reduces the benefits of moving to find work, especially when the unemployed worker lives in a region of high unemployment.

We thus find that two sets of phenomena combine to explain the persistence of higher unemployment in Quebec than in Ontario.

Aside from this disparity between unemployment rates in Quebec and Ontario, which can be considered as a constant, we find that the sensitivity of the unemployment rate to changes in aggregate demand is greater in Quebec than in Ontario. For a region such as Quebec, whose participation rate is traditionally below the national average, an expansionist policy based on the national average of economic indicators will not generally provide sufficient stimulus in periods of sluggishness. In periods of inflationary pressures, a restrictive federal policy may, on the other hand, take effect too soon for Quebec or may apply too much braking power.

2.3 Unemployment Disparities and Economic Policies

Reduction of these disparities in the unemployment rate between Quebec and Ontario could arise from an increase in the efficiency of the labour market through elimination of obstacles to adjustments of relative wages and from an increase in incentives for mobility. This solution would require, however, that the federal and provincial governments take regional conditions into account when drawing up their wage policies.

It would also be necessary to convince unions to give up their demands for wage parity. By facilitating the adjustment of relative wages, these measures would reduce the problem of regional unemployment disparities. In addition, the federal government should increase the benefits of mobility by cutting back unemployment insurance benefits and sharply boosting mobility bonuses.

But even if the different levels of government gradually adjusted their wage policies to take greater account of regional conditions, the strict application of the above-mentioned policies is highly unlikely for political reasons.

Of greater importance, however, is the fact that any solution dependent on labour force mobility to solve the problem of regional unemployment disparities between Quebec, Ontario, and the rest of Canada has always been, and will always remain, unacceptable to the Quebec elite, and perhaps the Quebec people as a whole. Any significant emigration of francophones from Quebec not only reduces the province's political weight in Confederation, but also threatens the survival of Quebec's culture.

The other theoretically possible solutions are based on a different approach, consisting of economic policies designed to create jobs mainly in areas with a high concentration of unemployed workers.

A set of restructuring and development policies for the Quebec economy, as well as policies aimed at increasing the skill of Quebec's labour force by promoting faster growth of productivity, would undoubtedly boost the equilibrium level of employment in this province under prevailing wage conditions. While generally considered as medium- and long-term policies, these could very well be partially tied to stabilization policies in a different context.

Furthermore, stabilization policies that would stimulate aggregate demand to varying degrees in different regions could, among other things, help to reduce disparities in the natural unemployment rate. These policies would have two beneficial effects: the first short-term, resulting from a better adjustment between the particular economic situation in Quebec and the stabilization policy aimed at maintaining the economy as close as possible to full employment; the second longer-term, a reduction of disparities in the unemployment rate through the gradual reduction of inter-regional differences in productivity.

As previously noted, these differences in productivity are a source of unemployment disparities because of a strong trend toward wage parity. How can a regionally differentiated stimulation of demand affect differences in productivity? The assimilation of technical progress through the activity of producing and increases in the quality of labour are two important factors in the growth of productivity. The rate of assimilation of technical progress depends in large part on the rate of renewal and growth of capital stock, which is a function of aggregate demand conditions. Thus, a particularly strong and persistent stimulation of demand in regions with high unemployment should eventually lead to a considerable improvement in productivity and finally in the equilibrium employment level of these regions.

However, these policies would not have a truly lasting effect on employment through productivity unless wages in the underprivileged regions continued to rise at a slower rate than in other regions, despite the fact that the unemployment rate had abandoned past trends. This danger is even greater since workers and unions would have become accustomed to high rates of unemployment and would, therefore, view the sudden drop in unemployment rates as the ideal situation to push for higher wages. Concerted action by the major social partners is therefore essential to the success of such a policy.

2.4 The Canadian Dilemma

In the postwar period, the federal government has traditionally assumed responsibility for stabilization in Canada. The provinces, in turn, have generally refused to intervene in this field, arguing that they had no access to the central bank and thus had neither the means nor the financial instruments to stabilize their economies. In addition, they also cited the problem of flights of funds to other regions.

Consequently, interventions by the provinces to stabilize their economies have been limited to a few precise cases.

2.4.1 The Responsibility for Stabilization

A set of arguments could be advanced to show that *in a federal system* the primary responsibility for stabilization must fall to the central government.

- Even if regional segments of demand are stimulated in such a way that interregional flights are minimized, there will still be significant "overflow" effects on other regions. However, the federal government is the only administrative level capable of recuperating part of these flights through its fiscal policy.
- One of Canada's main problems is the disparities in unemployment rates. While some regions are, for all practical purposes, in a full employment situation, others (all those east of Ontario) continue to register very high unemployment rates. The rate of output must, therefore, be held down or, perhaps, even decreased in low-unemployment regions while it is accelerated in high-unemployment areas. However, since regions are inter-related, the stimulation of demand in high unemployment regions should be accompanied by a more restrictive tax policy in low-unemployment regions to avoid overheating and inflation. In our opinion, only a responsible central government, by citing the national objective of its intervention, could apply such a policy.
- Finally a stabilization policy requires that the government responsible be capable of carrying a considerable budget deficit over a long period of time. Under present circumstances, this obligation would pose major problems if the provinces had the main responsibility for stabilization, mainly because they do not have use of the monetary instrument.

It would thus be an illusion to think that, in a federal system, one or more regions could take on the *primary* and *main* responsibility for stabilization of their own economy.

In view of this, a new organization of Canada's stabilization policies would absolutely require that we distinguish between the technical capacity for stabilizing intervention by provincial governments, and their ability to finance these interventions, including the consequences of such financing on the provinces.

We must, therefore, draw up an arrangement for stabilization policy that makes maximum use of the provinces' existing technical capacity for intervention, that retains the federal government's co-ordinating role and that prevents provincial interventions from having indirectly negative effects on the economies of other provinces.

2.4.2 The Provinces' Fiscal Lever

A detailed examination of public expenditures in Canada (Table 1.1) and Quebec has clearly indicated to us that non-recurrent expenditures on GFCF are made primarily by provincial and municipal administrations. The classification used in the national accounts was retained for this first section.

To obtain an even clearer picture of the influence of provincial governments, we must go beyond the national accounts and attempt to retrace the various investments that depend in one way or another on the provincial government. This exercise was carried out for Quebec and the results appear in *Table 2.2*.

The proportion of total investment excluding housing made, authorized or subsidized by the Quebec government, has been over 40 per cent for the last eight years. If we then add investments made by municipalities, the government share exceeds 45 per cent of total investment in Quebec. Thus, the Quebec government's powers under the present constitution give it quite considerable influence over the cyclical behaviour of the regional economy, since it can exert a certain measure of control over at least 45 per cent of the investment made within its jurisdiction. Appropriate planning of direct or indirect public investment would allow the Quebec government to take contracyclical action within the province. If we assume, for example, that approximately 10 per cent of the total investment can be delayed or speeded up for contracyclical purposes, approximately one-half billion dollars in investment could be utilized for stabilization purposes on the basis of 1978-79 data. On an annual basis, according to the calculations already performed (Section 2.1) this amount could reduce the unemployment rate by 0.5 to 1 per cent, if we take into account the effects of respending over the year in which the funds are first spent.

In view of this appreciable impact, the Quebec government (nor any of the other provinces in all probability) cannot feign an inability to exert contracyclical influence on its own economy through normal budget operations.

It should be remembered, however, that the analysis of the last fifteen years' experience tends to indicate that this influence has generally been neglected. In fact, we have demonstrated that the Quebec government has generally amplified the harmful effects of federal fiscal policies in Quebec (particularly during the 1960 and 1970 recessions). Ottawa's stabilization policy, therefore, does not deserve all the blame for aggravating the economic fluctuations in Quebec.

Table 2.2
Investments Made Directly or Indirectly by
the Quebec Government

	1971	1972	1973	1974	1975
	(\$ millions)				
I (a) Government Investment ¹	466.3	491.4	527.4	628.0	752.5
(b) Subsidies for Investment ²	205.7	212.8	206.6	265.0	228.7
(c) Authorized Investment ³	328.2	446.1	617.9	661.2	888.3
(d) Hydro-Quebec and James Bay Energy Corporation	388.0	450.0	550.7	616.0	1,142.0
(e) Olympic Facilities					910.
	1,388.2	1,600.3	1,902.6	2,170.2	3,921.5
II GFCF of Local Administrations	461.	448.	522.	598.	603.
III Private Residential Construction	892.	1,006.	1,223.	1,555.	1,695.
IV Total GFCF	4,145.	4,823.	5,846.	7,424.	9,013.
	(Per cent)				
Government GFCF/Total GFCF	33.5	33.2	32.5	29.2	43.5
Government GFCF/(Total GFCF- Residential Construction)	42.7	41.9	41.1	37.0	53.6
Government GFCF/(Total GFCF- Municipal GFCF)	37.7	30.0	35.7	31.8	46.6

1 Includes some purchases of existing assets; the amount is generally very small.

2 The amount invested could exceed the subsidy; part of this difference appears in line (c). The synchronization between investment and the year of subsidization can also vary slightly from year to year.

3 Same remark as 2 above, respecting the synchronization of investment.

Source Quebec budgets;
Quebec accounts and expenditures, Department of Industry, Trade and Commerce.

2.4.3 The Provinces' Financial Constraints

The year 1975 constitutes, as we have already stated, an interesting and exemplary experience. The increase of almost 40 per cent in investment made, subsidized or authorized by the provincial government, combined with the investment related to the Olympic games, has allowed Quebec to soften the effects of the North American recession: the disparity observed in Quebec's and Canada's 1973 and 1974 unemployment rates remained constant in 1975, although the Canadian economy was suffering a severe economic slowdown.

Although pure coincidence, the 1975 figures also illustrate the problems encountered by a provincial government single-handedly financing a contracyclical program. The Quebec government's relative ease in obtaining an additional \$1 billion beyond its normal financing needs proves that the financing flexibility of provincial governments is not as limited as previously believed. It was shown that a provincial government can markedly increase its borrowing on foreign markets at specific points in time, such as during the worst of a recession.

On the other hand, these same 1975 figures demonstrate that, in view of the particular nature of cycles in the Canadian and, particularly, the Quebec economy, a provincial government cannot use its own financial means to provide prolonged economic support over the usual full duration of a recession. The experience of the last two decades appears, in effect, to indicate that recessions in Canada last at least three years, and it can be argued that recessions in Quebec last even slightly longer. Stabilization policies, particularly in Quebec, should, therefore, be based on stimulation of demand over several years.

It was found that the exceptional borrowing required for the preparation of the Olympic games forced the Quebec government to impose fairly harsh restrictions in order to respect the conditions imposed by money-lenders. These restrictions produced a sharp decline in the growth of investment made, subsidized or authorized by the Quebec government, at the same time as a continuing period of contraction in the private sector.

The provinces must, therefore, have access to a source of financing other than traditional financial markets if they are to exert a significant stabilizing action on their own economy, and we have already seen that only the federal government has the financial and monetary instruments capable of supporting such policies.

3 A NEW ORGANIZATION OF STABILIZATION POLICY

Our analysis of the problem of stabilization in Canada and the disparities between regions leads us to propose a new organization of economic policy under which stabilization policy would become an important means of redistributing the nation's wealth and of modifying the economic structure of certain provinces over the medium and long terms.

We thus recommend a regionalization of stabilization policy in Canada. Before discussing the technical details of this regionalization, we should examine the question of interregional transfers involved in any regionalized stabilization policy financed by the federal government.

The federal government already oversees considerable transfers of wealth between Canada's regions. In addition, transfer payments between regions under the present system are not immediately evident because they pass through many channels: equalization; family allowance; old age allowance; unemployment insurance; DREE subsidies; other departmental subsidies; etc. Our proposal does not actually intend to increase transfers from one region to another, but rather to increase their economic effectiveness.

Under our proposal, transfer payments made for purposes of stabilization would also be designed to restructure the regional economies. Over the medium term, these stabilization policies would lead to a reduction or even a complete disappearance of some other transfers.

The major change in Canadian economic policy proposed here could, eventually, increase significantly the efficiency of the national system of redistributing wealth. Transfer payments to regions with lower productivity should, therefore, not increase significantly over present levels, but should become more effective by using new channels.

3.1 Creation of a Stabilization Fund

Our study of Canadian stabilization policy has revealed two points:

- The federal government controls the supply of money and possesses the independent financial resources that allow it to underwrite stabilization policies;
- The provincial governments do not have access to the central bank and the independent share of their income is much smaller than Ottawa's, particularly when we take into account the conditional transfers of tax points for personal income tax.

We believe this situation could be used for stabilization. Utilization of the fiscal lever available to the provinces for purposes of stabilization based on federal financing would make it possible to sidestep the problems faced by the central authorities in the area of stabilization instruments, as well as to meet the need for a regionalized stabilization policy in Canada.

The *Stabilization Fund* that would be made available to the provincial governments to finance their capital formation expenditures for purposes of stabilization would be entirely financed by the federal government.

Use of the fund by the provinces would be tied to certain procedures. The provinces would decide the nature of the capital formation expenditures on the basis of certain regulations, imposed particularly on interregional flows. The capital expenditures would be made by the provinces and any corporation, agency, or other level of administration responsible to the provinces. The amounts distributed to the provinces through the fund would constitute a transfer payment and would not, therefore, require any repayment.

Access to the Fund by the provinces would be controlled by a method related to economic indicators and calculations of the impact of capital expenditures on employment and output. This mechanism, therefore, assumes that the provinces and central government would keep close tabs on the growth of the economy and would make predictions on turning points in the economy as well as the duration and magnitude of recessions.

These forecasts should be made through an independent federal-provincial committee of politicians. Once this diagnosis is drawn up, the federal government, through arrangement with the provinces, would set objectives for the stabilization policy in terms of economic indicators such as the creation of a certain number of jobs in Canada and their regional distribution. Following this, the capital expenditures required in each region would be computed.

The formula for transfer payments to the provinces should be relatively simple, but a certain number of adjustments in the rules of accessibility to this fund would be unavoidable. For example, if a province had a particularly high fiscal burden -- the present case in Quebec -- a relatively larger amount of spending would be necessary to obtain the same results. Under these conditions, the amount transferred could not possibly achieve the predetermined objective for job creation, so the province involved would have to make up the difference. The province would thus have to accept this "price" or reduce its fiscal burden to the national average level.

Furthermore, the provinces would generally be free to supplement the moneys received from the stabilization fund in order to boost the target for job creation, particularly at low points in the recession. They would thus be able to decide whether an

additional injection of capital spending would create excessive inflationary pressure in their own economy.

Subsidy payments to the provinces to finance capital expenditures for stabilization raise questions concerning the social return on these investments and the co-ordination of stabilization policies with medium- and long-term structural policies. Obviously, the fund should not finance just any public infrastructure expenditure. Without conducting a precise calculation of cost-benefit analysis, we can reasonably expect the provinces and central government to agree on a fairly exhaustive list of "eligible" projects for the fund. Some notable examples are:

- the construction of transportation facilities;
- the development of infrastructures for industrial purposes;
- the part of capital expenditures paid by the state for reconversion of an industrial sector;
- anti-pollution equipment; and
- the construction of infrastructures helping to produce energy.

It would be particularly necessary to give priority to expenditures promoting the development of the potential output of a regional economy and forming part of a provincial or federal industrial strategy.

Among the particular advantages that we see in the establishment of such a fund are:

- The proposed mechanism should minimize typical delays in making problems known and getting decisions made. In effect, the fund would have its own "spending power" based on rules drawn up and passed by Parliament.
- The participation of provincial governments in setting stabilization targets and disseminating enlightened information on the economic situation of each region, should considerably reduce the problem of harmful fiscal policies at the national and regional levels.
- The federal government could also increase the automatic stabilization properties of its present means of intervention, such as reductions in taxes on profits reinvested during periods of slow economic growth.

The federal government would finance the stabilization fund in its entirety from its budget. When preparing its budget, Ottawa would receive an estimate of transfers for the current year. The fund would also have a credit margin guaranteed with the chartered

banks, which would allow it to make all transfers to provinces in the shortest time possible. Any use of this credit margin would be immediately repaid by the federal treasury through either a supplementary budget or the following budget.

Finally, there is no indication that the creation of this fund would increase the size of the federal government. It should especially be remembered that the effects of the stabilization policies would reduce other transfer payments. It was found, for example, that a drop of one point in the 1975 unemployment rate in Quebec would have reduced federal treasury payouts by \$154 million.

3.2 Some Implications of the Creation of the Stabilization Fund

The stabilization fund would give the provinces indirect access to the central bank since the financing of the fund would be integrated with the federal government's budget operations.

The creation of the fund would lead to an extensive reorganization of Ottawa's main expenditure items. As the fund itself should not result in an increase in the relative size of the central government, we can expect the federal government to transfer some budget items to the fund, while others would gradually disappear over the medium- or long term. This would be the case for:

- the Department of Urban Affairs;
- the various expenditures for job creation;
- all expenditures duplicating provincial budgets, such as the manpower training programs and some social programs; and
- the Department of Regional Economic Expansion.

This last budget item suggests another major implication of the creation of this fund: Ottawa and the provinces would be forced to agree upon a national economic strategy.

The creation and particularly the operation of the fund, would require the provinces to agree among themselves and with the federal government on how to co-ordinate their efforts.

CONCLUSION

Some federal transfers to the poorest provinces are now used to increase household demand or finance the current expenditures of the provincial governments.

However, transfers to households involve flights of funds to other provinces, particularly Ontario, and have no restructuring effect. The status quo favours the wealthiest provinces over the

long term and undoubtedly explains why they agree without too much complaint to participate in this process of regional redistribution of wealth.

Since the stabilization fund would also have restructuring effects over the medium- and long term, it would help to reduce the comparative advantage now enjoyed by Ontario. In addition, since transfers are aimed at financing capital formation expenditures, flights of funds to other provinces would be fewer.

We admit that a federal-provincial consensus on such a stabilization and restructuring system for the Canadian economy would be hard to obtain, but it is a question of recognizing that this may be the price that must be paid to keep Canada together and to achieve a considerable reduction of regional disparities over the medium- and long terms.

Comments by P. Fortin, Department of Economics,
University of Laval, Quebec

The final conclusions of the Rabeau-Lacroix study are that national stabilization policy since the middle fifties has lamentably failed to achieve a state of non-inflationary full-employment in Canada (and its regions), and, furthermore, that structural policies to reduce regional disparities have not altered the differential pattern at all. It is difficult not to concur with this judgment.

Their study attributes these failures to the fact that, more often than not, the wrong instruments have pursued the wrong targets.

Targets

Concerning stabilization targets they mention a number of years in which national policy was restrictive when it should have been expansionary (1960, 1969, 1977) or was expansionary when it should have been restrictive (1965, 1974). Again, I agree with their judgment in all examples. However, I suspect that the reason for this is that we share the same views on the relative importance of the social costs of unemployment and inflation. Perhaps the federal government, or even the Canadian public, thinks otherwise. If so, the question of what the socially desirable objectives of stabilization policy in Canada should be must be faced squarely. I am somewhat disappointed by the brief mention they make of this issue, but I understand their limitations in terms of space and time.

My own perception of the matter is that Canadian governments have recently been retreating from the goal of full employment for two main reasons:

(1) The social costs of unemployment have been downplayed. Nowadays, all unemployment is viewed either as voluntary, or structural, or demographic, or individually affordable given our generous unemployment insurance program and the rise of the multiple-earner family. This view is plainly wrong and socially dangerous. To be sure, there has been some increase in voluntary, structural and demographic unemployment since the middle 60's, but at least 30% of unemployment in Canada at this moment is still cyclical in nature and could have been wiped out by non-inflationary expansionary policies in the last 2 years. Moreover, even if individual jobless persons are compensated, society cannot be compensated for its unused productive resources which now cost in excess of \$15 billion a year in Canada as a whole.

(2) Other objectives have overridden the pursuit of full employment.

(i) Since 1975, just as in 1960 and in 1969, the federal government has launched a sterile crusade against inflation, forgetting at once the lesson of history and the results of two decades of hard economic research which have shown that inflation is very insensitive to high doses of unemployment, especially in a country like Canada which is so open to foreign influences.

(ii) Attempts to compress the share of the public sector in the aggregate economy have induced sharp reductions in the rate of growth of public expenditure in the last four years. This may be desirable from a structural point of view, but it has compounded the problem of unemployment, especially in view of the government's reluctance to cut taxes as an antidote. It has brought us back to a recessionary vicious circle à la Herbert Hoover or à la R.B. Bennett, despite the fact that the public sector deficit as a fraction of GNP has already been much higher at other times in both Canada and the U.S.

(iii) The maintenance of a stable or rising Canadian dollar up to the end of 1976, despite the important downward pressures on the currency already noticeable in 1974 through the extremely restrictive monetary policy of 1975-76, is also an indication that the government had chosen a cold-shower, unemployment-creating policy in 1975 rather than an employment-creating, currency-depreciation policy like the one it was finally forced to adopt in 1977-78.

I think it is time to restate clearly what the targets of stabilization policy should be in this country and how the available policy instruments should be assigned to the various targets. It is disgraceful that the Canadian discussion of macro objectives should have fallen to so low a level in this decade. My own suggestions are fourfold (following Mundell):

(1) Stabilize the exchange rate with the help of monetary policy so that we import foreign inflation on average, except when severe problems appear in the balance of payments (then depreciate or appreciate the currency).

(2) Reduce the unemployment rate in Canada to the 5.75-6% non-inflationary level with the help of federal fiscal policy. Experiment with tax-based incomes policy as President Carter is now doing to check whether lower unemployment rates could not be reached without accelerating inflation.

(3) Reduce the unemployment rate to about 7-7.5% in Quebec with the help of provincial fiscal policy.

(4) Reduce non-cyclical unemployment by providing seasonal employment alternatives, checking down accelerations in the minimum wage, reforming the UI program, adopting a more careful wage policy in the public sector and fighting against discrimination, protection and exclusion practices in the labor market.

Instruments

Rabeau and Lacroix also argue that the wrong stabilization policy instruments have been used. I am again in general agreement with their claim, although not totally with the specifics of what they say.

Their argument here is (1) that neither the federal nor the provincial governments have ever displayed any systematic preoccupation with the economic fluctuations specific to the regions; (2) that, despite its financial ability to incur large deficits, the federal government has been restrained in the stabilization field (i) by its fear lest any substantial decrease in its share of the income tax induce the provinces to steal this fat fiscal revenue source, and (ii) by the poor short-term efficiency of its policy tools; and (3) that, despite the high efficiency of their stabilization instruments, and their direct or indirect control over a third of aggregate capital expenditure, the provinces have been reluctant to realize budget deficits of the size needed in times of prolonged recession because the cost of borrowing is higher for them than for the central government.

The propositions that the regional business cycles in Canada are varied enough to warrant specific regional policy measures and that the provincial governments, if only because of their size and location, should be the main source of these measures, are not open to question. The longer the provinces postpone their systematic involvement in stabilization policy and continue to hold the federal government responsible for any slack or excess pressure in the economy, the longer Canadians will have to wait for an adequate anti-cyclical steering of overall economic policy and support the related welfare loss.

The federal government's fear of losing its income tax revenue to the provinces is justifiable. However, it would be good for this country to see more of this growth revenue in the hands of provincial and local governments. What we have now is a system of intergovern-

mental transfers which finances 25% of provincial expenditure and 50% of local expenditure. This system and most notably conditional transfers breed fiscal irresponsibility.

Rabeau and Lacroix also insist on the poor efficiency of taxes, current expenditure on goods and services and transfers as tools of economic stabilization. Temporary tax cuts or temporary surtaxes are said to generate low income and employment multipliers. Transfer and current expenditure programs are branded as recurrent expenditure which are quite inflexible in the short run. Therefore, they argue, stabilization policy should rely essentially on capital expenditure, which is the only instrument with both short-run flexibility and high income and employment multipliers.

I agree that capital expenditure should be one most important anti-cyclical tool, given only that it is harmonized with allocative efficiency. However, I find the authors' willingness to reduce stabilization policy to the exclusive manipulation of that instrument somewhat misleading. First, I think they have overestimated the rigidity of the expenditure budget and underestimated the efficiency of tax cuts. Second, it is the overall budget that has an impact on the economy. Governments include in any budget many temporary and permanent measures for all sorts of allocative and redistributive purposes, including decisions on capital expenditure. It would be strange to witness a situation in which only the latter would adjust to the needs of economic stabilization. Why not decide to advance or postpone temporary or permanent changes in taxes and current expenditure programs in addition to capital expenditure? For instance, why should we not have seen a postponement of current expenditure cuts and a rapid and permanent decrease in tax rates in the high and rising unemployment period from 1975-1978? In other words, I feel that their negative judgment on the empirical efficiency of tax cuts or raises is premature. And I submit that all policy measures, be they temporary as a capital expenditure or permanent as a change in a transfer program, should be scrutinized concerning the cyclical appropriateness of their timing.

Therefore, I believe it is true that the low percentage of capital expenditure in the federal budget reduces its stabilization efficiency, but I would refrain from exaggerating the situation in that respect. On the other hand, I side very much with Rabeau and Lacroix when they claim that the direct or indirect control by the provinces of more than a third of total capital expenditure is a definite proof of the immense potential of that level of government in the field of economic stabilization.

The problem that they raise here, however, is that of the high borrowing costs faced by the provinces, compared with the federal government, and the concomitant reluctance with which they plunge into important cumulative deficits in times of prolonged recession. I would have liked the authors to give a numerical estimate of the federal-provincial borrowing cost differentials and to check if, indeed, the disincentive to borrow provincially is real. I shall now do this for them. There are two things to note when considering the provinces' higher borrowing costs. First, they cannot borrow as easily as Ottawa on the short side of the financial market, which is generally less costly. This is largely due to the deep involvement of the banking system in the establishment of monetary policy and, notably, to the secondary reserve requirement imposed on chartered banks which provides the federal government with a captive market for 75% of its treasury bills. This reserve requirement is useless and should be wiped out. Second, the market charges higher interest rates to the provinces than to Ottawa for any bond issue with similar characteristics because it attaches a lower risk to federal bonds. This is due to the size of the federal government and to its pervasive involvement in the market through the central bank. These two factors account for various federal-provincial average interest rate differentials on the public debt across time and across provinces. In 1977 the Quebec-Ottawa differential was about 1.2%. What we need in principle is a scheme which will equalize federal and provincial borrowing costs at the margin, especially in times of recession.

But do interest differentials *per se* constitute a genuine disincentive for the provinces to incur deficits in slack periods? I have never seen any empirical evidence on this issue and, acknowledgeably, it would be hard to come by. One thing that we know is that since 1975 the cumulative budget deficit of the Quebec government has been of the order of 3.3 billions of 1978 dollars, which has been enough not only to maintain the full-employment (7.5%) budget surplus unchanged but even to decrease it somewhat. The Quebec budget has been gradually stabilizing every year since 1975, except in 1977. I think the importance of the recession would have required a quarter-billion-dollar additional deficit each year since 1975, which, at a 1.5% marginal borrowing cost differential, would have meant a permanent \$15 million dollar interest flow annually. Budget surpluses in future overfull-employment years could provide partial compensation for this. A federal-provincial interest equalization scheme might contribute to this stabilizing effort. Once again, I am not sure that provinces borrow less during recessions because of interest costs.

What I do know, however, is that if it is not more costly at the margin for them **to** borrow than for Ottawa, they will at least lose this excuse for not getting more actively involved in stabilization policy. Of course, one would also like to examine any equalization proposal on efficiency grounds.

Proposal

My remarks contain an implicit judgment on the authors' proposal for a Stabilization Fund. The Fund would transfer cyclical funds at no cost from the low-cost borrower and inefficient stabilizer - the federal government - to the high-cost borrower and efficient stabilizers - the provinces. The money would help finance capital expenditure projects contained in a list of admissible projects. The transfers would be generated from a reduction in other, "structural" transfer programs and/or from suppression of the DREE, the SDUA, the myriad of federal job creation programs, etc. They would involve no new additional transfers to the depressed regions from the have provinces. It is hoped that this scheme would help enhance the national and regional performance of stabilization policy and eventually make a substantial contribution to solving the structural disparities as well, presumably through the upgrading of manpower and equipment in the low income regions arising from a lower average unemployment rate there, and through the minimization of interregional import leakages brought about by the intensive use of the capital expenditure tool.

Rabeau and Lacroix's proposal is technically consistent with their premises. As I have said, I find that their emphasis on capital expenditure is pushed too far and their paper establishes no clear relationship between the size of the disincentive arising from higher borrowing cost at the provincial level and the size of the transfer scheme proposed. In fact, the authors are too modest to put any figures on the cost of their proposal to the federal government. But beyond that, if only a change in the nature, not in the size, of the transfers from rich regions to poor regions over a complete business cycle is involved, I see little net income and employment gains made by the poor regions in the long run, since there would be no incentives for higher federal or provincial deficits on the average. From a cyclical point of view, the proposal is equivalent to a switch from federal transfers to households to provincial capital information, and the balanced-budget multiplier of such a move is very low, something of the order of one-third of the usual government expenditure multiplier. Viewed upside down, this means that only a huge transfer scheme should bring an appreciable impact on the regional economies.

Furthermore, I doubt very much that the proposal of a stabilization fund will ever achieve political acceptability. The even more modest suggestion of Raynauld in 1971 involved only loans, not transfers, from Ottawa to the provinces. After a small trial in the early 70's it was scrapped outright by the federal government. There are three points to make here. First, it is extremely unlikely that Ottawa would abandon some types of expenditure it now controls in favour of additional transfers to the provinces, the use of which it would not control. Second, if Ottawa ever wants to put any condition on the use of funds, there will be still more inter-governmental battles, the likes of which we have seen too often in this country, and the Fund will never be born. And third, the very operation of the Fund, the choice of cyclical indicators and of their differential regional target values, and the examination of the economic outlook would, at best, be exercises that would breed repeated conflicts between Ottawa and the provinces and amongst the provinces themselves.

Summary

I conclude the following:

(1) The problem of stabilization policy in Canada at this moment is primarily one of ends and only secondarily one of assigning means to ends. I have tried to offer a few suggestions in this respect.

(2) Rabeau and Lacroix are basically right to give very low grades to the performance of stabilization policy in Canada in the last 20 years and to stress the need for a regional focus. But I find they have done some overselling of the propositions (1) that the federal budget cannot stabilize the national economy efficiently and (2) that the provincial budgets are severely constrained by borrowing costs in slack periods.

(3) The idea of a Stabilization Fund is most commendable, but its emphasis on capital expenditure is perhaps exaggerated; its link with higher provincial borrowing costs is not made clear enough; and its impact on the efficiency of regional stabilization policy is likely to be smaller than is claimed by Lacroix and Rabeau. Furthermore, I don't believe it is politically expedient for it to be implemented in the near future. I would personally prefer a federal provincial interest equalization scheme which would minimize the interfacing of the two levels of government and maximize the freedom of the provinces to spend where they want, with no federal interference, and the possibility for the provincial electorates to

judge their governments for their own stabilization efficiency.

The authors should be congratulated for the high quality of their study. I must thank them for the opportunity they have given me to go behind and beyond.

REGIONAL IMPACT OF SELECTED
NON-EXPENDITURES DECISIONS OF
THE FEDERAL GOVERNMENT OF CANADA

by

Fernand Martin

Department of Economics
University of Montreal

in collaboration with

A.R. Moroz

PART I

INTRODUCTION

Purpose of the Study

Balanced regional development would undoubtedly contribute to moderating strains within the Canadian Confederation, and unbalanced development to increasing them. It is against that background that this study was undertaken. The empirical research which it contains was done for the purpose of justifying the following proposition: non-expenditures or "pure decisions" are as potent for regional development (or lack of it) as expenditures decisions such as fiscal and monetary stabilization policies, provincial equalization payments, transport subsidies, exchange rate manipulations, etc. In other words, we plan to demonstrate that from a regional point of view "pure decisions" are in many cases an acceptable if not a preferable alternative to expenditures policies.

Non-expenditure policies or "pure decisions" are those federal government decisions which correspond to those policies that are not primarily implemented through its expenditures and/or changes in its fiscal or monetary operations. Specifically, they do not involve direct changes in the federal government fiscal aggregates; however, some expenditures might be incidental to their implementation. Pure decisions fall into three categories: (1) regulatory activities, including the setting of rates of the outputs of utilities, (2) international trade agreements and tariffs, and (3) the location of federal government footloose activities, i.e., situations where federal government activities such as its own administration activities could, without appreciable loss of efficiency, be located elsewhere than in Ottawa; similarly (under equivalent efficiency provisions), activities such as federal government purchases of goods and services.

Our proposition on the importance of pure decisions has two interesting implications:

- 1 The real cost of an explicit change in the fiscal aggregates of the federal government may not be the lost production of some other fiscal or monetary operation, but the loss of output which would result from the best alternative "pure decision."
- 2 Some regional absolute or comparative advantages (disadvantages) can be created by the stroke of a pen. A region's performance can be conditioned as much by "pure decisions" made by the federal

government as it is by the quality of the local natural and human resources and/or by the access to financial resources, etc.

A third major aspect of this proposition is that the resource cost, as well as the consequence of an expenditure action on the performance of other key variables in the economy, is not the same for a "pure decision" action as it is for most fiscal or monetary manipulations.

The above implications are only acceptable if we empirically demonstrate that the impact of a "pure decision" is spatially biased and that the regional impact can be considerable. Furthermore, the empirical work must support the proposition that regional consequences of the pursuit of a national objective differ considerably when a non-expenditure, as opposed to an expenditure policy, is utilized.

Canada's Past Experience with Pure Decisions

Non-expenditure policies are not a contemporary phenomenon. In the period of National Policies, which roughly stretches from 1867 to 1940, pure decisions were the cornerstone of the federal government's intervention in the economy. Three "basic national decisions"¹ characterize this period of Canadian economic history: Prairie Settlement; an All-Canadian Transportation System; and Industrialization by Protective Tariffs. While the last one is entirely a "pure" decision, the workings of the transportation system, at least with respect to rail rates, involved and still involves a large dose of "arbitrary decision and regulation by the state."

During the next twenty years, non-expenditure policies were displaced by changes in fiscal aggregates as the prime instruments of the federal government's policy arsenal. Known as the "Keynesian Period," the stabilization of the national economy by the use of macro-economic instruments became the major concern of the federal government. However, in the early sixties, the emerging regional disparities began to be more acutely felt and this led to a national commitment to the alleviation of spatial inequalities. The Keynesian doctrine remained as the basic rationale for policy actions, and the federal government resorted to Equalization Payments and an assortment of other regional development funds and agencies for needy regions. This culminated in 1969 with the establishment of the Department of Regional Economic Expansion (DREE). By the beginning of the sixties, Canada had entered an era of "Regional Awareness."

1 Mackintosh, 1967, p. 9ff.

"Regional Awareness" policies were first exclusively of the government expenditures type. Later, through DREE's mediation activities directed at other federal government departments (e.g., Transport), attempts were made to secure "pure" decisions favouring certain regions. Thus, by this time, the potential of "pure" decisions as a policy instrument had been rediscovered. The federal government had to have recourse to these measures partly to offset some of the adverse side effects, not only of the original national policies but also of the national stabilization policies.

The juxtaposition of regional goals with national goals, all this in a Keynesian policy framework, makes for very strange bedfellows, mainly because the mode of intervention to achieve regional goals has gradually moved from a state of compatibility with Keynesian policies (where regional goals were encouraged only by Equalization Payments and Shared Programs) to a state of near incompatibility where federal intervention is now directed at modifying the regional economic structure directly. In other words, when the "new" awareness of regional disparities was taken care of only with methods to ameliorate directly the per capita disposable income (e.g., through Equalization Payments), there was no fundamental incompatibility with Keynesian philosophy and, more importantly, with the pursuit of the original national goals. However, it gradually became apparent that trying to increase regional income directly by intergovernmental transfer payments had limited possibilities, and, more importantly, that it was very different in nature from an alternative set of regional policies attempting to buttress the ability of each region to create employment and high income on the spot. Indeed, in a federal country, there is a great difference between government policies that are oriented towards reducing regional income disparities and those that are directed towards reducing the regional differences in the ability of each region to embark on self-propelled development.² Simply reducing income disparities (when this is the only goal of regional policy) can be adequately dealt with by transfer payments (to alleviate short-run sufferings), financing emigration from depressed areas, and other similar measures. However, converting depressed areas

2 Many people refuse to recognize job creation within a region as a legitimate goal; they prefer national efficiency and thus prefer to encourage interregional migration of factors of production as the regulating mechanism. On the other hand, those who favour job creation on the spot prefer to speak about the ability to engage in self-propelled development on the part of the region. This removes part of the stigma attached to the policy of creating jobs for jobs' sake, without taking into account the quality of those jobs, or the "cost" of creating them.

into prosperous economic regions³ requires large structural changes which enhance or artificially create regional comparative advantages or eliminate the barriers to these advantages. It is the hypothesis of this paper that "pure decisions" offer an attractive and viable substitute to expenditure-oriented policies, and while non-expenditure policies do not eliminate the potential of tax rebates, transfer payments and decentralization of federal activities, they do provide a greater probability of success with less cost to the federal government, other regions, and the national economy.

To test the plausibility of this hypothesis, we use two examples: the Canada-United States Automotive Agreement and the impact on the flour and breakfast cereals industry of the regulation of railway freight rates in Canada. Despite their widely differing social importance, we believe that both examples support our thesis in a most convincing manner.

3 There are sociological, cultural and political reasons why development should occur in each region while not resorting to wholesale outmigration or transfer payments.

PART II

THE CANADA-UNITED STATES AUTOMOTIVE AGREEMENT

Introduction

The Automotive Agreement is a trade agreement made between the United States and Canada in 1965 which enabled automobile producers in Canada to import, free of duty, motor vehicles, parts and accessories as long as they satisfied certain conditions concerning the ratio of motor vehicle production to sales in Canada and the proportion of domestic value added in Canadian automobile assembly. The federal government also demanded and received "letters of intent" from the automotive assembly industry which pertained to the level of domestic value added in Canada. While these "letters of intent" are not part of the Agreement signed by the two governments, they constitute an important part of the arrangement.

Previous researchers (Beigie, Alexander and Wilton) have shown that great benefits have accrued to the Canadian economy. Our present study indicates that these benefits continued after 1971, the date with which the above investigators concluded their work. On the other hand, it now seems clear that the Automotive Agreement has increased the sensitivity of the Canadian economy to the U.S. business cycle.

The demonstration of our thesis outlined in Part I requires that we measure the net impact of the automobile agreement, first on the national economy (for a longer period than previous researchers), and then that we regionalize these results. We study the period from the inception of the Automotive Agreement in 1965 up to and including 1976.

The Net Impact of the Automotive Agreement at the National Level

The net impact of the Automotive Agreement is the difference between "what has happened to the Canadian economy and what reasonably could have happened in the absence of such an Agreement." This rewriting of history is, of course, a difficult job, but it is not completely arbitrary since we use a coherent general equilibrium econometric model developed by the Economic Council of Canada, CANDIDE Model 1.2M.¹ This model permits quantitative assessment of

1 We would like to thank Bobbi Cain and Tom Schweitzer of the CANDIDE Group, and Professor D.A. Wilton of Guelph University, for their valuable help and comments. However, the views expressed here are those of the authors, and not necessarily those of these individuals or the Economic Council. The following presentation is brief. Further discussion of the model and of the modeling of the Agreement in CANDIDE 1.2M as well as discussion concerning our differences with Wilton (1976) are available on request in A.R. Moroz, *The Auto Pact Study: Progress Report; The National Impact*; mimeo., June 1978, Economic Council of Canada.

the impact of structural changes, as well as of changes in fiscal policy, interest rates, the foreign exchange rate, etc.

In rewriting history in this way we follow what has become standard procedure in work of this type. First, we develop a "reference or control simulation." This is a set of tables which gives the model's estimates, for the period 1965 to 1976, of all important variables that are useful in describing the Canadian economy, ie. the gross national product, the consumer price index, the unemployment rate, etc. Then we develop alternative simulations, or scenarios, in which the influence of the automobile agreement has been removed. We choose several alternatives according to what government policies might have been followed in the absence of the automobile agreement, such as fiscal and exchange rate policies. We include as one possibility a policy of "no policy," or "passive government." Each of these alternative simulations is also a set of tables. Each set gives the model's estimates, again for 1965 to 1976, of what happens to all important economic variables under the chosen government policy. The difference between the control solution tables and the alternative scenario tables is the model's estimates of the effects of the automobile agreement on the economy. More precisely, it is the estimate of the effect of the automobile agreement relative to whatever government policy might have replaced it.

In choosing alternative scenarios we have tried to pick several plausible variants of the course of government policy and economic history that might have occurred in the absence of the Automotive Agreement. The choice of these scenarios must follow certain criteria, or we may end up being grossly unfaithful to history. For instance, we have ruled out other industrial policies that would have directly modified the Canadian industrial structure, because since 1965 the Canadian government has not (except in the Automotive Assembly Industry) been willing to change appreciably such a structure. Thus, there remains the realm of fiscal, monetary (interest rate), and exchange rate policies, or combinations of these. The main guiding criterion we used to produce the policies underlying the alternative scenarios was their effect on the annual level of the unemployment rate. We assumed that the rate of unemployment that has actually prevailed since the Automotive Agreement is one that the government would have tried to match even in the absence of an agreement, and we designed our alternative scenarios with this in mind. However, it soon became apparent that a rigid adherence to this criterion led, when ordinary fiscal policies were used, to unacceptable effects on other variables such as the balance of payments, the government deficit, etc. We therefore allowed a little more unemployment than in the control solution in order to achieve more acceptable results in terms of other variables. *

However, in our various scenarios the unemployment rate did play the role of a trigger setting in motion the government's intervention.

The fiscal policies that we have utilized for our alternative scenarios consist mainly of variations in personal income taxes and general federal sales taxes on consumer items, without involving, as Wilton (1976, p. 96) did, federal fiscal policies that would try, in a massive way, to influence *directly* private business investments. Our main reason for this choice is that the efficiency of fiscal policy designed to directly influence private investment has not been satisfactorily demonstrated.² In general, the effects of corporation tax rate changes, investment tax credits, etc.,³ are more uncertain than those involving personal income tax rates. Those who advocate influencing investment decisions through fiscal policies (or monetary policies) make the doubtful assumption that at any time and, more importantly, *anywhere* in Canada there exists an inexhaustible reservoir of worthwhile private projects at current interest rates.

A number of alternative strategies or scenarios were simulated, of which three are reported below. These are:

- (1) Alternative Strategy No. 4, which consisted of reducing the personal income tax by one percentage point from 1969 through 1976, and the federal sales tax by 2 percentage points from 1968 through 1976.
- (2) Alternative Strategy No. 6, which combined the fiscal policy in Strategy No. 4 with an exchange rate policy of setting the U.S.-Canadian exchange at its 1968 level for the entire simulation period, equivalent to a devaluation of 5 per cent over the period as a whole. This was done to ameliorate

*For the technically minded, we note that we used the concept of a disutility function as a guide to the formulation and acceptability of the alternative policy strategies. The arguments are real GNP, federal government deficit, current trade balance, basic current and capital account balance, unemployment rate, and the consumer price index. Details are available on request in a mimeo. by A. Moroz, "The Formulation of Alternative Strategies and some Results." Economic Council of Canada.

2 "Dans l'état actuel des connaissances, on doit considérer comme inefficace, une politique cherchant à affecter directement un investissement suivi" (Lacrois et Rabeau, 1978, p. 10, Chapter I.)

3 *Ibid.*, p. 9, Chapter I.

foreign deficits occurring under Strategy 4.

- (3) A "passive government" scenario, which assumed no change in the federal government's discretionary actions. This allows a measure of the maximum net possible impact that can be hypothesized for the Automotive Agreement. Strategies 4 and 6, in (1) and (2) above, assume that, had the Automotive Agreement not been concluded, the federal government would not have let the Canadian economy deteriorate as much as pictured by the "passive" or "*status quo*" scenario. But this eventuality, although very plausible, is not a certainty, especially if we examine the attitude of the government towards the present performance of the Canadian economy.

Table 1 shows the impact of the Automotive Agreement on Canada as a whole under the above alternative scenarios. Seven indicators (shown in Table 1) cover the main features of the impact on the simulated Canadian economy.

Consider first the passive government scenario. Although unrealistic in our view, this scenario is a useful benchmark. Real gross domestic product is annually about \$ 1 1/4 billion less in the nine years from 1968 to 1976, on average, as a result of eliminating the automobile agreement. There is also a 2 per cent annual loss in real wages. Unemployment goes up by nearly a percentage point in this nine-year period, though the rate of inflation rises less than half a percentage point per year. There is a serious deficit in government and foreign accounts.

Strategy 4, involving income and sales tax cuts, improves matters somewhat over the passive government scenario. It succeeds in generating nearly half as much gross domestic product, real wages, and employment as the automobile agreement. But the government and foreign account deficits are substantially worse than under the agreement. The performance on inflation is better, however, with the consumer price index rising less than half a percentage point per year.

Strategy 6 uses devaluation to try to offset the foreign account deficit problems associated with Strategy 4. This is partially successful, and in addition real gross domestic product and employment are improved in comparison with Strategy 4. They are still, however, not as good as under the automobile agreement, while the rate of inflation is worse, as are the other indicators.

Overall, the Automotive Agreement scenario is clearly superior to the three alternatives discussed. Indeed, it proved

Table 1
Impact of Various Policy Actions on Specific Indicators

Indicators or Targets	SCENARIOS		Replaced By	
	Control Automotive Agreement (What actually happened)	Non-Automotive Agreement:		
		Alternative Strategy No. 4 (Income Tax and General Federal Sales Tax Reductions)	Alternative Strategy No. 6 (Strategy No. 4 plus Devaluation)	Nothing (Passive Government)
(a) Real RDP (1968-76 average)	66.34	65.62	65.89	65.09
(b) Unemployment Rate (1968-76 average)	6.03	6.47 (Percentage)	6.26	6.83
(c) Rate of Change of CPI (1968-76 average)	6.72	6.05	6.90	6.24
(d) Federal Government Deficit (1968-76 average)	-0.42	-1.67 (Billions of current dollars)	-1.08	-1.12
(e) Current Trade Balance (1968-76 average)	-1.29	-2.03	-1.50	-1.60
(f) Basic Current and Capital Account Balance (1968-76 average)	0.47	-1.02 (Thousands of 1961 dollars)	-0.10	-0.82
(g) Average Personal Real Wages, Salaries, and Supplementary Income and Military Pay (1968-76 average)	4.97	4.90	4.89	4.86

impossible to find a scenario that, from the overall Canadian point of view as measured by variables such as employment, inflation performance, real wages, size of deficits, etc., was as good as the automobile agreement. A number of other strategies were simulated, involving larger and different types of tax cuts. We have not retained them for formal comparison because of the relatively large increases in both government and balance-of-payments deficits that they led to. For instance, we tried what might be called the "big bang" scenario.⁴ The results translated themselves into a larger level of real GNP for 1974-76 as compared to the Automotive Agreement; however, the government deficit is larger by 140 per cent in 1976 in the simulations and the deficit of the basic external balance would have required large corrective measures.⁵

In sum, a direct intervention in the economic structure of a country seems to be, from certain angles, a better way to stimulate the national economy, especially when the differences in federal government deficits are taken into account. The benefits of the Automotive Agreement include a larger level of real output, a higher level of real wages, a better external account, and less burden on the federal government. The cost is a slightly higher rate of increase in prices and, from detailed simulation evidence not presented here, a greater dependency of the internal economy on short-run U.S. economic conditions.

In terms of relationships with the rest of the world, the higher average real wage can be considered as part of the cost, and it is clear that this and the structural rearrangement of this relationship with the United States are important considerations. In our regional analysis this point will reappear, especially in the case of Quebec.

Finally, from the point of view of our research proposal, one important building block has been secured: we now know that pure decisions are significant, at least at the national level, i.e. the Automotive Agreement (a "pure" decision) has been revealed as a potent and plausible alternative expenditure policy.

4 In this strategy the income tax is cut to 15 per cent; the general federal sales tax on consumption expenditures is reduced to 9 per cent; the general federal sales tax on building materials and supplies is slashed to 5 per cent for the 1968-76 period.

5 The deficit on the external account increases approximately by \$3 billion in each of the last three years of the simulations and by approximately \$1.4 billion in the years 1971 to 1973.

*The Impact of the Automotive Agreement
at the Regional Level*

We have established in the preceding section that a "pure" decision like the Automotive Agreement can be as potent at the national level as rival expenditure policies and that, furthermore, the Automotive Agreement has two main characteristics:

- (i) Compared to the "passive" or *status quo* scenario, its net impact is very large.
- (ii) It is often superior to other more interventionist (comparable with the "passive" scenario) and desirable strategies.

Does this potency also apply at the regional level? To answer this question we have regionalized the national results obtained in section I at the level of the provinces. To expedite the matter we have computed the net impact only with respect to⁶ real domestic products. For each province and for selected years,⁶ we have subtracted from the RDP obtained for the Automotive Agreement (control solution) the various RDPs obtained through simulating three scenarios: the "passive" or *status quo*, Strategy No. 4, and Strategy No. 6. Another feature of our methodology is that our results can be provided not only by province, but by economic sector at varying levels of disaggregation (e.g., 31 manufacturing industries) so that more information is furnished for the detailed analysis of these provincial impacts. The method of regionalizing the national data (obtained in section I) makes use of the Inter-provincial Trade Matrix Data which is part of the 1966 Interprovincial Input/Output model constructed by Statistics Canada.

Analysis of the Results

Using data provided by the third panel of Table 2, one realizes that the potency of the Automotive Agreement scenario is great when it is compared to the "passive" scenario, and that, furthermore, this potency differs drastically among provinces. The annual average impact on Canada for the years selected is over a billion dollars. Nearly 90 per cent of this billion goes to Ontario, and correspondingly

6 Resources permitted regionalization for only six years. Comparison of the results for these years for Canada with those shown for RDP for all nine years in Table 1 indicates that Table 2 is, if anything, somewhat conservative in its implications concerning the order of magnitude of the regional distributional effects of the Automobile Agreement.

7 Our procedure is described in greater detail in A. Moroz, "Regionalization Methods for Automotive Agreement Study", mimeo., Economic Council of Canada.

Table 2
 Increase or Decrease in Real Domestic Product Attributable to the Automotive Agreement,
 by Region, under Three Alternative Views about What Might Have Replaced it,
 in Selected Years

(Millions of 1961 dollars)

Year	Newfoundland	Prince Edward Island			Nova Scotia	New Brunswick	Quebec	Ontario	Manitoba	Saskatchewan	Alberta	British Columbia	Canada
		Year	1968	1971									
Alternative Strategy No. 4													
1968	1.54	0.62	7.83	7.27	85.55	684.95	12.94	7.51	21.34	19.73	849.28		
1971	-1.67	0.19	2.22	4.46	47.10	846.94	7.62	-0.74	7.05	-2.09	911.68		
1973	-3.07	0.19	0.26	4.49	39.61	1,007.95	7.59	-1.18	5.95	-7.20	1,054.59		
1974	-14.59	-2.11	-27.54	-16.97	-227.33	142.05	-31.24	-32.32	-64.97	-93.88	-366.00		
1975	-10.29	-1.47	-18.95	-10.22	-149.09	369.59	-18.84	-22.48	-41.36	-86.15	39.74		
1976	-9.49	-1.23	-13.84	-5.46	-88.16	859.38	-12.43	-21.50	-31.75	-56.30	618.22		
Average of Selected Years	-6.26	-0.64	-8.34	-2.74	-48.72	651.81	-5.73	-11.79	-17.29	-22.88	516.00		
Alternative Strategy No. 6													
1968	1.54	0.62	7.83	7.27	85.55	684.95	12.94	7.51	21.34	19.73	849.28		
1971	-6.63	-0.62	-7.56	-3.05	-67.42	615.99	-7.74	-16.15	-21.39	-36.63	445.80		
1973	-9.32	-0.63	-10.42	-3.24	-106.68	711.31	-11.27	-21.05	-25.95	-41.26	481.49		
1974	-16.44	-2.21	-31.02	-18.16	-309.67	-21.22	-40.25	-46.25	-75.61	-89.15	-639.75		
1975	-11.82	-1.57	-20.31	-10.85	-208.09	235.07	-26.45	-33.17	-51.43	-68.44	-197.06		
1976	-8.66	-0.87	-9.99	-1.90	-100.46	818.34	-12.93	-26.69	-26.92	-42.05	567.67		
Average	-8.56	-0.88	-12.03	-4.99	-117.80	507.41	-14.28	-22.63	-29.99	-44.63	251.77		
Passive Government													
1968	3.06	0.93	11.01	9.85	116.71	749.09	17.44	11.51	30.29	31.28	981.17		
1971	5.76	2.05	18.94	18.07	209.62	1,137.32	33.13	24.07	56.91	62.01	1,567.88		
1973	1.79	1.58	11.44	13.67	151.02	1,186.23	25.43	16.71	40.54	37.84	1,485.45		
1974	-7.24	-0.11	-10.89	-3.20	-62.81	420.99	-4.93	-6.17	-13.51	-29.80	59.42		
1975	-3.41	0.46	-3.37	2.87	4.04	620.77	5.42	2.05	6.44	-5.54	629.73		
1976	-0.02	1.25	7.11	12.03	115.94	1,198.21	21.00	12.52	33.98	26.47	1,428.49		
Average	-0.01	1.03	5.71	8.88	89.09	885.44	16.24	10.12	25.78	20.24	1,025.36		

little to Quebec⁸ and the other provinces. On the other hand, a comparison of the Automotive Agreement with Strategies 4 and 6 shows even more inequality in the distribution of the effects of the Automotive Agreement among the provinces. The automotive agreement continues to have a positive effect in Ontario for every year except 1974. But it is a different story for Quebec, where the automobile agreement is less valuable than Strategy number 4 would have been for the years beginning in 1974, and then Strategy number 6 for the years starting in 1971. The overall effect for all years considered is an actual loss of real domestic product in Quebec when the effects of the automobile agreement are compared with Strategies 4 and 6 rather than with "passive" government policy. The same is true for every province other than Quebec and Ontario.

Another way to demonstrate the point that a "pure" decision such as the Automotive Agreement affects regions differently is to analyse the share of each province in the Canadian net impact of the Automotive Agreement (when compared to alternative strategies). By and large, whatever the scenario, the net Canadian impact is concentrated in Ontario. In the case of the net impact *vis à vis* the "passive" government scenario, the share of the net Canadian impact accruing to Ontario is (for selected years): 76 per cent, 72 per cent, 80 per cent, 149 per cent, 98 per cent, 80 per cent; while Quebec's share is, respectively: 12 per cent, 13 per cent, 10 per cent, negative, 0.6 per cent, 8 per cent. An interesting year is 1974 when all provinces are worse off than under the "passive" scenario, except for Ontario which still manages to gain, obviously partly at the expense of the other provinces. But 1974 is an exceptional year, so that over the entire period every province (except Newfoundland for some years) wins. Consequently, if we refer to the "passive" scenario, the Automotive Agreement is *not*, at the level of the provinces, a zero sum game: everybody wins.

When we envisage other plausible scenarios (No. 4 and No. 6), the picture is less clear, and the superiority of the Automotive Agreement in terms of increased output, employment, etc. is accompanied by pronounced regional effects. For Ontario, the Automotive Agreement is still preferable, whatever the alternative scenario envisaged, except for 1974 with respect to Strategy No. 6. Furthermore, its share of the Canadian gains, or more appropriately the ratios of its net gains over total Canadian net gains (in the case of Strategy No. 6) are as follows: 81 per cent, 137 per cent, 148 per cent, negative, positive gains, while Canada loses, and 139 per cent. This means that the Automotive Agreement is always

8 The ratio for each year of the net impact of the Automotive Agreement over the RDP of Ontario is, for the six years studied: 3.2 per cent, 4.4 per cent, 3.9 per cent, 1.3 per cent, 1.9 per cent and 3.1 per cent. For Quebec the corresponding ratios are: 0.84 per cent, 1.35 per cent, 0.84 per cent, negative, insignificant, and 0.57 per cent.

(except for 1974) more potent for Ontario than Strategy No. 6, and that for 1971, 1973, 1975 and 1976, the advantages for Ontario are greater than Canadian gains. This means that the potency of the Automotive Agreement is often compromised by a decided slip in potency for the other provinces when it is compared to Strategy No. 6.

From what precedes, it seems that the Automotive Agreement is necessarily a preferable scenario for Ontario and a much less desirable scenario for the other provinces, notably Quebec. But the matter is much more complicated than we have seen so far. In this respect five remarks are in order:

(1) Only two scenarios are absolutely certain: the Automotive Agreement and the "passive" or *status quo* scenario. Although Strategy No. 6 seems preferable for Quebec, because of uncertainty, it might still have been the choice of Quebec in 1965, because even for Quebec the Automotive Agreement is preferable to the *status quo*.

(2) The provincial results we have presented account for changes only in RDP. If other indicators are taken into consideration, the overall judgment might be different. We have shown in section I that Strategy No. 6 is inferior to the Automotive Agreement in many respects, notably as regards the level of unemployment. Since Quebec's unemployment level is usually higher than the Canadian level, that would have modified the value of this strategy for Quebec.

(3) Let us not forget that, except for 1974 and 1975, the Automotive Agreement (in RDP terms) is, at the Canadian level, superior to all other scenarios. Consequently, there is an overall surplus that could be (and probably was) redistributed to the other regions, which, because of distance or because of the characteristics of their own industrial structures, found (in some specific years only) the Automotive Agreement inferior to some other plausible strategies. In other words, to the extent that Ontario has been made richer by the Auto Pact, it has also contributed to the various transfer payments of the federal government to other regions.

(4) The implication of these results is not that "pure" decisions with characteristics similar to the Automotive Agreement should not be implemented, but that a whole arsenal of such "decisions" should be put to work in different regions because of their local and Canadian success.

(5) Finally, readers should bear in mind that our results come from the workings of two black boxes: CANDIDE 1.2M and Statistics Canada's Interprovincial Trade Data. To the extent that

these "boxes" produce imperfect results, especially because of the length of the period studied, one must interpret our results cautiously. Yet, we maintain that our results are of a better quality than "guesstimates" or other partial evaluations. We do not, however, pursue this line of inquiry because the purpose of this study is not to judge, *ex post facto*, whether the Automotive Agreement has been a "good" or a "bad" thing for Quebec. We wish simply to show that at the regional level:

- (i) "pure" decisions of the federal government are sometimes equivalent, if not superior, to fiscal, monetary or foreign exchange policies; for example, the case of Ontario.
- (ii) but that simultaneously, that same "pure" decision might be inferior in some ways to alternative (and equivalent at the Canadian level) fiscal, monetary and foreign exchange policies for other regions; for example, Quebec after 1971.

PART IIITHE ROLE OF RAIL RATES
IN THE LOCATION OF ECONOMIC ACTIVITY

The purpose of this part of our study is to stress the importance of major policy decisions in the field of railway transportation. These decisions either encourage or constrain regional economic development by making transportation costs an incentive (or a disincentive) for business firms to locate in certain regions. These decisions range from approving certain accounting practices (used to determine the variable costs that constitute both the floor below which railway rates must not go and the reference rate which can be increased up to 1.5 times), to authorizing the setting of rates according to what the traffic will bear (again up to 1.5 times the variable costs), to meeting competition and setting statutory rates such as the Crow's Nest Pass rate on grains and grain products.

These are "pure" federal government decisions because there are other **railway** pricing philosophies¹ which could significantly alter the rates being charged. These decisions also have important implications for the existence of regional comparative advantages. In this respect, Blackman (1977) contends that the western provinces are exploited:² "it is in reality a combination of geography and a transport system consisting of rail, trucks, and pipeline which makes this continued exploitation possible" (Blackman (1977) p. 45).

The upshot, according to Blackman and other writers, is that the Western region cannot industrialize except for a few activities not subject to returns to scale, these activities being able to survive within the region because of the protection of freight rates given to the local producers.

If the West has to increase its sales of finished goods in the central Canadian markets in order to industrialize, then railway freight rates will prohibit industrial expansion for one or both of the following reasons:

- (1) Distance;

1 See, for instance, K.I. Wahn, *Transportation and Industrial Development in Manitoba*, May 1973; or, The Government of Alberta, *The Equitable Pricing Policy, A New Method of Railway Rate Making* (1973).

2 See Blackman (1977), p. 414, for his definition of the concept of "exploitation".

- (2) Discriminating rail rates, i.e., rail rates that discriminate:
- (a) between raw materials and finished products;
 - (b) among shippers of the same product either according to direction of shipments, distance, or according to volumes of shipments.

The case of distance does not necessarily imply any "foul play" on the part of the "pure decisions" of the federal government because the federal government does not always have to suppress distance in a country as large as Canada.³

An interesting case for us is the discrimination practice of the railways. For instance, abstracting from space, western industrialization would be rendered difficult if the federal government decisions condoned railway rates (or forced railways to charge rates, i.e., Crow's Nest Pass rates) that would be unduly low on raw materials produced by the western provinces and very high on western-central region shipments of the corresponding finished products.⁴ Such a policy would condemn resource regions to remain resource regions indefinitely with little hope of industrialization based on local resources.⁵ The solution to this problem is, of course, for the western region to become a market; in order to become a market, however, it is necessary to industrialize. The western region is consequently faced with a chicken and egg problem. At least, this is the position of the

3 Consequently, it seems that Blackman (1977, pp. 415-16) has no ground to cite the case of "davit style lamppost" because it is obvious that, if both the market and the raw material (steel) are in central Canada, you cannot be competitive by incurring large freight costs even without rail rate discrimination, unless you provide exceptionally cheap labour and/or capital. However, there is one argument which could conceivably lead to a cry of "foul play" and that involves the West's perceiving one of the objectives or reasons for Confederation to be the elimination of distance as a factor in the location of economic activity. Specifically this argument would require the assertion that confederation includes the formation of a spaceless economy in Canada.

4 Neglecting cases involving large weight-losing production processes, etc. The case is reinforced if the production process requires intermediate inputs available only in central Canada.

5 A famous case is the one of *Rapeseed Oil* (Heaver and Nelson, 1977, p. 260).

representatives of the western provinces.⁶ As a follow-up to the Western Economic Opportunities Conference (held in 1973) where these claims were made, the federal government financed a series of studies to investigate these claims.⁷ For instance, the MPS (1975) study was made "to determine whether the cost of transport for inbound and outbound commodities for the same 'average plant' located in the Prairie provinces and in central Canada would significantly influence industrial development" (Heaver and Nelson, 1977, p. 56). Not unexpectedly, the MPS (1975) study found that industries trying to serve the Canadian national market in a central Canada location incur less transportation costs, the only reason for this conclusion (according to Heaver and Nelson (1977, pp. 56-57)) being the distance factor.⁸ If this is so, there is no room for "pure government" decisions having themselves, i.e., besides the distance factor, an impact on the location of plants through the freight rate structure. Consequently, in order to evaluate the possible impact of "pure" government decisions in freight rate matters we must distinguish among the total effects of freight rates, a distance effect and a rate of discrimination effect. This involves calculating the Effective Protective Rate (EPR) received by

6 See: "Freight rates exert an impact upon the location of economic activity because of weight and volume changes which occur during manufacturing or processing of raw materials into products. Rates thus usually encourage the concentration of industry at large population centres in Central Canada, or in a foreign country, instead of where the raw materials are located." (Government of Alberta, 1973, p. 10.)

7 Two of them have received some publicity:

(i) P.S. Ross and Partners, *et al*: *Two Proposals for Rail Freight Pricing: Assessment of Their Prospective Impact*. A report to the Federal-Provincial Committee on Western Transportation, 1974.

(ii) MPS Associates Ltd.: *Transport and Regional Development in the Prairies*. A report for the Federal Ministry of Transport, Vols. I and II, December 1975 (but released only in the Fall of 1976). This study is more extensive than ours. It consists of thirteen theoretical case studies in food products industries, metal products industries, and miscellaneous industries.

8 Apparently in this study, rate discrimination bears the name of "so-called rate anomalies" and has been either eliminated as a factor or averaged out! See Heaver and Nelson (1977), p. 57.

central Canada producers⁹ in two variants (for the same industry).

- (i) The EPR received on account of actual freight rates; and
- (ii) The EPR received on account of theoretical freight rates that would approximate the real full costs of moving different types of merchandise.

The difference between the two results measures the impact of "pure" government decisions in freight rate matters. The formula of the EPR in a simple case¹⁰ is:

$$\text{EPR} = \frac{[T_a \cdot F_a + T_b \cdot F_b + T_c \cdot F_c] - [T_x \cdot F_x + T_y \cdot F_y + T_z \cdot F_z]}{\text{Value added per unit of volume, the composite output}}$$

where T_a , T_b , T_c are the various tonnages of output that must be transported to central Canada; F_a , F_b , F_c are the corresponding freight costs that must be incurred. Freight costs are the product of freight rates multiplied by distance. In our calculations we used Regina as the typical location in the Prairies, and Toronto as the typical location for central Canada. Similarly, T_x , T_y , T_z represent the necessary inputs that must be imported from the Prairie region, and F_x , F_y , F_z , their corresponding freight costs. The unit of volume of composite output was one hundred pounds, comprising all the usual outputs in weights corresponding to their relative importance (in weight) in Canadian production.

Our main hypotheses are:

- (1) Every producing region must produce the different outputs in the fixed proportion (in tonnages) given by the Canadian production structure of the industry.

9 It measures the percentage increase in value added per unit of composite output of central Canada (or Ontario) producers made possible by freight rates. There is a vast literature on the subject. For instance, see: Waters II, W.G., "Transport Costs, Tariffs and the Pattern of Industrial Protection," *American Economic Review*, December 1970; Finger, J.M., and Yeats, A.J., "Effective Protection by Transportation Costs and Tariffs," *Quarterly Journal of Economics*, vol. 90, February 1976; Reinsch, A.E., *The Protective Effects of Domestic Rail Structures*, M.A. Thesis, Calgary, 1977.

10 A simple case is where all inputs are available in the Prairie region (if production is in the Prairie region) -- and most of the inputs must be imported from the Prairie region if production is in central Canada.

- (2) The same returns to scale are available and used everywhere.
- (3) In the calculations of real full cost rates, we assume that the cost of transporting different commodities is solely related to the type of equipment used (type of freight car used).¹¹
- (4) That the total costs of providing freight services correspond to the total freight revenues of the railways.

This approach is different from others in the following way:

- (a) We are *not* evaluating the viability of western region production.
- (b) Our method of pricing railway services does not involve (as the Alberta and Manitoba schemes do) federal government subsidies to balance the operating budgets of the railways. However, it does involve some redistribution of the freight costs among some commodities where the elasticity of demand for railway services does not intervene in any way.
- (c) Our study will not answer the question "is there a *general* rate discrimination against the Western region?" But if many cases (not yet studied) fall in the pattern of the results we obtained for SIC 105, our answer would be: "discrimination may not be "general" but it exists where it hurts, i.e., particularly in manufactured products linked to local resources, where the west is supposed to have a comparative advantage.

Ideally we should investigate all the industries in order to furnish the total amount of damages or benefits experienced by the Prairie region due to the freight rate structure designed under federal government rate-making rules. Lack of time and funds prevent this but it is not crucial to us since our purpose is simply to prove that federal government pure decisions, i.e., rate-making rules, have a regional impact. We will demonstrate our point by studying SIC 105 (Flour and Breakfast Cereal Products), an industry already studied by MPS Associates Ltd. Comparisons of results will then be possible.

11 A similar approach is used by the Government of Alberta (1973), p.22. Other experts consulted also agree that for a rough and ready estimate of operating costs such an approach can be used.

The Case of Flour and Breakfast Cereals -- SIC 105

Grains that are grown mainly in the Prairie region are the main input of this industry.¹² The outputs are mainly flour, breakfast cereals and feeds. In 1967, Ontario produced 36.7 per cent of the Canadian output of flour, 87.3 per cent of Canadian breakfast cereal output, or 45.4 per cent of the combined outputs. In 1974, Ontario produced 54 per cent of the combined Canadian outputs (in value terms). In 1974, it satisfied 90 per cent of its own needs for flour and breakfast cereals, while this proportion was 77 per cent in 1967. On the other hand, although the Prairies have the raw materials, they provided little of Ontario's needs for the finished products; not below 3.5 per cent in 1974 and probably 10 per cent in 1967, while Ontario satisfied the needs of the Prairies to the extent of 22.7 per cent in 1967 (mainly in breakfast cereals)¹³ and 23.6 per cent in both flour and breakfast cereals.

There are many reasons for this activity being in central Canada (urban external economies, propensity of U.S. firms to locate in Ontario, etc.). However, two reasons might be the protection offered by distance to central Canada producers and the structure of freight rates. As we have said before, this is measured by the EPR.¹⁴ The necessary data to compute the EPR are as follows.

In 1974, 67.4 per cent of Canadian output (measured in weights) of the Flour and Breakfast Cereal Products Industry (SIC 105) is in the form of flour, 3.8 per cent in breakfast cereals (32 per cent of them cooked and 68 per cent of them uncooked), and 28.8 per cent in the form of feeds. The inputs are 94 per cent in the form of grains, oil cakes and meals, and 6 per cent in the form of corn, peas, vitamins, cattle and dairy products, sugar boxes, etc. For our calculations, we hypothesize that, as far as Ontario producers are concerned, grains must be imported from the Prairies and the other inputs are available locally at no transportation costs.

12 Although some Ontario wheat is now available. Since we will work with the assumption that wheat is only available in the Prairie region, our results underestimate the true competitive position of the Ontario producers if they use some local wheat.

13 The data sources to make these calculations are Statistics Canada, Cat. Nos. 31-504 and 31-522.

14 Based on Statistics Canada, Cat. No. 32-228.

The nominal rates for shipment from Regina to Toronto charged by the railways on July 1, 1974 are:¹⁵

- \$1.29 per hundred pounds of grains and wheat flour
- \$2.25 per hundred pounds of cooked cereal preparations of grains and wheat flour
- \$1.29 per hundred pounds of uncooked grains and wheat flour
- \$0.584 per hundred pounds for feeds.

However, shippers can reduce the freight rate of shipping wheat and other grains to \$0.584 if they use boats to carry the grains from Thunder Bay to Toronto.¹⁶ It is assumed that shippers do so; it is also assumed that the feed travels by boat, and uncooked breakfast cereals move by rail.

The value added per one hundred pounds of output is established as \$2.4438. The results are as follows:

$$\text{EPR} = \frac{[.86946 + 0.16819 + 0.03333 + 0.02736] - [.54896 + 0]}{2.4438} = 22.5\%$$

The total amount of effective protection from western producers received by Ontario producers is thus \$18.5 million.¹⁷ This must

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- 15 The sources consulted were: Canadian Freight Association (Ottawa); Redma et Associés (Montreal); B.G. Baker, freight rate officer, CN Rail (Montreal); *Waybill Analysis 1974*; the MPS Associates Ltd. 1975 study; Mr. B. Hopkins, Canadian Livestock Association (Montreal). It should be noted that the rail rates for wheat and other grains to be exclusively used in the production of feed were approximately 54 cents; however, this is the result of the pricing policy of the railways to compete against boat rates for this particular demand for wheat.
- 16 Wheat flour or flour is not shipped by boat due to the high cost of handling, loading, unloading and sanitation. Prior to March 3, 1973, a shipper could save approximately five cents for every one hundred pounds off the rail charge for moving grains and grain products by using the rail and lake system; however, this was discontinued after this date.
- 17 Statistics Canada Cat. No. 32-228, Table 1, establishes at 84,102,000 the value added by Ontario producers of industry SIC 105. Multiplying this amount by EPR (i.e., 22 per cent) = 18.5 million.

be compared with their profits estimated at \$12.6 million.¹⁸ This means that without freight rate protection some Ontario producers would have to reorganize or relocate their production activities.

The effective protection is, consequently, rather important; however, this is for the most part due to the availability of an alternative mode of transportation for wheat and other grains from Thunder Bay to Toronto. In an "all rail" system the effective protection is only 3.8 per cent, and this protection is exclusively the result of the higher rate for prepared breakfast cereals and, more importantly, the availability of some of the inputs in both regions. It is evident that the Crow's Nest Pass rate system reduces drastically the cost of distance between Regina and Thunder Bay, and it seems that the railway's pricing policy almost eliminates distance as a location factor between the West and central Canada locations, when only the central Canada market is considered.

The effective protection, however, exists because of the availability of boats for moving wheat and feeds but not wheat flour and unprepared breakfast cereals. It is interesting to note that the boats in the Great Lakes system are subsidized and, with no charge for using the Welland Canal, it is suggestive that a "pure decision" is contributing to this protection and, furthermore, that a pure decision with regard to lake transportation contributes to eliminating distance as a locational constraint for the eastern producers.

This issue is further complicated by the pricing policy of the railways for the movement of wheat and wheat products from Thunder Bay to Toronto. While it seems that there is no apparent favouritism for finished products as opposed to inputs when costs are considered as opposed to rates, part of this protection, offered by the availability of boats, is due to the railway rates from Thunder Bay to Toronto¹⁹ being set significantly above the costs. Our full cost rates¹⁹ are calculated as follows:

18 There is no statistical source furnishing this information. However, the MPS Associates Ltd. study (1975) uses (p. 32, Table 3-2) an average of 14.5 per cent to estimate the ratio of net profit before tax over value added for a typical flour and breakfast cereal producer. We used this percentage to arrive at \$12.6 million of overall profits.

19 Our "full-costs" rate is based, among other things, on the same reasoning put forward in the case of an efficient rate structure as proposed in *Living Together*, pp. 199-200. Besides, rates are presented only for the purpose of regional analysis and are not alone a sufficient reason to suggest a change of the actual ones. Many other factors must be taken into consideration when rates are changed.

- (a) The cost of moving commodities depends upon the cost of the equipment in which it moves
- (b) Making an index (according to cost per car and the numbers of these different types of cars) for the eight types of cars used in Canada and applying it to the average cost of moving a ton-mile in 1975 (1.565 cents) and transforming that into rates per one hundred pounds per ton-mile we have the following rates:

Boxcar	= .08776¢ per 100 lbs. carried a mile
Flatcar	= .0553 ¢ per 100 lbs. carried a mile
Gondola car	= .0585 ¢ per 100 lbs. carried a mile
Hopper car	= .0715 ¢ per 100 lbs. carried a mile
Ore car	= .0683 ¢ per 100 lbs. carried a mile
Refrigerator car	= .1235 ¢ per 100 lbs. carried a mile
Stockbar	= .08776¢ per 100 lbs. carried a mile
Tank car	= .0845 ¢ per 100 lbs. carried a mile
Average car	= .0783 ¢ per 100 lbs. carried a mile

Wheat, grains and feed are assumed to travel in hopper cars, while breakfast cereals move in boxcars. On the basis of this, the full cost rate scheme, the effective protection for eastern producers is dramatically reduced to 4.8 per cent, as our estimate of the variable cost of moving grain and grain products (except prepared breakfast cereals) from Thunder Bay to Toronto is 57.2¢ per 100 lbs. This full cost rate rises to 70.2¢ if only boxcars are used; however, it is evident that the ability of the railways to set prices above their true full costs, which in turn are determined by accounting practices allowed by the government, results in an incentive to locate the processing plants in Ontario.

In short, pure decisions play an important role in the maintenance of effective protection. For the movement of these goods from the West to Thunder Bay, pure decisions reduce to almost nothing the differential effect of distance. Yet from Thunder Bay to Toronto, a number of pure decisions, as well as economic factors, result in a significant degree of protection for the central producers. By charging \$1.09 per 100 lbs. for grains and grain products for this latter journey, grain shippers have an incentive to move these inputs by boat. Consequently, the EPR enjoyed by Ontario producers has two causes:

- (1) Rail rates discrimination "from Thunder Bay to Toronto,"

- (2) The presence of an alternative mode of transport, whose competitive position is partly due to two federal government decisions—subsidization of the Canadian Great Lakes Fleet, and disregard of the cost of the Welland Canal.

PART IV

CONCLUSIONS

The results of this study should not be too surprising. Intuitively, under *ceteris paribus* conditions, in an economy as diversified as Canada and with widely separated regions, "pure" government decisions are overwhelmingly more potent on a regional basis than general expenditure policies. This is because they directly modify the industrial structure of a particular region, or, as in the case of discriminating rail rates, they directly modify the comparative advantages of regions, while federal fiscal and monetary policies (which at the moment are not regionalized) have only a diffused and runabout influence on local economic structures.

One explanation for this is that "pure" decisions can be better tailored to meet local conditions; furthermore, the transmission of local effects is short-circuited.

In the field of regional policy, it is much more effective to work directly on the economic structure or on the comparative advantages, and results are more assured through "pure" federal government non-expenditure decisions than through fiscal and monetary policies which, as Lacroix and Rabeau put it, have at the national level a highly uncertain effect on private investments. *A fortiori* (and the empirical testimonies we have offered in this study point in this direction), this statement should be true at the regional level.

Comments by M. Walker, Research and Editorial Director,
The Fraser Institute, Vancouver, B.C.

In his first sentence, Professor Martin asserts, "Balanced regional development would undoubtedly contribute to moderating strains within the Canadian Confederation." If this balanced development is achieved through national policy intervention, it will not necessarily have such a soothing effect. Although development potential varies from region to region, leading one to expect unbalanced development to be the norm, Economics tells us that the equilibrium situation within a free market area will eventually involve equal per capita incomes. When people are left to their own devices, the natural process of adjustment tends towards balance. If we take this assertion as a bench mark, it does not imply that GPPs will be equal for every province. It only tells us that differences must be compensated for by non-measurable income effects.

Every region comes equipped with an endowment of government policy, some regional and some national, whose objectives are often unfortunately at odds with the natural process of adjustment. Sometimes these policies involve territorial or population objectives which could never be attained if the market were allowed to operate freely. Thus, optimum development of the Maritimes and Quebec may involve out-migration and a consequent weakening of the local power base of their respective regional governments. The more highly developed recipient regions, on the other hand, must deal with the increased social pressures created by rapid population growth. Neither scenario is particularly attractive, and one solution has been for the "have-provinces" to bolster the "have-nots," in effect, to short circuit the natural adjustment process. Unfortunately such deals, insofar as they favour the faster growth regions and only seldom enjoy the unanimous consent of all the provinces, tend to prevent balanced development. They only exacerbate the development gap and put even greater pressure on the inter-regional transfer process.

In this brief digression from Professor Martin's paper, I have attempted to provide a bench mark - that a free market situation should naturally induce regional balance - and to indicate that government intervention may not facilitate balanced growth but frustrate it. Turning now to the paper, I should like to comment on three things in particular: on Professor Martin's taxonomic distinction between pure decisions and expenditure decisions, on his econometric evaluation of the Auto Pact, and on some of the wider implications of the kinds of solutions that political economists promote.

In terms of their economic effects, there is very little difference between pure decisions and expenditure decisions. Moreover, this suggested taxonomy confuses the real issues and cuts across policy categories instead of delineating them. The economic development of Quebec would obviously be hurt if one of its clothing manufacturers were put out of business by foreign competition. According to Professor Martin, the Federal Government can intervene and make either a pure decision, which would involve a quota, an embargo or some other non-tariff barrier, or an expenditure decision, which would entail an explicit subsidy to the firm and an increase in either the deficit or the general tax rates.

From an accounting point of view, the differences between these two choices are more apparent than real. The effect of the quota is simply to tax clothes buyers and give the proceeds to clothes manufacturers. The pure decision differs from the expenditure decision only to the extent that its tax and transfer do not go through the government's fiscal framework.

There are, of course, real differences. First, the quota benefits all clothing manufacturers, not just the endangered Quebec firm, and therefore costs more than a comparable expenditure decision. Secondly, this wide-ranging redistribution would probably cut across acceptable lines of tax equity. Finally, these two policies differ in the extent to which their costs are defineable. The actual cost and regional redistribution resulting from a pure decision is difficult to calculate, while the cost of a tax expenditure transfer is obvious and the inter-regional deal involved is explicit. Obviously, these two policies are not equally amenable to econometric simulation.

The third sort of pure decision mentioned by Professor Martin relates to the regional location of federal activities. Such expenditures do provide some "on the spot" stimulation, but federal agencies operating in lower income provinces often impose a higher wage sector with which local employers cannot compete. The introduction of this high income sub-sector interferes with local economic activity and, relative to the bench mark mentioned earlier, has a similar effect on migration. Thus, location decisions have many negative spill-overs on activity and cannot be regarded as costless.

With regard to Professor Martin's econometric evaluation of the Auto Pact, it is worthwhile to note that models are very much like sausages -- you like them much more before you know how they are made. I am especially sceptical about models which try to assess structural change. How does one really go about simulating the non-existence of the Auto Pact? It seems especially silly to assume that a reaction function with the unemployment rate as argument and tax rates as output could possibly reflect all of the changes that the

elimination of the Auto Pact would bring.

The Auto Pact has induced a regional redistribution of income from provinces which have no auto production to those which have. This is a redistribution relative to free trade in autos. If we wish to compare the Auto Pact to some tax expenditure pattern, then we have to know precisely what these income flows are in the case of the Auto Pact. The only way to calculate them is to use the free trade bench mark. I would conclude that the most interesting and important consequences of Professor Martin's simulation are not measureable within the confines of Candide.

Finally, I should like to look at some of the practical implications of the solutions we political economists have been suggesting. Professor Martin suggests that pure decisions are superior to expenditure decisions. I do not think the analyses in his paper prove this point, but the choice between these two sorts of policy generates two major concerns.

First of all, we should be concerned with the visibility differences between them. Since tax and expenditure policies are transparent as to incidence and first round effect, the "deals" struck during inter-regional bargaining are much more obvious. The other crucial difference between these two policies involves the extent to which they are each capable of serving the public interest. Cabinet government can make reasonably sound tax and expenditure decisions within the confines of a fiscal framework because the natural checks and balances of the adversary system ensure that different interests are represented. While such competition does not ensure that the best choice will always prevail, it does at least ensure some exposure to rival viewpoints. More importantly, Cabinet can be held responsible for its decisions because the effects of its policy are identifiable.

New regulations emerging from pure decisions do not generate this natural adversarial response unless the individuals affected have a concentrated interest. Moreover, the costs of these regulations are often hidden, which makes it difficult to assess their effectiveness. One could certainly question whether the recent regulatory changes related to foreign trade and agriculture are in the best public interest.

In closing, I would like to thank Professor Martin for his stimulating paper. I am sure you will find it useful in your deliberations.

THE EVOLUTION OF CANADIAN FEDERALISM

1867-1976

by

R. Durocher

Department of History
University of Montreal

The Parti Québécois victory on November 15, 1976 launched one of the most serious challenges that Canada has faced since 1867. How has Canada reached the stage where a provincial government representing more than one-fourth of the country's population holds as its stated objective the achievement of independence? This is a fundamental question for Canadians because the very existence of the country is threatened.

No one can doubt the seriousness of the crisis, even if the final outcome is still very uncertain and may remain so for a few years. The problem will not disappear on its own; even if the Quebec government loses its referendum for a mandate to negotiate sovereignty with association, the Parti Québécois would not disappear any more than the nationalists who run it and constitute its main driving force. Any possible succeeding government, even if it accepted the federal framework, could not break with Quebec's autonomous tradition, and would thus have to implement numerous reforms, involving difficult negotiations.

The present crisis is all the more serious because it has been mounting for some time, while some groups have chosen to deny its existence completely or at least play it down. Thirteen years ago, the Royal Commission on Bilingualism and Biculturalism wrote:

Le Canada traverse actuellement, sans toujours en être conscient, la crise majeure de son histoire, cette crise a sa source dans le Québec: il n'est pas nécessaire de mener une enquête approfondie pour le savoir (...) Quoique provinciale au départ, la crise devient canadienne à cause de l'importance numérique et stratégique du Québec, et parce qu'elle suscite ailleurs, ce qui est inévitable, des réactions en chaîne.

Well before 1965, this crisis had taken roots in the history of the country. It is a fact that the mythical vision many Canadians have of their history hardly helps them to understand the present. To begin with, Canada's history did not start with Confederation, nor even with the conquest in 1760, but with Champlain in the early 17th century. Furthermore, the relations between French and English Canadians have not always been peaceful: there was the military conquest in 1760, the 1837-38 rebellions, numerous ethnic conflicts, the conscription crises and, within Quebec itself, a situation in which the majority was dominated by the minority. Finally, Canada

has not always enjoyed an unalterable and sacred constitutional framework. From 1760 to 1867, it underwent five constitutional arrangements: the Royal Proclamation of 1763, the Quebec Act of 1774, the Constitutional Act of 1791, the Act of Union of 1840 and, finally, the British North America Act, which is deeply marked by the achievements and shortcomings of the preceding constitutions.

After studying the factors that led to the new constitution of 1867, we will analyse the nature of the B.N.A. Act. In the history of Canada's federalism, three major turning points stand out; to simplify things we will label them with three dates: 1896, 1939 and 1960. During this historical review, we will see how each period has solved the inherent problems of federalism such as power-sharing between the various levels of government, financing of the federation, the role of constitutional amendments and the judicial interpretation of constitutional change.

Canada's immensity and diversity have ruled out all but a federal political structure. Each province and each of the major regions in the country has its own particular physiognomy and has made specific contributions to the development of Canadian federalism. The political situation, the interaction of institutions and politicians, the economic situation, structural changes in the economy and changing relationships between the social classes in their fight for power are all elements that should be analysed to gain a thorough understanding of federalism.

In my paper, several of these dimensions will only be touched upon because of limitations of time and space. There is, however, one dimension that is paramount and that is Quebec's special role in the evolution of Canadian federalism. My reading of history has led me to believe that the most difficult problem facing the federal system is to reconcile Quebec's nationalism with Canadian national unity.

Canada is threatened with disintegration essentially because it has been unable to solve the Quebec problem. In the framework of federalism, Quebec has behaved as a province and a region in much the same way as the others. But Quebec has always been aware, with varying intensity depending on the period and the situation, that it constituted a distinct society and has intended to remain so. This national conscience has marked its relations with federalism and influenced the evolution of federalism.

History may help us to better understand the present national crisis since, as the political scientist Lucian W. Pye writes:

All political systems are deeply wedded to a particular place and time. The importance of the individuality of every policy means that its history is of enduring significance. Political systems cannot seek to advance by merely denying their past. Somehow or other they must seek to come to terms with what they once represented even as they take on new forms and new content.

I THE CAUSES OF CONFEDERATION

In the 1860s, the small English colonies in North America were forced to federate in order to survive in the face of an American colossus ten times more populous and infinitely richer and more dynamic, as was demonstrated by its canal and railway building and its settling of the West.

In 1861, when the U.S. Civil War broke out, the tensions between the United States and Great Britain, which recognized the Confederate States, proliferated. British North America, which shared a border with the United States and was a British colony, could not remain indifferent, since the colonies would serve as the battleground if a conflict broke out between the two major powers, as had occurred in 1775 and 1812.

Numerous incidents between Britain and the United States, as well as border incidents between the English colonies and the United States, caused Canadians much concern over the defence of their territory, as well as over their economic future since, as a retaliatory measure, the U.S. announced in 1865 that it would end the Reciprocity Treaty the following year.

The U.S. threat was all the more serious to British North America because London had begun in the 1840s to profoundly change its imperial policy. Beginning in 1846, the home country gradually abandoned the preferential trade system that protected Canada and began to move towards free trade. Since Britain refused to protect its colonies, they had to protect themselves through high tariffs applied even to English products. London gave in to Canadian protectionist policy and granted extensive internal autonomy to its colonies. In return, however, it planned to let the colonies assume

responsibility for their own defence. The small British colonies, not having the necessary resources to defend themselves against their only possible enemy, the United States, were forced to consider a military as well as an economic union.

These external causes alone were not sufficient to explain the constitutional change in 1867, nor the specific terms that accompanied this change. They did, however, coincide with a set of economic and political problems that would force anglophones and francophones to accept this federal compromise.

The British western territories, a vast land extending from the Great Lakes to the Arctic and Pacific Oceans, were administered by the Hudson's Bay Company. In the mid-19th century, Americans were making a strong push towards the West and settlers were hungry for fertile land. The Hudson's Bay Company constituted a very weak obstacle to this drive.

As London did not wish to take on too much colonial responsibility, it attempted to persuade Canada to act as the owner of this territory. Canada beat around the bush because it was experiencing economic difficulties and particularly because French-Canadians in Lower Canada would not accept annexation of the West. They felt it would upset the unstable and artificial balance that had emerged from the union of the two Canadas.

For several Fathers of Confederation, for Great Britain, for the English-Canadian bourgeoisie, annexation of the West would be an important justification for Confederation. In turn, Confederation would be a necessary condition for annexation of the West.

Canada undertook a large railway-building program in an attempt to compete with the U.S. and found itself in serious difficulties in the 1860s. The only alternative to bankruptcy appeared to be further and deeper commitment to the railway venture by uniting the Maritimes, Canada and the West: it was hoped that the railway could be made profitable by a larger market. However, this required a political union of the various colonies.

Finally, in 1850 and 1860, United Canada suffered chronic political instability that could only be overcome through a new political structure. The Union had been imposed on French-Canadians and it was hoped that, being in a minority, they would begin to assimilate as had the Louisianans before them. But it quickly became apparent that the new system could not function without their

participation. Consequently, the legislative union became a *de facto* federal system.

In return for French-Canadian acceptance of the new system which placed them in a minority, it was necessary to grant some degree of cultural autonomy in the areas of language, religion, law and education. They were even given some economic powers such as the control of some appointed offices, and of land and agricultural policy in Canada East. Thus, a *de facto* federal system gradually emerged, symbolized by bicephalous departments: Baldwin-LaFontaine, Hinks-Morin, Macdonald-Cartier, etc. Several departments were doubled, with one responsible for each section, which resulted in some duplication of the public service.

The system was generally as expensive as it was inefficient and tempers simmered among the majority of citizens in Canada-West, who denounced the French domination. Between 1861 and 1864, there were two elections and preparations were made to call a third that would have continued the impasse created by the constitutional status quo. The only solution was to transform the *de facto* federation into a true federation that would be both a union and separation of the colonies.

London wholeheartedly supported the project. It exerted strong pressure on Nova Scotia and New Brunswick to join the new union to be negotiated between the colonies from 1864 to 1867.

The long political crisis created by the imposed union of the two Canadas was solved under the pressure of powerful external and internal factors and by a long process of negotiation.

II THE BRITISH NORTH AMERICA ACT

From 1864 to 1867, the politicians who drew up the Constitution agreed on two basic points, that the union of the colonies would be of a federal type and that the federalism would be centralized. Most would have preferred a legislative union but because of the Maritimes and Quebec they had to accept the federal idea. On the other hand, the conservative French-Canadian leaders did not oppose the idea of centralization because, in their view, it did not threaten the rights of their nationality, which fell under the jurisdiction of the provincial government in which they held a majority. They stressed that in the federal system the central government would only deal with general issues, in which questions of "race" and religion would not be included. Finally, the federal model most familiar to the "Fathers"

was that found in the United States. After witnessing the United States Civil War, they believed that the U.S. Constitution was too decentralized and thus wished to avoid repeating this error.

The result of their efforts was an Act passed by the British Parliament under the name of the British North America Act, which has no official French translation and provides no formula for amending the Act. The B.N.A. Act is a lifeless and pragmatic document written in a heavy legal style whose text is as interesting and as complex as an insurance contract. We will now examine how the Constitution divides powers between the two levels of government and provides for the protection of minority rights.

In 1867, the powers granted to the provinces were those closely related to the social and cultural organization of the various communities, such as property and civil rights, health and social security, Crown Land, municipalities and local works, the administration of justice and education. At a time when governments intervened very little in these sectors and when the sums required to provide these services were fairly small, the powers granted exclusively to the provinces by Section 92 of the B.N.A. Act were believed to be secondary.

Section 91 of the act gave the central government exclusive power in particular over trade and commerce, currency, credit and banks, the post office, Indians, defence and criminal law.

While these powers are important, the centralizing characteristic of the union emerges in a set of provisions scattered throughout the Act. The preamble to Section 91 gives Ottawa the right to legislate "with a view to peace, public order, and the good administration of Canada, on any issue not falling into the categories of subjects that this Act grants exclusively to the provincial legislators" (unofficial translation). In other words, the federal government obtains the residual powers that may eventually become very important. This clause also allows it to legislate in all fields in emergency cases.

Agriculture and immigration are recognized as joint responsibilities, but in cases of conflict between the federal and provincial levels, the federal point of view automatically predominates. The federal government has the right to disallow any provincial legislation, and in 1867 there was no limit set to this right of disallowance. The Lieutenant-Governor, who must sign all provincial acts to make them official, is a public servant appointed by Ottawa. The federal

government may exert its authority "over those works which although entirely located in the province will be declared prior to or after their realization by the Parliament of Canada to be to the general advantage of Canada or to the advantage of two or more provinces" (unofficial translation). In a federal system, in principle at least, the Senate must defend the provinces, but Senators, as well as judges of the Supreme Court that the federal government created in 1875, are appointed by Ottawa. All this clearly demonstrates the centralizing character of the 1867 system. Macdonald himself admitted that the system granted "all the advantages of a legislative union." This judgment was later confirmed by K.C. Wheare in a classic study of federalism which presented the Canadian situation in 1867 as an example of quasi-federalism.

On the financial level, the same federal predominance prevailed. In effect, the federal government had the right to carry out "the levying of duties by all modes or systems of taxation," while the provinces were allowed "direct contributions in the province with a view to obtaining revenue for provincial purposes" (unofficial translations). The provincial governments had such limited revenue that the bulk of their financing came from Ottawa in 1867, and this placed them in a state of dependency.

The 1867 Constitution effectively made the provincial governments nothing but overgrown municipal administrations. Not only was Macdonald pleased with this situation, but he also believed that it was only temporary since, as he confided to a friend, these local governments would disappear within a generation and Canada would become a legislative union. This fully confirmed the apprehensions of French-Canadian opponents to the Confederation project, but we will see, however, the system evolved in an entirely different direction.

The Constitution provided very few guarantees for the protection of minority rights. Section 93 was totally ineffective in protecting the schooling rights of Catholics outside Quebec and Section 133 was clearly insufficient to ensure that federal institutions would be bilingual. The only minority truly protected was the Protestant minority in Quebec, but it was not because of the Constitution that this group was able to develop without any harassment by the majority. Rather, it was primarily because this minority relied on the Canadian majority and wielded enormous economic power.

III THE EMERGENCE OF THE PROVINCES

From 1867 to 1896, the new central government proved to be

extremely active. In only a few years, it succeeded in extending the territories of the new Dominion through annexation of the West and the admission of British Columbia and Prince Edward Island into the federation. It undertook the construction of the Intercolonial Railway and massively subsidized construction of the Canadian Pacific. It instituted a protectionist tariff policy that it publicized under the wisely-chosen name of National Policy.

However, the dream of John A. Macdonald and most of the Fathers of Confederation of erecting an increasingly centralized state was severely put to the test. During these first 30 years, the provinces succeeded in asserting their individuality and the central government was consequently forced to cool its centralizing ambitions.

The immensity and diversity of the new country made a decentralized federalism necessary. This was all the more true since the former colonies, now united by Confederation, had solid autonomous traditions and did not have any strong loyalty to this new Dominion of Canada. The ethnic and religious tensions that divided the country made its unification even more difficult. The unfavourable economic situation from 1873 to 1896 increased the provinces' discontent with Ottawa because it could not meet their financial demands. Thus, the provinces were highly unsatisfied with the agreements reached in 1867 which left them few resources.

This evolution towards a more decentralized federalism was confirmed and supported by the Privy Council in London which served as a final court of appeal for constitutional matters. The Privy Council, through its rulings, supported the autonomist views of the provincial leaders and, undoubtedly, of their electorate which identified more easily with their province than with the central government.

From the first federal elections in 1867, Nova Scotia vigorously expressed its opposition to the new system which had eliminated the autonomy the province had formerly enjoyed. Of its 18 elected members, 17 were opposed to Confederation. London's veto and an increase in the subsidies allocated to this province were necessary to prevent its secession. Despite all this, in 1886, Nova Scotians elected the Fielding government and again threatened to separate from Canada, which they held responsible for their economic difficulties.

The situation in the West was hardly any easier for the central government. Manitoba and British Columbia were unhappy with the stagnation that afflicted them and with Ottawa's rail policy, which

slowed their development. In addition to the West's economic difficulties, there was the problem of the Métis and the Indians, a large number of whom, under the leadership of Louis Riel, would twice take up arms against Ottawa.

These two rebellions had repercussions on relationships between French and English Canadians and placed the federal government in a difficult situation. In the same way, the issue of schools in New Brunswick and, later, in Manitoba, clearly demonstrated that federalism could not provide a miracle solution to ethnic problems. The federal government was forced by the majority to avoid effective intervention in these conflicts. This indirectly promoted provincial autonomy and also weakened Ottawa's prestige, at least in the eyes of French-Canadians in Quebec and the other provinces. Consequently, francophones in Quebec began to turn more towards their provincial government.

And to top it all off, even the richest and most influential province in the country was vigorously opposed to Ottawa's centralizing views. From 1867 to 1896, Ontario was unquestionably the leader in the fight for provincial autonomy. From 1868, the Liberals, who were in the opposition, denounced the centralizing manoeuvres of the federal Conservatives. Of course they were in favour of Confederation, but they emphasized that federalism was both a union and a separation. One of the basic reasons that prompted Ontario to support Confederation was the desire to control its local affairs and avoid what was termed the "French Domination." Moreover, since Ontario was the richest province, it was relatively independent of Ottawa even in difficult times. Ontarians were aware that as the federal government extended its powers and increased its expenditures, they would be required to pay more for the other, less fortunate provinces. When the province was led by the Liberal, Oliver Mowatt, from 1872 to 1896, he repeatedly and successfully contested federal moves either before his loyal electorate or before the highest court of the Empire, the Privy Council in London.

As the B.N.A. Act was particularly ambiguous, the courts were called upon to play an important role in the area of interpretation. In a series of rulings, particularly from 1883 to 1896, the Privy Council gave an interpretation very favourable to those who supported provincial autonomy. The Court opposed the idea that the provinces were subordinate to the federal government in the fields that were granted to them in the Constitution. The judges wrote in 1883: "Dans les limites des sujets précités (article 92) la législature locale exerce un pouvoir souverain, et possède la même autorité que le

parlement ou le parlement du Dominion aurait, dans des circonstances analogues."

This theory of provinces sovereign in their spheres of jurisdiction would come, through the force of events, to limit the federal government's right of disallowal and even seriously limit the general character of the preamble to Section 91 which authorized the federal government to legislate for peace, order and good administration. The Privy Council believed that it was necessary to strictly limit the powers of the federal government, particularly when dealing with residual powers or when the federal government cited the national scope of certain local problems. Stated in the words of the Council, this "would destroy in practice the autonomy of the provinces." Along the same lines the Court recognized that the Lieutenant-Governor directly represented the Crown in the provinces and was not a simple public servant of Ottawa. This meant that the provincial parliaments were not simple municipal councils.

In 1896, the Constitution still read the same, but the interpretation given to it had considerably modified the balance of power between the federal and provincial governments. The provincial governments alone, or in a coalition, as occurred at the first inter-provincial conference in 1887 called by Premiers Mowatt and Mercier, succeeded, with the support of their electorate and the Privy Council, in ensuring a certain jurisdictional autonomy.

From the financial point of view, they were still largely dependent on Ottawa since, in 1896, 43.1 per cent of their revenue came from federal subsidies. When the provinces could not obtain an increase in the federal subsidies, they gradually resorted to various forms of direct taxes: personal and corporate income tax and inheritance tax. These taxes represented 9.6 per cent of their revenue, while the sums coming from licences and the public field represented 47.3 per cent.

IV CO-ORDINATED FEDERALISM 1896-1939

Laurier's arrival in power in 1896 coincided with a phase of economic prosperity in Canada. The federal government was successful in furthering the National Policy: settlement of the West, railway building and protectionism.

Despite the conflicts dividing French- and English-Canadians over the school rights of minorities and imperialism, Laurier succeeded in maintaining a certain degree of harmony.

The provinces, particularly Quebec, Ontario and British Columbia, entered into what was called the second industrial revolution. The natural resources of the forest, hydraulic energy and mines became increasingly important for the provinces. Provincial revenues rose by more than 400 per cent from 1896 to 1913. However, with the rapid increase in population, growing urbanization and the necessity to develop their resources and provide public services, the provinces wanted more subsidies from Ottawa.

In 1902, the provincial premiers met and were successful in petitioning Ottawa to increase its subsidies to the provinces. In 1906, they succeeded in convincing Laurier to be flexible and he called a federal-provincial conference. He agreed to increase federal subsidies by approximately one-third and to adjust them after each census. Laurier hoped this revision would be final. In 1913, the provinces again took the offensive, this time against the new Borden government, but without success. The provinces wanted the federal government to redistribute to the provinces each year 10 per cent of customs and excise receipts.

Even the increased federal subsidies represented no more than 28.6 per cent of the provinces' revenue in 1913. As sums drawn from the public field and the sale of permits and licences represented 50 per cent of provincial revenue, the provinces had to rely increasingly on their direct taxes which represented 20.7 per cent. The provinces' expenditures represented approximately 50 per cent of federal spending and played an increasingly important role in the development of their territory and the organization of society.

The war which broke out in 1914 slowed the development of the provinces. To meet the emergency situation, the federal government passed the War Measures Act giving it greater powers. It had to intervene heavily to mobilize the population and the economy for the war effort.

To finance the enormous expenditure incurred by the war, the federal government, in addition to resorting to borrowing and inflation, had to use all its fiscal powers. In 1916, for the first time, it levied a tax on corporations and in 1917, on personal income. In both cases, Ottawa was almost apologetic for its actions and implied that after the war it would withdraw from these two fields previously held solely by the provinces. The federal government also wished to control borrowing by the provinces but, faced with protests from Quebec and Ontario, abandoned this idea.

Following the war, however, needs became so large that the federal government refused to repeal the two major direct taxes. Nonetheless, it provided assistance in the form of loans to the poorest provinces. It used conditional subsidies for programs in the fields of health (venereal diseases) and education (technical courses). This financing technique, which plays such an important role in present-day federalism, had been used for the first time in 1912 in the area of agriculture and had not triggered any opposition.

The federal government made spectacular progress during the war: Canada's economic potential grew considerably and the country gained a presence on the international scene. But it was also saddled with a very heavy debt and was deeply divided along ethnic, social and regional lines.

The provinces also had enormous needs to fill and were very critical of Ottawa. Consequently, the conservative federal government became increasingly unpopular.

The 1920s were marked by the federal government's loss of momentum. Because of the war effort and the bankruptcy of the railways, public debt rose by a factor of seven from 1913 to 1920. The central government wished to return to an orthodox finance policy of reducing the debt, cutting taxes and balancing the budget, and so adopted a careful attitude. The only major social measure during the period was the establishment of old age pensions in 1927. The government promised to pay 50 per cent of the cost of pensions paid to the elderly in provinces that agreed to participate in the program. Some provinces objected to this federal intrusion into an area of provincial jurisdiction. Quebec was the last province to give in, in 1936. This policy clearly discriminated against those provinces not participating, since they paid taxes for a service their citizens did not receive, but was a particularly effective technique.

However, the development of industries based on the provinces' natural resources and the growing importance of the automobile allowed the provinces to play a major economic role. They had to make considerable investment in infrastructure, and increased industrialization brought on accelerated urbanization and created new social needs: education, health, etc., that exceeded the municipalities' abilities and forced the provinces to shoulder greater responsibility.

Parallel to these new responsibilities, the provinces found

new sources of income. Receipts from the major direct taxes grew with the new prosperity, particularly since the federal government exhibited extreme moderation in these sectors. The sale of alcohol and automobile licences brought in large sums. Moreover, the provinces added taxes on consumption to their fiscal panoply: amusement tax, gasoline tax, tobacco tax and sales tax.

In the 1920s, the provinces had truly taken the initiative, and it was the golden age of provincial autonomy. They exerted a motivating influence on the economy, where the federal government had previously played this same role. In addition, they displaced municipalities in sectors such as education and social policy.

However, this type of development created problems of inequality between regions. Since the Maritimes and the Prairies were unable to benefit to the extent that Quebec, Ontario and British Columbia did, the federal government was forced to assist these underprivileged regions. Following the report of the Duncan Commission, it increased subsidies to the Maritimes and subsidized the railways to lower transportation costs. In 1930, it transferred to the Prairie Provinces the administration of their natural resources and provided financial compensation for the revenue they were unable to draw from these resources.

The economic crisis of the 1930s vividly exposed some of the latent problems of Canadian federalism and launched a move to question the very basis of the Constitution.

At the start of the crisis the federal government limited itself to traditional measures: monetary policy and tariffs. But as unemployment increased and municipal and provincial finances were overburdened, it intervened to bring assistance to the unemployed through agreements with the provinces. An effort was made to launch public works programs, colonization programs, direct aid, the establishment of work camps, etc. These measures were insufficient and anarchic. Discontent among the population ran deep when the Bennett government, inspired by Roosevelt's example, launched its own New Deal in 1935. This was a series of social and economic measures: limitation of the work week, limitation of working hours, marketing boards, etc. The liberals objected, pointing out that these measures were unconstitutional; they were, in fact, disallowed by the Privy Council.

Once in power, the liberals were faced with the same problems.

In 1937 they instituted the Rowell Commission to study the situation and suggest means for getting out of the impasse. However, Quebec and Ontario joined forces to block any profound changes to the federal system.

During this time, the situation continued to worsen and the federal government had to bail out the Prairie Provinces, which were on the brink of bankruptcy, and provide aid to the Maritimes.

The crisis hit the provinces unequally: the major industrialized provinces were better able to withstand the crisis. This did not, however, prevent them from asking the federal government to help the unemployed, provided of course, it did not invade provincial jurisdictions.

The years of misery traumatized many people and in English Canada in particular, there was growing criticism of provincial autonomy as a barrier to social justice and a threat to the nation's survival. The time had come for the central government to assume its national role.

Although the premiers of Quebec and Ontario successfully convinced Prime Minister Bennett in 1930 that the BNA Act constituted a pact between the provinces and that nothing in the Westminster Statute could infringe upon the roles of the provinces, this situation did not last long. The theory of the confederative pact was studied and rejected by many. It was discovered that the spirit and the letter of the BNA Act, constantly cited by Quebec and Ontario, were in fact centralizing. It was the Privy Council that had altered the Constitution. This centralizing current of thought was a consequence of the crisis and helped pave the way for the future.

The federal government made every possible effort to broaden its powers: it obtained authority over radio, created the Bank of Canada, implemented centralization of the major ports and sought ways to overcome opposition from Quebec and Ontario, which had managed to maintain their predominance and the constitutional status quo.

The Second World War helped to settle the economic crisis and gave the federal government the opportunity and means to work a basic change in federalism.

V THE NEW NATIONAL POLICY, 1939-1960

Canada's entry into the war gave the federal government the opportunity to take over all the levers of power. The War Measures Act became a surrogate Canadian Constitution.

Although there was no doubt that Canada would become fully involved in the war on the Allied side, King promised that the participation of Canadians would be voluntary because he wished to avoid a conscription crisis such as that which had deeply split the country in 1917. It was this double-edged commitment and his political ability that allowed him to get rid of Maurice Duplessis in 1939, obtain the massive support of Canadians in the federal election in 1940, and undermine the leadership of the provincialist Premier of Ontario, Mitchell Hepburn.

In 1940, the Rowell-Sirois Commission submitted its report, which remains to this day one of the most remarkable analyses of Canadian federalism. The Commission proposed that the federal government institute and administer a program of unemployment insurance and cover the full cost of old age pensions. It recommended that the central government have a monopoly on personal and corporate income tax and on inheritance tax. In return, the federal government would take on the provinces' debts and pay to the provinces an annual unconditional subsidy determined on the basis of the so-called "national standard." In addition, it recommended that the practice of delegating powers from one level of government to another be implemented as dictated by needs and circumstances. The Commission believed that by adopting these proposals, the taxation powers of each government would be clearly spelled out, the provincial governments would have a stable income and Canadians in all provinces would enjoy comparable services.

The following year, the federal government convened a federal-provincial conference to study this report. Ontario, Alberta and British Columbia vigorously opposed the project, while Premier Godbout did show a willingness to discuss the subject. The conference ended abruptly and apparently in failure. In fact, however, it constituted a victory for King. He had obtained the agreement of all provinces to mobilize all of Canada's resources for the war effort. Thus in 1942, he signed with each of the provinces an agreement for the duration of the war, through which the federal government would be the only government to levy personal and corporate income taxes in return for an unconditional subsidy. Moreover, after 1940, he had obtained the agreement of all provinces to amend the Constitution

in order to implement unemployment insurance.

As the war effort gained momentum, King was forced to do an about-face on the issue of Conscription. Francophone Quebecois were massively against this measure. The liberal regime of Gobout in Quebec was undermined, and he personally fell victim to the policy of the Ottawa liberals. The reaction of the Quebec francophones was autonomist, so that once again the political expression of their nationalism took the route of defending provincial autonomy. The Bloc Populaire as well as the Union Nationale denounced the Gobout government's allegiance to Ottawa and criticized it in particular for accepting the Constitutional amendment creating unemployment insurance, and for signing the 1942 tax agreements. They promised that if elected, they would fight Ottawa's centralizing policies tooth and nail.

During this time, not only did the war effort in Ottawa continue, but preparations were also made in the midst of combat for the post-war policy. This was a lesson that had been learned from the First World War. It was essential to plan for reconversion of the economy and avoid the social crises and economic depression experienced by Canadians in the 1930s. The growth of the CCF served as a reminder of this necessity. The central government was surrounded by experts and was convinced intellectually and politically of the absolute necessity of retaining exclusive control over major direct taxes and major social legislation.

At the 1944-45 session, the federal government passed several bills of great significance, particularly: a National Housing Act, a Family Allowance Act, and one announcing the creation of a Health and Welfare Department. All these measures dealt with sectors that could be considered as provincial jurisdiction.

The federal-provincial conference on reconversion (August 6-7, 1945 and April 29-May 3, 1946) provided the opportunity for the federal government to unveil its complete program for the post-war period. Ottawa intended to retain an almost total monopoly over the direct major taxes (personal income tax, corporate tax and inheritance tax). In return, the provinces would receive an unconditional subsidy of \$12.00 per capita that would be adjusted in terms of the GNP. It also proposed a shared-cost program, gradually leading through stages to a full program of health insurance. The federal government temporarily granted the conditional subsidies dealing with eight

sectors in health. It alone shouldered the cost of old age pensions for all citizens over 70 years of age and it also agreed to pay 50 per cent of the pensions granted to needy citizens from 65 to 69 years of age. It took responsibility for providing social assistance to all unemployed workers capable of working. In the natural resources sector, in addition to intensifying its efforts to develop agriculture, forestry, industry and mining (these sectors already fell under its jurisdiction), Ottawa established shared-cost programs and offered conditional subsidies to the provinces to include them in its development effort.

These federal proposals constituted an impressive program based on a Keynesian vision of the economy which gave it a remarkable coherence. The program had been carefully prepared over many years by large numbers of experts. The day after the war ended, the federal government found itself in a strong position: Canada enjoyed considerable prestige on the international scene; English Canada had gained a greater awareness of its unity and identity; and the federal government was motivated by a profound determination.

The federal program raised fundamental questions over the functioning of federalism as it had developed up to 1939. Ottawa planned to carry out this reform which gave it overwhelming power, without resorting to constitutional amendments or the courts. The government believed its spending power and the support of the population were sufficient to push through the new, extremely centralizing, national policy.

The war had perhaps caused the central government to forget certain basic realities in the country: its immensity, its diversity, its provincialist tradition that was still alive even though it had been contested in the 1930s and temporarily shelved during the 1939-1945 war period. And then there was Quebec, led by Duplessis with the support of a population that felt oppressed and dominated during these years, and whose nationalist desire had been frustrated.

Ontario, Alberta, Nova Scotia and Quebec formally opposed the proposals. In addition to finding the proposed subsidy insufficient to meet their enormous needs, the provincial governments felt they were in a better position to define the needs of their population and provide an effective response; they were unable to do this because of the crisis and the war which deprived them of the necessary financial means. Furthermore, the autonomist provinces demanded a

return to the spirit of federalism, which signified for them the respect of powersharing, as it had been defined and interpreted by the Privy Council from 1883 to 1937, and fiscal autonomy for the provinces. While the most articulate adversary was George Drew, Premier of Ontario, the most dangerous opponent was undoubtedly Maurice Duplessis. He was steadfastly opposed to the federal project. To begin with, social policy fell under provincial jurisdiction, as upheld in 1937 when the Privy Council in London disallowed Bennett's New Deal. Second, Duplessis insisted that provincial autonomy without fiscal autonomy was meaningless. He would never allow Quebec to be placed in trusteeship.

The federal government, however, was not to be stopped so easily. Following the conference, which ended in failure, it began to negotiate with the provinces individually. All, except Ontario and Quebec, signed an agreement for the 1947-52 period. In 1952, Ontario relented, leaving Quebec completely isolated in its opposition to the new national policy.

While it did not gain a monopoly over taxes, Ottawa nonetheless gained the upper hand and succeeded in completely reversing the situation prevailing before the war. "In 1939, federal government expenditures constituted 38 per cent of all government expenditure, while provincial and municipal spending accounted for 62 per cent. In 1952, this proportion was completely reversed, to 66.7 per cent for the federal government and 33.3 per cent for the other governments. Moreover, Ottawa's share of total revenue reached 67 per cent." (M. Lamontagne - unofficial translation)

In this way, Ottawa succeeded in gradually implementing -- if not imposing -- a large part of its program. When an agreement on health insurance proved impossible, it offered conditional subsidies for programs in the health sector. In 1957, a shared-cost hospital insurance program was launched. Ottawa succeeded in gaining support for an amendment to the Constitution, giving it authority over old age pensions, and also established a shared-cost program for needy individuals between 65 and 69 years of age. In 1957, the federal government began providing assistance to welfare recipients capable of working, and also participated in several shared-cost programs in the natural resources and transportation sectors.

During these years, the federal government implemented a policy of Canadianizing institutions. In 1949, it single-handedly abolished

appeals to the Privy Council in London, thus making the Supreme Court the final court of appeal. Similarly, it obtained from Westminster an amendment allowing it to modify, without consulting the provinces, what could be called the federal constitution. In 1950, Ottawa unsuccessfully attempted to obtain a provincial consensus to fully repatriate the constitution and work out an amending formula. In 1952, a Canadian was appointed governor-general.

During the same period, the federal government began to adopt cultural policies to complement its economic and social policies. The creation in 1949 of the Royal Commission on Literature, the Arts and Sciences, headed by Vincent Massey, marked the beginning of this new orientation. The federal government had in fact already created a place for itself in the cultural life of the country through a certain number of institutions: the National Archives, National Gallery, CBC, CNR, National Film Board, etc. The Commission's task was to analyse the operation of these institutions and "recommend the most effective means of administering them in the national interest." The Commission was also asked to suggest means by which Canada could participate fully in international cultural organizations. Finally, it was to analyse how the federal government and its agencies could assist the various nationwide volunteer groups dealing with cultural life.

After revealing the dangers threatening cultural life in Canada (Americanization, materialism, lack of funds, etc.), the Commission concluded that it was the duty of a national government to assist individuals and groups in their cultural development. Arts and literature "are also the basis of our national unity." The Commission was confident that it would be possible to promote the development of true Canadianism and safeguard the nation's integrity. Although some concern was expressed over respecting provincial autonomy in the area of education, the Commission could not overlook the fundamental role played by universities and research, which extended beyond provincial borders. After making a distinction between academic and general education, it recommended that the federal government come to the rescue of universities and researchers. The Commission also recommended an increase in the budgets of existing federal cultural agencies.

Beginning in 1951, the government agreed to provide assistance to universities by providing an unconditional subsidy of \$0.50 per capita, while in 1957, the Canada Council was founded.

Quebec, under Duplessis' leadership, headed the opposition to

this new national policy. With an unbelievable obstinacy, Duplessis held out despite the fact his actions deprived the province of millions of dollars each year that could have been obtained by accepting Ottawa's tax agreements and conditional subsidies. Donald Smiley estimates that in 1959-60, Quebec lost \$82,031,000 or \$15.60 per capita as a direct result of its opposition to Ottawa.

In turn, it opposed repatriation of the Constitution and the amending formula that was worked out in 1950. In 1951, it agreed to an amendment on old age pensions but obtained recognition of provincial legislative priority that would prove very useful to Lesage when Quebec created its own pension plan. In 1952, after accepting the federal subsidy to universities for one year, Quebec reversed its stance and touched off a major controversy. P.E. Trudeau himself was a defender of provincial autonomy in the area of education. In 1953, he set up a Royal Commission on the constitutional problems that would help to crystallize and reinforce opposition to the new federalism. It was also at the urging of the Chairman of this Commission, Judge T. Tremblay, who was a personal friend of Duplessis, that Duplessis decided in 1953 to levy a provincial income tax. Prime Minister Saint-Laurent realized that the conflict over fiscal autonomy had spilled out of government offices into the streets. Until a compromise could be reached between Quebec City and Ottawa, Quebec residents would be subjected to double taxation, and the electorate would have to decide which government was in the wrong. In a famous speech in Valleyfield on September 26, Duplessis explained in simple terms why he was fighting so tenaciously. After first stressing the importance of revenue to ensure Quebec's development, he explained why Quebec should never accept the substitution of grants for taxation powers essential to responsible governments. Continuing, he explained that in addition to this reason, which was valid for all governments, Quebec was a province unlike the others. After recalling the poor treatment of French-speaking Canadians outside Quebec, he declared that "the best means of obtaining justice is through a government in which we are a majority. Do you think that we would have justice in a government in which we were a minority?" Although the new federal policy might suit English Canada, Duplessis believed it was unacceptable for Quebec, and added:

We will never accept it. Why should we accept it? We would be replacing ropes with handcuffs. To accept it would be to replace a strong and lively future for our province with a federal oxygen tent. To accept it would be to replace our right of ownership, our control of our life in all fields with the title and function of a pensioner.

Shortly after, negotiations began between Saint-Laurent and Duplessis. The latter had to withdraw from his income tax bill the untenable assertion that the province had priority in the field of direct taxes; he also had to cut the reduction that taxpayers could obtain from the federal government from 15 to 10 per cent. Despite all this, Duplessis still won a very large political victory and was solidly supported by public opinion in Quebec. In 1957, the new fiscal accords ended financial discrimination against provinces not agreeing to hand over their major direct taxes. Not only did Ottawa have to show more generosity towards all provinces, but a method of equalization was also drawn up which constituted a major step forward for Canadian federalism.

To his very death, Duplessis remained firmly opposed to federal subsidies to universities. In 1959-60, the Diefenbaker government negotiated the first "opting-out" agreement with Duplessis' successors. The Quebec government obtained another corporate income tax point for subsidies to universities.

Despite all the numerous, justified criticisms that could be levelled at Duplessis and his regime, he won a fairly important victory on the constitutional level. He was a particularly clever politician, capable of communicating his message to the people. He forced the liberal opposition that had attacked his autonomist views to sit up and take notice.

It is certain, and I insist on this point, that Duplessis alone certainly could never have succeeded. The issue of autonomy involves deep-seated aspects of Quebec's history and is based on solid foundations which also explain the Quiet Revolution, the veto of the Victoria Charter and the rise to power of the Parti Québécois.

Nor is there any doubt that although federal dominance was lessened, this was also due to the actions of the other provinces and other regions of the country as well as to the political and economic situation in the world in the 1950s.

Ottawa realized that its Keynesian policy had not worked as planned. The overall policies of the federal government had a negative impact on some regions, some economic sectors and some social groups. The stabilization policy demanded a great deal of courage among politicians as well as close co-ordination between the various levels of government in the area of public investment. By the end of the 1950s, rising unemployment and inflation had harmed the credibility of the federal policy. The growing role of natural resources and the

weight of American interests gave new strategic importance to the provinces. Furthermore, in order to adjust its economic policy, Ottawa increasingly required co-operation from the provinces.

VI FROM COOPERATION TO CONFRONTATION, 1960-76

It is in this context that the Quiet Revolution began in Quebec. Under Jean Lesage, the liberals continued Duplessis' autonomist policy. In contrast, however, the liberals decided to make major reforms to the economic, social and cultural sectors. The government became the favoured instrument for giving Quebec's people some control over their development and their province. The liberals surrounded themselves with many competent civil servants. The reforms undertaken became a large burden, especially since the province had to make up for lost time. Taxes increased, the public debt rose and an effort was made to obtain the maximum funds available from Ottawa. In the area of federal-provincial relations, the liberals abandoned the doctrinaire and legalistic attitude of Duplessis in favour of a pragmatic approach. Quebec attempted to move into all sectors that fell under provincial jurisdiction and also showed interest in sectors that had been neglected, such as immigration and international relations. It even asked the federal government to consult the provinces before making decisions in areas under its jurisdiction but which might have repercussions on the provinces. The Quebec government, with facts and figures to back it up, pointed out that the issues coming under provincial jurisdiction should receive priority. The liberals accepted, with reservations, the conditional subsidies in almost all fields and participated in cost-sharing programs. They actively participated in federal-provincial conferences and an ever-increasing number of committees. After 1960, they even revived the long-abandoned tradition of interprovincial conferences.

The impact of the Quiet Revolution was all the greater because it was originally well-received in the rest of Canada and coincided on several levels with similar movements in other provinces except, of course, with respect to its nationalist dimension.

The various federal governments between 1960 and 1968 were not in a strong position as had been the governments of King and Saint-Laurent. Under Diefenbaker, the provinces considerably improved their position in the fiscal field and the federal government, through its lack of leadership, left increasing numbers of initiatives up to the provinces. Pearson's arrival bore some promise for Quebec at least. Through political necessity, but also through temperament, Pearson was ready to negotiate a "new deal" between French and English Canadians.

But Pearson, who had been in Ottawa for many years, still believed in the ideals of the new national policy. He was ready to make concessions to Quebec but wanted the federal government to stay closely in touch with the people. He therefore promised the establishment of a health insurance plan, showed interest in the Canada Pension Plan, created a municipal borrowing fund, instituted loans to students, extended family allowance to those 16 and 17 year-olds still in school, etc. He attempted to mobilize the population around the war against poverty and regional disparities.

During this period, Quebec was unquestionably in a position to exert its power in all traditional sectors as well as in the grey areas. Also, as a result primarily of the "opting-out" formula negotiated in 1964, it enjoyed much greater fiscal flexibility than the other provinces. However, the impression persists that the federal government continued to enter more and more sectors. Co-operative federalism had evolved into competitive federalism. Nor had Pearson lost sight of certain major "national objectives" such as a Canadian flag, repatriation of the Constitution and development of an amending formula.

In 1963-64, a spectacular break-through appeared to occur with the opting-out formula and the Quebec pension plan. In return, Lesage appeared to be ready to accept the Fulton-Favreau formula. But the nationalist movement was growing in strength and Lesage was forced to step back.

English Canada began to worry about events in Quebec and had difficulty understanding the accelerated and turbulent growth. There was concern over the special status that Quebec was in the process of obtaining, over the Quebec people's ambitions, their nationalism, and the first bombs exploding.

In 1965, the three doves, Marchand, Pelletier and Trudeau, entered the federal arena...to save federalism. Ottawa slowly took hold of itself, refuted the two-nations formula, the associated states proposal, and special status. Opting-out was severely criticized, and it was time to apply the brakes. Quebec would be treated like the other provinces, even if this required granting the other provinces certain privileges granted to Quebec. Obviously, the other provinces had no objection.

The rise to power of the Union Nationale under Daniel Johnson, who had just published the manifesto, Equality or Independence, failed to solve a thing. He called for a new constitution based on

the principle of two nations and wanted a greater share of direct taxes for Quebec, which Ottawa refused to accept. Quebec's international presence and de Gaulle's cry of "Vive le Québec libre" hardened positions on both sides.

Trudeau's ascendancy in 1968 singularly aggravated the debate. In some circles he was seen as a saviour who could put Quebec in its place.

Trudeau's credo in power could be briefly summarized as follows: on the constitutional level, Quebec must be a province like the others and the federal government is the government of all Canadians, including those who live in Quebec; Canada needs a strong central government that is in **direct** contact with its population; what Canada needs is a bilingualism and biculturalism policy; we must fight, if not expose, Quebec's nationalism on its homeground. All these symbolic battles, all the intrusions and manipulations of both governments over the past ten years which provoked a polarisation between federalists and independentists in Quebec culminated in the October Crisis.

After ruling out revision of the constitution, the federal government decided instead to bend. But it had made careful preparations, as demonstrated by the series of white papers **published** between 1968 and 1970. Three years of work and negotiations culminated in the 1971 Victoria Charter proposals. Even staunch federalists such as Claude Castonguay and Robert Bourassa could not agree to this Charter despite acceptance by all the other provinces. One must carefully read the opening statement by Robert Bourassa in Victoria on June 14 to understand why Quebec was so insistent on the decentralized federalism. Claude Castonguay carried the argument even further in a speech on June 7, 1972:

In Quebec in 1972, nationalism is an example of realism, of sentiment, of course, but of reason as well. It simply demonstrates that groups of men, those who make up governments among others, assume a continuity between ways of living, a way of speaking and rational planning of the techniques and resources available. When we in Quebec plead for coherent policies, we also defend the coherence of our society and culture. We defend the right to our own priorities, the right to do things in our own way, the right to combine our values and our tasks, particularly in the fields that affect us most or which are basic to achieving the social rights for our collective future (...)

I have already said, and I repeat, that I am convinced that the coherence required to govern Quebec is not incompatible with that required to govern Canada. Provided, however, that we agree that Quebec constitutes a social and cultural reality distinct from the rest of Canada, a reality that needs a sufficient framework for its development in terms of political and power structures to ensure for Quebec's citizens the maintenance of a dynamic and vigorous society and also the satisfaction of their basic needs. (unofficial translation)

From 1971 to 1975, the constitutional issues stagnated. However, the Quebec government slowly succeeded in explaining its point of view to premiers of the other provinces, particularly during the interprovincial conferences. In 1975, the federal government again took up the fight for repatriation. In November, after individual consultation with the premiers, the federal government suggested a few amendments to the Victoria Charter which tended to lessen Quebec's opposition on linguistic guarantees. Following this, in 1976, Trudeau defined his position: repatriation first, then discussion on the distribution of powers; he even mentioned the possibility of acting unilaterally if the provinces could not agree. The Bourassa government declared its staunch opposition and discreetly obtained the support of several provincial premiers. From August 18 to 20, the provincial premiers met at Banff, and Premier Lougheed announced that his government would officially ask that Alberta be given a right of veto, along with Ontario and Quebec, in the amending formula. The provincial premiers met again on October 1 and 2 in Toronto and succeeded in reaching a certain consensus on several points, as can be seen in a letter from Premier Lougheed to Prime Minister Trudeau on October 14:

All provinces agreed with the objective of patriation. They also agreed that patriation should not be undertaken without a consensus being developed on an expansion of the role of the provinces and/or jurisdiction in the following areas: culture, communications, Supreme Court of Canada, spending power, senate representation and regional disparities.

No unanimous decision was reached on the amending formula. British Columbia wanted to be considered as a distinct region and have the right of veto, as did Quebec and Ontario. Alberta, in turn,

wanted the veto on ownership of natural resources. Finally, Premier Lougheed mentioned the points where a consensus existed among the provinces: they wish to play a larger role in immigration; they agree on linguistic rights; they wish to see the provinces' taxation rights reinforced for their natural resources; the power of proclamation must be limited; the new constitution must provide for at least one conference of the eleven first ministers each year; the creation of a new province must occur through constitutional amendment. Finally, Premier Lougheed mentioned other points (cultural affairs, communications, Supreme Court, spending power, Senate, regional disparities and equalization) which did not have unanimous approval but still were the subject of some agreement.

The direction of the letter is very clear: 1) the provinces wish to discuss the distribution of power and repatriation at the same time; 2) the new constitution must respect provincial autonomy. In part, this repeats the demands made by Quebec over several years and extensively reverses or opposes the constitutional strategy developed since 1968 by the federal government.

This burgeoning consensus among the provinces is not coincidental. Since the end of the 1950s, the provinces have recouped many initiatives. Provincial and municipal public spending have grown spectacularly when compared to Ottawa's (see Appendix 1).

The increased strategic importance of natural resources, particularly of oil, has provoked a serious crisis involving Ottawa and two of the Western provinces.

Federalism, at first co-operative, then competitive, has resulted in acute problems. The conditional subsidies entail many disadvantages, and the cost-sharing programs have become so expensive and restrictive for the federal government that it has attempted to withdraw from them, despite the protests of the provinces. The overlapping of federal and provincial programs constitutes a source of waste and frustration.

The provinces are generally discontented with the federal government's economic management and want more control over their development. They are convinced that they know better the needs of their population than politicians in Ottawa. The provinces have finally accepted equalization and the importance of reducing regional disparities. They have learned to collaborate with each other: interprovincial conferences, regional conferences in the West and the Maritimes. The provinces' desire for autonomy is based on a deep-rooted regionalism that is a basic fact of federal Canada and that was far too often neglected in the 1940s and 1950s.

As Canada's provinces and regions have matured, so has Quebec. The balance of power in Quebec has changed profoundly since 1968, and the emergence of the Parti Québécois has given a voice to those Quebecers who wish to manage their own affairs. A growing number of them are rejecting dependence, collective welfare and perpetual guerilla warfare with Ottawa. The real bargaining between Quebec and Canada will soon begin.

Comments by S. Ryerson, Department of History,
University of Quebec at Montreal

Lester Pearson stated in 1964 that Quebec is, in a sense, the homeland of a people. Surely it is just this peculiar dynamic of two nation-communities evolving within the structure of one state, of regionalisms evolving within the framework of empire, that has led to our present impasse of conflict, deadlock and frustration. My reservations regarding Professor Durocher's survey should perhaps be directed against a more general tendency, common amongst historiographers, to view historical events as if they were reducible to stages in a totally self-contained and self-propelling unilinear development. This predisposition has led Durocher to overlook an important relationship between property and power.

Current democratic theory, except for some analyses of interest groups, takes little account of business enterprise. Government must consider the needs and preferences of large corporations no less than the wishes of its citizens, yet corporations wield greater political clout than ordinary men on the street. As Lindblom says:

It has been a curious feature of democratic thought that it has not faced up to the private corporation as a peculiar organization in an ostensible democracy. Disproportionately powerful, the large corporation fits oddly into democratic theory and vision.

Indeed, it does not fit, but its role in our current crisis must be viewed within the context of our colonial past.

In their paper on "The Roots of Discontent," Professors Evenson and Simeon stress the importance of specifying what our current crisis is not. Professor Durocher seems to share their belief that the fundamental social and economic order of Canadian society is not at issue. He views the current unrest as a political crisis in which government institutions and mechanisms are under **attack**. This is probably true to the extent that most things pass through the filter of government, but that filter is not the totality of the social organism. I would suggest that "the roots of discontent" are more easily scrutinized in the interweaving of socio-economic inequality and ethnic cleavage.

Lord Durham had little doubt that French Canadians would eventually abandon their nationalistic yearnings and begin to mingle

1 Charles Lindblom, Politics and Markets: The World's Political Economic Systems (New York, Basic, 1977), p.356.

with the English, if only to better themselves economically. Those who were unable, or unwilling, to fraternize in this way would be reduced to labourers in the employ of English capitalists. Thus, many French Canadians were doomed to occupy inferior positions and to be dependent upon the English for employment. There is both a sting and a warning in the following statement by Durham.

The evils of poverty and dependence would merely be aggravated in a tenfold degree by a spirit of jealous and resentful nationality, which should separate the working class of the community from the possessors of wealth and employers of labour.²

This statement anticipates the October Crisis by focusing on the three areas of property, private business and labour in which the basic structure of inequality between the two nation-communities of British America was so blatantly expressed. The resulting ethnic cleavage has encumbered the evolution of federal state structures and contributed in no small measure to the current crisis in their development.

Durocher concludes that "the real negotiations between Quebec and Canada are about to begin," and that "the new Quebec Government is now actively participating in the elaboration of what might become a new federalism." If a truly new and satisfactory federal structure is to emerge from these negotiations, they will have to encompass, what I would call, the basic equivocation of 1867. On the one hand, Canada professes to be an equal partnership of peoples; on the other hand, the assumptions underlying this structure of equality appear to be triple-mortgaged, not only by our constitutional insufficiencies and the reality of our social, economic and ethnic situation, but by the underlying fact that these impediments are intimately related to an industrial revolution that began in the workshops of Britain, the country that defeated France in the Seven Years War and annexed Canada. Thus, the Conquest and the Industrial Revolution are themselves equal partners in a pattern of equivocation that has become intolerably frustrating because of its pretensions to be something that it is not.

If the sixth man in the Cross Kidnapping is identified as a police *provocateur* we may have to reassess the October Crisis as an act of desperation designed, not to snuff out the flames of separation, but to head off the possibility of a restructuring of Confederation which would overcome the equivocation of 1867, pay off our historical

2 Sir C.P. Lucas (ed.), Lord Durham's Report on the Affairs of British North America, Vol.I: Text of the Report (Oxford at the Clarendon Press, 1912), p.293.

triple mortgage and establish our two nation-communities on a truly equal footing. This is a disquieting scenario because of its implications for American investment and for the structure of private business and property; we note that some sixty corporations control sixty-two per cent of the industrial output of Quebec. However, this is part of the anatomy of the social and economic structure of Canada. We must take into account the physiology and, especially, the pathology of this structure as we begin to deal with our present crisis.

LIST OF PARTICIPANTS

Mr. A. Alexandroff
Queen's University
Kingston

Mr. George Anderson
Federal Provincial
Relations Office
Ottawa

Professor H. Bakvis
Queen's University
Kingston

M. Claude Beauchamp
Le Soleil
Québec

Monsieur Gérard Bélanger
C. D. Howe Research Institute
Montréal

Professor D. Blake
University of British Columbia
Vancouver, B.C.

Mr. D. Brown
Queen's University
Kingston

Monsieur Jean Chapdelaine
Ministère des Affaires
intergouvernementales
Québec

Mme. Solange Chaput-Rolland
Task Force on Canadian Unity
Ottawa

Professor A. Corry
Queen's University
Kingston

Professor T. Courchene
University of Western Ontario
London, Ontario

Monsieur Léon Courville
Ecole des Hautes Etudes
Commerciales
Montréal

Professor J. de Wilde
Queen's University
Kingston

Mr. Joel Diena
Statistics Canada
Ottawa

Mr. J. Evenson
Queen's University
Kingston

Monsieur Pierre Fréchette
Université du Québec
à Montréal
Montréal

J. F. Gautrin
Expansion Economic Region
Ottawa

Mr. John Gray
The Citizen
Ottawa

Professor H. Guindon
Concordia University
Montréal

Mr. Richard Gwynn
The Toronto Star
Ottawa

Dr. Michael Jenkin
Science Council of Canada
Ottawa

Mr. William Johnson
The Toronto Globe and Mail
Québec

Mr. Kaelmen Kaplansky
International Labour Office
Ottawa

Monsieur Pierre Lamonde
Office de planification
et de développement
du Québec
Québec

Monsieur Réjean Landry
Université Laval
Québec

M. R. J. Lévesque
Director
Economic Council of Canada
Ottawa

Professor Richard Lipsey
Queen's University
Kingston

Professor John Meisel
Dept. of Political Studies
Queen's University
Kingston

Mrs. S. Ostry
Chairman
Economic Council of Canada
Ottawa

Ms. C. Pestineau
C. D. Howe Research Institute
Montréal

Mr. D. Slater
Director
Economic Council of Canada
Ottawa

Professor D. Soberman
Queen's University
Kingston

Monsieur Pierre Tremblay
Le Droit
Ottawa

Professor J. Whyte
Queen's University
Kingston

LIST OF AUTHORS

Mr. L. Auer
Economic Council of Canada
Ottawa

M. R. Durocher
Universite de Montréal
Montréal

Mr. T. Hazledine
Economic Council of Canada
Ottawa

Mr. W. P. Irvine
Queen's University
Kingston

M. R. Lacroix
Université de Montréal
Montréal

Mr. P. Leslie
Queen's University
Kingston

M. F. Martin
Université de Montréal
Montréal

Mr. B. MacDonald
Economic Council of Canada
Ottawa

Mr. K. Norrie
University of Alberta
Edmonton

M. Y. Rabeau
Université de Montréal
Montréal

Mr. G. Rawlyk
Queen's University
Kingston

Mr. R. Simeon
Queen's University
Kingston

LIST OF DISCUSSANTS

Mr. R. Boadway
Queen's University
Kingston

M. B. Bonin
Ministères des Affaires
intergouvernementales
Québec

Dr. V. Corbo
Concordia University
Montréal

Mr. H. C. Eastman
University of Toronto
Toronto

M. P. Fortin
Université de Montréal
Montréal

Mr. P. Gunther
Task Force on Canadian Unity
Ottawa

Mr. K. Z. Paltiel
Carleton University
Ottawa

Mr. D. Perry
Canadian Tax Foundation
Toronto

Mr. S. Roberts
Canada-West Foundation
Calgary

Mr. S. Ryerson
Université du Québec à
Montréal
Montréal

Professor D. Usher
Queen's University
Kingston

Mr. M. A. Walker
The Fraser Institute
Vancouver

STAFF

B. Guitard
Economic Council of Canada
Ottawa

K. Mills
Economic Council of Canada
Ottawa

A. Moroz
Economic Council of Canada
Ottawa

E. Nyberg
Economic Council of Canada
Ottawa

N. Swan
Economic Council of Canada
Ottawa

M. Vastel
Economic Council of Canada
Ottawa

H. Bradley
Carleton University
Editorial Service
Ottawa