The Battle Over Deficits;

The Struggle To Maintain Canada's Social Welfare State.

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be discussed throughout this thesis. These economic theories will have far-reaching influences on the federal government's decision-making process. The economic theories that influence government policies, both at the federal and provincial levels, are interconnected. A number of these theories have been adopted by both federal and provincial governments. The purpose of this cross-country product (GDP) is to estimate the annual value of the country's goods and services produced by its residents. In Canada," the federal government's target level of debt in percent of GDP is approximately $594 billion dollars or 74.4% of GDP. This thesis seeks to answer a number of questions concerning federal and provincial government policies at home and abroad. It focuses primarily on the government's view of the national debt and on the level of debt that needs to be maintained.
Chapter One: Introduction

We have won a major battle. We have not yet won the war. Twenty-five years of deficits have left us with a debt burden that is far too high. - Paul Martin, Budget Speech, 1998

With the dawn of the 1990s, the true Age of the Economist arose. Although this phrase, the "Age of the Economist" originated with the social philosopher Edmund Burke who used the term to characterize the eighteenth century, Burke’s statement was merely a foreshadowing of today's faith in economic theory. Today, politicians generally adhere to the advice of the economists; politicians rarely operate without first consulting their economic advisors. The economists may be described as shepherds, herding their lost sheep through the fields and pastures of economic dogma. Removing these shepherds would have disastrous consequences; without the foundation upon which the government is now based, the sheep would become disoriented.

Though they do not seem to speak with one voice, economists today speak with almost the same authority as eighteenth century rulers did during the Divine Right of Kings. The word of God has been replaced by various economists' statistics, charts, and data. Thus, the "Economist" has become an ambiguous ruler. Today's political sheep are torn between theories; whose economic advice should they follow?

In Canada, this scenario is overwhelmingly apparent. Today, society cannot determine which economic theory is authentic: Laissez-faire or free market economy, Keynesian, neo-Keynesian, post neo-Keynesian, conservatism or neo-conservatism. The
confusion regarding which economic theory to follow has caused various degrees of uncertainty regarding Canada's domestic affairs. The national debt has become the symbol of economic uncertainty in Canada.

In 1997, Canada's federal debt came close to six hundred billion dollars - $594 billion or 74.4% of GDP.² This number may even have been two billion dollars higher - $596 billion. The federal government stated in its 1998 budget, that it had paid down $13 billion of its marked debt;³ reports cite Canada's National debt load in February of 1998 as $583 billion.⁴ However, because of continuous strong economic growth and low interest rates the debt to GDP ratio is expected to fall to 61.7% (from 72%) by 2000.⁵

The massive debt was accrued from constant deficits. In Paul Martin's fourth budget speech in 1997, he predicted that the deficit for 1997 would "be no higher than $19 billion....$9.5 billion below the previous year."⁶ This example demonstrates the extreme government overspending (or under-taxing) typical of Canadian governments since 1970. By the 1998 budget, Paul Martin had created a new era of government spending with the goal of "zero - deficits" for 1999 and 2000. Paul Martin's budget of 1998 was heralded as a great achievement.

Politicians are torn between economists' two contrasting views regarding deficits: neo-Keynesian and neo-conservative. The neo-Keynesian school focuses almost exclusively on the short term stability of the economy and tends to dismiss concerns regarding the level of the debt. Neo-conservatives focus almost exclusively
on the perceived costs of growth in the national debt and are willing to forego any stabilization benefits to ensure that the debt is controlled. These polar views do have one thing in common; both confirm that deficits influence government policies. Both of these economic theories will have far-reaching influences on the federal government's decision-making processes regarding the debt.

The purpose of this thesis is threefold: to find out why Canada accumulated such a debt; to discover if there is a so-called debt crisis; and to discover if it is possible to preserve Canada's national welfare state given the financial restraints that have been adopted by both federal and provincial governments. It will delve into past and present economic battles between the neo-conservative and neo-Keynesian economists through a historical exploration of events. These experts relied on particular strategies, models and estimates in an effort to legitimize their position into state policy. This continual conflict between the two schools of thought has ultimately left Canadians burdened with uncertainty. Massive interest repayment responsibilities required by the state has recently enabled the neo-conservatives to represent a populist movement. This movement is evident particularly among Reform party members as well as a few provincial premiers such as Ralph Klein or Mike Harris.

This thesis will illustrate the different options that are open to the Prime Minister and to Canada's provincial premiers. Presently, the emphasis on deficit reduction has been made evident
among other things through cuts to social programs; the fabric of Canada’s social welfare state has been weakened. There are no guarantees that future generations will have universal health care; as well, a number of other government funded services may be lost. The federal government has begun to explore the possibility that Canada’s universal programs - which are subsidized by Canadian tax dollars - may no longer be sustainable. The government of today argues that Canadians’ tax dollars must now be used to service the debt.

The consequences of the deficit, including its effect on federal-provincial relations, will also be discussed in this thesis. The consequences of the deficit have made it imperative for political scientists to re-examine the different solutions offered by the economists. Perhaps the answer to Canada’s debt woes is for the government of Canada to find a compromise between the two schools of thought.

Perhaps the government should look to a program that may increase inflation and lower interest rates in order to bring down the "real value" of the debt. According to the neo-Keynesian philosophy, Canada’s fiscal situation is an optimal time for the federal and provincial governments to spend more money to encourage employment and development. This is in part based on the argument that it has been the government’s draconian cuts which have so far resulted in greater unemployment and stagnation in development. Although this is a "short-term" view, some neo-Keynesians persist that the federal government could increase taxes on the rich (by
way of decreasing the number of tax "loopholes" for one example). If the Chrétien government were to favour the neo-Keynesian school of thought, it would act upon its election promises and create jobs; the Liberal government could forego its fascination with the debt.

In the Liberal Party's famous "Red Book" of 1993, Jean Chrétien criticized the Mulroney/Campbell government for its obsession with the deficit and inflation, while ignoring job losses and poverty. Once in government, however, Chrétien "converted" and brought the deficit and inflation concerns to the forefront. The question this thesis will address is: Why did the Liberal government abandon the party's typical "left" teachings after 1993 by embracing the principles of the political "right"? Neo-conservatives would argue that this was the only reasonable choice the federal government could make given the dangerously high level of debt; despite the poor performance of the economy in Canada, neo-conservatives would not sanction an increase in government spending in order to stabilize the economy.

An implication of neo-conservative thinking down-played by the federal government is that more cutbacks means more people will become unemployed. More people unemployed in Canada puts greater pressure on the welfare state's services. More people unemployed in Canada also means a loss in tax revenues. This naturally places greater pressure on the debt load.

According to the neo-Keynesian, the Liberal government "adopted" the deficit battle as part of a successful strategic
plan. Some neo-Keynesians such as Maude Barlow and Bruce Campbell or Linda McQuaig argue that Chrétien was manipulated by the neo-conservatives' economic theory such that Canadians may have been the victims of a deliberate "co-opting" by the elite (i.e. the neo-conservatives). As such, neo-Keynesians would maintain that it was only the elite who believed that the answer to Canada's debt was to cut social programs. If this is the case, then these "lenders" of money in Canada (bondholders for example) would have received huge financial gains at the expense of a population that was unemployed; these lenders gained at the expense of a country whose stagnant economy pursued zero inflation and unnecessarily high interest rates. According to the neo-conservative, these policies were pursued as a consequence of unusually high deficits.

The neo-conservative argument stressed that the Bank of Canada was forced to push up short-term interest rates in order to control inflation. Given that nearly half of Canada's debt is "foreign owned", the Bank of Canada pursued a "low inflation policy" in order to quell any international fears of a "debt crisis" or possible hyperinflation.

The neo-conservatives would correctly argue that the only way to balance the budget, given the massive interest payment requirements, is to cut spending. This would allow for the possibility of the Welfare State programs being dismantled. Brian Mulroney received pressure from powerful business lobbyists, such as the Business Council on National Issues (BCNI) and the Fraser Institute, for a massive reduction in the "welfare State". This
may have caused the Mulroney government such uneasiness that it attempted to protect Canada’s social security network. Even though Mulroney did cut program spending, to give Mulroney credit, he advocated the entrenchment of Canada’s health insurance program in the Charlottetown Accord. Mulroney may have believed that health care should become a constitutional right for all Canadians. On the other hand, perhaps Mulroney was simply trying to attract more voters in favour of the Accord.

In order to suggest which domestic policy Chrétien and the provincial premiers should follow, it is important to outline which choice of action will benefit the majority of Canadians. This idea of "the greatest happiness for the greatest number" or "majority rule" is most consistent with democratic principles. This may not necessarily be the recommendation put forth by members of the C.D. Howe or the Fraser Institute, or other special interest groups such as the Canadian Council for Policy Alternatives.

The government needs to strike a delicate balance between a social safety net that is fair and equitable and a budget that is efficient and temperate. Despite the "balanced" Budget in 1998, the battle over deficits continues. Debate over which programs will be maintained and which programs will be forced into retreat will be nothing short of a battle of ideologies. It will witness the rise of leaders and will reveal the presence of avarice, the fears of victims, as well as the persuasion of propaganda. The battle over deficits has only begun. The question now is: can Canada maintain her social programs while balancing the needs of
all Canadians?
Chapter Two: Understanding the deficit:

"The federal debt is accumulating at $85,000 a minute, 24 hours a day"
"Interest on the federal debt is growing by $5.1 million an hour or $122 million a day"
"In the early 1990s our Governments were borrowing money at a rate of $7 million an hour." 10

These declarations demonstrate the onerous nature of the debt. Although the tendency is to disregard these incomprehensible numbers, it is important for Canadians to realize that ignorance will not serve as a solution to a problem so persistent as the Canadian debt. It is important for Canadians to understand economic theory, because without it, good economic policy cannot be designed. Furthermore, without understanding, Canadians risk having other decide policies for them. Without an understanding of the breadth and the causes of a problem, a solution cannot be formed. Often, however, the two disciplines - economics and politics - do not have similar objectives and criteria to evaluate their objectives.

Economic policy includes a set of objectives, as well as the instruments necessary for their achievements and constraints. These goals are usually determined through the political process. The appropriate instruments can be derived from economic analysis but they may also be politically determined.11 In other words, solutions to economic problems are given to the politician by the economic advisor; the politician must then "decipher" the advice, in an attempt to "mould it" and satisfy public opinion. For example, an economic analysis of a problem might suggest
that an increase in government expenditures is a better measure to combat unemployment than a cut in taxes. However, a government today would probably reject an increase in the size of the budget in favour of a cut in taxes. This is due to the fact that, in 1998, the public generally has the perception that taxes are too high and excess government spending is inappropriate. Stated more earnestly by Paul Martin in his 1998 budget speech, "Never again will we allow the spectre of overspending to haunt this land. Never again will we let old habits return - of defining bigger government as better government, of believing that every problem requires another program."¹²

Conflict between economic efficiency and political expediency is commonplace. "Good economic policy" may not get the government elected. Conversely, The Liberal government during the 1993 election promised to create jobs through a $6 billion infrastructure program. One might suggest that this was a classic case of "good politics and bad economics."¹³

Economic management refers to the actual process of achieving the goals of economic policy.¹⁴ Responsibility for management of the economy rests with a number of political organizations. In the federal government, the principal agents of economic management are: the cabinet, the Department of Finance and the Treasury Board. Other areas of management are occupied by the Bank of Canada, the Department of Industry, and the Department of International trade.

As discussed earlier, economic theory can be defined as the generally accepted body of theory available to economists at a
given time. This body is not fixed but changes continuously with time. New theories are added; old theories are modified; some theories discarded altogether.

Nevertheless, some basic goals for economic policy remain constant in most Western democracies. The ways of achieving these goals and rating their relative importance are subject to the winds of change in the political process. These primary goals for economic policy include full employment (the definition has ranged from 97% to 91% of the labour force), price stability (i.e., low inflation), a high rate of real economic growth, a viable balance of payments, an equitable distribution of income, and a reduction in the severity of the business cycle. These goals were introduced to the Canadian government during the Great Depression but were entrenched in 1963 by the Economic Council of Canada in its first annual review.15

All of these factors affect the government's decision-making process with regard to the deficit. Only one factor requires further clarification: price stability. Price stability means a zero or low rate of inflation. Inflation can be defined as a continuous increase in the general level of prices. This increase is measured by the rate of increase of an index of prices - most commonly the consumer price index. The Consumer Price Index (CPI) is designed to measure, over time, the cost of a representative basket of goods and services to the average Canadian family. The Economic Council set a goal of 2 percent inflation in 1964, but during the 1970s this goal became unrealistic.
In 1972, the Economic Council of Canada introduced a new way of defining inflation: inflation becomes a problem only if the rate exceeds that of a number of industrialized countries.\textsuperscript{16} Canada's rate of inflation during the 1970s was "high" in that it reached an average of 8.9 percent, but compared with other countries such as the United States (11.4) or the United Kingdom (13.3) there was allegedly no need for alarm.\textsuperscript{17} However, had Canada's rate of inflation been worse than that in other countries, the Balance of Payments would have been affected since the price of Canadian goods would have ceased to be internationally competitive. This would have meant that there were more imports coming into the country than exports going out.

When inflation is high and anticipated to remain so, debtors (including the state) gain and creditors lose. Workers who are members of a strong union will likely have wages that keep up with inflation. Pensioners however, or people on fixed incomes, tend to suffer if inflation is high, because the value of the dollar decreases. Indexing of personal exemptions and tax brackets can partly counter the effect of inflation.\textsuperscript{18} Thus, the rate of inflation has a significant impact on the deficit.

The public deficit is explained as the excess of government outlays over government receipts. The accumulation of deficits is referred to as the net debt. Figure one entitled "The Deficit" illustrates expenditure, revenue and the deficit from 1969-1998.\textsuperscript{19} If revenue exceeds expenditure then government experiences a budget surplus. If however, expenditure exceeds revenue the budget
balance is negative and government experiences a budget deficit. If the revenue and expenditure are equal, then government has a balanced budget.

Figure 1: The Deficit

![Graph showing the deficit from 1969 to 1997]

Source: Bank of Canada Review, Table G1, Summer 1998.

Figure two illustrates the budgetary deficit acquired from the disequilibrium between government expenditure and revenue. The deficit in figure two illustrates the financial requirements of the federal government from 1970-1998.
The state is unlike a household or a corporation because it does not have a typical "lifetime" over which its expenditures and receipts must balance. It can hypothetically continue to run deficits. The state, however, is like a household because it can "buy on credit." Today, in Canada, buying on credit is the only way for most people to afford home ownership, a new car, post secondary education or even a new dining room set. Most people borrow money and eventually pay back their loans while finding themselves better off.

Borrowing money to attain a higher quality of life is assumed
for most Canadians. This is stated appropriately by Susan George: "Without credit modern capitalism would grind to a halt." According to Susan George, "there is nothing infamous or irresponsible about corporations or national debt - the modern world couldn't function without it... not holding any debt would be real cause for concern - it would mean that a nation or a firm had no valuable assets" (emphasis added). Thus, the medieval notion of "usury" as a mortal sin has completely reversed itself to such a degree that the statement "governments which do not borrow money are acting against modern capitalism" can pass without much dissent. Indeed, being "in debt" is simply a fact of life for most Canadians.

Governments do, however, face an economic restraint that prevents them from unlimited borrowing. Simply stated, this is related to interest payments and credit ratings. Assuming that interest rates remain the same, if the government’s debt grows faster than its receipts, the interest payments required to service the debt will also grow faster than its receipts.

In Canada, the perceived costs of the interest payments currently servicing the debt in Canada is explained by Paul Martin in the House of Commons. He explained that in 1975 Canada’s federal debt was $25 billion. By 1997, it was estimated at $594 billion. The annual deficit was now due entirely to interest on the past debt. In 1993, Canada had to pay $38 billion in interest payments. In 1994, Canada had to pay $42 billion. These payments increased in 1995 to $46.9 billion; in 1996, they fell slightly to
$45.5 billion; in 1997, Canada paid $46 billion on interest charges alone.\textsuperscript{23} In 1998, the amount of interest paid on the debt was $43.5 billion. This represents almost thirty percent of total outlays.\textsuperscript{24}

Public debt Charges
(Billions of dollars)

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<tbody>
<tr>
<td>Amount</td>
<td>-38.4</td>
<td>-42.0</td>
<td>-46.9</td>
<td>-45.0</td>
<td>-41.5</td>
<td>-43.5</td>
</tr>
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Figure three illustrates both the federal and provincial-territorial debt charges as a percent of total revenue.\textsuperscript{26}

Thus, it becomes clear why "fighting" the deficit has such serious ramifications. It becomes very difficult to extract any increased revenue in the form of taxes from Canadians in order to service the debt's interest payments. Servicing the debt is a very politically unrewarding way to spend tax-payers' dollars and is considered a burden of the debt costs. According to Jeffrey Simpson, these interest payments are a travesty of foolery embarked upon by Canadian governments. He states

What fools Canadian governments were for a quarter of a century, beginning with the nightmarish fiscal management of prime minister Pierre Trudeau... Think of how much more Canada would have been able to spend constructively or to reduce taxes if our governments had exercised a modicum of fiscal prudence. They did not, however, so that today Ottawa runs a vast and unprecedented operating surplus of $41-billion, then watches debt repayment take all that $41-billion away, leaving the federal government with a balanced budget.²⁷

Furthermore, Jeffrey Simpson points out that even if the debt repayment were "only $20-billion, or even $30-billion... We'd be awash with money to support tax cuts or enriched programs or both. We are paying, and will continue to pay for the folly of the last twenty-five years."²⁸ These sentiments may be valid, depending on why the government went into debt - if it was for productive investment or transfer payments.

Productive investment relates to government purchases of goods and services; for example, national defence, policing and a judicial system, street lighting, building roads or garbage collection. Transfer payments do not represent a purchase of goods and services; transfer payments represent a transfer of money from one household to another with government as an intermediary.²⁹
Productive investment also refers to the capital stock of the country. Following Confederation, Canada invested in the country by building a National Railroad and improvements to the infrastructure, thereby increasing its capital stock.

Furthermore, aggregate demand is the "entire relationship between the quantity of real GDP demanded and the price level." The scale of government purchases has a direct effect on aggregate demand. If taxes remain the same, the more hospitals, schools, and infrastructure works the state demands, then government purchases of goods and services will increase, which in turn, increases aggregate demand. The greatest changes in government purchases of goods and services occur when the government experiences international tensions and conflict. In times of war, for example World War II, government purchases increased dramatically.

Government transfer payments also have an effect on aggregate demand. Similarly to a decrease in taxes, an increase in transfer payments increases aggregate demand. Both of these examples increase aggregate demand by increasing a household's disposable income. The larger the disposable income, the higher the demand for goods and services. For example, during the late 1960s, there was a larger increase in government services under various social programs, and these led to a sustained increase in aggregate demand and higher inflation.

Interest rates also have an effect on aggregate demand. If the Bank of Canada increases interest rates, households and firms will adopt new spending habits - they will try to borrow less, lend
more and cut back their spending. This cut in spending on goods and services will result in a decrease in aggregate demand. Figure four illustrates the dramatic portion of revenues which must be allocated to interest payments on the federal debt.

Figure 4: Spending on Programs vs. Interest


The deficit is one year's shortfall between what the government spends and what it collects in taxes. The federal debt is the total amount of incurred deficits minus incurred surpluses since Confederation. The deficit is measured in actual terms because it is unadjusted for inflation. In order to establish this "real" value, the effects of inflation must first be removed. This will allow economists to examine the real value of one year's
shortfall between what the government spends and what it collects in taxes. For example, if prices go up ten percent and the deficit goes up by nine per cent, the real value of the deficit drops by one percent.”

Economists also look at the debt in relation to the size of the overall economy - Gross Domestic Product (GDP). As a percentage of the overall economy, the federal debt in 1996-97 equalled 74.4 percent of Gross Domestic Product. As a form of comparison, the debt to Gross Domestic Product (GDP) in 1975 was 37 percent. However, burdened with the large debts from the Second World War, this ratio was over 100 percent in 1946. The Minister of Finance, Paul Martin, predicted in his 1995 budget statement that by 1996-97 "the economy will finally be growing faster than the debt and the debt to GDP ratio will begin to decline. This ratio will continue to fall after that in response to the permanent spending reductions in the budget." By 1997, the Liberal government accomplished that goal. In his fourth budget, Paul Martin announced that:

Over the past two decades, [the debt to GDP] ratio has been rising relentlessly. In other words, the debt of Canada's government has been rising faster than the income of the country. This had to be stopped. And we are stopping it. Our economy will soon be growing faster than our debt. More and more of each revenue dollar will go to pay for services that Canadians need rather than to pay bondholders. Our goal is to put the debt to GDP ratio on a permanent downward track. It is a goal that for the first time in over 20 years is now within reach.”

The debt to GDP ratio in 1997 was 74.4 percent and was predicted to decline to 71.2 percent in 1998-99. By 1998, with the growth in
the economy, the debt-to-GDP ratio is expected to fall to 63%. Paul Martin states in his fifth budget:

The best measure of the debt burden is to consider the size of the economy that supports it. This measure is called the debt-to-GDP ratio - What we owe in relation to what we produce. The lower the ratio, the more manageable the debt. In 1996-97, the debt-to-GDP ratio fell meaningfully for the first time in more than 20 years. It will fall again this year even more. Over the next two years, the pace of improvement will continue.

The following chart illustrates the debt to GDP ratio over a prolonged period of time in Canada.

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Debt as a Percent of GDP</th>
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<tr>
<td>1971-72</td>
<td>20.5%</td>
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<tr>
<td>1972-73</td>
<td>19.9%</td>
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<tr>
<td>1973-74</td>
<td>18.5%</td>
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<tr>
<td>1974-75</td>
<td>16.8%</td>
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<tr>
<td>1975-76</td>
<td>19.3%</td>
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<tr>
<td>1976-77</td>
<td>19.0%</td>
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<td>1978-79</td>
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<tr>
<td>1996-97</td>
<td>74.4%</td>
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Figure five illustrates the debt to GDP ratio over time in a line graph.  

**Figure 5: Debt to GDP vs. Time**

![Graph showing debt to GDP ratio over time](image)


The previous paragraph helps to explain the fact that for many economists, it is the relative size (as a percent of the Gross Domestic Product) of the debt that counts, not the actual size. This means that assuming that debt stays constant, as the value of Canada’s assets (such as mines, resources, factories, land, skills and knowledge of the entire population) grows, the relative size of the debt shrinks. An example may serve to illustrate this point more clearly. On an individual level, putting a $400,000 mortgage on a house that costs $500,000 seems very large. But if the family income appreciated to $1 million, the relative size of the mortgage becomes more manageable. As Robert Heilbroner and Peter Berstein would say "it would be a fortunate bank indeed that held the
mortgage on the Canadian economy for a mere $420 billion."\textsuperscript{41}

An economist may dispute this notion on the grounds that $420 billion is the debt of government not the entire economy. When firms or households borrow they use assets as collateral. If a government were to borrow they use either "money financing" or "debt financing." When the federal government borrows it can finance its expenditure by selling bonds to the central bank. The provincial governments must sell their bonds to the public. When the federal government sells bonds to the bank, these bonds are paid for with new money. An increase in the money supply causes an increase in aggregate demand. This new money also creates inflation. Thus the government gets resources from inflation just as if it had increased taxes. The "real value" of money decreases at a rate equal to the inflation rate. This is called "money financing."

"Debt financing" on the other hand is the financing of the federal deficit by selling bonds to anyone other than the Bank of Canada - householders, firms, or foreigners. In order to sell a bond, the government must offer a rate of return that creates incentive to purchase the bond. This process leads to an increase in interest payments and can lead to a mushrooming debt. In Canada, money financing is used very little, and debt financing has left the government with an ongoing obligation to pay interest.\textsuperscript{42}

Thus, Heilbroner and Berstein's analogy may be guilty of oversimplifying the matter. Never the less, the analogy does serve to illustrate that Canadians can afford to service the debt or in
other words keep up the interest payments of the debt, if the share of income it takes to carry it, or what percent of the national income goes to paying the interest on the debt is considered." This would mean that, despite that fact that the national debt has increased, Canada’s capacity to service it is not in jeopardy. According to this rationale, Canada can afford to pay its interest payments. Currently, Canada’s fiscal requirements, meaning a measure of what the federal government must borrow on debt markets were expected to decline from $29.8 billion to $24.3 billion in 1996-1997." According to Paul Martin, this represents 1.7 percent of the GDP, the lowest borrowing requirement since 1973-74." By 1998, however, Paul Martin had eliminated the deficit. This means that Canada can afford its interest payments. This perspective represents the neo-Keynesian short-term analogy of the deficit. For the Neo-conservative, the "real burden" of the debt is not measured by whether or not Canada can afford to pay its interest rates right now; the real burden of the debt is its potential negative impact on long run growth.

Such an effect can be diagnosed as the burden of inflation on future generations. The interest on the national debt is paid with money it collects in taxes. Thus, taxes may be increased. However, interest is paid each year with tax financed dollars so the deficit can only be a burden to some members of the future generation - others will benefit; the bondholders.

One feature of Canada’s present debt is that it is partly held by foreign investors. This means that future Canadian tax payers
will have to provide the resources to pay interest to foreign holders of Canadian government debt. According to Miville Tremblay:

Foreign held securities represent a quarter of federal and two-thirds of provincial debt financed on the open market... Applying the broader concept of net debt which includes accounting entries, 40 percent of Canadian net debt is held by foreigners. 46

Figure six illustrate the breakdown of government securities held by foreign investors at the end of 1994.

Figure 6: Breakdown of Federal Government Securities by Foreign Investors

Source: Miville Tremblay. p. 5

There is another way in which the debt may have a negative impact on long-run growth; by "slowing the pace of investment and reducing the stock of productive capital equipment available for future generations." 48 This occurrence is called crowding out.

In order to stimulate the economy the government must increase
aggregate demand." An increase in government spending of goods and services may bring a decrease in private investment. In essence, government spending may "crowd out" private investment. Crowding out will occur if the economy is operating at capacity or full employment, then government spending must come at the expense of less spending elsewhere. Furthermore, if the government increases its spending on the purchases of capital or services that is less than the return on privately purchased capital crowding out will occur. Crowding out will not occur if there is unemployment or if government spending was for the purchases of capital on which the return equals or extends that on privately purchased capital.

Thus crowding out will result in a decrease of the capital stock that future generations would otherwise have had. The degree of the loss is dependent on its opportunity cost. This is the real interest rate. The higher the real interest rate the less incentive for firms to invest in new plants, research and development or the purchasing of new equipment. For a government deficit to crowd out investment the deficit must cause real interest rates to decline.50

As a response to these economic consequences of deficit and debt, beginning in 1993, the Chrétien government made a serious commitment to "balancing the books." The Liberal plan to achieve this end was through "maintaining our pace: deliberate, measured and responsible. We will maintain our approach of two year rolling targets. And we will not alter course. Moreover, we will meet our objectives ... by focusing on getting spending right, not by
In February 1997, it was predicted by non-governmental analysts that by 1998-99, the deficit would be "flirting with zero." In the Liberal's fourth budget, Mr. Martin predicted that the 1996-97 budget would be no higher than $19 billion. This is a reduction from the $24.3 billion that he predicted in 1996. The actual 1996-97 budget deficit was $8.9 billion. These same non-governmental analysts predicted that the deficit for the 1997-98 fiscal year would be close to $10 billion. Canada's deficit had not been below $10 billion since 1976-77. In fact, by 1998, the books had been balanced the first time since 1969, establishing a zero deficit. Thus, the Liberal government's long term objective to produce an absolute decline in the size of the federal debt relative to the G.D.P. was reached. The government made a decision to end the "deficit crisis" - not through increased printing of money or raising taxes but by decreasing spending. This decision has received mixed reviews from the public.

As with any government decision, there were many special interests to consider; the Liberal government has had to make many difficult decisions in an attempt to "keep the peace" between the opponents on the left and the opponents on the right of the political spectrum. Canadians have entered a new era of fiscal restraint. The following chapters will provide a historical analysis; beginning with the spending patterns of the new Dominion, including the prudent financing of the King era and continuing through to the spending splurge of Trudeau's government.
This historical inquiry will culminate in a return to the "fiscally responsible" administration of the Chrétien government.

When my father retired in 1964 our national debt was about $17 billion. Given our population at the time, that represented about $900 per Canadian. Of course, we had to pay interest on that debt. The cost of that interest—spread among Canadians was less than $40 per person per year. Since then, however, government debt has grown alarmingly. When my daughter presented us with our first grandchild in 1982, his share of the combined federal and provincial debt was about $6,400. Today at the ripe old age of 12 my grandson's share of the total government debt has skyrocketed to over $26,000. At the turn of the century, my grandson's generation will be leaving high school. By then, per capital debt will likely be more than $30,000.53

Deficits, deficits and nothing but deficits from the early 1970s on, year in and year out, in good times and bad, ran up a staggering national debt. 54

Historically since the 1920s, government spending has grown more rapidly than the economy. The normative rationale for government intervention in the economy states that government is required to deal with problems that arise from market failures. It is only within the last ten years that the idea of government intervention in the economy has begun to wane.

There appear to be four distinct phases in government spending. Each phase was influenced by the dominant economic theory of its time. In the earliest period, 1867-1920, governments did not worry about balancing the budget.

In the first phase, government spending—particularly at the federal level—was mainly on infrastructure (such as railways, harbours and canals) rather than transfer payments to assist social welfare. During this period, Canada had no experience with social security, as well as no recognition of social rights. According to
Maude Barlow and Bruce Campbell:

Child labour was common. Churches, private charities and minimal municipal assistance provided the only relief for the poor. The destitute, the ill, the insane, the homeless, criminals - all were sheltered together in poorhouses. Some communities contracted out the care of their poor to the lowest bidder; some held annual public auctions of "paupers." This custom, which resulted in much mistreatment, and many deaths, persisted in New Brunswick until the end of the nineteenth century.55

The Dominion of Canada was in its infancy and quite possibly could not have sustained a welfare state, without the means to "properly" redistribute the country's wealth. Furthermore, the new Dominion's policy was to maintain a low level of taxes comparatively with the United States. According to Irwin Gillespie, the objective in this first phase of government spending was twofold; building up the Dominion in terms of infrastructure and luring immigrants into Canada. In order to attract people to the new Dominion, the government had to keep its taxation "competitive" with the United States. This required that the government borrow money to uphold its decision not to use the possible revenue source of direct taxation.56 As a result of this policy, finance ministers strived to keep a "good credit standing" for the Dominion.

The rationale behind such a policy in the first phase of government financing stemmed from the notion that once immigrants had been attracted to the new country, an extended tax base could be established. These new tax revenues would be used to pay off the debt. In short, an idea was born in this first phase of government financing; borrow money now, and pay off the burden of
the debt when times are economically improved. Also, this new government would only borrow for productive investments. In the second phase, from the mid-twenties to the Second World War, the rationale for government intervention into the economy stressed concern for frugality and regularity of spending. Not surprisingly, government intervention into the economy was timid, and financial management was primarily centred around annual estimates which were categorized under standard categories of expenditure such as salaries or supplies.\(^5\)

In the 1940s, 1950s and particularly during the 1960s, the third dominant economic influence was developed from a renowned economist: John Maynard Keynes. Although Keynes published his major work in 1936 and his influence began to affect policy during the Second World War, it was not until the late 1940s that the full impact of his work began to be realized. After the war, massive spending by the federal government was used to offset a negative growth period. During this phase, attitudes toward spending were based on massive government intervention into the economy in an attempt to control the natural business cycle of booms and busts. Naturally the earlier concern for frugality and regularity was attempted to be added to the requirements of Keynesian economics. However, frugality more often than not was sacrificed in the name of regularity or universality. In addition, true Keynesian economics was not applied as government found it difficult to control spending during "boom" periods.\(^6\)

In the 1960s, this third phase was dominated by a concern for
positive "program" management. At this time, government expenditure programs were developing rapidly and the federal government's efforts were focused on extending the time frame of expenditure planning within government beyond the one-year estimate period. This planning was increased to a three to five year period.

The second and third periods were followed by a fourth phase in government fiscal policy which began during the late seventies. Although this phase was suspended for a time after the re-election of Trudeau in 1980, it returned in 1984 with Brian Mulroney and continued with full force after 1993 with Jean Chrétien. In this period, the "neo-conservative" era, fiscal control by the federal government focused on "expenditure management." This phase was forced to contend with the financial impact of previous government's overspending. The government had to compensate for past governments' decisions - for their abilities to spend better than to save. Parliament's power to tax was more effectively used than its powers to control expenditures. By letting this phenomenon continue through time, governments may have permanently distorted "good" economic policy.

Although this fourth phase was similar to the second period in terms of "frugality", it differs on "regularity". As in the third period, expenditure planning also goes beyond the one-year estimate period. This fourth phase, a return to prudent planning, will be further discussed in chapter four.
Phase I: Government beginnings

The first period of fiscal management for the federal government, in retrospect, demonstrated what would now be described as tendencies toward Keynesianism. Fiscal policy in this era differed from true Keynesianism in that it did not attempt to counteract the business cycle by increasing spending in hard times. The new Dominion displayed some conservative tendencies in terms of letting private charities provide for social welfare services, the government's priority was in attracting new immigrants. In order to fulfil this goal, the government used what now could be called Keynesian fiscal policy. Attracting immigrants to secure a revenue base could be considered as the short run "stabilization policy" of Keynesian economics.

At the time of Confederation there were only 3.5 million Canadians. Thus, luring immigrants (and preventing population losses to the United States) was a high priority for the new country. This goal created the incentive for Macdonald's National Policy. Canada's earlier finance ministers used two interdependent economic philosophies regarding the collection of revenue. The first conscious policy objective regarded the issue of debt; the second concerned taxes.

As a new country, it was important to acquire a good credit rating, and to ensure beneficial interest rates. Thus concerning debt, the new government hoped to secure good economic standing with other nations. This policy was also used because in order for the federal government to sustain itself it had to keep its rate of
It was important to keep taxation low in order to attract immigrants. Although this has recently been something that governments seem to have forgotten, the federal government at the time of Confederation was careful not to "overtax" its citizenry. The Dominion government was in "competition" with the United States and feared losing potential immigrants to the American colonies. As a result, the federal government kept a low rate of indirect taxation and rejected altogether the notion of direct taxation. According to Gillespie "the principle applied to numerous tax rate changes was that they should not exceed the tax levels in the United States."\(^\text{61}\)

Thus, the federal government saw their taxing power as limited. This perceived limitation was stated in 1876 by Minister of Finance Sir Richard Cartwright:

> The power of any Government to impose taxation is subject to stringent restrictions, and in no place to more stringent ones than in Canada.\(^\text{62}\)

Furthermore, Conservative Minister of Finance, George Foster stated in 1893, "I would like to see the man (sic) who could be elected in any constituency on a policy of direct taxation."\(^\text{63}\)

This desire led the federal government to look towards deficit financing. In order to finance Dominion expenditures, the rationale for deficit financing was that in order to lure immigrants into Canada, a policy of low taxation must be observed. In time, once a population base was established, the government's capacity to pay off the debt would increase. Thus, the trade-off between balancing
the tax rate and deficit financing was characteristic of the first phase in government expenditure. Deficit financing was also used characteristically in this first phase to fund operations that were capital based.

The idea of deficit financing was backed by many prominent citizens of the time by assumptions that a young country ought to have a deficit. A new country needed to expand its infrastructure. In order to finance these ventures, while maintaining a "low taxation policy" the government needed to exercise its borrowing capacity.

William S Fielding, who held the position of Minister of finance in 1903, stated "I do not think that any Minister of Finance of this country should be expected to show often a reduction of the public debt." Fielding maintained that a new country would need the federal government to assist in the many public works projects. This assistance would need to last for several years. As such, Fielding asserts "I do not hesitate to say that as a rule, a Minister of Finance will not be able to show reductions of the public debt, and it will be no discredit to him [sic] if he is not able to do so."

Finance ministers at this time were aware that increased tariffs would lead to increases in smuggling, and a subsequent loss in revenue. Thus, according to Cartwright "... the power of imposing fresh taxation is limited within comparatively narrow bounds... there are considerable dangers incident to any largely increased measure of taxation." In short, a tariff that was
too high and over-protective would increase smuggling and result in a loss of revenue.

Although Sir John A Macdonald's "National Policy," first proposed in the election campaign of 1878 did promote national economic development through protection of Canadian industries by way of an external tariff, interprovincial tariffs by the 1870s had already been removed. Freeing interprovincial tariffs was seen to aid the free flow of raw materials and goods within Canada. The imposition of an external tariff was designed to reduce the flow of imports - particularly manufactured imports - into the country. This creation of this import tariff and the abolition of interprovincial tariffs were designed to enhance the economic and political integration of the new Dominion.\(^67\) The political creators of the new Canada were aware of the potential loss in revenue due to smuggling with the imposition of an import tariff that was too high and over-protective.

Excise duties on alcoholic beverages and tobacco were, however, a popular source of taxation for the new Dominion. Alcoholic beverages and tobacco have always been taxed abundantly in Canada.\(^68\) Governments take advantage of the old notion that tobacco and spirits are considered by some to be sinful or evil. Taxes on spirits and tobacco are often referred to as "sin taxes."\(^69\) They are a popular source of revenue for the government because users and non-users display relatively low levels of opposition towards the levy, and subsequent increases in these "luxury" taxes.

Finance minister Sir Leonard Tilley, in 1882, made the first
link between voluntary taxes and luxuries. He argued that revenue collected in the form of taxation on wines, spirits, silks and satins were taxes volunteered by the purchaser.\textsuperscript{70} Conservative minister Sir George Foster strengthened this link in 1889. He states:

Taxation, then may be of two kinds - voluntary, and what you may call involuntary taxation. What I mean by it is this: I, for my part, do not use tobacco and intoxicating liquor...\textsuperscript{71}

In 1893, Sir George Foster states:

What [the farmer] ought to drink, according to my opinion, are free [of taxes]. His water, tea and coffee are free. If he desires to drink anything stronger - which is option with himself - it is a luxury he takes, and he has to pay for it, and we will have a tax on that so long as Canada is a country...\textsuperscript{72}

Thus, the 'sin taxes' were and remain a popular tax revenue source for Canada.

These taxes along with customs duties and excise duties as well as debt issue were the main revenue sources for the new Dominion. Decreasing the public debt was not a policy goal during this first phase in government financing. The Dominion governments borrowed both domestically and from foreign sources. The domestic sources were post office and private savings banks as well as chartered banks. The foreign sources were largely bond issues.\textsuperscript{73}

The new Dominion pursued an active policy of extensive borrowing and debt increases in order to keep taxes low and to pursue "great works projects." The British North America Act was framed to suit the needs of a strong centralized federal government that would concern itself with providing the new country with
transportation and communication (railways canals and harbours) the development of the frontier economy, and defence. Low taxes were seen as necessary in order to encourage immigrants and to minimize smuggling. Borrowing accounted for up to 10 percent of total financial requirements. Thus, good credit standing of the country was paramount in the minds of finance ministers. The expenses of building up Canada's infrastructure had left the finances of the new country in a precarious state. The provinces were willing therefore to turn over to their federal government the responsibility for major works such as the transcontinental railway and the improvements of the St. Lawrence River canal system.

Although during the first seven years of Confederation, the federal government enjoyed a respectable source of revenues, this prosperous interval was ended by the worldwide depression that began in 1873 with Canada feeling its full effects by 1875. The recovery did no begin until 1895. The federal government's responsibilities in transportation expenditures coupled with a reduction in imports (and custom duties) imposed strains on the new Dominion's financial position. The depression also created financial problems with the provinces, that will be discussed in chapter seven. The federal government assumed the large colonial debt related to capital assets used for development.

These policy choices had a profound effect on Canada. Borrowing money to fulfil the policy objectives of government would continue to be a substantial revenue source within Canada. This first phase in government spending introduced the notion of being
able to afford certain capital investments or infrastructure programs (i.e. the expansion of the West, building of the Transcontinental Railway or improving the St. Lawrence River Canal) without requiring a direct revenue source (i.e. personal income taxes). Thus, the early acceptance of deficits paved the way for Canadians to accept the Keynesian theory after it appeared. The first phase in government spending was not Keynesian in terms of the new governments concern for the cost of taxes, and the use of debt was only to finance capital projects and not as a stabilization policy in order to spur development during a "bust" period. However, the federal government assumed the debt responsibility from the provinces and borrowed money to finance its massive ventures. In this way, the federal government established a precedent of providing for its citizenry. The first phase of government spending enables the Keynesian philosophy to take root in Canada without seeming as a radical departure from the norm.

Phase II: Prudent planning

In the second phase, from the mid twenties to the Second World War, the rationale for government intervention into the economy stressed concern for frugality and regularity of spending. Thus, government intervention was timid. During the transition years from the first phase of government spending to the second - between 1917 and 1920 - the Dominion government introduced three major new taxes in rapid succession; the personal income tax, the corporation income tax and the sales tax. The growth of these taxes had the
most profound impact on the Canadian tax structure.

The second period of fiscal management coincided with the arrival of Prime Minister William Lyon Mackenzie King. King governed within the parameters of the legacy of the first World War. These parameters were what seemed to be unsustainable high levels of public debt and taxation. For King, this required prudent public financing in order to cut spending, reduce taxes and cut down the national debt. Canada did manage gradually to reduce the burden of its war debts during the 1920s and particularly in the boom years after 1926. The King government offered Canadians substantial annual tax reductions while still running budgetary surpluses. King’s finance minister from 1925-1929, J.A. Robb, based his budgets on mottoes such as "work and thrift are the only sure roads to success." King was a classic federalist and believed that the development of social policy at the national level would be unconstitutional. King believed that all forms of social welfare including old age pension and unemployment relief fell under provincial jurisdiction, in accordance with the BNA Act. King also believed that unless reform was supported by the public, his government should not initiate an ambitious program for the welfare state. He was particularly sensitive to opinion in Quebec— the political base of his party — where social conservatism was combined with hostility to centralization. For example, Quebec nourished the ideological principle that the family rather than the state should be responsible for supporting elderly persons.
considered the financing of pensions by conditional grants as though it were a unilateral federal program. Coupled with an innate reluctance against "heavy expenditures" political persuasion was necessary to convince Prime Minister King in providing pensions for the elderly. It was ultimately a pressure group known as the "Ginger Group" - Independent and Labour Members of Parliament - who pushed for an old age pension bill. Needing their support, King promised, in the 1925 election, to bring in a bill which would satisfy their demands. This bill would enable the federal government to share with the provincial governments the costs of giving needy Canadians over the age of seventy-five, a twenty dollar a month pension. It was defeated in the Senate, reintroduced after the 1926 election where it was passed without opposition - except from the provincial premiers. However, the provinces eventually "fell into line" with the federal government's "requests."

King's government thus provided the stepping stones to the welfare state. In the 1920s, the network was exceedingly primitive compared to the programs that exist in the 1990s. These social programs, despite King's initial reluctant support, continued to grow and expand - particularly in the 1960s.

After 1926, King took the initiative to gain support from Atlantic Canada. The Maritime region had suffered serious economic decline in the 1920s and was petitioning the federal government for help. King responded with a Royal Commission on Maritime Claims. The Commission recommended that the Atlantic provinces be given
special subsidies and that the government reduce freight rates.\textsuperscript{85} Although King believed that "the whole problem seemed a futile effort to combat geographical and other economic conditions"\textsuperscript{86}, he agreed—solely to gain political support in the Atlantic region. When the Maritime provinces asked for more, he declined; he believed that favouring one region over another would have unfavourable political repercussions.

Despite his initial reluctance to design a socialist state, bringing the welfare state into existence was to become the main part of King’s government. It seemed that he was ready to accept the idea of welfare policies when the perception reigned that it was what the public wanted. King was responsible for developing policies to provide assistance to the underprivileged provinces. The legislation that he agreed to was an important milestone in Canadian politics because it demonstrated that the government of Canada accepted and supported the idea of regional welfare as well as social welfare politics. This legislation has led to regions demanding more and more from the federal government. The analogy of the provinces as "spoiled children" requesting more money from their federal "parents" was John A Macdonald’s description of British Columbia. The analogy has often been used to illustrate the fiscal demands put on the federal government from the provinces in a country that has according to Mackenzie King "Too much geography rather than too much history."\textsuperscript{87} In the 1990s, however, these federal transfer payments are seen as another cost cutting arena in which to experiment.
In the 1920s, the King government raised the idea of unemployment insurance. However, they quickly dropped the idea when there appeared to be little interest. Instead, King reminded the provinces that care of the unemployed was solely their responsibility. As depression conditions began to surface after 1929, he denied provincial requests for money for the unemployed. In the 1930 election, King still believed that the country simply needed another term of good prudent government.

King lost the 1930 election to R.B. Bennett, yet he was re-elected again in 1935. At this time, an important economic theory was developed. Some economists and politicians began favouring notions of artificially inflating demand to stimulate the economy. Social Credit, a theory developed in the 1920s by a Scottish engineer Major Douglas, became popular in the Canadian Prairies, and in 1935, a Social Credit government was elected in Alberta. A much more sophisticated version of the idea was developed by the Cambridge economist John Maynard Keynes, who referred to Social Credit in his *General Theory of Employment, Interest and Money* (1936). Keynes believed governments could implement fiscal policies to counter the cyclical fluctuation in the business cycle. This notion of Keynesian economics meant that in times of a "bust" period within the economy, the government would intervene through increased spending to level off the natural tendencies of a business cycle. Likewise, in times of a "boom" period within the economy, the government would intervene with decreased spending. The money "saved" from decreased expenditure would be used in times
of "bust."

However, on the eve of the Great Depression, this "new" economic theory would compete against the classical theory which maintained that individual initiative, free enterprise, private charities and families could adequately provide for those in need.

Some members of the civil service and members of the Liberal party called for government leadership in managing the economy and providing for the disadvantaged. From the "intellectual" side came Keynesianism; governments could implement effective fiscal and monetary policies to combat fluctuations in the natural flowing business cycle.⁹⁰ The struggle for the development of Canada's social welfare state was based on this Keynesian argument - the belief that Canadians were becoming deeply divided by class and only collective action backed by government programming would ensure equality of opportunity and social rights. In short, only a policy which favoured increases in government spending and program initiatives could eradicate chronic poverty; this would be accomplished by monitoring the "boom" and "bust" periods.

In the midst of these competing ideologies were the victims of the Great Depression. Canadians were hit as hard as any country in the world.⁹¹ Atlantic Canada was devastated as fish exports began to dwindle away and unemployment reached unprecedented heights. In Ontario, unemployment soared from 2 percent in 1929 to 36 percent in 1936.⁹²

The Prairie regions were devastated by drought and shrinking
world wheat markets; they suffered total economic collapse. The Prairies became "one vast drifting desert where 40,000 families fought to survive - travelling miles for a little drinking water, reduced to starvation diets, forced to pull children out of school when no more patching could salvage worn-out clothing." Relief in Saskatchewan was provided for one-third of all farmers in 1936; only one year later, this number had risen to two-thirds. Maude Barlow and Bruce Campbell explain that in some districts every single family was on relief.

However, this relief was not the same type of relief of today. To be eligible for relief, a family had to demonstrate that it was nearly destitute. Inspectors would come to the home, and if they found any signs of food, new clothes, liquor or, in some cases, even a radio, relief was denied. Most municipalities had a one-year residency requirement for even emergency health care, and immigrants were not only turned down for help but deported for requesting it. Medical aid was scarce and far too expensive for most Canadians. 93

At its worst hour, the depression saw half of the wage earners in Canada on some form of relief. This occurred given the intense competition for scarce jobs which gave employers almost unlimited power to exploit their workforce: wages as low as two cents an hour, work weeks as long as one hundred hours. 94

Furthermore,

Employers terrorized their employees, docking pay for failure to meet impossible production quotas, strictly limiting washroom visits, telling part-time workers when or if they would be called in only at the last moment, firing without notice. There was no sick leave, paid holidays or insurance for unemployment or hospitals. Yet, these workers were still the lucky ones. By 1932 almost 100,000 homeless men were wandering the country, sleeping in alleys, riding the rails, growing restless in relief camps. 95
Although the government did try to offset the terrible effects of the Depression through increased spending, these attempts were administered in an ad hoc basis and were largely ineffective for providing substantial relief. According to Maude Barlow and Bruce Campbell:

In the absence of any coherent national plan or notion of social rights, money was often wasted. Relief was administered by the provinces and municipalities, who were generally punitive in their approach to welfare. Standards varied widely. Several provinces were unable to meet their relief obligations, and assistance was minimal even by the standards of the day. In 1936 Quebec dropped relief payments altogether, forcing all recipients onto workfare. 96

Amidst all this spending, it was impossible for the federal government to balance the budget. Nevertheless, the conservative forces were at work. In a report from the Canadian Centre for Policy Alternatives, Harold Chorney quoted the Financial Post headline of March 18, 1933. This headline read "Completely Balanced Accounts Urgently Needed to Maintain Complete Confidence in Nation's Financial Stability." 97 On Feb. 4, 1933, an editorial in the same newspaper read:

There is a breaking point in public finance and Canada is not far from it... Before the Canadian budget can be balanced there must be a drastic and "painful" process of slashing government departments and services. More economy in the sense of pruning expenditures will be of little value. 98

Harold Chorney recounts a number of front page stories and editorials in 1933.

...(Feb 4) What we can do to end the depression. First must balance budget... (Feb.11) What the [Financial] post is saying is not new to these columns. For years the Financial Post
has warned of trouble ahead for Canada if it continued to spend extravagantly through government channels... Once the budget is balanced I believe that confidence will be restored in ourselves, our institutions and our country; capital will come out to seek employment, prices will rise and we shall be better able to meet the rest of our obligations..... (March 4) To protect our credit structure in Canada it's essential that we make the necessary sacrifices to balance the federal budget.... (March 18) Mr. Bennett and his government have upon themselves the sole responsibility for balancing the budget and thus protecting the credit structure of the Dominion of Canada..."

Keynes' ideas were received by Canadian business and government with mistrust. Support for fiscal orthodoxy was provided by the financial and industrial sectors. Business strongly believed in balancing the budgets and maintained that recovery would soon arrive, if the government remained prudent with its financing. The president of the Bank of Toronto said in 1931 that recovery would soon arrive. In the spring of 1931, the Minister of Labour, Senator G.D. Robertson, stated:

We have experienced the most distressing winter in many years, but we can emerge into the sunlight of hope at the beginning of another season, and its within the realm of reason to say that before the snow falls again our worries will have largely disappeared.100

The extent of the disaster clearly was not truly understood. Businesses relied on laissez-faire approaches to the economy - limiting the role of government and regarding unemployment as a result of wage rigidity (i.e. workers refusing to receive lower wages). The testing of Keynes' theories on a grand scale occurred with Canada's entry into World War II.

After 1935, King was unsuccessful against his "spenders" in the new government. He blamed his ministers for not concentrating on restraint and for submitting increased estimates for their
departments at budget time. Hence, King's finance minister, Charles Dunning, in the 1938 budget provided for the first planned deficit in Canadian history - a projected $23 million shortfall. The government argued on behalf of the Keynesian revolution - the extra money in the economy (and not in the treasury) would stimulate effects on the economy and create a "boom" period to offset the temporary "bust." Thus, government financial management and accountability were influenced greatly by the prevailing Keynesian economic theory.

Social changes to policy did emerge from the King government despite his assertion that federal relief was "an orgy of public expenditures." King's statement could be compared to R.B. Bennett's declaration on the eve of the 1935 election that the capitalist system lay in ruins and that it was time to replace the conservative ideological approach - laissez-faire economics, free competition and corporate evils - with government regulation and economic controls (via attempts to counter-balancing the boom and busts of the business cycle). These two statements may help to illustrate the clash between the Keynesian and conservative ideologies.

King reduced aid to the provinces by 25 percent in 1936 and by 34 percent in 1937 because of his assertion that relief was a provincial matter, in accordance with the Constitution. It was beginning to dawn on Canadians that something in their economic and social system was fundamentally wrong. Canadians began to view the underlying structures of their society and social institutions as
a travesty. Compassion seemed to be utterly missing from the government's response to the crisis of the Great Depression.

Phase III: The Keynesian Experiment

With the growing belief that social welfare was a national responsibility, (coupled with a growing popularity of the CCF) the King government began to lay the foundation for a social welfare state. A Royal Commission was established in 1937 - the Rowell Sirois Commission - on Dominion-Provincial Relations. The Royal Commission was established because the Judicial Committee of the Privy Council had struck down Bennett's New Deal. The Commission's mandate was to study the division of powers and responsibilities in the Canadian federation.

The Commission presented its recommendations in 1940, but it was not until 1942 that the Commission's recommendations were partially implemented. The Commission was opposed to conditional grants (shared-cost programs) and the post-war governments disregarded this advice. The Commission also recommended that the federal government provide grants to subsidize the impoverished provinces so that national standards could be reached. Ultimately the Rowell-Sirois Commission became synonymous with the welfare state; ironically, this may have opened the flood-gate to Canada's national deficit.

These social changes occurred in an economic environment previously unknown to Canada. Until the 1940s, Canadian economic development had not reached its potential, given the country's vast
resources. During the second World War, Canada's resources had been utilized as they never had before; post-war circumstances gave Canadians the opportunity to develop these even further.\textsuperscript{105} It was during this unprecedented growth period in Canada's economic history that the welfare state took its roots. This period also saw the emergence of the third phase of Canadian government spending.

After the Rowell-Sirois Commission, both federal and provincial governments became "Reformers of the State." Although unemployment insurance began during the war by a constitutional amendment in 1940, after the Second World War, the federal government created new departments to look after veterans, and subsidize housing, health and welfare. During peace-time, through the appropriate use of fiscal and monetary policy, the federal government continued to build up an impressive welfare state. This should have included the deliberate use of budget deficits in "bust" periods of the business cycle. Government policy however did not decrease spending or increase taxes during "boom" periods. In effect, only the spending side of Keynesian economic philosophy became very popular among government policy makers during this period.

In 1945, King's election campaign was based on the theme of "building a new social order"; he promised a "new Liberalism" that would provide, for all Canadians, better jobs and homes, better labour conditions, collective-bargaining rights, guaranteed farm prices, social security, veterans benefits and family allowances.
Despite the growing force of Canada's democratic socialist party, the Co-operative Commonwealth Federation (CCF) this new platform enabled the Liberals to barely retain a majority in the Commons. The Liberal party's popular vote declined from 53 percent in 1940 to 39 percent in 1945. Although they retained their majority, King lost his seat to the CCF.

The CCF, by comparison, had doubled its national vote and won twenty-eight seats. This support, during 1945, may have been indicative of the wave of public support for the creation of a welfare state. It may have been initiated as a short term reaction to the Great Depression.

Either way, this change in government expenditure, and policy creations was such that even by as early as 1941, Saturday Night declared that:

...almost everyone agrees that health and unemployment insurance schemes, regulation of business, and a sharp limitation of profits are all necessary to provide the individual with real security.

Throughout the next forty years, governments continued to introduce new social programs. In 1944, the Liberal government passed a bill establishing family allowances, or the "baby bonus". Old Age pensions also increased. In 1951 it made old age pensions universal and began to pay them directly to the recipients, after the provinces agreed to a constitutional amendment. By 1957, the federal government was beginning to fund hospital insurance. In addition, the unemployment insurance fund formed a huge surplus during the post war years of prosperity and the government decided to provide more generous benefits to seasonal workers. Apparently,
the governments proved to be better spenders than savers. Federal government spending grew as depression memories dimmed and Canadians gave little consideration to the impact of a continuously growing welfare system that might one day become unsustainable. Thus, Keynesian economic policy was not properly implemented in Canada.

In 1957 and in 1958, John Diefenbaker led the Conservative Party to a victory on a nationalist campaign. Like Bennett with his 1935 "New Deal" the Diefenbaker government reversed the traditional Tory doctrine of fiscal restraint. Diefenbaker scored political points by accusing the Liberals of being "too stingy." Once in office, the Conservatives raised the pension entitlement, and Ottawa still had money surpluses to offer Canadians in the form of tax reductions. In addition, the Saskatchewan-raised Prime Minister did not ignore the Western farmers; thus providing them with monetary subsidies.

Diefenbaker won the 1958 election at a time when the postwar boom was faltering and a period of stagnation was emerging. This is part of the natural business cycle. Unemployment rose and at this time the Minister of Finance, Donald Fleming, tried to balance the budget and hold down inflation. However, since some people in the Diefenbaker government were now devoted "spending" Keynesians, they were more comfortable spending to spur development through job-creation and social programs. The Keynesian economists encouraged government spending under the rationale that this was a classic example of a "bust" time in the business cycle; planned
deficits were all that were needed to get the country on an even keel again.

As the 1960s approached, it became apparent that there was a serious imbalance between revenue sources and expenditure responsibilities.\textsuperscript{110} The federal government seemed to be losing its mastery over the economy as the country began to experience a recession with slow economic growth. Perhaps sensing the federal government's weakness, the provinces began to claim more responsibility for their own economies and questioned their past economic policies.\textsuperscript{111} Providing education and health care was a growing financial burden and the provinces placed further economic demands upon the federal government.

The most apparent indicator of these provincial demands was in the area of tax-sharing. Previously, the provinces were given compensatory payments referred to as tax rental payments where the federal government in effect took over virtually all provincial sources of revenue.\textsuperscript{112} In 1942, the federal government had substantially increased its direct taxes to help pay for the war effort; they had persuaded the provinces, by an offer of financial compensation, to terminate provincial income, corporation, and succession taxes for the duration of the war. After the war, the federal government offered to make new tax rental agreements with those provinces that desired them. Provinces that did not agree would receive no tax rental payments; however, they could levy their own taxes which would be credited against the federal taxes. Provinces agreed to "rent" their constitutional authority to levy
either income, corporate or succession taxes to the federal government. This agreement would last for periods of five years at a time.\textsuperscript{113} In return, the provinces would receive uniform per capita payments from the federal government. These payments would naturally rise with growth in the Gross National Product (GNP). In January 1947, Ontario and Quebec imposed their own succession and corporate taxes; however, they excluded personal income. Only Quebec imposed a personal income tax in 1954. Newfoundland also signed a tax rental agreement in 1949 when it became a province of Canada.\textsuperscript{114}

Since the tax rental arrangements between Ottawa and the provinces were due to expire in 1957, a renewed system was implemented. The Prairie and Atlantic provinces were content with the tax rental agreement; however, the central provinces and British Columbia raised objections due to financial concerns and desire to control more of their own revenue. Premier George Drew of Ontario proposed a tax sharing agreement as early as 1945.\textsuperscript{115} Tax Sharing was a continuation of the tax rental program. Instead of per capita grants, the provinces were able to receive a fixed percentage of personal income taxes, corporate taxes and federal succession duties.

Tax-sharing, beginning in 1962, allowed provinces to set their own rates or to top off the federal tax; the federal government still collected the tax on their behalf if they so wished. More specifically, the tax sharing included the sharing of income tax between the two levels of government. The federal government acted
as a collector and had control of succession duties. Tax sharing also included a formula to allocate the provincial share of corporation tax and a "national adjustment fund" to redistribute some direct tax revenue from the rich to the poor. Quebec chose to continue collecting its personal income tax, while Quebec, Ontario, and later Alberta collected their own corporation taxes.

Conditional grants were a second area in which the provinces were able to regain some of their autonomy vis-a-vis the federal government. This was done through an "opting out" formula which allowed provinces exclusive provincial control for certain shared cost programs. Provinces would be compensated by federal abatements (or tax reductions). Previously, the federal government offered the provinces "50 cent dollar" programs; for example, Ottawa would offer to pay half the costs of a certain program, while the province would pay for the rest. While these programs were attractive to the provinces, they meant that provincial legislatures had to spend their limited resources on programs the federal government had chosen.

Quebec was particularly dissatisfied with the "fifty cent program", and in 1964 the government decided to allow any province which did not want to be involved in a joint-cost venture to "opt out." These provinces would receive an equivalent sum of money either by way of a federal tax withdrawal or in another form. In 1977 conditional grants for health insurance and post secondary education were replaced by a block grant known as Established Programs Financing (EPF). In 1995, the federal government
decided to combine the three major areas of transfer payments to the provinces - health, education, and welfare - into one Canada health and Social Transfer (CHST)." Finance Minister Paul Martin called this an "example of fiscal federalism." The Canada Health and Social Transfer combined all the transfers to the provinces for health, post-secondary education, and social assistance, into one block grant which came into effect in April, 1996.

While Diefenbaker was in office, some of his programs such as the northern road-building, the South Saskatchewan dam, "winter-works" to reduce seasonal unemployment and wheat sales to China were considered a success. However, the 1962 campaign saw a loss of confidence in the Bank of Canada's ability to keep the Canadian dollar fixed at par with the American dollar. Canada's dollar was devalued. "Diefenbucks" were only worth 92 1/2 cents; this was one of the many reasons for the short-lived Conservative minority government.

In 1963, Diefenbaker's minority government fell over the issue of nuclear weapons. Diefenbaker was criticized as being indecisive; his stability was also questioned. In 1963, the Liberals also had to form a minority government. After the election, a foreign-exchange crisis forced the imposition of emergency controls on imports and spending abroad. However, the Canadian economy was beginning to prosper again and new jobs were being created. The recession at the end of the 1950s had caused alarm about job prospects for Canadians. However, any concerns for the economy or the size of the debt quickly dissipated as the
economy began to pick up again. The foreign-exchange crisis did not seem to have a lasting impact on the economy. The rest of the 1960s were good years, to the political profit of Lester Pearson.

Pearson once referred to the 1960's as the "age of grants" due to the tendency toward government intervention in the economy. Rather than letting individuals do it themselves, Pearson believed that the state should control more, and spend more by using its powers to provide material aid to ordinary citizens. This would "liberate" them from poverty, ignorance and other disadvantages. This new "visible hand" of modern management in the welfare state created vigorous activity by politicians and government. Programs for better pensions and health insurance were among the reforms that the Pearson government instituted. It also created very high tax levels with negative effects for capital formation and productive growth.

The 1960s were marked by a tremendous growth in the economy. In the early 1960s, exports doubled; these were again doubled in the late 1960s. Unemployment fell below four percent and inflation was just above two per cent. This decade has been used as an example of successful macro-economic policy by the Bank of Canada's current governor Gordon Thiessen who has justified his policy of continuing a fight against inflation by citing the experience of the 1960's.

However, Thiessen, unlike the policy makers of the 1960s, has not advocated that social programs grow and prosper under such positive economic conditions. In the 1960s it was believed that
extra resources needed for new social programs would be gained from the prospects of northern abundance which seemed unlimited. In such an environment, programs such as Health insurance seemed like a natural way to spend the harvested wealth.

The Canada Pension Plan enshrined several key new rights: it lowered the age of eligibility to sixty-five and the Plan declared that Canadian seniors should receive a government pension adequate to maintaining a socially acceptable standard of living, rather than bare subsistence. Therefore, there would be automatic increases in benefits in line with increases in the cost of living. For the first time, those who were widowed or had long term disabilities were fully provided for.124

The Pearson government launched the era of "co-operative" federalism which was characterized by constant consultation between the two levels of government. Ottawa’s proposed Canada Pension Plan was to be built on top of the universal old-age pension; however, this proposal became a serious threat to "co-operative federalism," due to the heavy handed way in which the federal government required the provinces to "fall into line."125 Pearson’s government proposed an idea for an unfunded "pay as you go" policy. Quebec rejected this plan as "any plan controlled by Ottawa was unacceptable to Quebec."126 Instead it proposed a funded plan under Quebec’s exclusive control.

Hence, the Canada Pension Plan compromise emerged. This agreement allowed any province to set up a pension plan similar to the one Ottawa would administer while the federal plan was modified
to resemble Quebec's. Not surprisingly, Quebec was the only province to go ahead with its own plan. Consequently, there would be two partially funded pension plans in the one country: one for Canada and one for Quebec. The Quebec government controlled its own investments built up in the plan. Quebec also began suggesting that it should take over family allowances. These sentiments coincided with the passionate separatist movement which was growing more and more visible during the 1960s.

The spirit of "co-operative" federalism continued to wane when the government proposed health care insurance. Ottawa became less interested in provincial autonomy; rather, it favoured a national perspective. Ottawa insisted that the provinces implement plans which met the strict criteria of universality, comprehensiveness, and portability in order to receive health insurance grants. The provinces obviously could not afford the political repercussions of opting out of health insurance. Thus the provinces and Ottawa abandoned co-operative federalism.

The National Health Insurance Plan was approved by the House of Commons on December 1966 in a vote of 177 to 2. It came into effect on July 1, 1968. The conditions for provinces receiving federal grands for health care were clear: provinces had to deliver non-profit, comprehensive, universally available health care to their residents; and benefits had to be portable from one province to another. This act transformed daily life for millions of Canadians. Furthermore, during this time, there were also discussions revolving around scholarships and other programs that
would eliminate tuition fees for universities.

These policy plans laid the foundation for the social welfare state, despite the "stodgy, penny-pinching" Finance Minister Mitchell Sharp. In 1965, federal welfare expenditures exceeded the nation's defence bill for the first time.

The late 1960s were also the time when Pierre Elliot Trudeau became Prime Minister. Although he is often viewed as the "father of a new social order" the following statement is a much more accurate depiction of the federal government's spending capabilities. As Michael Bliss stated,

What did emerge was a slow realization of the limits of government, of the inability of bureaucrats and social engineers to control the forces of the marketplace and to change people's behaviour. In the end, the Trudeau Liberals left Canada sinking in debt and facing a tidal wave of conservative reaction.

The Liberal campaign slogan in 1968 was for a "Just Society." This included a large government with a huge staff of "experts" for policy and program analysis. A total of 114 new administrative and regulatory agencies came into existence between 1968 and 1984. Trudeau created Ministers of State for economic development, science and technology, social development and urban affairs. The creation of new departments and ministers of state ultimately led to bloated cabinets and the public perception of an inefficient bureaucracy. In 1867, fourteen ministers governed the Dominion; even Diefenbaker only had about twenty. In the early 1980s, this number reached thirty-nine. In other democratic countries, only the British come close to this number with 25. Switzerland managed
with seven ministers, and the United States ran its powerful nation with twenty. As D'Arcy Jenish states Canada "achieved the dubious distinction of becoming one of the world's most over-governed democracies."

The economic consequences of the increase in ministers meant it became more and more difficult for the Minister of Finance to practice fiscal prudence of any kind. Thus, grants were given liberally to native groups, women's organizations and ethnic groups in order to support multiculturalism and regional interests. After 1973 the government intervened in the market to keep the price of oil at an artificially low level, at considerable expense. Added to Pearson's medicare and Canada Pension Plan, the welfare state was pushed beyond its limits as government expenditures grew far more costly than anyone had anticipated.

As Minister of Finance in 1978, Jean Chrétien stated "It is clear now how the economic boom of the 1960s and early '70s tempted all of us - workers, management and governments - to live beyond our means and demand more than the economy could sustain. By 1974-75 this pushed inflation to critical levels, pricing us out of world markets and bringing on the surge of unemployment that still besets us." Chrétien in the same budget speech states "...we are going through a difficult period of adjustment.... but the recovery is proceeding. Employment is rising.... The question now is whether the gradual recovery that has been established should be given an added push from policy. I have decided that it should." He then proceeded to announce tax cuts that would benefit 7.5 million low-
and middle-income Canadians and cost the treasury $700 million in forgone revenue. He also announced a plan to index personal tax exemptions by 7.2 percent allowing an additional $850 million in forgone benefits plus rapid growth in money supply. All of these measures contributed to the increase in inflation. Thus, in 1978, dealing with the deficit clearly did not make Chrétien's agenda. In part this was due to the fact that government (nor did many economists) did not know how to address the supply side shocks like increasing oil prices and a belief that spending would lead to a decrease in unemployment and help re-fuel a stagnant economy.

Such Neo-Keynesian spending-side ideologies do have positive attributes. According to D'Arcy Jenish, the Liberal government under Trudeau instilled the notion that the wealth of a nation should be distributed throughout the country. The Liberals

 Changed our way of thinking about poverty, unemployment, and the personal misfortune of others. They made compassion one of our core political values. They enlarged the role of the state in the economy, raised our expectations of government, and withdrew the line between the obligations of the state and the responsibilities of the citizen.138

Thus, as spending-side Keynesian economic policy flourished, Canadian governments were dominated by aphorisms of universality rather than frugality; this formed the third phase of Canadian economic spending. Out of this phase of great reforms Canadians were less vulnerable to the severe recessions to come, the most notable being those at the beginning of the 1980s and the 1990s. Out of this period also emerged a huge debt burden that would be placed on Canadians.

Economic uncertainty came to dominate in the late 1970s, 1980s
and 1990s. This was a new era. The 1970s were characterized by an unprecedented degree of criticism and cynicism towards and about government in general.\textsuperscript{139} The quadrupling of world oil prices in the fall of 1973 was one cause of a decade of high inflation, intense fears of resource shortages, persistent unemployment and lagging productivity.\textsuperscript{140} Also in the 1970s Canadians witnessed an increase in the generosity of unemployment premiums, decreased tax revenues due to cuts in corporate income tax and greater regulation of the economy in general. The government felt that it had to cushion Canadians from the global energy crisis, from the impact of inflation, and from all of the failings of a market economy. The government spent (some say wasted) billions on regional development schemes and in 1975, the federal government implemented wage and price controls.

Despite Trudeau's attempts to quell the growing anxieties created from inflation and unemployment, the 1979 election clearly illustrated the population's dissatisfaction with the Trudeau government through the election of Joe Clark. Inflation and unemployment soared in the early 1980s despite a massive effort from the Trudeau government to control it. Unemployment refused to retreat despite stimulative budgets, regional development policies and job creation schemes. Interest rates soared with disastrous consequences for home owners who had to renew their mortgages and business people who had to borrow money.\textsuperscript{141}

Although Clark did not have a majority government, he believed he had a clear mandate to cut spending. The Minister of
Finance, John Crosbie, and the Treasury Board president, Sinclair Stevens, made promises to "get government spending [in Canada] under control." Stevens suggested that 60,000 jobs in government could be eliminated and that one of the government’s most important goals was to reduce the deficit.

John Crosbie’s first (and last) budget announced that the annual growth in government spending would be limited to ten per cent. In addition, he raised a number of taxes including an eighteen percent tax on gasoline. At this time, Canadians were apparently not willing to accept the idea of "short term pain, for long term gain" in order to bring the deficit under control. The Clark government fell on the issue of the budget and the Liberals terminated Trudeau’s first attempt at retirement.

As Prime Minister once again, Trudeau initiated the controversial National Energy Program (NEP) in the autumn of 1980. The NEP consisted of a complicated regime of taxes, controls, subsidies and incentives. This was done in an attempt to keep Canadian energy prices below world levels, to stimulate petroleum exploration and development in the Canadian North and to generate $30 billion a year or more in revenues. The National Energy Program did succeed in stimulating a substantial transfer of foreign assets to Canadian investors, as private and public Canadian companies were as Michael Bliss stated "encouraged to buy up petroleum assets at what proved to be the highest [prices] in history." The NEP was based on incorrect assumptions about permanent shortages of oil supply and rising oil prices. The price
of oil collapsed in 1981 and continued to decline throughout the 1980s. This policy seriously damaged the federal government's reputation for intelligence and judgement. This was particularly true in the West, where sentiments of Western alienation were becoming full blown.

The economic situation throughout the 1970s made its true impact with the extreme recession of the early 1980s. The National Energy Program resulted in a major decline in Trudeau's popularity. Industrial bailouts created incentives for every failing firm in the country to turn to the government for help. Regional equalization had created a constant dependence from most of Atlantic Canada and large parts of Quebec. This dependence was assumed willingly by the federal government.

Trudeau also created the Foreign Investment Review Agency; this partially succeeded in controlling foreign investment. Furthermore, the Liberals had hoped that the NEP and a wave of resource "megaprojects" would generate the revenues necessary to keep the welfare state solvent. As resource prices collapsed and the recession hit, the government simply kept spending. The government of Canada ran its last budgetary surplus in 1972-1973. In 1979-1980 it spent $12 billion more than it took in; in 1982-83 the deficit topped $24 billion and the following year it surpassed $32 billion. 146 As Michael Bliss stated "Everywhere they had been applied, the visible hands of the planning generation had been clumsy, unproductive and damaging." 147 D'Arcy Jenish confirms these sentiments when stating:
The effect of the deficits was to misrepresent the cost of government programs. People received their benefits but they did not receive an accurate bill. Had they been taxed in full, they might well have rebelled and said that the price was too high. Borrowing allowed Trudeau and his ministers to spend freely, and often frivolously, without risking their political hides.148

History had shown that Keynesian economic theories seemed to be unworkable in practice, given the government's temptation to continue spending through incurred deficits. In fact little of what Trudeau did was really "Keynesian." The Liberals set out to create jobs and prosperity; they partially succeeded. However, the creation of this protected shelter resulted in a haven filled with debt and inflation. Thus, true Keynesianism was never practiced in Canada.149

In the early 1980s, the government's ability to "deliver the goods" via Keynesian philosophy was beginning to be questioned. As Michael Bliss stated, "...Keynesian, socialist and other anti-market schools of economics became an object lesson in what governments could not achieve in a competitive market economy."150 The net effect of "nation-building" economic strategies, industrial policies, regional development schemes, energy policies, megaprojects, and tax juggling left the deficit during a very bad recession soaring close to $40 billion in 1984.151 It was in this economic environment that the fourth phase of financial management emerged. This "neo-conservative" era attempted to maintain social programs while increasingly cutting funds to more and more areas in a seemingly ad hoc basis. In response to this "neo-conservative" movement, the "neo-Keynesian" emerged. While the classical
Keynesian saw a limited role for the state in contemporary capitalism, the "neo-Keynesian" modifies the original Keynesian doctrine to include socialist intervention as an essential component of redistribution. The neo-Keynesian legitimatizes state intervention to include "those activities designed to create or maintain the conditions necessary for social harmony." 152

Until he left office in 1993, nine years after Trudeau, Brian Mulroney continued to blame Trudeau and "spend-happy" Liberals for Canada's increasingly worrisome debt levels and high interest rates. Mulroney became Prime Minister in 1984 on a platform that favoured "restraint in governments and a greater dependency on the private sector towards general economic growth." 153 Mulroney pledged that his government would "spend smarter." His campaign slogan "Pink slips and running shoes" for thousands of civil servants, simply was not implemented and did not occur. The status quo was maintained virtually unscathed. In fact, federal spending went up each year that Mulroney was in office. Transfers to other governments (including equalization payments to the provinces, the Canada Assistance Plan, and Established Program Financing) were $21.7 billion when the Mulroney government arrived in office. Nine years later, they had climbed to $29.4 billion. 154 However, they did use monetary policy to increase interest rates and slow down inflation.

The Nielsen Task Force, appointed soon after Mulroney became Prime Minister, proposed a long list of suggestions to cut spending through improved management and eliminating waste and duplication
in its multi-volume report; they were largely disregarded. Mulroney and his first Minister of Finance, Michael Wilson, did initiate spending cuts and government spending did fall relative to GDP. However, these cuts were mostly cosmetic or "deferred" costs. Michael Bliss also reported that by "mid 1985, it was clear that the Conservatives had little interest in taking the heat that would be generated by a serious attempt to return Canada to fiscal responsibility." D'Arcy Jenish also revealed how the Conservative government only cut "spending projections." Jenish explained how government managers and planners generally anticipated that one dollar this year would become $1.05 or $1.10 the following year. The Conservative government tended to trim these increases back to $1.03 or $1.04. As such:

...the opposition parties [ie. the Liberals] and the organizations affected by these modest reductions would howl in anguish. This is like a group of unionized workers demanding a 10 percent pay hike, settling for 3 percent, the telling the public they had taken a 7 percent pay cut. In most places, such an assertion would correctly be dismissed as sheer nonsense. But in Ottawa, it passed for the truth.

It has been stated that the 1960s were considered to be the age of grants. It should be noted that this phenomenon continued to flourish into the 1990s. During the 1992-93 fiscal year, for example, a Nova Scotia company called Canadian Hybrid Farms received almost $100,000 to develop genetically altered hamsters. A local industrial commission on Prince Edward Island received $31,000 for its I Want To Be A Millionaire Program. An even more outrageous program was the $22,300 in funds awarded to the University of Moncton for "a study to develop blueberry jelly."
Thus, some government funded programs were wasteful, frivolous, and unnecessary.

The Mulroney decade was not without its accomplishments. For example, the federal deficit which ran at $38.5 billion in 1984-1985 was at $34.6 billion in 1991-1992. However, it was reported by the Liberals that Kim Campbell’s government left office in 1993 with a deficit of $42 billion. Although the Conservatives came to power promising to tame the deficit, Finance Minister Michael Wilson and his successor, Don Mazankowski continued to borrow money to pay for the welfare state, as well as the mammoth interest payments on the accumulated debt. Bliss believed that the inability of the Mulroney government to balance the budget could be described as a:

...failure of intelligence and will, a betrayal of the Conservative Party’s supporters and the country’s children that would burden Canada for generations to come. The government’s only defence was that it was trying to exercise restraint and was doing a better job than the Liberals had.

High levels of spending had become the norm in Ottawa and it was very difficult for the federal government to break this politically rewarding system. The Conservatives did manage to slow down growth in spending, but only minimally. One could argue that the Conservatives controlled what they could: program spending. Interest payments on the debt were largely a function of history and high interest rates caused by the Bank of Canada. D’Arcy Jenish argues however, that parliament’s ability to tax was utilized to a greater extent than its ability to control spending.
Indeed, D'Arcy Jenish explained that the Conservatives' only headway against the deficit was through increased revenue, not through lower expenditure. He states "while the robust economy of the 1980s would have generated billions of dollars in new revenues for Ottawa, the Tories conducted a major overhaul of the tax system, which dramatically increased the government's take."  

In 1984-85 Ottawa took in $29 billion through income tax. By 1991-92 the government took in more than $61 billion. In the 1985 budget, the Conservatives brought in eleven new tax measures in an attempt to eliminate tax loopholes. These initiatives included: the elimination of the Registered Home Ownership Savings Plan; the de-indexation of personal income taxes; a minimum income tax imposed on high income Canadians; amendments which prevent taxpayers from avoiding tax by splitting income through the use of loans to spouses and children; elimination of tax shelters involving property such as yachts, recreational vehicles and hotels; a tax imposed on the capital of large chartered banks and trust companies; a 1-per cent increase in the federal sales tax beginning in 1986; 25-cent increase in the tax on cigarettes; a 2 percent increase in the tax on alcoholic beverages; and a 2 cent per litre increase in the excise tax on gasoline and other transportation fuels. The government had once again resorted to antiquated "sin taxes" in order to justify the increase in taxes. The notion of "voluntary tax" was still being utilized by the federal government. The federal government also announced its plan to sell off Crown corporations in order to create a government that
was "lean, efficient and effective." 165

These measures were expected to cut the projected debt by $75 billion. 166 What resulted, however, was the growth of the underground economy, with its cash transactions and tax avoidance. The revolt against excessive tobacco taxes changed the public's perception towards government. The Canadian public had become infuriated by the tax increases.

This antagonistic response towards tax increases had been foreseen and avoided by Canada's early ministers of finance. Members of Parliament at the time of Confederation feared a loss in valuable revenue through illegal smuggling and underground activity. Members of Parliament during the mid-eighties witnessed the evolution of a permanent resentment of tax increases of any kind. It was for this reason that the Chretien government was forced to deal with the deficit/debt problem without raising taxes; they attached themselves to the proverbial pledge of "No New Taxes!"

The Mulroney government made another critical error regarding the deficits and debt problem in Canada. They underestimated their deficits year in and year out. The trouble with promising to cut the deficit and not doing so was that it affected Canada's international credibility. For example, the May 1985 budget called for a deficit of $35.8 billion for the fiscal year; the actual deficit was $38.6 billion - a shortfall of $2.8 billion. The April 1993 budget predicted a shortfall of $32.6 billion; however, the Conservatives produced a $42 billion deficit - a $9.4 billion
shortfall.\textsuperscript{167} The effect that these shortfalls had on finance Minister Paul Martin’s budgets were apparent. Martin was forced to make conservative estimates on deficit projections, so as to placate Canada’s international investors.

Such over-cautious estimates meant that Paul Martin continuously underestimated his economic expectations for the coming years. For example, the Liberals faced a $42-billion deficit in 1993. At that time, they promised that by 1997, the deficit would be nor more than three per cent - or $24.3-billion. The deficit in 1997 was $19-billion... $9.5-billion below the previous year. Martin predicted that the 1998 budget would be no higher than $17-billion. The 1998 budget witnessed a zero deficit.
Chapter Four: The Chrétien Government and the deficit:

The Deficit-debt crisis is a story of failure at the highest level of our political system. And the plot is as simple as this: Pierre Trudeau lit a fire; Brian Mulroney wouldn’t put it out; so the problem has landed on Jean Chrétien desk.\(^{168}\)

Canada in 1867 was a financially sound country. However, by the end of World War Two, the national debt had reached unprecedented levels of 106 percent of the country’s gross domestic product. Over the next twenty years, successive federal administrations whittled away at the debt while the economy grew at a remarkable rate. By Centennial year, 1967, the debt stood at 26 percent of the economy and continued to fall in relation to GDP to 16 percent in 1975.\(^{169}\) The dramatic increases in the debt to GDP ratio beginning in the early 1980’s had significant consequences; a seemingly uncontrollable level of debt evolved.

Phase four: a return to prudent financing:

As a result of Liberal extravagance and relative Conservative inaction, Prime Minister Chrétien and his Liberal party have been awarded the task of setting Canada’s finances "back on track." This would require characteristically un-Liberal actions. These actions have to be done in an environment that has already endured skyrocketing interest rates and a continuously high rate of unemployment.

The Welfare state had become a defining characteristic of the Canadian state during the third phase of financial management.
This idea became so popular that for some it was considered to be a universal right as it was one of the most defining characteristics of the Canadian state. However, the welfare state and the mis-application of Keynesian economics contributed to government overspending and overtaxing. The welfare state was put under scrutiny as the public's trust in the competence of the government and its institutions decreased.

Governments were seen as unresponsive and non-reactive as they became unable to "deliver the goods" promised. It was in this environment that the fourth phase of parliamentary financial management arose. A neo-conservative agenda of neo-classic economic theories had not begun to surface until the late 1980s and into the 1990s, particularly under the influence of the Reform Party's platform.

Prime Minister Kim Campbell also addressed deficits and debt in the 1993 general election. For most Canadians, the condition of the economy was the issue deciding which party would gain their support. On the eve of the Conservative campaign "kick off", the economy was still sluggish, particularly in Ontario and Quebec.470 Forty-three thousand jobs were lost in 1993 alone.471 However, the Campbell platform stated that renewal and growth would take time, and that education, rather than government intervention, would hold the key to future economic growth. This policy platform signalled the shift away from short-run stabilization policy toward neo-classical ideas regarding the promotion of long-run growth through increased investment, increase in education and increase in
research and development.

Campbell focused almost exclusively on the debt as she believed that the deficit adversely affected future generations. She promised that her government would erase the $35.5 billion dollar deficit through a non-interventionist, neo-conservative agenda. Campbell told Canadians to "tough it out because a deficit strapped government has neither the money nor the tools to lead the country out of recession." The Conservatives insisted that the economy would only rebound properly if left alone. Partly for this reason, Jean Chrétien won the 1993 election, promising 65,000 new jobs with a six billion dollar investment in infrastructure.

In the early 1990s, Chrétien, as opposition leader, had promised that once he was elected into office, jobs and economic growth - not deficit cutting - would be his priorities; "as long as we have unemployment in our society and no growth, we have to use the deficit to keep the dignity of our people... Zero deficit means zero jobs, zero growth, zero hope." Similarly, Chrétien promised "not to touch social programs" or cut transfer payments to the provinces.

Once Chrétien was in office, he retreated from his earlier campaign promises; the Liberal government adopted the deficit-reduction platform which it had once been so quick to criticize. In the Red Book, the Liberals had argued that "faster economic growth and reduction in unemployment is a prerequisite for sustained deficit reduction (emphasis added). However, by 1994, despite the fact that Kim Campbell had lost the election on a deficit
fighting platform, the Liberals' view of the relationship between the debt/deficit and jobs/growth had been completely reversed. In a speech to the International Monetary Fund, Paul Martin was quoted as saying deficit reduction "was a pre condition for sustained economic growth and job creation (emphasis added)."176

The debt/deficit and jobs/growth relationship has taken on a "which comes first, the chicken or the egg" argument. Neo-conservatives maintain that reducing the deficit will lead to economic stability; Neo-Keynesians, such as Maude Barlow and Bruce Campbell or Linda McQuaig, however, maintain that creating jobs will reach this same end. To say that each strategy will achieve the same end skews the truth. While each economic philosophy may promise similar benefits in regard to the end result, their methods to get there vary drastically.

As stated earlier, Neo-conservatives focus almost exclusively on the perceived costs of growth in the national debt and thus will forgo short-run stabilization methods. Neo-Keynesians focus almost exclusively on the short-run stability of the economy and tend to dismiss concerns regarding the level of the debt. Thus, ignoring the methods of the two economic theories trivializes their consequences and may mislead Canadians.

To declare that it does not matter which economic strategy the government follows initially; because both hope lead to the same end - economic stability - is a fallacy. For most of the 1990's, Chrétien was attempting to use Neo-conservative methods while promising the Neo-keynesian safety nets. As many Canadians are
now subscribing to the Neo-conservative ideology, Chrétien’s subtle misrepresentation between jobs/growth and debt/deficit has been very successful. Canadians must be reminded that which policy the government chooses to follow has serious consequences.

As fighting deficits has become a priority for the Liberal government, Canadians are asked to rethink what their "rights" entail; for example, is universal entitlement a realistic policy? The question is: how far are Canadians willing to go to pay off the debt? This question will generate a variety of different ideas regarding what it means to be a Canadian citizen, particularly in the post - deficit era, when governments must decide what to do with annual surpluses - pay down the debt, or re-address social security networks.

*Chrétien’s 3% solution and the Program Review Process:*

The Liberal government, despite their campaign promises, seems to have become converted to the principles of Neo-conservative economics. According to Robert Allen, Neo-conservative economics includes a "righward drift" among state and provincial governments. He states:

> All of these [conservative] governments have sought to reduce taxes (especially for the well-to-do), government spending, and the public provision of social services. Government owned enterprises have been privatized, business have been de-regulated, and organized labour has been attached....The collapse of communism in 1991 was taken by conservatives as proof that the state cannot improve on the market as the coordinator of social life. Today history seems to be marching towards free markets and minimal government rather than socialism and state planning."^{177}

Chretien’s commitment to jobs and economic growth dissipated as he
embraced a new focus on deficit fighting. In an attempt to reach balanced budgets, the Liberals promised to maintain a "social security system that is fair, compassionate and affordable." Also, the Liberal government adopted the "three percent solution." The government's deficit target was to reduce the deficit by three percent of GDP until zero deficit was achieved. In the 1994 budget, Martin stressed that this goal could not be achieved simply by making cuts to government expenditure - "Significant reform of the way government operates was also essential." In order to achieve this objective, the Liberal government began a comprehensive plan called Program Review. Program Review was announced in the 1994 budget to "ensure that the government’s diminished resources [were] directed to the highest priority requirements and to those areas where the federal government [was] best placed to deliver services." Program Review’s main objective was to bring about the most effective and cost efficient means of delivering programs and services. Each program and service was evaluated and classified under an "appropriate" title for the federal government to deliver.

In theory, Program Review followed six guidelines or "tests" (see following chart) to assist federal departments and agencies in making critical review of their activities.
### Six tests of Program Review*182*

<table>
<thead>
<tr>
<th>Test</th>
<th>Purpose</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public Interest Test</td>
<td>Does the program area or activity continue to serve a public interest?</td>
</tr>
<tr>
<td>Role of government Test</td>
<td>Is there a legitimate and necessary role for government in this program area or activity?</td>
</tr>
<tr>
<td>Federalism Test</td>
<td>Is the current role of the federal government appropriate, or is the program a candidate for realignment with the provinces?</td>
</tr>
<tr>
<td>Partnership Test</td>
<td>What activities or programs should or could be transferred in whole or in part to the private or voluntary sector?</td>
</tr>
<tr>
<td>Efficiency Test</td>
<td>If the program or activity continues, how could its efficiency be improved?</td>
</tr>
<tr>
<td>Affordability Test</td>
<td>Is the resultant package of programs and activities affordable within the fiscal restraint? If not, what programs or activities should be abandoned?</td>
</tr>
</tbody>
</table>

These tests were designed to serve as screens to assist in the decision-making process. Unfortunately, Program Review did not work out as effectively as hoped. Gilles Paquet and Robert Shepherd - "insiders" to this review process - discovered that the "Federal Program review, while producing dramatic results in terms of dollars or job cuts, was primarily a scramble for cash, and did not represent a "re-design" or "re-invention" of government."*183*
Furthermore:

Federal Departments cut what could be cut, and little real attention was paid to the six starting criteria. There was little or no attempt made to examine the structure and process of government on a horizontal basis. There is little evidence that the Program review was either strategic or guided by any overall notion of where this will take the Federal Role.\textsuperscript{184}

In other words, despite its attempt to do so, there was a lack of adherence to the policy guidelines. Paquet and Shepherd in their article in \textit{How Ottawa Spends} examined the Program Review process and discovered that there was a "pattern of 'unstated objectives'"—meaning Program Review errors. These "errors" were: Type I error—rejecting or cutting a program when it was most satisfactory according to the tests—and Type II error—maintaining programs that would appear not to meet the six tests.\textsuperscript{185} Their study then proceeds to cite many examples that in their opinion meet the criteria of Type I (such as Environment Canada National Contamination Sites remediation or Western Economic Diversification Program) and Type II errors (Indian Affairs and Northern Development Native Claims Programs).

Paquet and Shepherd claim the drift from Program Review Process was due to three main reasons: the first was the complexity of the issues facing the government and the fact that "citizens have been prone to conform to any strategy that would give the appearance that the government was addressing important issues of governance rationally (emphasis added)."\textsuperscript{186} Second, it was difficult for the public at large to detect the extent of the drift
until it had become a reality; third, the lack of a public forum resulted in a degree of "secrecy" surrounding the Program Review Process. The authors suggest that this was a deliberate attempt by the Chrétien government to "immunize Program Review from both public scrutiny and disapproval."187

The failure of the Program Review process was largely due to a lack of real commitment by the federal Liberals to restructure the massive bureaucratic machinery of government based on the Six Tests. Anything beyond the 'Affordability Test' was merely a facade. To have achieved the Program Review process to perfection, however, would be a difficult, if not impossible task. Although the authors criticisms of the Review Process are valid, it would take a remarkable leader to restructure the bureaucracy to reach an "ideal" stage.

The Program Review Process was successful, however, in terms of spurring the government into deficit-fighting action. The Program Review encompassed approximately $52 billion worth of spending, excluding only major block transfer funds (which were addressed in the 1995 budget).188 Program review led to the structural change of Canada's transportation system ("no longer will the federal government own, operate and subsidize large parts of Canada's transportation system. It will instead focus on core policy and regulatory responsibilities and ensuring the safety and security of the system..."), agricultural subsidies (integrating agricultural subsidies which "emphasizes income stabilization rather than income support."), Department of Fisheries and
Oceans (potential devolution of freshwater fisheries management) and business subsidies (reduced by 60% and the remaining assistance will be largely in the form of loans and other repayable contributions). Furthermore, an immigration fee and sponsorship financial guarantee were initiated, as well as Environment Canada will shift away from local issues and service delivery toward research and policy. Program Review initiated a new Expenditure Management System to "ensure that the scrutiny of government spending initiated in Program review becomes a permanent feature of public sector management." Basically, this means that departments will no longer have access to a "central funds" reservoir. For new policy initiatives funding was to come from reallocations within existing budgets. These are some examples of the structural changes introduced to Canada because of the Program Review Process introduced in the 1994 budget.

In the 1994 budget speech, Paul Martin also began "prepping" Canadians for what was to come in the 1995 budget. Martin stated "It is time now for the government to get its fiscal house in order." Furthermore Martin warned: "The challenge today is not to rush. The challenge is to get things right. But make no mistake. There will be change. This is a two stage process, not a twenty-stage process. We are setting the stage this year for completion next year. There are due dates. There are deadlines. And there are firm fiscal targets to guide our reform."
The 1995 Budget

The political environment leading up to the 1995 budget was unusual in Canada. Whether these circumstances were orchestrated by an elite group of neo-conservatives is not clear, but certainly, the neo-conservatives gained an advantage in terms of the deficit battle. By way of explanation, the pre-budget debt "hysteria" was fuelled by two major events: One was the December 20, 1994 collapse of the Mexican peso, The second factor contributing to pre-budget debt "hysteria" was news that the New York bond rating Agency "Moody" was putting the federal government’s debt on a credit watch, a signal that it was about to lower the government’s triple A rating. As a preamble to these two major events, however, negative commentaries in The Financial Times of London and the Wall Street Journal acted as a catalyst to the neo-conservative movement. The most publicized article was an editorial entitled "Bankrupt Canada" published in mid January, 1995. The article declared that Canada’s debt was so precarious that the country was headed for third world status. The article stated "Canada has now become an honourary member of the third world in the un-manageability of its debt problem... if dramatic action isn’t taken in the next month’s federal budget....Canada could hit the debt wall... and have to call in the International Monetary fund."

The Mexican peso crisis – a sharp devaluation of the currency that created economic havoc – was considered by some to be a major "wake-up call" for Canada. Some headlines in major newspapers
warned that Canada’s financial situation was not much better: On January 14th, 1995 the Globe and Mail reported: "The Peso debacle sends a bracing message to Canadians." Similar warnings were found in the Financial Post; Mexico and Canada share several frightening similarities. In the Montreal Gazette, the title read: "Mexico’s financial turmoil serves as lesson for debt-ridden Canada." In the Halifax Chronicle Herald: "Canada, Mexico like apples, oranges." On January 16th, 1995, the Western Report queried: "Is the Loonie the next Peso?" On January 17th, 1995 the Toronto Star declared "Lessons to learn from Mexico: Canada must deal with its current account deficit." The Globe and Mail warned: "Massive Crisis seen coming in Canada." These reports demonstrated the "crisis-like" atmosphere that was being orchestrated by the media. According to Gideon Rosenbluth in his article The political economy of deficit phobia:

Fear of deficits has become a major conservative propaganda tool used by both the federal and provincial governments. It is used to make it seem inevitable that social programs must be pared down - so that we will be able to afford them in the future. It is used to attack public service unions - to protect public service jobs when 'the cupboard is bare.' It is used to attack public service jobs - to protect the taxpayer. It is used when privatizing government functions and when whittling away the regulatory functions of government. It is used, particularly by provincial governments, as an argument for following a pro-cyclical fiscal policy, cutting expenditures and raising taxes in recession... the propaganda has been so successful that deficit phobia has engulfed the politicians of the left.

The second major event leading up to the 1995 budget was the announcement made by the New-York based Moody’s Investors Services (the world’s most influential bond rating agency) that the
government of Canada was under review due to high levels of debt. Headlines in the Montreal Gazette read "Moody warns that Canada could lose triple A rating no matter what Martin does." The Vancouver Sun stated: "Triple A rating looks like history." The Globe and Mail reported that "Canada's credit rating in Jeopardy." The Financial Post Daily cried: "Moody warning rattles C$: bonds, C$plunge as rating agency puts federal debt under review for possible downgrade." Finally, the Globe and Mail admonished: "Credit reviews shocks markets: Moody's report creates chaos as investors unload dollar, driving up interest rates."

This "credit watch" combined with the Mexican crisis led to speculation by the media that Canada was headed towards a "debt wall." In other words, they alleged that Canada was close to bankruptcy. Even as early as January. 26th, 1995 the Halifax Chronicle Herald cautioned "Ottawa must control debt or others will." Also, in February the Vancouver Sun asserted that "hitting 'the wall' over debt not pleasant." On Feb. 16th the Calgary Herald reports "There is no escape, someone has to pay" and "Decision time: Canada has some tough choices to make, but it must tackle the national debt and deficit." These examples recapture the expressions of urgency relayed in the media regarding the deficit 'crisis.'

Maude Barlow and Bruce Campbell, as well as Linda McQuaig question why Moody timed its announcement so close to the budget. Linda McQuaig also reports that Moody's senior Canada analyst, Vincent Truglia, informed McQuaig that Canadian analysts were
continually harassing him to downgrade his rating of Canadian debt. Truglia states that Canada "is the only country that I handle where, usually, nationals from that country want the country downgraded even more - on a regular basis. They think it's rated too highly." At this time, Canada was rated "triple A" which meant "the risk of a default on a triple A is something under three-tenths of one per cent over ten years. even if Canada's debt were downgraded to a notch to Aa1, this would only raise the probability of default very slightly to five-tenths of one per cent over ten years." The following chart illustrated the bond ratings.

### Credit-Rating Agency Listings

<table>
<thead>
<tr>
<th>Standard &amp; Poor's</th>
<th>Moody's</th>
<th>Definition of ratings applied to long-term securities</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAA</td>
<td>Aaa</td>
<td>Excellent quality debtor, minimal investor risk; extremely strong repayment capacity.</td>
</tr>
<tr>
<td>AA</td>
<td>Aa</td>
<td>High quality debtor; debt well protected over a long period, very strong repayment capacity.</td>
</tr>
<tr>
<td>A</td>
<td>A</td>
<td>Upper medium grade; numerous positive aspects but also long-term risks; strong principal repayment capacity but more vulnerable to unfavourable circumstances.</td>
</tr>
<tr>
<td>BBB</td>
<td>Baa</td>
<td>Medium grade; good chance that debt will be repaid in time, but long-term protection uncertain.</td>
</tr>
<tr>
<td>BB</td>
<td>Ba</td>
<td>Risky investment of deteriorating quality; interest payments and the investment itself are minimally insured.</td>
</tr>
<tr>
<td>B</td>
<td>B</td>
<td></td>
</tr>
<tr>
<td>CCC</td>
<td>Caa</td>
<td>Small probability that debt can be serviced on time and in total. For Moody's, possible delay of interest payments.</td>
</tr>
<tr>
<td>CC</td>
<td>Ca</td>
<td></td>
</tr>
<tr>
<td>C</td>
<td>C</td>
<td></td>
</tr>
<tr>
<td>D</td>
<td>—</td>
<td>Late by more than one interest payment deadline</td>
</tr>
</tbody>
</table>

Source: A country Held Hostage. p. 195
Nonetheless, these two major events led to a shift in public opinion regarding deficits. In short, deficits became a 'household' concern among the Canadian population. For example, when Paul Martin delivered his 1995 budget speech he stated:

Canadians want to cut the deficit. They do not believe that governments can borrow us out of the trouble that the governments borrowed us into. They know that higher debt means higher taxes, and they want an end to rising taxes. Canadians want government streamlined and made less wasteful... They want government to adjust to the same budget realities that households and business must face every day. They want the burden of government reduced. They want less regulation, less overlap and duplication. They want less government and better service.\textsuperscript{212}

The "neo-conservative" rally cry was gaining momentum with each turn of events. As a result, Paul Martin was able to deliver his characteristically Un-Liberal 1995 budget, without much dissent among the population.

Jeffrey Simpson noted however, that Paul Martin has been able to reinforce his image a "caring, swell guy forced to make 'tough' decisions not because he wished them, but because the devil of the debt made him."\textsuperscript{213} Simpson's article explained that it was Paul Martin and his campaign to reduce the national debt that led to the Liberals' popular support; Simpson stated "The triumph of Finance has been the Liberals' education."\textsuperscript{214} This triumph was somewhat miraculous given that as finance Minister, Mr. Martin had decided that:

Canadians were going to pay an extra $500 million a year at the gas pumps. The Unemployed were going to suffer another $500 million drop in benefits. Western grain farmers were going to lose their $560 million transportation subsidy and eastern dairy producers were going to get 30 per cent less within two years. Immigrants and refugees were going to be
slapped with an entry tax of $975 per adult. The regional development agencies were going to be down-sized by more than half. The CBC and other cultural industries were going to be squeezed once again. Federal funds to the provinces for health, education, and welfare were going to plunge by $7 billion in three years. And forty-five thousand federal jobs were going to be axed as a total departmental expenditures fell by 20 per cent.\textsuperscript{215}

Despite these radical changes, the neo-conservative C.D. Howe Institute argued that the "three percent solution" was unambitious and the government's approach to deficit reduction - reforming social programs and intergovernmental fiscal organization - was too tentative.\textsuperscript{216} Neo-conservatives argued that the social security network in Canada could no longer be maintained without drastic reforms and that the massive networks of subsidies for culture, business, and special interest groups could not continue. Sectors of the economy can no longer be sheltered from technological change and other pressures of global competitiveness. The C.D Howe Institute and other neo-conservative economists argued the case for greater fiscal restraint.

In the 1996 budget, the neo-conservative force grew stronger. The 1996 budget added more cuts to those imposed by the 1995 budget. The new cuts were announced following Paul Martin's introduction:

There are times in the progress of a people when fundamental challenges must be faced, fundamental choices made - a new course charted. We can take the path - too well trodden - of minimal change, of least resistance, of leadership lost. Or we can set out on a new road of fundamental reform, of renewal, of hope restored. Today we have made our choice.\textsuperscript{217}

This "fundamental reform" meant an end of a federal role in social housing, cutting foreign aid to its lowest levels since the
1960s, removal of $8 billion from pension funds. Other cuts by fields include: Transport, 69 percent; Natural Resources, 58 percent; Human Resources, 40 percent; Environment, 33 percent; Agriculture, 30 percent; Heritage, 29 percent; fisheries and Oceans, 22 percent. Coupled with the elimination of more than 40,000 public service jobs, these changes suggested that the Liberal government, despite their campaign promises, had converted to the principles of neo-conservative economics.

This neo-conservative agenda can be seen in Paul Martin’s Canada Health and Social Transfer (CHST) initiative. Allan M. Maslove in How Ottawa Spends 1996-97 maintained that although the CHST was "forcing Canadian governments at all levels to re-examine some of the fundamental precepts of social programs and of federal-provincial fiscal relations," the CHST "fails to address some fundamental problems of social programs and of fiscal federalism... as a result, further adjustments will be required." Martin’s Canada Health and Social Transfer combines transfers to the provinces for health, education, and social assistance into a single block grant. The CHST eliminates Established Programs Financing (EPF) the previous block fund of transfers payments to the provinces for health care and post secondary education. The CHST also eliminates the Canada Assistance Plan (CAP) under which the federal government would contribute up to 50 percent of the cost of provincial welfare programs. Figure seven and figure eight illustrates the reduction in cash transfers to the provinces, as anticipated by the 1996 budget. (In fact these reductions were
not fully carried out, since the 1999 budget provided additional funding for health care).

**Figure 7: Cash Transfers to Provinces**

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<tr>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Nfld.</td>
<td>410</td>
<td>341</td>
<td>281</td>
<td>263</td>
<td>244</td>
<td>239</td>
<td>235</td>
<td>233</td>
</tr>
<tr>
<td>PEI</td>
<td>87</td>
<td>71</td>
<td>60</td>
<td>57</td>
<td>53</td>
<td>53</td>
<td>53</td>
<td>54</td>
</tr>
<tr>
<td>NS</td>
<td>625</td>
<td>515</td>
<td>429</td>
<td>405</td>
<td>380</td>
<td>377</td>
<td>376</td>
<td>377</td>
</tr>
<tr>
<td>NB</td>
<td>489</td>
<td>402</td>
<td>332</td>
<td>314</td>
<td>295</td>
<td>293</td>
<td>293</td>
<td>294</td>
</tr>
<tr>
<td>Que.</td>
<td>5,504</td>
<td>4,583</td>
<td>3,876</td>
<td>3,644</td>
<td>3,406</td>
<td>3,343</td>
<td>3,304</td>
<td>3,275</td>
</tr>
<tr>
<td>Ont.</td>
<td>6,271</td>
<td>4,979</td>
<td>4,072</td>
<td>3,860</td>
<td>3,635</td>
<td>3,662</td>
<td>3,720</td>
<td>3,799</td>
</tr>
<tr>
<td>Man.</td>
<td>730</td>
<td>599</td>
<td>496</td>
<td>469</td>
<td>441</td>
<td>439</td>
<td>440</td>
<td>444</td>
</tr>
<tr>
<td>Sask.</td>
<td>624</td>
<td>501</td>
<td>418</td>
<td>396</td>
<td>373</td>
<td>373</td>
<td>373</td>
<td>377</td>
</tr>
<tr>
<td>Alta</td>
<td>1,477</td>
<td>1,173</td>
<td>956</td>
<td>913</td>
<td>867</td>
<td>882</td>
<td>904</td>
<td>934</td>
</tr>
<tr>
<td>BC</td>
<td>2,248</td>
<td>1,813</td>
<td>1,517</td>
<td>1,457</td>
<td>1,389</td>
<td>1,408</td>
<td>1,437</td>
<td>1,473</td>
</tr>
<tr>
<td>NWT</td>
<td>50</td>
<td>42</td>
<td>36</td>
<td>33</td>
<td>30</td>
<td>29</td>
<td>29</td>
<td>29</td>
</tr>
<tr>
<td>Yukon</td>
<td>23</td>
<td>19</td>
<td>17</td>
<td>16</td>
<td>14</td>
<td>14</td>
<td>14</td>
<td>15</td>
</tr>
<tr>
<td>Total</td>
<td>18538</td>
<td>15047</td>
<td>12488</td>
<td>11826</td>
<td>11129</td>
<td>11111</td>
<td>11180</td>
<td>11303</td>
</tr>
</tbody>
</table>
Because the CHST places transfers for health, post-secondary education and social assistance into a single block fund, the measure did loosen the strings on how the provinces can spend the money. Given that Ottawa cannot regulate the provinces in their area of jurisdiction, traditionally, Ottawa has wielded its influence through its 'spending power.' The block funding proposed in the 1995 budget suggested that this role was about to change. Will Ottawa maintain enough fiscal clout to maintain Canada's loose "national standards?" There are no guarantees what the provinces will do with their block transfer payments.
The decline in transfer payments presents challenges to the provinces to maintain an accepted level of services, while the federal government's financial participation is dwindling. This change in government structure may be worrisome to Canadians. Advocacy groups such as the National Council of Welfare and the Canadian Centre for Policy Alternatives are pressuring the federal government to continue supporting the social welfare principles to which many Canadians have become accustomed.

In a report entitled "The 1995 budget and block funding", the National Council of Welfare criticized the federal government for including welfare into a lump sum given that welfare spending is "erratic and tends to increase sharply when the economy goes in a tailspin."\(^{222}\) When the economy is strong, however, the number of people who are forced to rely on welfare tends to be relatively low (assuming that being on welfare is not a choice). Thus, a block grant is inappropriate for welfare given that funding may need to vary from year to year. The Council maintained that medicare, post-secondary education, and welfare are each too important and "all deserve reasonable federal financial support in their own right."\(^{223}\) The National Council of Welfare argued that "Budget speeches are no place for the federal government to make changes in social policy. The 1995 budget speech proves our point beyond any reasonable doubt. Bluntly put, the proposed Canada Health and Social Transfer is the worst social policy initiative undertaken by the federal government in more than a generation."\(^{224}\)

As of April 1st, 1996, it was up to each province to determine
how much of the block funding it would spend on welfare. In a perfect world, each province would use more of its fund for welfare when the economy is weak, and less when the economy is strong. The result of the CHST may lead to a greater decentralization within Canada. This may occur because individual provinces can still bring in progressive social policies but there is no longer any likelihood of these programs becoming national. Without federal contributions, programs will be difficult at best to maintain, and may even be eliminated.

According to Maude Barlow and Bruce Campbell in their controversial book *Straight through the Heart*, the shrinking CHST money would have the following effects in 1996, its first year of operation:

* Newfoundland will lose $73 million. This amounts to 85 percent of the provincial operating grant for school boards, or more than half of all payments to physicians.

*PEI will lose $17 million in 1996. This amounts to the total funding for six of the nine public nursing homes in the province, or almost half of total spending on post-secondary education.

*Nova Scotia will lose $118 million in 1996. This amounts to more that all provincial grants to public libraries and museums, or twice the provincial spending on mental health services.

*New Brunswick will lose $94 million in 1996. This amounts to almost half of the total cost of the provincial medicare program or more that the total operating grant to municipalities.

*Quebec will lose $1.1 billion in 1996. This amounts to twice the cost of the drug plan for the elderly, or half of all payments for doctors' services.

*Ontario will lose $1.4 billion in 1996. This amounts to twenty times the amount spent on community health centres or almost three quarters of the budget for universities.
Manitoba will lose $139 million in 1996. This amounts to the entire budget to operate the provinces sixty-five smaller hospitals, or two and a half times the child-care budget.

Saskatchewan will lose $123 million in 1996. This amounts to half the budget for long term care services, or more that twice the budget for community living services for the disabled.

Alberta will lose $330 million in 1996. This amounts to more than five times the cost of cancer diagnostic and treatment centres, or more than twice provincial spending on student assistance.

British Columbia will lose $471 million in 1996. This amounts to four times the cost of ambulance services, or one-fifth of the budget for all acute care and extended care hospitals.  

However, according to the federal government's February 27th, 1995 Budget Plan, the Canadian Social Transfer created a system that "is better suited to contemporary needs and [is] fiscally sustainable." In the 1996 budget, Martin included the word "health" in an attempt to assure Canadians that the Canada Health Act would continue to be upheld. As part of their first "priority" under the new mandate Martin stated that

We are committed without reservation to sustaining and strengthening the Canadian system of health care. In 1995, when the country's fiscal back was to the wall, we took some very difficult decisions. We recognize this. That is why the very first action we took when our progress on the deficit became clear was to increase the floor under cash transfers to the provinces in support of health and other programs from $11- billion to $12.5 billion annually.

Furthermore, "the new transfers will end the intrusiveness of cost-sharing under CAP and will reduce the federal-provincial entanglement that has been a source of irritation with current cost-shared transfer arrangements."

The rationale behind the CHST was that provinces would be free to pursue "innovative approaches" to social security reform without
having to consider whether such approaches met the requirements for cost-sharing. Yet, in an attempt to appease public concerns regarding the future of health care, Paul Martin declared rhetorically that "although provinces will be able to spend the transferred resources on priorities of their own choosing, the transfer will not be totally unconditional. No change will be made to the Canada Health Act. The government will continue to enforce it by withholding funds, if necessary." The fact remains however, that the provinces will have to do more with less.

Maclean's reported that "in a rare show of unity" the provincial premiers maintained that "Ottawa should boost transfer payments before concocting glitzy new programs, such as its $2.5 billion Canada Millennium Scholarship Foundation." The provinces were angry that, since 1990, Ottawa had reduced its annual cash transfers by almost $7-billion. The provinces argued that Ottawa had ignored their attempts at a renewed federal-provincial partnership to address growing concerns in health care and university funding. According to Ontario's finance minister, Ernie Eves, "I think Canadians and Ontarians should feel a sense of betrayal. I can assure you that every finance minister and every premier across the country was expecting some return of the fiscal dividend in the form of reinstatement of at least some of the cuts. We didn't see a cent of that returned today."

Saskatchewan Finance minister Eric Cline expressed a similar response to the federal government; he stated "This budget is a failure. Ottawa obviously feels that if it gives more money in
transfer payments, the provinces will get the credit." Thus, the debate over transfer payments continues and Canadians are "making do with less." In total, the Liberals had extracted $14 billion in program cuts since 1993. This fact led Peter C. Newman to conclude "Martin is doing the right thing, cautiously, but don't ever expect him to kick-start Ottawa's free spending ways of the past. The age of entitlement is well and truly over."

Some analysts argue that the message behind Paul Martin's 1995 budget contradicts everything the Liberal party has represented since the 1930s: Mackenzie King's unemployment insurance, Louis St. Laurent's Old Age Security and Lester Pearson's Canada Pension plan. As Ron Graham states "Much of the work of at least two generations of Canadians in building national institutions, national policies, national programs, and national standards was about to be undone - including the work of Paul Martin's own father." According to Maude Barlow and Bruce Campbell: "So synonymous is the Liberal Party with social progress that even now we cannot recognize the wolf in sheep's clothing." It was under the Liberal government that feminists, environmentalists, farmers, aboriginal people, peace activists, and a variety of other social advocates and programming have been funded. After 1998, the continuance of such programs appeared increasingly unlikely.

These structural changes made to Canada's welfare state have had a profound effect on Canadians. In Maclean's annual poll at the end of 1996, respondents said that the most important issue facing Canadians was unemployment (31%). The second most important
issue, was deficit/government spending (15%). However, the poll did not specify whether the deficit was a major concern for Canadians because they would have to "make do with less" or because they were in favour of deficit reduction strategies. The poll did specify however, that the majority of Canadians (76%) believe that none of the federal parties has concrete solutions to Canada's major challenges. The remaining 24% of the respondents divided their votes in the following manner: Liberals - 10%; Reform - 4%; Conservatives - 3%; Bloc Québécois - 1%; Don't Know - 6%.

The New Democratic Party was not even cited as offering the country viable solutions for the future. With regard to the cuts made to the social security network, it would seem an opportune time for the NDP to attract substantial support as the Party which best represents the defender of the Welfare State.

The 1997 election demonstrated that the NDP offered comfort for many Canadians, as their seats in the house rose drastically from eight to twenty-one. In Atlantic Canada, Alexa McDonough's New Democratic Party made an unprecedented breakthrough as they swept through the Maritimes with one quarter of the thirty-two seats. The Liberals lost seats throughout Canada's poorest region and were completely shut out in Nova Scotia. The Liberals maintained their majority in the House with 155 of the seats, despite holding only 38 percent of the popular vote.

The Liberals wavered on their neo-conservative agenda by announcing a plan for $6.5 billion in new spending before balancing the budget and no tax cuts. Chrétiens's enthusiasm for the "three
percent solution" had waned. Thus, Paul Martin's agenda regarding
the deficit poses many uncertainties for the Canadian Public.
Furthermore, the House of Commons has become a political mosaic.
The renewed Liberal government faces stronger forces for the Neo-
conservative agenda represented in Her Majesty's Loyal Opposition -
the Reform Party; even though, the New Democratic Party captured an
increased electoral support for the neo-Keynesian philosophy.

The Maclean's 1996 year end Poll draws the conclusion that
there is a wave of pessimism in Canada where people believe they
can no longer rely on governments. This cynicism about the federal
government is mirrored in a general cynicism towards life in
Canada. This Maclean's poll also demonstrated that "...in a
continuing but deepening trend, overwhelming majorities expect the
society of tomorrow to be a poorer, more violent place where full
time work will be harder to come by and people, by necessity, will
be more self-sufficient." 242

Despite Finance Minister Paul Martin's, and Prime Minister
Chrétien's continuous promises that the social security network
including universal health care, old age pensions, and unemployment
insurance will be upheld, many Canadians simply do not believe
them. Figure nine demonstrates the sentiments that Canadians hold
regarding the government's influence over social programs by the
year 2005.
Figure 9

<table>
<thead>
<tr>
<th>Issue</th>
<th>Percentage saying that it is Likely</th>
<th>Percentage saying that it is acceptable</th>
</tr>
</thead>
<tbody>
<tr>
<td>People who will never find full time work</td>
<td>80%</td>
<td>30%</td>
</tr>
<tr>
<td>No government pensions</td>
<td>39%</td>
<td>80%</td>
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<tr>
<td>Charities taking over social services</td>
<td>53%</td>
<td>79%</td>
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<tr>
<td>Larger role for private sector</td>
<td>87%</td>
<td>47%</td>
</tr>
<tr>
<td>Two Tiered Health care system</td>
<td>81%</td>
<td>47%</td>
</tr>
<tr>
<td>Private Universities</td>
<td>80%</td>
<td>61%</td>
</tr>
</tbody>
</table>


Figure nine demonstrates that Canadians are hearing the deficit warnings and media reports regarding the state of Canada's finances. Accordingly, it is time for the government to "get its fiscal house in order". Almost half of the responders believed that a two tiered health care system was acceptable and a considerable number felt that a larger role for the private sector was not only imminent but also acceptable. The most surprising finding is the overwhelming majority who consider the termination of government pensions acceptable. The chart also demonstrates that the goal of social equality is no longer seen as an essential component of Canadian citizenship.

Canadians have adopted a belief that they should be grateful
for social programs. However, Maude Barlow and Bruce Campbell insist that "Governments ceded to public demand in creating social security... [thus], Canadians should not be grateful for social programs; we secured them and they are our birthright." Nevertheless, Canadian citizens have adopted the neo-conservative, pro-business, deficit-fighting attitude on many important issues. This includes support for a two-tiered health care system and the privatization of universities. Moreover, the vast majority of Canadians under 50 state that they do not expect to receive the retirement benefits promised by the Canada Pension Plan. If the neo-conservative attitude is predominant among Canadians then government is correct in giving people what they want. Neo-Keynesians argue that the adoption of this neo-conservative attitude is based on false assumptions regarding the state of the nation.

In Paul Martin's fifth (1998) and sixth (1999) budget he addressed these growing concerns among Canadians regarding social issues, particularly the widening gap between the rich and the poor. Martin's fifth budget was dubbed "the education budget" and his sixth was dubbed "the health care budget." Martin called his fifth budget "a new mandate" without a new "mission." He states:

This is the first budget of a new mandate. But if the mandate is new, our mission is not. Our goals today remain what they were when Canadians placed their trust in us in 1993: first, to build a country of opportunity - of jobs and growth - one where every Canadian has equal access to the avenues of success; and second to safeguard and strengthen a caring and compassionate society.
the budget. According to Martin, "This budget will demonstrate that we have left the era of chronic deficits behind, that we are now on an irrevocable course to reduce the debt." Martin promised that by the year 2002, the provinces would receive an additional $7 billion in transfer payments as part of the CHST. He was able to "deliver" this promise by 1999.

By 1999, a new "social-union" was established by Prime Minister Jean Chrétien with the agreement of all provincial governments except for Quebec. Under this deal, Ottawa will not pursue initiatives without the agreement of a majority of provinces, and provinces can design their own programs. Ottawa will give notice when it intends to overstep the provincial boundaries established in the BNA act. A mechanism will be established to settle disputes over the programs. In return, the provinces received the promise of more health-care money in the 1999 budget; they received an addition $11.5 billion over the next five years.

The 1998 budget also announced a renewed commitment to hold inflation inside the range of one to three percent. The debt repayment plan was based on the $3-billion Contingency Reserve "buffer" that was established in 1997. If this money was not needed, it would go directly to paying down the debt.

What was referred to as the "Centrepiece" of the 1998 budget was the $2.5 billion multiyear Canada Millennium Scholarship Foundation. This foundation would provide 100,000 scholarships a year to low and middle income students. Scholarships would average $3,000 each, per year. Martin based this program on the
rationale that "the backbone of a country is the strength of its middle class. There is no better way to reduce the gap between the rich and the poor, no surer way to widen the mainstream, no more meaningful way to reduce the numbers of those left behind, and no better way to provide a higher quality of life for Canadians, than to facilitate the path to greater education. Quite simply, every Canadian who wants to learn should have the opportunity to do so."\textsuperscript{249} Thus, the scholarships will be awarded to Canadians of all ages, part time and well as full time students, colleges as well as universities on the basis of financial need and "demonstrative merit."

To alleviate provincial concerns, Martin ensures that the Millennium Scholarship Foundation will consult closely with provincial governments to "complement existing provincial programs."\textsuperscript{250} As expected, Premier Lucien Bouchard of Quebec denounced the Millennium Fund as an intrusion into provincial jurisdiction.

The 1998 budget also took initiatives to help students manage their debts by offering tax relief on interest payments on their student loans. The "education" budget included measures to assist families to save for their children's education through a Registered Education Savings Program; effective January 1999 Canadians would be able to make tax-free withdrawals from their RRSPs to support full-time education and training. The 1998 budget also promised that the program SchoolNet, introduced by the federal government in 1998 would continue to work towards connecting
Canadians "young and old, rural and urban, to the technology of the information age and all the knowledge it makes possible."\textsuperscript{251}

In order to address the high unemployment rates, particularly among young people, Paul Martin's budget eliminated the required employment insurance premiums that were paid by employers. This applied only to new jobs for persons between the ages of 18 and 24. This was a very small initiative to address the high unemployment rates.

In terms of tax relief, Globe and Mail, reporter Rob Carrick states, "Tax relief is coming for most Canadians, but it's more in the order of a band-Aid than a strong painkiller."\textsuperscript{252} In total, Canadians will pay $7.2 billion less in taxes over the next four years. Individuals with incomes above $65,000 will see no change in their taxes. The 1998 budget's tax plan is a $500 increase on July 1 in the amount of money that low-income Canadians can earn without paying income tax. The current level is $6,456. Raising the limit will mean that 400,000 low income people will be off the tax rolls. Furthermore, the three percent surtax for people with incomes up to $50,000 will be eliminated.\textsuperscript{253}

According to Alexa McDonough of the NDP the Liberal's fifth budget was "very disappointing." She stated "It is very disappointing that they have done nothing at all with the GST. That would have been a very important way to provide relief and it would have been a positive job generator. It's very disappointing they did not go that route."\textsuperscript{254} Jean Charest, then Progressive Conservative leader, also criticized the federal government for not
providing more tax relief. His response to the 1998 budget was "I mean, if 40 percent of the available money is going to go to new spending, what has been learned? The first priority has to be tax relief for those Canadians who have suffered and paid a very high price in their standard of living." Furthermore, Reform party leader Preston Manning states "Taxpayers should be aware, the chequebook is out again and it’s your chequebook... The first thing they [the federal government] do[es] is go and spend that surplus on their pet projects rather than give the money back to the taxpayer." Bloc Quebecois leader Gilled Duceppe asks "Why don’t they [the federal government] reimburse the provinces and the provinces will determine themselves the priority. We’ll set our priorities by ourselves. We don’t need that old attitude of Ottawa knows best."

Thus, the competition to promise tax relief for Canadians was evident. In Ernst & Young’s analysis of the 1998 federal budget, they proposed that lower taxes would generate more spending, jobs and income. Accordingly, lower taxes would "increase Canada’s attractiveness for new investment and improve the quantity and quality of job opportunities particularly among our youth. They would add to our efficiency and competitiveness, leading to even greater success in global markets." Entering the Millennium, it seemed that Canadians were asking the federal government of Canada to provide more tax relief. In 1999, according to a National Post/Compas poll, nine out of every ten Canadians want tax cuts and the government debt paid down.
The 1999 "health care" budget provided minimum tax relief for Canadians. According to Brien Gray, Canadian Federation of Independent business "Most Canadians were looking for some substantial tax relief. We are disappointed and I think a lot of ordinary Canadians will be disappointed." The 1999 budget eliminated the three percent surtax for Canadians earning up to $65,000 and increased the personal exemption $675 to $7,125. This measure caused Jeff Rubin, Chief economist at CIBC Wood Gundy, to state "Hallelujah, he got rid of the surtax. They only brought it in 1985." Martin also increased the child-tax benefit for poorer families by $350 per child and gave $300 million to enhance the child-tax benefit system which will help about 100,000 low to modest-income families. The five percent surtax for people earning more than $65,000 a year remains. Royal Bank chief economist John McCallum stated that these tax reductions amount to about a two percent tax cut which represents a "very meagre downpayment" on the tax relief Canadians had been hoping to receive.

Reform Party leader Preston Manning commented that "Canadians will be paying about $42 billion more at the end of this year than they were when the Liberals took office... Even with the tax changes the average taxpayer will be paying about $2,000 more in taxes than they were at the beginning of the administration." According to Maclean's magazine, Canadians are poorer in 1999 than they were in 1990 with real disposable income per person dropping to $16,332.17 in 1998 from $17,292.28 in 1990. Canada's tax
burden is 36.8 percent of the size of the economy. Figure ten illustrates the total tax revenue as a percentage of GDP for Canada and selected members of the Organization for Economic Co-operation

Figure 10: Tax Revenue as a Percent of GDP

The problem with a tax burden that is almost ten percentage points higher than Canada’s largest trading partner is this: the number of people migrating to the United States on temporary visas is estimated between 12,000 to 20,000 people per year. This is in addition to the approximately 9,770 workers who permanently emigrated in 1996-97. Furthermore, neo-conservatives link
productivity to a lower tax base. According to an editorial in the conservative owned newspaper *National Post*, "For a finance minister who talked extensively about enhancing Canada’s long term productivity, Mr. Martin somehow managed to avoid taking the most vital step to improving it: substantially lowering taxes."\(^{267}\)

Paul Martin had succeeded in eliminating the deficit. As an interesting historical perspective, Figure eleven maps out the rise and fall of the deficit from 1970 to the projections made in 1999 to 2001 under both the Conservative and the Liberal party. The Conservative trend under finance minister Michael Wilson from 1985-1990 shows a reduction in the deficit. The deficit rises again in 1991-93 under Finance Minister Don Mazankowski. Neo-conservatives worry that a similar trend will befall the current Liberal government if they return to program "over"-spending. Paul Martin has pledged never to allow Canada to return to fiscal deficits. However, some neo-conservatives maintain that Martin ought to have reduced taxes and eliminated some of the debt burden rather than increase spending in "politically rewarding" programs (other than health care).
Figure 11: The Deficit Vanishes

% GDP

-9 -8 -7 -6 -5 -4 -3 -2 -1 0

2000
1998
1996
1994
1992
1990
1988
1986
1984
1982
1980
1978
1976
1974
1972
1970

-9 -8 -7 -6 -5 -4 -3 -2 -1 0

Paul Martin
Don Mazankowski
Michael Wilson
Marc Lalonde
Allan MacEachen
John Crosbie
Jean Chretien
Donald Macdonald
John Turner
Edgar Benson


The domestic economic environment of the 1999 budget was somewhat positive. Employment rose by 453,000 jobs in 1998, in addition to the 368,000 jobs that were created in 1997. Higher employment means that the government will have an increased tax revenue source of $156.7 billion for 1999-2000 an increase of $200 million from 1998-99. Unemployment has dropped to 7.8 percent in January 1999, the lowest level since June 1990.

The focus of the 1999 budget was the emphasis on health. The federal government pledged to disburse $3.5 billion among the
provinces to deal with acute problems facing health care; namely overflowing emergency rooms and long waiting lists for treatments. According to Paul Martin Canadians "worry about crowded emergency rooms, about understaffed wards, about waiting lists for tests and for treatment. They worry about the costs of paying for services or drugs that are not covered." The provinces can access this money in the 1999 fiscal year or over the next few years. This $3.5 billion is in addition to $8 billion increase in the social health and welfare transfer over the next five years. The administrative details of these programs are left to the provinces' discretion.

According to Jeffrey Simpson "The $11.5 billion Ottawa will pour into the system during the next five years will patch cracks and forestall crises. But the system is so demanding of public money that the new funds will only prevent it from getting worse rather than making it significantly better." Governments spend about $55 billion each year on health care. Given that Medicare costs rise faster than the Consumer Price Index, there are huge cost pressures currently existing within the system and the aging population will put more pressure on the system. Simpson's statement reflects the position that the new spending will not even keep the existing system at its current level.

Opposition members and some provincial premiers share Simpson's view regarding Paul Martin's health initiative. According to New Democratic Party Leader Alexa McDonough the increases in health do not go far enough. She states "It's not
going to deal with the critical condition that we find our health care system in. By next year, they'll have replaced about one dollar for every ten they've taken out. It's a small dose and I think Canadians are in for a long recovery."²⁷³ Progressive Conservative leader Joe Clark stated "What we've had here is a number of one-off initiatives from the Liberals."²⁷⁴ Similarly Ontario's Conservative Premier stated that the federal government's reinvestment into health care is "only the first step in a much longer journey."²⁷⁵ British Columbia premier Glen Clark stated "We clearly need more money to reverse the decline in our health care system."²⁷⁶

In addition to an increase in transfer payments to the provinces the federal government announced in its 1999 budget that it would spend $1.4 billion over the next three years on a series of government initiatives to improve the health care program in Canada. These include $328-million to improve the reporting on the health of Canadians and the functioning of the health care system, $75 million on the National Health Surveillance Network which will provide Canadians with information on diseases and will be accessible from the Internet or 1-800 number; $550 million on health related research including funding to set up the Canadian institute of Health Research are a few examples of these initiatives.²⁷⁷

Other spending initiatives in the 1999 budget include $600 million for the Agricultural Income Disaster Assistance program, a shared cost federal-provincial program designed to help farmers

Furthermore, the 1999 budget announced that it would spend $1.5 billion more for scientific research including $430 million to the Canadian Space Agency. Military spending will also receive an additional $325 million, mainly to increase salaries of military personnel.

Despite these spending increases, Program spending will decline from 12.6 percent of the economy’s size to 12 percent by 2000-01. Figure twelve and figure thirteen illustrate revenue sources and expenditure for the 1999-2000 fiscal year.278

Figure 12: Revenue Sources (1999-2000: $156.7 Billion)

- Excise Taxes 7%
- GST 14%
- EI 12%
- Corporate Income Tax 13%
- Personal Income Tax 47%
- Other 7%

Figure 13: Outlays (1998-99: $153.5 Billion)

- Interest 28%
- EI 9%
- Transfers to Provinces 13%
- Defense 6%
- Direct Program 12%
- Other 17%
- Elderly 15%

For the purpose of debt repayment, as in 1998, Paul Martin included a $3 billion contingency spending provision, to be applied to debt reduction if it is available at the end of the year. According to John McCallum, given that the government assumes a financial surplus the "federal government will have paid down some $20 billion in marketable debt in the two years to March 31, 1999. According to Ernst & Young's analysis of the 1999 federal budget, Paul Martin "did not go far enough on debt reduction. Paying down the debt faster saves interest costs and encourages greater investment, productivity and growth by fostering lower interest and tax rates. It also adds to fiscal flexibility in the event of any future downturn, and ensures greater inter-generational equity by easing the debt load on the next generation of workers."^280

This perception reflect the influence of the neo-conservative economic doctrine. This economic philosophy stands in sharp contrast to the neo-Keynesian economist^281 who would argue that the welfare state must be maintained. The neo-Keynesian would argue that the social networks do need to be re-evaluated, but not with the exclusive preoccupation of reducing costs. Such neo-Keynesian economists argue the case for fiscal spending. These two arguments - neo-conservative and neo-Keynesian - will be discussed at length in the next two chapters.
Chapter five: Monetary Policy and the Deficit

We will balance the budget next year. We will balance the budget the year after that. And, Mr. Speaker, we will balance the budget this year. - Paul Martin

Neo-conservatives maintain that the market will function well (create jobs etc.) if distortions such as taxes are reduced. The thrust of the neo-conservative mandate is to reduce the overall size of the public sector and to limit government’s role to laissez-faire policies. Market coordination would replace government intervention in social and economic activity.

In regards to the deficit, one may ask: how does the deficit affect Canadian citizens? Are Canadians responsible for the debt? Ought Canadians to take responsibility for the debt? It also seems Canadians would respond to the question "Ought we to take responsibility?" with a resounding "YES!" given their public support of the Liberal government’s campaign to reduce the deficit and subsequent debt. The neo-conservative rationale for why Canadians ought to take responsibility for the debt will be discussed in this chapter.

The Structural Deficit:

A structural deficit occurs when government runs a deficit even if the economy is at potential GDP (or full employment). This is different from persistent or cyclical deficits where debt interest repayments grow at such an alarming rate that they begin to feed on themselves: "the deficit led to increased borrowing; increased borrowing led to higher interest payments; and higher interest payments led to a larger deficit." There is a
correlation between unemployment and the federal deficit. During a recession more people unemployed means a decrease in tax revenue and increase in transfer payments. During recession economic hardship from poverty increases and government transfer payments increase to respond to this hardship. Thus, the deficit rises when the economy is in a depressed state and falls when the economy is in "boom" period. Thus economists have devised a deficit concept called the "cyclically adjusted deficit" which measures the deficit that would occur if the economy were at full employment.\(^{285}\)

Chrétien’s Liberals made a commitment to reducing the deficit. Nevertheless, figure fourteen illustrates that although the deficit has been decreasing since 1994, the interest (Public Debt Charges) which are largely a function of past interest rates has been increasing. The following chart also illustrates the disparity between the interest and the federal deficit in 1997.

**Figure 14: Federal Deficit and Public Debt Charges Over Time**
According to the C.D. Howe Institute, this growth in public debt charges limits the government’s ability to meet new demands for public services, and reduces its flexibility in stabilizing the economy during economic slumps. In addition, the larger the share of interest payments in government spending, the greater the chance that changes in interest rates may throw the government’s plans off course. Thus, high deficits lead to the loss of fiscal flexibility.286

Canada’s growing debt can also be seen as a burden on younger generations. Neo-conservatives argue that future Canadians will be worse off because further payments on interest will lead to a depletion of services. In the spring of 1991, the former Minister of Finance, Michael Wilson, appeared on stage with a small boy during a campaign to fight the national debt. The boy had come to contribute his allowance towards Canada’s financial problems.287 This act demonstrated the growing acceptance among some Canadians that the growing debt is a cause for concern among future generations.

In response to these concerns regarding the increasing debt, some neo-Keynesians (such as Linda McQuaig) argue that the reason for Canada’s colossal debt was John Crow’s (and the succeeding governor Gordon Thiessen’s) "War on Inflation."288 Crow and Thiessen both used interest rates as their ammunition to fight this "inflation war". As the governor of the Bank of Canada, Crow and Thiessen maintained high short-term interest rates, in an attempt to alleviate the fears of potential bond holders. Both governors
believed that this might assure bondholders that the yield on their investments would not deteriorate; inflation rates would not be upset.

The neo-Keynesians have become angry at the federal government because they maintain that the true cause of Canada's debt is the Bank of Canada's policy of keeping inflation between 1 to 3 percent. This is contrary to the neo-conservative belief that the true cause of Canada's debt was social spending.

Figure fifteen, however does illustrates some correlation between interest rates and Debt as a percent of GDP. Neo-Keynesians argue that the high interest rates which characterized the decade between 1980-1990 are the true cause of the debt "crisis." As Figure fourteen illustrated, the real "debt -load" is closely related to the interest payments. These mammoth interest payments are in part a result of the high interest rates that the Bank of Canada set for itself for most of the 1980s. Neo-Keynesians argue that this policy has cost Canadians dearly, for even in the late 1990s when there was some reprieve from the high interest rates, the debt as a percent of the GDP continued to grow.
Neo-Keynesians such as Linda McQuaig, and Maude Barlow and Bruce Campbell hold that the growth of the debt was due entirely to compounding interest on the original debt. An unpublished Statistics Canada study by Hideo Mimoto revealed that government spending, and specifically social spending, remained steady from 1975-1991. However, between 1985 and 1991, the government paid out a total of $200 billion in interest payments alone.\textsuperscript{289} The study states that:

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expenditures on social programs did not contribute significantly to the growth of government spending relative to
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Expenditures on social programs did not contribute significantly to the growth of government spending relative to GDP. Excluding the cost of unemployment insurance, which is intended to be [and is] self-financing, over the business cycle, social program spending has not increased relative to GDP over the last 16 years.²⁹⁰

Furthermore, according to Barlow and Campbell, "By 1991, debt interest payments had soared to $43 billion and were draining one-third of government revenues - the equivalent of 6 percent of the nation's output. This was more than the combined spending on transfers for education, health, welfare and unemployment insurance."²⁹¹ Thus, according to this argument, it was not the growth of program spending that caused the increase in deficits, rather, increased debt charges on interest payments. This increased spending went to service the debt, not on programs. Increased interest rates coupled with the recession of the early 1990s equalled increased deficits. Thus was the Bank of Canada doing the "right" thing by increasing interest rates? Was the "war on inflation" worth the cost?

According to Pierre Fortin in his Canadian Economics Association presidential address entitled The Great Canadian Slump, Canada "manifested a strong deflationary bias and has considerably underestimated the amount of unemployment needed to hold inflation below two percent. To redress the situation I propose changes to the management structure and mandate of the Bank of Canada."²⁹² Fortin maintained that the large increase in government deficits from 1990-1993 was caused by high interest rates and the accompanying recession on debt service costs, tax revenues and social expenditure. Fortin stated "The large government deficits
of the 1990s essentially resulted from the high interest rates and the accompanying recession." Fortin believes that the Bank of Canada's inflation objectives have negatively affected the employment rate in Canada. He compares the employment rate of Canada to that in the United States as illustrated in figure sixteen.

Figure 16: The Employment Ratio: Canada and the United States
(Number of Jobs per 1,000 adults)

*Source: Pierre Fortin. The Great Canadian Slump. p. 763

Given that the in the United States, the Federal Reserve has no official inflation target and in practice, since 1989 the inflation rate remains around three percent, the graph illustrates that the Bank of Canada's inflation policy has been detrimental to the employment rate in Canada. Fortin states "pursuing the extreme goal of zero inflation has forced the Bank of Canada to impose permanently higher unemployment through higher interest rates." According to Neo-Keynesians, the Bank of Canada's priorities
lie not in preserving the welfare state, reducing inequality, and creating an environment conducive to full employment; the Bank of Canada's priorities lie in preserving price stability. As Maude Barlow and Bruce Campbell bluntly stated "So low is unemployment on the Bank of Canada list of priorities that when the unemployment rate drops close to 9 per cent, it feels justified in raising interest rates and slowing the economy in order to cool the potential inflationary pressures (emphasis added)."

There is a natural rate of unemployment which is determined in part by the size of new entry into the labour force and in part by the rate of change of skill and mobility requirements in the economy. According to James Brander, the unemployment rate is determined mainly by the willingness of workers to be unemployed. Government stabilization policies affect this natural rate of unemployment, and according to Brander, the natural rate in Canada is too high. Some economists believe that the natural rate of unemployment for Canada is around six percent of the labour force. Figure seventeen depicts the relationship between inflation and interests rates vs. time.
Fortunately for Canadians, there was some reprieve from the high interest rates that characterized the 1980s and early 1990s. In 1996, Canada’s interest rate dropped to 4.53 per cent. Canada’s interest rates averaged 9.92 percent from 1979-1996. The following chart illustrates Canada’s interest rates from 1979-1996.

**Interest Rates**

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<tr>
<td>1979</td>
<td>12.10</td>
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<tr>
<td>1980</td>
<td>12.89</td>
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<tr>
<td>1981</td>
<td>17.93</td>
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<tr>
<td>1982</td>
<td>13.96</td>
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<td>1983</td>
<td>9.55</td>
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<td>1984</td>
<td>11.31</td>
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<td>1985</td>
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<tr>
<td>1986</td>
<td>9.21</td>
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<tr>
<td>1987</td>
<td>8.4</td>
</tr>
</tbody>
</table>
The relatively high interest rates are a direct result of John Crow and Gordon Thiessen's "war on inflation". The rationale behind the Bank of Canada's strict neo-conservative policy which in recent years has kept inflation between one and three per cent was and is not endorsed by the neo-Keynesians. Thus, it is also important to look at the rate of inflation. The following chart illustrates the rate of inflation, defined as the annual average change based on the Consumer Price Index (CPI) including all items where 1986 = 100.

### Inflation Rate

<table>
<thead>
<tr>
<th>Year</th>
<th>Percent</th>
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</thead>
<tbody>
<tr>
<td>1979</td>
<td>9.1</td>
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<tr>
<td>1980</td>
<td>10.2</td>
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<td>1981</td>
<td>12.5</td>
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<td>10.9</td>
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<td>1983</td>
<td>5.7</td>
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<tr>
<td>1984</td>
<td>4.4</td>
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<td>1985</td>
<td>3.9</td>
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<td>1986</td>
<td>4.2</td>
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<td>4.4</td>
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<tr>
<td>1988</td>
<td>4.0</td>
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<tr>
<td>1989</td>
<td>5.0</td>
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<tr>
<td>1990</td>
<td>4.8</td>
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<tr>
<td>1991</td>
<td>5.6</td>
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<td>1992</td>
<td>1.5</td>
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<td>1993</td>
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<tr>
<td>1994</td>
<td>0.2</td>
</tr>
<tr>
<td>1995</td>
<td>2.1</td>
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</tbody>
</table>
Thus, Thiessen has been successful in controlling the rate of inflation. The neo-Keynesians believe that the cost of maintaining low levels of inflation, however, has had a profound effect on employment. The following chart illustrates the changes in the unemployment rate between 1979 and 1996:

<table>
<thead>
<tr>
<th>Year</th>
<th>Percent</th>
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</thead>
<tbody>
<tr>
<td>1979</td>
<td>7.5</td>
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<tr>
<td>1980</td>
<td>7.5</td>
</tr>
<tr>
<td>1981</td>
<td>7.6</td>
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<tr>
<td>1982</td>
<td>11.0</td>
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<tr>
<td>1983</td>
<td>11.9</td>
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<tr>
<td>1984</td>
<td>11.3</td>
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<tr>
<td>1985</td>
<td>10.5</td>
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<tr>
<td>1986</td>
<td>9.6</td>
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<tr>
<td>1987</td>
<td>8.9</td>
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<td>1988</td>
<td>7.8</td>
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<td>1989</td>
<td>7.5</td>
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<tr>
<td>1990</td>
<td>8.1</td>
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<tr>
<td>1991</td>
<td>10.4</td>
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<td>1992</td>
<td>11.3</td>
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<td>1993</td>
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<td>1994</td>
<td>10.4</td>
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<tr>
<td>1995</td>
<td>9.5</td>
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<tr>
<td>1996</td>
<td>9.7</td>
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<tr>
<td>1997</td>
<td>9.2</td>
</tr>
<tr>
<td>1998</td>
<td>8.3</td>
</tr>
<tr>
<td>Jan. 1999</td>
<td>7.8</td>
</tr>
</tbody>
</table>

The following chart illustrates all three components: inflation rate, interest rate, and the unemployment rate.
<table>
<thead>
<tr>
<th>Year</th>
<th>Inflation</th>
<th>Interest</th>
<th>Unemployment</th>
</tr>
</thead>
<tbody>
<tr>
<td>1979</td>
<td>9.1</td>
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<tr>
<td>1980</td>
<td>10.2</td>
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<td>1981</td>
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<td>7.6</td>
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<td>1982</td>
<td>10.9</td>
<td>13.96</td>
<td>11.0</td>
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<td>1983</td>
<td>5.7</td>
<td>9.55</td>
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<td>1985</td>
<td>3.9</td>
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<td>10.5</td>
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<tr>
<td>1986</td>
<td>4.2</td>
<td>9.21</td>
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<tr>
<td>1987</td>
<td>4.4</td>
<td>8.40</td>
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<tr>
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<td>4.0</td>
<td>9.69</td>
<td>7.8</td>
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<tr>
<td>1989</td>
<td>5.0</td>
<td>12.29</td>
<td>7.5</td>
</tr>
<tr>
<td>1990</td>
<td>4.8</td>
<td>13.05</td>
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<tr>
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<td>5.6</td>
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<td>10.4</td>
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<tr>
<td>1992</td>
<td>1.5</td>
<td>6.78</td>
<td>11.3</td>
</tr>
<tr>
<td>1993</td>
<td>1.8</td>
<td>5.09</td>
<td>11.2</td>
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<tr>
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<tr>
<td>1997</td>
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<td>1998</td>
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<tr>
<td>Dec 1998</td>
<td>1.0</td>
<td>5.25</td>
<td>Jan. 1999</td>
</tr>
</tbody>
</table>

Figure eighteen demonstrates a correlation between Interest Rates and Unemployment:

Figure 18: Unemployment and Nominal Interest Rates vs. time
The data demonstrate that there appears to be a correlation between interest rates and Unemployment. The data demonstrate that all things remaining the same, unemployment trends follow the interest rate trends after a two year lag period. According to this trend, given the reduction in interest rates, the data indicate that unemployment will also reduce in 1999. According to this rationale, if the federal government wishes to keep unemployment down, it could do so by encouraging the Bank of Canada to maintain low short-term interest rates. Even real interest rates - show a relationship with unemployment and interest rates minus inflation.

Figure 19: Unemployment and Real Interest Rates vs. Time
Figure twenty: Unemployment Rate and Rate of Inflation vs. Time illustrates that as real interest rates rise, the unemployment rate rises. Furthermore, controlling the rate of inflation seems to have a negative effect on employment. As the following graph illustrates, as the rate of inflation decreases, the unemployment rate increases. Whether there is a "trade-off" between inflation and unemployment is very controversial. Pierre Fortin maintained that there is a relationship and the "central bank has misjudged the nature of the trade-off between inflation and unemployment in the range of very low inflation rates, where it has led the Canadian economy. The unemployment costs of zero inflation have turned out to be not transitory and small as expected, but permanent and large."³⁰¹

Figure 20: Unemployment and Inflation Rates vs. Time
Figure twenty-one depicts all three correlations: inflation, interest and unemployment. The data illustrate how unemployment trends follow the interest rate trends after a two year lag period, as well, how a lower rate of inflation seems to have a negative effect on employment.

According to Bank of Canada governor Gordon Thiessen, however, "Personally, I think wrestling inflation is the best contribution that monetary policy can make to the proper function of the economy. It will encourage employment more than a policy of higher inflation, which does not work...It is not true that there is a
trade-off between employment and inflation. There is no such thing." According to Thiessen, then, the relationship between unemployment and interest rates is in part coincidental. High unemployment rates are caused by structural technological changes and cyclical factors in the economy which have caused a temporary displacement of jobs.

Neo-Keynesians object to the Bank of Canada's determination to maintain inflation between 1 - 3 percent. This objection is based on the notion that low inflation increases the risk of deflation - or falling prices. Neo-Keynesians argue that some of the consequences of deflation are beginning to take root. People stop buying during periods of deflation because they believe that prices will continue to fall; this would cause a downward spiralling of the economy. However, the Neo-conservative rationale is represented in Mr. Thiessen's statement:

Our target is to hold the inflation rate within a range of 1% to 3%. If prices were falling on average, absolutely, in this country, I would regard it a criticism of monetary policy as much as if the prices were rising faster than 3%. This is a symmetrical policy. Deflation is not good for the economy; inflation is not good for the economy. Our objective is to hold inflation at an extremely low level, and, by and large, to have more stability than we've had in the past. Indeed, in the 1999 federal budget, Paul Martin renewed the government's commitment to hold inflation within the 1% to 3% range. However, there is no consensus on whether a strict monetary policy regarding inflation is good for Canada.

According to the neo-Keynesian, the problem with a one-sided fight against inflation is that it does not look at the impact of its policy on real incomes or unemployment. Pierre Fortin
explained in his presidential address, *The Great Canadian Slump*, that the causes of Canada’s economic slump during the 1990s were not the popular explanations given in the newspapers such as globalization, technological changes, political uncertainty, social policy, payroll taxes, and minimum wages. Fortin’s conclusion is that Canada’s economic downturn is primarily the result of official policy - more specifically, the Bank of Canada and its single minded pursuit of a low inflation policy. Fortin’s solution is to have the Bank of Canada relax its inflationary target and pursue a rate of about 3 percent; it is also important for the government to include a policy objective of an unemployment rate ranging about 7 percent. The governor of the Bank of Canada, Gordon Thiessen, does not see unemployment as the Bank’s concern, but rather argues that unemployment should remain within the political realm of policy making.

Professor Duncan Cameron remarked before a Parliamentary Committee that "The Bank of Canada, rather than being a servant of Parliament, has become its master. This is unacceptable in a democracy where elected representatives, not appointed officials are supposed to govern." Neo-Keynesians, clearly, do not support Governor Gordon Thiessen’s fight on inflation. They adhere to the tactic of controlling short term interest rates; they believe keeping interest rates low will spur on employment and inflation unfortunately.

Some Neo-Keynesians argue that the Bank of Canada’s "war on inflation" has become instilled in the Bank’s philosophy; even
though that battle has been won, it continues to fight. According to Clement Gignac, chief economist and strategist at Lévesque Beaubien Geoffrion Incorporated, "Let's face it, there is no underlying inflation pressure in Canada at this time." Similarly, Jeff Rubin, Chief economist at CIBC Wood Gundy Inc., says that the "Bank of Canada went too far in the late 1980s and early in 1990s in keeping interest rates high as it tried to stamp out inflation and Canada still bears the scars of that effort."

In the 1990s, the Bank of Canada does not have to do much to keep inflation down. As Ross Laver states in Maclean's, "powerful structural changes - new labour saving technology, weaker unions, deregulation and increased competition - have made it harder for workers to push up wages and for companies to raise prices." Inflation is at its lowest level in 30 years; this may trigger further adjustments in an attempt to control the "new economy."

This era of "price stability" also affects home owners. Persistent inflation meant that home buying was a "Good Investment." Although, home ownership may still bring a "good value" to an investment, it will not be the "money spinner" of days past - particularly during the 1970s.

Despite the statements made by Laver, Gignac and Rubin, Bank of Canada's Governor Gordon Thiessen affirms that "The Bank of Canada is absolutely committed to holding inflation inside its 1% to 3% target band." Furthermore, "Even if the budgetary situation were much healthier than it is now, the Bank of Canada would pursue a policy of controlling inflation, because that is the best
contribution we can make to the proper behaviour of our economy. Indeed, the 1999 budget confirms this statement. According to Thiessen, the purpose of Canada’s monetary policy is to contribute to economic stability by preventing inflation from undermining the value of Canada’s currency. The Bank of Canada attempts to avoid major fluctuations in economic activity by controlling inflation. Thiessen stated at the annual Douglas Gibson Lecture in October 1998 that the favourable characteristics of the Bank of Canada’s inflation policy include "increased transparency, better accountability, improved internal decision making and a mechanism for responding to demand and supply shocks that reduces potential fluctuations in output." Inflation containment would be maintained throughout the new millennium for two reasons: "It had been a long time since Canada had low rates of inflation" and "since inflation had dropped rather dramatically and unexpectedly during 1991, it was unlikely that Canadians had completely adjusted to the improved inflation situation. More time was therefore needed to make that adjustment before announcing any further changes to the target." Furthermore Thiessen stated that the extension of the inflation controls reflected the fact that the economy had not yet reached full capacity and it "would therefore, be helpful to have the economy demonstrate more fully its ability to perform well under conditions of low inflation before determining the appropriate long run target consistent with price stability." The Bank of Canada was also concerned about Canada’s credit rating. Thiessen argues that the Bank has been ‘forced’ into
keeping interest rates high in order to protect Canada’s "borrowing capacity." According to Thiessen, "the crucial thing here is to have a credible plan that convinces investors they don’t need to worry about their investment into the future." There is a legitimate concern among investors; when there is a high debt load, there is a possibility of inflation rising, or a fall in currency. This may mean that investors may not get a good return on their money. This kind of undermining of confidence causes interest rates to go up. Thus, when interest rates declined, as Canada experienced in 1996, it means a narrowing of risk premiums.

In 1984, the C.D. Howe Institute argued that "the accumulation of the federal deficit is now so large that the cost of servicing the debt is one of the fastest-growing items in the annual budget." The Institute then explained that in "a period of high and uncertain interest rates the deficit easily could grow out of control." To remove this threat, the Institute did NOT recommend lowering the above average interest rates in Canada, but rather the C.D. Howe Institute explained that in order to remove the deficit "threat", "the projected deficits should be cut by $11 billion by 1988." The Institute’s advice in 1984 stated:

Canadians need to be convinced that significant cuts in the federal deficit are possible... The Institute’s objective is to demonstrate not only that the deficit can be reduced, but that expenditure programs and tax rules can be redesigned in ways that lead to simpler, fairer and more efficient policy. (Emphasis added)"

According to Prime Minister Chrétien, one percent of interest costs 1.7 billion dollars to the taxpayer. Thus, one could argue that it would have been more cost effective for the government of
Canada, under the Bank of Canada's influence, to set a limit on interest rates rather than (or as well as) inflation rates. This would require a less rigid position to keep inflation down; perhaps the government should return to the recommendations made by the Economic Council of Canada in 1972. David E.W Laidler and William Robson from the C.D. Howe Institute state, however, that abandoning the one-to-three percent band on inflation would:

...signal a major step backward in Canadian economic policy, putting monetary policy into the same unsustainable and indefensible position now occupied by fiscal policy. With both federal and provincial finances in such unhealthy shape, it is more than usually desirable to keep monetary policy firmly on a stable course.
Chapter Six: The Deficit and the provinces

Social security has become accepted as one of the things for which the peoples of the world are fighting. It is one of the concrete expressions of a better world.¹¹²

The federal government's decision to reduce transfer payments to the provinces has created new controversy in the deficit battle. The Neo-Keynesians accuse the government of trying to "download" on to the provinces and consider that the federal government is not facing up to its responsibility to provide national quality standards. The Neo-conservative counter-force maintains that decentralization is the most efficient and effective way of administering welfare programs. The provincial governments, although many of them favour decentralization in principle, are unhappy about the reductions and complain that the federal government has "solved" its deficit problem at their expense. Thus, the question arises: Are these centrifugal forces spinning in desperate hopes that the problem will disappear? Or is downloading a viable strategy to fight the deficit?

As explained in chapter four, in the 1995 budget, Paul Martin introduced the Canadian Health and Social Transfer payments. The federal government by 1998 had reduced its annual cash transfers to the provinces by $7 billion.³²⁰ Neo-conservatives believe that greater provincial autonomy will lead to a more co-operative federalism. They feel that federal and provincial governments need to co-ordinate their efforts to control deficits and reduce debt. This should be accompanied by lowering and eventually eliminating interprovincial trade barriers.
The priority of the Neo-conservatives with regard to federalism is to eliminate internal trade barriers, to reduce the overall "burden" of the government, and to create a more decentralized federalism. In this decentralized federalism, the government "closest" to the people provides services such as welfare, infrastructure and education. Federal-provincial cooperation will be required in order to reduce overlap and duplication across jurisdictions. As well, Neo-conservatives feel that all levels of government need to be involved in the overhaul of national programs. On the other hand, the Neo-Keynesian forces argue that the replacement of the Canada Assistance Plan and the Established Program Financing with the Canada Health and Social Transfer will have detrimental effects on the quality and uniformity of care.

In 1966, Canada ratified the UN Covenant on Social, Economic and Cultural rights; in 1976 along with every other industrialized nation - except the US. - Canada also agreed to article 6 which upholds the states "right of everyone to the opportunity to gain his living by work which he freely chooses or accepts, and will take appropriate steps to safeguard this right." The Neo-Keynesians argue that the Canadian government always cited CAP as evidence of its adherence to the Covenant, especially CAP's prohibition against forcing people to work for welfare, and CAP's guarantee of financial assistance based on need. According to Craig Scott - a professor of law at the University of Toronto, the CHST "will place Canada in a position of breaching international
human rights law." The Chrétien government was accused by social action groups of violating this international treaty. In May 1994, sixteen social action groups went before the UN with the charge that Canada had violated its obligation under this Covenant.

The Neo-Keynesians cite Chrétien's Red Book which criticized the Tories for their "unilateral decisions... to cut transfer payments to the provinces" as proof of the government's flexible stance on issues. The Liberal party's campaign attempted to assure Canadians that stability and predictability in financial arrangements would come with their victory. The Neo-Keynesians argue that the federal government's actions have not produced stability; rather have created disorder partly due to the ad hoc manner in which many of the reforms were carried out.

The Neo-conservatives assume a certain mobility of persons and argue that if a person is not satisfied with the policies of their province, they can move to a province which they prefer. Alberta premier Ralph Klein's neo-conservative agenda includes the welfare policy known as workfare. Municipalities and non-profit organizations present the government with community projects such as planting trees, cleaning up parks and river banks, and maintaining or repairing buildings. The province provides these organizations with $6 per hour to hire welfare recipients to perform the work. For those who would not accept work and are from out of province, the Alberta government would buy a one-way ticket home. This stance has been widely publicized as harsh and insensitive. British Columbia estimates that at least 20,000
Albertans have fled there.\textsuperscript{323} However, by 1997, interprovincial migration into Alberta rose to 8500 people in the second quarter. Attracted by job growth and low unemployment, this interprovincial migration into Alberta is at its highest level since the oil-related boom early in the 1980s. The growing population pushed down the rental vacancies to 0.5 percent in Calgary - the lowest in the country in October 1997. In addition, according to Statistics Canada, Alberta had the highest retail sales growth.\textsuperscript{324}

For the Neo-Keynesian, however, Alberta's welfare policy is unfair. According to Maude Barlow and Bruce Campbell, welfare rolls have been chopped by 40 percent, cutting off more than 45,000 welfare recipients, many of them single mothers. Barlow and Campbell report that food banks in Alberta are coping with increased demands as high as 50 percent.\textsuperscript{325} Furthermore:

Mothers must find work when their babies turn six months rather than two years or be cut off assistance. The thirty day warning for welfare cut-off has been scrapped. Teenagers under the age of eighteen, with or without parents or a home, are no longer eligible for assistance; the government is talking about extending ineligibility to those under thirty. Welfare no longer pays for diapers, child car seats, telephone or utility hook-ups; welfare recipients must accept workfare jobs offered at $6.00 an hour or lose their benefits. Unqualified workfare employees are replacing health-care professionals in hospitals, putting the safety of patients in jeopardy.\textsuperscript{326}

Also according to Barlow and Campbell, the Klein government's policy has resulted in a deplorable injustice to the poor. Barlow and Campbell believe that teenagers thrown off welfare are turning to prostitution, theft, and drugs. Single mothers are denied
welfare if they miss even one training session, even if they had to stay home because their child was sick.

Neo-Keynesians believe that the Klein government's policies are so poorly administered, in part because of the "ad hoc" nature of the programming. According to Satya Das, an editorial writer in the *Edmonton Journal*, Klein's conservative policies are:

The whole chaos theory of management. You make quantum leaps, not in one area but in every single department, watch the fallout and take corrective measures. That's the way these guys are operating. If they were writing a book, they wouldn't understand that having the words in the right order is as important as having the words in the book.327

In regard to health care, this may seem to be the case as the Klein government in 1996 underestimated revenue by $500 million.328 $100 million will go to paying down the debt; $200 million will go to health and education; and $200 million will go to creating a tax break. Critics of the Klein government called this excess proof that the cuts were unnecessary, and claimed that the move accelerated demands from nurses and other groups for budgetary relief.

The situation of health care in Alberta is an area that causes much unease with Canadians in the 1990s. In Alberta, health care funding was cut before the regional health authorities were established. The hospitals became caught in much in-fighting between ministers and authorities. Hospitals were trying to hang on to what they had, while still providing core services with less money; seven hundred and fifty million dollars had been taken out of health care in three years.329 There was low staff morale because of lay offs, and many nurses were forced to shift from
full-time to casual status, hence losing their security and benefits. The remaining nurses were forced to accept salary freezes after roll-backs of over five percent.\textsuperscript{330} This type of administration could have been better managed with more planning. The Neo-Keynesian would argue that it could have been avoided altogether, if Ottawa had exerted a stronger influence in terms of legislating standards of quality care.

The Klein "common sense revolution" meant that 1,250 hospital nurses were replaced by 4 community health nurses.\textsuperscript{331} Medical specialists were leaving the province in a mass exodus; they were fed up with the lack of fully functioning medical teams and the crucial follow-up care needed for their patients. According to the \textit{Globe and Mail}, Alberta's finance minister, Jim Dinning, was not unduly worried about the "brain-drain" of experienced, professional people because "revolutions have their consequences."\textsuperscript{332} Mr. Klein favoured de-licensing nurses, health-science technicians, dentists and psychologists in favour of a "generic" health-care worker who will require fewer qualifications and earn substantially lower wages. One hospital is calling these nurses, "patient hostesses."\textsuperscript{333}

The Klein government is pursuing a Neo-conservative agenda; they announced their objectives in broad terms and filled the details in later. In this type of approach, there were many areas left open for mistakes. There have been a series of health care horror stories in Alberta.

One northern Alberta resident died when an air ambulance was
forced to fly to Calgary because there were no beds available in Edmonton. There was the case of an Edmonton man who severed three fingers and had to wait seventeen hours for surgery, by which time doctors were unable to reattach them. An elderly pensioner who was flown by air ambulance from Medicine Hat to Edmonton for a liver transplant was told to find his own way from the airport to the hospital. Once he arrived, he found that because he was late arriving, the liver had been given to another patient. The man then had to borrow money to find his own way back to Medicine Hat.

In Alberta, the quality of care can be questioned. New mothers are sent home from the hospital, the day they give birth. A man dying of cancer was sent home from the hospital with no home care because he didn’t qualify; he had a wife. A lone nurse in charge of pediatric care was called to an emergency and left the maintenance man in charge of the floor. A two year old boy died because he had to be transferred to another hospital because his local facility was filled to over-capacity. These types of examples are plentiful. This type of care in Alberta is surprising since Albertans unlike residents of other provinces pay medicare premiums which by 1998 are expected to be raised by 50 percent.

Under Premier Mike Harris, Ontario residents are facing similar preliminary cuts. In June 1995, the provincial treasurer, Ernie Eves, announced $1.9 billion in spending cuts, including a 21.6 percent reduction in welfare rates. In October of 1996, the Ontario government announced a further $1.3 billion cut in hospitals over three years. The government also established the
Health Services Restructuring Commission: an independent body that has decided that Ontario must eliminate 4,800 of Ontario’s 24,000 acute care beds.

The Commission’s influence resulted in many mergers and closures. Among these affected were the Ottawa Civic and the Ottawa General hospitals, which the Commission said will have to merge administrations. Three other hospitals in Ottawa will be completely closed, including the Montfort - Ontario’s only French-language facility with specialized care. According to Maclean’s, some conservative backbenchers had agreed with MPP’s from the opposition to vote for a private member’s resolution calling for an end to the hospital cuts. Never the less, in the spring of 1997, an announcement was made of the government’s intentions to close 12 of Toronto’s 44 hospitals.

The neo-conservatives, however, believe that these cuts are paramount in overcoming the deficit. They paint a more optimistic picture and favour the Canadian Health and Social transfer payments. The Royal Bank’s chief economist stated that many of Canada’s provincial governments are making stable enough fiscal strides that they could begin cutting taxes, spending more or doing both early in the next century. Saskatchewan could eliminate its debt entirely by 2005 without any further tax increases or spending cuts. The four Atlantic provinces could reduce their debt to GDP ratio to 10 per cent between 2005 and 2010 just by maintaining their current fiscal policy. Ontario has a $5.2 billion deficit and Quebec anticipates a deficit of $1.2 billion for 1998 with a
balanced budget next year. British Columbia expects a deficit of $185-million in 1997-98, and it is unlikely that it will balance its books in the coming year. Alberta has the smallest per capita deficit in the Country; Manitoba will be able to eliminate its deficit by the year 2005.

Canada's provinces thus are in different positions regarding their deficits. Quebec's tax and debt burdens are the country's second highest (after Newfoundland). The PQ government in Quebec has pledged to eliminate the deficit by increasing its taxes (chiefly payroll taxes). New Brunswick on the other hand, "faced with growing anger about cuts to health care and education... unveiled a budget that will offer its citizens $588 million in tax breaks." In the 1997 election, the Atlantic provinces overwhelmingly voted against Prime Minister Jean Chrétien and his deficit-fighting policies.

Reform Party finance critic Monte Solberg agreed with New Brunswick's tax breaks and argued that "the government should introduce a major tax cut as a means of creating jobs." Conversely, the Globe and Mail reported a Liberal MP as saying "The public mood at the moment amounts to 'I won't ask for a tax cut so long as you don't spend my tax dollars badly.'"

Both Neo-Keynesians and Neo-conservatives agree that the effect of the Canada Health and Social Transfer has led to more variance in health care standards across Canada. The influence of this de-centralization has reached the communities as well. The federal government has "downloaded" some of its responsibilities to
the provinces; the provinces have, in turn, "downloaded" their social "responsibilities" to the municipalities. In Ontario, for example, municipalities will be responsible for providing services worth more than $5.3 billion annually including welfare, public health care for the elderly, child care and public housing, according to the Globe and Mail. This new policy between provinces and municipalities mirrors the "fifty-fifty" agreement once shared by the provinces and the federal government.

The Globe and Mail reported that as a result of this decentralization process, municipalities want to play a greater role in setting the agenda for social policies. This is something typically done by the provinces. Local governments rely on property taxes for most of their revenue and may have difficulties funding the growing health-care needs. As a result, social service "experts and political analysts" according to the Globe and Mail say that the shift will put municipalities under pressure to try to reduce welfare services.

An example of reduction in welfare services include Ontario municipalities having to assume the burden of the cost of the 494 nursing homes and 1,200 community agencies that provide long-term care for elderly and disabled people. In addition, all Ontario municipalities will be required to pay for policing and taking control of police budgets.

This change in Provincial/Municipal responsibilities will mean $525 million in spending currently overseen by the provinces will be transferred to their respective municipalities. According to
the Neo-Keynesians, the result of this shift will likely be a combination of increased property taxes, as well as a decline in the type of services offered to communities. It is also likely that the disparity between communities will become greater.

Comparatively, however, Neo-conservatives such as Al Leach state: "we're also quite confident that the cost of welfare delivery is going to continue to go down over the next several years." Neo-Keynesians question how Leach can insist that there will NOT be an increase in taxes when it is not certain how the municipalities will be able to afford the services. Leach does not give assurance that the quality of care or services will NOT go down; merely that the services will stay in existence. The Neo-conservatives, however argue that simpler, smaller, and more accountable governments will be the result of this decentralization; a less costly government will also be the reward for such a shift.

The 1998 budget contributed to a deterioration in federal-provincial relations. The provinces were angered at Ottawa's Canada Millennium Scholarship Foundation, and Maclean's alleged that Ottawa is considering a "another flashy, highly expensive federal program to cover the costs of patient home care - which will again intrude into provincial jurisdiction." Thus, the new era in federal - provincial relations will likely be one of escalating confrontations between the federal government and the provinces. According to Tom Courchene, Queen's University economist, the provinces could retaliate against the federal
government by "uploading" their problems. The provinces could allow universities to raise tuition fees, for example, because Ottawa has ensured that needy students will be allowed access under the Millennium scholarship. Courchene states "If we don't tackle this together, there are going to be some important clashes." \(^{351}\)

One province that is known for its "clashes" with Ottawa is Quebec. A further consequence of the federal deficit, it may be argued, is that reduced federal transfer payments to Quebec have weakened the arguments in favour of federalism, and have provided further ammunition to the sovereignists. Furthermore, the 1998 creation of the Canada Millennium scholarship foundation, according to Quebec Finance Minister Bernard Landry, is an example of "abusive and predatory federalism." \(^{352}\)

Quebec Premier Lucien Bouchard refused to sign Prime Minister Chretien's new "Social Union" with the provinces: $11.7 billion increase over the next five years to the CHST. Never the less, Quebec's "have-not" status, and 23 percent of the country's population will entitle it to $6 billion in increased payments from the federal government. \(^{353}\) Despite this increase, Bloc MP Yvan Loubier complained that in 1997-98 Newfoundland received $1,648 per resident in equalization payments and New Brunswick $1,154. Quebec with its larger tax base received $521 per person. However, National Post author Giles Gherson points out that Quebec still received more than Saskatchewan, the least poor of the equalization-receiving province which received $232 per person. \(^{354}\)

For the 1999 fiscal year, Quebec will receive $932 per person in
CHST transfers, compared to Alberta's $734 or Ontario's $824 per person.355

Nationally, the transition to a more globalized economy has meant that tremendous pressure has been placed on the social welfare system. As such, programs such as unemployment insurance, social assistance, and universal health care "have suffered through program cuts" to such a degree that "fissures in society have widened between the poor and other classes, between peripheral regions and metropolitan centres, and between ethnic and religious groups."356 Maclean's reported in February 1999, that societies thrive when they have a large and industrious middle class. In Canada, the top fifth of income earners - those who earn more than $40,000 have increased their share of the nation's income to 47.3 percent in 1996 from 46.4 percent in 1990. Furthermore, if the status quo persists the OECD forecasts a gradual slide in Canada's per capita incomes from 10 per cent above the OECD average to 15 percent below average around 2020.357 If this proves true, the neo-conservative view that Canada ought to emphasize productivity rather than redistribution in enhanced. Furthermore, if this prediction proves true, it may contribute to a deterioration of federal-provincial relations as peripheral regions become more depressed and fissures in society are heightened.

Faced with such changes in society, the PQ offers a solution: the government should not stand aside - rather, it must actively formulate strategies to maximize opportunities in this economy while protecting as best they can the social safety nets. For such
action to occur in Quebec, the PQ maintains that sovereignty is necessary. Accordingly, "the Canadian federal system is so paralysed by overlapping responsibilities and intergovernmental bickering, and the Canadian state so lacks legitimacy in Quebec, following failed constitutional discussion, that no effective state response is possible within existing arrangements." 358

The PQ argue that a revitalized social democratic society can be created and sustained only if Quebec becomes a sovereign state. Sovereignty, the PQ argues, will provide "the conditions in which full employment can be achieved because it will, at long last, make possible reaching the crucial goal of coherence in [their] policies relating to economic development - job training polices, fiscal and budgetary policies, industrial and agricultural policies, regional development policies." 359

Quebec has an unemployment rate of 9.4 Percent. Quebec also has a high rate of high school dropouts relative to other jurisdictions in North America. Furthermore, "current patterns of inequality push the poor, the young, women, and ethnic minorities further onto the margins of the economy and society." 360 Thus, Quebec is facing a difficult challenge. If the federal government continues its neo-conservative strategy this may serve only to fuel the separatist fire. If the federal government "forces" Quebec to become more "independent" by reducing federal transfer payments to Quebec, resentment may grow towards the federal government if Québécers experience a decline in the quality of welfare services. This would provide ammunition to the sovereignists who may promise
a "renewed Quebec" complete with full employment and higher standards to the welfare state. By lessening the financial benefits provided by the federal government, neo-conservatism lessens Quebec's attachment to the rest of Canada. This would partly explain Prime Minister Chretien's renewed spending in the Canada Health and Social Transfer payments (as opposed to using surpluses to pay down the debt).

In response to the Canada Millennium Scholarship Foundation, Quebec demanded the right to opt out - with full compensation - so that it could implement its own education grants program. Ottawa has refused and according to former Bloc Quebecois MP Jean Lapierre; Ottawa gave Quebec "on a silver platter, the pretexts to call an election." The expected election took place and the PQ won.

Thus, the 1998 budget may be the catalyst to yet another round of Quebec "accommodations" by the federal government. However, without any economic backbone, the federal government might not be able to hold Canada together.

This chapter has debated the federal-provincial repercussions of the deficit battle. Neo-Keynesians argue for a return to stronger federalism in order to better redistribute the country's wealth, as well as to ensure the allegiance with people in Quebec. The neo-conservatives argue for greater competition, and autonomy among the provinces. Currently the federal government's policy to favour the neo-conservative argument has resulted in greater provincial autonomy and detachment. Provinces have greater control
over the type and quality of services they will - or can - provide. As a result, greater differences among the provinces mean an erosion of the idea of "national standards." Indeed, they mean very different ideas regarding the classification of the "Canadian citizen." Being Canadian may not assure citizens the same universal standards they have become accustomed to enjoy.
Chapter Seven: Conclusions: scenarios for the future: The economist sheep or shepherd?

Cabinet Ministers are firmly convinced that economic policy is much too important to be left to economists, or administrators for that matter, just as the conduct of war is too important to be left to the generals.²⁶²

Canada in the 1990s is living the "true age of the Economist". People are torn between two contrasting views on the deficit: Neo-Keynesian and Neo-conservative. As previously stated, the Neo-Keynesian forces give priority to the short term stability of the economy and tend to dismiss concerns regarding the level of debt. The Neo-conservatives, on the other hand, focus on the perceived costs of growth in the national debt, and are willing to forgo stabilization benefits in order to bring down the level of the debt. Both theories agree that deficits influence government policy.

In the 1990s, everywhere Canadians looked, there were new sources armed with statistics promising huge economic growth. As Bruce Little reported in the Globe and Mail's Report on Business Magazine,

Suddenly, Canada has the "fundamentals" that investors and economists adore: low inflation, rapidly falling government deficits, a current account surplus in its financial affairs with the rest of the world, free trade and a restructured business sector whose companies have become competitive enough in world markets to generate an export boom.

All that, plus "excess capacity" (economistese for high unemployment) means that the country can turn in several stellar years of growth with no danger of triggering a new wave of inflation."²⁶³
Although Little points out that normally this would be a recipe for powerful growth, the federal and provincial governments' emphasis on the deficit, and the resulting tendency to cut spending, has led to "fiscal drag." While the private sector is expanding, the public sector is shrinking.

One ought to recall at this time the words of G.D. Robertson who stated in 1931 that "we have experienced the most distressing winter in many years but we can emerge into the sunlight of hope at the beginning of another season." Although these hopeful and poetic words must have been comforting at the time, they did not represent the truth. As Canadians enter the new millennium, perhaps they should heed the words of Alan Peacock: "Economic policy is much too important to be left to economists." The conclusion of this thesis is that the dominant economic theory of the day must not be taken as divine truth. Each theory has value, and it is this value that must be extracted.

The purpose of this thesis was threefold: to find out why Canada accumulated such a debt; to discover if there is a so-called debt crisis; and discover if it is possible to preserve Canada' National welfare state given the financial restraints that have been adopted by both federal and provincial governments.

The reasons why Canada accumulated such a debt, according to the Neo-conservative economist, are due to inefficiencies within the government coupled with overspending and "living beyond our means." The Neo-Keynesian, although admitting that the level of the debt is high, does not condone draconian cuts to spending.
Rather, the Neo-Keynesian looks to the revenue side of government by way of increasing taxes on the rich and environmentally unfriendly businesses, in order to collect additional revenue needed to support government programs.

Robert Campbell comes closest to a "meeting ground" between these two theories in his analysis of the Keynesian revolution. According to Campbell, the perverse execution of the Keynesian theory led to its ultimate breakdown. According to Campbell, the federal government was not effective in controlling its level of spending during "boom" times, when it was supposed to be saving for "bust" periods in the natural business cycle."

Both neo-Keynesians and neo-conservatives agree however that high interest rates negatively affect Canada's debt. Chrétien stated, in February of 1997, that "Lower interest rates [are] better than tax cuts." The fact that high interest rates have contributed to the high level of debt in Canada is the extent of the similarities between the two schools of thought. Neo-Keynesians maintain that high interest rates were a deliberate policy created to reduce aggregate demand and thus decrease inflation which subsequently caused the high level of debt. These economists maintain that the elite deliberately "co-opted" the public into believing that there was a debt crisis that must be dealt with immediately.

Neo-conservatives however, argue that high interest rates were a consequence of the high levels of debt brought on by massive over-spending. Thus, Neo-conservatives do not see high interest
rates as the cause of Canada's debt. Neo-conservatives argue that the high level of debt forced the Bank of Canada to push up interest rates in order to alleviate the threat of inflation. This would also quell any fears that the government would offset the debt by an increase in monetary supply. Neo-Keynesians question whether neo-conservatives are even sincere in wanting to reduce the debt; as long as there is a debt someone is collecting those interest payments at the expense of ordinary taxpayers. David Wolfe suggested that right-wing governments are more likely than left-wing governments to have large deficits. More recent experiences in some places. (eg. Saskatchewan) tends to confirm this.

The true answer to the question why Canada has acquired such a debt rests within the two schools of thought. High interest rates contributed to the debt in that the massive interest that the government is forced to pay required further borrowing - and increased the level of debt. High interest rates were introduced however, because the level of debt - due to an increase in spending - became worrisome. Thus, the answer to the deficit problem rests with keeping interest rates low and reorganizing public spending.

It must be pointed out that there can be no simple, single-valued evaluation created by the economist which can calculate efficiency, distributive justice, and stabilization of income. It is diverse value judgements that prevent such an evaluation from being realized. Thus, the Bank of Canada's single minded policy objective to maintain low levels of inflation was not the answer
for resolving Canada's economic stability. Indeed, there is no historical precedent of a nation solving its debt problem in this way. The Bank of Canada indirectly controls short term interest rates and has the power to bring interest rates down. In 1996, relief was finally available as low interest rates were used to spur market forces.

It has further been demonstrated that low interest rates create a positive economic environment for growth. According to Paul Martin in his fifth budget speech, "Consumer confidence has rebounded. The economic recovery is now supported by strong domestic demand. Business confidence has hit record levels. Investment is surging. Stimulated by lower interest rates and renewed confidence, economic growth reached a level in excess of 3.5 per cent last year. This year, continued strength is projected." Furthermore, the largest item in the expenditure accounts in the 1999 budget was the $42.5 billion for interest payments. If interest rates were to increase, this would cause that figure of $42.5 billion to increase simultaneously. The increase would be marginal given that the interest payments are largely a function of past interest rates.

Simply "downloading" the costs of the services to the provinces (i.e. the Canadian Health and social Transfer) will result not only in a more decentralized federation, but a country that has no universal standards to the quality of life it provides its citizenry. Furthermore, a provincial deficit is not better than a federal deficit. The same taxpayers ultimately have to make the
interest payments in either case.

The cause of the deficit can also be attributed to government overspending. At times, as pointed out in this thesis, the government has been frivolous with its contributions to society. It is politically rewarding to spend tax payers money on services. It is even more politically rewarding to spend borrowed money to provide a lavishness of services for Canadians. During the Trudeau era, the federal government began to borrow money for unnecessary services. Had taxpayers been expected to pay for the true value of these services, they might have demanded that the government spend less, in order to receive a tax break.

However, when evaluating social spending, Canada must maintain its compassion. It is important that both provincial and federal governments remain committed to providing for the poor, the sick, and the elderly. In 1997, Canada's social spending is at 18 percent of GDP and falling. This is relatively low for an industrialized country. The European countries' average is 23 percent. To date, Paul Martin's spending cuts have had serious consequences both in terms of the deficit, as well as in the quality of services. The government must be aware that spending cuts can cause unemployment in the short run which will place an increased pressure on the treasury. Not only does the government lose tax revenue, but they must pay out an increase in unemployment or insurance welfare. However, unemployment has fallen since Martin became Minister of Finance.
Bridging the gap between efficiency and equity is not an easy request to make to the government. The new millennium will see Canada in her new era of restructuring. Canada faces a long arduous task to eliminate the $579.7 billion dollar debt. This should take decades, not years. It will require some sacrifices to balance the budgets, but these sacrifices should not be made all at once. It took decades for Canada to obtain such a high level of debt; it should take as long, or longer, to dissipate this debt. As John McCallum, senior vice president and chief economist of the Royal Bank stated that while Paul Martin's budgets have marked a turning point in Ottawa's war on debt "the length of this struggle is likely to be measured in decades rather than years."^370

The reason behind this assertion is linked to the second purpose of this thesis: to discover whether there was a debt-crisis during the 1990s. Neo-conservatives argue that the current level of debt was in a "crisis" situation, and Moody's downgrading of Canada's credit rating served as evidence to support this statement. Neo-Keynesians argue, however, that even with the downgrade, Canada's credit rating was not in jeopardy. Canada simply needed to do a better job of collecting monies in order to maintain her social services. It may be pointed out that within Canada there was a false perception regarding the notion of "structural deficit." During the 1990s there was a widespread belief that Canada might "hit the deficit wall" and be unable to borrow any more money to meet its deficit and debt interest payment requirements. D'arcy Jenish stated that Canada "cannot tax, spend,
or borrow any more because, contrary to the assertions from the left, we have hit the wall in all three areas, the wall being a psychological barrier rather than an objective, measurable obstacle."

Thus, the answer to the question if there was "debt crisis" would be "yes". This affirmative answer is not congruent with the neo-conservative view that the country will "hit the debt wall" if the deficit does not remain at zero. Rather, this answer regarding the "debt crisis" requires that the government not ignore the high levels of debt. The high level of the debt has caused a "crisis" in Canada. Simply trying to generate new sources of revenue cannot eliminate the "debt crisis". On the other hand, the crisis needs a re-evaluation of past habits; spending should be re-evaluated, not slashed.

The final purpose of this thesis was to determine whether Canada could maintain her social programs. According to the neo-Keynesians, the answer is clear. Canada simply must sustain her programs. According to the Neo-conservatives, Canada can not afford to maintain the welfare state (health care now exempted). Again, a meeting of the two philosophies is needed in order to reach the truth. When enough people are working, Canada can sustain her welfare state. The government's emphasis must therefore focus on stimulating the economy through growth. The government's emphasis therefore must temper its pursuit of deficit-fighting cutbacks of the "slash and burn" nature as well as policies of near-zero inflation.
The government of Canada should stop listening exclusively to the fiscal demands of the economic elite. Canada’s Prime Minister should re-think how the financial house should be put back in order. Eliminating waste and duplication within the bureaucratic machine is a worthwhile and necessary task. The Liberal government’s Program Review venture in 1994 was a step in the right direction. Unfortunately, this program was not executed to its potential. The Canadian government of the 1990’s has a difficult task; it must lead this country past a profound debt.

The reform of social programs should look towards eliminating waste and inefficiencies without destroying the programs. The "bottom line" should not state how much money can be saved; rather, it should state how can services be better administered.

The two sides of the deficit battle are in a continual clash. If governments were to take the best from each side, then the governments - both federal and provincial - would have within their power the ability to instill hope and optimism. Canadians should enter the next century not burdened with a deficit battle. Both levels of government have within their means the ability to restore a dynamic economy. This new beginning must start with the federal government. The federal government must preserve the welfare state; it must also set a secure course towards balanced budgets. The Liberal’s budget of 1999 is a step in the right direction. While tempering federal-provincial relations it has attempted to put some money back into health care.

Thus, the deficit battle has begun, and rages on, but it is
far from over. The federal government must decide to end the war. The government is a body representative of the people. As a body, it is capable of compassion and intellect. Value ought to be given in full to neither the heart nor the mind. Rather, a delicate balance is possible between compassion and intellect. The Neo-Keynesians represent compassion; the Neo-conservatives represent intellect. Both schools of thought believe that their philosophy is the best for Canada; both are fighting for Canada.

The federal government must temper compassion with intellect. A balance must be struck. Canada must ensure that neither side wins the deficit battle. For if one side wins, Canada has been lost. Only peace between the two philosophies will provide Canadians with the kind of legacy they can uphold with pride.
Endnotes


9. According to an economic study done by Diane Bellemare and Lise Poulin-Simon the direct revenue cost to the economy as a consequence of high unemployment was $109 billion in 1993. Maude Barlow and Bruce campbell. Straight Through the Heart. p. 85.


17. Organization For Economic Co-operation and Development. Main Economic Indicators. as cited in Ingrid Bryan p.5.


22. Ibid. p.12.


28. Ibid.


30. Ibid. p. 650.

31. Ibid. p. 653.

32. Ibid. p. 653.


34. Statistics Canada Information Line. 1999.


38. Ernst & Young's analysis of the 1998 Federal Budget.


42. Michael Parkin and Robin Bade. p. 950-953.

43. Ibid.


45. Ibid.


47. Ibid. p. 6.


50. Michael Parkin and Robin Bade. p. 954.


52. Table 1.1 Summary Statement of Transactions: **The Budget Plan 1998**. p. 12.


54. Jeffrey Simpson. "A Wise Budget, but we're still paying for it."

55. Maude Barlow and Bruce Campbell. p.11.


65. Ibid.


68. Irwin Gillespie. p. 62.

69. Ibid.

70. Ibid. p. 63.


72. Ibid.

73. Irwin Gillespie. p. 65.


75. Irwin Gillespie. p. 71.

76. David Perry. p. 4.

77. Ibid. p. 6.

79. Ibid.

80. Ibid. p. 159.

81. Ibid. p. 159.


83. Michael Bliss. p. 159.

84. Ibid.

85. Ibid. p. 160.

86. Mackenzie King, as cited from King’s Diary by Michael Bliss. p. 160.


92. Ibid.

93. Ibid. p.16.

94. Ibid. p. 15.

95. Ibid.


100. Harold Chorney. p. 11.
102. Maude Barlow and Bruce Campbell. p. 16.
103. Ibid.
106. Maude Barlow and Bruce Campbell. p. 21.
108. Michael Bliss. p. 179.
109. Ibid. p. 204.
111. Tom Kent. p. 12.
113. Quebec began to impose its own income tax in 1954. Ibid.
115. Ibid. p. 133.
117. Maude Barlow and Bruce Campbell. p. 161.
118. Michael Bliss. p. 192.
119. Michael Bliss. p. 207. Bliss also reports that the Leader of the Opposition Lester Pearson abruptly reversed his party's stance on nuclear weapons (thus proving himself "decisively inconsistent" while Diefenbaker was "consistently indecisive." p. 210.
120. Ibid. p. 207.
121. Ibid. p. 233.
121. Ibid.
123. Ibid. p.236.
124. Maude Barlow and Bruce Campbell. p.28.
126. Ibid.
127. Ibid. p.232.
129. Michael Bliss. p.236.
130. Ibid.
131. Maude Barlow and Bruce Campbell. p.28.
134. Ibid. p.35.
137. Ibid. p.12.
141. D'Arcy Jenish. p.28.
143. Ibid.
144. Michael Bliss. p. 269.
145. Ibid. p. 270.
146. Ibid. p. 271.
147. Ibid. p. 270.
151. Ibid. p. 274.
152. David Wolfe. p. 133.
156. Michael Bliss. p. 290.
158. Ibid.
159. Ibid. p. 17.
162. Michael Bliss. p. 290.
164. Ibid.
166. Ibid.
169. Ibid.


174. Chrétien, as cited by Maude Barlow and Bruce Campbell. p. 104.

175. Chretien. As cited by Maude Barlow and Bruce Campbell. p.139.

176. Paul Martin, as cited by Maude Barlow and Bruce Campbell. p. 147.


180. Ibid. p.32.


182. Ibid.

183. Ibid. p. 49.

184. Ibid. p.45.

185. Ibid. p.55.

186. Ibid. p.62.

187. Ibid.


189. Ibid. p.33.

190. Ibid.

192. Ibid.

193. Maude Barlow and Bruce Campbell. p.151.

194. Ibid.


210. Truglia, as cited by Linda McQuaig. _Shooting the Hippo_. p. 43.

211. Ibid.


214. Ibid.


218. Maude Barlow and Bruce Campbell. p. 128.


223. Ibid. p. 19.

224. Ibid.

225. Maude Barlow and Bruce Campbell. p. 167.


228. Ibid. p. 5.

229. Ibid.

230. Ibid.

232. Ibid. p. 21.


237. Maude Barlow and Bruce Campbell. p. 8.


239. Ibid.


241. Ibid.

242. Ibid. p. 18.

243. Maude Barlow and Bruce Campbell. p. 32.


246. Ibid.


250. Ibid.

251. Ibid.


253. Ibid.


258. Ernst and Young's Analysis of the 1998 Federal Budget.


266. Ibid.


274. Joe Clark. Ibid.

275. Mike Harris. Ibid.


281. For the purpose of this thesis, the neo-Keynesian holds that the welfare state is an essential component required to maintain the business cycle at an equilibrium. This notion obviously differs from the puritan Keynesian philosophy.


285. Ibid. 945.


289. Maude Barlow and Bruce Campbell. p. 86.
290. Ibid. See Also Linda McQuaig. p. 53-62.

291. Maude Barlow and Bruce Campbell. p. 86.


293. Ibid. p. 771.

294. Ibid. p. 778.

295. Maude Barlow and Bruce Campbell. p. 90-91.


303. Ibid. p.1645.

304. Maude Barlow and Bruce Campbell. p. 69.


310. Ibid. p. 417.

311. Ibid. p. 418.


314. Ibid.

315. Ibid.

316. Prime Minister Jean Chrétien as cited by D’Arcy Jenish. P. 23.

317. As stated in Chapter 2, inflation becomes a "problem" only if the rate exceeds that of a number of industrialized countries particularly the United States.


321. Craig Scott. As cited by Maude Barlow and Bruce Campbell. P. 182.

322. Maude Barlow and Bruce Campbell. P. 140.

323. Ibid.


325. Maude Barlow and Bruce Campbell. P. 247.

326. Ibid.


329. Maude Barlow and Bruce Camobell. P. 249.

330. Ibid.

331. Ibid.

333. Maude Barlow and Bruce Campbell. p. 250.


335. Ibid.

336. Maude Barlow and Bruce Campbell. p. 249-250.


340. Ibid.


346. Ibid.


348. Ibid.


351. Tom Courchene. As cited by Mary Janigan. p. 22.


354. Ibid.

355. Ibid.

356. Ibid.


359. Ibid.

360. Ibid. p. 271.


362. Alan Peacock.


364. Robert Campbell.


367. Maude Barlow and Bruce Campbell. p. 88.


369. Ibid. p. 213.

370. McCallum. as stated by D'Arcy Jenish. p. 224.

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