

# HOW OTTAWA SPENDS 2016 - 2017

THE TRUDEAU LIBERALS IN POWER

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## PREFACE

This is the 37<sup>th</sup> edition of *How Ottawa Spends*. As always we gratefully thank our roster of contributing academic and other expert authors from across Canada and abroad for their research, their insights and for their willingness to contribute to informed public debate in Canada.

This edition is our second digital on-line publication rather than the normal book version of its 35 years from 1980-81 to 2014-15. And it is also the second volume where contributing chapters have been assessed under normal academic anonymous peer review processes. We thank these peer reviewers as well.

Very special gratitude is owed to Sheena Kennedy for her skill in helping us launch an on-line peer reviewed process and to Mary Giles , the Special Projects Administrator in the School of Public Policy and Administration for her work and expertise in the on-line publication and distribution process.

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G. Bruce Doern and Christopher Stoney  
Ottawa  
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## Chapter 1

### THE TRUDEAU LIBERALS IN POWER

G. Bruce Doern and Christopher Stoney

#### INTRODUCTION

In this 2016-17 edition of *How Ottawa Spends*, we examine key aspects of the Liberal agenda as both the defeated main opposition parties, the Conservatives and the NDP, now look for new leaders and take their time in choosing successors who would be capable of taking on Prime Minister Justin Trudeau. As last year's *How Ottawa Spends* illustrated, the Liberal election campaign platform and its later first Speech from the Throne revealed a Liberal Party with a massively ambitious socio-economic agenda on offer, characterized by its effort to be in as many ways possible, the quintessentially opposite of the controlling one-man Harper Conservative government it had defeated (Stoney and Doern 2015, Chapter 1).

In the immediate aftermath of the vote and of the dynamics of taking power, Canadians witnessed the dominance of Justin Trudeau's own outgoing persona and style and how he was being seen positively both nationally and internationally. Trudeau had initially spent most of his time abroad on a series of meetings with massive positive media coverage in Washington, and in Europe but also in social media coverage. This included coverage of his government's support for the admission of 25,000 Syrian refugees including Trudeau personally greeting the new arrivals at Toronto airport.

At home, Canadians, both those who voted for him but also many who did not, were presented with an expressive and outgoing leader in sharp contrast to the often severe and sombre

shadow cast by Stephen Harper's persona and modus operandi during the previous decade.

Trudeau and his Cabinet were now meeting publically with provincial leaders and with organizations representing city mayors and municipalities in ways that Harper had not and did not want to. Ten months after his election and well past the honeymoon stage of most freshly elected governments, the Trudeau Liberals were still riding high in the opinion polls.

In reflecting on and covering the so-called shift to Trudeau's self-declared "sunny ways" it is often difficult to keep track of what more significant policy and agenda changes are and have been, something that *How Ottawa Spends* has done for almost 4 decades. In the editors' lead chapter therefore we cover four aspects of the Liberal agenda. We look first at the inaugural Liberal Budget including its large deficit infrastructure focus and early comments about it. We then examine the Liberal strategy on democratic institutions centred on electoral reform to replace the current first-past-the-post system. Third, we probe the complex agenda links and content regarding pipelines, interest group democratic pluralism and indigenous peoples. Fourth, we draw attention to three agenda events and pressures, national and global, that were not in the frame at the time of the election, the Speech From the Throne (SFT) and the Budget, but which are now emerging as important factors in politics and policy. These include the Fort McMurray Alberta fire and ecological disaster; the UK's Brexit referendum decision to leave the European Union and its initial impacts, and "Trumpism", the unprecedented chaotic, divisive and verbally abusive US election battle being waged by Donald Trump in the name of the Republican Party. In both the Brexit and Trumpism developments, there is new uncertainty for Canada and the world, to which Trudeau will have to react both with words and actions. These appear to be coalescing around changing views of the excesses of globalization and stronger concerns about free trade and free

trade agreements. Much depends of course on whether Trump wins the November 2016 US Presidential election against Hilary Clinton, a prospect that at time of writing seems unlikely but not impossible.

The final section of this chapter also highlights some of the important insights, arguments and findings of our contributing authors in their chapters on other key policy and agenda features of the early Trudeau era. Some of these are also referred to briefly in the main earlier sections of this chapter.

#### THE LIBERAL AGENDA: BUDGET SPEECH 2016.

Finance Minister Bill Morneau presented the first Trudeau Liberal budget on March 22<sup>nd</sup>, 2016 (Department of Finance, 2016). It built on the earlier first Liberal *Speech from the Throne* (2015) tabled early in December 2015 and perhaps even more on the Liberal 2015 election platform where planned deficits anchored around infrastructure investment demarcated the Liberals from the Harper Conservatives and the NDP opposition which opted for balanced budgets, and by implication, more austerity. This was pivotal in gaining the Liberals a resounding and in many ways unexpected majority government (Stoney and Doern 2015).

The Budget Speech developed 15 themes and realms for political-economic action and discourse, beginning with “help for the middle class” and ending with “a strong voice” on the international stage. Help for the middle class highlighted the already announced Liberal tax cuts for the middle class, paid for partly by “raised taxes for the top 1 per cent” (Department of Finance 2016, 3). Announced in the budget is the “introduction of the new Canada Child Benefit” cast as a “plan to help families more than any other social program since universal health care”

(Ibid, 3). Not mentioned in the budget speech, though it was in the earlier SFT, was the promise of Canada Pension Plan (CPP) reform and renewal (see Ian Lee’s detailed analysis in Chapter 10).

The middle class was also central in the “long term growth for the middle class” theme that followed but which otherwise was *de facto* the government’s commitment to “new investments in infrastructure from coast to coast to coast” (Ibid 4). This was the core of the deficit spending and investment macro budget strategy and would amount to “\$11.9 billion over five years” and more than \$120 billion over the next decade (Ibid, 4). The investments would “focus on long- term value” and would focus initially on “public transit, water and wastewater systems, provide affordable housing, and to protect infrastructure systems from the effects of climate change” (Ibid 5). Fanny Demers and Michel Demers in Chapter 2 provide a detailed early look at the Liberal infrastructure plans and agenda, including their underlying economics but also governance challenges. It is worth keeping in mind that the Harper government had also promised in its budgets long multi-year infrastructure investment plans both when it was running deficits and when it was aspiring to be a responsible balanced budget government when and if it was re-elected (Doern and Stoney 2014-2015; Doern, Maslove and Prince 2013).

These lead-off commitments in the Budget Speech were followed by measures more broadly aimed towards an “innovative and clean economy” and then in more detail for measures on “post-secondary education” (including increased Canada Student Grant amounts) and “investments in world-class institutions and research” including \$95 million per year through Canada’s granting councils, but also \$2 billion over 3 years for a new Post-Secondary Institutions Strategic Investment Fund “to modernize on-campus research, commercialization and training facilities” (Department of Finance 2016, 6). Commitments then follow in the Speech on “clean



growth and a low carbon economy” (Ibid 8) where Canada’s new stronger focus on a working climate change plan had already been evident, led by Trudeau as prime minister, and coordinated nationally and via renewed federal-provincial negotiations anchored in Environment Canada, already renamed Environment and Climate Change Canada. While it was infrastructure investment that anchored the macro fiscal deficit position of the government, there was, as seen above, considerable new spending of other kinds as well, including new commitments to foster “new relationships with Indigenous Peoples” amounting to “8.4 billion over the next five years” (Ibid 12).

Interestingly and crucially, but without being covered by its own heading, the Finance Minister very early on in the Budget Speech stated that

[F]ortunately, circumstances for investment are ideal... Wise management of the nation’s finances back in the 1990s restored Canada’s fiscal health, giving us a debt-to-GDP level today that is by far the lowest of any G7 country. At the same time, our interest rates have never been lower, so we can borrow on excellent terms—as governments are being urged to do by everyone from the IMF to the OECD to the G20. Our plan is reasonable and affordable. By the end of our first mandate, Canada’s debt-to-GDP ratio will be lower than it is today” (Ibid 2-3).

On the federal budget per se, the immediate issues raised by critics and observers are highly selective and even curiously expressed. The *Economist* (2016) characterized the overall budget with an overall label of “globalization with a human face” (Ibid 58) a phrase far removed from any such stated theme in the Budget per se. It also said that Trudeau and his finance minister “had no hesitation in keeping the lavish promises of extra spending made by their Liberal Party during the election campaign” (Ibid) but also that their infrastructure spending increases “wisely does this by boosting maintenance spending on existing facilities, while they ponder backing

bigger projects” (Ibid). According to the *Economist* there is wisdom in the Liberal budget approach noting that “most economists support deficit spending when borrowing rates are low and the economy is weak” but then ends its analysis with a note of caution adding that the “question is: will Mr. Trudeau know when to stop?” (Ibid).

Globe and Mail columnist Jeffrey Simpson (2016) who is sympathetic to the Liberal Trudeau agenda, has also raised the issue about when Trudeau will have to stop saying yes but relates it more to overall limits on policies that are not just spending in nature but rather to the normal limits of trying to please everyone, all of the time. The C.D. Howe Institute’s Craig Alexander emphasizes a different argument about the budget plans (Alexander 2016). He argues that the “2016 budget delivers on the Liberal election platform but it comes with fiscal risks” (Ibid 1). There is, in Alexander’s view, “a real risk that the economy does not grow as fast as predicted, that tax revenues disappoint, that interest rates rise more than anticipated or that more spending is called for in future budgets. Sustained deficits can add up quickly and dramatically, which is why they are not sound fiscal policy” (Ibid 3). This kind of analysis, however, leaves out the crucial absence in public budgeting of viable ways to budget for capital assets which have long lifetimes and are not and should not be treated in debates and fiscal practice as just operational spending (Doern, Maslove and Prince 2013).

Still other initial commentaries in Canada on the budget were centred initially in a dispute between the Parliamentary Budget Office (PBO), an independent entity which had battled with the Harper government over its budgetary accountability. The PBO took on the Trudeau government by arguing that its fiscal plan was less transparent, making it more difficult for parliamentarians to scrutinize public spending (Parliamentary Budget Office 2016a; Curry 2016). Interestingly, this

PBO report received major media coverage, whereas a further PBO report two weeks later concluded that “despite this weaker external outlook, the PBO anticipates that the combination of fiscal measures in Budget 2016 and accommodative monetary policy will help bolster the Canadian economy. PBO projects that growth in real ...GDP will rebound to 1.8 per cent in 2016 and then rise to 2.5 per cent in 2017” (Parliamentary Budget Office 2016b). This more favourable PBO report received little or no media coverage.

The Trudeau Liberals are it seems prepared to take significant risks. But there is another related dynamic, certainly in the early years, that may play out in different ways. This dynamic centres on the fact that Trudeau, as a cure for Harper centralism and “one-man” government, has promised that his ministers, half men and half women for the first time in Canadian history, will have their own space to make decisions, and also to act and advise on the basis of good policy evidence. This means that some laudable decisions will be taken as ministers decide (to spend and regulate, or to cut spending and deregulate) but also that mistakes will be made and spenders and guardians will intervene and collide in the name of conflicting values and events. And eventually, the Prime Minister may be required to intervene and say no more often.

#### DEMOCRATIC INSTITUTIONS AND ELECTORAL REFORM.

The Liberal Speech from the Throne committed the Trudeau government to adopt its campaign promise that it would take action to “ensure that 2015 will be the last federal election conducted under the first-past-the-post voting system” (Speech From the Throne 2015, 2). Trudeau had already established Canada’s first ever Minister of Democratic Institutions and appointed as its minister Maryam Monsef, a newly elected MP from Peterborough, the youngest member of the

Cabinet, and a new Canadian from Afghanistan, who arrived in Canada in 1996 (ipolitics 2015). Her full mandate encompassed electoral and voting reform; Senate reform centred on creating a new non-partisan, merit-based process to advise the Prime Minister on Senate appointments; and the reform and strengthening of House of Commons committees (Speech from the Throne 2016, 3). In this section, we focus only on the early work and debate on electoral reform.

The motion in Parliament to establish a Special Committee on electoral reform was appointed with a mandate to “to identify and conduct a study of viable alternative voting systems to replace the first-past-the-post system, as well as examine mandatory voting and online voting, and to assess the extent to which the options identified could advance the following principles for electoral reform:

- 1) Effectiveness and legitimacy: that the proposed measure would increase public confidence among Canadians that their democratic will, as expressed by their votes, will be fairly translated and that the proposed measure reduces distortion and strengthens the link between voter intention and the election of representatives;
- 2) Engagement: that the proposed measure would encourage voting and participation in the democratic process, foster greater civility and collaboration in politics, enhance social cohesion and offer opportunities for inclusion of underrepresented groups in the political process;
- 3) Accessibility and inclusiveness: that the proposed measure would avoid undue complexity in the voting process, while respecting the other principles, and that it would support access by all eligible voters regardless of physical or social condition;
- 4) Integrity: that the proposed measure can be implemented while safeguarding public trust in the election process, by ensuring reliable and verifiable results obtained through an effective and objective process that is secure and preserves vote secrecy for individual Canadians;
- 5) Local representation: that the proposed measure would ensure accountability and recognize the value that Canadians attach to community, to Members of Parliament understanding local conditions and advancing local needs at the national level, and to having access to Members of Parliament to facilitate resolution of their concerns and participation in the democratic process; and

that the Committee be directed to issue an invitation to each Member of Parliament to conduct a town hall in their respective constituencies and provide the Committee with a written report of the input from their constituents to be filed with the Clerk of the Committee no later than October 14, 2016 (House of Commons, Journals, June 7, 2016)

The alternatives that will be explored include: preferential voting, proportional voting but also in the context of possible mandatory voting and online voting and the Trudeau government says that it is “confident that multiple reform options (are) possible without constitutional negotiations” (Democratic Institutions 2016, 3). The government had also not expressed a specific preferred option of its own in advance. The future politics of the electoral reform issue was given an early preview in the new minister’s second question period encounter in the House of Commons, when a Conservative opposition MP, Blake Richards, asked her whether once the proposed new electoral system has been designed “will the government hold a referendum on that proposed system? Yes or no.” (Quoted in Wherry 2016, 1). The minister declined to answer. The Conservatives aimed to embarrass the government because in all probability they themselves were most supportive of the status quo electoral system. In addition they were not on solid ground on the referendum option because when they were a new Party, and then a new Harper government advocating an elected Senate, they did not argue for a referendum in spite of sending up a trial-balloon to explore this option. Moreover, they did not have a convincing answer when the Minister later noted that giving women the vote early in the 20<sup>th</sup> century was surely a major decision in electoral reform and that it did not involve a referendum.

The structure of the House committee on electoral reform soon became an issue partly because there was no rule that stated the government had to accept its

recommendations. Andrew Coyne (2016) observed accurately that the Liberals initially wanted their own way on how to proceed but then they agreed to establishing a committee that the Liberals knew they would not control. There are four Liberals on the committee (including its chair), but also three Conservatives, two NDP members, and one each from the Bloc Quebecois and the Green Party. Coyne thus observes that the “committee on electoral reform (is) now a working model of proportional representation” (Ibid 1) and thus as a “practical matter, that means the Liberals cannot force the committee to adopt a given plan on the strength of their own votes alone. That was always unlikely: for a government to unilaterally alter something as fundamental as the voting system, without the support of any other party, would be so contrary to the laws of political warfare as to poison the rest of this Parliament” (Ibid 2).

Other expert commentators such as Paul Thomas (2016) have stressed also that changing the electoral system is never simple, given its intricate partisan calculus. Similar views also emerged in earlier 21<sup>st</sup> century assessments of why so many Canadian provinces launched electoral reform with very mixed results in the last twenty years (Cross 2005). These kinds of assessment also include analysis of why electoral reform failed, including Ontario’s 2007 referendum on electoral reform which failed after a Citizen’s Assembly had worked for months, with the result being the retention of the first-past-the-post-system (LeDuc, Bastedo and Baquero 2008).

Thus it very much remains to be seen whether the electoral reform and political commitment that the 2015 election would be the last to be based on the first-past-the post system will be kept. It is highly likely, given all the things that might and might not happen regarding the Liberal mandate, that the final decision on electoral reform will be made in some key sense by Justin Trudeau on his own. The odds still favour reform and that such reform is needed in

Canada's democracy but it is not guaranteed.

## PIPELINES, DEMOCRATIC INTEREST GROUP PLURALISM, AND INDIGENOUS PEOPLES

Electoral democracy is not the only form and type of democratic renewal that is on the Trudeau agenda. We look briefly at this part of the Liberal plan and the different kind of combined ways pipelines, democratic interest group pluralism and Indigenous Peoples democratic governance has emerged. We also address some of the ways that the Liberals may make some progress but also suffer setbacks including those that arise because of the fact that final energy pipeline decisions to proceed rest with the federal government and in these pipeline contexts, *de facto* with Prime Minister Trudeau.

Four policy/agenda trajectories have now been triggered. First, in its election platform (Liberal Party of Canada 2015) the Liberals promised “a renewed relationship with Indigenous Peoples” via a “new nation to nation process” that covered several overall socio-economic and democratic policy fields (Ibid 46-48). Pipelines were not mentioned in this election platform section. Second, pipelines and related issues overall of democratic interest group pluralism and its serious weakening in the Harper era featured in the Liberal agenda. This is shown in the analysis in Chapter 6 by Glen Toner, David Cherniak and Kevin Force who trace how energy, environment and climate change as intersecting realms needed both policy and democratic renewal as the Liberals took power. Third, the pipeline agenda was more explicitly joined in June 2016 when six Liberal ministers jointly announced a series of public consultations that would provide public reviews of environmental assessments, and the National Energy Board (NEB) (Canadian Press 2016a). Fourth, on June 30<sup>th</sup> the Federal Court of Appeal overturned the Northern Gateway

pipeline approval on the grounds that “the Canadian government had neglected to consult with First Nations by ignoring many of the project’s impacts which were left undisclosed” (Canadian Press 2016b, 1).

The six minister initiative, as per their mandate letters from the prime minister, involves two House of Commons committees to study protection for fisheries and for navigable waters. Separate expert panels will also examine the *Canadian Environmental Assessment Act* and the National Energy Board. The overall Liberal argument is that these were all in their own way weakened greatly in the Harper era via its responsible resource development ethos which strongly favoured pipeline development via speedier business and industry crafted regulation and which, from 2012 on in particular, was also accompanied by Harper government attacks on environmental groups. Other review and reform analysis had also called for reform from longer term assessment of the performance of environmental assessment regulators and the NEB (Doern, Auld and Stoney 2015, chapters 4 and 5; Doern, Prince and Schultz 2014, 125-137). These were in democratic terms centred on the rights and responsibilities regarding social and also economic interest groups functioning in public interest-oriented pluralist democratic fora. These processes needed to be re-anchored in evidence and science-based processes and accountability (Doern, Castle and Phillips 2016; Doern and Kinder 2007).

The court decision on the Enbridge \$7.9 billion Northern Gateway pipeline project was the latest in its developmental saga (Proctor 2016; Canadian Press 2016b). The Calgary company had 31 aboriginal equity partners and so there was some built in aboriginal support including from nations that were supportive because of its efforts in earlier NEB and Canadian Environmental Assessment agency joint processes leading up to its federal approval in 2014. Given the complex



209 conditions of approval, Enbridge asked the NEB for a three-year extension to the initial 2016 construction deadline. But seven B.C. First Nations which were parties to the court appeal opposed the pipeline and had from the outset because of its adverse environmental impacts on the waterways in their traditional territory that would be used by tankers to further transport the oil to international markets. Another key factor in the story at present is that Prime Minister Trudeau's 2015 election campaign commitment included a formal banning of tanker traffic on the north coast of British Columbia.

The pipelines story in energy and environmental policy terms evokes interest group pluralism as democratic theory and practice. But of course Canada's First Nations have constitutional rights as nations and are thus not just another interest group, though they undoubtedly feel like one on many occasions and situations. And of course, as noted above, First Nations can be on both sides of any given question rather than being a one party interest. Recent studies by academics and think tanks have brought out convincingly the need for deeper involvement by First Nations in the context of the overall dilemmas and multi-level and spatial regional location of environmental, climate change, energy and natural resource development projects, and evidence (science-based and precautionary). The analysis by Noble (2016) of eight policy case studies across Canada argues in part for the need for regional assessments by governments that are more comprehensive, rather than being triggered by a given *project*.

Related analyses by Maclean (2016) and Hughes (2016) also argue for more comprehensive scope and governance change, the former based on root and branch change in Canada's weakened environmental governance system, and the latter arguing increasingly that in the choice between pipelines and reduced carbon emissions, you can increasingly choose one but

not both. A further recent study by Cleland, Nourallah and Fast (2016) focusses on how to understand local communities' trust and confidence in energy authorities. Among its findings are that "there is a lack of adequate forums for community involvement and a lack of adequate and accessible information, all well upstream of individual project applications and regulatory decisions, often involving regional level, multi-project and long-term considerations" (Ibid 2).

#### DEALING WITH CHALLENGES AND CHOICES, NATIONAL AND GLOBAL: THE FORT MCMURRAY FIRE, BREXIT AND TRUMPISM

As is always the case, governments new and mid-term have to deal with other challenges and choices not of their own making both with regard to what to say and what to do about socio-economic problems and events. In this regard, we look briefly at: the massive **Fort McMurray fire in Alberta** that dominated the national agenda in May 2016; Britain's **Brexit** referendum decision on June 23<sup>rd</sup> 2016 to leave the European Union and its raucous political aftermath; and **Trumpism**, the media blizzard of belligerent talk, anger and anti-immigrant racism uttered by Donald Trump and his successful celebrity campaign to become the Republican Party's leader and to battle with Democrat Hilary Clinton in the November 2016 US Presidential election.

The **Fort McMurray fire** was a massive fire feeding off tinder dry Alberta forests that suddenly engulfed the city of 70,000, a population that had doubled in the previous 15 years and that symbolized the booming Alberta oil sands, as oil industry workers and their families came from all over Canada and also from a large migrant and immigrant population from around the world. As its population rushed to escape the fire, their rescue and survival was the political and human focus of Albertans and the Alberta government but also garnered responses of concern and

support from across Canada and indeed globally under massive media coverage (Markusoff, Macdonald and Gillis 2016; Levin and Austen 2016). The rescue was perilously successful but at present policy and funding is focussed on rebuilding the city, large parts of which were destroyed.

The political socio-economic intricacies of the disaster and its aftermath are complex but also likely to be pivotal in the near term future. In Alberta, it brought largely positive political attention to NDP Premier Rachel Notley, who had lead her party to a historic election victory a year earlier and ended 50 years of Conservative Party rule. In her first year, she was dealing with a serious decline in the Alberta oilsands and oil industry due to falling international oil prices. Her personal relationship with Justin Trudeau was a positive and mutually supportive one before the fire and after it. She was earning strong approvals for her leadership and competence a year after her election victory (Mason 2016) although economic challenges and striking a balance with environmental concerns in an oil rich province will continue to make this a difficult balancing act.

Just before the fire in late April 2016, she had met with the entire Trudeau Liberal Cabinet in Kananaskis Alberta when she sought approval for her case for the Energy East pipeline (Dyer 2016). She was a supporter of stronger climate change policy in Alberta and Canada but in the context of reasonable oil sands development because the latter was crucial for garnering the needed provincial revenues and continuing better employment in the Alberta economy. Trudeau and Notley sought out a much less partisan relationship than had been true in recent decades. But both were also conscious of the fact that federal conservatives and Alberta's Wildrose party (the official opposition in Alberta) and the Alberta Conservatives, now the "third" party in Notley governed Alberta were plotting to unite the latter two parties into a new Conservative Party to hopefully win the next Alberta election in 2019. But this means reading the political tea leaves in

modern urban Alberta where political futures may be less easy to design, imagine and predict. Views about links between oil companies, climate change and the cause of the Fort McMurray fires were also now becoming more explicit (Lukacs 2016) though they were by no means the majority view.

**Brexit** refers to the British referendum debate and decision as to whether Britain should leave the European Union or remain in it. The June 23<sup>rd</sup> vote resulted in a narrow 52 to 48 percent decision to leave the EU. It resulted in the immediate resignation of Conservative Prime Minister David Cameron. He had called for a referendum mainly to appease a small set of his Tory Eurosceptic MPs but of course he planned for a positive “remain” verdict. It was a self-inflicted political debacle. In the weeks following the vote it was political anarchy of biblical proportions as Tory ministers on both sides of the question pilloried each other and/or rushed to resign. The already strong splits in the opposition Labour Party were exacerbated, and new coalitions across parties were advocated to advance/restore national unity, especially in the name of the 48 percent remainers. The liberal *Economist* publication which supported the remain side pronounced the referendum result as “divided we fall” (Economist 2016b) and the political debacle afterwards as “anarchy in the UK” (Economist 2016c). Less than three weeks later Britain had a new Conservative Prime Minister, Theresa May, who had been a remainer but had not campaigned much for the remain side. As PM she promises to implement the Brexit verdict and produce a “better Britain” but in a Tory majority House of Commons where a large majority of Conservative MPs were and are remainers and a minority are leavers. And it remains the case that no one has yet developed a coherent or considered view about what a post-Brexit deal and world will look like and consist of.

The Brexit referendum campaign had brought out deep-seated features of division that crossed party lines and reflected conflicts: between elites and the rest of the population; the poor and disadvantaged and the rich in an era of UK austerity policy: the UK as a whole versus Scotland, the latter voting strongly for remain; priorities regarding national values; restoring national identity, control and independence, with issues frequently tied to opposition to immigration (O'Connor and Vina 2016; Colley 2016) and thinly veiled racist views as exhibited by the United Kingdom Independence Party (UKIP) and its leader Nigel Farage who was an elected member of the European Parliament. In a sense both the leave and remain sides wanted to retain or renegotiate access to the large European market but without the migration and immigration freedom to move requirements that were at the heart of the EU.

During the debate and after it attention was drawn to other possible models for a new UK-Europe access model, including the Norway model (Chu 2016), the Swiss model; and the Canada-EU model as per the continuing Comprehensive Economic and Trade Agreement (CETA) trade deal 5 years in the making and nearing completion. In many ways, Brexit involved the need to negotiate over several years at least six difficult deals each of which would impact the others, economically and politically, with regard to whether they impacted services, the core of the British economy vis- a-vis Europe and vis- a-vis London's global banking and financial services industry (Grant 2016; Rankin 2016).

Meanwhile the EU (and the Euro Zone) was dealing with its own problems of unity and the state of its democracy in an era of uncontrolled global migration and refugee movements from Middle East conflicts mainly, including Syria. As it voted to leave the EU Britain continued to make new pro-Europe arrangements and had to deal with 27 other EU members including

Germany and France whose leaders were the *defacto* power centres that drove key EU decisions more often than not. Deep down in the inner reaches of the debate was the view that the EU for all its faults had above all been the institutional leader that had *prevented* European wars, a much better result than the decades of war that had raged in Europe in the first half of the 20<sup>th</sup> century and was in that respect still very much needed now.

Canadians and the Trudeau government were left to watch in bewilderment at the Brexit events and debates. For the most part, they support the remain option for the UK and do not want the EU harmed or weakened, in spite of being unaware of exactly how it works or what kind of democracy it produces. The most likely post-Brexit explicit impact on Canada and on the Trudeau agenda and strategizing will centre on trade policy overall and on CETA. Trade policy overall refers to the fact that the UK will be seeking above noted new trade agreements with more than just the EU. It may want a direct UK-US free trade agreement because the UK already is its 6<sup>th</sup> largest trading partner (Canada is the first leading trade partner for the US). But any US-UK agreement would affect Canada-US markets in competitive terms, for good or ill.

Signed between the EU and Canada last year after a very secret negotiation process, CETA may now face serious final obstacles both as it is reviewed for approval in 27 EU countries but also by the UK as the 28<sup>th</sup> member which is not yet out of the EU but which will be relating CETA terms, strengths and weaknesses to its new post-Brexit trade agenda. There are numerous provisions in CETA that will not meet EU approval and also the possibility of fast passage by the EU may no longer be acceptable in the post-Brexit context (Brunsdon and Barker 2016; Dearden 2016). The new Trudeau government International Trade Minister, Chrystia Freeland, has supported the CETA deal but other informed analysts such as Thomas Walkom (2016) think that

she is seriously underestimating the problems ahead concerning the EU.

The potential ultimate impact of **Trumpism** in US politics will not be known until the November 2016 presidential election battle between Donald Trump and Hilary Clinton is decided by American voters. A large majority of Canadians and the Trudeau government will be devoutly hoping for a Clinton victory but in the meantime have to prepare in some way for what a Trump Republican presidency or a Hilary Clinton presidency and the new post-election composition of both houses in the US Congress might involve in both policy and political terms.

Trumpism as a socio-political phenomenon has been the quintessential “in your face” TV, print media and social media reality for Canadians who are continually bombarded with US media. Analyses of Trumpism are numerous with David Tabachnick’s portrayal pinning it down to four interacting characteristics: “celebrity; nativism; the outsider, and populism” (Tabachnick 2016). Celebrity refers to Trump’s business and media CEO fame and arrogance. Nativism refers to his “Making America Great Again” banner and his “conspiratorial fear of foreigners” (Ibid 1) hence his pledge to build a wall along the Mexican border, to deport all illegal immigrants, and to ban all Muslim immigration. The outsider notion crafts strong views about Trump as an anti-establishment figure but also because he is a rich businessman he is also an “insider-outsider” (Ibid). Populism is also central as Trump “relies on the rhetoric of resentment but is thin on specifics” (Ibid).

Disgruntled white males have been attracted to him particularly because of the above features and the overt and latent racism. But the male protest base is a complicated one. Many have genuinely lost out in the last decade or more, perhaps due to free trade impacts or perhaps also due to technological change. Others are entertained by Trump both at his campaign

rallies and his media performances where he both uses and attacks the media. Others have looked at whether Trump has an ideology and concluded that it is hard to find, though on matters of international trade he seems to favour attacks on recent liberalized trade agreements such as NAFTA because the rules are unfair to America and its workers and businesses are losing out. But he seems not to have a good grasp of markets per se in spite of his purported business acumen. As Tucker (2016) points out, as a self-styled CEO businessman who “competes and wins”, he wants to beat the competition, which is other countries. Thus, “he speaks of the United States as if it were one thing, one single firm. A business” (Ibid 2) when in fact it clearly is not.

Trumpism is already very real internationally in some political senses. The label was applied to some of the anti-immigration and racist features of the UK Brexit debate and impacts (Judah 2016; Colley 2016). Within the US there are genuine concerns about what it already means for American democracy and governance whether Trump wins or not (Bacevitch 2016; Draper 2016; Cassidy 2016) but of course even more compellingly if he does. In policy terms, Canadian debate has speculated mainly on possible impacts on NAFTA where Trump has stated that he wants to renegotiate the agreement with Canada and Mexico to get a better deal for American workers (Gollom 2016). The initial media commentary has focussed on whether a President Trump would have “the power to just tear up the agreement” (Ibid 1) since aspects of the US process in getting NAFTA approved were partly under the President’s powers and partly via Congressional approval. The response in Canada to Trumpism and to possible trade implications, or also to appeals to Canada by Mexico for help and support, is unlikely to become a partisan issue fuelled by the federal Conservatives (Martin 2016) or by the NDP. If Hilary Clinton wins there also may be NAFTA trade issues to deal with because in the Democratic Party’s election



campaign criticism of NAFTA has emerged as a fairly central part of the Bernie Saunders candidacy against Clinton but which is now in the Clinton-led campaign agenda.

The above three kinds of future agenda known unknowns are in one sense normal for new governments and for established ones but there will be others for the Trudeau Liberals, including some embedded in their own mandate agenda items, as revealed also by our contributing authors.

## RELATED CONTRIBUTING AUTHOR ANALYSES

Our expert authors offer informed and considered views about policy and budgetary realms in the emerging Trudeau and national agenda (as will other authors in the coming 2017-18 and 2018-19 editions that lead into the 2019 federal election). We preview several other analyses in the chapters that follow.

*Fanny Demers and Michel Demers* in Chapter 2 take an early informed view on Liberal *infrastructure policy and spending*. It offers views about the economic impact of infrastructure investment on productivity and growth. They agree that the financing of infrastructure spending through deficit financing at a time of economic slack is optimal given low interest rates. They examine the value of a two-phase plan being advocated but also stress the need to avoid the pitfalls of distributive politics through closer attention to key features of governance and accountability. The pros and cons of using the public-private partnership (PPP) model are examined for the delivery of infrastructure projects and the delivery of public services. Also explored are other financing options such as asset recycling and the planned creation of a Canadian Infrastructure Bank.

In Chapter 3, *John Lester* makes the case for why Canada needs an *entrepreneurship*

*policy rather than a small business policy.* He argues that small business has a well-deserved reputation as the engine of job growth and a key contributor to innovation in Canada but that unfortunately, a large fraction of Canada's spending on small business is wasted. He argues that overall, "a better approach would be to focus policies on ensuring that innovative startups do not face any unwarranted barriers to entry and growth. The intermediate result would be fiscal savings, higher-quality entrepreneurship and a more innovative economy. The ultimate impact would be a more prosperous Canada".

The *Michael Prince and Pamela Moss* analysis in Chapter 4 looks at Liberal plans for a *Canadians With Disabilities Act*. They show how Minister Qualtrough as Minister of Sport and Persons with Disabilities will need to reconcile three sets of structural tensions within three powerful discourses and that managing the fractious relationships across groups will need a deep understanding of, and sensitivity to, how to make sense of disability itself. They argue that the "enthusiastic optimism of Prime Minister Trudeau and his Liberal government is a refreshing respite from the years of austerity talks. ...unfortunately, we cannot be as enthusiastic or optimistic that sunny days are the forecast for persons with disabilities in Canada. They are "Encouraged? Yes. Confident? No. Hopeful? Cautiously so".

In Chapter 5, *David Castle and Peter Phillips* probe the potential for a "*new innovation agenda*", proposed by the Liberals, given the current conditions for STI left by the Harper and earlier Chrétien -Martin governments. The Trudeau Liberals have inherited this situation, but Castle and Philips show that thus far it "speaks primarily to their intended style of government". The Liberals propose to change how government works by focusing on government-by-cabinet, re-establishing the position of Chief Science Advisor, a commitment to science-based evidence,

horizontal collaboration between ministries and departments, and public mandates for ministers that make clear the intention of government to put resources into policy areas that are either focused directly on or underpin the core STI effort. They argue that it is “too soon to tell whether their style of government will mean the continuation of the current conditions for STI, or a transition to a new policy”. The authors also stress that “given the importance of growing the knowledge economy, remaining internationally competitive, and acknowledging higher rates of inflation in R&D than other parts of the economy, chronic underfunding of research has become a localized structural deficit”.

The analysis by *Glen Toner, David Cherniak and Kevin Force* in Chapter 6 examines the the *Liberal Energy and Climate Agenda*. They ask whether the Trudeau government in its first year in power, “has begun to walk the talk of sustainable development (SD) by instituting a more equitable balance in the energy/environment domain”. They argue that it is too early to answer the question definitively, but that the tone and substance of the ministerial mandate letters, the financial commitments made in the budget to support climate change initiatives and low carbon energy systems “suggest the Liberals are following through on their campaign commitments”. The tone and substance of engagement with the provinces/territories and cities and the broader policy community including Indigenous Peoples is “a stark rebalancing of the energy/environment domain” compared to the Harper era. Regarding multiple pipeline decisions, the analysis suggests that the Liberals will support some but also that “the Liberal cabinet will face tough decisions which may generate the support of governments in the producer provinces but also stir opposition in major cities and local communities along the projects and in at least part of the broader scientific and environmental community. The Liberals will not be able to please

everyone with the outcomes of these decisions regardless of the degree of inclusiveness of the process”.

*R. Paul Wilson* in Chapter 7 looks at a largely unexamined but very important aspect of the management of politics regarding the *inter-executive activity of ministerial advisors in the Government of Canada*. While specifically examining a single point in time under the government of Prime Minister Stephen Harper, Wilson’s analysis reveals significant parallels in ministerial policy staffers' horizontal activities with documented practice elsewhere. At the same time, however, it suggests caution with respect to generalization. Practice in Canada, moreover, differed under Harper from that under previous prime ministers; but there was even variation within the Conservatives' decade in power. Wilson argues that “many factors, including the prime minister's personal style, the parliamentary context, the overall government culture and its relationship with the public service, impact the role of ministers and therefore the role of ministerial staff. While it can be predicted that ministerial staff will use networks and relationships to pursue political goals, how they do so is very much context specific”.

Chapter 8 looks at the prospect of the Liberals achieving a *targeted federal transfer for mental health*. *Mary Bartram*’s detailed analysis traces these prospects in the light of the roots of fiscal federalism and the federal spending power and later health-related fiscal federalism. Her analysis shows early criticism in Parliament and elsewhere of the historic failure to directly fund mental health. The chapter then explores more recent history extending to the very recent past and shows further federal neglect and related disproportionate gaps in mental health funding due to shifts in the overall structure and nature of fiscal transfers in public health. The final conclusions of the chapter then offer a political analysis for the early Trudeau era arguing that the

near-term prospects for a targeted mental health transfer are good and maybe even strong but also conditional. It also offers brief discussion of the forms that such a transfer could take in the current context.

*Karine Levasseur* offers an in-depth analysis in Chapter 9 of Liberal policies for *renewal and support to registered charities* which had been, in the view of many, excessively politicized by the previous Harper government. She sees some hopeful signs of progress including the announced consultations on this Canada Revenue Agency-centred activity. But she also concludes that Canada is a laggard on the international scene and needs “changes to the rules far beyond mere clarification of the existing rules” and thus the government should look in depth “at other common law countries and how they modernized charity policy”.

In Chapter 10, *Ian Lee* examines key issues in *Canada Pension Plan enhancement* in the context of historic evidence about the adequacy of the Canadian Retirement Income System (RIS). The three versus four pension pillars of the RIS are mapped and the issue of whether personal investments outside of registered plans ought to be included or excluded when analyzing adequacy of the RIS are examined as are the alleged inadequacies of the CPP. Lee then looks at the introduction in 2014-15 of the proposed Ontario Registered Pension Plan (ORPP) on the assumption of serious pension savings inadequacies which had a direct political impetus in the quick and the unexpected CPP agreement of June 2016 between the Trudeau Liberal government via Finance Minister Bill Morneau (a pensions expert) and 8 of 10 provinces. Lee concludes that the CPP reform agreement of 2016 was not designed to help existing retirees nor those near retirement. Rather the new CPP reforms were designed primarily to benefit millennials and Gen X people who will be retiring many years in the future. Unfortunately, public debate mostly ignored

the unprecedented intergenerational wealth transfer that will take place over the next 10 to 30 years as the parents of the boomers pass on followed by the boomers. For these and other reasons, Lee concludes that the Canada Pension Plan remains a work in progress.

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## Chapter 2

### INFRASTRUCTURE POLICY AND SPENDING: AN INITIAL LOOK AT THE TRUDEAU LIBERAL PLAN<sup>1</sup>

Fanny Demers and Michel Demers

#### INTRODUCTION

Infrastructure investment, viewed as an engine of growth and a means of improving both productivity and welfare is a cornerstone of the newly-elected Liberal government's economic policy platform as well as its first budget, *Budget 2016: Growing the Middle Class*.

In Canada as in other advanced economies, public investment as a share of GDP has fallen substantially during the last decades<sup>2</sup>. Aging infrastructure and inadequate maintenance have led to a significant deterioration of the public capital stock with an ensuing loss of productivity. At the same time with population aging and environmental concerns such as climate change, new needs for public infrastructure have arisen, while public investment has not kept pace. In the past decades, various federal governments have addressed the issue with varying degrees of success and effort (Doern, Auld and Stoney, 2015)<sup>3</sup>.

In this chapter, we first examine the economic impact of infrastructure investment on productivity and growth as well as the empirical evidence with respect to its quantitative impact. We note that the overall impact of public investment tends to be larger (1) when there is economic slack, (2) monetary policy is accommodative, (3) public investment is efficient, and (4) debt finance is used. The financing of infrastructure spending mainly

through deficit financing at a time of substantial economic slack is optimal given low interest rates.

Secondly, we present and analyse the features of the Liberal government's two-phased (Phase 1 and Phase 2) and three-pronged infrastructure plan according to which new infrastructure spending will be allocated over the next ten years to public transit, social and green infrastructure investment. Thirdly, in view of the large infrastructure projects that are envisaged, especially during Phase 2 of the Liberal government's infrastructure plan, we argue that project efficiency, good governance and oversight will be paramount in securing the anticipated economic, social and environmental benefits of this plan for all Canadians, and avoid the pitfalls of distributive politics.<sup>4</sup> In this vein, we outline the best practices that need to be followed to ensure the success of the projects undertaken. We then present a brief synopsis of the pros and cons of the public-private partnership (PPP) model for the building of infrastructure projects and the delivery of public services.

Finally, we also discuss alternative financing options such as asset recycling and the planned creation of a Canadian Infrastructure Bank. In order to benefit from these financing arrangements, public investment efficiency and sound governance will be essential.

## THE ECONOMIC IMPORTANCE OF INFRASTRUCTURE

### *Economic benefits*

Infrastructure has usually been provided by the government or public-private partnerships for several reasons. First, since the social benefits of public capital exceed the private benefits a sub-optimal level of infrastructure investment will result if left to private interests alone. Secondly, infrastructure investments typically consist of large scale, capital-intensive projects such as highways, bridges, harbors and airports, water and sewage treatment, and

transit systems that require substantial initial disbursements by the provider while at the same time, the uncertain returns are reaped over a long horizon lasting many decades. These features constitute important challenges for the private sector, leaving public procurement as the likely option.

Since the stock of public capital is a complementary input in the firm's production function, infrastructure spending raises the productivity of other inputs such as private capital and labour thus lowering unit production costs thereby leading *ceteris paribus* to higher output.<sup>5</sup> In addition to this direct effect, there is also an indirect impact: infrastructure spending leads to adjustments in inputs such as labour and private capital. Infrastructure stimulates private capital formation by increasing the marginal productivity of private capital and thus the rate of return. It also lowers investment adjustment costs and hence the costs of investing.<sup>6</sup> For example, reduced highway congestion lowers the costs of carrying heavy equipment and materials for building a new factory, thus inducing greater investment. In view of the complementarity of inputs, employment also rises.

Economic geography arguments emphasize that greater public investment in transport infrastructure enables producers to cluster, thus leading to greater specialization, economies of scale and innovation. (de Haan, Romp and Sturm (2007) and Venables (2016)). By reducing commuting time, they also decrease worker fatigue, enhance labour productivity and welfare.

Infrastructure investment also has indirect effects on productivity and growth through another important channel, namely through its beneficial impact on health. Thus, for example, Agénor and Moreno-Dodson (2006) find that access to clean water and sanitation infrastructure have important health benefits, substantially reducing child mortality, increasing life-expectancy, improving school attendance, leading to greater

productivity. Their study based on an endogenous growth model that also takes into account the rival use of public funds, demonstrates that this indirect channel of infrastructure investment may have a sizeable impact on growth.

In the long-run, provided public investment is efficient, a larger infrastructure capital stock contributes to raising the productive capacity of the economy and potential output. Clearly, a well-maintained, durable, stock of infrastructure is essential in order to reap these benefits. In fact, a greater flow of infrastructure services may be obtained not only by building new infrastructure but also by spending adequately on operations and maintenance so as to preserve the quality of the existing infrastructure.<sup>7</sup> Maintenance expenditures not only extend the durability of *public* capital but also increase the efficiency and durability of *private* capital making more funds available for private investment thus enhancing growth. (Rioja (2003) and Calderón and Servén (2004)).<sup>8</sup>

Furthermore, the import-leakage of infrastructure projects are low, since mostly domestic inputs are utilized, an important consideration given the depreciation of the Canadian dollar.

#### *Quantitative effects*

While the economic benefits of infrastructure are clear, measuring its quantitative economic impact, that is, the multiplier effect on output of a one-dollar increase in infrastructure investment, has been the subject of some controversy and of a large literature.

*Budget 2016* (p. 255) distinguishes between housing investment measures and infrastructure investment. The multiplier for infrastructure investment alone is estimated to be 0.9 in 2016-17 and 1.4 in 2017-18. Its impact on real GDP is estimated to be 0.2% and 0.4% respectively for these fiscal years (p. 256). The type of expenditures that fall under

housing investment are also part of Phase 1. (p. 257) Table 1 shows the estimates for both types of spending.

**TABLE 1**

Type of expenditure	Multiplier		Millions of dollars		Impact on real GDP (%)	
	2016-17	2017-18	2016-17	2017-18	2016-17	2017-18
<b>Housing</b>	1	1.5	1,359	966	0.1	0.1
<b>Infrastructure</b>	0.9	1.4	3,967	7,316	0.2	0.4

Source: *Budget 2016*, p.255-57

In order to gauge the plausibility of these estimates, it is useful to briefly review the different methods that have been used to assess the magnitude of the economic impact of public spending, and the results that have been obtained.

The quantitative economic impact of infrastructure spending has been estimated using various methods. Relying on static single equation estimation of a production function, Aschauer's (1989) pioneering study found an implausibly large value for the output elasticity of public capital implying that public investment would pay for itself three times in the form of additional tax revenues. Although some studies obtained similar values, issues of reverse causality (that is, higher output leading to greater infrastructure spending)<sup>9</sup> and non-stationarity put these estimates in doubt. Estimations based on multivariate cost functions yielded lower values but they were plagued with similar problems, and they ignored dynamic feedback effects, that is, the important indirect effect through adjustments of private inputs.

In order to address the causality between public investment and output, cross-country panel estimation (Canning and Pedroni, 2008),<sup>10</sup> simultaneous equation models

(Cadot, Roller and Stephan, 2006) and instrumental variables methods (Calderón and Servén, 2004)) have been used. All these studies conclude that although there is evidence of reverse causality, infrastructure spending raises output and crowds in private investment.

Another approach has used vector autoregressions (VAR) to address the simultaneity issue and to estimate the multiplier within a dynamic model of the economy. (Romp and de Haan, 2007 and Perreira and Andraz, 2013). In these models, the elasticity of the marginal product of capital refers to the total accumulated *long-term* change in each private input generated by an initial increase in public capital. This permits the model to capture both the direct (short-run) effect and the indirect (long-run) effect of a change in public capital on output through the adjustment of private inputs.

Using the VAR methodology, in a study for the U.S. economy, Pereira (2000) found that an increase in public investment crowds in private investment in the long-run. He found that \$1 spent on infrastructure in the aggregate raises private output by \$4.46 over a 20-year period, yielding a 7.8% rate of return. Thus, if output were taxed at 25%, public investment would pay for itself in the long-run. His results also showed that *different types* of infrastructure spending have *different* multipliers. Core infrastructure such as electric plants, transit, sewage and water supply systems have the largest impact with \$1 of public investment generating private output by \$19.79 over a 20-year horizon with a rate of return of 16.1%.<sup>11</sup>

#### *The State of the Economy and the Multiplier Impact of Infrastructure Programs*

The quantitative impact of infrastructure programs also greatly depends on the state of the economy when these are undertaken. As Christiano, Eichenbaum and Rebelo (2011) have shown, the fiscal multiplier for government spending can be greater than one when the

nominal interest rate is low and there is enough slack in the economy so that the interest rate does not respond to a rise in economic activity. In their model, a rise in government expenditures helps stop a deflationary spiral thus lowering the real interest rate<sup>12</sup> and stimulating economic activity.<sup>13,14</sup>

Abiad, Furceri and Topalova (2015) estimate the asymmetric effects of the business cycle on the multiplier.<sup>15</sup> If short-term multipliers and the elasticity of output to public capital are sufficiently large, public investment will succeed in increasing the productive capacity of the economy. In the baseline case, the short-term (one-year) and medium-term (four-year) multipliers were found to be 0.4 and 1.5. Their simulations also show that the state of the economy, efficiency of public investment and financing matter.

During economic slack, the short-term multiplier rises by 50% to 0.6. During such low-growth periods, the increase in private investment exceeds the increase in GDP resulting in a rise in private investment as a share of GDP, a consequent increase in tax revenues, and thus a fall in the debt-to-GDP ratio since debt increases by less than GDP does.

When public investment is highly efficient (Pritchett (2000)), thanks to sound project selection, implementation and monitoring, the level of output increases by 0.8% in one year and by 2.6% after four years. Private investment rises by more, and the debt-to-GDP falls by more in the medium term when efficiency is high.

Similarly, when debt-finance is used, a public investment increase amounting to 1% of GDP increases the level of output by 0.9% in the same year and by 2.9% four years after the shock. The medium term effect on investment is larger with debt financing and the debt to GDP ratio falls more quickly.



In short, the mode of financing of infrastructure spending, the economic climate within which it takes place, and importantly, the efficiency with which it is carried out, affect its economic benefits.

Thus, the multiplier effects cited in the Budget are short-run effects and fall within the range predicted by most of these studies, and are plausible in view of the current economic climate, low interest rates and debt-financing. As noted above, the long-run multiplier taking into account the indirect effects of infrastructure expenditures may be much larger. In addition, the Budget predictions do not distinguish the different *types* of infrastructure investment. Yet, as pointed out by Pereira, the short and long run multipliers may vary depending on the type of infrastructure and can be quite large for some types such as core infrastructure.

However, ensuring the maximum benefits of the Liberal government's infrastructure plan in terms of economic growth and welfare will depend crucially on its efficient implementation.

Before analysing the exact significance of “efficiency” in the context of public infrastructure projects, we first turn to an overview of the projected infrastructure spending as described in *Budget 2016*.

#### THE LIBERAL BUDGET PLAN ON INFRASTRUCTURE SPENDING: AN OVERVIEW

The share of infrastructure investment in Canada has declined from 4.8% of real GDP in 2010 to about 3.7% in 2015. In addition, according to the survey-based *Canadian Infrastructure Report Card* (2016, p. 10) about 35% of municipal infrastructures are either in fair, poor or very poor condition and in need of urgent repair.<sup>16</sup>

The first budget by the newly-elected Liberal government has attempted to redress the situation. Quoting two prominent economists (Lawrence Summers and Joseph Stiglitz) who have been strong proponents of infrastructure investment to promote growth in a time of sluggish economic performance, the budget has launched a comprehensive program to overhaul existing infrastructure and to undertake new large projects over the next ten years.

The Liberal government's projected infrastructure expenditures over the next ten years will be in the amount of \$120 billion, \$60 billion of which constitute new spending. With this announcement, the Liberal government means to fulfill its campaign promise regarding new infrastructure funding over the next decade.<sup>17</sup> This will be the largest infrastructure investment plan in Canadian history, surpassing the Conservative government's New Building Canada Plan announced in the 2014 budget, which planned for \$53 billion over ten years, \$47 billion of which was new funding. The main motivation for these infrastructure plans was the creation of jobs and increasing economic growth. These economic benefits of infrastructure projects are certainly an important motivation for the expenditures announced in *Budget 2016*. However, the current budget distinguishes itself by the special emphasis on Green Infrastructure and on spending devoted to First Nations communities.

The infrastructure expenditures in *Budget 2016* are organized into two phases. Both phases will allocate infrastructure spending with a focus on three main areas, namely Public Transit, Social Infrastructure and Green Infrastructure.

Phase I is itself comprised of more urgent expenditures which are to start immediately in 2016 and extend mainly over a two-year period, while some expenditures within this phase will be spread over a five-year period, for a total of \$11.9 billion. The Phase 1 investments will mainly focus on maintenance and upgrading of existing structures,

that is, "...to modernize, and rehabilitate public transit, water and wastewater systems, provide affordable housing, and protect existing infrastructure from the effects of climate change." (*Budget 2016*, p. 87) <sup>18</sup> This strategy is also in line with what has been recommended by The World Bank and IMF.

In addition, provinces, municipalities and territories will have access to accelerated spending from the \$9 billion of funding available from the Provincial-Territorial Infrastructure component of the *New Building Canada Fund*. The Canadian government will also provide up to 50% of the admissible costs of eligible projects in the public infrastructure and clean water infrastructure programs instead of the heretofore more commonly applied equal sharing of costs (i.e., 33% each) among the federal government, the provinces and the municipalities.

Phase 2 expenditures, the details of which will be announced during the course of next year, relate to major infrastructure projects "...of local and regional importance, and [also] larger economically strategic projects that can provide transformative change at the national level. ... Ambitious projects will be supported to reduce urban transportation congestion, improve and expand trade corridors, and reduce the carbon footprint of the national energy system." (*Budget 2016*, pp. 87-88) Phase 2 of the infrastructure plan will be determined by consultation with other levels of government, and its details are not yet known at this time.

The Phase 1 spending plan and its three-pronged approach is summarized in Table 2.<sup>19</sup>

**TABLE 2**  
**Phase 1 Infrastructure Projects**  
**in the Liberal Government's Budget 2016**

- **Public Transit:** \$3.4 billion over three years. This financing will be provided through a new Public Transit Infrastructure Fund, and will be allocated to provinces on the basis of their share of the national public transit ridership. The federal government will finance up to 50% of eligible project costs.
  - ❖ \$852 million of this amount is to be spent in 2016-17 and \$1.7 billion in 2017-18, and the remaining \$848 million in 2018-19.
- **Investing in Green Infrastructure:** \$5.01 billion (most of it over five years) will be allocated to the following projects.
  - ❖ **Water and waste infrastructure for First -Nations communities:** \$ 2.24 billion over five years.
  - ❖ **Clean water and waste water fund:** \$2 billion over four years. This is a newly created fund, and includes financing that will be allocated to the upgrading of high-risk wastewater facilities to meet higher environmental regulation standards by 2020. The federal government will fund up to 50% of the eligible costs of these projects.
  - ❖ **Adaptation and climate resilient infrastructure:** \$518 million over five years which includes a funding of \$248 million for the Lake Manitoba and Lake St. Martin outlet project and \$212 million for the upgrading of the Lions Gate Wastewater Treatment Plant that services the Districts of West and North Vancouver.
  - ❖ **Building capacity in municipalities to address climate change:** \$75 million funding in 2016-17 to be delivered by the Federation of Canadian Municipalities (FCM) to local governments "to identify and implement greenhouse gas reduction opportunities" and to assess climate risks. (*Budget 2016* p. 93)
  - ❖ **Funding innovative green municipal projects:** \$125 million over the 2016-17 and 2017-18 fiscal years to enhance the Green Municipal Fund administered by the FCM.\*
  - ❖ **Developing asset management best practices:** \$50 million in 2016-17 to fund sound asset-management practices in order to guide the building, the operation, the maintenance and renewal of "core" infrastructure projects. These funds are to be delivered to communities through the FCM.
  - ❖ **Supporting municipal capacity building:** \$75 million in 2016-17 (administered by the FCM) to help municipalities "identify and implement greenhouse gas reduction opportunities."

\* The Green Municipal Fund, established in 2000 by a \$550 million federal endowment to the FCM, "provides funding and knowledge services to support sustainable community development. GMF-supported initiatives aim to improve air, water, and soil, and mitigate the impacts of climate change." FCM Website: *Green Municipal Fund: About GMF* <http://www.fcm.ca/home/programs/green-municipal-fund/about-gmf.htm>.

- **Social Infrastructure:** \$ 3.4 billion over five years with \$2.3 billion of this amount to be spent over 2016-17 and 2017-18 to “help expand affordable housing (including shelters for victims of violence), support early learning and child care, renew cultural and recreational infrastructure, and improve community health care facilities on reserve.” (p. 97) The government intends to develop a “National Housing Strategy” in consultation with provinces, territories and municipalities in order to better target these investments. (p.98)
  - ❖ **First Nations, Inuit and Northern Communities:** \$1.219 billion over five years, of which \$739 million over 2016-17 and 2017-18 specifically for housing and shelters, and \$100 million in 2017-18 for on-reserve child care and early learning.
  - ❖ **Affordable housing:** \$1.48 billion over two years which includes
    - \$504.4 million to double current federal funding that is provided to provinces and territories through the Canada Mortgage and Housing Corporation in the context of the Investment in Affordable Housing initiative introduced in the 2011 budget by the Conservative government. According to this initiative, provinces and territories match federal investments and have the flexibility to design and administer the investment plans to suit local needs.
    - \$200.7 million to increase affordable housing for seniors
    - \$573.9 million for “supporting energy and water efficiency retrofits and renovations for existing social housing,” and to generally improve the energy-efficiency of existing housing thus helping to reduce gas emissions.
    - \$89.9 million to support shelters for victims of violence.
    - \$111.8 million for dealing with homelessness.
  - ❖ **Early learning and child care:** \$400 million in 2017-18. The government proposes to establish a National Framework on Early Learning and Child Care in 2016-17 prior to providing the investment funds for this initiative.
  - ❖ **Cultural and Recreational Infrastructures:** \$342 million over 2016-17 and 2017-18.
    - \$168.2 million of this amount will be invested in the Canada Cultural Spaces Fund intended for local governments as well as heritage organizations and non-profit art organizations.
    - \$150 million will be given to the Canada 150 Community Infrastructure Program towards funding celebrations in the context of the 150<sup>th</sup> anniversary of the Confederation.\*\*
    - \$20 million will be given to the Parks Canada Agency towards funding for non-federally owned national historic sites.
    - \$4 million will be given to the Enabling Accessibility Fund to improve accessibility by individuals with disabilities.

\*\* This fund was created by the Conservative government and endowed with a \$ 150 million to be spent over two years (2016-2018). This new financing by the Liberal government thus doubles the budget of this fund.

In addition to these expenditures of \$11.9 billion, the government will also spend \$3.4 billion over five years on a cash basis for the maintenance and upgrading of airports, harbours, and border installations, as well as for decontaminating hazardous waste sites on federal property.

Municipalities will also continue to receive \$ 3 billion per year from the (combined) Gas Tax Fund and the GST rebate for municipalities.<sup>20</sup> The government will also provide provinces, territories and municipalities with accelerated spending of \$9 billion available in the Infrastructure Component of the New Building Canada Fund (established in 2014) and will provide them with the idle funds available in older federal infrastructure programs. Planning, design and engineering costs have now also been included among the eligible cost categories. The mandatory P3 screening that was imposed on projects under the New Building Canada Fund has been removed, thus permitting faster approval. This measure would also permit local governments to choose the financing option for the projects.

In addition, oversight of PPP Canada, a Crown Corporation created in 2008 by the Conservative government<sup>21</sup>, has been transferred from the Department of Finance to the Department of Infrastructure and Communities (Infrastructure Canada). According to the Minister of Infrastructure and Communities, (Sohi, 2016) this move will permit the harmonization of practices and policies across different infrastructure projects, so that eligible projects could now receive greater government contribution (up to 33% or 50% depending on the project) as opposed to a maximum of 25% under the old regime.

#### ADDRESSING SOCIAL, ENVIRONMENTAL AND DURABILITY CONCERNS

As mentioned above, the deterioration of the public capital stock threatens the flow of services from past infrastructure investments. This concern is fully reflected in the

government's budget commitments. In addition to recognizing the urgency of maintenance and repair of Canada's transportation infrastructure, a notable aspect of the investments envisaged under Phase 1, is the emphasis on Green Infrastructure and on First-Nations communities. Another, is the flexibility granted to municipalities with respect to funding issues.

The budget plan thus highlights areas of past neglect and the urgency of palliating for it. First, with respect to First Nations, the \$1.25 billion funding of on-reserve education over three years starting in 2016-17 that was announced in the 2014 budget, was reduced to \$241 million in the 2015 budget. *Budget 2016* allocates overall (in the combined Green and Social infrastructure categories) \$3.5 billion over five years to infrastructure in First-Nations communities (p. 103). The water and wastewater infrastructure components of this spending are crucial for the good health of these communities. The findings indicated above about the linkages between the quality of infrastructure, health, education, and productivity point to the importance of this initiative for First-Nations communities and for overall economic growth. (Agénor and Moreno-Dodson, 2006).

Secondly, having reintegrated the international environmental community by signing the Paris Accord in April 2016<sup>22</sup> Canada has agreed to cut its gas emissions by 30 per cent from 2005 levels by 2030. (Hannay, 2015) According to the Vancouver Declaration on Clean Growth and Climate Change (2016) announced during the First Ministers' Meeting on March 3, the government and the provinces committed to "build on the momentum of the Paris Agreement by developing a concrete plan to achieve Canada's international commitments through a pan-Canadian framework for clean growth and climate change. Together, we will leverage technology and innovation to seize the

opportunity for Canada to contribute global solutions and become a leader in the global clean growth economy.” (Vancouver Declaration, 2016).

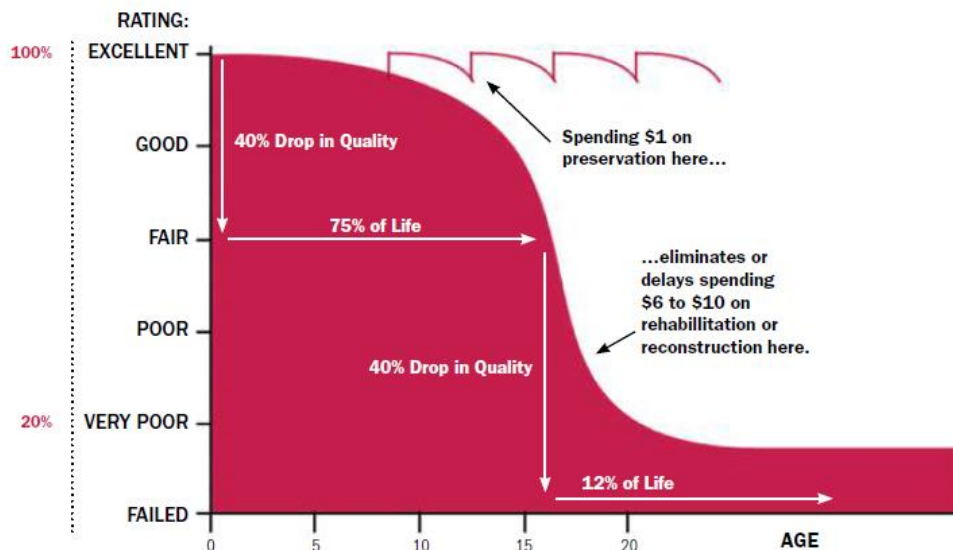
The Green Infrastructure plan is a step in the right direction.<sup>23</sup> The federal government intends to consult with the provinces in order to develop a climate strategy, and at the same time pursue negotiations with the US and Mexico on comprehensive environmental rules regarding greenhouse gas emissions. (McCarthy and Curry, 2015) The emphasis on federal-provincial collaboration is a marked change from 10 years of Conservative unilateral rule and will be essential to achieving the ambitious targets set in Paris.

In *Green-Lite*, Doern, Auld and Stoney (2015) have decried “the sub-optimal nature of federal stewardship from an environmental perspective and the tendency for other levels of government and the private and not-for-profit sectors to assume greater responsibility for environmental policy in the absence of strong and sustained federal leadership...” (p.4) as well as “the gap between federal environmental discourse and rhetoric on the environment and the influence and impact of federal policies.”(p.4) This new expansive infrastructure program responds to the call for greater emphasis on environmentally and climate-change friendly greener infrastructure, and for greater leadership by the federal government made by Doern, Auld and Stoney.

The “Clean water and waste water” component of the Green Infrastructure Plan and the Public Transit component of Phase I projects emphasize the much needed upgrading to Canada’s water system<sup>24</sup> and transportation infrastructure<sup>25</sup> as has been highlighted by two recent tragedies.



The following graph from the *Canadian Infrastructure Report Card* (2016, p.13) which describes the deterioration of roads, provides a stark illustration of the importance of undertaking maintenance projects such as those of Phase I. Roads experience a 40% drop in quality after 15 years of usage. The graph indicates how a \$1 spent on maintenance “in time,” that is when the road is still in good condition could save \$6-\$10 of reconstruction when the road is in poor condition. This fact reinforces Rioja’s (2003) findings referred to above. Thus, for example, the cleaning of the reinforcing steel of a bridge constitutes a minor repair and could avert the need for its eventual replacement, a major repair requiring the mobilization of more qualified workforce and equipment, with large ensuing costs, and disruptions to traffic and to the community. (See Sundholm, Lepech and Wikström, (2015, p.11)).



Another notable aspect of Phase I is the flexible administration of funding, a feature that is deemed important for municipalities and local governments as it facilitates their planning. (FCM 2016b)<sup>26</sup>. This management style is modelled after the federal Gas Tax which does not require any application to obtain funds for specific projects. This is the

municipalities' preferred management style of funding, according to the FCM's Budget Recommendations. (FCM, 2016a). The Prime Minister's announcement that municipalities would be responsible for project selection, goes in this direction, and was well received.<sup>27</sup>(Curry, 2016)

Explaining to the Canadian Council of Public Private Partnership the decision to remove the P3 screening requirement before approval of projects, the new Minister of Infrastructure stated: "We also believe in local autonomy. We believe that provinces, territories, and municipalities who own the projects we support should make their own procurement decisions. Removing the mandatory P3 screen respects their ability to make their own decisions on how to best meet their infrastructure needs." (Sohi, 2016)

The FCM has repeatedly stressed the importance of having "predictable" funding to permit better planning, and greater flexibility in choosing the projects that municipalities prioritize. The measures in *Budget 2016* respond to many of the pre-budget recommendations of the FCM and were very well received by the FCM. Its post-budget declaration praised the increase in federal contribution to 50% of eligible costs on major projects, stating that: "Ottawa's 2-phased approach to infrastructure investment is a smart plan. Phase 1 will give municipalities the flexibility and resources needed to fix and maintain core infrastructure and to plan for the future." (FCM, 2016b).

#### ENSURING PROJECT SUCCESS IN THE FACE OF COMPLEXITY, IRREVERSIBILITY AND UNCERTAINTY: EFFICIENCY AND GOOD GOVERNANCE

##### *Efficiency*

Clearly in order to reap the full benefit of these infrastructure projects, be it the anticipated multiplier effects or the social and environmental benefits, these projects must be

efficiently chosen, designed, built, managed and operated. It is also important to establish a good governance framework. It must be emphasized that the need for efficiency and good governance is essential whether the projects are carried out through the traditional government procurement model or the more recently popular public-private partnership (PPP) model. (We provide a discussion of the PPP models later in the chapter).

The projects that fall under Phase 1 tend to be complex in many ways. Larger projects that fall under Phase 2 are bound to be even more complex. These are multi-faceted projects that often cost several hundred million dollars, whose construction stage extends over many years, which have very complex design and planning stages, and which are fraught with uncertainties that often lead to enormous cost-over-runs and very important delays.

Ensuring the success of such projects requires first a judicious choice of projects in view of well-established needs, secondly, a thorough understanding of the different ways in which they are complex, and thirdly, responding to the challenges raised by this complexity. The complexity of an infrastructure project is due to several important characteristics which encompass (Lessard, Sakhrani and Miller, 2014, p. 172):

- the irreversible nature of the project,
- the many uncertainties and risks<sup>28</sup> which unfold and become known only through time,<sup>29</sup>
- the size, the number of tasks and types of technical expertise required,
- the “connectivity” or interrelationships among different parts of the project,
- time constraints,<sup>30</sup>
- the hierarchy among different levels of governments (sometimes with conflicting interests) that are involved in the project.

Some of these characteristics are also related. For example, the larger the size and the greater the number of tasks and types of technical expertise, the greater the technical risks and the larger the potential problems due to the interrelationships among different parts of the project. In addition, as Flyvbjerg (2005) and Salet, Bertolini and Giezen (2013) point out, even the size and scope of the project may change through time.

One important characteristic that contributes greatly to the complexity is that these large engineering projects represent substantial irreversible commitments.<sup>31</sup> The end-product (a road, a bridge or a sewage system) cannot be put to an alternative use even if future needs turn out to differ from prior estimates. The initial planning stage is the phase during which the project design is elaborated. This is the most important phase because it has a determining impact on its outcome. It is also the phase that affords the greatest flexibility to project managers. When the project has been defined and all decisions are taken, the latter become in great part irreversible.<sup>32</sup>

During the operational phase, once projects are completed, few modifications are possible. Since the risks associated with the project become known only through time as it evolves, its irreversible nature becomes an important challenge to its efficient completion. There are numerous risks that contribute to the complexity of a project. Some relate to its technical aspects and affect completion while others are market-related or stem from institutional factors. Technical risks consist of engineering and design-specific problems, difficulties encountered during the construction phase and especially problems due to the use of innovative techniques.<sup>33</sup> This type of risk also includes implementation errors caused by lack of experience or expertise such as human errors in the execution stage and in the setting of the critical path, or decisions taken with incomplete data and imperfect forecasting.

Market-related risks arise due to errors in forecasting demand (such as the number of customers in urban transport projects), supply (inputs into the project) or financial factors. Institutional risks include changes in regulations, practices and social acceptability.<sup>34</sup> Finally, projects are also subject to what Miller and Lessard (2008) refer to as “turbulence risks”. This type of risk refers to cases when some unanticipated, though technically manageable, difficulty arises, but the latter provides ammunition to the opponents of the project, causes a chain reaction leading to substantial delays and even total abandonment.

Different types of projects present various configurations of complexity and risks. (Miller and Lessard, 2008). For example, some projects tend to present low market riskiness and moderate technical riskiness but can be quite risky on the social/institutional front due to environmental concerns. Other projects involving roads, bridges and tunnels are very risky both from a technical point of view (due to possible unforeseen geological difficulties or soil contamination), and also in terms of market-related elements such as difficulties in forecasting demand (flow of traffic) and hence their benefits with sufficient accuracy.<sup>35</sup>

As mentioned above, the irreversible nature of infrastructure projects makes it difficult, and sometimes impossible, to respond to the realization of specific risks. The only way of mitigating this inescapable fact, is to maintain enough flexibility, especially during the initial planning stages of the project when the latter is in the process of being defined and formulated.<sup>36</sup>

One important consequence of all these elements that characterize the complexity of projects is that they contribute to endemic cost overruns, major delays, overestimation of benefits and underestimation of costs.<sup>37</sup>

As Flyvbjerg (2005 and 2014) notes, three types of explanations may be provided for very large deviations from projected costs, benefits and timing of these projects, namely: “technical, psychological, and political-economic.” Technical explanations refer to imperfect forecasting, incomplete data, and the lack of experience of forecasters and administrators as well as the technical risks mentioned above.

Psychological explanations hinge upon the “over-optimism”<sup>38</sup> of project planners who are so keen on seeing the project go ahead that they underestimate costs, overestimate benefits and the probability of success. The third, political-economic, explanation, has to do with “strategic misrepresentation.”<sup>39</sup> That is, “planners and promoters purposely spin scenarios of success and gloss over the potential for failure” (Flyvbjerg 2005, 9) due to political or economic pressures to obtain funding for the project. Such misleading forecasts are a major source of risk in large projects, and ignoring this risk undermines economic and social goals.

In order to circumscribe these detrimental effects, a thorough definition of the project based on reliable data and a good governance structure is essential. Defining the project well at the outset is of paramount importance.<sup>40</sup> Many factors including the exact purpose and scope of the project, the gap in the existing infrastructure that it is supposed to fill, the potential beneficiaries, the stakeholders and the risks are all part of the definition of the project. This comprehensive approach is essential for accurate forecasts, and a sound cost-benefit analysis on the basis of economic, social and environmental costs and benefits.<sup>41</sup> As mentioned earlier, the definition stage is the one that provides the greatest flexibility to the planners. The latter must ensure that a consensus is reached at this stage with respect to the exact purpose and design in order to mitigate regret once project construction begins and irreversibility sets in.

The importance of project definition is highlighted by Hilton and Stoney (2007) in their detailed analysis of Ottawa's failed north-south Light Rail Train (LRT) project that was abandoned in 2007. They point to poor project definition and the ensuing contradictory announcements with respect to projected benefits and costs as being at the heart of this failure.<sup>42</sup>

### *Governance*

It is also necessary to establish a good governance framework. According to Miller and Lessard (2008), a governance framework “provides the scaffolding around which the various issues of projects can be shaped ... to make sure all the right questions are being asked ...to develop answers and to outline the hurdles that the project must clear.” (169-170). Good governance requires transparency and oversight, accountability and public participation. (Flyvbjerg, 2008, Flyvbjerg, Bruzelius and Rothengatter, 2003, Haider and Badami, 2007).

Transparency is the first requirements of good governance. It necessitates due diligence, that is, a thorough analysis by independent experts of forecasted costs and benefits and making use of appropriate benchmarks based on comparable projects undertaken in the past to determine the uncertainty surrounding estimates. In this respect, Lovallo and Kahneman (2003) have emphasized, the importance of using a “reference class” of projects as a check on optimism-bias. Given the tendency for biased forecasting, whether due to honest over-estimation or to strategic misrepresentation, it is necessary to have peer review of forecasts. (Flyvbjerg, 2013) Forecasts, peer reviews, benchmarks and other relevant information should be made available to the public.

Accountability of officials is also essential. One needs to induce project planners to rely on truthful information and accurate forecasts. As stated for example in Article 1.2 of

the Code of Ethics of the Canadian Institute of Planners, members should “provide full, clear and accurate information on planning matters to decision-makers and members of the public.” (Canadian Institute of Planners, 2016) Professional penalties should be imposed on planners and forecasters by their relevant professional associations for failing to abide by this rule. For example, violation of a code of ethics should entail sanctions and even exclusion from one’s professional order. Project planners and promoters should also be made accountable for misuses of public funds in the event of systematic and willful misrepresentation of forecasts with the intent to obtain project approval and funding.<sup>43</sup>

In a democratic society, alongside transparency and accountability, it is also vital to have public participation and consultation (Bennett 2012; Dutil and Park 2012). Public hearings should be held to permit all stakeholders as well as citizens to express their views. This feedback should be taken into account by planners and decision-makers. Such a process would ensure “inclusiveness,” build stronger support and reduce resistance from opponents to the project. There is also a need for oversight, especially as these projects involve very large sums of taxpayers’ money.

In order to ensure that the Liberal infrastructure plan meets the requirements of efficiency and good governance, it will also be essential to heed the recommendations of the Commissioner of the Environment and Sustainable Development.<sup>44</sup> While many of these criticisms are levied at how infrastructure programs were managed under the Conservative government, they remain relevant to improving efficiency and governance, and they have drawn a positive response from the Trudeau government. According to the Commissioner, improvements on funding and choice of projects, performance measurement, data collection and reporting are needed.



### *Funding of projects*

With respect to funding of projects, inadequate identification of environmental risks and lack of support for innovations to mitigate environmental risks were noted. Furthermore, the New Building Canada Fund does not prioritize disaster mitigation since the latter is only 1 of 14 criteria to obtain funding. In view of the critical importance of “increasing the resiliency of infrastructure” to deal with extreme weather conditions, these are serious deficiencies.

In response to these claims, the Trudeau government indicated that beginning with the 2016-17 fiscal year, it will ensure that appropriate measures to address these risks have been adopted in new and revised projects. It also intends to seek innovative mechanisms for project funding and support the use of modern innovative technologies for the long-term infrastructure investment plan announced in Budget 2016.

### *Performance measures and accountability*

The lack of performance measures such as final indicators, targets or timelines in projects financed by Infrastructure Canada was also observed, for example, for the Gas Tax Fund. The federal government is committed to work with other levels of government to develop a more informative reporting approach in the next outcomes report in 2018. The FCM has also agreed to develop specific objectives, performance targets and indicators to better assess the Green Municipal Fund.

### *Data*

Access to quality data is essential for efficient project selection. There needs to be standardized, reliable and updated information on the state and condition of core public infrastructure for all levels of government. However, such information is not available. For

example, approximately one half of the 123 municipalities that have participated in the Canadian Infrastructure Report Card are not aware of the state of their underground infrastructure such as the water distribution system. In 2009, in spite of a memorandum of understanding between Infrastructure Canada and Statistics Canada to collect these data, no action was taken by the Harper government.

As the Commissioner remarked, the Canadian government also needs to update the data and the tools used by engineers “to predict the probability of extreme rainfall amounts and the duration of storms” because many of these tools were found to be obsolete and the data has not been updated since 2006. (Office of the Auditor General of Canada, 2016) Such information is crucial for the design of municipal water infrastructure. Furthermore, national guidelines and floodplain maps are essential to help municipalities plan development in areas of low flood risk and to improve the resiliency of infrastructure where high flood risk prevails. However, they have not been updated since 1996, thus leaving the task to provinces and territories with ensuing inconsistencies between jurisdictions.

The National Building Code serves as a guide to provincial and territorial codes. It is based on historical data and needs to be updated to account for climate change so as to ensure that homes and buildings are solid enough to endure extreme weather conditions.

In response to these remarks by the Commissioner pertaining to data, Infrastructure Canada is committed, in line with Budget 2016, “to working with Statistics Canada as well as other stakeholders to improve infrastructure-related data.”<sup>45</sup>

### *Management practices and training*

Efficiency and good governance also require an appropriate expertise for public officials at the three levels of government. To this end, Budget 2016 announced \$50 million for a new

asset management fund whose purpose will be to support the implementation of sound asset management practices and data collection on assets. Furthermore, funding is available under the Gas Tax Fund to improve project management.

However, in order to ensure the efficient selection, the federal government could revive programs such as the National Guide to Sustainable Infrastructure (Infra Guide), which in collaboration with the FCM produced a body of technical and best-practice management information for public and private decision-makers involved in infrastructure programs. It could fund the Knowledge-Building Outreach and Awareness programs which in the early 2000's provided funding for research in infrastructure. Funding for both of these programs was abandoned in 2007.

#### *Federal-provincial-municipal cooperation*

Under the Canadian constitution, municipalities and local governments fall under provincial jurisdiction. Infrastructure spending decisions thus require coordination not only among federal departments but also between the federal government, the provinces and territories and the municipalities. The Commissioner recommends greater federal-provincial-municipal cooperation with respect to clarifying the role of each level of government and setting long-term infrastructure priorities. In contrast to the unilateralism of the Harper government, the Trudeau government is adopting a collaborative approach.<sup>46</sup> While the federal government will play a leadership role and be a funding partner, the responsibility with the planning, prioritization, design and operation of infrastructure projects will lie with provincial-territorial and municipal governments. However, the federal government should work with the provinces, territories and municipalities to develop clear guidelines to screen projects and to ensure that selected and funded projects meet rigorous criteria of efficiency and sound governance.

## DELIVERING INFRASTRUCTURE PROJECTS THROUGH PUBLIC-PRIVATE-PARTNERSHIPS (PPPs)

In 2009, the Conservative government created PPP Canada, a Crown Corporation, and imposed mandatory screening of projects under the New Building Canada Fund by PPP Canada. As mentioned above, according to *Budget 2016*, this mandatory screening has been abolished. The Minister defended this decision by saying:

“There has been some discussion in infrastructure circles and the media that this campaign commitment to remove the P3 screen indicated a lack of support for P3s in general.... [However,] this is not the case....

[A]s a councillor in Edmonton I worked with PPP Canada to help us design and build our new LRT line. We saw the benefits of transferring the design and construction innovation – as well as the risk – that came from our partnership with the private sector. But our City Council struggled to transfer [the] operation of our transit system which we had effectively managed for a century...

Removing the mandatory P3 screen respects [provinces, territories, and municipalities’] ability to make their own decisions on how to best meet their infrastructure needs.

Our government believes that for certain projects, P3s are the right method to build the infrastructure we need. Not all projects are well suited, but many are...” (Sohi, 2016)

The change in *Budget 2016* together with the Minister’s statements indicate a more reserved endorsement of the PPP model by the Liberal government than its predecessor.

This may be in response to the criticisms faced by the PPPs which we discuss below.

The PPP model has elicited some controversy and a large literature on both sides of the debate in recent years.<sup>47</sup> While a thorough analysis of the PPP model is beyond the scope of this chapter, we briefly describe the important points of this debate.

The traditional model for carrying out infrastructure investment projects and providing public services is through public procurement, whereby the government plans

and designs the projects and then contracts out the actual building of the infrastructure project to various private enterprises. Usually the private firms that will be in charge of construction are chosen through a competitive bidding process. Government borrowing is used to pay for construction. After the construction phase is completed, the administration and maintenance of the project are traditionally conducted by the government, but sometimes these may be contracted out to private enterprises as well. In either case, government borrowing is used to defray the costs while revenues from the projects accrue to the government.

In recent years, Public-Private Partnerships (PPPs) have been quite popular as a means of providing public infrastructure projects in Canada especially in Ontario, Québec, Alberta and BC. (See Vining, Boardman and Poschmann (2005), Boardman and Vining (2010) and Boardman, Siemiatycki and Vining (2016)). Thus, Ontario alone has more than 70 either almost completed or on-going AFP (“Alternative Financing and Procurement,” i.e., PPP) projects. Infrastructure Ontario’s (2016) web site contains a list of these projects. Similarly, the Société québécoise des infrastructures (2016), Partnerships British Columbia (2016) and Alberta Infrastructure (2016) also list on-going and completed PPP projects. The exact contractual arrangements differ widely among PPPs: build-finance (BF), design-build-finance (DBF), design-build-finance-maintain (DBFM) or design-build-finance-operate-maintain (DBFOM). They may thus involve varying degrees of private sector participation in the projects.

The most important characteristic that distinguishes PPPs from traditional public procurement is that most (or all) of the initial financing is privately provided, but the government must eventually pay the (consortium of) private companies once the project is completed (unless the contract specifies that the private parties will benefit from the

revenues generated by the operation of the facility that was built). In the case of public procurement, the government must pay up front for the construction of the project. The private provision of initial funds in the case of PPPs does not constitute an “alternative source of financing” of the project in the sense that it does not alleviate the burden on the government’s intertemporal budget, since the present value of the future payments by the government equals the payment it must make up-front. In principle it can be shown that whether the project is financed by traditional procurement or by PPPs the impact on the government’s finances are identical once one takes into account the transfer of risks. (See for example, Grout, (1997), de Bettignies and Ross, (2004), and Engel, Fischer and Galetovic, (2010).

PPPs are a relatively new form of public service delivery and administration. Actual experiences with PPPs in Canada and around the world are a mix of both successes and failures. (See, for example, Bordeleau (2012), Hilton and Stoney (2007), Koppenjan (2008), Siemiatycki (2013)).

Arguments often given in favour of PPPs are mainly greater efficiency and a more efficient allocation of risks among partners. The private sector has greater expertise, is more innovative, can build and manage infrastructure projects in a more cost-efficient and timely manner thus increasing “Value for Money” (VfM) relative to traditional public project development.<sup>48</sup>—Most importantly, an essential benefit of PPPs stems from the efficient management of risks related to asymmetric information and incentive issues.

There are often complementarities between the different stages of a project. (See de Bettignies and Ross, 2004, p. 149). Private involvement in several stages (rather than only in building and financing) may yield efficiency gains, and also alleviate moral hazard problems that may arise. Hence, for example, if a private firm is only involved during the

construction and not the maintenance stage, moral hazard issues arise since the company may reduce costs in order to obtain the procurement contract during the bidding process, and then provide a lower quality product along with the lower costs. (This may also be the case in the traditional procurement model where the private firms are only contracted to build.) If instead the firm is responsible for both construction and maintenance, then overall efficiency objectives over the life-cycle of the project will dictate a good quality product in order to minimize maintenance costs.

Good quality service may also be ensured by carefully drafted contracts that include clauses with precisely defined quality standards for the service flow. These are some of the ways in which PPPs can lead to more effective risk management, whereas a traditional procurement model cannot address risks related to asymmetric information issues. In the latter case, there is a lack of incentive to control costs and there is no market discipline or detailed contract to control for quality of service delivery. (Murphy, 2008 and Engel, Fischer and Galetovic, 2010). It is also worth stressing that private partners in a PPP must have enough funds committed in the project so as to retain the financial incentive to efficiently and successfully complete the project, thus curbing agency problems.

It is often argued that the PPP mode of financing is costlier than the traditional model, and that there is a substantial PPP premium relative to the traditional government procurement model, especially as the government can borrow at a cheaper rate than private firms.

However, this premium is related to the risks that are transferred to the private partner, and can be reduced with an efficient allocation of risks to the party that can best deal with it. In general, it is optimal for the private partner to bear all technical risks related to construction and for the government to bear demand (or revenue) risk. (Engel, Fischer

and Galetovic, 2010) Consider for example, the case of a highway construction where the revenue stream will depend on user fees (tolls). The demand for the highway services depends in great part on general economic conditions which are exogenous to the firm. The latter can have no influence on this risk no matter how efficient it is. Bearing this risk will increase the firm's exposure to systematic (market) risk thus increasing its overall borrowing costs. (That is, the firm's *beta* increases.) Thus the firm will charge a higher premium as compensation for bearing demand risk. As Engel et al. point out, this premium could be quite high. In this case, facing the demand risk is a cheaper option for the government, and will lower the PPP premium.<sup>49</sup> On the other hand, all technical risks related to the construction of the project should be optimally borne by the private partner. Bearing this risk has a cost reflected in the PPP premium, but it also induces the firm to be efficient and find expedient solutions to emerging hurdles. It is thus, as Engel et al. put it, "the flip side of the efficiency advantage of PPPs." (Engel et al., (2010), 42)

Murphy (2008) stresses that "An appropriate risk allocation requires that governments have the expertise to identify all of the relevant risks before entering into the partnership contract. Governments must also have the contract management skills to ensure that those risks are in fact borne by the private sector." This latter point is very important in the case of PPPs since they involve long-term contracts that must be carefully crafted in order to minimize the occurrence of costly renegotiations, (Guasch, 2004) and yet must be flexible enough to allow for such renegotiations if necessary.

The fact that most PPP models involve very complex and long-term contracts has also been criticized on several grounds. First the negotiations are very lengthy and the transactions costs are substantial, thus adding to the costs of the project under PPP. Secondly, it is impossible to completely avoid "contract incompleteness" especially in



long-term contracts, since all eventualities cannot be foreseen and contracted for in advance. Grout (1997, 64) illustrates this point with an example. In the 1990s it was commonplace to require microwave ovens as part of the quality standards for university accommodation contracts. However, given the 20-to-30 year lengths of contracts, this requirement could not have been anticipated in the 1970s. Hence, the government may not want to lose the flexibility of providing a modified set of public services if the need arises in the future. This introduces operating risks for the private partner and may lead to controversies between the partners. Entering renegotiation clauses is one option, but such renegotiation may be costly. Choosing a type of PPP model that does not include the operation or administration task may be a way to circumvent this problem, and some critics have advocated the “unbundling” of tasks performed by the PPP. As a matter of fact, as Siemiatycki and Farooqi (2012) note, “the provincial government in Ontario has not widely sought to transfer ... operating risks, thereby avoiding the planning-related concerns that arise around loss of government flexibility...” (2012, 295) However, there are tradeoffs. Such unbundling also means that the adopted PPP model remains susceptible to the asymmetric information and moral hazard risks (mentioned above) that a more comprehensive PPP model can avoid.

Another argument against PPPs is the difficulty in, not only correctly identifying, but also correctly quantifying, the risks borne by each partner.<sup>50</sup> Thus, arriving at a correct calculation of VfM and making an accurate comparison of the costs of PPP versus traditional procurement becomes very difficult. As Siemiatycki and Farooqi (2012, 291) note, the cost of the PPP model is lower than the traditional procurement method only after accounting for the risks borne by the private partner. Yet, since the details of how the risks are quantified are not revealed, verifying the VfM calculations becomes impossible.

Infrastructure Ontario's web-site makes available the reports of two independent consulting agencies identifying a large number of possible risks and indicating the risks that are transferred to the public.<sup>51</sup> However, since very little empirical data are provided, it is not possible to verify the assessments. This points to another major concern in relation to PPPs, (and public infrastructure spending in general), namely the lack of transparency and accountability.

In relation to the impact of the infrastructure stimulus spending, Stoney and Krawchenko (2012) compare the programs in Canada, Australia and the US. They arrive at the conclusion that transparency, accountability and oversight in Canada were far inferior to those in the other two countries.

“The Canadian government stands out among the countries in our case studies for its failure to implement measures aimed at ensuring accountability and transparency in decision making and in reporting mechanisms that aid in communicating program results. For Canada, no special auditing or oversight functions were adopted apart from regular departmental reporting and annual reports to Parliament from the Office of the Auditor General... in sharp contrast to those measures adopted in the United States and Australia, where accountability/reporting mechanisms specific to the stimulus funds, as well as independent audits, were conducted. [T]he dissemination of information and tracking of results as well as the evaluation of stimulus spending were much stronger in United States and Australia than in Canada... making it not only difficult, but also impossible to evaluate one of the key stated objectives [namely, job creation] of the stimulus program.” (pp. 15-16).

Bennett (2012) also notes a lack of data availability in order to assess the impact of the given stimulus: “no Canadian official agency had the kind of data that one might have found, for example, in the USA with respect to similar programmes.” This lack of data was also noted in the Auditor General's Report. (Office of the Auditor General of Canada, 2010, p. 3).<sup>52</sup>

A similar lack of transparency was noted by Hilton and Stoney (2007) in the context of the initial attempt at building a Light Rail Transit in Ottawa, a PPP project that involved a consortium led by Siemens. The project eventually failed and was abandoned in 2007.<sup>53</sup> The exact nature of the project design and the contract itself were not revealed as the

private partner claimed confidentiality issues. The city councilors were obliged to vote without full cognizance of the details of the project. To the extent possible, the PPP contracts should be designed to limit the inclusion of confidentiality clauses in order to ensure transparency and accountability towards the public.

As PPPs are increasingly adopted as a means of providing public services, it will be important to have well-designed contracts in order to reap the benefits and limit the drawbacks of the PPP model.

## FINANCING

According to *Budget 2016* the government will be financing most of these projects by borrowing to take advantage of the current historically low interest rates. As mentioned above, deficit financing of infrastructure is also the mode of financing that will yield the largest multiplier effects.

As a consequence of debt-financing, the budgetary balance will move from a \$1.9 billion surplus in 2014-15 to deficits that are projected to first increase and then gradually decline in the next five fiscal years, with \$5.4, \$29.4, \$29, \$22.8, \$17.7 and \$14.3 billion respectively between 2015-16 and 2020-21. The debt as a percentage of GDP will also initially rise from 31% to 32.5% in 2016-17 before gradually falling to 30.9% in 2020-21.

Canada currently has the lowest debt-to-GDP ratio among the G-7 countries and ranks below average among G-20 countries. Given current very low debt servicing charges, this provides the federal government with some leeway to use deficit financing to palliate for decades of neglect of the Canadian infrastructure. In addition, since infrastructure investment provides a flow of services for many years to come, it makes sense to use deficit financing as future generations will also benefit from current spending.

Yet, in view of probable increases in interest rates as the economy recovers and of the very large infrastructure gap evaluated at \$172 billion by the FCM, the government will need to resort to alternative sources of financing in addition to the \$120 billion that it has promised in *Budget 2016*.

According to *Budget 2016* the government intends to “where it is in the public interest, engage public pension plans and other innovative sources of funding—such as demand management initiatives and asset recycling—to increase the long-term affordability and sustainability of infrastructure in Canada.” (p. 88)

While the Canada Pension Plan Investment Board, the Caisse de depot et placement du Québec and the Ontario Teachers’ Pension Plan invest extensively in international infrastructure projects, they refrain from doing so in Canada due to lower rates of return. At The Economist’s Canada Summit Conference, Finance Minister Bill Morneau recently stated “We’ve got these very successful investors in Canada that invest in infrastructure around the world and yet have not found the projects in Canada of the scale that makes sense for them... We’ll need to ensure that there are appropriate risks and rewards for those investors.” (Scuffham and Hopkins, 2016)

### *Asset Recycling*

Budget 2016 refers to the possibility of using asset recycling, which refers to the sale or long-term leasing of public assets such as ports, roads or bridges to private interests in order to finance new infrastructure projects with the proceeds being allocated to an infrastructure fund.

Canada has many mature assets such as harbors, airports and highways which generate a predictable stream of revenues. Furthermore, institutional investors are seeking

to invest in infrastructure worldwide. For example, the Ontario Teachers' Pension Plan (OTPP) holds \$17 billion of infrastructure assets internationally but less than 20% of it is in Canada. As the head of the infrastructure division of the OTTP, Andrew Claerhout indicated, "an airport investment has potential to generate big returns if an investor can improve how it's managed and lure more airlines to its runways." (Biatchford, 2016)

This mode of financing new projects, also called capital recycling, has been adopted in many countries and in Canadian provinces, notably Australia and Ontario. For example, Port Kembla and Port Botany in Sydney, Australia, were sold for A\$5 billion in order to invest the proceeds in new infrastructure. Furthermore, with the goal of leveraging \$40 billion of investment, the Australian government has set up a \$5 billion 5-year program to encourage states and territories to pursue asset recycling. The latter are eligible to receive 15 per cent of the sales price of the asset provided the proceeds are allocated to funding new infrastructure projects. (Australian Government, 2014)

As Gordon (2014) notes, "there may be cases where 'mature' assets, such as ports, would be better privatised so proceeds can be reinvested in new areas, such as urban arterial roads, where need is greater. Public assets may also be more efficiently run by the private sector and a sale of existing publicly-owned facilities could increase returns even on 'mature' facilities."

There are several examples of asset sales or long-term leases in Ontario. As an example of the latter, in June 2000, the Crown corporation, Ontario Power Generation, signed a long term lease with private sector consortium Bruce Power to take over Bruce station, the largest nuclear facility in the world.<sup>54</sup> The 18-year lease could be prolonged for an additional 25 years. It was announced that Bruce would invest \$13 billion over 15 years to refurbish the facilities. At the same time, the province would commit to pay \$77 per

megawatt-hour for the electricity, which is below the \$83 per megawatt-hour price of electricity in Ontario. (Morrow, 2015) Bruce Power would be responsible for cost overruns.

An example of an asset sale is the current (partial) sale of Hydro One. After considering the loss of annual income of \$100 million (remittances from Hydro One), the Advisory Council on Government Assets recommended that the Ontario government proceed with the sale of Hydro One to the private sector, arguing that the rate of return of new infrastructure projects is likely to exceed the rate of return of money locked in Hydro One. (Government of Ontario, 2014) In 2015, the government of Ontario proceeded with its plan to sell 60% of Hydro One while retaining the remaining 40% and regulatory control over electricity rates. The objective is to generate \$9 billion of revenues: \$5 billion to lower Ontario's debt and \$4 billion to invest in the Trillium infrastructure fund. (Morrow, 2016) In 2015, the government of Ontario launched other major initiatives, notably selling head office lands belonging to the Liquor Control Board of Ontario for \$260.

Asset recycling requires a careful assessment of its net present value, considering all the costs and benefits, as well as an open and transparent process. (Galston and Davis, 2012) Assuming that the deal is advantageous from the government's point of view, it is also necessary to ensure that the funds be indeed devoted to new infrastructure by establishing Special Purpose Vehicles to manage them. (Gordon, 2014).

#### *Infrastructure Bank*

An alternative source of financing is the creation of an infrastructure bank. Several countries around the world have established infrastructure banks such as the European Investment Bank (EIB), the Green Investment Bank in the UK and the Asian Infrastructure Investment Bank.

While *Budget 2016* does not refer to the possibility of establishing an infrastructure bank, in its pre-electoral platform, the Liberal Party proposed the creation of a Canadian Infrastructure Bank to help provinces and municipalities in obtaining the necessary capital for infrastructure projects by providing loans and loan guarantees:

“This new CIB will work in partnership with other orders of governments and Canada’s financial community, so that the federal government can use its strong credit rating and lending authority to make it easier – and more affordable – for municipalities to finance the broad range of infrastructure projects their communities need... The new CIB will issue Green Bonds<sup>55</sup> ... [to] fund projects such as the electrification of transportation, smart grid technology, and transmission lines for renewable energy, electric vehicle charging stations and networks, retrofits of buildings, and clean power storage. When appropriate, the CIB will issue Green Bonds to the public so that they too can invest in such projects.” (Liberal Party of Canada, 2015b, p. 7)

The EIB may be an interesting model for the CIB. There are a number of issues to address.

First, the EIB is financially independent, but it is owned by the member states of the European Union (EU) which contribute paid-in capital in proportion to their economic weight in the EU. It is authorised to make loans amounting to 2.5 times its capital. (European Investment Bank, 2015) In order to give loans, the EIB raises funds in the capital markets, for example by issuing bonds and other debt instruments. Its bonds may be purchased by institutional investors, such as pension funds and life insurance companies whose liabilities are long-term. Siemiatycki (2016) proposes to capitalize the CIB with federal funds that are in addition to existing federal capital grants. Hodgson (2015) argues that provincial governments and even pension funds could become shareholders of the CIB thereby increasing its capital base. According to the Liberal Party’s platform, the CIB will issue green bonds which could be very long-term, extending to 30 or 40 years to match the lifetime of infrastructure assets (Liberal Party of Canada 2015a).

Secondly, the EIB only considers loans for projects whose costs exceed € 20-25 million. Siemiatycki (2016) also favours CIB involvement only for projects exceeding a

threshold of \$10 million. Thirdly, the EIB has put in place an appraisal process based on “due diligence” which screens projects according to strict economic, technical, environmental, social and financial criteria. Project appraisal is conducted by a team of loan officers, economists, engineers, sector specialists, risk managers and lawyers. The projects are monitored throughout the life-time of the loan according to specific guidelines to permit early detection of contract breaches and deterioration of initial conditions. Environmental monitoring is also conducted by the Bank which “calculates and reports on the carbon footprint ... for all directly financed projects that have material emissions. In addition, an economic price of carbon is incorporated in the accounting for environmental externalities.” (European Investment Bank, 2015).

Following the example of the EIB, the CIB should select only efficient projects for funding, that is those that meet rigorous cost-benefit analyses based on economic, financial, technical and environmental criteria and, as Siemiatycki emphasizes, have been prioritized by municipal and provincial authorities. To this end, it should provide the necessary financial and technical expertise and monitoring as does the EIB. In addition, during the selection process, the CIB should also require recipients to include maintenance reserve accounts and regular inspections in view of the past neglect of infrastructure maintenance.

Fourthly, the CIB could help lower the cost of municipal borrowing. Provinces and large municipalities such as Toronto and the Municipal Finance Authority of British Columbia borrow at rates that exceed the AAA rating of the federal government by more than 1%. The differential is even higher for smaller municipalities. For large projects, the cost savings would not be negligible. For other municipal or local governments, access to the CIB may even facilitate access to credit markets. Low interest loans by the CIB could



also exert some leverage and attract financing from nonprofit organizations with respect to social housing projects. (Siemiatycki, 2016 and Hanniman, 2014).

Finally, access to financing does not solve all the funding problems. If the project is expected to generate a stream of revenues such as user fees or some specific other source, the asset owner may be able to finance the borrowing and operating costs. Such is the case of power grids, toll roads, electric vehicle charging stations and networks. However, for projects such as public transit, water and waste-water treatment user fees may not suffice and provinces, territories and municipalities may have to resort to general tax revenues or transfers. In this case, the CIB will simply ease the liquidity problems faced by provinces-territories and municipalities<sup>56</sup> but not the long term financing problem.

## CONCLUSIONS

In this chapter we have provided an overview of the Liberal government's two-phased infrastructure plan and of the salient features of Phase 1 projects, the only ones known at this time. We have looked at the economic benefits of infrastructure projects. We have argued that in order to reap these benefits, the projects undertaken in both Phase 1 and Phase 2 must be judiciously chosen to respond to the needs of Canadians, and efficiently managed within a good governance structure and with adequate oversight. To this end, we have analyzed the literature on efficient project management and some of the pitfalls that large infrastructure projects involve. We have stressed that adequate oversight is necessary where large public funds are concerned.

The PPP formula has become a very popular method of delivering infrastructure in Canada and in the world. However, several challenges need to be addressed, such as maintaining transparency and accountability and drafting carefully designed contracts to

ensure that Canadians' best interests are served. We have also discussed different financing options for projects such as asset recycling and a Canadian Infrastructure Bank. Canada has many mature assets such as harbors, airports and highways which institutional investors, in particular Canadian pension funds, seeking to invest in infrastructure worldwide would find to be attractive investments. However, we note that asset recycling requires a careful assessment of the net present value of the asset, considering all the costs and benefits, as well as an open and transparent process.

In view of Canada's large infrastructure needs, additional funding could be obtained by creating an investment bank. In its pre-electoral platform, the Liberal Party proposed the creation of a Canadian Infrastructure Bank to help provinces and municipalities in obtaining the necessary capital for infrastructure projects by providing loans and loan guarantee. The European Investment Bank (EIB) provides an interesting model for the CIB. Analogously to the EIB, it could be allowed to raise funds in capital markets, for example by issuing long-term green bonds that would be purchased by institutional investors such as pension funds or life insurance companies. Provincial governments and even pension funds could become shareholders so as to increase its capital base. Following the example of the EIB, the CIB should implement an appraisal process based on due diligence and select only efficient projects for funding, that is, those that meet rigorous cost-benefit analyses based on economic, financial, technical and environmental criteria among those prioritized by municipal and provincial governments.

Infrastructure spending of the type envisaged in *Budget 2016* will require coordination among the federal government, the provinces, territories and the municipalities. Contrary to the Conservative government's unilateralism, the Trudeau government has indicated that it will adopt a collaborative approach. Cooperation among

levels of government, good project selection, efficient administration and good governance will be key aspects of the success of these projects.

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## Endnotes

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<sup>1</sup> We would like to thank the editors G. Bruce Doern and Christopher Stoney as well as two anonymous referees for very helpful comments.

<sup>2</sup> In Canada the infrastructure gap has increased steadily since the 1980's and according to the Federation of Canadian Municipalities (FCM) the infrastructure gap is in the order of \$172 billion. See S. Mirza (2012). According to the International Transport Forum (OECD, 2015), transport infrastructure as a percentage of GDP has fallen to 0.8%, its lowest level since 1995. Mackenzie (2013, p. 14) also notes that: "In 2011, ... the depreciated value of the general government capital stock in Canada amounted to 22% of GDP. Simply to maintain that level would require an annual investment of 2.9% of GDP. That level of investment activity compares with the 2.7% of GDP that was invested in the peak year of the stimulus program... To reach a target of 30% of GDP [as was the case in the 1970s] in ten years would require an annual investment in general government infrastructure of 4.3%—a higher investment rate than was ever achieved in the period from 1955 to 2011. In 2013–14, that would require an investment of approximately \$75 billion for general government infrastructure alone."

<sup>3</sup> Doern, Auld and Stoney (2015, Chapter 8) make a comprehensive analysis of Canadian infrastructure investment spanning a 50-year history.

<sup>4</sup> In the context of the Conservative government's 2008 Economic Action Plan, Doern, Auld and Stoney (2015, p. 283) discuss "the increasing politicization of infrastructure spending, with signage, advertising and branding taken to levels never seen in Canada before" and its "role in furthering distributive 'retail politics.'"

<sup>5</sup> Public capital may also include education and health infrastructure.

<sup>6</sup> This argument is developed by J.R. Tybout (2000), S. Turnovsky (1996) and P-R. Agénor and B. Moreno-Dodson, (2006).

<sup>7</sup> However, the maintenance and repair of public capital has often been neglected. For example, Gyamfi, and G. Ruan (1996) found that *every* dollar *not* spent on road maintenance leads to a \$3 increase in vehicle operating cost.

<sup>8</sup> Calderón and Servén (2004) find an empirical link between indicators of infrastructure quality and economic growth.

<sup>9</sup> That is, rising output increases tax revenues and makes it possible to finance additional infrastructure spending. Moreover, a recession may also induce policy-makers to launch new public investment programs.

<sup>10</sup> Their study focuses on electricity, telephone and road construction.

<sup>11</sup> Leduc and Wilson (2012) also use the VAR methodology with federal highway grants that are predetermined by the U.S. Congress (and thus exogenous to the state of the economy) and estimated the impact multiplier as 3.4, the peak multiplier (6 years out) as 7.8 and the mean multiplier as 1.7. Thus, they confirm that the multiplier is large for highway spending. When they use state

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government total spending on highway construction, the impact, peak and mean multipliers are lower but still large: 2.7, 6.2 and 1.3. With a third measure, the multipliers are: 1.4, 3.0 and 0.6.

<sup>12</sup> The real rate of interest is (approximately) the difference between the nominal rate and the expected rate of inflation. In the presence of *deflation*, the real rate is higher than the nominal rate.

<sup>13</sup> Kraay (2012) and DeLong and Summers (2012) similarly have large values for the multiplier. Leduc and Wilson (2012) also estimated the multiplier for highway spending to be twice as large during a recession.

<sup>14</sup> Cogan, Cwik, Taylor and Wieland (2010) underestimate the size of the multiplier because in their model fiscal policy does not have a significantly different effect when the nominal interest rate is at the zero bound and there is substantial economic slack.

<sup>15</sup> Their methodology follows that of Auerbach and Gorodnichencko (2012.)

<sup>16</sup> Gagnon, Gaudreault and Overton (2008) estimated that bridges, roads and water treatment plants in Canada had reached 57%, 53% and 63% of their expected useful life respectively.

<sup>17</sup> The Liberal Platform had originally announced infrastructure spending in the amount of \$17 billion over four years, with \$5 billion to be spent during each of the first two years and \$3.5 billion in the third and fourth year. Instead, the *Budget 2016* announcement presents two phases, as discussed below. There has evidently been a rearrangement of spending over a longer ten-year period with substantially larger allocations to infrastructure over this period than announced in the Liberal Platform. Liberal Party of Canada (2015a and 2015b).

<sup>18</sup> To quote the Prime Minister, during his interview with Bloomberg on March 22, 2016, “We’re going to do ... things that you don’t get to cut a ribbon and announce a shiny new building on.” (Bloomberg, 2016) This contrasts with the Conservative government’s very politicized approach to infrastructure investment pointed out by Doern, Auld and Stoney (2015).

<sup>19</sup> The following relies on Chapter 2 of *Budget 2016* entitled “Growth for the Middle Class.”

<sup>20</sup> As indicated in *Budget 2016* (p. 242): “The Gas Tax Fund is projected to grow from \$2.0 billion in 2015–16 to \$2.2 billion in 2020–21 as these payments are indexed at 2.0 per cent per year, with increases applied in \$100 million increments.”

<sup>21</sup> This Crown corporation became fully operational in 2009 with a board of directors that included several members with very close ties to the private sector. This aspect, according to Bordeleau (2012), creates a “public administration malaise” (p. 148) since it generates an incentive problem. Namely, it becomes unclear whether decisions relating to the spending of public funds will indeed be taken to benefit public welfare or instead, the private sector.

<sup>22</sup> Canada failed to reduce emissions to the levels agreed on in the 1997 Kyoto Accord, and the Conservative government withdrew Canada from the Kyoto Protocol in 2011, the first (and only) country to do so. The US and China were not signatories of the Accord, a fact that was brought forward by the Conservative government among its justifications for Canada’s withdrawal. (Reguly and McCarthy, 2015).

<sup>23</sup> Further initiatives to help the development of clean technologies are also included in *Budget 2016*, such as \$50 million over four years provided to the Sustainable Development Technology

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Canada's Tech Fund to develop "new technologies that address climate change, air quality, clean water, and clean soil" as well as \$82.5 million over two years to Natural Resources Canada to support the development of "clean energy technologies ... reducing the environmental impacts of energy production and creating clean jobs." (pp. 150-51). In addition, \$50 million over two years will be given to Natural Resources Canada "to invest in technologies that will reduce greenhouse gas emissions in the oil and gas sector" (p.154); and \$2 billion over two years to establish a Low Carbon Economy Fund. "The Fund will support provincial and territorial actions that materially reduce greenhouse gas emissions... Resources will be allocated towards those projects that yield the greatest absolute greenhouse gas reductions for the lowest cost per tonne." (p. 157).

<sup>24</sup> The urgent need for spending on clean water infrastructure became quite evident when contaminated water caused the death of seven residents and the illness of more than 2300 residents in Walkerton, Ontario in May 2000. Hence, such infrastructure responds not only to environmental concerns, but also to urgent health concerns.

<sup>25</sup> Repairing roads and bridges is necessary to prevent tragedies such as the one in in September 2006, in the City of Laval, Quebec, when the Concorde Boulevard overpass bridge, built in 1970, collapsed on top of Highway 19 killing five persons and severely injuring six others. Yet, it had received an approval for 35 more years of service during a maintenance check in 2005 just one year before the tragic event. (See Crisis and Disaster Management Research and Training Initiative, 2014). This observation points to the necessity of using more modern techniques "to predict the time-dependent changes in structural load capacity of a reinforced concrete highway bridge investment" and other infrastructure investments in order to increase their life-cycle value and to eliminate or reduce investments during the operations stage, as advanced by recent research in civil engineering. (See Sundholm, Lepech and Wikström, 2015.)

<sup>26</sup> The Federation of Canadian Municipalities (FCM) has about 2000 members who represent almost 90% of the Canadian population and own 56.8% of Canada's core public infrastructure such as water systems, roads and bridges, buildings, sport and recreation facilities and public transit. Infrastructure related to other waste management, affordable housing, energy systems, and information and communication technologies also owned by municipalities is not included in this figure. Provinces own 41.4% of core infrastructure while the federal government owns only 1.8%. (Canadian Infrastructure Report Card, 2016, p. 5.)

<sup>27</sup> According to the Mayor of Calgary, the Prime Minister's commitment was what all mayors had been requesting and it is "a really, really big deal." See Curry (2016).

<sup>28</sup> Risk refers to a random event whose probability distribution is known. It is therefore possible to assign probabilities to these events. Uncertainty, on the other hand, refers to random events whose probabilities are not known, and which may not even be elements of the set of events taken into account by the decision-maker. They cannot be assigned probabilities and in that sense are truly unexpected.

<sup>29</sup> The uncertainties are even larger when the project involves innovative techniques or materials that have not yet withstood the test of time.

<sup>30</sup> For example, speeding up projects to meet deadlines may lead to even greater cost overruns. (Lessard et al., 2014).

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<sup>31</sup> For an analysis of the impact of irreversibility in the presence of uncertainty on investment, see Demers, Demers and Altug (2003) which also analyzes the real-options approach.

<sup>32</sup> The appropriate approach to irreversible investment projects is based on real options which is an extension of the Black-Scholes financial options pricing method. The essence of this approach consists of maintaining flexibility in the decision-making process, not committing too soon and preserving the option to adapt to unforeseen circumstances and new information. See Miller and Lessard (2008).

<sup>33</sup> In an analysis of 52 large projects with costs exceeding \$500 million, Mellow, McDonnell and Argüden (1988, p. iv) note: “Doing something different -even slightly different- ... dramatically increases the probability of operational problems.”

<sup>34</sup> As Lessard, Sakhrani and Miller (2014) point out, the Eurotunnel Project involved both technical and institutional risks: “... the governments of UK and France had to pass new legislation to enable the new border crossing between the two nations, which represented a major institutional undertaking. Stakeholders with disparate interests had to be aligned by revamping regulation on both sides of the Tunnel... the distance to be traversed in tunneling presented the major technical challenge.... Once the tunnel concept was locked in, the architectural decision to fast-track the project by concurrently tunneling from both ends raised the logistical challenge of excavating tunneling debris, further increasing the technical complexity of the project. ... Safety-related design changes late in the execution process because of changing regulations delayed the project, thereby increasing costs and decreasing its profitability.” (p. 176)

<sup>35</sup> Bad weather, strikes, delays in the delivery of inputs, construction in remote areas may also constitute significant risks for certain types of projects.

<sup>36</sup> Wherever possible, taking a modular approach by breaking up a large project into consecutive smaller ones may provide greater flexibility in the planning and design of such projects “...creating opportunities for adaptive process management and no-regret policy.” See Priemus and van Wee (2013).

<sup>37</sup> Flyvbjerg’s (2007) study provides an illustration for urban rail projects. In a study of 44 urban rail projects completed between 1966 and 1997, 18 of which North American, 13 European, and 13 in other parts of the world, the actual cost of the project exceeded its forecast by 35.8% in North America and 44.9% overall. The data for bridges and tunnels indicate similarly high cost overruns (33.8%). (p. 16) Depending on the type and magnitude of the infrastructure project, it is not altogether uncommon to see actual costs that are 200% of the projected ones. Just as costs are often underestimated, benefits of some projects also tend to be overinflated. Flyvbjerg (2005, p. 3) observes an overestimation of railway ridership by 105.6% on average over 25 analyzed projects.

<sup>38</sup> Flyvbjerg (2005) appeals to Kahneman and Tversky’s prospect theory and optimism-bias, and to Lovallo and Kahneman’s (2003) delusional optimism.

<sup>39</sup> Thus, in an article in the *San Francisco Chronicle* in July 2013, the Mayor of San Francisco defended the US \$300 million cost overrun of the San Francisco Transbay Project by saying: “In the world of civic projects, the first budget is really just a down payment. If people knew the real cost from the start, nothing would ever be approved. The idea is to get going. Start digging a hole and make it so big, there’s no alternative to coming up with the money to fill it in.” The quote appears in Flyvbjerg (2014, p. 12).

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<sup>40</sup> Merrow (2011) shows that poor project definition increases the level of costs and completion time by about 25% and also substantially increases their variability, thus raising the riskiness of the project. See chapter 10, Figures 10.6 and 10.7.

<sup>41</sup> For a thorough discussion of how to accurately assess these broader benefits in the context of transport projects, see Venables (2016).

<sup>42</sup> See also Salet et al. (2013) for an interesting account of how inadequate project definition and rigidity in the planning stage led to a suboptimal solution in the case of the high speed rail project (HSL South) in the Netherlands. They emphasize the need for the “framing and re-framing” of complex projects and for reaching out to different stakeholders to explore all the different views on the scope of the project.

<sup>43</sup> In the case of willful misrepresentation of forecasts, Flyvbjerg advocates that perpetrators even face criminal charges. Flyvbjerg (2008, p. 138).

<sup>44</sup> The following discussion of the Commissioner’s recommendations and the government’s responses is based on the Commissioner’s report published on the web page of the Office of the Auditor General of Canada. (See Office of the Auditor General of Canada, 2016).

<sup>45</sup> In relation to this point, Budget 2016, (p. 94) indicates that: “... Infrastructure Canada will work with Statistics Canada to improve infrastructure-related data.”

<sup>46</sup> In a recent interview the Prime Minister “said he is working on a wholesale change in relations among levels of government in Canada, after several years when Harper met rarely with premiers and preferred not to deal directly with municipal governments.” (Wells, 2016).

<sup>47</sup> See, for example among others, Iacobacci (2010), Gill and Dymick (2013), Lammam, MacIntyre and Berechman (2013), Vining, Boardman and Poschman (2005), Boardman and Vining (2010, 2012) and Boardman, Siemiatycki and Vining (2016).

<sup>48</sup> In cases where the government is in charge of designing the project, however, the scope for innovation on the part of the private partner may be more limited. Koppenjan (2008).

<sup>49</sup> As de Bettignies and Ross (2004, p.147) note, however, it may not always be the case that governments can borrow at a cheaper rate. Provincial governments with large budget deficits may see their overall credit rating affected by further borrowing.

<sup>50</sup> It must be noted that quantifying risks is as important to the assessment of the traditional procurement model as it is to the PPP model, since these risks are borne by one of the parties in any case, but remain mostly hidden in the case of the traditional model. As mentioned above, this is the reason that Flyvbjerg recommends the use of “reference groups” of similar projects when evaluating these risks.

<sup>51</sup> The consulting agencies are the Altus Helyar Cost Consulting Group (2007) and more recently the MMM Group. Altus Helyar’s risk matrices date from 2007. See the risk matrix for DBFM and for BF types of PPPs respectively in <http://www.infrastructureontario.ca/WorkArea/DownloadAsset.aspx?id=2147488712> and <http://www.infrastructureontario.ca/WorkArea/DownloadAsset.aspx?id=2147488711>.

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More recently, (September 2015) a new document prepared by Altus Helyar entitled “Assessment of Innovation through AFP Project Delivery,” provides some quantification for the contribution to innovation of a few PPP projects. However, the available empirical data are not extensive.

<sup>52</sup> Pal (2011) also evaluates the stimulus funding undertaken by the Conservative government during the last recession in 2008-9. He concludes that although it stabilized the economy, the program’s impact on jobs created was not evaluated and it lacked transparency. Furthermore, since it was not planned ahead, projects with long-term growth benefits could not be chosen.

<sup>53</sup> It should be noted that the new Ottawa LRT project started in 2012 (also referred to as the Confederation Line) is also a PPP with the Rideau Transit Group consortium which includes SNC-Lavalin and ACS Infrastructure among other partners. It is currently under construction.

<sup>54</sup> Bruce Power is a private company owned by TransCanada Corp., the Ontario Municipal Employees Retirement System and the Power Workers’ Union.

<sup>55</sup> “Green bonds are a way to finance projects that support important environmental objectives. They are also a way for investors to know that their money will be used in an environmentally sound manner.” *Budget 2016*, p. 154.

<sup>56</sup> Some municipalities may not have access to borrowing because their debt-to-municipal-revenue ratio or debt service charges as a percentage of municipal revenue are too high.



## Chapter 3

### CANADA NEEDS AN ENTREPRENEURSHIP POLICY, NOT A SMALL BUSINESS POLICY

John Lester

#### INTRODUCTION

Federal and provincial governments have a substantial number of policies that support small and medium sized enterprises (SMEs) and their owners. The key motivation for providing extra support for SMEs is that they are considered a major source of employment growth and innovation, leading to rising living standards, but face barriers impeding their full development. These policy measures are delivered through the tax system, through government business enterprises and through direct spending programs. In the 2013-14 fiscal year, federal support targeted at small business and their owners amounted to \$6 billion, or about 40% of all federal support for business.<sup>1</sup>

Most of these measures are available to all SMEs. However, a very small number of firms are responsible for the bulk of employment creation and innovation, so broad-based support for small business runs the risk of harming rather than helping economic performance by encouraging small scale, less efficient production. A more satisfactory policy framework would have a more nuanced approach to dealing with the obstacles faced by SMEs and would promote a favourable environment for the entrepreneurs that have a high impact on innovation and prosperity.

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<sup>1</sup> See Table 2 in the text. Information on overall business subsidies is provided in Lester (forthcoming).

Despite emphasizing the importance of entrepreneurship and innovation, federal policy remained tilted towards broad-based support for SMEs under the Conservative government. It is too soon to draw firm conclusions about the policy direction of the Liberal government, but initiatives announced in the 2016 budget were focussed on innovative and growth-oriented businesses. The two percentage point reduction in the small business tax rate legislated under the Conservatives was partially reversed.<sup>2</sup> In addition, funding to support innovation networks and clusters was increased and more funding to support high-impact firms was also announced.

Federal measures to support small business and entrepreneurship can be grouped into three broad groups: financing programs, support for R&D and tax measures for SMEs that are particularly beneficial to entrepreneurs. The analysis in this chapter sets the stage for recommendations to:

- Improve financing programs by eliminating the special low income tax rate for SMEs and restructuring the Business Development Bank of Canada;
- Eliminate the gap between the federal R&D tax credit for large and smaller firms and restrict the “stacking” of benefits from other federal and provincial programs; and,
- Use the savings from the above measures to fine-tune some existing tax measures that benefit entrepreneurs and implement some general tax changes that would be of particular benefit to high-impact entrepreneurs.

## HIGH-IMPACT ENTREPRENEURSHIP

Small business benefits from a highly positive image in Canada and many other countries. SMEs are correctly seen as the drivers of employment growth and as important contributors to innovation. Data from Statistics Canada confirms that SMEs create most of the jobs in Canada. Over the 2001 to 2013 period, SMEs (defined as firms with less than 500 employees) accounted for approximately 90% of net employment creation in the private sector (Table 3.1). Their

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<sup>2</sup> The reduction was to be phased-in over four years beginning in 2016. The half-point reduction in 2016 was allowed to stand.

impact on job creation arises, however, from a small fraction of firms: most small businesses start small and stay small or exit. MacDonald (2012) reports that in 2002, 94% of startups had 5

Firm Size (employees)	0 to 4	5 to 19	20 to 49	50 to 99	100 to 499	500 and up	Total
Number of jobs created	415,533	440,975	321,818	199,874	339,556	173,594	1,891,349
Share of total	22.0%	23.3%	17.0%	10.6%	18.0%	9.2%	100.0%
Source: Cansim Tables 527-0004 and 527-0006 and calculations by the author.							

or less employees and that almost half had stopped operating after 3 years. Dixon and Rollin (2014) examine employment dynamics in Canada over the 2000-2009 period and find that a large number of firms experience very little employment growth each year while a small number either grow or decline rapidly. The authors also find that age rather than size is a better predictor of rapid firm growth – young firms of any size are more likely to grow than mature firms.

SMEs are also responsible for many new products and services that have a profound impact on our well-being. But these innovations are introduced by a small fraction of all small firms. Hurst and Pugsley (2011) estimate that 10-20% of US small firms could be described as innovative, in that they successfully develop and commercialize new ideas. Following Henrekson and Stenkula (2010), the owners of these firms are described as “high-impact” entrepreneurs to distinguish them from the typical owner of a small business.

Programs that subsidize all SMEs are therefore inefficient because most of the benefits will be received by firms that do not grow or innovate. Policy should be focussed on ensuring that high-impact entrepreneurs do not face unwarranted obstacles to starting and growing firms. To do this, governments have to identify and act on market failures as well as mitigate unintended impacts of policy on high-impact entrepreneurs and their firms. Implementing this approach does not require governments to identify high-impact entrepreneurs before the fact; it

involves creating conditions favourable to their success. This approach is described as entrepreneurship policy because it focuses on the incentives for individuals to create and grow the innovative firms that make a disproportionate contribution to growth and prosperity.

The next section reviews the rationales for providing support to high-impact entrepreneurs, focussing primarily on the innovative firms they operate. The emphasis is on startups and younger firms, which are the major source of employment growth and which experience entry barriers and more difficulties obtaining external finance for expansion than established firms. The analysis sets the stage for a technical assessment of existing federal programs in section 4 of the chapter.

### RATIONALES FOR SUPPORTING HIGH-IMPACT ENTREPRENEURSHIP<sup>3</sup>

The most common rationales for supporting innovative startups relate to financing, R&D and the unintended impacts of tax policy. Other factors often cited as reasons for supporting innovative startups are barriers to entry erected by existing firms, spillovers from learning by doing, agglomeration or network effects and signalling effects from entry.

The difference between private and social benefits is an important theme running through the analysis of these factors. When markets are functioning properly, private and social benefits are aligned so that individuals and firms acting in their own interest will generate a socially efficient outcome. When markets do not capture all of the social benefits (or costs) of private actions, individuals and firms acting in their own interest confer additional benefits (or impose additional costs) on society. The existence of these external benefits or costs, usually called externalities or spillovers, is a necessary condition for successful government intervention.

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<sup>3</sup> The discussion in this section was influenced by Boadway and Tremblay (2005).

### *Financial Barriers*

The conventional wisdom is that SMEs have inadequate access to financing for expansion and growth, leading to underinvestment in the sector. Economic analysis confirms that capital markets do not function perfectly, largely because lenders and investors have difficulty assessing the quality of specific projects and of the entrepreneur seeking finance. The consequences of this difficulty vary by type of startup.

The most common form of formal outside financing for SMEs is bank loans. Given the difficulty assessing individual projects and individuals, loans are offered at interest rates that on average will cover costs by class of project. But many individuals seeking finance have better information on the quality of their investment than lenders, so borrowers with high-risk, high-return (if successful) projects are more likely to apply for loans than those with low-risk, low-return projects, who will consider the cost of financing too high. Defaults on the high-risk loans increase costs and loan rates, which in turn drives borrowers with low-risk projects out of the market.

If this were the end of the story, the impact on investment would be ambiguous: too many lower-quality projects would be financed, but this would be offset by financing of too few higher-quality projects (Boadway and Keen 2006). The rational response of lenders to loan losses is to spend more effort assessing project quality. This improves profitability but borrower mobility means that these extra costs cannot be recovered from higher risk borrowers. Faced with higher interest rates, lower-quality borrowers can apply for credit at a competing institution, which can undercut the interest rate offered by the amount of the assessment premium since they would have no need to undertake an independent assessment (Boadway and Sato 1999). As a result,

assessment costs get shifted to the higher quality loans, which makes overall underinvestment the more likely outcome.

Subsidizing borrowing costs for all SMEs does not mitigate this problem. In contrast, a loan guarantee program addresses the market failure by reducing the effort lenders expend assessing loan quality, which lowers the interest rates charged on better quality loans. On the other hand, a loan guarantee reduces the interest rate charged on lower quality loans below its efficient level, so if the portion of the loan guaranteed is too high, economic efficiency could be harmed rather than helped. A second policy response to dealing with high assessment costs is for governments to become direct lenders. A government-supported bank could promote efficiency by pricing loans to risk and not recovering the cost of assessing loan quality. The potential improvement in efficiency may not be realized if the public sector bank is not as good at assessing risk as private sector banks, which is a legitimate concern since a public bank has less of an incentive to maximize profits.

The higher risk associated with bringing an innovative product or service to market often results in recourse to equity financing. Parallel to the debt-financing case, investors cannot assess project quality as well as entrepreneurs, so they end up financing too many low-quality projects. However, with equity financing, costs do not get shifted among entrepreneurs, so there is no offsetting underinvestment (Boadway and Keen 2006). Braido, da Costa and Dahlby (2011) demonstrate that the over-investment result may not apply to initial funding of innovative startups (“seed capital”) if entrepreneurs need a premium to invest in their own risky projects. At a minimum, entrepreneurs will require a rate of return on their investment that compensates for the higher risk of the investment. However, borrowers contemplating allocating a substantial fraction of their wealth to a business venture may require an extra premium before they are

willing to make such a commitment. If so, entrepreneurs would invest less in risky projects than is socially optimal, which would justify government intervention to increase the supply of venture capital seed financing.

While market forces may result an excessive supply of later stage venture capital, too little advice and screening will be supplied. Advice raises the profitability of entrepreneurial projects, but venture capitalists only own part of the enterprise, so they only get a partial return on their effort. Government support designed to increase the return to advice by venture capitalists could therefore improve economic performance. Project screening by venture capitalists provides entrepreneurs with a more realistic appreciation of the quality of their projects and could therefore result in fewer resources being wasted on low-quality projects. However, venture capitalists will invest in screening only to the extent that their private gains and losses are equalized. They will not consider the social benefits that arise from dropping low-quality projects, so subsidizing venture capitalists to provide additional screening services and basic advice would be socially beneficial.

Direct provision of advice by government agencies could also be beneficial. Such advice could be a substitute for screening by venture capitalists. Government-provided advice could also raise the probability of success of particularly high-risk conventional projects, for which venture capital financing would not be appropriate.

### *R&D Spillovers*

There is a solid case for supporting R&D undertaken by SMEs and other firms. The line of argument starts with the observation that firms performing R&D cannot retain all of the benefits for themselves. Some of the knowledge created inevitably spills over to other firms, which they use to reduce production costs, create new production processes or introduce new products and

services. The firm performing R&D is focussed on its own benefits and costs when deciding how much to spend on R&D and does not consider these spillover benefits, so society has an interest in encouraging additional R&D. The nuance in the argument is that innovations reduce the value of investments by existing firms, which has a social cost, so the net benefit could in principle be positive or negative. Empirical work finds spillover benefits that are generally thought to be large enough to generate a net benefit. Recent work by Bloom et al. (2013) confirms that the net benefit is positive even if the loss in value of existing investments is taken into consideration.

The outstanding issue is whether additional support for small firms is justified.

Qualitative analysis does not provide clear guidance and there is only one study that provides empirical evidence on the social benefits of R&D by size of firm. Bloom et al. (2013) present evidence that the net benefit rises with firm size. Their explanation for this finding is that smaller firms operate in technological “niches”, which limits the scope for knowledge spillovers. The niche effect is substantial: spillovers associated with the smallest size category in their sample (less than 500 employees) are only 55% as large as spillovers associated with the largest size category. While it would not be prudent to advocate treating small firms less generously than larger firms based on one study, the case for more generous treatment is weak.

#### *Unintended Consequences of Tax Policy*

A number of tax policy measures have unintended impacts on entrepreneurship. In most tax systems, asymmetric treatment of corporate profits and losses raises the effective tax rate on startups. Existing firms are able to deduct losses incurred during the introduction of a new product or technology from other revenue streams. Losses can also be used to reduce taxable income in previous years. Startups incurring losses can only carry them forward for deduction against future profits. Since the losses carried forward are held constant in nominal terms,



startups will on average face a higher effective tax rate on innovation than existing, diversified firms. The impact of this asymmetry could be mitigated by ‘indexing’ the value of losses carried forward.

Capital gains and losses are not treated symmetrically in most tax systems, which discourages risk-taking. Capital gains are taxed upon realization, but capital losses can only be deducted against capital gains. Investment in projects with a greater variance in rates of return will therefore face a higher effective tax rate than investment in less risky projects. Finally, since there is a substantial fixed-cost component to tax compliance, small firms will in general suffer a disadvantage relative to larger firms.

#### *Other Rationales*

A number of other factors suggest that the number of innovative startups will be too low from society’s perspective. These include barriers to entry and externalities associated with learning by doing, entry signalling effects and agglomeration or network effects.

- Existing firms have an incentive to overinvest in capital, advertising and patents in order to deter entry.
- Experience working with new technologies and production methods raises productivity. Some of this knowledge spills over to other firms, but this social benefit does not affect the decision to enter.
- Entry also provides a signal about the profitability of products and processes that benefits other firms, causing entry to fall below the social optimum.

- Innovative startups may have less flexibility than larger firms about location decisions so it could be more difficult for them to take advantage of agglomeration or network economies.

In addition, labour market imperfections have a clear adverse effect on the entry and performance of innovative startups.

A general conclusion of this section is that, on balance, innovative startups face barriers that adversely affect entry and growth. Acting directly on these issues is not always possible and when it is, the cost of intervention can exceed the benefit. As a result, a bias to subsidizing entrepreneurial activity as a second-best policy may be appropriate..

#### *Assessment of Federal Programs and Policies*

Federal government programs that support small business and entrepreneurship are presented in Table 2. These programs are delivered through the tax system, through direct spending programs and through the Business Development Bank of Canada (BDC). Official sources indicate that these programs have a total cost of about \$5 ½ billion. However, the cost of programs delivered by the BDC is understated and the total cost of the enhanced Scientific Research and Experimental Development (SR&ED) tax credit overstates the extra benefit provided to SMEs. The adjusted cost of support programs is about \$6 billion, which represents about 40% of all federal support for business.<sup>4</sup>

Programs are classified as supporting small business or entrepreneurship largely on whether they provide support to all small businesses or whether they are restricted to SMEs with specific characteristics or undertaking certain activities. For example, the small business

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<sup>4</sup> Lester (forthcoming) estimates that federal support for business from all sources was approximately \$15 ½ billion in 2013. This support is provided through spending programs, tax incentives, losses on loans and equity investments and through the activities of government business enterprises.

deduction, loan guarantees and loans provided by the Business Development Bank (BDC) are available to all firms meeting the definition of an SME. In contrast, BDC venture capital financing and the enhanced SR&ED tax credit are restricted to innovative small firms. Based on adjusted costs, programs are tilted roughly 80-20 in favour of general support for small business as opposed to benefiting innovative startups and their owners. There are, however, a number of programs available to all SMEs that are particularly

**Table 2: Federal Tax and Spending Programs that Support Small Business and Entrepreneurship<sup>1</sup> 2013<sup>2</sup>**

Policy	Description	Type of Support	Cost (\$ Million)	
			Reported	Adjusted <sup>3</sup>
<i>Financing Programs</i>				
Small Business Deduction	Low rate of income tax on up to \$500,000 of active business income; reduced to zero as assets rise from \$10 to \$15 m.	SB	3030.0	3,030.0
Small Business Financing (Loan guarantee program)	Government pays 85% of loan losses, capped at about 12% of value of portfolio. Fees cover about 70% of program costs.	SB	59.2	8.3
Business Development Bank of Canada (BDC)	Financing--direct provision of loans	SB	-433.8	822.8
	Subordinate financing--direct supply of higher risk instruments	E	-16.0	22.2
	Venture capital program	E	11.4	51.0
	Consulting -- below-cost provision of business advice	E	16.9	16.9
	Securitization--promote asset-based financing by small fincos	SB	-5.8	19.2
	Venture capital action plan		1.4	1.8
	Total BDC			-425.9
Labour-sponsored venture capital corporations tax credit	15% tax credit on up to \$5,000 investment in these entities.	E	145.0	145.0
<u>Subtotal Financing Programs</u>			2,808.3	4,117.2
<i>Other programs targeted at small business</i>				
Hiring Credit for small business	Reduction in employment insurance premiums	SB	225.0	225.0
Spending programs supporting small business	Regional development	SB	177.4	177.4
	Youth employment strategy	SB	5.1	5.1
	Community futures program	SB	2.1	2.1
<u>Subtotal other programs</u>			409.6	409.6
<i>Support for R&amp;D and innovation</i>				
Enhanced SR&ED Investment Tax Credit	Higher refundable tax credit for R&D small firms (35% vs.15%)	E	1,455.0	831.4
Industrial Research Assistance Program	Subsidies and free advice for undertaking R&D.	E	168.1	168.1
Digital Technology Adoption Program	Subsidies and free advice for firms adopting digital technologies.	E	24.2	24.2
<u>Subtotal: Support for R&amp;D and Innovation</u>			1,647.3	1,023.8
Spending programs supporting entrepreneurship	Youth Business Foundation, Women's Enterprise Initiative	E	14.9	14.9
<i>Non-targeted programs supporting entrepreneurship</i>				
Lifetime Capital Gains Exemption	Up to \$800,000 capital gains tax exemption on disposition of shares in Canadian-controlled private corporations.	SB	580.0	580.0
Deduction of Allowable Business Investment Losses	Capital losses deductible from ordinary income when they exceed realized capital gains.	SB	39.0	39.0
Rollover of investments	Sales of small business shares do not trigger a capital gain if the proceeds are re-invested in another small business	SB	4.0	4.0
Employee Stock Option Deduction	Only half of the employee benefit is included in income. Available to all employees.	SB	N.A.	N.A.
<u>Subtotal: non-targeted support for entrepreneurship</u>			623.0	623.0
<b>Total Support</b>			<b>5,503.1</b>	<b>6,173.5</b>
<b>Percent of total support</b>				
Entrepreneurship			33.1%	20.6%
Small business			66.7%	79.3%

1. Excluding agriculture and fishing. 2. Fiscal year 2013-14 for spending programs. 3. See text for explanation. Legend: SB Small Business; E Entrepreneurship

Sources: Finance Canada (2014); Public Accounts of Canada 2014; Business Development Bank Annual Report 2014; Budget 2013; and author's calculations.

beneficial to high-impact entrepreneurs. These include the lifetime capital gains exemption on the sale of small business shares and employee stock option deductions. Including these programs in the entrepreneurship category would raise its share of the total to 30%.

### *Financing Programs*

The most expensive federal capital market initiative is the small business deduction (SBD), which provides a tax preference for SMEs financing capacity-expanding investment with retained earnings. The special low rate of income tax is available on up to \$500,000 of active business income. The federal small business tax advantage has been 4% points since 2012, resulting in a maximum tax reduction of \$20,000 per year.

The SBD has two social benefits. First, it mitigates a problem some SMEs have accessing financing. Second, it stimulates additional investment by SMEs. The key social cost arises from the need to recover the tax revenue forgone by the measure. For example, if the financing source is higher taxes on larger firms, it imposes a cost by encouraging a shift in investment from large to less-efficient small-scale firms. Baldwin, Leung and Rispoli (2014) report that in 2008 labour productivity in SMEs (firms with less than 500 employees) was 55% of labour productivity in large firms in Canada.

Dachis and Lester (2015) demonstrate that the SBD is harming economic performance as the cost of shifting capital from large to small firms outweighs the benefit of improved access to capital for smaller firms. (The benefit-cost framework used by Dachis and Lester is summarized in Box 1.) The net social cost represents about a fifth of the tax revenue forgone through the SBD, or approximately \$600 million in 2013.<sup>5</sup> A general point to be made is that because

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<sup>5</sup> This estimate overstates the long-run gain. The SBD is only available to finance capacity-expanding investment. Once a small business stops expanding, profits are taxed at the large business rate. As a result, the SBD is more like a long-term loan than a permanent tax reduction. Unfortunately, the value of the “loan repayments” is not included

government intervention can be costly, correcting a market failure does not always pay off.

Mintz and Chen (2011) also recommend eliminating the SBD, but out of concern that a two-tiered rate creates disincentives to grow.

The small business financing program (SBFP) guarantees loans originating in the private sector. The government pays 85% of losses on defaulted loans, but for large lenders total default claims cannot exceed approximately 12% of the value of the loan portfolio. In exchange for the guarantee, lenders cap interest rates on loans and collect a fee for the government. In 2014, the total value of new loans registered with the federal government was \$853 million, trending down from about \$1 billion in 2011 (Industry Canada 2014). The cost of the SBFP net of fees collected was \$8 million.

A government-sponsored loan guarantee program allows higher-risk borrowers gain access to credit without driving up the cost for other borrowers. Applying the same methodology as in Dachis and Lester (2015), indicates that the benefit from providing additional credit is more or less offset by administration expenses and the cost of financing defaults less fees charged. Factors affecting the program's effectiveness include a relatively substantial share of loans guaranteed that would have obtained conventional financing from a commercial lender – the program's incrementality is less than 100% – and relatively low caps on interest rates that can be charged by lenders participating in the program.

The SBFP should be retained with some fine-tuning to improve its performance. In particular, the interest rate caps should be revisited. An increase in the caps would raise take-up. With no change to the loan guarantee provisions, benefits and costs would rise by the same percentage, so the dollar value of the net benefit would increase. Ex post assessment of

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in the fiscal cost of the SBD, so the benefit from its elimination is overstated. See Dachis and Lester (2015) for additional detail.

borrowers who have been offered loan guarantees would raise program incrementality, but efforts have to be focussed in order to prevent additional administration expenses from absorbing the savings.

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*Box 1: Benefit-Cost Analysis*

When governments implement policies that favour SMEs and entrepreneurship, the expectation is that the real income of Canadians will be higher as a result. Benefit-cost analysis provides a framework for assessing if this expectation is realized.

When markets are functioning properly, capital and labour are being used as efficiently as possible, so there will be a benefit from government intervention only when markets fail to allocate resources to their best uses. This is in contrast to the popular view that the increase in output and employment arising from a business subsidy is proof of policy success. A benefit-cost analysis recognizes that the direct gains in output and employment will be more or less exactly offset by indirect losses caused by the higher taxes or lower spending required to finance the intervention.

Further, raising taxes to finance a spending program will in itself harm economic performance through negative effects on incentives to work, save and invest. Empirical research (Dahlby and Ferde, 2012) indicates that on average raising an extra dollar of tax revenue reduces economic efficiency by 25 to 30 cents. Shifting the burden of corporate income taxation among sectors (e.g. from small to large corporations) will also affect economic performance if the affected sectors are not equally productive.

Government intervention in the economy imposes an additional cost by shifting resources from their most efficient private use. That is, government assistance allows projects to go ahead that have a below-market private rate of return and this lower return represents a loss in economic output. This loss occurs even if the policy is addressing a market failure.

Additional administration and compliance costs arising from policy initiatives absorb resources that could be used more productively elsewhere, and so are included as a cost in the benefit-cost framework.

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*The Business Development Bank (BDC)*

The BDC is a government business enterprise that provides debt and equity financing as well as advice to SMEs. The BDC's mandate is to provide services that are complementary to rather than competitive with private sector suppliers. BDC makes an accounting profit based on a cost of capital of about 1%.<sup>6</sup> BDC's true cost of capital is substantially higher. Funds used by BDC could have been deployed elsewhere in the economy. Jenkins and Kuo (2007) recommend using

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<sup>6</sup> Calculated as interest and dividends paid to the federal government divided by loans and share capital provided by the federal government.

an 8 per cent real rate of return for this economic opportunity cost of capital in Canada. Using this estimate, BDC makes a substantial loss on its operations (last column in Table 2). However, making a loss is not necessarily a problem since there could be offsetting social benefits from the BDC's operations.

The *Financing Program* is a direct loan program that is described by BDC as offering financing to SMEs with a higher risk profile than those financed by private lenders, although an explicit comparison is not made. The value of the loan portfolio was \$17.2 billion in the 2014 fiscal year. A public direct lending program could result in a net social benefit if loans are made to relatively risky borrowers and if these loans are priced to risk, excluding the cost of assessing loan quality. An implication of these conditions is that the Financing Program should make a loss that is approximately equal to the cost of assessing loan quality. These conditions do not appear to be met.

- The average interest rate and the default rate on Financing Program loans are lower than on SBPF guaranteed loans,<sup>7</sup> suggesting that the risk profile of borrowers is too low.
- The Financing Program recorded a profit of \$433 million in 2014. However, evaluated using an 8% cost of capital, the loss was \$920 million. This loss is more than 2 ½ times total operating and administrative expenses attributed to the Program, so it clearly covers more than the cost of assessing loan quality.

In addition to indicating that the Financing Program imposes a net cost on society, this outcome suggests that the Financing Program is using its below-market cost of capital to compete with

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<sup>7</sup> In 2014, SBFP variable and fixed rate loans were capped at 6% and 7.9% respectively. The average interest rate on Financing Program loans was 5.4%. On average from 2000 to 2009, the SBFP default rate was 9.6%, compared to 6.1% for the Financing Program. (The SBFP default rate was calculated using loan and claims data accessed at: [https://www.ic.gc.ca/eic/site/csbfp-pfpec.nsf/eng/h\\_la00039.html](https://www.ic.gc.ca/eic/site/csbfp-pfpec.nsf/eng/h_la00039.html) (Tables 10a, 10b and 10c).)



commercial lenders. The Financing Program should therefore be restructured either to meet the conditions for an efficiency-enhancing public bank or to offer guarantees on loans issued by the private sector. A BDC loan guarantee program could be integrated with the SBFP to secure additional efficiencies.

BDC's *Subordinate Financing Program* targets high-potential firms that need financing to sustain growth or to transition from one owner to the next (BDC 2015, 24). The program makes debt and some equity-like investments that have subordinate status relative to other debt issued by firms. The value of the portfolio in 2014 was approximately \$575 million. Subordinate Financing clients have a higher risk profile than Financing Program clients: interest income per dollar of loan issued was 9.3% compared to 5.4% for the Financing Program.

The Subordinate Financing Program therefore may meet the minimum requirements for a successful public direct lending program. The net social cost of the program represents about .6 cents per dollar of financing provided, or less than \$4 million in fiscal 2014. The benefit-cost analysis does not capture the role that the Subordinate Financing program may be playing in providing financing for projects too risky for conventional debt but not suitable for venture capital financing because the expected return is too low. As a result, the net social benefit is understated.

The benefit-cost analysis suggests that the Subordinated Financing Program should be fine-tuned rather than eliminated. Consistent with the analysis in the preceding section, it would be worth investigating if more resources should be allocated to screening and advising loan applicants. The possibility acting as a passive investor in partnership with commercial lenders should also be investigated. (Details on how this would work are provided below in the section describing BDC's venture capital business line.)

BDC also provides *advice to entrepreneurs* at below-market rates. The percentage of costs recovered through fees has been on a downward trend since 2010; in 2015 the cost recovery rate was 41.3%, a bit more than half its value in 2010. A further decline is expected for fiscal 2016. Providing technical advice to innovative startups is sound policy that is likely to generate a net social benefit. The case for providing subsidized business management advice to all startups to address an externality is much less compelling.

The BDC is an important player in the *venture capital* market, accounting for about a sixth of new investments on average over the last two years. BDC makes venture capital investments directly at every stage of a technology-based company's development and makes indirect investments via funds, some of which are led by private and other public sector funds. It was not possible to undertake a formal benefit-cost analysis of BDC's venture capital activities. Data availability is an issue, but assessing BDC's newish strategic direction (discussed below) would be particularly challenging. Nevertheless, two policy recommendations based on the analytical framework developed above can be made.

First, as discussed above, there are reasons to suppose that the seed capital market is characterized by underinvestment, so BDC should continue its efforts to increase supply in this segment. While in principle direct investment should be avoided, BDC has made a plausible infant industry argument that would justify a period of continued direct investment (Business Development Bank of Canada 2011). BDC should nevertheless begin a shift from direct seed capital investments to passive or side-car investments with angel investors. In this approach, BDC would offer private investors leveraged returns by capping its return while leaving its entire investment at risk. The cap would be set with the intention of encouraging angel investors to offset the reluctance of entrepreneurs to invest in their own risky projects. The size of the

subsidy required to achieve this objective is unknown. The BDC should therefore experiment with relatively small subsidies – e.g. 3 to 7% of the investment – to gain some understanding of the market.

Second, there is an ongoing need to encourage private investors to supply more advice to firms they support. Continued presence by BDC in the form of passive investment with leveraged returns for its partners is one solution. The social benefits of mitigating this market failure are difficult to assess, so BDC should proceed cautiously. A prudent starting point would be to set a cap that raises the expected value of private sector returns by 1-3 % points. The BDC adopted a new strategic direction in 2011 (Ibid 2011). A key element of this strategy is to use its influence to improve the quality of fund managers and to increase the size of venture capital funds in Canada. These are sensible objectives that would be best achieved through indirect rather than direct investment by BDC. For example, BDC can select a small number of the most talented managers as partners and encourage them to increase the size of funds they manage. In the longer-term, BDC Venture Capital should invest only with private sector partners. Its goal should be to increase the supply of seed capital and to encourage later-stage venture capitalists to supply more advice to their clients.

#### *Support for R&D*

The two largest programs supporting R&D by SMEs are the enhanced SR&ED investment tax credit and the Industrial Research Assistance Program (IRAP). The enhanced SR&ED credit provides a 35% refundable tax credit on up to \$3 million of R&D undertaken by SMEs. R&D performed by other firms is eligible for a 15% non-refundable credit. In 2013, the enhanced credit cost approximately \$1.5 billion, although the additional cost of the higher credit for qualifying SMEs was about \$825 million.

IRAP offers financial assistance and free business and technical advice to SMEs. Program funding in 2013-14 was \$168 million. On average in 2009 IRAP assistance, including advice, accounted for 24% of project costs. IRAP provides financial assistance to firms through contribution agreements. The monitoring and reporting requirements of this type of funding are much more burdensome than for grants and tax credits.

A benefit-cost analysis of the enhanced SR&ED tax credit and IRAP indicates that in both cases the net social benefit is negative (Lester 2012). High compliance costs, and in the case of IRAP, high administration costs, are a factor in this outcome, but the key consideration is excessive subsidization. A firm claiming the federal and provincial SR&ED tax credits receives, on average, a 43% subsidy. Almost all firms obtaining support from IRAP also benefit from federal and provincial tax credits, which means they are likely to have more than half of their project costs paid by the government. In contrast, the average subsidy rate for a large firm benefiting from federal and provincial tax credits is about 20%.

Taken at face value, the benefit-cost analysis suggests that the federal enhanced SR&ED tax credit should be eliminated. However, the benefit-cost framework does not adequately capture the large, long-lasting impacts on living standards of some innovations. Another consideration is that subsidizing R&D performed by SMEs compensates for other barriers experienced by innovative startups that cannot be corrected. A more prudent policy approach than eliminating the enhanced credit would be to set it at the same rate as for large firms. This would reduce the combined federal-provincial credit rate to about 25%. And it would save the federal government about \$800 million a year.

The benefit-cost analysis of IRAP, although based on the 2009 version of the program, highlights the need to reduce administration costs of the program. The contrast with the

enhanced SR&ED tax credit, which costs about 2½ % of program expenses to administer, is striking. Part of the explanation for the difference is economies of scale -- the SR&ED tax credit is received by almost ten times as many firms – but substantial savings would be realized by applying the same risk management practices used to monitor tax credits. This would involve establishing client characteristics that trigger in-depth reviews and randomly selecting clients for detailed assessment.

If the enhanced credit rate were reduced to 15%, a restructured IRAP could offer subsidies of around 25% without causing the overall subsidy to exceed half of the value of the project and without causing a substantial imbalance between social benefits and costs. However, if the SR&ED incentive remains at current levels, the maximum subsidy rate would have to be reduced to about 15% to keep the overall subsidy rate under 50% of project costs.

#### *Tax Measures Supporting Entrepreneurship*

The federal government has implemented a number of tax measures available to all SMEs but which are particularly beneficial to high-impact entrepreneurs because their income is more variable and has a substantial capital gain component. These measures comprise the lifetime capital gains exemption (LCGE), allowable business investment losses (ABILs), rollovers of investments in small business shares and the employee stock option deduction.

Up to \$800,000 in capital gains on the sale of qualifying shares in Canadian-controlled private corporations (CCPCs) is exempt from taxation over the taxpayer's lifetime. There is no explicit size limit on the exemption but most CCPCs have well under \$10 million in assets.

There is a solid case for exempting capital gains earned on the sale of assets used to generate active business income. An increase in the flow of net income generated by business assets will increase the market price of the business by an amount equal to the present value of the rise in

the income stream. If the assets are sold, the income stream will be taxed twice: once as a capital gain and a second time when it is distributed as dividends. On the other hand, exempting capital gains would result in unintended revenue losses as taxpayers characterize other sources of income as capital gains.<sup>8</sup> However, by restricting the exemption to SME shares, the LCGE appears to be a reasonable compromise between efficiency and protecting the tax base, so no changes are recommended.

While allowing capital losses to be deducted only from capital gains is justifiable as a measure to protect the tax base, the asymmetric treatment may be particularly burdensome for owners of young firms, who may be more likely to have capital losses without offsetting capital gains. The deduction for allowable investment business losses (ABIL) permits losses incurred on shares or debt issued by a small business to be deducted from ordinary income. This selective measure can be justified as an offset to the other barriers faced by innovative startups that cannot be addressed directly by policy.

A more general solution to the problem of asymmetric treatment of capital gains and losses should be considered. Allowing all capital losses to be deducted from ordinary income after they have been applied to realized and accrued capital gains (in order limit the benefit of a tax deferral) would raise efficiency. To the extent that losses cannot be fully deducted from current income, carry-backs and “indexing” capital losses would improve efficiency. There would be an offsetting loss through higher compliance and administration costs – determining the value of unrealized capital gains could be relatively expensive. The net effect is unknown, but with the advances in computerized systems a net positive impact is possible.

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<sup>8</sup> The preceding points were made by Mintz and Richardson (1995), although Mintz and Chen (2011) recommend replacing the LCGE with a reduction in the capital gains tax on shares issued by a CCPC when it goes public.

Tax on the capital gain realized from the disposition of small business common shares can be deferred provided that the proceeds are reinvested in another small business. This roll-over provision extends the deferral of capital gains, thereby reducing the effective tax rate. Given that exemption of capital gains on small business shares is sound policy, deferral of capital gains is an appropriate second-best policy for investors that have used up their LCGE.

Stock options confer a benefit equal to the difference between the cost to the employee and the fair market value of the stock at the time the option was granted. The employee stock option deduction allows half of this benefit to be excluded from taxable income. The additional benefit for employees of CCPCs is deferral of tax on the benefit until the stocks are sold. The cost of the stock option is not a deductible expense for firms, so there is a net subsidy only for firms subject to the lower small business corporate income tax rate and for unprofitable firms.

As recommended by Mintz and Venkatachalam (2015), full taxation of employee stock option benefits combined with deductibility of the cost by corporations would improve tax neutrality with respect to forms of employee compensation. Maintaining the current system for young CCPCs – under 5 to 7 years old, for example – would preserve a small benefit for high-

<b>Table 3: Summary of Key Policy Recommendations</b>
<i>Financing programs</i>
Eliminate the small business deduction
<u>Business Development Bank</u>
Transform the BDC's Financing Program into a loan guarantee program and consolidate it with the Small Business Financing Program
Seed capital: subsidize supply through leveraged returns for private investors
Venture Capital: Eliminate direct investment; subsidize provision of advice via leveraged returns.
<i>Support for R&amp;D and innovation</i>
Reduce the enhanced SR&ED tax credit rate from 35 to 15%
Limit stacking of federal and provincial subsidies to 50% of project costs
Apply SR&ED risk-management approach to IRAP
<i>General tax policy initiatives to support entrepreneurship</i>
Allow deduction from ordinary income of capital losses net of realized and accrued gains
Allow non-capital losses to be carried back indefinitely and "index" their value when carried forward

impact entrepreneurs. This departure from neutrality could also be justified as an offset to other barriers faced by innovative startups that cannot be addressed directly.

## CONCLUSIONS

The key policy recommendations made in this chapter are summarized in Table 3. Small business has a well-deserved reputation as the engine of job growth and a key contributor to innovation in Canada. The federal government has responded by implementing a generous set of policies intended to promote growth and innovation by SMEs. Unfortunately, a large fraction of this spending is wasted.

- The most expensive program, the small business deduction, improves access to financing for all small businesses but on balance harms economic performance by encouraging small-scale, less-efficient production.
- BDC's Financing Program also helps small firms access financing, but the benefits could be achieved at a dramatically lower cost by switching to a loan guarantee program from a direct lending program.
- Excessive subsidization of R&D performed by small business is a major concern. It makes us poorer, not richer.

Overall, a better approach would be to focus policies on ensuring that innovative startups do not face any unwarranted barriers to entry and growth. The intermediate result would be fiscal savings, higher-quality entrepreneurship and a more innovative economy. The ultimate impact would be a more prosperous Canada.



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## Chapter 4

ARE SUNNIER DAYS AHEAD? LIBERAL PLANS FOR  
THE CANADIANS WITH DISABILITIES ACT

Michael J. Prince and Pamela Moss

We know that there are still far too many persons with disabilities who face social and economic barriers to realizing their potential and being fully active participants in society. Too often, persons with disabilities are confronted with stigma, discrimination and, ultimately, denied the most basic human rights. We will work to ensure the full diversity of Canadians is reflected in their government and in its decisions ... We have a duty to help eliminate the systemic barriers that persist in our society, and we will work with the provinces, territories and others to make sure that all Canadians have equality of opportunity.

Justin Trudeau, Prime Minister of Canada, 2015 (Prime Minister of Canada 2015e)

Around the cabinet table, some of the most compelling conversations we had [were] around the disability community and the concerns around protecting vulnerable Canadians. Because, yes, defending people's choices and rights is part of being a Liberal – but protecting the vulnerable is, too.

Justin Trudeau, Prime Minister of Canada, 2016 (Wells 2016), remarks on the medical aid-in-dying legislation

## INTRODUCTION

Under the Trudeau Liberal government two primary features of the trajectory for disability policy are an identity-based rights approach to dismantling systemic barriers of discrimination and the protection of vulnerable Canadians through legislation. Indeed, the principles of inclusion and diversity resonate throughout the actions of the Liberals thus far in their nascent administration. After Prime Minister Justin Trudeau announced his cabinet in November, 2015, discussion of the traditional historical divisions in Canada between Francophone and Anglophone communities and between different regions of the country was not centre stage as it has been in the past. Rather, commentaries mostly focused on what the people in the cabinet

actually looked like. Trudeau made history by putting himself in charge of Intergovernmental Affairs and Youth. Of the remaining 30 posts, two-thirds were from minoritized groups.

While much was made over the declaration of gender parity, there were also other historically significant milestones for which Prime Minister Trudeau received kudos. For the first time in Canada's history, nearly a quarter of the ministers were not white, two Indigenous people were given prominent portfolios in the government, and four Sikh Canadians were named as members in the cabinet. Also equally historical, but not with such popularized accolades, was the appointment of two ministers with visible disabilities to the cabinet: Carla Qualtrough as Minister of Sport and Persons with Disabilities and Kent Hehr as Minister of Veterans Affairs and Associate Minister of National Defence.<sup>1</sup>

What the cabinet looks like is important because the embodiment of the ideals of inclusion and diversity creates expectations about who gets to make decisions and how they get made. Arranging the heads of official positions based on identity is novel in Canadian national politics. While it may appear, at least initially, that appointing a cabinet that would both symbolically and in practice mirror the diversity of Canadians, it may be more difficult to reflect this diversity in making decisions, especially when it comes to dealing with disability issues and including persons with disabilities. These acts promise to deliver government services at the most through identity-based groups and at the least via a sensitivity to identity as an organizing element of Canada's constituencies. For disability policy, Trudeau's establishment of a Minister of Sport and Persons with Disabilities, with the foremost policy responsibility of establishing a Canadians with Disabilities Act, suggest that there will be new ways of doing things in the administration of disability issues. The appointment and commitment not only raise expectations for a diverse community that has rarely been part of a national agenda, but also signal an

innovative measure to tackle *systemic* barriers and advance the full inclusion of persons with disabilities.

Innovation comes with caution, and difficulties are already cropping up. Outside the mention of persons with disabilities in the ministerial title and the mandate to create a Canadians with Disabilities Act, there is little else to indicate how to accomplish these goals. Identity as a politics around which to organize political decision-making is fraught with problems. Whose identity matters most? How can a policy capture the complexity of disability when individuals and groups of individuals have difficulties in understanding themselves as members of groups? How might the administration of programs defined by an idealized definition of disability be implemented without compromising the singular reality of living with a disability or disabling condition? Already, persons with disabilities have been aligned with sport, especially the Rio 2016 Summer Olympic and Paralympic Games, with a Minister who herself was a Paralympian. Does this arrangement indicate that physical disabilities will dominate discussion of the preparation of the Act? Will persons with disabilities recognize themselves as part of this identity-based constituency?

The extent to which these problems emerge will depend primarily on what plans Trudeau's Liberal Government put into practice that would reflect their own commitment to inclusion and diversity. Given their hopeful propositions thus far in light of both how government works and how disability politics play out in the community, we are left wondering if there will be sunnier days for persons with disabilities in Canada. What measures can be taken to dismantle systemic barriers facing persons with disabilities in Canada when identity is the fulcrum around which change is organized? Which Canadians will be included in the Act? How is disability going to be defined in the Act? What processes will be put into place to solicit input

from a wide range of persons with different types of disabilities? How will the government make the most of the existing knowledge located in the numerous and varied disability organizations? In the rest of this chapter, we address these questions. First, we describe the portfolio within which persons with disabilities are positioned. We next discuss two sets of challenges the Minister of State faces: structural tensions within and between ministerial portfolios across the government and the potential for democratic spaces for engagement with persons with disabilities in Canada. We follow with observations as to what a Canadians with Disabilities Act might look like. We close with conclusions regarding the challenges facing the Minister responsible for persons with disabilities in the Cabinet.

#### MINISTERIAL PORTFOLIO: MANDATE, PRIORITIES AND THE 2016 BUDGET

Including persons with disabilities as part of a ministerial designation, Minister Carla Qualtrough is making history. It is the first time at the national level that this constituency of Canadians has been expressly named in the duties and functions of a member of Cabinet and the Queen's Privy Council for Canada. Persons with disabilities finally join other social groups officially named in formal federal cabinet positions and portfolios over the last 40 years, such as multicultural communities, seniors, women, children, and youth, in addition to groups traditionally represented by federal cabinet portfolios, namely, indigenous peoples, immigrants, and veterans. As well, in this 42<sup>nd</sup> Parliament, there is the House of Commons Standing Committee on Human Resources, Skills and Social Development and the Status of Persons with Disabilities.

As Minister of Sport and Persons with Disabilities, Carla Qualtrough holds a relatively unique position as far as Canadian government ministries are structured. She is

tasked with the responsibility for both a long-standing portfolio of amateur sport which has been part of federal ministries since 1961 and a new portfolio that has yet to be integrated into the daily workings of government. Her reporting lines are mixed. In her role as Minister of Sport, Qualtrough supports the work of the Minister of Canadian Heritage, Mélanie Joly. In her role as Minister of Persons with Disabilities she supports the work of the Minister of Families, Children and Social Development, Jean-Yves Duclos, who is responsible for the department of Employment and Social Development Canada. The Minister of Employment, Workforce Development and Labour, MaryAnn Mihychuk, also supports the work of the Minister of Families, Children and Social Development. This mélange of dual and tri-reporting lines of various junior ministers to more senior ones means that junior ministers will be competing for attention with other heritage and social development Ministers. One potential effect is a tempering of zeal to keep disability policy at the forefront of social change within the Liberal government.

This multi-support tapestry characterizes much of the seemingly innovative features of Trudeau's identity-based cabinet. The ministerial mandate letters<sup>2</sup> reveal a multilayered system of ministerial activity, a system that defines two types of Ministers of State: one that presides over a Ministry and another that is assigned to assist existing Ministers in carrying out their statutory duties (Chenier 1985). Although all Ministers of State are individual in key respects around charge for specific activities, such as responsibility for particular constituencies of Canadian citizens, there is still a hierarchy in reporting. Mandate letters reveal that Ministers of Employment, Workforce Development and Labour, of International Development and La Francophonie, of International Trade, of Small Business and Tourism, of Science, and of Women – all of whom are women – report to other Ministers: Ministers of Canadian Heritage, of Family,

Children and Social Development, of Foreign Affairs, and of Innovation, Science and Economic Development (Prime Minister of Canada 2015a). Unique to the Minister of Sport and Persons with Disabilities is that her responsibilities are split between two other Ministers. Although numerous references punctuate ministerial mandate letters for various Ministers to work with other Ministers in order to achieve goals set out in the individual mandate letters, the hierarchical relationships with Sport and Persons with Disabilities carry an additional patina of horizontal relationships across Ministers who report to the Prime Minister. In many ways, the two constituencies do not overlap: the vast majority of persons with disabilities do not identify as athletes. A message being sent with this combination, even if inadvertently, is that disability is something to be overcome, much like Paralympians who are an elite sub-group of persons with disabilities.

The primary goal of the Minister of Sport and Persons with Disabilities, according to her mandate letter from the Prime Minister, is twofold: “to promote healthier Canadians through sport and recreation, and to ensure greater accessibility and opportunities for Canadians with disabilities” (Prime Minister of Canada 2015d). To these ends, as a Minister of State, Qualtrough is to assist more senior Ministers on *two* clearly circumscribed matters of federal public policy and administration pertaining to *two* discrete clientele constituencies for *two* separate government departments. Although not the political head of any government department, something that requires parliamentary sanction, Qualtrough is the political head of these specified constituencies and, on those matters, she is, based on her mandate letter from the Prime Minister, the recognized liaison between the public service and Parliament.

Substantively, at least in the initial stages of the government’s plans, Minister Qualtrough’s top priorities are to:



- Lead an engagement process with provinces, territories, municipalities, and stakeholders that will lead to the passage of a Canadians with Disabilities Act.
- Work with the Minister of Infrastructure and Communities to deliver on our commitment to support the construction of recreational infrastructure that allows more children access to sport and recreation.
- Work with the Minister of Health and the Public Health Agency of Canada to support a national strategy to raise awareness for parents, coaches, and athletes on concussion treatment.
- Work with the Minister of Canadian Heritage to include sport and recreation in championing government-wide efforts to promote the celebration of Canada 150, with a particular emphasis on celebrating the achievements of athletes and persons with disabilities.
- Lead preparations for the 2016 Rio Olympics and Paralympics and future international sporting events.
- Create greater links between our elite athletes and young Canadians to promote health and achievement among youth (Prime Minister of Canada 2015d).

Minister Qualtrough will be judged – and made accountable – in terms of her demonstrated efforts and concrete achievements as the champion of these core values and policy priorities that entail vertical and horizontal dimensions of her mandate. Celebrating the achievements of athletes and persons with disabilities for Canada 150 and leading preparations for the 2016 Rio Olympics and Paralympics, for example, are vertical priorities that serve both constituencies, especially those few that are members of both. Leading an extensive public engagement process that leads to passage of a Canadians with Disabilities Act is a priority that, in order to effectively ensure greater accessibility and genuine opportunities for persons with disabilities, must extend horizontally across the federal government and Parliament, the federal public service and broader federal public sector.

Supporting this horizontal dimension of her mandate, the Minister is assisted by the Office for Disability Issues (ODI). Established in 2001, the mandate of ODI is to support the lead minister for disability issues in the federal government and work with all sectors of Canadian society to ensure the equitable access and full participation of persons with disabilities

in all activities within federal jurisdiction (Office for Disability Issues 2002). The principal function of the ODI is to share information and support networking with other federal government departments as well as with non-governmental organizations. The ODI has modest program responsibilities, including the administration of the Enabling Accessibility Fund, which supports capital costs related to improving physical accessibility for persons with disabilities in Canadian communities and workplaces, and the Social Development Partnership Program, which provides funding for non-profit organizations to advance the social participation and community development needs of persons with disabilities.

What does the Trudeau government's 2016 budget tell us about Liberal plans for the disabled? While the budget has been called a "social-policy-is-back budget" (Battle, Torjman and Mendelson 2016), people with disabilities are not a notable theme in it (Government of Canada 2016). No substantial new investments in programs and services for people with disabilities were announced and relatively few elements of the government's disability agenda were signalled. There were some modest investments: \$2 million over the next two fiscal years in support of consultations with provinces and other stakeholders on introducing a federal disabilities statute; \$4 million over the next two fiscal years to enhance the Enabling Accessibility Fund to improve the physical accessibility and safety of community facilities for people with disabilities; and, in the renewed Youth Employment Strategy, a mention of disabled youth in regards to the Skills Link program.<sup>3</sup> Tellingly, while there are enhanced investments in training for the Canada Job Fund Agreements and for the Labour Market Development Agreements (\$175 million in additional funds for 2016-17), no new finances were allocated to the Labour Market Agreements for Persons with Disabilities in the 2016 federal budget. Given explicit statements by Prime Minister Trudeau acknowledging the economic barriers many

persons with disabilities still face and his government's commitment to introduce a Canadians with Disabilities Act during this mandate, subsequent federal budgets will very likely include more significant investments and program initiatives.

#### CHALLENGES FACING THE MINISTER OF SPORT AND PERSONS WITH DISABILITIES

Given the composition of the Sport and Persons with Disabilities portfolio, with its dual policy fields, constituencies, and ministerial supporting structure, Minister Qualtrough faces two distinctive challenges: those that are structural in nature and those that deal with inclusion and diversity. Structural tensions exist because of the federal condition of the Canadian state.<sup>4</sup> Jurisdiction for delivering the recreation and sport programs that can actually bring the stated objectives to fruition lies with the provinces. As well, because persons with disabilities occupy multiple constituencies, such as children, indigenous people, people of colour, religious minorities, immigrants, women, and youth, there is the added inter-ministerial tension of having to work across several departments beyond Canadian Heritage and Employment and Social Development. Diversity and inclusion as policy principles for persons with disabilities, much like other minoritized groups, require thoughtful strategies and procedures to assemble equitable means and bring about full participation. Diversity among persons with disabilities, unlike other minoritized groups, is based on a classification of bodily status ascribed by a professional class of experts. Innovative policies flexible and sensitive enough to the wide range in type of disability, including for example physical, mental, invisible, and episodic disabilities, could facilitate inclusion.

### *Structural Tensions*

Both symbolic and substantive elements of the vertical and horizontal dimensions epitomizing the portfolio of the Minister of Sport and Persons with Disabilities frame how to recognize and talk about the structural tensions. The central symbolic element, noted already, is the explicit recognition of persons with disabilities in the federal cabinet with their own designated representative. In addition to being a high-profile symbolic response to the concerns of a client group, Chenier (1985) indicates a minister of state can serve other functions: a training ground for new cabinet ministers; a means for exercising political control over a segment of the public service; and a role for coordinating policies and programs within a department or across a number of government departments and agencies.

Establishing a ministerial position for persons with disabilities creates a new institutional bridge directly between outside groups and the executive of government, between the claims-making of societal interests and the decision-making of cabinet, and between the identification of policy objectives and the constituency the policy is directed at. The minister also symbolically embodies a link of political responsibility to the national electorate as well as an organized space of political opportunity for democratic engagement by movement activists and community groups. For individuals and families among those most discriminated against and disadvantaged in Canadian social and economic life, this is a significant political measure (Prince 2009; 2016).<sup>5</sup>

Substantively, there are three sites of structural tension: intra-ministerial, inter-ministerial, and federal/provincial. The Minister is responsible for two discrete, but occasionally overlapping, constituencies. Among national, provincial and local organizations in the disability community, expectations of the Trudeau government are high. A Minister of

Persons with Disabilities, who herself is disabled and an ex-Paralympian, represents core public values and aspirations of the disability community: values of accessibility and opportunity, equality and inclusion, rights and responsibilities, human dignity and respect, social participation, and economic self-sufficiency. Yet placing the responsibility of persons with disabilities alongside sport repeats a fundamental binary that disability activists have been trying to dismantle for generations: the normal functioning body acts as the model against which to gauge an abnormal dysfunctioning one.<sup>6</sup>

Contrasting the two may signal the orientation of what the Liberal Government sees as disability: either physical in nature or lack of health with recreational programs as a fundamental strategy for inclusion. Given that biomedicine organizes knowledge around what constitutes disability, especially with regard to adjudication of eligibility for benefits claims, there seems to be a potential problem when trying to move forward with decisions about persons with disabilities. The only mention of links to Health Canada in the mandate letter is for concussion awareness programs for children, coaches, and parents.

Depending on how well the Liberal vision of collaborating Ministers actually works out, in this case in the general social policy field, Qualtrough's success in delivering on her horizontal mandate items is uncertain. She will need to liaise across several departments, offices, and ministries not necessarily included in the mandate letter. Though not unique to a Minister responsible for specific constituencies in a federal cabinet, her positioning as a junior Minister matters because her efforts to liaise as the representative of either sport or persons with disabilities cross so many boundaries without the authority of being a senior Minister of State. How well will the Minister of Health and Health Canada accept or integrate substantively different definitions of disability than those based solely on biomedicine? Will people with

debilitating and disabling chronic illness be considered a person with a disability in the new Act? What components will Employment and Social Development, at the direction of Minister Duclos, integrate into a poverty reduction strategy that will address the varied needs of persons with disabilities? On what matters will the Minister of Immigration, Refugees and Citizenship consult Qualtrough about accepting persons with disabilities as potential new citizens and not excluding anyone because of a disability or disabling chronic illness?

Minister Qualtrough is tasked with manoeuvring between and among various Ministers and departments to achieve her mandate. For example, an implicit yet undoubtedly important part of Qualtrough's mandate on sport and her future actions around sport, relates to the prime minister's pledge to implement all the calls to action by the Truth and Reconciliation Commission. Calls to action deal with the history and legacy of residential schools and advancing the process of Canadian reconciliation. Of the Commission's ninety-four calls to action, five expressly deal with sports and reconciliation, addressing, among other things, the federal government's *Physical Activity and Sport Act*, community sports programs, an elite athlete development program for Indigenous athletes, sports halls of fame, and programs for coaches, trainers, and sport officials culturally relevant for Indigenous peoples.

The Commission touches on disability issues in just two specific ways: in terms of the justice system, on people with Fetal Alcohol Spectrum Disorder; and, in terms of health, on measuring indicators of chronic diseases, mental health, and illness and injury incidence (Truth and Reconciliation Commission of Canada 2015). Qualtrough's ability to work with the Minister of Indigenous and Northern Affairs, Carolyn Bennett, matters in her ability to achieve the goals of her mandate.

Living in a federated political system, Canadians are simultaneously a citizen of their province and of the country (and, for Indigenous peoples, of their nation and territory). In matters of human affairs and social development, provincial government activities are extensive and substantial. Provincial states are crucial to determining the quality of social citizenship – that is, equality of opportunity, personal well-being, and community cohesion – in the country. In their provincial community, Canadians have certain rights or entitlements, duties and responsibilities, political socialization and identifications, and potentially numerous forms of interpersonal attachments and memberships. At the same time, the fiscal side of Canadian federalism remains central to social policy in the provinces and in supporting basic rights and equality of opportunity. Issues about disability as well as persons with disabilities themselves cross federal and provincial boundaries. The spirit of that which Minister Qualtrough may be able to accomplish federally may be taken up unevenly across provinces.

#### *Acting Within Democratic Spaces for Engagement*

Cabinet portfolios and specific cabinet appointments can themselves influence public perceptions and beliefs, which in turn affect the expectations and actions of community groups. Minister for Democratic Institutions, Maryam Monsef, is responsible for ensuring that Trudeau's Liberal government delivers on its promises for transparency and accountability (Prime Minister of Canada 2015b). She will work "closely with colleagues" as Ministers and generate "constructive dialogue" across constituencies in civil society "including business, organized labour, the broader public sector, and the not-for-profit and charitable sectors" (Ibid). For persons with disabilities and disability movement organizations, democracy is closely linked with equity in that policy and regulatory interventions need to take into account

the long history of discrimination and marginalization both of individuals and as a community. It is also linked directly with a politics of inclusion and recognition of diversity.

Terms are significant in the way that democracy operates in the Canadian federal government. In opening up constructive dialogue, Minister Qualtrough will need to be specific as to who are persons with disabilities under consideration for purposes of any new federal legislation of the potential scope of a national act. Delineating a constituency for persons with disabilities is not an easy task. Disability policy in Canada is a rather incoherent field of services and programs; a fragmented field evident in the various definitions of disablement in effect and it is an uncoordinated field with a complicated array of organizations and programs. Compared to other policy domains – education, health care, or criminal justice as cases in point – disability has a lower profile in Canadian politics and policy discourse. The wide variation among groups means that the language used to describe disability is often specific to a group of disabilities (e.g. invisible disabilities, impairments) or a specific type of disability (e.g. spinal cord injury, mental illness). Breaks in solidarity within the disability movement – locally, provincially, and nationally – commonly arise out of how group members make connections among terms used to describe disabilities.

Many individuals do not identify as a person with a disability and instead claim either a temporary disabling condition or just sick. The move to include chronic illness, contested illness, and mental illness under an umbrella term that would define disability as a temporary or permanent disruption of a bodily system creates a new category of *episodic* disability (Brown et al. 2012; Moss and Teghtsoonian 2008; Prince 2008). There is also the question of what to do about aging among persons with disabilities and whether to include the frail elderly among those with disabilities is a point of debate (Aronson 2000; Guay et al. 2014). Although it may seem



rather fussy to figure out who is disabled and who is not, as policy analysts and advocates know, terms are incredibly important in messaging the public and the government as to what is important within the movement.

The capacity of disability organizations to engage with the federal government is circumscribed by the spaces available to make known their individual and collective interests, concerns, and suggestions and the terms they use to convey them. There are four spaces within which disability groups organize in order to have a say in national policy, all of which have both symbolic and real effects on everyday life: (1) the disability movement; (2) the general public and media; (3) government and parliamentary processes and structures; and (4) the judiciary (courts and tribunals). Although not exhaustive of the types of spaces in which disability groups conduct their work, these spaces cover a range of activities that permit engagement with the federal state. These spaces have both discursive and material aspects in that documents set up the conditions within which the group can engage (e.g. legislation, vision statements, group bylaws) alongside the specific places where the engagement happens (e.g. courtrooms, news media, community halls). Disability groups are active in (1) setting policy agendas and advancing claims to political parties (especially during an election campaign) and to the state (various public authorities to ensure political parties live up to their election promises); (2) raising awareness and generating knowledge about disability, about the organization of public spaces, processes, and policies in relation to discrimination and marginalization of persons with disability, and about what issues disability groups and persons with disabilities think are significant; (3) participating in public consultations, including the Canadians with Disabilities Act; and (4) seeking equality rights through the legal system with litigation.

Devising a method to include the entire menu of salient issues sets up the consultation as fragile from the beginning which can potentially undermine the process itself because the priorities of individual disability groups do not always coincide with either individual or collective interests. There are groups involved in setting agendas for the national disability movement that then become strategic stakeholders in debates around disability and resource allocation and program funding, as for example, the Canadian Association for Community Living, the Council of Canadians with Disabilities, and DisAbled Women's Network. Groups engage in generating knowledge about disability through awareness campaigns including organizing events on particular days designated for disability or illness, such as 3 December as International Day of Persons with Disabilities and 11 May as International Chronic Fatigue Syndrome/Myalgic Encephalomyelitis and Fibromyalgia Awareness Day. Fundraising for charity and social networking for individual support for persons with disabilities, their family members, and their caregivers are singularly focused on one particular task. Groups have also advocated for social and physical inclusion through accessibility that includes measures for dismantling systemic barriers particularly around hiring practices in the workplace and poverty reduction strategies (Prince and Peters 2015).

Bodies themselves too need to be taken into consideration in setting up a democratic space for constructive dialogue. When taking into consideration the embodied dimensions of disability, commonplace activities for consultation, such as local and cross-provincial travel, face-to-face communication, and scheduling of public meetings, can be challenging for disability activists, especially in the absence of supports and accommodations. Mobility limitations and fatigue, for example, circumscribe the how and the where disability activists can engage in public processes. Even though there is funding for care attendants to fly with persons with

disabilities who have demonstrated a need for constant care, not all persons with disabilities qualify. As well, those people with chronic, contested, and mental illness and those who are deaf and/or blind may tire easily when engaged in sustained interaction.<sup>7</sup> Alternate communication methods, such as signing and Braille, need to be made available in all venues. In Canada, there is also a need for more than one sign language, such as Langue des signes du Québec, or LSQ, for French and American Sign Language, or ASL, for English. Physical impairment and support service needs vary widely. Early, late, and long meetings comprising engagement processes are not perhaps the best option. Thus a longer than usual lead time for planning participation may be particularly important in creating a democratic space for persons with disabilities.

Competing knowledge systems inform definitions of disability, such as law, biomedicine, and science. In the federal government, it is legal, biomedical and scientific knowledge that set up the parameters for determining those who are disabled. Yet reflected in the mandate letter for Minister Qualtrough is a human rights approach to understanding disability. The Charter, in particular, bestows a highly significant constitutional status on persons with disabilities, encouraging disability groups to express their interests in the language of equality rights and to seek clarification of these rights and others through tribunals and the courts. By virtue of direct identification in the Charter, disability and persons with disabilities have constitutional status. Section 15 offers an officially authorized space for disability groups to legally defend and advance their material, procedural, and cultural concerns. To define and enforce these fundamental rights and freedoms, such as mobility and equality, litigation has become an important strategy of individuals with disabilities and organizations representing their interests. This has raised the profile of the Canadian judiciary in the disability field and the wider social policy domain. Restoration of the Court Challenges Program with the Liberal government's first

budget, with \$12 million new dollars over five years, covers these costly proceedings brought forward by groups contesting rights violations and infringements (Government of Canada 2016, 182).

In everyday life, however, barriers when framed in rights of equality are mostly insurmountable. Disability advocates, families and community groups have learned that judicial victories are not necessarily make a case of winner-take-all. A rights-based approach to seeking equality through litigation can be lengthy, financially expensive, and emotionally stressful for individuals involved. It also risks fragmenting wider campaigns for obtaining services or supports for all groups. In addition to court rulings against disability claims, even victories can result in further delays due to appeals, discretion of public agencies in interpreting decisions, and then the frustratingly gradual, partial implementation of changes. Thus, the overarching structure of the legal system can only bring formal equality to some while continually reinforcing other barriers of access for many others.

A rights-approach to understanding disability, already established through the Charter and clearly reflected in public announcements and the wording of the mandate letter, is not the only approach that could achieve a barrier-free society for persons with disabilities. Given that biomedicine and science provide the base upon which human rights rest, there is a need to incorporate information about how these knowledges reinforce the marginalization of persons with disabilities into policy measures and legislation. Even though, “because of its complexity, there is no single, harmonized ‘operational’ definition of disability across federal programs,” definitions take concrete form through the adjudication process of applications for eligibility of benefits (Human Resources and Skills Development Canada 2013, 2).

This type of exclusionary barrier reproduces the very barriers that uphold the marginalized status of persons with disabilities. Including insights from the experience of living with a disability can be important in informing issues that greatly affect persons with disabilities and their families. Concern over a bias toward physical disabilities has been part of a discussion for some time, particularly with the prominence of celebrity activists with spinal cord injuries (Edwards 2015; Riddle 2013; Siebers 2013). Concerns about physician-assisted suicide have been voiced by several, though not all, disability groups across Canada arguing, among other points, that ideas about quality of life, death with dignity, and choice not override the experience of being alive for persons with severe disabilities. The effects of structural positioning of disability issues within the federal government mean there is no obvious space for input into the issues that persons with disabilities have a major stake.

#### DRAFTING THE ACT: A HORIZONTAL PROJECT

The crucial piece of Minister Qualtrough's mandate for persons with disabilities is the drafting and passage of the *Canadians with Disabilities Act*. Formal authority for this particular horizontal policy development – a governance space that fosters policy and program coherence as well as social inclusion and equality for people of all disabilities – derives from several sources: the UN Convention for the Rights of Persons with Disabilities, the Charter of Rights and Freedoms, the *Canadian Human Rights Act*, *Employment Equity Act*, *National Transportation Act*, various other federal statutes and programs, and Treasury Board Secretariat policies. Crosscutting aims and activities include removing discriminatory practices, providing accommodation, and ensuring equal and respectful treatment of persons with disabilities (Human Resources and Skills Development Canada 2013).

To advance real change in the supports, services and opportunities for persons with disabilities, developing a Canadians with Disabilities Act is both a challenge and opportunity for Minister Qualtrough and the ODI, as well as for Parliament and the disability community. This undertaking is the most important policy initiation role of the Minister, involving her in discussions and engagement with federal officials and parliamentarians, provincial and territorial governments and municipalities, most likely indigenous organizations, and other stakeholders that include not-for-profit and charitable sectors, business interests, organized labour, disability associations and self-advocates. A novel ministerial post, in a new government with a mandate to formulate original legislation, encouragingly signifies an inclination to new open ways of making policy. With a willingness to adopt innovative policy strategies, a commitment to revive and introduce fresh financial investments, and an affinity to using state-of-the-art methods of monitoring and evaluating the implementation of policy reforms (in the form of digital technologies, real-time updates sent directly to constituencies through social media, and cross-country public consultation forums via claims of democracy and transparency).

In politically ambitious language characteristic of the Trudeau Liberal government, the mandate letter for the Minister of Families, Children and Social Development describes the purpose of a national disabilities act as “to eliminate systemic barriers and deliver equality of opportunity to all Canadians living with disabilities” (Prime Minister of Canada 2015c). Unquestionably, this kind of statement, as per the earlier discussion of ministers of state, “serves as a signal to the affected constituency that their concerns will now receive more attention, both quantitatively and qualitatively” (Chenier 1985, 405). The Trudeau Liberal government’s expressed commitment to disability rights legislation, we would suggest, is

a specific policy response to sustained advocacy efforts by disability organizations and their leaders. Leading up to, and during the 2015 election, active political efforts by disability groups were directed at the major federal parties and their platforms, with the aim of advancing the inclusion and participation of persons with disabilities in Canadian life.

As a horizontal project, a new act for persons with disabilities in Canada – if it is to be more than a framework for future legislation – will need to articulate federal jurisdictional matters of accommodation, communication, safety and security, housing, social participation (cultural, political and recreational), education and training, employment, income security and tax measures, health care, caregiving, national transportation, infrastructure (green, public transit and social), and disability-specific supports and services. This horizontal mandate spans all age groups of persons with disabilities, from preschool children, youth, and young adults, through prime working-age adults, older workers, and seniors. This mandate also extends interdepartmentally across several federal government portfolios and cabinet ministers.

The ODI has been tasked with setting up the consultation processes in preparation for drafting the Act as well as communicating with the public about disability. The name of the Act is in flux for the ODI is framing engagement processes around “Federal Accessibility Legislation”. The consultative mechanisms through which the diverse community of persons with disabilities will participate are somewhat different than conventional processes. First, the ODI has introduced a funding scheme open to disability organizations in partnership with other disability organizations. Grants of \$700,000 per year over two fiscal periods are available, which must include accommodation expenses. A single disability organization is designated as applicant and must have a minimum of four co-applicants for each funding request. Second, the ODI opened an online consultation process scheduled to solicit input between July 2016 and

February 2017. The objective is “to promote equality of opportunity and increase the inclusion and participation of Canadians who have disabilities or functional limitations”. (Employment and Social Development Canada 2016).

This particular organization of consultation already is proving to be problematic for the very reasons we outline here. Imposing collaboration across five or more groups sets up groups to hash out differences prior to presenting a cohesive view, which in many cases will be a generic version of what is already known to exist. Group identity and formal organizing skills will inevitably create holes where policy fields within disability are just emerging and sorely need attention, such as medium-term disability insurance and what counts as financial hardship in accommodation cases. Online consultation encourages smaller groups and individuals to make submissions which presumably will run the gamut of types of disabilities including disabling illness. We anticipate vulnerability to be a key element of debility in these online submissions. Being able to capture the human aspects of vulnerability in the legislation will be a difficult undertaking for how does a piece of parchment grasp an outpouring of the hope, fear, intimacy, worry, and doubt that are part of living with a disability? Given the size of these new tasks, it will be interesting to see how the ODI manages the influx of information, especially with reduced staffing over the past several years across programs delivering benefits to groups of persons with disabilities (Macdonald 2013; see also Galloway 2015)

To be sure, responsibility for drafting the Act is both an opportunity and a challenge. Our vision of the Act is one that does not impose artificial boundaries on unruly bodies that reproduce traditional identities based on similarities. Our vision of the Act is one that is porous and fluid, one that works to include persons with disabilities and disabling conditions in their own context. Specifically, the Act needs to make reference to existing federal



legislation and programs in, for example, transportation and telecommunication, and in programs the Canadian Pension Plan benefits for persons with disabilities. As well, legislation needs to reflect the mandate about removing systemic barriers so as not to erect new barriers or new discriminatory practices, including for example reflections on how physician-assisted suicide is wrapped up in existing systems of knowledge that marginalize and exclude particular groups of vulnerable children and seniors with disabilities. There is a call for a new Health Accord between the provinces, territories, and the federal government. A new Accord will have to be commensurate with what is going to be included in the Act, recognizing that there is a delicate and tenuous relationship between understanding disability as a medical condition and refusing medical bias in defining what disability is.

An Act inclusive of diversity with an eye on full participation as citizens needs to connect with the Liberal's commitment to a federal poverty reduction plan. Of the top priorities for the Minister of Families, Children and Social Development, one is "the development of a Canadian Poverty Reduction Strategy that would set targets to reduce poverty and measure and publicly report on our progress, in collaboration with the Minister of Employment, Workforce Development and Labour. Our strategy will align with and support existing provincial and municipal poverty reduction strategies" (Prime Minister of Canada 2015c). Minister Duclos has extensive experience with poverty reduction strategies and should be aware that persons with disabilities need to be included. While the mandate letter for the Minister of Families, Children and Social Development did not reference the Minister of Sport and Persons with Disabilities in regard to developing a Canadian poverty reduction strategy, it is vital that Minister Qualtrough participate in setting the vision, policy goals and design of such a federal strategy. Experience with the formulation of poverty reduction plans

in some provinces suggests that the rights and needs of persons with disability tend to be overlooked, particularly when plans entail a repackaging of existing services, unless disability organizations are actively engaged in the organizing and policy development processes (Brown 2015; Prince 2015a). A similar risk of marginalization could apply, we believe, at the federal level of public policy and administration.

#### CONCLUSIONS: DISCURSIVE TENSIONS AND STRUCTURAL CAUTIONS

In this chapter, we have conceptualized and problematized how the legislative development process on federal disability policy could unfold organizationally and discursively in the next few years. The Trudeau Liberal government's commitment to create national disabilities legislation raises a number of issues and questions, of which we have discussed only some here. How the structural tensions, processes of inclusion, and the drafting of a Canadians with Disabilities Act play out will be revealed over the term of the government. In preparing to draft the Act, Minister Qualtrough as Minister of Sport and Persons with Disabilities will need to reconcile three sets of structural tensions within three powerful discourses.

One set of structural tensions involves the inherent limitations of the cabinet role of a minister of state for achieving a major policy innovation and the coordination of disability policies across the federal government and wider federal public sector. This issue is a familiar one in contemporary Canadian government and public administration. A second set comprises the policy development processes to be used on this legislative project for consulting and extensively engaging with disability groups and other social organizations and thus, fundamentally, about the nature of participation and democracy exercised. This entails more than deploying consultative and evidence-based mechanisms for policy formation. Differences of

viewpoints, differences in material practices and embodied experiences, all expressed by diverse interests and claims are unavoidable.

The third set includes the scope and potential effect of such legislation. Disability measures comprise an important part of social policy activities by the federal government and even more so by provincial governments and other public authorities within their jurisdictions. This relates directly to the actual correspondence between the *everyday lived experiences* of persons with disabilities and their families, and the *jurisdictional status* of their membership in federal policy and program communities. While there are important issues and needs that must be addressed at the federal level – certainly enough to occupy the full mandate of this Trudeau administration – most systemic challenges, service gaps, and living requirements of persons with disabilities lie within the responsibilities of the provinces. In light of these circumstances of our federal and human condition, intergovernmental relations are crucial to advancing the inclusion and participation of persons with disabilities. This is where the Liberals' plan for a federal poverty reduction strategy assumes significance both in what it could mean for federal programming and for how any federal strategy connects with comparable strategies in the provinces.

These structural tensions must be negotiated within three powerful discourses informing disability issues. The first discourse is definitional within biomedical, scientific, social, and cultural discourses around definitions of disability and determinations of who is a person with a disability. Framing disability in terms of human rights or as a network of systemic barriers conflict head on with the way in which disability is justified and practiced in everyday life in that medical practitioners are the arbiters of ascribing disability as a bodily descriptor. The second discourse is political among the various disability movement

organizations that can be described as a fragmented social movement. Managing the fractious relationships across groups will need a deep understanding of and sensitivity to how to make sense of disability itself. The third discourse is ideological between the values of inclusion and diversity for the Trudeau Liberals and the bureaucratic logic of implementation of disability issues.

The multiple sites where disability has been being negotiated have been located primarily within bureaucratic processes within federal departments. A somewhat dramatic shift in policy will no doubt clash with decades-old practices that have been transformed numerous times with the effect of tightening eligibility and restricting payouts (Stapleton et al. 2015, 175).<sup>8</sup> That Minister Qualtrough has been given a green light to be innovative and initiate a more inclusive way of writing legislation, her ability to deal with these tensions may determine her success. Alongside this flexibility comes great expectations for the Minister to achieve distinction in drafting a Canadians with Disabilities Act. Exclusion of anyone who claims to be a person living with a disability or of any major areas of federal policy will denote failure. Thus, the Act will need to be robust and woven into the existing legislative and programmatic landscape. Effects of the implementation in terms of cost, process, and revision of existing programs have not been costed out and are yet to be determined.

We are still left with the question, will there be sunnier skies for persons with disabilities in Canada? The enthusiastic optimism of Prime Minister Trudeau and his Liberal government is a refreshing respite from the years of austerity talks. Unfortunately, we cannot be as enthusiastic or optimistic that sunny skies are the forecast for persons with disabilities in Canada. Encouraged? Yes. Confident? No. Hopeful? Cautiously so.

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## Endnotes

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<sup>1</sup> Because of the nature of invisible disabilities, and the stigma still attached to disclosure (Prince, 2015b), there is no way of knowing who, if anyone, lives with an invisible disability.

<sup>2</sup> Mandate letters for all Ministers in Prime Minister Trudeau's cabinet are available online (see Prime Minister of Canada 2015a). Letters are located with each Minister's profile.

<sup>3</sup> Arguably, if a much wider view on disability policy is adopted, mention could be made of planned investments in the 2016 federal budget in chronic health and long-term care; support for caregivers; increases to Canadian student loans and grants; an increase in the Child Disability Benefit as part of the new Canada Child Benefit; and the increase to the Guaranteed Income Supplement for low-income single seniors, many of whom have functional limitations in their activities of everyday living. These announcements, however, were identified as initiatives in health care, helping middle class families, post-secondary education, and retirement income security for current seniors. Furthermore, no disability lens analysis was applied to these measures in the budget that could have specified the kind of impacts for particular constituents of persons with disabilities. If a cross-government approach to disability issues is to be achieved, this is the kind of analysis that will be required to support such a horizontal policy approach.

<sup>4</sup> Canada's past, present and foreseeable political future is some variant of federalism and intergovernmental relations. For a classic study, see Smiley (1987).

<sup>5</sup> For disenfranchised persons with disabilities, see Ben-Moshe, Chapman and Carey (eds. 2014).

<sup>6</sup> On the construction of the abnormal, see Foucault (2003). See also, Silva and Howe (2015) and Giulianotti (2015)

<sup>7</sup> Descriptions of groups of communities of persons with disabilities is problematic when it comes to identify and self-disclosure. Words and turns of phrase can include people who do not consider themselves disabled and exclude those who do. Mental illness alienates those with mental health issues just as those with chronic illness may not be endure disabling effects of a disease. When marked with an uppercase 'D', people identify with Deaf culture and lifestyles. Whereas a lowercase 'd', refers to partial or complete loss of hearing among those outside Deaf culture. Our choice in language errs on the side of inclusion.

<sup>8</sup> For example, refusal rates for applications for disability benefits through the Canada Pension Plan is about 50 percent, with heavy reliance on medical practitioners filling out forms, for which applicants pay. The program uses a strict definition of disability, "severe and prolonged is incapable of gainful employment" which means that a person must be 100 percent disabled for 100 percent of jobs available. See Prince (2016) and Stapleton et al. (2015).



## Chapter 5

## A NEW GOVERNMENT AND ITS “NEW INNOVATION AGENDA”

David Castle and Peter W.B. Phillips

## INTRODUCTION

After nine years of Conservative government, the Liberals regained a majority government (184 seats) in October 2015 with an attenuated Conservative opposition (99 seats) in a newly expanded Parliament of 338 seats. The Liberals campaigned on promises that their government would deliver the kind of change Canadians were seeking, mainly ushering out Stephen Harper and his policies and style of government. Yet while the electorate knew well what they would be forfeiting with a change of government, less clear is what change the Liberals intend in both the style and substance of the science, technology and innovation (STI) agenda.

This chapter assesses the Liberal government’s early steps to develop a new agenda for STI by first evaluating the current conditions for STI, some attributes of which result from now two-decade old Liberal programs and policies, and some of which are attributable to the Harper Conservative agenda of the last decade. The question under examination in this chapter is whether there are early signs that the Liberal government’s agenda for STI will be a truly new agenda, whether it ends up being continuous with the past Conservative agenda, and whether new initiatives are a resumption of previous Liberal policies under Chrétien and Martin.

What evidence is there that something new is afoot in Ottawa? An analysis of the cabinet structure and membership initially suggests STI could factor more in policy debates and possibly in policy actions. Renaming Industry Canada as the department of Innovation, Science and Economic Development, promising to reinstate a science advisor, and continuing

the Minister of State for Science suggests renewed emphasis on STI, but also a return to past practices. New ministerial mandate letters, subsequent department restructuring and commitments to support STI provide early indications that these changes could substantively address the long-standing gap between basic science and industrial application, on the one hand, and science's role in providing evidence for decision-making on the other.

Yet while these portents for a new innovation agenda are promising, and are being buoyed by public declarations in support of a new focus on STI, particularly around climate change (e.g. see chapter 6 in this years 2016-2017 *How Ottawa Spends*), other aspects of government initially appear to be stuck in the past. Take for example the re-emergence of old-style industrial policy, which seems out of character with the new rhetoric around STI. Within 30 minutes of the swearing of the new government, the Government of Quebec challenged the new minister of Innovation, Science and Economic Development to match a Quebec \$1 billion US\$ subsidy to Bombardier. How the federal government responds could signal whether we are truly on a new policy track or returning to a focus on large, strategic plays.

## CURRENT CONDITIONS FOR STI

In many ways, the past decade of science and innovation policy has been a disappointment both in terms of overall supports and in terms of program and policy development. While there have been some successes, for the most part Canada has not kept up with other Organization for Economic Cooperation and Development (OECD) countries. Using an internationally recognized benchmark of Gross Expenditure on R&D as a percent of GDP (GERD), as of 2014 Canada had slipped back to about 1.6%, down from over 2% in the early 2000s; this puts Canada's effort at half the average OECD effort (see Table 1). The downward trend is a matter of concern in this chapter, but can be conditioned by three

observations. The first is that GERD is a 50+ year old metric developed by the National Experts on Science and Technology Indicators (NESTI) group for the OECD for the so-called

	<b>Canada</b>	<b>OECD</b>	<b>US</b>
Year	2014	2014	2013
Gross expenditure on R&D (GERD), US\$ Million Current PPP	\$25,813	\$1,178,899	\$436,078
\$ per capita	\$726	\$930	\$1,442
% GDP	1.61	2.37	2.74
% GDP avg 2011-2013	1.79	2.6	2.35
% Financed by			
- Industry	45	61	61
- Government	35	28	28
% performed by			
- Industry	50	71	51
- Higher Education	40	18	40
- Government	9	11	10
FTE Researchers in 2012	161,590	4,411,450	1,265,064
Per thousand total employment	9.06	7.78	8.74
Source: OECD, 2016, <i>Main Science and Technology Indicators 2011-2014</i> , <a href="http://stats.oecd.org/Index.aspx?DataSetCode=MSTI_PUB">http://stats.oecd.org/Index.aspx?DataSetCode=MSTI_PUB</a>			

Frascati Manual. R&D metrics are an indicative, but not unequivocal, measure since every national innovation system parses its economic sectors, sources of funds, and measures of success slightly differently, despite the OECD's best efforts to standardize these measures. For example, Statistics Canada's annual survey methodology and robustness of data collection has changed over the decades.

Irrespective of the slippage that might exist in country comparisons, a second observation is that R&D expenditures, however they are constituted, are both a direct but partial measure of expenditure on science and technology and an indirect measure or proxy for overall support to innovative activity. Third, evidence of changing R&D expenditures does not assume a static economic or political backdrop. In Canada, declining R&D expenditure might reflect weak policy and administrative support for STI, or it might be a

symptom of Dutch disease (reliance on natural resource booms against other sector development). Despite these caveats, the new government faces an uphill climb to make globally competitive Canada's science and innovation performance.

Renewed federal investment in STI after 1999, especially through a number of new research institutions, moved Canada into the top tier of scholarly research in a number of areas, but little of this appeared to influence the shape and scope of the larger economy. The emergence, under the Chrétien Liberals, of the Canadian Foundation of Innovation, Genome Canada, National Centres of Excellence, the Canada Research Chairs programs and then the Conservatives contribution of the Canada Excellence Research Chairs and the Canada First Research Excellence Fund, increased the number of highly qualified people, the number of researchers and our scholarly output (Organization of Economic Cooperation and Development 2012; Council of Canadian Academies 2012).

Supporting the mix of new and old programs gives the appearance that the Conservative government was making progress on their investments but, in reality, following the 2008 financial meltdown the Canadian government pulled back on investments in R&D. By 2014-15, total outlays on S&T totalled \$10.3 billion, down by 14% from a peak of \$12.0 billion in 2010-11. Outlays on R&D dropped to \$6.5 billion, down by 16% from \$7.7 billion while related scientific activities (RSA) dipped to \$3.8 billion from a peak of \$4.4 billion, a reduction of 13%. These developments reflect an attempt to bring budgetary discipline in times of austerity, but the Conservative view that more commercial outputs must arise from STI investments drove other significant changes in Canada's innovation ecosystem.

The Scientific Research and Experimental Development (SR&ED) program, a federal tax incentive program to encourage Canadian businesses to invest in research and development, at its peak in 2010-11 supported more than \$4.5 billion dollars of private R&D, costing the treasury almost \$3.5 billion of foregone revenue. In response to a range of advice

from the Council of Canadian Academies (CCA) and the Jenkins Panel, the Conservative government in the 2012 budget made capital expenditures no longer eligible for SR&ED investment tax credits starting in 2014 and lowered the rate for calculating the prescribed proxy amount from 65% to 60% effective January 1, 2013, with a further reduction to 55% effective January 1, 2014. The net effect is that the implicit tax expenditure (and by inference the subsidy to private R&D) dropped to an estimated \$1.8 billion by 2014-15.

The latest breakdowns of expenditures by the federal government are from 2012-13, when the total outlays for both R&D and RSA almost reached \$11 billion (see Table 2). At that time, about 25% of the total outlays flowed through the three leading granting agencies: Canadian Institutes of Health Research (CIHR), Natural Science and Engineering Research

	<b>2012/2013<sup>P</sup></b>
<b>Total</b>	<b>10,946</b>
Agriculture and Agri-Food Canada	364
Atomic Energy of Canada Limited	430
Canada Foundation for Innovation	559
CIHR	1,010
CIDA	407
Canadian Space Agency	345
Environment Canada	668
Fisheries and Oceans Canada	267
Health Canada	584
Industry Canada	486
National Defense	367
National Research Council Canada	722
Natural Resources Canada	690
NSERC	1063
SSHRC	692
Statistics Canada	654
Other	1,639
Statistics Canada 2012. <i>Federal Scientific Activities 2012/13.</i>	

Council (NSERC) and the Social Science and Humanities Research Council (SSHRC). The rest, about half R&D funding and half Related Science Activities (RSA), flowed through an array of departments and agencies with either regulatory or sector development responsibilities (or in some cases, both functions).

As the new Liberal government considers how to develop and implement its proposed “New Innovation Agenda”, it will have to face some uncomfortable realities. In the first instance, business expenditure on R&D (BERD) is significantly lower than in most other OECD countries and to a great extent it is more vulnerable to disruption, due to the large concentration of R&D in a few firms in a few sectors in Canada. Complicating this is the reality that most government funding flows through the higher education sector—only a small amount is directly engaged with firm-level R&D. In 2013, for example, federal spending on R&D (i.e. excluding related science activities), was almost all directed to intramural research and activities in the higher education sector. Only about 7% of federal R&D funds flowed to firms to do firm-based R&D. When one maps and considers the flows between funders and performers of R&D, it is clear that federal influence on business is quite limited and other difficult to measure influences, such as the impact of private non-profit entities, might have more impact because foundation funding is often direct and leverages others investments .

One of the challenges the federal government faces is that the different regions have different capacities to engage in research (see Table 3). In *per capita* terms, economy-wide R&D is highest in Ontario and Quebec; the West invests about 20% less than the national average per capita and the Atlantic region only reaches 55% of the national effort. Provincial governments, for the most part, are not major players. The governments of Alberta, Saskatchewan and Quebec are, relatively speaking, the most engaged in R&D, but, except in Alberta, their share of the total activity in their provinces is modest. Industry is relatively

more engaged in Alberta and Quebec, where half or more of the funds come from business. Universities provide about one in five dollars of funding nationally; in the Atlantic Provinces, with weak provincial and business capacity, universities are the anchor, funding about 42% of total R&D. Not-for-profit and foreign investment in R&D is relatively modest. One result of this uneven distribution of capacity is that the federal government plays a different role (and has different potential) in each region and province. The federal government on average directly funds about 19% of total R&D, ranging from as low as 12% in Alberta to as high as 37% in PEI.

	<b>Canada</b>	<b>Atlantic</b>	<b>Quebec</b>	<b>Ontario</b>	<b>West</b>
All sectors (\$ millions)	31,972	1,196	8,391	14,081	8135
Per Capita	909	504	1,029	1,039	742
% Canada	100%	4%	26%	44%	25%
Sources of funds (%)					
Federal government	19	30	15	22	17
Provincial governments	6	3	8	4	7
Business enterprise	46	21	49	45	48
Higher education	20	42	18	18	20
Private non-profit orgs	4	3	3	4	4
Foreign	6	1	6	8	4
Source: Statistics Canada, 2014.					

The implications of this for the Liberal's new Innovation Agenda are relatively well researched. The Conservatives undertook a number of expert consultations, including the Science and Technology Innovation Council (STIC) annual reviews from 2007 to 2014, the Competition Policy Review Panel (the Williams committee) in 2008 and the Expert Review Panel on Research and Development (the Jenkins panel) in 2010, and made a number of special references to the CCA to review the state of science and technology in Canada. All of

the reports came to similar conclusions. First, the efforts to refinance basic research were generally judged to be positive. The CCA report on the State of Science and Technology in Canada in 2012 summed up what is now the predominant view, powerfully reinforced by the 2015 Science, Technology and Innovation Council (2015) report : Canadian scholarly output "is healthy and growing" but with limited economic impact. In 2005-10, Canada produced more than 4% of the world's scientific papers and almost 5% of the most cited papers (with less than 0.5% of the world's population), and output rose by almost 60% over the previous five years, the only G7 country posting an above average increase. The challenge comes in translating those outputs into social and economic use. While Canada has a high number of well-cited patents, overall Canada files a relatively low number of patents, which is judged to be one of the causes of a net \$5 billion outflow of royalties in 2010 (Ibid).

Moreover, in spite of what is arguably the best after-tax package of incentives for R&D, Canadian business both perennially underinvests in research and is slow and hesitant in commercializing new technologies (Science, Technology and Innovation Council 2011, 2015). The end result is disappointing productivity levels and growth. The OECD (2012) reported that multifactor productivity (MFP) in Canada actually fell between 2002 and 2011. Performance relative to the US has been particularly poor: average hourly labour productivity in Canada declined by more than 11% relative to the US after 1998 and MFP in constant purchasing power parity terms trended flat to down in Canada but jumped about 35% since the late 1980s in the US.

#### THE NEW LIBERAL INNOVATION AGENDA

The new Liberal government has committed to a "New Innovation Agenda" but its scale and scope remains unclear. The 78 day election campaign, the longest and most expensive in modern times, offered ample time to have a rich debate about science, technology and



innovation policy in Canada, but for the most part the opportunity was forgone by all three of the leading parties. A few small and targeted promises were made, especially from the victorious Liberal Party, yet none of the debates and very little of the campaigning or reporting focused explicitly on science, technology or innovation. At the five debates—three unfocused sparring, one thematically organized on security, and the other on the economy—little of the formal questioning pertained, even obliquely, to science, technology and innovation topics, and none of the take-away moments from the debates reflected any of the parties' views on science, technology or innovation.

The party platforms in some ways are more helpful in understanding the focus and emphasis the new government (and the opposition) might put on science, technology and innovation policy (Liberal Party of Canada 2015; Stoney and Doern 2015). During the campaign, and core to the electoral debate, was a focus on the macroeconomic choices Canada can make. The biggest divergence in the parties was on fiscal priorities, with the Conservatives and NDP proposing to maintain balanced budgets (with the Tories offering legislation to entrench that promise), while the Liberals broke ranks, took leadership risks, and proposed to accelerate spending on infrastructure (up by 1% of GDP to \$10B annually) and to run a significant short term deficit to accommodate that growth. As part of that commitment, the Liberals proposed to allocate up to \$6 billion of the infrastructure budget over the next four years (or about 15%) for green infrastructure, for a range of potentially-innovative water and wastewater facilities, climate resilient infrastructure, clean energy, clean-up of contaminated sites to facilitate new construction and protection against changing weather patterns (Liberal Party of Canada, 2015, 11-15).

Taxes also generated significant debate. While the Conservatives proposed to hold steady on tax policy, the NDP and Liberals both proposed rebalancing the tax load by shifting taxes more to higher income Canadians and reducing the burden on the middle class. While

the NDP favoured doing a similar rebalancing on the corporate side, the Liberals were more restrained, simply offering modest cuts to the small business tax rate (from 11% to 9%), offset by measures to prevent professionals from using this system to avoid income tax.

Science, technology and innovation platform promises varied between parties. The Conservatives mostly proposed to continue their support for the existing set of programs in areas such as the Tri-Councils, CFI and NRC, while the NDP proposed a number of industrial-style innovation programs for major sectors, such as autos. The Liberals offered their more aggressive “new Innovation Agenda” (Liberal Party of Canada 2015, 15). In total, they proposed in their first term to invest more than \$1.6 billion into new or expanded spending on science, technology and innovation, including: \$200 million per year over the next three years to support technology incubators, research facilities and financing for small businesses; \$200 million each year to support innovation and the use of clean technologies in natural resource sectors, including forestry, fisheries, mining, energy, and agriculture; \$100 million per year for the next three years for IRAP; \$100M over four years for agricultural research; and \$80 million over four years for the Canadian Food Inspection Agency (15-16). Other parts of the innovation package included: setting aside a portion of federal procurement budgets for “promising new Canadian technologies and businesses, consistent with international trade agreements”; establishing Canada Research Chairs in sustainable technology; reinstating the Labour-Sponsored Venture Capital Corporation tax credit; and a general promise to base decisions related to GM crop production on sound science and transparency.

While the actual scale, scope and components of the new agenda is fairly straightforward and unsurprising, it is clear the new administration will present a different style of governing. The unveiling and swearing in of the new cabinet was heralded as the “return to government by cabinet”, with individual ministers presented as sources of power

and influence in their own right. Prime Minister Justin Trudeau made significant effort to signal that he was ending the tight central control of the PM and PMO exercised by Stephen Harper. This was reflected in the following days as more than a dozen individual ministers engaged in scrums with media to lay out early priorities for the government (some of which directly focused on science, technology and innovation policy and governance).

The cabinet structure and membership suggests science and innovation could factor more in policy debates and possibly in policy actions. While the superstructure of departments and agencies has not changed in any obvious way, the new government has signalled a change in emphasis, renaming Industry Canada as the department of Innovation, Science and Economic Development (ISED), while the Minister of State for Science continues, creating the sense of a double focus on science in the new government, even though there were also two ministers in earlier periods. Early opinion suggested the new Science minister, Dr. Kirsty Duncan, a medical geographer who served on the International Panel for Climate Change, would focus on “renewal” of the federal science system, which many assert declined under the Harper government.

Some speculate that the science portfolio may rebalance investment in research, focusing more on “basic” research driven by curiosity, in contrast with applied science, research and development. Meanwhile Environment Canada was renamed Environment and Climate Change, and Public Safety was enjoined with Emergency Preparedness. The orientation of the new Innovation Agenda, plus the addition of two ministers interested in infectious diseases (Kirsty Duncan and Jane Philpott, a medical doctor named as Minister of Health), may signal a subtle shift of the innovation agenda toward a focus more on sustainability and “pan-Canadian collaboration” (on health and other public priorities) and away from broader firm-based industrial innovation (Liberal Party of Canada 2015, 9).

One innovation of this government, in vogue in some of the provinces, is the development and public release by Prime Minister Trudeau of ministerial mandate letters that assign lead responsibility and set deadlines for many of the election platform commitments. Before delving into the mandates, a few points warrant consideration. First, the mandate letters for the science and innovation ministers are far less specific than the election promises; most talk about process rather than specific measures. Furthermore, none of the money ideas in the Liberal election platform are in the mandate letters. Second, the mandate letters suggest they will use science and evidence to make government policy and regulatory decisions, but then promise incubators, new programs in value added agriculture and various other initiatives that are hotly contested and not obviously supported by evidence.

Third, and related, none of the mandate letters offered any sense that the federal government would look to other countries for ideas and innovations; rather, the letters focused on engaging domestic agencies, local authorities, and the various provincial and territorial powers in the innovation agenda. Fourth, the mandate letters suggest there will be a lot of interconnectedness of the Ministers in completing their mandates. This could, if well-orchestrated, lead to new synergies in government, or it could lead to chaotic or stalled delivery. At the moment, however, horizontal collaboration between federal departments is a gesture at a preferred governing style, without corresponding mechanisms developed to overcome the counterbalancing structure of government: vertically integrated and budgeted ministries, accountabilities (including for specific legislative acts), and cultures of work. For example, the Department of Fisheries, Oceans and Coast Guard is expected to work with the Ministries of Environment and Climate Change, Transport and Natural Resources to deliver on resource protection, climate change initiatives and marine transportation, as well as coordinate its activities with a wide variety of other federal and provincial partners and through the regional DFO offices. For ministries and departments more accustomed to

attending to their internal hierarchies, the mandate letters signal significant change and uncharted waters for some.

The mandate letters also indicate the new style of government and how it would like to engage with both its scientists and the scientific community. This change, some would say reversal of the last decade of government, is likely to achieve more immediate results than horizontal governance between departments. The mandate letter for the Minister of Science explicitly directs her to “create a Chief Science Officer mandated to ensure that government science is fully available to the public, that scientists are able to speak freely about their work, and that scientific analyses are considered when the government makes decisions.” (Trudeau 2015a). One early target of this new approach is to contribute to the review and reform of Canada’s environmental assessment processes “to ensure that environmental assessment decisions are based on science, facts, and evidence.” (Ibid).

Meanwhile, Nadeem Bains, Minister of Innovation, Economic Development and Science, was directed to “develop an Innovation Agenda that includes: expanding effective support for incubators, accelerators, the emerging national network for business innovation and cluster support, and the Industrial Research Assistance Program.” (Trudeau 2015b). These investments will target “key growth sectors”. Secondly, the minister was directed to both review “our programs that support innovation, scientific research and entrepreneurship” to increase alignment between federal efforts and provincial and industrial capacity and to the Minister of Finance to “ensure tax measures are efficient and encourage innovation, trade and the growth of Canadian businesses; and working with Regional Development Agencies to make strategic investments that build on competitive regional advantages.” (Ibid). While this sounds promising, most new governments in the past 50 years in Canada have promised to right the errors of their predecessors and make federal programming more effective; success is not guaranteed.

A few selected new investments were signalled in the mandate letters. Minister Bains was directed to examine programming to make new investments in clean and sustainable technology and processes for fisheries, in the auto sector to assist them to compete in the context of greater market liberalization reflected in the Trans-Pacific Partnership and to support the Minister of Science to establish new Canada Research Chairs in sustainable technologies (Ibid). Meanwhile, the Minister of Agriculture and Agri-food (Trudeau 2015c) was directed to develop a new Agri-Food Value Added Investment Fund to attract investment and create good jobs in food processing, once again in response to liberalizing markets. The new fund (value not disclosed yet) is designed to provide technical and marketing assistance to help food processors develop new value-added products that reflect changing tastes and market opportunities.

#### THE POTENTIAL FOR THE NEW INNOVATION AGENDA TO TRANSFORM CANADA

Doern, Castle and Phillips (2016) recently assessed the Canadian science and innovation policy landscape over the past 50 years in the context of eight science, technology and innovation policy domains: macro S&T policy; the S&T departments and agencies; the granting councils; intellectual property (IP); industry; agriculture and biosciences; genomics; and the internet, communications and social media (broadly ICT). Here we use this structure to offer some observations about the prospects for the Liberal's new Innovation Agenda to transform Canada's economic and social prospects.

The *macro S&T and innovation policy domain* can be parsed into two halves: the role of science in policy; and the policy for science. The new government has locked onto and engaged initially with the role of science in the policy system and in government. The return to dual science ministries, the reappointment of a chief science advisor, the “un-muzzling” of

public scientists and the commitment to science-based decision making represent modest but widely welcomed changes in the style of governing. Science-based and evidence-informed policy and regulation as a concept and as discourse arose mainly in the late 1980s and early 1990s in the wake of free trade agreements that normalized and codified policy and regulatory norms and practices. These agreements sought to ensure that any future efforts to create policy or regulations would not become illegitimate barriers to trade; rather, by making them science-based, evidence-based or based on “sound science”, it was hoped they would erect dams against the feared flood of policy and regulatory protectionism triggered by reduced capacity to use tariffs to control trade.

Even early on, however, notions of “science” in policy and regulation always involved not just the natural sciences but also the social and managerial sciences, including and drawing on related kinds of evidence such as that supplied in regulatory benefit-cost analysis, red-tape analysis, and concepts of justice that are at the heart of administrative law. In the era of distributed governance, policy and regulatory systems have widened to include guidelines and codes underpinned by the system-wide assessment and governance system. All of this has led to greater interest in and consideration of related science activities (RSA), which now account for about one third of all federal outlays on science, technology and innovation. RSA is embodied in the brains, experience, and social networks of front-line S&T personnel and has been extended from safety as a predominant goal to more complex notions of risk-benefit and smart regulation. Policy and regulation over the past decade has aspired to not just involve pre-market assessment of products, processes and developments but also extended to longer-term, post-market, life-cycle monitoring. The Liberal government has signalled in the context of the environmental impact assessments of a number of significant oil and gas pipelines that it will open the processes to address a broader range of considerations. Making these changes actually work will require seriously addressing what

“science-based” decision making means and how economic, social and cultural considerations will be assessed and accommodated alongside objective, statistically-validated scientific evidence.

Policy for science, technology and innovation is sometimes harder to pin down, as it includes all the system-defining S&T policy statements, rules, and budgetary decisions regarding science, technology and innovation. Change in this area is often much more complicated, and unlikely to deliver significant impacts in the short to medium term. Sustaining enthusiasm to make fundamental and long-term choices is much more difficult, if for no other reason than that any resulting benefits are likely to be delayed significantly—recent evidence suggests the average lag between an inventive or innovative discovery and the peak of any resulting benefits is in the range of 17-20 years (Alston et al 2010). This long lag helps explain why science and innovation policy tends to slip from the agenda.

Equally challenging is that most of the structures underlying effective government policy are shared by many policy areas, making them harder to change simply to address innovation priorities. Many of the underlying concepts currently driving S&T policy emerged under the Chrétien Liberals and are widely accepted and supported within and beyond government, so there are limited degrees of freedom for change. And, while governments can put a focus on policy for science and innovation, the structures of government have significant potential to limit the impact of those changes. Budgets, budget processes, and annual policy and investment decisions, regulatory policy, processes, and related science activities, and the ongoing public service renewal process may have a greater long-term impact than any specific innovation measure. Many of these efforts will undoubtedly change and contribute to, but likely will not be driven by, the emerging innovation agenda.

The *S&T departments and agencies*, viewed by many as the core of federal S&T capacity, are due for some renewal. R&D and RSA in executive government and the special



agencies are complicated. As mentioned earlier, the federal government is relatively more important than any single other actor in the Canadian S&T field, with only a few provincial programmes and a handful of large firms reaching the scale of the federal effort. This puts the federal government in the sights of almost all those organizations hoping to gain through renewed S&T policy in Canada. After 1988, more than five years of program cuts, combined with some recent managerial decisions, worked to limit the federal government's capacity to either act definitively in areas of federal responsibility or to partner with the provinces, universities or industry to advance priorities of mutual interest. Health Canada, Environment Canada, Fisheries and Oceans, Agriculture and Agri-Food Canada and the Canadian Food Inspection Agencies generally stepped back from leadership in recent years. The Liberals have promised, either in the election platform or in the ministerial mandate letters, more funding and a more aggressive agenda for all of them.

These promises have created expectations that new investments will bolster or build new federal capacity or influence in these areas. One outstanding issue that has not been addressed yet is that many of these agencies have been forced by budgetary cuts or encouraged by management fads to adopt matrix management, which for the most part has undercut the ability of these organizations to partner effectively with industry or government. AAFC and the National Research Council are particular targets for renewal. The Research Branch of AAFC moved to a matrix management system as early as 2003, and since then it has had great difficulty exercising leadership in this federal constitutional field. The NRC was slower to adapt to new management styles, but in 2011 the Council eliminated all of the Institutes, replacing them with Research Platforms, in an attempt to emulate the German Fraunhofer system. While a few of the platforms have had some success in leveraging private interest, much of the NRC research effort has not been able to align to this model and has languished. These two agencies, in particular, have been major contributors to past innovative

capacity in Canada—renewal of their mission, mandate and capacity would go a long way to advancing federal influence on the national economy.

Meanwhile, the *granting agencies and universities* are chomping at the bit for change, but there is no sense of if or how the government can do much that will change the system. The three independent federal granting councils – the Natural Sciences and Engineering Research Council of Canada (NSERC), the Canadian Institutes of Health Research (CIHR), and the Social Sciences and Humanities Research Council of Canada (SSHRC)—provide funds to approximately 140 eligible institutions, primarily university academics and researchers in hospitals. Over the past decade the principles of merit review (in addition to peer review), leveraging, and large scale networking, all introduced under the Chrétien Liberals, have become embodied in the Councils and generally accepted by the broader research community.

The announcement in the mandate letters of new Canada Research Chairs for sustainable development and the post-election confirmation of a second round of the Canada First Excellence Research Fund are fair indications that the granting agencies may need to live with this new reality for some time to come. The federal budget in March 2016 sustained and in some ways enhanced the CFI, Genome Canada and the NCE programs (all built on merit review, leveraging and large scale networked science), signalling that change will not come as quickly as some might like.

The *industrial structure* to a great extent defines what can be done with innovation policy and instruments. Just because a government wants to go in a different direction doesn't mean that it will be able to engage differently with industry. At the front of the queue are a number of large Canadian-based multinational firms seeking support to compete internationally. Recent research (Milke 2013) shows that Canadian R&D subsidies and tax credits are highly concentrated in a few sectors and most of the funds are directed to a small

subset of firms. The top 25 companies using these programmes, representing about half of all the funds invested, were regular dippers, drawing an average of 25 times from the support programs (in one case up to 83 times). The main beneficiary was the aerospace sector: in all, 13 aerospace firms (out of the top 25 recipient firms) collected about 38% percent of the funds. Pratt & Whitney Canada Corp. received the most money over the decades, almost \$3.3 billion via 75 disbursements; Bombardier and de Havilland were the second- and third-largest recipients, each receiving disbursements worth \$1.1 billion over the years (Milke 2013). This goes a long way to explaining how Canada remains a global competitor in the aerospace sector but also highlights the challenge of the current types of programming. How the federal government responds to Bombardier could signal whether we are truly on a new policy track or returning to a focus on large, strategic plays as has been historical practice. Bombardier, one of the perennial national champions of high tech Canada, has suffered a series of delays recently in its new CSeries of narrow-body, twin-engine, medium-range jet airlines, causing serious erosion in its market value. As a result, the Government of Quebec on 29 October 2015 committed US\$1 billion of new support for the company and, within 30 minutes of the swearing-in of the new government, challenged the new minister of Innovation, Science and Economic Development to match the Quebec contribution. No decisions were made before early autumn.

Effective *intellectual property* systems are widely viewed as necessary for an innovative, knowledge-based economy. Federal laws and policies underpin this domain, but to a great extent policy regarding intellectual property is not controlled by the federal government alone. The current system of formal and informal IPRs has been constructed through a mix of national litigation, international negotiation and firm-level strategies. Over time, the IPR system has expanded the scope of private property, especially in the life-sciences and ICT areas, by lengthening the term of protection, by extending the scope of

claims and by processes that facilitate multijurisdictional management of property claims. In some ways, Canada has been pulled into a fast-flowing international stream of intellectual property. Instead of pushing for this, both federal and provincial governments in Canada have sought to preserve some balance between public and private interests and to optimize the socio-economic benefits of innovation. Technology issues re-emerged in the early days of the new government in response to the Trans-Pacific Partnership (TPP) trade pact. Key technology businessmen, such as Jim Balsillie, immediately voiced serious concerns about possible adverse impacts for Canada in some of its provisions related to increased intellectual property rules and standards insisted on by the US and achieved in the TPP.

Balsillie, former co-chief executive officer of BlackBerry, has helped form and now chairs a new lobby group to represent the ICT sector and entrepreneurs in Ottawa — the Canadian Council of Innovators (CCI). It draws its membership from technology firms that are: Canadian-based; rapidly growing through sales, not acquisitions; generating at least US\$15 million a year in revenue; and scaling up for global expansion. For the most part it represents a set of ICT firms centred in the Waterloo-Toronto-Ottawa corridor. The CCI came out early in 2016 against Canada ratifying the proposed Trans Pacific Partnership trade deal involving 12 countries, including the U.S., Canada, Japan and Australia. Balsillie argued that the TPP proposal to extend copyright protection to life plus 70 years would hurt Canadian innovators, especially in the ICT domain. While IPRs are important, it is not entirely clear whether the system can accommodate all of the specific interests of every sector.

The *agriculture, food, biosciences, and biotechnology* domain is set in the fundamental reality that agriculture and food occupy a unique place in the hearts and minds of people. As the first and until relatively recently the most important social and economic activity in Canada, agriculture and food has historically held an important place in the

science, technology, and innovation space for Canada. While agriculture is to a great extent now off the national innovation agenda, it offers some real opportunities. Food security is on the global political agenda and Canada is likely to be a major contributor. The agricultural sector is Canada's annual mega project, directly investing and generating more than \$100 billion of economic activity annually and sustaining 2.1 million jobs, about 12% of total employment. Canada is the fourth largest food exporter in the world.

The sector involves a complex and integrated supply chain which includes input and service suppliers, primary producers, food and beverage processors, food retailers and wholesalers, and foodservice providers. The activities along this supply chain generate significant economic benefits both in rural areas and in many of Canada's large urban centres. More than half of the value added in the sector is located in urban settings. The sector has grown faster than the overall economy since 2007 and there is significant room to invest more in research and development to improve productivity and quality, to expand value-added processing in Canada and to expand Canada's global market share. With *Growing Forward II*, the federal-provincial strategy for agriculture, past its midway point, discussions are already underway about what might follow. Successive versions of the agricultural policy framework have become more focused on science and innovation in agriculture—the next is likely to sustain that trend.

*Genomics and life sciences technologies* are related to, but go well beyond, the issues and concepts found in the agricultural, food, biosciences, and biotechnology domain. In addition to many applications in the agri-food sector, there are a range of opportunities in the fisheries, forest, natural resource and health sectors. The mandate letters suggest that fisheries are already on the national agenda. The lead in this area is Genome Canada, which made a major (>\$500 million) pitch for multi-year funding to sustain and expand its programming

and research in all these areas. The budget allocated \$237.5 million as a first tranche of this funding, signalling this government intends to sustain efforts in this area.

The emergence of the *internet of things* may define this government, and perhaps resolve the long-standing debate about how we see ourselves. While Canada has spawned a range of ICT success stories—particularly Nortel and Blackberry—none of them has secured a long-term future in global marketplaces. The ICT industry looks askance at government, alleging that its policies and programs remain in the “staples trap”, sapping the strength of innovative, technology-based firms and industries. One cannot deny that natural resources in Canada are still powerful parts of Canada's political economy. Some assert that they in fact constitute a form of embedded staples trap that harms the continuous development of both economic and social innovation.

Others see a more nuanced story here. Canada's natural resource development historically was anchored in S&T work and applications. Canada was one of the first and most globalized economies. But once the first phase of development was over, nation builders downplayed our historical resource-based roots and projected an image of Canada as a vibrant manufacturing and services-producing economy. In spite of all the efforts to develop capacity that is disconnected from our resource roots, it remains true that much of Canada's industry that is thriving is also inextricably connected to the primary sector – providing inputs and processing outputs, financing and developing new production technology, and moving and marketing those products. There have been efforts to show the interconnectivity and mutual prosperity from further engagement between some of the resource sectors – e.g., agriculture in the 1980s and oil and gas in the 2000s – and manufacturing and services sectors, but that message is still often subsumed into a partially but importantly misleading two-category discourse of old economy/new economy.

For the most part, policy analysts and policy advocates actually ignore the resource sectors as a source of international industrial competitiveness and instead assert Canada needs to move towards a knowledge-based economy focused on inventing, producing and selling disembodied technologies and information-rich products and services. The internet of things may make this dispute moot as the introgression of digital sensing and artificial intelligence into the goods-producing industries may make them as knowledge and information intensive as the services sectors. If the new Innovation Agenda comes to grips with this challenge, the historical tension between natural resource development and advanced industrial development may vanish.

## CONCLUSIONS

We can now bring the three main lines of analysis in this chapter together, which are: 1) the current conditions for STI; 2) the new Liberal innovation agenda; and 3) the potential for the new innovation agenda to transform Canada. With respect to the current conditions for STI, the past decade's steady decline to 1.6% of GDP expenditure for STI in Canada is worrying – Canada should aim for at least 2.5%. Given the importance of growing the knowledge economy, remaining internationally competitive, and acknowledging higher rates of inflation in R&D than other parts of the economy, chronic underfunding of research has become a localized structural deficit. The Conservative government intended to stimulate private sector R&D to shore up innovative capacity and boost MFP. But they did so during a tumultuous economic period, were receiving recommendations from various panels that sent the government swimming upstream against Canada's low R&D business culture, and it was never clear from a government policy standpoint that improved commercialization and R&D performance would feed back into federal supports to STI and generate a flywheel effect.

The Liberals have inherited this situation, but their “innovation agenda” speaks primarily to their intended style of government. They propose to change how government works by focusing on government-by-cabinet, a commitment to science-based evidence, horizontal collaboration between ministries and departments, and public mandates for ministers that make clear the intention of government to put resources into policy areas that are either focused directly on or underpin the core STI effort. At the time of writing Trudeau’s government passed its ten month window, having solidified an early reputation for adopting an open and internationalized style of government. But where STI policy is concerned, ministries have only recently settled down with key staffing appointments and organizational ramping up. It is too soon to tell whether their style of government will mean the continuation of the current conditions for STI, or a transition to a new policy.

What is at stake in continuation versus transition becomes clearer with our third analytical framework that could tap into the potential for the new innovation agenda that would transform Canada’s STI landscape. Take for example the role of the Chief Science Advisor in the macro S&T and innovation policy domain. Many interpret this as a return to the pre-Harper Conservative approach of a national science advisor, such as when Dr. Arthur Carty gave science advice directly to the Chrétien Liberal PMO. This is positive for many who see it as a form of restoration of the role of science in policy; the Canadian Science Policy Conference (November 2015) dedicated a session to national science advice and showcased the work of New Zealand’s Sir Peter Gluckman, who exemplified the value of this model when it works. The other option is for Trudeau’s government to appoint a science advisor that has an intramural function – *policy for science* – by taking on the role of providing the mechanisms to support and sustain the horizontal governance of STI indicated in the ministerial mandate letters. This approach could be more innovative and consistent with the government’s new collaborative and consultative style.



In our framing of the central issues for setting a new STI agenda for Canada, we singled out the capacity of the S&T departments and agencies; how science and innovation policy meshes with Canada's industrial structure; the efficacy of intellectual property systems; and critical domains such as agriculture, food, biosciences, and biotechnology; genomics and life sciences; and the internet of things. Will real change be possible in these domains? Changes in governments offer a window for policy reform, yet portfolios like science and innovation often find it difficult to take advantage of the opportunity. While governments can and often do quickly put a new face on the role of science in policy, they find it much harder to develop new policies for science and innovation activities. The Harper government was quick to change the role of science in policy, replacing expert advisory groups with STIC, "muzzling scientists" and winding down the office of the Chief Scientist; the Liberal government has similarly acted quickly to reverse many of the Harper choices. In contrast, Harper made only small and iterative changes to the policy for science and innovation, for the most part building upon the structures, principles, discourses and partnerships bequeathed by the outgoing Chrétien /Martin government. Given the challenges facing the new government, now that the first "100 days of decision" and the almost twelve months of gestation are complete, one might expect a similarly modest and incremental set of changes in policies, programs and institutions to emerge. The good news is that the mandate letters signal a plan to keep innovation on the agenda; the reality is that there is little yet to signal any material change in the policy.

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## Chapter 6

## LIBERAL ENERGY AND CLIMATE CHANGE GOVERNANCE: REBALANCING THE ENERGY/ENVIRONMENT DOMAIN POST-HARPER

Glen Toner, David Cherniak and Kevin Force<sup>1</sup>

## INTRODUCTION

The Justin Trudeau Liberal government approach to governance in the energy/environment policy domain can only be understood in the context of the 2006-2015 Stephen Harper Conservative government approach. The Liberal policy platform and governance approach were built “against” the Harper record – with respect to both the *content* of Harper’s oilsands-first focus and indifference to climate change and his confrontational *style* of policy development and implementation. Harper intentionally politicized the energy/environment domain in the interests of wedge politics; a governance strategy designed to divide Canadians into ‘friends’ and ‘enemies’ simultaneously undermining opponent’s legitimacy and enraging the Conservative base who can then be tapped for donations.

This governance strategy targeted the minimum number of Conservative voters required to win a majority, but was a “high risk roll of the dice” with “no guarantee the wedge will break their way” (Toner and McKee 2014). It did not. Indeed, Harper’s gamble failed miserably and in the October 2015 election Conservative victories retreated primarily to the party base in the West and in rural Canada. Conversely, Trudeau crafted a campaign targeting the 65% of voters spurned by Harper and won with support in the cities and in all regions.

The Liberals’ goal in this field is to shift the energy/environment domain away from Harper’s energy development fixation toward a position nearer the centre of the spectrum where

energy and environmental considerations will *both* be taken into consideration in policy decisions. This chapter is a sequel to the Toner and McKee (2014) analysis of Harper's governance approach in the energy/environmental policy domain and explores whether the "window of opportunity" provided by the confluence of strengthened scientific evidence on climate change in the 2014 IPCC Report and domestic electoral politics in 2015 will allow the Trudeau Government to deploy a contrasting governance approach that will shift the balance of power within the domain. To achieve this shift Trudeau will have to undue much of what Harper did – in terms of both substance and process. The Conservative parliamentary opposition and their remaining provincial allies can be expected to oppose this transition.

This chapter has three parts. Part one contrasts Harper's and Trudeau's vastly different political ideas and governance approaches to energy/environment policy. While the Liberal's engagement approach is what the provinces have been seeking, the history of federal-provincial politics teaches us that collaboration will be challenging (Simmons 2016). Still, engagement and collaboration is an inherently more mature approach to governance than the confrontational "friends and enemies" approach of the Conservative decade. VanNijnatten argues that Canadian governments have historically exhibited ambivalence when it comes to attempting to graft more environmentally friendly policy tools onto regimes fundamentally favouring extractive activities and that federal leadership will be required if we are to coordinate our environmental protection and sustainability efforts (VanNijnatten 2016). In their sweeping review of 50 years of environmental policy and governance in Canada, Doern, Auld and Stoney (2015) argue that environmental ideas, policies, and institutions have almost always come out second best when attempting to challenge the entrenched policies, institutions and actors in the energy and resource sectors. They characterize the historical outcome as a condition of "Green-Lite" wherein

environmental progress is relatively modest in the face of constant pushback by developers and their political and bureaucratic allies on the energy side of the domain (Ibid 2015). Given these historic constraints, the critical question for the next four years is whether the Trudeau government, with its strong majority and cross-Canada representation, can sustain a governance approach that will allow it to implement its commitments and disrupt these historical patterns to make environmental policy considerations central to decision making in the environment/energy policy domain, in a manner that can begin to transition Canada to a low carbon future.<sup>2</sup>

Part two assesses the Liberal's dramatically different approach to governance of climate change policy at home and on the international stage. 21<sup>st</sup> century energy policy is intimately intertwined with environmental policy and now substantially driven by greenhouse gas (GHG) related issues. The Liberals assumed power just before the United Nations Framework Convention on Climate Change Conference of the Parties (COP21) convened in Paris in December 2015, thrusting the climate change file into the limelight and testing Liberal campaign commitments immediately. The Liberals identified a broad agenda of programs on climate change including: infrastructure investments to enhance the efficiency of the Canadian economy and strengthen the growth of renewable energy; rebuilding environmental protection and assessment policies ravaged by the Conservatives, while taking science seriously. It is simply too early in the mandate to evaluate the implementation process. Part two focuses therefore on early actions...recognizing that the ghost of the Jean Chrétien government's failure to deliver on an earlier era of climate change commitments will stalk current Liberal efforts. Part three assesses several hydrocarbon energy projects and processes that will test the Liberals' approach to governance in this domain.

## JUXTAPOSING THE HARPER AND TRUDEAU GOVERNMENTS' APPROACHES TO ENERGY/ENVIRONMENT POLICY GOVERNANCE

### *The Tone of Wedge Politics*

The spirit of Harper's wedge politics governance approach can be reduced to "polarize," "patronize," and "demonize" (Toner and McKee 2014). Polarizing the energy-environment file reflected an ideological determination to replace the sustainable development (SD) paradigm associated with the Mulroney Conservatives, the Chrétien /Martin Liberals and the United Nations (Toner, Meadowcroft and Cherniak 2016). To undermine SD the Conservatives adopted the Canadian Association of Petroleum Producers 'responsible resource development' (RRD) framework. RRD rejected the SD goal of integrating environmental, economic, and social factors in decision making and privileged economic considerations and rapid resource development. Patronizing multi-million dollar taxpayer funded advertising campaigns designed to 're-educate' sceptical Canadians about the correctness of RRD attempted to convince Canadians that their only hope for hospitals, schools and other social programs depended on the frenetic extraction and export of oilsands bitumen. On their lands, First Nations stood in the path of many projects and had to be turned, especially in light of court decisions that governments had a constitutional obligation to consult: patronizing quick trip 'lectures' by Conservative Natural Resources Minister Joe Oliver to First Nations leaders just served to enrage First Nations (Fekete 2013).

A leaked memo from Harper's Prime Minister's Office used explicit Nixon-era 'friends and enemies' language to demonize the parliamentary opposition, bureaucracy, media, scientists, and environmentalists as 'enemies' (Ottawa Citizen 2013). Conservative Ministers attacked scientists and environmentalists as 'radicals' and accused them of money laundering. Harper

launched a multi-million dollar Canadian Revenue Agency audit of environmental groups and instructed the RCMP and CSIS to spy on environmental and science groups.<sup>3</sup> Harper's flippant comments about Canada being an 'energy superpower' and that President Obama's approval of the Keystone XL pipeline was a 'no-brainer' were indicators of an ideologically infused naivety that served only to overinflate the value of Canadian currency in international financial markets, annoy the White House, and push swing voters away.<sup>4</sup>

### *The Substance of Wedge Politics*

To institutionalize the wedge politics governance approach Harper used omnibus budget bills in 2013 and 2014 to roll back much of the SD policy and program capacity built by Mulroney and Chrétien. This was done by slashing federal environmental regulations and program spending with respect to: the Fisheries Act, the Species at Risk Act, the Canadian Environmental Assessment Act, the Navigable Water Protection Act, the Kyoto Protocol Implementation Act, the National Energy Board (NEB) Act and the National Round Table on the Environment and Economy Act, among others. Hiding the rollbacks in omnibus bills ensured they did not have to be debated openly in relevant parliamentary committees. All of this, including the streamlined NEB process, was designed to expedite oilsands and mining projects, move bitumen to tidewater, and limit serious climate change commitments. The multimedia Economic Action Plan advertising campaigns in Canada and the advertising campaigns in Washington in support of TransCanada Pipelines' Keystone XL project were very expensive but futile. Little was accomplished except mobilizing those Canadians who cared about the environment and the sustainable development of the economy to coalesce against the Conservatives. Picking fights with the U.S. President and aligning yourself with the opposition Republicans was a destructive way to engage with your largest trading partner but consistent with a wedge politics framework.

### *The Tone of Engagement Politics*

In contrast to the secrecy and centralized control of the Harper government Trudeau promised a governance approach that would engage policy actors in and out of government. Rejecting Harper's 'war on science' Trudeau committed to respect the public service and allow scientists to speak about their work. Rather than deny climate change Trudeau promised to move climate change to the forefront of domestic and international policy by making it a cabinet priority and by reengaging with the international climate change process. The Liberals committed to undo much of the legislative agenda implemented by Harper in order to reinstate SD as a guiding principle, deploy evidence based policies, and to re-engage premiers and mayors as partners. Indeed, financial investments in GHG mitigation strategies in public transit and renewable energy and adaptation strategies in water and sewer and flood management systems were key campaign themes. First Nations' involvement on a range of sustainability issues was emphasized and the campaign spoke in terms of nation-to-nation relations.

### *The Substance of Engagement Politics*

For six years Harper simply refused to meet Canada's premiers as constitutional partners, while Trudeau hosted a first ministers meeting on climate change a month after the election followed by a second meeting in early March 2016. Provincial, city, opposition, business, aboriginal, and environmental group leaders were invited to join the Canadian delegation to COP21. In an historic transparency initiative, Trudeau made the traditionally secret 'ministerial mandate letters' public. These letters instruct ministers to reverse much of the Conservative agenda, to institutionalize campaign commitments to reengage scientists, and recommit to evidence based policy by creating a Department of Innovation, Science and Economic Development Innovation,



*and* a Minister of State for Science. Over a dozen ministers had SD goals documented in their mandate letters requiring them to integrate SD principles into policies and legislation.

The prioritization of climate change is reflected in renaming Environment Canada as Environment and Climate Change Canada, and by creating a cabinet committee integrating Environment, Climate Change and Energy and making it one of the five key commitments identified in the Speech from the Throne. It should no longer be possible for cabinet to discuss energy policy without the air and water quality and climate change impacts being front and centre, a fundamental feature of SD (McCarthy 2015). Paraphrased below are the critical energy/environment policy responsibilities assigned to ministers in the mandate letters:

**Environment and Climate Change:** establish national emissions-reduction targets, ensure provinces and territories have targeted federal funding and the flexibility to design their own carbon pricing policies; review Canada's environmental assessment processes to regain public trust; ensure that decisions are based on science, facts, and evidence.

**Natural Resources:** work with provinces and territories to develop a Canadian Energy Strategy to protect Canada's energy security, encourage energy conservation, and bring cleaner, renewable energy onto a smarter electricity grid; modernize the National Energy Board; work in partnership with the United States and Mexico to develop a North American clean energy and environment agreement.

**Fisheries and Canadian Coast Guard:** review the previous government's changes to the Fisheries and Navigable Waters Protection Acts, restore lost protections, and incorporate modern safeguards.

**Finance:** enhance tax measures to generate more clean technology investments; create a new Low Carbon Economy Trust to help fund projects that materially reduce carbon emissions; fulfill G20 commitment to phase out subsidies for the fossil fuel industry.

**Global Affairs:** develop a North American clean energy and environment agreement; make Canada a leader of international efforts to combat climate change.

**Indigenous and Northern Affairs:** amend environmental assessment legislation to enhance the consultation, engagement and participatory capacity of Indigenous groups in reviewing and monitoring major resource development projects; promote economic development and create jobs for Indigenous Peoples.

**National Revenue:** allow charities to do their work free from political harassment; clarify the rules governing “political activity,” with an understanding that charities make an important contribution to public debate and public policy.

**Infrastructure and Communities:** rebuild Canada for the 21<sup>st</sup> Century with significant new investments in public transit, green infrastructure including investments in local water and wastewater facilities, clean energy, climate resilient infrastructure like flood mitigation systems; establish the Canada Infrastructure Bank to provide low-cost financing for new municipal infrastructure; launch a new Canadian Green Bond to enable additional investments when a lack of capital represents a barrier.

**Innovation, Science and Economic Development:** support investments that will make our resource sectors world leaders in the use and development of clean and sustainable technology and processes, and establish new Canada Research Chairs in sustainable technologies.

**International Trade:** support strategic investments in clean technology to make Canadian firms world leaders in the use and development of sustainable technology and processes that can be exported globally.

**Science:** invest in scientific research, including an appropriate balance between fundamental research to support new discoveries and the commercialization of ideas; create a Chief Science Officer mandated to ensure government science is fully available to the public; scientists can speak freely about their work.

**Transport:** review the previous government’s changes to the *Fisheries Act* and the *Navigable Waters Protection Act*, restore lost protections; formalize a moratorium on crude oil tanker traffic on British Columbia’s North Coast.

Hence, the goal is to adopt an SD orientation, work with provincial/territorial/city governments, reverse the Conservative legacy, and develop a forward looking clean energy and environmental protection governance approach to Canada’s economy.

## ENERGY AND ENVIRONMENT POLICY MERGE IN CLIMATE CHANGE POLICY

The Intergovernmental Panel on Climate Change's Fifth Assessment Report (IPCC) consolidated the scientific certainty of anthropogenic climate change leading countries to embrace the goal of instituting mitigation policies that will cap global temperature rise to 2 degrees above pre-industrial levels (it has just passed 1 degree). 2015 was the warmest year on record and extreme weather events around the world underscored the costs of inaction. In 2015 global investments in renewable energy grew by US\$329 billion outpacing investments in oil, gas, and nuclear showing movement on the mitigation agenda is already underway (Bloomberg 2016).

The Liberals' governance approach to COP21 could not have been more different than Harper's. This process started with a first ministers meeting on November 23rd that included a briefing by climate scientists revealing Canada's rate of warming is about twice the global rate (Fekete 2015a). Trudeau invited premiers to join the Canadian delegation to Paris arguing he did not want to unilaterally impose a target like Chrétien did without buy-in from the provinces or without a joint plan to achieve the target. The Liberals did not create a new GHG target prior to Paris stating that Harper's commitment to reduce emissions by 30 percent from 2005 levels by 2030 should be considered a floor that Canada would exceed once a target had been arrived at after engaging provincial leaders. Even without a new target Canada was asked to take on a leadership role in Paris when Environment and Climate Change Minister Catherine McKenna was chosen as one of 14 ministers tasked with bringing COP21 to a successful conclusion. At the Commonwealth Heads of Government Conference in Malta just before COP21 Trudeau committed to increasing Canada's contribution to the United Nation's Green Climate Fund to help developing countries operationalize both mitigation and adaptation policies to \$2.65 billion over five years (Canada 2015b). In Paris, Canada joined the U.S., China, and 17 other leading

countries in launching Mission Innovation, a commitment to dramatically accelerate public and private sector clean energy innovation. Under this initiative, Canada committed to investing an additional \$100 million each year in clean technology (Canada 2015a). The Mission Innovation project included a significant commitment from over 20 leading global private sector innovators led by Bill Gates and Richard Branson. This partnership between government and industry is dedicated to a “dramatically scaled-up public research pipeline, linked to a different kind of private investor with a long term commitment to new technologies who is willing to put truly patient flexible risk capital to work” (Breakthrough Energy Coalition 2015).

These international initiatives are intended to support various provincial climate change plans. The Liberal government of British Columbia instituted a carbon tax in 2008 which was credited with reducing GHG emissions while the economy grew, while the Quebec Liberal government officially joined California in a cap-and-trade system for carbon emission reductions targeted at major emitters. The Liberal government of Ontario announced in 2016 a climate change program that included joining the California and Quebec cap-and-trade system, enhancing building efficiency codes and retrofits, and expanding the uptake of zero emission and plug-in hybrid electric vehicles. Even the small ‘C’ conservative government of Saskatchewan committed to producing 50% of its electricity from renewables by 2030 and in May 2015, Albertans replaced a 44 year Conservative dynasty with an NDP government that in November announced a new strategy to shed its status as an ‘international pariah’ by phasing out coal-fired electricity by 2030 replacing it by two-thirds renewable energy generated electricity, placing a hard cap on annual GHG emissions from the oilsands, reducing emissions of the potent GHG methane by 45% by 2025, and applying a \$20 a tonne price on carbon emissions in 2017 rising

to \$30 (the current BC price) in 2018. Almost 90% of Canadians will soon live under a carbon price regime led by provincial actions.

The engagement politics governance approach was on display when Trudeau met the premiers in March 2016 to develop an intergovernmental climate change strategy. The Vancouver Declaration on Clean Growth and Climate Change that emerged was built on the 2015 provincial and territorial Canadian Energy Strategy and on the Paris COP21 Agreement. First Ministers stated they would “leverage technology and innovation to seize the opportunity for Canada to contribute global solutions and become a leader in the global clean growth economy” (CICS 2016). This was the first time first ministers had sat down in over a decade to craft a joint approach to climate change and they understood the need to show progress now that collaboration was an option. To address differences first ministers created working groups to identify options for action in four areas: clean technology, innovation and jobs; carbon pricing mechanisms; specific mitigation opportunities; and adaptation and climate resilience. Each working group was instructed to assess impacts on economic and environmental outcomes and to report to the ministerial tables charged with overseeing their work by September 2016. Ministers will review these reports and provide their recommendations to First Ministers by October 2016, and make the working group reports public.

In March Trudeau travelled to Washington to meet President Obama. While trade and security issues were addressed, climate change and low carbon energy systems were a central component of the discussions. In pursuit of commitments made at COP21 both countries committed to build on the Canada - U.S. Air Quality Agreement by reducing methane emissions in the oil and gas sector by 40 - 45% by 2025. They agreed to continue to strengthen fuel efficiency standards for appliances and cars and light trucks and to extend these to on-road heavy

duty vehicles. Accelerated clean energy and technology innovation through Mission Innovation and other R&D programs were to be complimented by increasing integration of renewables to the interconnected grid, bringing more wind, solar, hydro power online. There was also a substantial section on shared Arctic Leadership to conserve Arctic biodiversity through science based decision making that incorporates indigenous traditional knowledge in order to build a sustainable Arctic economy and strong communities. (U.S.- Canada Joint Statement 2016). Trudeau was also feted at a state dinner, the first for a Canadian prime minister in 19 years signifying a substantive change in the way Canada was viewed in Washington. Climate change was also be prominent when Trudeau hosted the North American Leaders Summit in Ottawa in June and when Obama addressed a joint session of Parliament. However, the future of enhanced cooperation for the two national governments depends in large part on the outcome of the 2016 Presidential election (Fife 2016).

The first Liberal budget underscored the fundamental transformation of the substance and style of the governance approach in this policy domain from the Harper to Trudeau eras. It announced over \$7 billion of initiatives to ensure Canada is ‘a champion of clean growth’ and makes ‘a speedy transition to a low-carbon economy.’ Included were \$2.9 billion over the next five years to address climate change, including \$518 million for local governments to upgrade infrastructure; \$2 billion over two years for a low-carbon economy fund, beginning in 2017-18; \$132.5 million over five years to research and develop clean technologies; \$62.5 million over two years to build charging stations for electric vehicles and hydrogen and natural gas refueling stations; \$128.8 million over five years to retrofit buildings and to improve standards for vehicles and products; \$142 million over five years to add and restore national parks. There were also

multi-billion dollar investments in science and innovation in both the university and government sectors to reinforce clean energy and environment initiatives (Canada 2016).

## ENERGY PROJECTS AND PROCESSES

The Liberals inherited an energy/environment policy domain that was becoming increasingly unstable driven by both domestic and international policies pursuing environmental, economic and health objectives and by supply/demand and price fluctuations in international hydrocarbon markets. While oil prices around \$100 a barrel in 2011-13 stimulated rapid investment in oilsands projects and raised hopes for a string of liquefied natural gas terminals on the B.C. coast, slumping demand and increased production in 2014-16 weakened prices and shrunk oil and gas investment in Canada. OPEC's capacity to stabilize prices collapsed when Saudi Arabia refused to slash production and shifted its position from swing producer to global policeman penalizing unconventional producers in the deep offshore, fracking, and oilsands plays by forcing them to reduce their higher cost production (Financial Post 2015).

The world has seen price hikes and slumps before, as recently as 2008-09, but the current situation reveals a new geopolitics of oil in which producers maximize production to enhance returns without consideration for price. Simply put, OPEC members have little else to sell and are utterly dependent on maximizing oil and gas revenues. Even non-OPEC producers like Russia have few options but to maximize exports, especially in the face of sanctions introduced in response to Vladimir Putin's adventurism in Crimea and Ukraine. The critical historical difference now is that international demand reduction from cyclical slowing of global economic growth is reinforced by structural changes in economies that are integrating conservation systems and reducing the energy intensity of their economies, such as Europe, and from economies

moving from a manufacturing to a service base such as China. In most of the developed world economic growth has already been decoupled from increased oil consumption. In early 2016 international oil prices fell below \$40 while oilsands bitumen dropped below \$20 hammering the Canadian oil and gas sector.

Another critical factor for Canadian hydrocarbon exports has been the dramatic increase in American oil and gas production. Substantive increases in oil and gas production from multi-stage fracking of shale and tight oil and natural gas formations has resulted in the U.S. becoming largely self-sufficient, even capable of exporting both oil and gas (Energy Information Agency 2015). Natural gas prices also declined as a result of significant U.S. and international production increases. These price reductions have had significant impacts on the profitability calculations of oilsands and LNG projects and investment declined precipitously in 2015-16. Questions are emerging as to whether new oilsands and pipelines projects, if they were built, could become 'stranded assets' over the next 2-3 decades never recovering the investment of their owners, as is happening to coal fired electricity plants in the face of climate change policies (CBC 2016). Still, there are still some hydrocarbon issues in play in 2016 that the Liberals will have to deal with.

While they support increased oil and gas production, the Liberals committed to making decisions on major energy projects in a more balanced manner by fixing the NEB pipeline approval process. In her mandate letter the Minister of Environment and Climate Change was instructed to review Canada's environmental assessment processes to regain public trust and help get resources to market and introduce new, fair processes that will: restore robust oversight and thorough environmental assessments of areas under federal jurisdiction; ensure that decisions are based on science, facts, and evidence; and provide ways for Canadians to express their views and opportunities for experts to meaningfully participate, including



provisions to enhance the engagement of Indigenous groups in reviewing and monitoring major resource development projects. The Minister of Natural Resources was instructed to modernize the NEB to ensure that its composition reflects regional views and has sufficient expertise in fields such as environmental science, community development, and Indigenous traditional knowledge.

Anticipating defeat, Harper made a spate of appointments to federal boards and agencies in the dying days of his government. The NEB is viewed as being particularly close to the energy sector during the Harper era (Doern et al, 2015:155-162) and Harper reappointed Conservatives whose terms expired immediately after the election. Steven Kelly was actively submitting evidence before the NEB on behalf of Kinder Morgan's Trans Mountain project when he was appointed. He had to resign from representing Kinder Morgan before the NEB, and his evidence had to be 'expunged' from the panel record 'to reassure the public' before his appointment commenced six days before the election (Hume 2015). The NEB comes about as close as possible to the condition of 'regulatory capture' wherein an agency is captured by industry interests with significant career interchange between the regulator and the industry with bias built in through political-industrial collusion.

The 2015 Report of the Commissioner of Environment and Sustainable Development (CESD 2015) criticized the NEB for doing an 'inadequate' job tracking the petroleum sector's compliance with pipeline-approval conditions and found that there have been significant problems in the regulator's reviews of firm's emergency procedures. On 27 January 2016, the day after the Commissioner's report was released, the Liberals introduced plans to address the Conservatives' 2013-14 amendments to the NEB approval processes and to begin to address the appointments problem. They created a two stage process which will allow

current projects to be reviewed by the NEB under existing Conservative rules while a revised project assessment and regulation regime is crafted over the next two years. The Liberals diminished the influence of the NEB on current projects by establishing a parallel processes designed to engage a broader cross section of stakeholders who were intentionally excluded from the NEB processes by the Conservatives. With respect to integrating climate change science into project assessments, for the first time in Canadian history the lifecycle GHG emissions produced at both the upstream production stage and the transportation to markets stage will be considered (Fekete 2016b). Consultative processes independent of the NEB will be established to engage with Aboriginal people.

In order to allow these new scientific assessments of upstream GHG emissions and broader non-NEB consultative processes to work, the Liberals extended the review time from 15 months to 21 months for TransCanada's Energy East pipeline with a likely decision in mid-2018 and extended the Kinder Morgan Trans Mountain pipeline decision from August to December 2016. The Liberals argued that these broader processes were required to regain the legitimacy that had been lost under the Conservatives and to allow cabinet to take SD informed final decisions by integrating economic, environmental and social factors, and not simply privileging economic considerations (Fekete 2016a). With the changes made in the first few months the Liberals are underscoring the very different governance approach they will deploy compared to the Conservatives.

The Edmonton to Vancouver Trans Mountain pipeline expansion will change the oil transported from refined products and synthetic and light crudes to diluted bitumen and triple the volume. Given these changes along with the 7 fold increase in oil tanker traffic into Vancouver, the project is opposed by Vancouver area municipalities and coastal First

Nations, both of whom fear the threat of a bitumen spill. In January 2016 the Government of B.C. announced that it could not support the project precisely because it failed to provide sufficiently detailed spill response plans (Shaw 2016). In 2016 the NEB will begin review of the TransCanada Pipelines' Energy East project to ship bitumen from Alberta to refineries in Quebec and an export terminal in New Brunswick. TransCanada has already started community outreach campaigns along the route in Ontario, Quebec, and New Brunswick and even at the early pre - environmental assessment process stage has met a mix of reactions including a set of conditions from the government of Quebec.

While the Liberals have agreed to let the Energy East assessment proceed under the Harper era rules, they appointed three temporary NEB members for the review and expand public input. The Energy East project stirred regional tensions when the Mayor of Montreal Dennis Coderre, a former Liberal MP, and 81 other Montreal regional mayors announced in early January that they opposed Energy East on environmental grounds fearing the impacts of a pipeline spill of bitumen on Montreal area water systems. Rona Ambrose, interim leader of the federal Conservatives played the national unity card, arguing that Energy East is a nation building project that everyone should support. Ambrose's attack on Quebec politicians provoked the Parti Quebecois to claim that "They've given themselves the right to act like the owners of Quebec in the name of Canadian unity." (Clark 2016) Ambrose's position also caused tensions within the Conservative caucus with Quebec MPs rejecting the proposition that the Montreal mayors' position is a threat to national unity while noting that Ambrose had not leveled the same charges at Vancouver area mayors who have come out in opposition to the Trans Mountain expansion project (Ibid.). Low oil prices has slowed oilsands investment likely restricting production to existing projects and the already approved access of Montreal refineries to

Canadian crude oil by the reversal of Enbridge's Line 9 from Sarnia may undermine as least some of the energy security and international trade arguments favouring the Energy East project.

In 2014 the NEB recommended, with 209 conditions, approval of Enbridge's Northern Gateway pipeline project to carry bitumen through the Rocky Mountains to Kitimat on the North Coast of British Columbia and by tanker to international markets. This project was opposed by First Nations communities on the route, particularly the coastal First Nations who virulently rejected the project on the grounds that a bitumen spill would endanger the coastal ecosystem and fishery central to their economy and culture. In the campaign, the Liberals stated their opposition to Northern Gateway on environmental and NEB process grounds and Trudeau's mandate letter instructed the Minister of Transport to formalize a moratorium on crude oil tanker traffic on British Columbia's North Coast, including the Dixon Entrance, Hecate Strait, and Queen Charlotte Sound which would effectively kill the project (Hoekstra 2015).

Trudeau did support TransCanada's Keystone XL pipeline to move bitumen from Alberta to U.S. Gulf Coast refineries but this project was rejected by the Obama administration shortly after the Liberal victory, a decision supported by Hilary Clinton. American opponents of Keystone XL opposed it on the grounds that it "enables" the expanded production of "dirty oil" and attendant GHG from the oilsands. In early 2016 TransCanada launched a lawsuit against the U.S. Administration and mounted a NAFTA challenge. The fate of this project is outside the Liberal government's power and the only hope, it would appear, for Keystone XL is if the Republicans capture the White House in 2016.

## CONCLUSIONS

Clearly, *ideas* matter in the energy/environment policy domain. The contrasting governance approaches of the Liberals and Conservatives bring this into stark relief. Sustainable development and responsible resource development (RRD) embody very different visions of the future and a different emphasis on what ideas matter in decision making. With RRD, the Harper government walked the talk of the wedge politics governance approach. With respect to both tone and substance they identified their friends and picked fights with those they viewed as getting in the way as they deployed policies to tilt the playing field as steeply as possible toward the energy end of the energy/environment domain.

Harper chose to appeal to the smallest possible slice of the electorate required to retain power but in the process alienated many voters handing power to a Liberal party that had designed its governance approach on energy/environment policy to correct what it viewed to be an imbalance created by the Conservatives. Has the Trudeau government, in its first 10 months in power, begun to walk the talk of SD by instituting a more equitable balance in the energy/environment domain?

While it is too early to answer the question definitively, the tone and substance of the ministerial mandate letters, the financial commitments made in the budget to support climate change initiatives and low carbon energy systems suggest the Liberals are following through on their campaign commitments. The tone and substance of engagement with the provinces/territories and cities and the broader policy community including Indigenous Peoples is a stark rebalancing of the energy/environment domain. Elevating the prominence of science in the mandate letters and the budget shows a commitment to sustainability. The idiom of SD is prominent in the throne speech, the mandate letters and in renaming departments and committees. The process changes to ongoing pipeline project assessments and the promised

legislative modifications to the NEB reflect a serious commitment to a more inclusive and balanced governance approach.

The Liberal vision of Canada simultaneously reducing domestic consumption of hydrocarbons while continuing to produce oil and natural gas for export will be put to the test by international market forces that may be questioning the value of Canada's oil and gas. International energy markets may simply lose interest in buying GHG intensive bitumen in a world that is awash in cheap oil and beginning an overall shift away from hydrocarbon energy as carbon pricing regimes become entrenched over the next couple of decades. Trudeau has spoken favorably of the Trans Mountain project in the past but has withheld commitment on Energy East until the regulatory process is completed. Some oil pipelines or LNG plants will almost certainly be approved by the Liberal cabinet. Economic growth from hydrocarbon energy exports while protecting the environment is possible, but such decisions will not please everyone.

Whether it is Trans Mountain, Energy East, or the Pacific NorthWest LNG export project in Kitamat (Jang 2015) the Liberal cabinet will face tough decisions which may generate support of governments in the producer provinces but also stir opposition in major cities and local communities along the projects and in at least part of the broader scientific and environmental community. The Liberals will not be able to please everyone with the outcomes of these decisions regardless of the degree of inclusiveness of the process.

Doug Macdonald has argued that the Harper government had simply no interest in collaborating with the provinces on a Canadian Energy Strategy or any "interest in a policy thrust which sees climate change action as an economic opportunity" (Macdonald 2011).

Moreover, Macdonald asserted that the ‘carbon provinces’ of Alberta and Saskatchewan had essentially exercised a veto over national climate change policy for two decades. But times have changed. Trudeau’s governance approach has enthusiastically embraced the provincial/territorial Canadian Energy Strategy project and underscored the opportunities associated with climate change action for both the oil and gas and the low carbon sectors. Indeed, it is international market forces, not climate change policies, which have devalued the oil and gas assets of the carbon provinces and exposed the economic and social vulnerability of overdependence on hydrocarbons.

Hammering out a federal-provincial agreement on a pan-Canadian climate change by the end of 2016 will be challenging but made easier with the vast majority of provinces prepared to move forward. Provinces covering nearly 90 percent of the population that have carbon pricing mechanisms will continue to act and be able to take advantage of the 2016 federal budget funds designed to assist provinces and cities. It remains to be seen whether such a process can bring all provinces/territories into a Pan-Canadian climate change strategy by year’s end. It also remains to be seen whether the Liberals ensure that carbon pricing mechanisms establish some common level of commitment for all Canadians, or if adjustments are made to accommodate regional specificities. The Liberals engagement governance approach, compared to the Conservatives wedge politics approach, likely increases the chances of success.

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## Endnotes

<sup>1</sup> All three authors were students of Professor Jim Lightbody in the Department of Political Science at the University of Alberta. This chapter is dedicated to Professor Lightbody.

<sup>2</sup> For insight on the transition to a sustainable future see Global Commission on the Economy and Climate, *The New Climate Economy 2015*. In March 2016, a coalition of business, labour, think tank, Indigenous, and NGO leaders released a vision for transitioning Canada onto a sustainable path. See Smart Prosperity, *New Thinking: Canada's Roadmap to Smart Prosperity*, March 2016.

<sup>3</sup> For an assessment of the role of public agencies like the Alberta Energy Regulator, the National Energy Board, CSIS and the RCMP in partnership with private firms Enbridge and TransCanada to "supress dissent" around pipeline projects see Carter, 2016.

<sup>4</sup> In the previous edition of *How Ottawa Spends*, the editors trace Harpers evolution 'from leader to loner,' as the Conservatives slid from initial political success to a failed and increasingly isolated one man government. They go on to note that even sympathetic conservative journalists like John Ibbitson and Conrad Black acknowledged that, "in the end it was Harper's controlling one man government hubris, his contempt for democratic conventions and institutions and continuous negative politics that ensured his demise, along with his utter failure to reach out to Canadians he disagreed with" (Stoney and Doern, 2016).

## Chapter 7

THE INTER-EXECUTIVE ACTIVITY OF MINISTERIAL POLICY  
ADVISERS IN THE GOVERNMENT OF CANADA

R. Paul Wilson

## INTRODUCTION

Ministerial political staffers are frequently discussed with respect to their “vertical” activities within the traditional bilateral relationship between ministers and permanent public servants and, in particular, whether, as contributors to “new political governance” (Aucoin 2012), they further public service politicization (Benoit 2006; Eichbaum and Shaw 2007a, 2007b; Tiernan 2007; Wilson 2016). However, while their relationship with the public service is important, it is not the whole story. Power within Westminster systems of government flows across a complex web of relationships in and around the core executive (Dunleavy and Rhodes 1990; Rhodes 1995). Because of their shared political affinity and personal ties with ministers, political staffers are well placed to exercise influence within multiple networks that criss-cross government and politics. (Craft 2016; Gains and Stoker 2011; Eichbaum and Shaw 2010; Rhodes and Tiernan 2014; Yong and Hazell 2014; Zussman 2009). Examining this “horizontal” dimension (Connaughton 2010; Craft 2016; Maley 2000, 2011) illuminates the mechanisms of co-ordination and information transmission on the political side and provides insight into how decisions are shaped within the black box of ministerial offices.

It has long been recognized that political staffers actively work across departmental boundaries. For example, Lenoski observed how, under Prime Minister Pierre Trudeau, “the political staff network contributes to the reinforcement of the solidarity in which, to survive, collective ministerial responsibility has to be firmly rooted” (1977, 172). Bakvis (1997, 119)

recognized how staffers act "...as a primary node in a network or more likely a number of networks of specialist advisers and contacts, channelling critical information to the key decision maker, the minister." However, Maria Maley first systematically documented this aspect of political policy staffers' work and identified distinctive policy roles which were "important in shaping policy outcomes" and which depended on advisers' privileged involvement "in a minister's overlapping relationships with other policy actors and [as] conduits for information within these relationships" (2000, 467-8). She further elaborated on the importance of ministerial staffers' informal networks and relationships which provide a vehicle for political and policy co-ordination across government (Maley 2011, 1484).

Other researchers identify similar themes. In New Zealand, Eichbaum and Shaw (2011, 596 ) find that staffers are "key actors" in core executive networks, connecting on behalf of their ministers across a range of executive relationships, brokering policy agreements and negotiating with legislators in the context of minority governments resulting from proportional representation. Connaughton (2010, 362-3) concludes that political policy advisers in the Republic of Ireland have "significant" duties on "cross-cutting issues that transcend departmental boundaries and include consensus building in complex policy networks". Jonathan Craft (2016) provides the fullest analysis of partisan policy advisers in Canada. He documents how they provide substantive and procedural brokerage and co-ordination across government, not only in first ministers' offices but throughout the executive, and uses this framework "to move beyond country-specific accounts...toward a more comparatively generalizable framework" applicable across and even outside the Westminster family (Craft 2015a, 136-7).

Such a broad perspective is necessary for theorizing the role of political staff in executive government, but must have a solid empirical foundation. Through evidence from a 2013 survey

as well as elite interviews, this chapter confirms the trajectory of recent literature, namely that political staffers use their networks of relationships to impact the policy process, through analysing the horizontal policy activity of ministerial policy advisers in Canada under the government of Prime Minister Stephen Harper (2006-2015). Due to space constraints, it considers only relationships within the executive and parliamentary contexts and not those with outside stakeholders. Emphasis is given to the "deep structures" (Connaughton 2010, 366) of co-ordination and discussion between Canadian ministerial offices which augment and facilitate advisers' more relationship-based networking, and to the significance of such practices for policy development.

### *Methodology*

Using the Government of Canada's online Electronic Directory Services (GEDS) a total of 64 individuals were identified who served as senior level ministerial political policy advisers (in all but a few instances with the title of either director of policy or senior policy adviser) at some point during the period from October 2012 to June 2013.<sup>1</sup> These 64 staffers were invited by email to participate in a survey which consisted of both forced response and open-ended questions. Thirty-four responses were received back from individuals employed in a wide range of ministerial offices, including at central agencies, the Prime Minister's Office and the offices of ministers of state. The final survey response rate was 53 percent. Survey data were augmented by elite interviews (and one email exchange) with the following: 14 current (at the time) or former Conservative political staffers who had served under the Harper government; two Chrétien-era Liberal staffers; one long-serving deputy minister; and a currently-serving senior adviser from Prime Minister Justin Trudeau's office. The analysis also reflects the experience of

the author, who served as director of policy in the Prime Minister's Office (PMO) from 2009 to 2011 and in the offices of three other federal ministers from 2006 to 2009.

*Political Staffers: The Canadian Context*

Contextually, it is important to stress from the outset that ministerial political staffers are a comparatively numerous group in Canada (Yong and Hazell 2014, 152). Appointed under section 128 of the *Public Service Employment Act* they are formally known as "exempt staff" because they are exempt from the usual public service rules for competitive hiring and non-partisanship. Hired directly by the minister, they serve at his or her pleasure and explicitly support the government's political agenda. As context for the period under consideration in this study, there were in total 558 full-time exempt staffers across the Canadian government on March 31, 2013 (Dawson 2013, 5). Ministerial *policy* advisers, a prominent species of the broader taxonomic genus of exempt staff, comprised about 20 percent of the entire ministerial staff community (Wilson 2015b).

The Privy Council Office (PCO) states that the *raison d'être* for ministerial exempt staff "is to provide Ministers with advisors and assistants who are not departmental public servants, who share their political commitment, and who can complement the professional, expert and non-partisan advice and support of the public service," and recognizes that this involves horizontal "liaising with other Ministers' offices and caucus" (Canada, Privy Council Office 2015, 46). In setting out generic job descriptions for staffers, the 2011 *Treasury Board Policy for Ministers' Offices* establishes that, among other things, a minister's director of policy "needs to work closely with the Prime Minister's Office and other ministers' offices in order to coordinate the development of policies and programs within the government" (Canada, Treasury

Board 2011, 66). The horizontal themes of co-ordination and networking with other ministerial offices, including PMO, are again clearly emphasized. These also emerge as prominent features from the survey.

## INTRA-GOVERNMENTAL RELATIONSHIPS: SURVEY FINDINGS

### *How Advisers See Their Role*

When asked what skills advisers felt were "most useful" to their position, the relational aspects of the job figured prominently. As Table 1 shows, 42% of respondents mentioned the importance of "interpersonal skill/relationship building/listening to others/respect." This was tied as the top response along with strong written communication skill. The latter reflects the strong—and perhaps idiosyncratic—culture of documented political advice characteristic of the Harper PMO and many ministers' offices (Craft 2016, 58; Wilson 2016 forthcoming). But the former demonstrates that staffers prize these relational skills well above other characteristics that might be commonly expected in a political policy role such as: political judgment (mentioned by 29% of respondents), political analysis (16%) and policy portfolio knowledge (13%). A further relationally-oriented category of "teamwork/networking" was also mentioned by 13 percent of respondents. This high emphasis upon interpersonal skill suggests that advisers recognize the importance of relationship building for their policy advisory work.

Table 2 lists the top 10 ways in which survey respondents described their job.

Unsurprisingly, policy advisers most commonly say that they advise the minister with respect to policy (58%) and politics (48%). But, given how so much attention is devoted to the relationship of political staff with public servants, it is noteworthy that meeting/working with officials (36%) ranks in fourth place, tied with the notion of collaborating and networking with other ministerial

offices, including PMO (36%). Respondents also recognize the importance of implementing and ensuring congruence with the government's policy objectives (26%) and co-ordinating and managing the policy and cabinet process (19%), both functions which could apply to working with departmental officials (vertical) and across political networks (horizontal).

### Table 1-Most Useful Skills

"What do you feel are the most useful skills for someone in your position?" (Top grouped responses by percentage of cases mentioned).

Rank	Response	%
1	Strong communications – writing	42
1	Interpersonal skill/ relationship building/ listen to others/ respect	42
3	Analyse/synthesize large amounts of information/ multiple issues	32
4	Political judgment	29
5	Time management/ work well under pressure/ remain calm	26
6	Knowledge of institutions/government/electoral systems	19
7	Strong communications – oral	16
7	Knowledge of politics/political context	16
7	Political analysis	16
10	Teamwork/networking	13
10	Portfolio/policy field knowledge	13

### Table 2-How Policy Advisers Describe their Job

"In one paragraph, please describe your job" (top 10 grouped responses by percentage of cases mentioned).

Rank	Response	%
1	Advise minister – policy	58
2	Advise minister – politics	48
3	Manage/work with stakeholders	39
4	Meet/work with officials	36
4	Collaborate/network with other ministerial offices, including PMO	36
6	Implement/ensure congruence with government policy objectives	26
7	Supervise/manage staff/assist Chief of Staff	23
8	Co-ordinate/manage policy/cabinet process	19
8	Oversee/challenge/monitor departmental policy/admin	19
10	Support/assist/defend minister	16



One adviser clearly articulated how different aspects of horizontal relationship- building come together in practice: “My job is to make the Minister look good. My colleagues are focused on him looking good in the media or in parliament - my role is more general in that he needs to have politically consistent policy content to discuss in those contexts and others. So, my job is to take the overarching narrative of the Government and apply it to items within my Minister's portfolio. I help him make decisions within this context. I help him make relationships. I help him speak to stakeholders, caucus, and cabinet in this context. I help him achieve his personal goals. I help him avoid problems and pursue successes" (Survey respondent 19). This sums up the horizontal dimension: developing relationships inside the executive (cabinet) and outside (stakeholders, parliamentary caucus) in order to advance the minister's policy agenda.

#### *Relations With Other Ministers*

Policy staffers who work for one minister do not as a rule interact deeply with other ministers. As Table 3 shows, 50 percent of policy advisers will “occasionally” attend meetings between their own minister and other ministers, but only 6 percent will actively participate either very frequently (3%) or frequently (3%) in those meetings. It is even more uncommon for them to represent their own minister at meetings with other ministers: 9 percent did so occasionally, and only 3 percent did so very frequently. It was somewhat more common for them to mobilize support for their own minister's policies among other ministers, presumably on an informal basis: 25 percent did this either very frequently (9%) or frequently (16%), with a further 22 percent doing so occasionally. One adviser described how he regularly dealt with another political office on a joint file. “I actually got [name of policy adviser] to get me ten minutes to

brief [name of minister] on [topic of legislation under consideration] before officials got to him.... Once that relationship had been cultivated, the implementation of the [file] agenda moved much more smoothly” (adviser 9). Such meetings happened, though they were not typical.

### Table 3-Interaction with Cabinet and Other Ministerial Offices

"Thinking of your own work as a policy adviser in a minister's office, please rank the following activities on a scale of 1 to 5 according to how often you would engage in the activity, where 1 means 'very frequently,' 2 means 'frequently,' 3 means 'occasionally,' 4 means 'rarely,' and 5 means 'never.'"\*

		Respondents (%)				
		1	2	3	4	5
1	Attend meetings between minister and other ministers	9	25	50	16	0
2	Actively participate in meetings between minister and other ministers	3	3	61	27	6
3	Represent your minister at meetings with other ministers	3	0	9	50	38
4	Attend cabinet meetings (including cabinet committees)	22	9	41	19	9
5	Meet with political staff from PMO (non PMO only)	36	39	21	4	0
6	Meet informally with staff from other minister's offices	30	30	30	9	0
7	Mobilize support for your minister's policies among other ministers	9	16	22	38	16
8	Mobilize support for your minister's policies among political staff from other minister's offices	25	41	25	6	3

\*Questions taken or adapted from Eichbaum and Shaw 2007, 99 and/or Eichbaum and Shaw 2011, 587).

#### *Attending Cabinet*

PMO staffers have traditionally monitored and attended cabinet committee meetings (Campbell 1987, 130; Goldenberg 2006, 110) but until recently advisers to other ministers have not done so. This reduced their policy influence and placed them at a distinct disadvantage not only compared to PMO but also to senior departmental officials who either attend cabinet or will be debriefed by those who do (Savoie 1983, 518). The traditional rules for attendance continued in the early Harper years: advisers from PMO would attend cabinet committees and might (or might not)

provide political feedback to the ministerial staffers who were working on a file. Later on, however, PMO instructed PCO to permit ministers presenting items at cabinet committees to bring one political staffer (often but not necessarily a policy adviser) into the room to listen to the discussion (Canada. Privy Council Office 2012, 19). This practice is reflected in the survey. As Table 3 shows, 72 percent of respondents attend cabinet meetings at least occasionally. Such access permits the ministerial staffer involved on the file to hear the political discussion among ministers which is vital when follow-up policy work is required.

#### *Working with Members of Parliament*

According to Eichbaum and Shaw (2007c, 99-100), political advisers in New Zealand have an important role in working with Members of Parliament. They found that 88 percent of advisers at least occasionally had meetings with members of the government's parliamentary caucus (50% did so frequently or very frequently), and that 78 percent also met with MPs or advisers from other political parties (45% did so frequently or very frequently). Advisers in Ottawa also interact with MPs from the government caucus, although less often than those in Wellington. According to the survey (Table 4), 72 percent of Canadian policy advisers at least occasionally accompany their minister to meetings with caucus colleagues (30% frequently or very frequently) and 60 percent actively participated in such meetings (27% frequently or very frequently). This would include their role supporting Minister's Caucus Advisory Committees which Prime Minister Harper instituted to obtain input from backbench government MPs into policy proposals (Wilson 2015a, 236). Indeed, 72% of Canadian advisers at least occasionally meet government MPs without the minister being present, although only 21% do so frequently or very frequently. But meeting with MPs or staff from other political parties is much less common in Canada than in New Zealand, with only 22 percent of survey respondents doing so

occasionally. Perhaps this difference in approach is due to the challenge of governing with multi-party coalitions under New Zealand's system of proportional representation (Eichbaum and Shaw 2007a, 463). Or perhaps MP liaison including cross-party contact in Canada is, given role differentiation among political staffers, led by political staffers other than policy advisers (for example, parliamentary affairs advisers).

#### **Table 4- Activity with MPs**

"Thinking of your own work as a policy adviser in a minister's office, please rank the following activities on a scale of 1 to 5 according to how often you would engage in the activity, where 1 means 'very frequently,' 2 means 'frequently,' 3 means 'occasionally,' 4 means 'rarely,' and 5 means 'never.'"

		Respondents (%)				
		1	2	3	4	5
1	Accompany minister to meetings with caucus colleagues	9	21	42	24	3
2	Actively participate in meetings between minister and caucus colleagues	9	18	33	30	9
3	Meet with members of the government caucus without minister	6	15	51	24	3
4	Meet with MPs or staff from other parties	0	0	22	50	28

\*Questions taken or adapted from Eichbaum and Shaw 2007, 99 and/or Eichbaum and Shaw 2011, 587).

#### *Working with Other Ministerial Offices*

Not surprisingly, given how they view it as intrinsic to their job description, policy advisers report high levels of interaction with other ministerial offices. As shown in Table 3 above, 60% of respondents meet either very frequently (30%) or frequently (30%) on an informal basis with staff from other ministerial offices. Meeting with political staff from the Prime Minister's Office is even more common, with 75% of (non-PMO) policy advisers doing this very frequently (36%) or frequently (39%). This level of engagement with other political offices is expected based on

practice elsewhere. For example, Eichbaum and Shaw (2007c, 99) found that policy advisers in New Zealand met frequently or very frequently with both other ministerial advisers (78%) and with PMO (69%), while Connaughton (2010, 359) observed a similar pattern in Ireland (72% and 64% respectively).

Advisers consider good relationships across political networks to be "very important...because you never know when you'll need them. And offices don't do enough of this" (adviser 7). Adviser 11 explained how relationships gave him a conduit for discussions with other political staffers: "You got to know people in other ministers' offices because the idea was then if there's anything your boss ever needed from that other office you had somebody you knew who you could call there. Even if it wasn't their direct responsibility, they'd say to you 'that's so and so, call them and tell them I said you should call them.' And you could very quickly find out who the right person was and get into a discussion with them. So knowing people across government was quite helpful."

Such connections could be valuable for different reasons. In order to fully brief their own ministers, advisers might need either substantive information on a proposal or political intelligence on how their own proposal is being received. One former PMO policy adviser observed how frequently presenting ministers were surprised at Cabinet by other ministers' questions, and concluded "This is their staff's fault." (Adviser 7) Advisers do not only convey information. They are also active in mobilizing political support for their ministers' policies. Sometimes, as shown in Table 3, they do so with other ministers directly: 25 percent do so very frequently (9%) or frequently (16%), although this is notably less often than in New Zealand where 41 percent do so very frequently (19%) or frequently (22%) (Eichbaum and Shaw 2011, 593). On the other hand, Canadian staffers are more likely to mobilize support for their

ministers' policies among other advisers to other ministers. In Canada, 66 percent of policy staffers do so very frequently (25%) or frequently (41%), while only 9 percent do so rarely (6%) or never (3%). In New Zealand, by contrast, only 37 percent do so frequently/very frequently and 44 percent rarely/never (Eichbaum and Shaw 2011, 593).

Maley describes how Australian advisers have become the "executive-level negotiators within government" and hold delegated authority (if informally) from ministers to negotiate policy positions with other political offices in the expectation of ministers' approval (2000, 463). In Canada the mobilization function certainly involves political discussions between ministers' offices in response to disagreement between officials. As one adviser explained: "If departments had differing views then [political] staff needed to talk stuff out to resolve. Staff would negotiate and could work horizontally to develop a common position to present to their ministers which might hope to overcome the department gridlock." Another adviser was blunter: "We did the behind the scenes work below when the civil service would not listen....I would call it an end run around the civil service" (Adviser 3).

A former chief of staff explained that, on high level matters of conscience and general principle, ministers "were very much their own chief interlocutors. But, as issues descended into complexity, extreme levels of detail, and protracted discussion or conflict, ministers delegated more and more authority to issue area experts on the political staff" (Adviser 10). A PMO policy adviser agreed and talked about meetings "to try and bridge the gap and come to a consensus" (Adviser 7). Ministers simply could not dedicate the time needed to work through the minute details on a single file. Further, using staff for such "proxy conflicts" allowed ministers to act as "nominal peacemakers to close the deal" once the details had been thoroughly debated (Adviser 10). But, he explained, in such cases he always worked within the negotiating parameters set by

the minister in advance. Further, “humility and vigilance were key” so that he always delineated his minister’s express views from his own. Staffers who had a “very strong track record of anticipating the minister’s views and wishes correctly” had strong currency and would be treated, by officials and other offices, as a “direct proxy for the minister.” But the key was “never to overstep” since doing so even once seriously undermined a staffer’s reputation (Adviser 10).

Do negotiations become political horse-trading? Adviser 10 describes how, “shamefully,” he once committed to have the minister commission a study in his department in exchange for support from another minister for action on an unrelated but regionally significant file. “Not my finest moment,” he conceded, “but my minister was *in extremis*” (adviser 10). Another former staffer who had worked with several ministers and at PMO felt that such explicit bargaining was rare. Nevertheless, he did recall a time when, in order to advance an important file in provincial negotiation, his minister needed support from other federal ministers and he was “deployed to represent our political master in discussions with another minister’s office” (adviser 13). While not typical, staffers are on occasion involved in such *quid pro quo* negotiations.

While it is open to all policy advisers to network on an informal basis, geography hinders this since ministerial offices in Ottawa are political enclaves isolated (symbolically and physically) within their departmental headquarters. Consequently, ministerial staff have relatively easy access to public servants but must make a conscious effort to develop personal relationships with political colleagues. On the other hand, technology—in particular, email and direct messaging with Blackberry BBM (the ubiquitous tool within government), including group BBM chats—permits instant communication between political offices. But while informal networking has never been easier, not all advisers are equally well-placed to take advantage.

Some might lack the temperament or opportunity to make connections, while others might not succeed in escaping from their departmental officials' orbit. Political staffers "work within their own stovepipes," observed one policy director. It is possible to pick up the phone and work out issues directly with other ministerial offices or with PMO, "but I'm finding a lot of offices don't do this. If you are entrepreneurial this can be very useful" (adviser 2).

### *Cabinet Pre-Briefs*

In order to facilitate broader political engagement, the Harper PMO hosted formal meetings with senior policy advisers from all ministers' offices. The nature of these meetings evolved over time. Soon after the Harper government was elected in 2006, the PMO director of policy, Mark Cameron, began to convene regular meetings on a monthly to semi-annual basis in order to discuss implementation of the government's priorities and future agenda. Some PMO policy advisers also held meetings for policy staffers from the ministerial offices within their areas of responsibility; these focused on broad discussion of emerging issues, not on specific cabinet agenda items, and were held on a similarly occasional basis—sometimes monthly or more, sometimes less frequently.

By 2009, PMO policy advisers had regularized a system of weekly "cabinet pre-briefs" which continued in more or less the same form until the government's defeat in 2015. A few days prior to the weekly meeting of most cabinet committees, the responsible PMO policy adviser would chair a meeting at PMO for the directors of policy representing each of the ministers on that committee. The meetings had several purposes. First, PMO was acting as a "social convenor" (adviser 7) in bringing advisers together regularly from across government and assisting them to build personal relationships. Adviser 11, who (above) emphasized the



importance of personal relationships, recognized the importance of central convening, saying that "A good network of people across the government is very helpful. The policy director meetings at PMO were valuable even just for that reason alone."

Second, the pre-briefs permitted detailed political consideration of items on the upcoming agenda of each cabinet committee. Context is important. In Canada, the Privy Council Office (PCO) acts as the secretariat for all cabinet and cabinet committee meetings (except for Treasury Board) and prior to a meeting will circulate the agenda as well as one or more binders containing the formal cabinet submissions for consideration as signed by the sponsoring minister(s). At the time of the PMO pre-brief, ministers' staffers will usually have received and reviewed the materials (they are permitted to do so for most items); their ministers, however, likely will not yet have done so. Instead, ministers will usually review the binder closer to the meeting, along with a political memo prepared by their own office staff with political context and advice.

The meetings, therefore, have several important functions. They allow the lead office - whether the director of policy or the policy adviser working most closely on the file - to explain to the group his or her minister's policy position and political rationale. This is an important opportunity for information transfer, especially complex background or technical details, as well as for mobilizing support and saying "Here's our proposal, and here's why we think it is the best option" (adviser 12). Other advisers also have the opportunity to seek clarification in anticipation of writing briefing notes to their own ministers on the topic. The meetings also provide political intelligence. The presenting office will likely not hear the specific views of other ministers (who will not yet have read the proposal). However, a room full of political staff is a useful political sounding-board; questions and challenges indicate possible weak points and allow the minister to shore up his or her argument.

A senior PMO adviser lauded the pre-briefs, observing that "the efficiency of having everyone in the same room just can't be replicated" (adviser 12). All offices receive the same information from the expert staffer on the file and heard the same political discussion at the same time. Since all advisers would have to brief their own ministers in the next few days, the meetings helped them to prepare and lessen the time crunch. While the meetings provided opportunity for PMO to provide instruction on policy files, this was not their usual purpose. From the PMO's perspective, "We could function quite nicely without [them]...This was about getting other ministers' offices up to speed on the files" (adviser 12). The relevant PMO policy adviser would have been in ongoing communication with the sponsoring office, and so would already know the lead minister's views. Further, by this point the PMO would already have provided a memorandum to the prime minister with their view and sometimes received back his response. If he provided direction, they could pass it on (adviser 12) but they did not need the pre-briefs to do this.

#### *PMO and "Four Corners" Meetings*

While the cabinet pre-briefs may have been largely about information transmission for the benefit of other offices, another "deep structure" implemented under the Harper government, the "four corners" meeting, was very much (although not exclusively) for the benefit of the PMO. Involving departmental officials as well as other political offices, these meetings allowed the PMO to integrate vertical and horizontal networks in order to obtain expert information and exert central influence—if not sometimes direct control—over policy development in key areas. Craft noted the existence of these meetings (2016, 190) but, thinking them "rare" (272), underestimated their significance.

Normally in Canada the PMO advisers deal directly on a daily basis with PCO officials, but much less regularly with public servants in other departments. For their part, departmental officials take their direction from their own minister, subject to co-ordination by the PCO, and not from the PMO. This system has the advantage of clear lines of accountability, but there is also the potential for miscommunication. Of course, the PMO and the minister's office will try to maintain horizontal contact along political networks. And individual PMO advisers may (and should) have personal networks across government, including with deputy ministers and other senior officials (Goldenberg 2006). Sometimes, however, these are not sufficient.

In order to dialogue across the political-public service divide, the PMO instituted "four corners" meetings at which PMO and PCO personnel could meet together in one room for briefing and discussion on a single issue with the relevant departmental officials and the appropriate staff from their minister's office. Usually these meetings involved policy issues, although the tool could also be used for communications or issues management purposes. Ministers themselves did not attend.

In an email, Guy Giorno, who served as chief of staff to Ontario Premier Mike Harris as well as to Prime Minister Harper, explained that he first instituted "four corners" meetings in the Premier's Office at Queen's Park. From there the concept--and the name--were imported by the Harper PMO; this occurred, as advisor 11 recalls, "after we'd been in government a few years." In an interview a deputy minister confirms that they were, federally at least, an "innovation" of the Harper administration. "Absolutely. Sure. We never had four corners before." The innovation invited controversy.

From the PMO's perspective—often shared by the minister's office—the meetings were useful in three ways. First, information transfer. The meetings gave the PMO "access to the real

experts that we couldn't speak with otherwise" (adviser 12) and allowed everyone to hear the same answers at the same time, rather than having the expert information filtered through non experts, whether in the minister's office or at the PCO. Second, as a ministerial adviser said, four corners meetings served to "get everyone on the same page" in terms of direction. As he explained, "if ministerial staff wanted to drive forward on an issue but the public service had concerns," then they could be put on the table and resolved (adviser 11). Third, meetings helped to overcome delay. As the same ministerial adviser explained, "if stuff was held up, then it was a good way to get an issue moving. If a department was holding something up, then PMO could call the department in front of PCO who could then give them marching orders to get things going" (adviser 11). A chief of staff agreed that four corners meetings helped to "break the power of the 'telephone game' and various delay tactics, which is why I like them so much" (adviser 10). He added that in his experience "sometimes just suggesting a four corners can break the log jam."

From these comments it is clear that four corner meetings were not just useful to the PMO but also to ministerial offices in some circumstances. Meetings, however, did not always involve the two political offices ganging up on the public service. Some configurations might have PMO and PCO on the same page seeking information and responsiveness from the department and minister's office.

The downside of four corners meetings is the perception that the PMO could use them to issue direction to ministerial staff and to departmental officials, which only their own minister ought to do. Thus, according to the deputy minister interviewed, they represent "an insidious intrusion into the proper chains of accountability," potentially undermining ministers and their responsibility for actions taken in their departments. PMO policy advisers were conscious of this

problem. One senior PMO policy adviser explained: “I tried to be very careful about never giving direction. We weren’t authorized to give direction unless it came from the PM himself. And there were relatively few instances where that was the case.” (adviser 12). An experienced ministerial director of policy agreed that, from what he saw, the PMO did not use the meetings to give direction to departments or to minister’s offices. Rather, the PMO used them to call both minister’s offices and departments “to the principal’s office” if they weren’t moving a file quickly enough, and he didn’t see this as inappropriate (adviser 11).

Whether because of these accountability concerns or, as a PMO adviser suggested, PCO’s fear that they were losing control of the information flow to PMO (adviser 12)—or a combination of both—at one point PCO sought to restrict four corners meetings to items on the main agenda of the Priorities and Planning committee of cabinet. As a PMO senior adviser explained, the offices settled on a compromise whereby all requests for four corner meetings had to be submitted from the PMO chief of staff directly to the Clerk’s office, and could not be requested at lower levels. “This was not a huge impediment,” the adviser explained, but “we thought more about whether we really needed one before submitting the request,” and presumably PCO felt somewhat more comfortable about how they were being used (adviser 12).

### *Institutional Choices and Government Style*

Political offices everywhere are under the same pressures and so, quite independently, can develop similar solutions to similar problems. Connaughton (2010, 365) notes that Irish policy advisers met on a weekly basis under the auspices of the first minister’s office to discuss the weekly cabinet agenda. This resembles the Harper PMO. Sometimes practices are imported from elsewhere, just as four corners meetings derived from a previous Conservative government

in Ontario. Structured and centrally co-ordinated meetings for political policy staff were not unique to the Harper government; but neither had they been a prominent feature of previous Canadian federal governments. A former policy adviser under the Chrétien government recalls that, in her experience, structured meetings were rare, most conversations were ad hoc, and co-ordination across offices and with PMO occurred “through more informal mechanisms where social capital and personal networks played a big role” (Adviser 14). Eddie Goldenberg, long-time senior policy adviser and later chief of staff to Prime Minister Chrétien, agrees. “Before each [cabinet] committee there was nothing formal,” he explained in an interview. “The Economic policy person would get the agenda and may talk it over with her counterpart in the minister’s office....But we didn’t have any of the so-called four corners meetings or anything like that.” Different PMOs have different structures and processes depending on their style and needs. The Harper PMO developed a higher than usual institutional formality in terms of horizontal co-ordination, in part as a way to focus on the government's political agenda in the uncertainty of a minority parliament but also as a way to develop political staff networks as a counterweight to the public service.

Early indications are that the still relatively new Liberal government of Prime Minister Justin Trudeau (elected in October 2015) is maintaining some of the Harper government's practices in terms of central co-ordination. According to a senior adviser in the Trudeau PMO, four corners meetings continue and are "seen as regular course of practice." In cases where there is a "blockage or misunderstanding" they are "a way to get everyone around the table and identify what those issues are and solve them." The adviser considers the tone of the meetings to be "pretty positive," and he believes that PCO is of the same view. While the Trudeau PMO does not hold formal briefings on cabinet committee agenda items, the Trudeau adviser says that

PMO uses its "convening role" to hold a monthly meeting of ministerial policy directors in order to "co-operate and share best practices" and also to encourage "informal consultations" between offices.

As under all governments, the practices of the Trudeau PMO will evolve to meet its unique needs and operating style. For example, reports indicate political staffers being recruited from the public service to a much greater extent than under the Conservatives (Shane 2016) as well as extensively from the Liberal provincial government in Ontario (Taber 2015). The former practice will tend to create a different and less adversarial relationship between the political staff culture and officials; the latter means importing ready-made personal networks between advisers and suggests that perhaps the ministerial staff culture in Ottawa is more likely to resemble that under the provincial Liberal government at Queen's Park than the federal Liberal government under Jean Chrétien. The evolution of practice in the Trudeau government over time bears watching.

## CONCLUSIONS

While specifically examining a single point in time under the government of Prime Minister Stephen Harper, this analysis has revealed significant parallels in ministerial policy staffers' horizontal activities with documented practice elsewhere. At the same time, however, it suggests caution with respect to generalization. In important ways, practice in Canada differed under Harper from that under previous prime ministers; but there was even variation within the Conservatives' decade in power. Many factors, including the prime minister's personal style, the parliamentary context, the overall government culture and its relationship with the public service, impact the role of ministers and therefore the role of ministerial staff. While it can be predicted

that ministerial staff will use networks and relationships to pursue political goals, how they do so is very much context specific.

Advisers' political work is entirely appropriate for political staff supporting political decision-makers. However, as this chapter has shown, it is double-edged. With respect to the public service, by taking responsibility for supporting ministers with the political aspects of briefing and bargaining, policy staffers allow departmental officials to maintain an appropriate distance, thus reducing pressures towards inappropriate politicization. However, exempt staff can complement but never replace the need for professional advice from public servants to ministers, and relying only on political networks in an attempt to "end run" deputy ministers should be resisted. On the political side, the PMO has a positive role to play in facilitating relationships and information transfer between ministerial offices, and by co-ordinating discussions can strengthen the government's ability to pursue its agenda. But while the prime minister may direct ministers, his office holds no such power; therefore the PMO must (without explicit warrant) resist using horizontal levers, whether formal or informal, to lord it over ministerial offices. Nevertheless, political policy advisers play an essential role in supporting ministers and, in Canada as elsewhere, any account of cabinet decision-making is incomplete without recognizing their formal and informal inter-executive activity.

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#### Endnote

<sup>1</sup> This is the third in a series of studies based on the same survey of ministerial policy staffers. The first established a demographic profile and examined their tenure in office (Wilson 2015b). The second considered staffers' "vertical" relationship with public servants (Wilson 2016).



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## Chapter 8

### A TARGETED FEDERAL MENTAL HEALTH TRANSFER: ARE PROSPECTS BETTER UNDER THE TRUDEAU LIBERALS?

Mary Bartram

#### INTRODUCTION

Mental health problems and illnesses affect one in five Canadians in any given year, with the combined cost to the economy (from both lost productivity and direct service provision) estimated at more than \$50B annually (Lim et al. 2008; Mental Health Commission of Canada 2012a; Smetanin et al. 2011). However, significant gaps and inequities have arisen over the history of mental health policy in Canada. This chapter for example leaves open the complex question of the extent to which addictions are considered to be a part of mental health policy.

With spending on mental health at only 7 per cent of public spending on health, Canada is far from keeping pace with the 10 to 11 per cent reached by counterpart countries such as the UK and New Zealand (Jacobs et al. 2010). Further, gaps in public insurance coverage have created inequities in access, with unmet needs for mental health problems more highly concentrated at lower levels of income than for physical health problems (Statistics Canada 2013), and with treatments people receive largely “decided not on evidence-based best practices but on their employment benefits and income level” (Anderssen 2015, F1).

As documented below, the historical record shows that in the absence of targeted mental health transfers, provincial (and subsequently territorial) governments will continue to be hard pressed to narrow the gap in funding for mental health services. Starting in the post-World War II era, federal transfers have played a critical role in supporting provinces to better meet needs

for health care through enhanced funding, and to reduce inequities in access to care through public health insurance. However, the history of federal transfers for mental health has been largely one of exclusion, evasion and neglect. Unmet needs for mental health care have just been too vast and expensive to take on, too jurisdictionally thorny to address, too politically expedient to evade, and too stigmatized to make a real priority.

Despite and to some extent because of this history, prospects for a targeted mental health transfer under the Trudeau Liberals are good, maybe even strong. In both the federal Minister of Health's mandate letter and the Liberal's first budget (Prime Minister of Canada 2015; Finance Canada 2016), the government has reconfirmed platform promises to negotiate a new Health Accord and improve access to mental health services. *Changing Directions, Changing Lives: The Mental Health Strategy for Canada (MHS)* recommended that public spending on mental health be increased from 7 to 9 per cent of all public spending on health, along with an equivalent increase in social spending and more effective use of current expenditures (Mental Health Commission of Canada 2012a). Support for mental health as a policy priority has grown over the past decade (Mulvale et al. 2014), reflected in a wave of provincial and territorial mental health strategies and action plans, and increased attention from the public and the media. A recent survey found that 90% of Canadians support a targeted mental health transfer (Canadian Mental Health Association, 2015). The stage is thus set for renewed consideration of a targeted mental health transfer, to help close the gap in funding and inequities in access to services. Will it be possible to open a "policy window" (Kingdon 1995) to advance this policy solution on the national agenda?

This chapter is divided into three sections. First, the potential for a targeted mental health is situated in the context of overall fiscal federalism and the nature of the federal spending power.

This account includes early criticism in Parliament and elsewhere of the failure to directly fund mental health. The second section explores more recent history extending to the very recent past and shows further federal neglect and related disproportionate gaps in mental health funding due to shifts in the overall structure and nature of fiscal transfers in public health. The final conclusions of the chapter then offer a political analysis for the early Trudeau era arguing that the near-term prospects for a targeted mental health transfer are good and maybe even strong but also conditional given the dual histories presented above. It also offers brief discussion of the forms that such a transfer could take.

#### MENTAL HEALTH FUNDING IN THE CONTEXT OF FISCAL FEDERALISM AND THE FEDERAL SPENDING POWER

The prospects for a targeted mental health transfer in Canada hang in large part on whether mental health is considered to be a national priority, thereby justifying the use of the federal spending power in an area of provincial/territorial jurisdiction. Broadly speaking, the distribution of tax room, tax revenue and spending responsibilities lies at the heart of federalism, with federal transfers as a critical distribution mechanism (Ouimet 2014). Further, vertical fiscal imbalances tend to be built into fiscal federal arrangements, with federal governments holding back some fiscal room to deploy its federal spending power in order to promote national objectives through transfers (Boadway 2001).

Canadian federalism is both highly decentralized and highly complex relative to other federal jurisdictions (Ouimet 2014; Boadway and Watts 2004). Canadian history has been shaped by debates over vertical and horizontal fiscal imbalances and federal spending power, both the principles embodied in the constitution and the practices expressed through equalization

payments and health and social transfers. What is more, the highly political nature of Canadian federalism may have played out most intensely in the health sector. According to Banting and Corbett (2002,31), healthcare in Canada is “intensely politically salient,” with “health politics influenc[ing] federalism as much as federalism influences health politics.”

After 150 years of heated political debates over the distribution of resources and responsibilities, in general and as related to healthcare specifically, suffice it to say that the near-term prospects for a targeted mental health transfer will depend on the outcome of highly political negotiations between federal, provincial and territorial governments, not to mention other powerful interests such as the Canadian Medical Association. After the perceived failures of the 2004 Health Accord to buy change with increased but largely unconditional federal transfers (Health Council of Canada 2014; Maslove 2016), it remains to be seen how the new Liberal government will navigate the tricky political waters of a new Health Accord. Will it be more successful at tying transfers to specific targets and reforms, or will provincial autonomy prevail again? Thus far, mental health is perceived to be a national priority, after or perhaps alongside pharmacare and home care (which also confront significant gaps in public insurance coverage). Will that be enough for mental health to become enough of a national objective to justify the use of federal spending power? Even if negotiations bog down, could mental health be the exception that proves the rule?

### *The Federal Role in Mental Health: Compounding Legacies of Exclusion*

The stage was set for mental health policy to fall outside of federal jurisdiction even before a federal government existed in Canada. The first asylum was established in Saint John in 1837, and by the time of confederation asylums had spread across North America such that they were

explicitly named as an area of provincial jurisdiction in the Constitution Act of 1867: “The Establishment, Maintenance, and Management of Hospitals, Asylums, Charities, and Eleemosynary Institutions in and for the Province, other than Marine Hospitals” (Canada 2012:s.92).

A mix of best intentions and political expediency drove this early spread of asylums. On the one hand, the beginning of colonial governments coincided with the emergence of the moral treatment movement in Europe and North America. Asylums were envisioned as an enlightened alternative to the warehousing of people with mental illness in jails or poorhouses, and as offering a well-ordered respite from the fast-paced, rapidly changing early 19<sup>th</sup> century society (Brown 1984; Rothman 1990). On the other hand, asylums were a politically-expedient solution to a pressing public health and safety issue, providing a morally defensible method for getting unmanageable numbers of people affected by mental illness off of the streets regardless of the quality of care they received in asylums (Rothman 1990). For example, the first asylum was established in Saint John, where higher rates of immigration made “the plight of the insane more evident and more urgent” (Francis 1977, 26).

The intent to provide treatment in a therapeutic setting was overwhelmed by the reality of the high demand for this new institution. Asylums quickly became overcrowded (presumably because they provided a better alternative to jails, living in the streets, destitution, or family care). By 1891, the superintendent of the asylum in Saint John estimated that “of the 442 mental patients residing in the asylum, only 16 are expected to be restored to mental health” (New Brunswick 2011, 4). Similarly by 1939 at the Ontario Hospital for the Insane in Whitby, Ontario, “the patient population swelled to 1,736, bed capacity was 1,542, and patients overflowed into the hallways” (Ontario Shores n.d.). In the face of this increasing demand and overcrowding, the



ideals of moral treatment gave way to warehousing, seclusion and restraints (Lurie and Goldbloom 2015).

*1948-1972 National Health Programme: Targeted, Conditional Grants*

In the years following World War II, Canadian federalism became more centralized in the interests of national re-building and the development of a welfare state. Returning soldiers both exacerbated over-crowding in mental hospitals (as asylums were now called) and drew attention to the poor quality of care. The number of patients in mental hospitals grew from 31,686 in 1931 to 48,056 in 1945, making up 50% of hospital patients in Canada (Canada, House of Commons, 1948, 6169). These urgent mental health needs compelled the federal government to use its federal spending power in a long-standing area of provincial jurisdiction. Targeted mental health grants were included under the National Health Programme in 1948 as one of a handful of national health priorities such as tuberculosis, venereal disease, and hospital construction. These grants were administered almost like contribution agreements, with provincial proposals reviewed by and held accountable to officials at the Department of National Health and Welfare in Ottawa. At \$7M per year at the outset of the program, mental health was the largest grant targeted to a particular disease.

*1957-1977 Cost-Shared Hospital and Medical Services Transfers*

Prime Minister Mackenzie King explicitly intended the National Health Programme grants to be “fundamental prerequisites of a nation-wide system of health insurance” (Canada, House of Commons 1948, 3931). Nevertheless, when it came time to consider mental health in the context of health insurance debates in the 1950s and 1960s, the earlier investments (both the federal

grant and provincial investments in asylums) provided an excuse for the decision to exclude mental hospitals. As argued by Paul Martin Sr., the then federal Minister of Health who introduced the *Hospital Insurance and Diagnostic Services Act (HIDSA)*: “It would be wrong by any principle ... for us to include as part of the hospital insurance scheme ... mentally ill people who receive treatment in provincial institutions” (Canada, House of Commons, 1957, 2677). Further, “No attempt is being made to discriminate against tuberculosis patients and those who suffer from mental illness ... This bill is designed to assist individuals in their individual hospital problems and not to subsidize provinces which are receiving assistance in other ways from the government” (Canada, House of Commons 1957, 3384).

The federal government’s position was extensively criticized by opposition parties, and a proposed amendment to re-consider including mental hospitals in *HIDSA* was debated right up until the final vote in 1957. According to Alexander Nicholson, Member of Parliament from Saskatchewan: “[I]t is most unfortunate that half of the people who are sick every day in the year are barred from the benefits of this so-called national health insurance plan... The cost per day for the patients in the mental hospitals of Canada [was] \$2.70 per patient per day in the mental hospitals ... and \$10.77 per day in the public hospitals. It now becomes clear why the minister is trying to get from under the responsibility of the federal government for this very large group” (Canada, House of Commons 1957, 3382). Erhart Regier, a Member of Parliament from British Columbia, couched the argument more in terms of the vertical fiscal imbalance: “This government gets over 70 per cent of every tax dollar; and simply because most of the provincial governments have now assumed full responsibility for mental care..., the federal government saw a way of saving some money” (Canada, House of Commons 1957, 2667). John Diefenbaker (Leader of the Opposition) put it more colourfully: “Why is this? Why are these [mental]

hospitals ... discriminated against? ...At the present time the provinces find themselves with a smaller and smaller share of the tax dollar and with an increasing problem intensified by our modern way of life which has resulted in the multiplication of the number of mental patients. This load of responsibility cannot be discharged properly by the provinces” (Canada, House of Commons 1957, 3386).

These debates were revisited in the 1960s, with the Royal Commission on Health Services (the Hall Commission) and the introduction of the *Medical Services Act (MSA)*. The Canadian Mental Health Association (1964) (CMHA) released its study, *More for the Mind*. This report recommended a shift from mental hospitals to care in general hospitals and communities in light of new treatment advances and concerns about stigma. However, the CMHA recommended that this shift be phased in: “The immediate scrapping of all old-style mental hospitals in favour of some new ‘master plan’ is not advocated, but planning at the regional and local levels can lead to the development of a new pattern of services which will better meet the needs of the mentally ill” (CMHA 1964, 45).

Accordingly, the Hall Commission made a series of detailed recommendations designed to encourage the shift, but also recommended that *HIDSA* be expanded to cover mental hospitals in the meantime (Canada, Royal Commission on Health Services 1964, 26). However, these nuances were ultimately overlooked as both federal and provincial governments appeared to latch onto the notion that mental illness could be most effectively treated in general hospitals; as these were already covered under *HIDSA*, little in the way of action was needed beyond encouraging the shift.

The federal government was again criticized for seeking to avoid shouldering an expensive responsibility. Harry Harley (Member of Parliament for Halton, Ontario) pointed out

that psychiatric beds in general hospitals still only numbered 4,000 compared with the 68,000 beds in mental hospitals (a number which still totalled nearly half of hospital beds in Canada in 1967) (Canada, House of Commons 1967, 1803). In one of his many speeches on this issue, David Orlikow (Member of Parliament for Winnipeg North) argued that the exclusion of mental hospitals resulted in “one type of treatment for people in the middle and upper income brackets” being far more likely to access higher quality care from psychiatrists and in general hospitals in urban centres, and “another and much poorer type of treatment for people in the low income brackets” (Canada, House of Commons 1968, 3508).

The federal government openly recognized the financial implications of expanding *HIDSA*, both in light of the high costs involved and in light of on-going fiscal federal negotiations. As recounted by federal Minister of Health Judy LaMarsh, during the 1964 federal/provincial conference on health: “[T]here was general acceptance of the principle of the integration of mental hospitals and tuberculosis sanatoria into the general hospital system. However, I did point out that the financial implications would need to be reviewed within the framework of the proposed study of the tax structure” (Canada, House of Commons 1964, 5814). Further, federal Parliamentary Secretary for Health Margaret Rideout argued that: “The question of extending federal contributions so as to include mental and tuberculosis hospitals is a financial question and is precisely the type of question which is now being studied in depth, along with other federal- provincial financial arrangements, by the tax structure committee. It is because of this, and pending a decision as to the future of federal-provincial programs such as hospital insurance, that the government does not propose to make any move at this time to include mental hospitals in the Hospital Insurance and Diagnostic Services Act” (Canada, House of Commons 1967, 1798-9).

The outcome of these considerations is telling: in 1967 the *MSA* was voted in without expanding *HIDSA* to include mental hospitals. Certainly the *MSA* improved access and equity of access to mental health care provided by physicians, a significant policy achievement. However, the importance of this improvement was overshadowed by the hugely disproportionate number of people receiving sub-standard, uninsured services in mental hospitals. When the targeted mental health grant under the National Health Programme was dropped not long after in 1972 (National Health and Welfare 1972), the federal role in mental health was further diminished.

#### FURTHER FEDERAL NEGLECT AND DISPROPORTIONATE GAPS IN MENTAL HEALTH FUNDING

The more recent history shows federal neglect and related disproportionate gaps in mental health funding due to shifts in the overall structure and nature of fiscal transfers in public health. Two periods of change and complexity are examined below.

##### *1978-1992 Block-Funded Transfers, De-Institutionalization and the Canada Health Act*

Mental health policy faded further from view at the federal level over the next fifteen years. The shift to block-funding, the move toward de-institutionalization without the required investment in community services at the provincial level, and the unwillingness by either level of government to expand insurance coverage with the *Canada Health Act (CHA)* did nothing to address the long-standing gaps and inequities in mental health policy.

Mental health was largely absent from the debates about the *Established Programs Financing (EPF) Act*, introduced in 1978. The shift from cost-shared to block-funded transfers was caught up in the broader dynamics of fiscal federalism, with provincial governments gaining more autonomy in the form of fewer conditions on federal transfers and a greater share of tax

room, in exchange for greater budgetary certainty for the federal government (Ouimet 2014). As argued by Maioni (2002), the *EPF* tied federal transfers to the gross domestic product rather than actual health care costs, leaving provinces with greater responsibilities for growing health care costs.

These cost pressures combined with new opportunities for community-based treatment noted in the Hall Commission report to once again provide a recipe for political expediency. The move to close mental hospitals (known as de-institutionalization) that started in the 1970s was driven as much by the cost pressures on provincial health systems in the wake of *EPF*, as by the imperative to provide higher quality care for people living with mental health problems and illnesses. By the mid-20th century new pharmacological and psychotherapeutic treatments had opened up new opportunities for active treatment (as opposed to custodial care) and recovery of meaningful lives in the community for people living with mental health problems and illnesses (Canadian Medical Health Association 1964). In combination with a new wave of advocacy to address deplorable conditions in mental hospitals, these treatment advances built public support for de-institutionalization (Mulvale et al. 2007).

However, the promised re-allocation of funding from psychiatric institutions to community-based services was never fully realized (Lurie and Goldbloom 2015). According to Orlikow: “With the development of the tranquillizer drugs, many people who earlier spent years, if not their whole lives, in mental hospitals have been and are being released. The idea was that they would be serviced outside in the community which would help them in the transition years. ... [E]ven in a city like Toronto there are very few services for these people, so they are going back to the hospitals again” (Canada, House of Commons 1982, 15869). While de-institutionalization undoubtedly improved the lives of those who were able to secure community-

based treatments and supports, it also provided a political rationale for further erosion of public funding for mental health services at a time when provincial health systems were under increasing cost pressures.

The *CHA*, passed in 1984, further entrenched the legacies of exclusion and neglect of mental health services. In the wake of the 1980 Quebec referendum, the federal government was able to shift the federation toward a more centralized approach in the name of national unity (Ouimet 2014). This centralization included imposing national health standards to put an end to extra billing through the *CHA*. However, this new appetite for federal standards did not extend to under-insured areas such as home care and pharmacare, and perhaps even more particularly it did not extend to mental health.

At the time of the *CHA* negotiations, the combined impact of the shift from cost-shared to block transfers, growing health care costs, and the shortfalls of de-institutionalization left both levels of government with little appetite for expanding responsibility for mental health insurance coverage beyond services provided by physicians or in general hospitals. Federal Minister of Health Monique Bégin recalled federal/provincial discussion of the “gray areas of medicare” as follows: “Some ministers felt it put expansionist pressure on the health-care system ... Strategic as well as economic considerations prevented me from deviating one iota from the principle that the basic rules of health insurance remain unchanged ... Mental illness was a touchy question. Though in practice many of the treatments and services for mental illness were fully integrated into general health care, the provinces did not want to see anything in this category included in medicare” (Bégin 1987, 160-1).

By this time the issue was not so much coverage for mental hospitals; block transfers made the details of how federal health transfers were spent quite at the discretion of provincial

governments. However, with new forms of psychotherapeutic and community-based treatment, coverage of non-medical providers (such as psychologists, social workers, and nurses) had become increasingly relevant. As argued by Bill Blaikie, a Member of Parliament from Winnipeg, the *CHA* failed to “provide leadership and incentives for moving the health care model with which medicare currently co-exists away from the present physician-dominated, curative model, toward a more comprehensive, community-based preventive health care model such as groups like the Canadian Nurses' Association have suggested” (Canada, House of Commons 1984, 454).

Largely as a result of advocacy from the Canadian Nursing Association and over the objections of the Canadian Medical Association, a small toehold for non-medical providers was achieved in the comprehensiveness clause (clause 9) of the *CHA*: “In order to satisfy the criterion respecting comprehensiveness, the health care insurance plan of a province must insure all insured health services provided by hospitals, medical practitioners or dentists, and where the law of the province so permits, similar or additional services rendered by other health care practitioners” (CHA 1984). However, provincial governments have been very reluctant to use this clause to expand coverage of non-medical providers, which to date has been largely limited to public insurance coverage for midwifery services. When provincial governments have acted to expand access to non-medical services, they have sought to retain control by making targeted, direct investments in community agencies or hospital-based clinics, rather than opening the door to demand-driven insurance coverage. While these developments have been positive, these controlled investments have fallen far short of closing the gap in funding for mental health services.



*1992-2014 Health Reform Transfers and National Mental Health Funding Proposals*

Mental health has steadily moved onto the national agenda over the past two decades of health reform transfers. However, none of the health reform transfers has resulted in significant mental health investment, as mental health has been largely crowded out by other priorities. The Standing Senate Committee on Social Affairs, Science and Technology report (Canada 2006) on mental health, titled *Out of the Shadows at Last*, and the subsequent release of the 2012 Mental Health Commission of Canada report set out clear funding proposals, but to date the impact beyond raising the profile of mental health has been limited.

The motivation for broader health reform stemmed as much from concerns about the sustainability of the healthcare system in the face of spiralling costs, as from new thinking about comprehensive, patient-centred, quality healthcare. In the context of these concerns about sustainability, it was once again difficult for real progress to be made in narrowing the gap in funding for mental health care. For a total cost of \$150M between 1997 and 2001, the *Health Transition Fund* funded 141 pilot projects, of which 21 focused on mental health (Goldner 2002). For a total cost of \$800M from 2000 to 2006, the *Primary Healthcare Transition Fund* funded a variety of projects, including \$3.8M for one national project on collaborative mental health care and a few provincial mental health projects (Canada 2007; Health Canada 2007). Even with the massive increases to federal health transfers with the 2003 and 2004 Health Accords, mental health only warranted being included as “short-term acute community mental health home care for two-week provision of case management and crisis response services,” an awkward add-on to one of three home care priorities (Canada 2004).

It was only when the above mentioned Senate Standing Committee on Science and Technology followed up its 2002 report on health (Canada 2002) with *Out of the Shadows*, its

2006 report on mental health (Canada 2006), that momentum started to build for mental health as a national priority. Building on the earlier transition funds, the 2006 report recommended a 10 year, \$5.1B Mental Health Transition Fund, with a focus on supporting the transition to community-based services and improving access to housing for people living with mental health problems and illnesses. The Harper Conservatives did not take up this recommendation, but did follow the Senate's recommendation to establish the Mental Health Commission of Canada (MHCC) in 2007 with a budget of \$140M over 10 years and a mandate that included the development of a national mental health strategy (Finance Canada 2007). The development of the *MHS* has spurred unprecedented mental health policy development at all levels of government and in many sectors (Mulvale et al. 2014; Lurie and Goldloom 2015). However, this policy development has not been matched by anything more than marginal new investments.

To put some real numbers around the shortfall, the goal set in the *MHS* was to bring the proportion of public health spending on mental health up from 7 to 9 per cent (with equivalent increases in social spending as well as more efficient use of existing spending). Based on the \$145B in public spending on health in 2012 (Canadian Institute for Health Information 2014), reaching 9 per cent would require increased spending on mental health by \$3B per year, from \$10B to \$13B. The federal *CHT* made up 21 per cent of provincial health expenditures in 2012 (Canadian Institute for Health Information 2014; Finance Canada 2015a). If the federal government took on 21 per cent of this \$3B mental health funding gap, the cost would be \$630 million per year; if it went back to the original 50/50 cost-sharing formula for public health insurance, the cost would be \$1.5B.

These kinds of numbers far exceed previous federal transfers on mental health, which seems to have peaked with the \$7M per year spent on the mental health grant starting in 1948,

the equivalent of \$73M in 2015 after adjusting for inflation. Just as in 1957 and 1964 when mental hospitals were excluded from hospital insurance, in the 1970s when provinces closed mental hospitals without re-investing accordingly in community and general hospital services, and again in 1984 when the *CHA* did not expand to include coverage of non-medical mental health services, provincial and territorial governments today are challenged to close the mental health funding gap without targeted federal support.

At the same time, this lack of progress in closing the mental health gap through the health reform years has been influenced by broader developments in fiscal federal politics. In exchange for commitments to consult and secure a set threshold of provincial support for major initiatives, the federal government pushed for greater constitutional recognition of federal spending power through the Meech and Charlottetown Accords. After these Accords failed, softer policy recognition was secured in 1999 with the Social Union Framework Agreement (SUFA), which was approved by all provinces and territories except for Quebec (Ouimet 2014). However, this new recognition has not fundamentally changed the political nature of fiscal federalism. Post-SUFA, the federal government's choice of which national objectives to pursue through the use of federal spending power has been as much based on the political calculus of the day as ever.

For example, the 2011 announcement by the Harper Conservatives of a completely unconditional approach to the *CHT* (Finance Canada 2011) was consistent with the government's "open federalism" position, whereby the federal government sought to limit its involvement to areas of clear provincial and territorial jurisdiction. At the same time, this approach distanced the Conservative government from the perceived failures of the 2004 Health Accord. While provinces and territories gained certainty regarding federal health transfers, they were left to their own devices for the increasingly impossible task of health reform. By contrast, in 2014 the

Conservatives strongly exerted federal spending power on job training (also clearly under provincial and territorial jurisdiction) through the Canada Jobs Grant, a far more politically-attractive policy area.

#### A CONCLUDING POLITICAL ANALYSIS ON THE PROSPECTS FOR A TARGETED MENTAL HEALTH TRANSFER BY THE TRUDEAU LIBERALS

What then are the prospects for a targeted mental health transfer under the Trudeau Liberals? Is the moral and economic case for closing the gap in funding for mental health services compelling enough? Has a real policy window opened?

On the down side of the ledger, early signs suggest that mental health may be overshadowed by other pressing healthcare priorities, namely home care and pharmacare (Simpson, 2016). Mental health was not mentioned in the joint press release coming out of the first Federal/Provincial/Territorial Ministers of Health meeting early in 2016 (Canadian Intergovernmental Conference Secretariat 2016). Meanwhile, federal fiscal politics are bound to be as intense, and health policy as intensely politically salient, as ever. Whatever interests provincial and territorial governments have in improving access to mental health care will be at least balanced by their interests in maintaining their autonomy, and Quebec will likely opt out of whatever deal can be reached. The \$3B that would be required to bring the mental health from 7 to 9 per cent of public spending on health would be difficult to achieve at the best of times, let alone during an economic downturn. Finally, while stigma may be lessening, the risks of exclusion and neglect by policy-makers are alive and well in a country where 46 per cent of people believe that mental illness is used as an excuse for poor behaviour (Canadian Medical Association 2008).

On the plus side, the independent streams of problems, policies and politics in the Kingdon model of agenda setting are strongly aligned (Kingdon 1995). The funding and equity gap between mental health and health care is increasingly recognized as a serious problem. To quote Prime Minister Trudeau, “this separation of mental health as being outside of health has to stop...we have to lean in” (quoted in Crespi 2016). The *MHS* and related work lay out numerous policy solutions which are based on extensive civil society engagement (Mulvale et al. 2014), and have been welcomed by provincial governments. Lessons learned from the early Health Accords may also have increased the appetite for policy solutions which attach stronger conditions to federal transfers, by either targeting to specific issues such as mental health or setting specific targets. The political stream is also favourable, with public support for a targeted transfer at 90 per cent and a commitment from the Trudeau Liberals to improve access to mental health on the books. The remaining ingredient may be the policy entrepreneur who will invest the time and energy to advance this topic firmly on the decision agenda by coupling the three streams.

This political analysis suggests that the prospects for a targeted mental health transfer are good, maybe even strong, but not a sure thing. There are a variety of forms that such a transfer could take. It seems highly unlikely that there would be support from the provincial and territorial governments, let alone the federal government, to expand demand-driven public health insurance coverage under the *CHA*. The same can be said for approaches that tie federal transfers to employment-based or private insurance; thus far, such proposals have invoked politically unpalatable moves away from first-dollar coverage, even though they might actually be an improvement over the status quo for non-medical mental health services.

Far more likely is a variant of the earlier Health Accords. A targeted mental health transfer could be tied to fairly specific actions such as expanding access to psychotherapy (Anderssen 2015:F1), or to the *Out of the Shadows* report proposal for transitional funding to strengthen community-based services. Alternatively, a targeted transfer could be more loosely tied to the implementation of the *MHS*, with a specific target to reach the 9 per cent targeted share of public health spending. As argued by Maslove (2016), the bilateral gas tax transfer agreement model might be more effective than multilateral agreements such as the earlier Health Accords. The gas tax transfer set national objectives but was implemented through bilateral agreements which responded to different provincial and territorial needs. Such a bilateral approach could potentially leverage federal spending power to spur innovation across the country, in a manner consistent with the spread of Saskatchewan-based innovations in health insurance in the mid-20<sup>th</sup> century.

In the absence of successful negotiation of a targeted transfer, incremental progress can still be made to close the mental health gap, or to at least slow the rate at which the gap widens. With their recent mental health strategies and plans, some provincial and territorial governments have been able to make targeted investments in mental health, even in the face of escalating health costs and projected declines in federal transfers (although in the case of Ontario targeted investments in mental health have been outstripped by spending on physician health). The federal government could make smaller-scale transfers to provincial and territorial governments and organizations through departmental budgets as it has done for addictions funding through the National Anti-Drug Strategy (Canada 2015), or it has done for cancer and mental health through federally-funded organizations such as the Canadian Partnership Against Cancer (2015) and the MHCC.

While the focus of this chapter has been on prospects for a targeted mental health transfer under a new Health Accord, social spending plays a critical role in mental health policy as well, in sectors such as housing, education, justice and child welfare. Moreover, the federal government has important jurisdictional responsibilities to improve the quality and availability of mental health services for specific population groups such as indigenous peoples, federal inmates, and the military. The opportunity also exists to advance mental health funding through other health reforms, for example through home care or pharmaceutical insurance. This strategic approach has long been used as a way to advance mental health reform, which has traditionally been below the radar screen of policy makers (Rocheffort 1999).

Incremental progress on health spending is of course to be welcomed, as would increased social spending, increased investment in direct federal services, or investments that are piggy-backed on other health reforms. However, there does seem to be a window of opportunity to introduce a targeted mental health transfer. A national mental health strategy is in place, the federal government is committed, public interest and support are at an all-time high, and Health Accord negotiations are underway. With its decision in 1957 to not take on the high cost of insuring services for the 40 per cent of hospital patients in mental hospitals, the federal government entrenched a gap between mental health and physical health care that has never been closed. Without significant federal support, history tells us that provincial and territorial governments will continue to be challenged in their efforts to address this fundamental disparity affecting the lives of millions of Canadians.

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## Chapter 9

## HOW OTTAWA MENDS: RENEWAL AND SUPPORT TO REGISTERED CHARITIES UNDER A LIBERAL GOVERNMENT?

Karine Levasseur

## INTRODUCTION

The relationship between the Harper government and registered charities was an uneasy one at the best of times. With the election of a majority Liberal government, will this relationship change and if so, how will it change? This chapter provides answers to these important questions. If the Trudeau government is serious about repairing its relationship with the charitable sector, the government must resolve several pressing policy problems facing charities. First, the new government must reassure charities and Canadians that the regulator — the Canada Revenue Agency (CRA) — is independent and follows the rule of law amidst recent concerns that the Harper government politicized the CRA to silence charities.<sup>1</sup> Second, the new government must modernize the meaning of charity and advocacy rules.<sup>2</sup> While there are several options for reform, this chapter argues that legislating a definition of charity is needed along with an expansion of the advocacy rules.

These proposed solutions are significant and go far beyond merely clarifying the existing rules. For too long, Canada has initiated small incremental change while other common law countries have undertaken significant reform making Canada a laggard on the international stage. To be sure, this type of reform is not without its challenges and there have been signals by the new government that it may be realigning (read: lowering)

expectations as to what policy change it can deliver. On this point, I argue that the new government is not moving away from its political commitments, but moving ahead albeit very gently.

The chapter begins with an overview of the charitable sector in Canada followed by an examination of the problems associated with the meaning of charity and advocacy. It assesses the relationship between the sector and the Harper government, and then turns its attention to the new Trudeau government with its promise of renewal and support. The chapter discusses some possible reform options and closes with a discussion related to the support for, and the challenges to, modernizing the meaning of charity and advocacy.

#### SIZE, SCOPE, AND ROLE OF REGISTERED CHARITIES

There are approximately 86,000 charities currently in operation in Canada. Charities comprise organizations or foundations that provide a public benefit and pursue one of the following purposes: relief of poverty; advancement of education; advancement of religion; or purposes that benefit the community. Registered charities are permitted to issue income tax receipts for donations that may then be claimed by the donor to reduce taxes. This ability to issue income tax receipts for donations is significant with Canadian tax filers reporting a total of \$8.8 billion in donations in 2014 (Statistics Canada 2016). To become a registered charity for tax purposes, a non-profit organization must apply to the CRA and receive charitable status.

Presumably, the federal government's provision of charitable status is recognition that certain purposes are deemed worthy of support under interpretation of the common law<sup>3</sup> since charitable status confers certain benefits. In her earlier work this author

(Levasseur 2008) concluded that receiving charitable status matters to the functioning of an organization because of the benefits that flow from receiving said status, notably the ability to expand and diversify funding opportunities. There is a heightened legitimacy that comes with being a charity. With the government's stamp-of-approval, charities are trusted and perceived as being held accountable.

When registered charities are combined with non-profit organizations, they form the world's second largest voluntary sector proportional to Canada's economic output and contribute 8.9% to the GDP (Hall, et al. 2005:7-9). Indeed, their economic contribution exceeds that of several industries including agriculture and motor vehicle manufacturing (Statistics Canada 2009). Besides this economic importance, Canadians place a high value on the role of charities in governing. A recent survey initiated by the Muttart Foundation (Lasby and Barr 2013:9-10) reveals that 79% of Canadians trust charities and two-thirds believe that charities understand the needs of citizens better than government. Studying the relationship between charities and the federal government is critical because charities deliver some of the most important goods and services such as food banks, shelters and hospitals in Canada, but they do so much more. They represent identities, promote citizenship and build social capital, thus making them crucial governance actors.

## INSTITUTIONAL LEGACIES

The Constitution Act of 1867 (s. 92(7)) grants exclusive regulatory powers over charities to the provinces in such matters as fundraising. The registration of charities, however, in the form of tax expenditures for donations falls under the jurisdiction of the federal

government constitutionally (s. 91(3)). As the regulator in this area, the federal government is responsible for defining the meaning of charity for tax purposes.

For non-profit organizations to become registered charities for tax purposes, both the purposes and activities must be deemed charitable. For the former, no definition of charitable purposes exists within Canadian legislation so officials must rely on the common law for guidance when determining which purposes should be deemed charitable. Charitable purposes are rooted in the common law of the *English Preamble of the Statue of Charitable Uses*, 1601. The *Preamble* provides a list of acceptable charitable purposes and this list was later interpreted in an English court decision of the *Commissioners for Special Purposes of the Income Tax Act v. Pemsel* in 1891. In that case, Lord Macnaughten outlines four heads of charity — relief of poverty, advancement of education, advancement of religion and purposes beneficial to the community — that are used today to determine which purposes are charitable (Bridge 2002, 5; see also Webb 2000, 27).

Canada's interpretation of the common law is more restrictive than many other common law countries (Broder 2014; Drache 2002; Levasseur 2012; Phillips 2011). Purposes considered charitable in other common law countries, such as the promotion of multicultural activities, amateur sports, and patriotism may not necessarily be considered charitable in Canada (Broder, 2001).

Non-profit organizations that are denied charitable status may appeal the decision to the courts. The court of first instance for issues concerning charitable status is the Federal Court of Appeal followed by the Supreme Court of Canada. The costs associated with an appeal are considerable so few appeals are pursued. Indeed, Broder (2014) points

out that the Supreme Court has only rendered decisions to date on three cases related to the meaning of charity.<sup>4</sup> Phillips (2011, 220) notes that the courts can update the meaning of charity through regular review. However, she is also quick to point out that insufficient regular review leaves the common law “calcified depending on that last case heard” (Ibid, 220). With the few opportunities provided for the courts to render decisions, they have not updated the meaning of charity. Space constraints prevent a full overview of court decisions rendered (see Cullity 2014; Stevens 2000 for more details), but one decision worth exploring clearly illustrates this point.

In 1999, the Vancouver Society for Immigrant and Visible Minority Women appealed the denial of charitable status to the Supreme Court. While Vancouver Society has several goals, one of its primary goals involves the social and economic integration of immigrant and visible minority women through a variety of services including a job referral service and other services such as resume writing, accreditation, and counseling (Stevens 2000). Despite its laudable goal, the majority justices denied the appeal on two grounds according to Stevens (2000). First, the recipients — immigrant and visible minority women — are not necessarily in need of charity. Stevens (2000) notes, “The target ‘all immigrants’ would include independent immigrants who would not require assistance and therefore could not be the object of charity”. Second, the promotion of employment is not charitable unless it is incidental and ancillary to other charitable purposes. The majority justices concluded that the employment-related purposes and activities such as the provision of a job directory are neither incidental or ancillary. As a result, Vancouver Society “was not exclusively charitable” (Stevens 2000). While the Supreme Court refused to modernize the meaning of charity, it called upon Parliament to



do so with Mr. Justice Frank Iacobucci asserting: "...even though some substantial change in the law of charity would be desirable and welcome at this time, any such change must be left to Parliament" (Vancouver Society of Immigrant and Visible Minority Women v. Minister of National Revenue 1999).

Non-profits that apply for charitable status must have both charitable purposes and activities. In terms of activities, organizations that apply for charitable status must limit their political activities better known as 'advocacy'. The courts have defined political activities as the "seek[ing] to retain, oppose, or change the law or policy or decisions of any level of government in Canada or a foreign country" (Canada Revenue Agency (CRA) 2003). In 2003, the CRA updated its administrative guidelines that limit the amount of advocacy activities that a charity may initiate to 10-20% of resources, depending upon the size of the organization.<sup>5</sup>

This limitation on advocacy has been thoroughly reviewed in the literature. Two basic views on this limitation exist. One view suggests that limiting advocacy is reasonable because the use of taxpayer dollars vis-à-vis the charitable tax expenditure is inappropriate (Bryden 2002). The second view suggests this limitation undermines charities and their ability to address the root-causes of problems in society (Bridge 2002). In this view, charities are left to respond to the problems caused by poverty, for example, but are limited in advocating systemic changes. Yet, advocacy is an important public policy input that has contributed to some important public policy changes particularly related to smoking regulations and drunk driving (Imagine Canada 2014).

## REGISTERED CHARITIES UNDER THE HARPER GOVERNMENT

Budget 2012, which largely focused on jobs and economic growth as a response to the financial downturn starting in 2008, contained an important public policy decision that had an impact on registered charities in relation to their advocacy. The Budget frames the advocacy undertaken by registered charities as a problem that requires increased oversight and states, “Recently, concerns have been raised that some charities may not be respecting the rules regarding political activities. There have also been calls for greater public transparency related to the political activities of charities, including the extent to which they may be funded by foreign sources” (Department of Finance 2012, 204).

These “calls for greater transparency” were rooted in the controversial Northern Gateway pipeline designed to connect Alberta’s oilsands to the BC coast and support the export of crude oil. In early 2012, Natural Resources Minister Joe Oliver penned an open letter to charities in the *Globe and Mail* where he implied that certain groups, notably environmental charities, were undermining the interests of Canadians. He notes that these groups “threaten to hijack our regulatory system to achieve their radical ideological agenda. They seek to exploit any loophole they can find, stacking public hearings with bodies to ensure that delays kill good projects. They use funding from foreign special interest groups to undermine Canada’s national economic interest.” (Oliver 2012). This letter, according to Kirkby (2014), establishes an ‘us versus them’ narrative whereby good economic development with the promise of good-paying jobs were at stake because of radical groups including charities. Following this open letter, Environment Minister Peter Kent appeared on CBC’s *Power and Politics* and suggested that charities were engaging in money laundering to support their political activities: “offshore funds have

improperly been funneled through — laundered if you will, that's a fairly accurate word — through Canadian organizations that have charitable status to be used in ways that would be improper given that charitable status" (CBC News 2012).

As a response to this so-called problem, Budget 2012 allocated \$8 million to the CRA (\$5 million in 2012-2013 and \$3 million in 2013-2014) at a time when departments experienced budget reductions to achieve two goals: ensure greater transparency and institute new audits. For the first goal, Budget 2012 expanded authority to the CRA to require additional information from charities related to their political activities and whether these activities are funded through foreign donations. This resulted in a revision made to the annual return for charities (T3010) that contained a new political activities schedule (schedule 7). No changes were made to the legislation related to the permissible advocacy activities of registered charities. For the second goal, the budgetary increase required the CRA to conduct special audits of political activities undertaken by charities. Between 2012-2016, an additional 15 'political activity' audits were to be completed in each year for a total of 60 in addition to the 'regular' 800-900 audits completed annually as outlined in Table 1.

Phillips (2009) asserts that the approach of the Harper government to the sector was one of neglect in failing to address important issues. She notes that

“The federal government has created a dilemma for itself. It appears to have made it clear that it does not need any relationship of significance with the voluntary sector — not advocacy, nor research, nor the promotion of volunteerism, nor social enterprise nor active citizenship.” (2009, 30).

Yet, Phillips (2011) also concedes that the Harper government expanded the amount of the charitable tax expenditure so there is some semblance of a governing philosophy for

**Table 1: Completion of political activities audits**

	<b>As of January 20, 2016</b>
Completed	30
Underway	24
Not yet started	6
	<b>TOTAL: 60</b>

Source: Canada Revenue Agency 2016

this sector whereby citizens have the choice to direct their philanthropic dollars and provide greater opportunity for charities to attract private funding. By way of example, the Harper government introduced an expanded charitable tax credit for first-time donors to receive an additional 25% in tax credits for donations. Moreover, the Harper government allowed the donation of shares in public companies without payment of the capital gains tax in 2006. In 2015, the Harper government sought to extend this provision to shares in private companies and real estate, which was expected to take effect in 2017, but was cancelled by the Trudeau government in 2016. Carter et al. (2016, 2) identifies that the “proposed rules were complicated and fraught with practical and implementation challenges” so this may explain why the new government opted not to further expand the charitable tax expenditure. Moreover, there were comments made by the Liberal Party during the election against the reliance on boutique tax expenditures.

The central question raised is whether this heightened scrutiny over ‘political activities’ is an act of good stewardship to ensure the integrity of the tax system or a bullying effort on the part of the Harper government to distract charities with audits and create a chilly environment for charities engaging in advocacy? The comments made by the Harper government were both inflammatory and divisive. Of further concern were the specific comments by the Environmental Minister Peter Kent that charities were involved in money laundering operations to undermine domestic public policy conversations. While framed as an appropriate course of oversight to protect domestic public policy formulation from foreign interests, the introduction of these ‘political activities’ audits were rooted in spite. The Harper government employed inappropriate rhetoric and imagery that undermines the trust that Canadians have with charities.

Another question worth probing is whether certain types of charities — those in opposition to the government agenda — were targeted for audits. Kirkby’s (2014) research concludes that certain charities from the environment, development and human rights, and charities receiving donations from labour unions were targeted for political activity audits. The CRA indicated that it selected the charities to undergo a political activity audit without political interference (Canada Revenue Agency 2015). Yet, we may never fully know whether certain charities were targeted because of the privacy associated with tax matters. Unless a charity reveals that it is being audited by the CRA, there is no conclusive evidence for social science researchers to assess whether certain types of charities were targeted.

## LIBERAL PARTY PLATFORM: RENEWAL OF A RELATIONSHIP WITH CHARITIES?

The 2015 federal election saw the Liberal Party of Canada advance a platform with key electoral promises that, if implemented, will have an impact on charities. The electoral promises are three-fold: elimination of political activities audits instituted by the Harper government; heightened transparency through modernization data collection processes including the T3010 which is an annual form completed by all registered charities; and, creation of a new legislative framework for registered charities.

These promises were articulated in the mandate letters to the Minister of Finance, who is responsible for the *Income Tax Act*, and the Minister of National Revenue, who is responsible for the CRA. The mandate letter to the Minister of National Revenue expects the Minister to:

“allow charities to do their work on behalf of Canadians free from political harassment, and modernize the rules governing the charitable and not-for-profit sectors, working with the Minister of Finance. This will include clarifying the rules governing “political activity,” with an understanding that charities make an important contribution to public debate and public policy. A new legislative framework to strengthen the sector will emerge from this process” (Office of the Prime Minister 2015).

When it assumed office, the new government was seen as ushering in a change as to how the federal government relates to the charitable sector. The approach under the Harper government was one of scepticism and spite, particularly in the latter part of its mandate, but the initial approach of the Trudeau government is a willingness to engage the sector. The Trudeau government has followed through with its electoral promise to end the political activity audits or what it dubbed “political harassment”. On January 20, 2016, Minister of National Revenue Diane Lebouthillier announced that the political activity

audits would cease and that of the 30 completed audits to date, only five (5) resulted in revocation of charitable status for reasons not related to advocacy. Twenty-four audits are still in-progress and will be completed, but the audits will now be conducted as regular audits, not as political activity audits. The remaining six audits that have not commenced, will not occur (Canada Revenue Agency 2016). In her estimation, the audits show compliance: “The results of the political activities audit program have shown that the charities audited have been substantially compliant with the rules regarding their involvement in political activities” (Canada Revenue Agency 2016).

As for the other electoral pledges to clarify the advocacy rules and construct a new legislative framework, it is unclear whether the rules will simply be clarified, which would mean incremental change at most, or whether the rules themselves will be changed. The mandate letters provide directives to the Minister of National Revenue and the Minister of Finance, but they are quite broad so it is not entirely clear if the new government is focused on incremental or larger more transformative policy change.<sup>6</sup>

## MOVING FORWARD

### *The Meaning of Charity*

There are several ways to address the public policy problem related to the meaning of charity in Canada. The first option is to do nothing. The second option is to maintain the common law. One example includes some changes to the institutional configuration whereby access to the courts becomes easier in the hope that it allows for more review of the meaning of charity. Another example is the reliance on administrative guidelines that clarify, and at times update the meaning of charity, but within the confines of the common law. These guidelines have been used extensively by the CRA in recent years

and they are designed to supplement the common law and lead to greater transparency by “promot[ing] a better understanding of what types of organizations may be registered within the parameters of the charity law” (Canada Revenue Agency 2004). Guidelines have been issued in some of the most problematic areas including human rights, ethnocultural communities, advocacy, and racial equality to name a few examples. To what degree, though, do the guidelines update the meaning of charity and advocacy from its roots in 1601?

Phillips (2011) suggests the changes are marginal at best. She notes, for example, that the administrative guidelines related to ethnocultural communities, which presumably would help an organization like Vancouver Society to become registered as a charity, do not require the “courts to be bound by CRA guidance, and they have not been put to the test” (Phillips 2011, 222). Drache (2004) agrees and states, “[CRA] takes the position that in order to qualify, organizations must meet the common law tests of what is a charitable activity. The end result is that while the paper offers considerable guidance as to what will be acceptable, it is far from a forgone conclusion that all or most existing ethnic organizations will be able to meet the tests.”

A third option involves legislation. Since Canada’s meaning of charity is rooted in common law, it can learn from other common law countries that have updated the meaning of charity through this option notably the UK, Australia and New Zealand (Lalonde 2016: 5). Space considerations prevent a full comparative treatment of how each jurisdiction has updated the meaning of charity. Rather, this section will explore one jurisdiction — England and Wales — to illustrate that things can be done differently.



England and Wales engaged in this debate under former Prime Minister Tony Blair. Blair requested the Strategy Unit to examine how the legal and regulatory frameworks affect charities and non-profit organizations with a specific emphasis placed on the meaning of charity. In his opening remarks to the Strategy Unit's final report, Blair agrees with the report's findings that there is a serious public policy problem related to the meaning of charity:

“The comprehensive analysis underlying this report shows that the law and regulation have not kept pace with developments. Charitable purposes, for instance, were set out in a statute over 400 years ago. The current law is unclear, has not evolved in a way which best meets the needs of contemporary communities and does not reflect the diversity of organizations which operate for a public benefit” (United Kingdom, Strategy Unit 2002:5-6).

The final report concluded that a need existed for a legislated definition of charity with the concept of conferring a public benefit at the heart of any new definition. The government's response to this report — *Charities and Not-for-profits: A Modern Legal Framework* — followed in July 2003 which accepted most of the recommendations.

The next step consisted of a draft Charities Bill introduced into the legislature in May 2004 with the Charities Bill receiving Royal Assent on November 8, 2006. The new *Charity Act, 2006*, provides a two-fold statutory definition for charity (Morris 2011:41). Organizations seeking charitable status must confer a public benefit and fall under one of the new heads of charity. The *Charity Act, 2006* expands the four heads of charity under the *Pemsel* Test to 13 heads as follows:

- Prevention or relief of poverty;
- Advancement of religion;
- Advancement of education;
- Advancement of health or the saving of lives;
- Advancement of citizenship or community development;

- Advancement of the arts, culture heritage or science;
- Advancement of amateur sports;
- Advancement of human rights, conflict resolution or reconciliation or the promotion of religious or racial harmony or equality and diversity;
- Advancement of environmental protection or improvement;
- Relief of those in need by reason of youth, age, ill-health, disability, financial hardship or other disadvantage;
- Advancement of animal welfare;
- Promotion of the efficiency of the armed forces of the Crown; of the efficiency of the police, fire and rescue services or ambulance services; and,
- Any other purposes charitable in law.

These 13 heads of charity, according to Morris (2011:43), “widen the scope of what might be considered charitable”. A good example that illustrates the kinds of purposes that can be registered as charities in England and Wales, but not in Canada, are those dedicated to the prevention of poverty. In 2014, Oxfam Canada was informed by the CRA that its goal to prevent and relieve poverty was problematic. While the common law clearly identifies the *relief* of poverty as a charitable purpose, the *prevention* of poverty is not a charitable purpose because resources may be directed at individuals who are not yet poor and thus not in need of charity (Tsao et al. 2015, 44). Yet, Morris (2011) clearly illustrates the difference under the *Charity Act 2006* that allows for the prevention of poverty to be considered charitable in the UK, not just the relief of poverty as found under the common law.

Another example relates to amateur sport. When sport is used to achieve a charitable purpose, it is generally viewed as charitable. For example, the promotion of sports to assist persons with disabilities would generally be viewed as charitable in Canada. Sport, by itself and most notably amateur sports, is not recognized as charitable under our common law tradition according to Broder (2001: 80). First, sport is difficult to

place within the four heads of charity since it does not: relieve poverty, advance religion or education, or encompass the broader community. Second, sport can generate a personal, but not necessarily a public benefit. This interpretation was confirmed by the Supreme Court in its 2007 decision on the Amateur Youth Soccer Association (AYSA) whereby “sport does not qualify as charitable under Canadian law” (Phillips 2011, 221). In Canada, only national organizations that promote amateur sports are eligible for quasi-charitable status under the Registered Canadian Amateur Athletic Associations (RCAAA) as ‘qualified donees’ under s. 149.1 of the *Income Tax Act*. This leaves local, provincial or regional amateur sports organizations unable to access the benefits of charitable status vis-à-vis the tax system. Drache (2002b: 9) argues that the addition of the RCAAA to the *Income Tax Act* was done to nurture the development of Canadian athletes competing in the 1976 Olympics in Montreal without calling the organizations charities and to overcome the common law that could not accommodate these types of organization. Yet, the legislated definition in England and Wales permits amateur sports organizations to be registered as charities unlike in Canada (Valentine 2015: 2).

The benefit of a legislated definition is that it can accommodate those purposes that are not deemed charitable in the common law. For example, common law does not permit the preservation of a culture, promotion of multiculturalism, or provision of employment services to immigrants to be deemed charitable in Canada. Under a legislated definition, however, these purposes could be charitable whereby the meaning of charity becomes a political decision, not an administrative decision.

### *Advocacy*

In relation to advocacy, Canada relies on a *quantification model* to determine the level of acceptable advocacy based on the budget of a registered charity, and this model is also used by the United States. However, the spending limits are much higher in the United States than in Canada despite the fact that the “fundamentals [in the States] are not markedly different from Canadian regulation but overall are more flexible and accommodating of advocacy” (Harvie 2002, 21. See also Boyle 1997, G9). Charities in the United States with budgets under \$500,000 may spend up to 20% (maximum of \$100,000) on advocacy initiatives (Smucker 1999, 55). Comparatively, charities in Canada with budgets over \$200,000 may only spend 10% whereas small charities with budgets less than \$50,000 may spend up to 20% (maximum \$10,000).<sup>7</sup>

In contrast, the *education model* provides discretion to government officials as to what are acceptable levels of advocacy. England and Wales is an example of this model, and Cullity (2014, 29) contends that their approach to advocacy is far “more benevolent” than the Canadian approach because there is no expectation that advocacy be ancillary or incidental to the pursuit of charitable purposes. Rather, advocacy is permitted as a means to an end, so long as advocacy does not comprise the sole means of the charity (Cullity 2014). Harvie (2002, 21) agrees. In her estimation, the important distinction is that England and Wales do not require charities to allocate substantially all of their resources to charitable purposes as in Canada thus providing greater room for advocacy.

### *Support and Challenges to Reform*

Moving a reform agenda will require support from charities, non-profits and the broader public. At the height of the Voluntary Sector Initiative in the early 2000s, there were

several sources of evidence to suggest unity for reform within the voluntary sector.<sup>8</sup> The Voluntary Sector Forum, launched in 2002, comprised 19 members of the sector representing various and broad constituencies identified advocacy reform as a top priority. The Let Charities Speak consultation process in 2001 involving the former Canadian Centre for Philanthropy (now Imagine Canada) visited 14 cities with 700 participants. A survey formed part of this consultation process with 490 completed surveys. 91% agree that the advocacy laws were unacceptable with 97% agreeing that legislative change is required. A consultation process organized by Canadian Policy Research Network (CPRN) amongst the voluntary sector also shows support for updating the meaning of charity (Goldenberg 2004). Many of these sources of evidence are now feeling their age so Gibbins (2016) is quite accurate in saying that these proposals need to be updated with consultations occurring with the non-profits, charities and the public. More recently, the Max Bell Foundation held a two-day consultation process on May 10 and 11, 2016 with the sector in Calgary to ascertain its views on the need for reform. The results from this consultation process are not yet available.

In the area of advocacy, public opinion supports the need for reform. A recent survey by the Muttart Foundation (Lasby and Barr 2013: 88) reveals that 94% of Canadians agree charities should advocate on public problems “like the environment, poverty, or healthcare.” Moreover, 69% agree that the current advocacy “laws should be changed to permit charities to advocate more freely for their causes” (Lasby and Barr 2013: 91).<sup>9</sup>

While there is clear support for reform, there is evidence that charities are not meeting the current limits placed on advocacy. A 2011 analysis of the T3010 data

reported by charities reveals that for every \$10,000 spent on charitable activities, only \$1 is spent on political activities which equates to .01% — an amount far below what is permitted (Blumberg 2012a).<sup>10</sup> Three explanations exist as to why charities are not engaging more in advocacy: the ‘advocacy chill’ discussed earlier, lack of interest, and/or lack of expertise. This raises a challenge: if the Trudeau government liberalizes the advocacy rules, will charities engage in more and better advocacy?

Answering this question involves some gazing into a crystal ball, but there are some signs that charities are taking advocacy more seriously. First, there is more training offered in the areas of advocacy,<sup>11</sup> public policy<sup>12</sup> and government relations<sup>13</sup> to improve capacity. Second, intermediary organizations are lending their expertise in these areas or are active in recruiting volunteers with these skillsets for charities.<sup>14</sup> Last, there are well-documented success stories of charities involved in advocacy (Cave 2016). It has a snowball effect whereby success shows board members and donors the possibility of what can be achieved with modest investments in advocacy such that there is a desire to engage in future advocacy initiatives (Levasseur 2014, 283-284).

Another challenge relates to the generosity of the charitable tax expenditure. There are concerns to protect the treasury from a liberalization of the meaning of charity and advocacy (Levasseur 2012). With more non-profit organizations registered as charities under an expanded meaning of charity and advocacy, there may be more tax receipts issued that could erode the tax base. A 2016 evaluation of the charitable tax credit in Canada reveals that donors respond positively when the tax credit for charitable donations is increased (Department of Finance 2016). Moreover, with the generous tax expenditures currently provided for charitable donations, to what degree should

governments subsidize advocacy? This question will no doubt be challenging for the new Trudeau government.

Yet another challenge for modernizing the meaning of charity and advocacy relates to transparency. Public opinion shows there is heightened demand for greater transparency over charities in light of recent fraud cases involving charities (for example, inflating tax receipts for amounts higher than the donated amount). The Muttart Foundation survey reveals that Canadians expect charities to provide information, but few Canadians agree that charities are providing sufficient information related to their impact (36%), use of donations (26%) and fundraising costs (21%) (Lasby and Barr 2013, 64). To provide more accurate and timely information, the CRA received funding to allow charities to file their annual charity information form electronically.

The charity information T3010 annual form requires charities to disclose information about their activities, revenues, expenditures, charitable gifts and political activities. Implementation of e-filing is expected in November 2018. While Canada is hailed as the leader in open data related to charitable information that is comprehensive, accessible and user friendly (Power By Data 2016), e-filing is expected to make it easier for charities to file annually. With more accurate data, this should result in heightened transparency and accountability according to McMurren et al (2016, 4). They note that, “Not only can openness lead to more eyes on relevant data, but it can also lead to the right eyes on the data – i.e., making the data accessible to the people with the specific knowledge needed to recognize troubling discrepancies”. Despite this important development, there remains an important challenge in that the CRA is bound not to divulge personal tax-related information. As a result, Canadians will do not know when

charities are audited as noted earlier or the details surrounding the revocation of charitable registration.

## CONCLUSIONS

These challenges illustrate that reform is complex. To be sure, there is support for reform, but the challenges are significant and could explain why the Trudeau government has been relatively quiet in recent months. Indeed, there have been recent signals that the new government is realigning expectations about what policy change it can deliver. One example relates to the political activity audits. As noted earlier, the new government ended these audits in January 2016. However, the audits in-progress will continue, but the six audits that have not started are cancelled. This decision has not been well received by some in the charitable sector and has been described as a “half-measure” and a “timid” decision with supporters calling for an end to *all* the political activity audits (Beeby 2016; Kirkby 2016).

The concern for those charities undergoing an audit is the drain on its resources whereby time is spent working on the audit not on advancing the mission of the organization or the needs of clients. This disappointment is understandable, but so too is the need for the new government to maintain the independence of the regulator and not interfere with the auditing process as per the first goal for the new government indicated earlier in the introduction. Another example of concern involves the 2016 budget that contained little to no substance on how the new government will modernize charity policy.

To what extent, then, is the new government shying away from its electoral commitments to modernize charity policy? Is it moving *away* from its commitment or



moving *ahead*? I argue the latter and suggest the new government is proceeding with its commitments albeit very gently for two reasons. First, it is important to keep in mind that the new government came into office with a very ambitious policy agenda and some issues such as assisted-suicide have become urgent in nature. It is not surprising then that the government has attended to other policy issues prior to modernizing charity policy. Second, the government is developing a process to consult on these matters. Budget 2016 (206) directs the CRA to consult with stakeholders and develop an online consultation process on the “rules governing charities and their political activities”. By emphasizing a process to consult with charities, non-profits and the broader public, it signals that the new government desires input on modernizing charity policy rather than the government pre-determining the policy outcome.

Consultations are a good starting point and may finally allow Canadians the much-needed opportunity to discuss what it means to be a charity in 2016, not 1601. That said, Canada is a laggard on the international scene despite many years of small, incremental changes resulting from the issuing of administrative guidelines. What Canada needs are changes to the rules, far beyond mere clarification of the existing rules. Fortunately, Canada does not need to reinvent the proverbial wheel. The new government would do well to look at other common law countries and how they modernized charity policy.

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## Endnotes

<sup>1</sup> I would like to thank the peer-reviewers for raising this idea.

<sup>2</sup> There are other pressing concerns, notably federal government funding to charities and non-profit organizations and the institutional design to support charity policy specifically whether the CRA is the best institution to monitor charities. This chapter focuses its analysis exclusively on issues related to the meaning of charity and advocacy.

<sup>3</sup> I would like to thank the peer reviewers for this point and for other constructive insights and suggestions regarding my analysis.

<sup>4</sup> These cases include: *Guaranty Trust Co. v. Minister of National Revenue* (1966); *Vancouver Society of Immigrant and Visible Minority Women v. Minister of National Revenue* (1999); and, *A.Y.S.A. Amateur Youth Soccer Association of Canada v. Canada (Revenue Agency)* (2007).

<sup>5</sup> This administrative guideline incrementally changes the limit for advocacy amongst charity, but only for smaller charities. Prior to this updated guideline, the limit for advocacy was 10% for all charities.

<sup>6</sup> The points in this paragraph were raised during Imagine Canada's webinar titled 'State of the Sector' held Feb. 24, 2016.

<sup>7</sup> Canada employs a sliding scale to quantify advocacy. For charities with budgets less than \$50,000, 20% may be spent on advocacy; budget between \$50,000-\$100,000 may spend 15% on advocacy; budgets between \$100,000 - \$200,000 may spend 12% on advocacy; and, budgets over \$200,000 may only spend 10%.

<sup>8</sup> See Johnston (2015) for a more complete history of how the voluntary sector and federal government worked together.

<sup>9</sup> Nearly two-thirds (62%) agree that a new organization that is independent of government should regulate charities (Lasby and Barr 2013: 103). However, Gibbins (2016) indicates that public knowledge related to regulatory oversight is limited at best so cautions should be exercised when interpreting public opinion in this area.

<sup>10</sup> There are concerns related to reliability of the reported T3010 data (see Blumberg 2012a).

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<sup>11</sup> The Advocacy School started by Sean Moore is a good example.

<sup>12</sup> The Max Bell Foundation is offering its eighth Public Policy Training Institute for registered charities, and Canada's first graduate program in non-profit studies at Carleton University offers courses in public policy and advocacy as both core and optional courses.

<sup>13</sup> The United Way of Winnipeg offers a three-day workshop aimed specifically at charities and non-profits on how to develop a government relations strategy and engage in the public policy process.

<sup>14</sup> The Ottawa-based Canadian Advocacy Network connects charities and non-profits with professionals in the areas of public affairs and government relations on a voluntary basis. SPARK, a service provided by the Canadian CED Network, also pairs volunteers with these skills with the voluntary sector.

## Chapter 10

## CANADA PENSION PLAN ENHANCEMENT: ISSUES AND UNEXPECTED OUTCOMES

Ian Lee

## INTRODUCTION

Through much of the 20<sup>th</sup> century in Canada it is fair to state that health care policy and pension policy attracted disproportionate political debate and a great deal of attention from policy analysts. Thus, after the major policy reforms of the 1960s that saw the introduction of a single payer public health care system and equally importantly the introduction of Old Age Pensions, the Guaranteed Income Supplement and the Canada Pension Plan, one would think that in the words of the late US Senator Daniel Patrick Moynihan, that a period of benign neglect was in order.

Yet in the last decade and especially so after the Great Recession of 2009-10, increasing concerns were expressed concerning the Canadian Retirement Income System (Prince 2013; Moscovitch, Falvo and Macdonald 2015). This chapter offers a further contribution to the debate surrounding the adequacy of the Canadian Retirement Income System (RIS) but one that focusses on the Canada Pension Plan (CPP).

The chapter is organized around a five part analytical story: the origins and design of the RIS and its three versus four pension pillars and whether personal investments outside of registered plans ought to be included or excluded when analyzing adequacy of the RIS; the alleged inadequacies of the CPP; the introduction in 2014-15 of the proposed Ontario Registered Pension Plan (ORPP) on the assumption of serious pension savings inadequacies; the unexpected CPP agreement of June 2016 between the Trudeau Liberal government and 8 of 10 provinces and how it was achieved; and an analysis of the agreement. Conclusions then follow.

The central argument advanced in the analysis builds on empirical income and asset data from Statistics Canada and the OECD that demonstrates that elder poverty collapsed in the 30 years following the Pearson RIS reforms in the mid-1960s and that Canada has in fact one of the lowest rates of elder poverty in the OECD. I argue that, despite this, the union movement, NGOs, and some pension scholars and some leading politicians insisted large numbers of future elders would experience financial difficulties in retirement. But the argument made that Canadians are saving inadequately for retirement hinges on whether one includes or excludes investments outside of registered pensions. I conclude for these and related reasons that the 2016 CPP agreement will benefit Gen X and the millennials many years in the future. Yet, there was no public discussion at all of the unprecedented staggering intergenerational transfer of wealth in the billions and likely trillions that will occur over the next 30 years as the parents of the boomers pass their wealth to the boomers and then the boomers pass their wealth to their children. As no attempt was made in the CPP reforms to target those future seniors that need help – advocated by the Quebec Minister of Finance – it is likely the CPP will continue to be a work in progress that will need to be reformed again in the future.

#### THE RETIREMENT INCOME SYSTEM (RIS) IN CANADA: THREE PILLARS OR FOUR

The origin of Canada's RIS can be dated to the introduction of the Old Age Pensions Act in 1927 that provided for a small monthly benefit that was means-tested for Canadians who reached 70 years of age, with costs shared between the federal and provincial governments. In 1952, this was replaced by the Old Age Security (OAS) Act that converted the pension to a universal pension for all Canadians at 70 or older supported exclusively by the federal government from general taxation revenues (Parliamentary Research Branch 1990). It should be noted that while



the OAS was initially established as a universal social program, a claw back through the income tax system was introduced much later by Finance Minister Paul Martin that transformed OAS to a de facto means-tested program. In 2015, recovery tax for OAS starts once an individual earns more than \$72,809 and OAS is fully clawed back once earnings exceed \$118,055.

In 1967, to supplement the OAS, the Pearson Government established the Guaranteed Income Supplement (GIS), a means-tested, non-taxable benefit for low-income retirees funded out of general revenues. In 1968, the eligibility age for an Old Age Security pension was reduced from 70 to 65 where it has remained since. In the 1970s, payments made from these programs were indexed to inflation. The GIS was also expanded several times between 1971 and 2006 to further target low income elders who were below the poverty line. Together, the OAS and GIS are considered to be the *first pillar* of the pension system that is designed to provide for a minimum income in retirement for all Canadians.

The *second pillar* of the RIS consists of government-sponsored and managed compulsory contributory earnings-related plans. In 1965, the Pearson Government established a multi-tiered system with the phase-in of the Canadian Pension Plan (CPP) which provided a pension benefit during retirement years funded by compulsory payroll contributions as a percentage of income made by the worker (and matched by the employer).

The primary eligibility age for the Canada Pension Plan was set at 65. In general, benefits under CPP depend on annual earnings up to a cap called the Year's Maximum Pensionable Earnings (YMPE) and the contributory period starts at age 18 and continues until benefits are taken up, or age 70. The benefits during retirement years are calculated using three components: the basic replacement rate (25% of covered earnings), the average ratio of earnings to the Year's Maximum Pensionable Earnings and the average of the last five Year's Maximum Pensionable

Earnings numbers. The pension payments are treated as taxable income and can reduce or eliminate the amount of GIS an individual may receive.

The *third pillar* of the RIS is widely considered by scholars, policy analysts and elected officials to include employment-related pension plans which are either Defined Benefit (DB) plans (providing a guaranteed monthly income in retirement based on years of service) or Defined Contribution (DC) plans (providing an income in retirement based on the contributions and investment income earned while working). The payroll premium contributions to these plans are tax deductible and are subject to an annual cap/limit established by the Income Tax Act. Taxes on investment income while in these plans are deferred and are only taxed when monies are withdrawn or received. The income received from these plans through withdrawals also impacts eligibility for the income-tested guaranteed income supplement benefits (for additional income received reduces the amount of GIS received).

The third pillar also includes individual savings made pursuant to registered tax-assisted plans designed primarily for those who do not participate in employer-sponsored pension plans. Registered retirement savings plans (RRSP), are treated the same for tax purposes as DB or DC pension plans. A much more recent addition to tax assisted plans was introduced in 2009 by the Harper Government - Tax-Free Savings Accounts (TFSA) - where no tax deduction for contributions are provided but investment income accumulates tax free while in the TFSA and withdrawals from the TFSA are tax free. Both plans have annual caps or limits which are indexed and are cumulative in nature. However, as the TFSA is not pension specific for it can be used to purchase real estate or chattels, it could be argued it should be considered as part of a *fourth pillar* (i.e. all investments outside of registered pension plans whether employer or individual).

Seldom discussed with respect to the three pillars are underlying principles that cohere to create the Canadian retirement system. The first - implicit - principle is that no Canadian should live below the poverty line. Consequently, the first pillar – OAS and GIS – are in fact pure social welfare programs and not a genuine pension plan as no premium contributions are required nor are benefits based on years of employment. Indeed, both programs are funded from general taxation revenues. Without stating so explicitly, these two programs are de facto targeted to low-income Canadians in the bottom two quintiles, based on the accurate but unstated assumption that low income people have little or no discretionary income to save while working. The second pillar, the universal obligatory CPP, has a forced savings component built into it with compulsory premiums of 9.9% of salary by both the employer and the employee. However, the caps placed on contribution levels also ensure that the savings component is not onerous enough to significantly impact consumption (as premiums deducted from income cannot be spent on consumption) but enough to provide a reasonable amount of retirement income for low income people when combined with OAS and GIS. Restated, the CPP was never designed to replace workforce pensions.

Many lower income Canadians – mostly employed in small and medium sized firms earning minimum or near minimum wage incomes – typically have no employer pension, while people in the upper two quintiles (and virtually everyone in the broader public sector (including education, utilities, healthcare) are far more likely to have an employer sponsored pension plan. Indeed, the approximate percentage of Canadians without an employer pension plan is suspiciously similar to the percentage of the workforce employed in SMEs.

Importantly, the first three pillars do not include any accumulated investments in assets such as a primary residence, vacation properties, equity investments and bonds or ownership of

SMEs, each of which are held outside of registered pension plans. This exclusion strongly suggests that analysts who only recognize the first three pillars (mostly those who advocate an enhanced CPP) – believe that investments outside of registered pension plans cannot or should not be used to supplement retirement income. Yet, a recent HSBC study showed that Canada is among the global leaders of retirees planning to partially fund their retirement with the sale of property (Marr 2016). Indeed the English language created a word to describe this phenomenon – “downsizing”. This suggests that the public component of the three pillars, while available to all Canadians, was designed to address the needs of Canadians in the bottom two quintiles – and not the needs of all Canadians. We return to this theme below.

#### THE ALLEGED INADEQUACIES OF THE CPP

One of the most popular allegations made by pension reform advocates such as the Canadian Association of Retired Persons (CARP), the Canadian Centre for Policy Alternatives (CCPA) and the Broadbent Institute is that a substantial number of Canadian seniors live in poverty. For the vast majority of Canadian seniors, nothing could be further from the truth. It was once true that prior to the pension reforms of the 1960s, the face of poverty was overwhelmingly that of senior citizens. However, elder poverty – measured by the percentage below the poverty line collapsed over the decades after these policy reforms. Moreover, according to the OECD “Pensions at a Glance” 2013 report, Canada has enjoyed one of the lowest levels of elder poverty in the entire OECD for many years at approximately 7.2% of elders (Organization of Economic Cooperation and Development 2013). And it must be noted that the OECD are the most affluent countries in the world with the highest per capita incomes. Restated, Canada has one of the lowest elder poverty rates in the world.

These findings of low levels of elder poverty are corroborated by the Statistics Canada Household Balance Sheet that reveals year after year that elders are by far the wealthiest age cohort in Canada – measured by average net worth (Statistics Canada 2013). There is nothing unusual about this – as we move through life most (but not all) individuals save and invest and accumulate wealth.

However, asset poverty is strongly correlated with youth, with people under 35 having a very small median net worth of less than \$35,000. At the other end of the age continuum, senior couples have an average median net worth of a remarkable \$650,000. It must be immediately acknowledged that a substantial portion of this net worth is in residential properties, which should not surprise as Canada has one of the highest rates of home ownership in the world at 69% of households (and 75% of seniors). The discussion of net worth leads us inexorably to an analysis of the composition of household wealth in Canada. Contrary to the gloomy and frequent media headlines of deeply over indebted Canadians, the Statistics Canada empirical data reveals a completely different picture. Approximately one third or \$3 Trillion of Canadians' gross assets are held as investments in various asset classes by employer pension plans and individual registered pension plans such as RRSPs while 2/3 of total Canadian personal wealth is held in asset classes outside of registered pension savings vehicles.

Yet such *pillar four* investments in asset classes held outside of registered pension plans are just as real and legitimate for they possess the same legal characteristics as any private property asset that can be sold and monetized as assets held inside registered pension plans. Restated, an asset in any asset class can be sold and converted to cash – whether equities, bonds, real estate, art etc. It must be noted that when dealing with pension investments, the liquidity of

the investment – how quickly it can be sold and monetized to cash – is irrelevant as pension decision making involves the very long run where any asset can be sold and converted to cash. Even more importantly, very few analysts have noted the following crucial contradiction. Pension funds invest in some of the very asset classes that pension reform advocates insist must be excluded when owned individually outside of a registered pension plan. Advocates deny the legitimacy of the very same or similar investments outside of pension plans that they expect pension plans to make.

An example vividly illuminates this. The 2016 Liberal federal budget introduced us illustratively to David and Neera, a middle class couple. Imagine, however, the following further thought experiment. One day, Neera instructs her bank to debit her bank account for \$1000 to purchase a GIC and then instructs her bank to place the GIC in her self-managed RRSP at the bank. Pension advocates nod sagely and agree aggregate pension savings increased in Canada by \$1000 (because it did). However, the following day, her spouse David, instructs his bank to purchase a \$1000 GIC by debiting his bank account. But he tells them he does not want the GIC placed in his RRSP. David will hold it as a simple investment outside of any pension plan. The cry goes out – it does not count towards pension savings in Canada! Yet, it is the identical amount invested in the very same asset class. One GIC is held inside an RRSP and one GIC is held outside an RRSP.

This illuminates the nature of the debates between those analysts who claim Canadians are not saving enough and face a growing pension crisis versus those who argue there is no pension or savings crisis. The CPP pension reform group refuses to recognize or accept the substantial personal wealth in asset classes in this fourth pillar as a source to supplement

retirement income. Consequently, this group argues the mere \$3 Trillion held in registered pension plans is woefully inadequate, thus demanding a “universal” policy solution - an across the board increase in CPP benefits (and premiums). Meanwhile, those who believe there is no pension crisis argue most Canadians are doing well in retirement if one recognizes the substantial wealth – 70% of total personal wealth - in the fourth pillar that can and is used to supplement income in retirement.

There is a second issue relating to pension reform in Canada concerning those who have not yet retired. As shown above, Canada has one of the lowest levels of elder poverty in the OECD. Nonetheless, we must address the financial viability of Canada’s future seniors who have not yet retired. Are they as well equipped for retirement? According to a McKinsey & Company (2015) study on pension readiness, “4 out of 5 Canadian households are on track to maintain their standard of living in retirement...but they still leave 17 percent of households at risk of having to lower their standard of living when they stop working.” Interestingly, most of the households at risk are not in the bottom two quintiles but rather in the middle quintile and upper middle quintile. This identified minority of middle and upper middle income individuals who will experience a significant decline in income in retirement have a common profile: 1) they do not own their home; 2) they are not members of employer pension plans and 3) they do not contribute to RRSPs or TFSAs. This research is confirmed in separate findings by Milligan 2015, and Mintz 2016.

We can now step back and observe the architecture of Canada’s hybrid retirement system. In retrospect, what is not well understood at all today by a number of pension analysts is that the designers of our retirement income system in the mid-1960s effectively established two pension systems. The well-known and well understood first two pillars of OAS, GIS and CPP

were designed to ensure that Canada's two bottom quintiles (mostly) did not fall below the poverty line (however measured). While OAS and CPP was provided universally to people above 65 years of age, the amounts were relatively small – enough to bring low income people above the poverty line – but radically insufficient to ensure upper middle income earners would maintain their income status in retirement in the absence of additional income from other sources.

The Pearson Government understood what is still not well understood to this day even by many pension experts. Low income working Canadians are low income as they are employed largely in minimum wage employment in for example, the myriad retail strip malls across Canada, businesses on main streets including hospitality and restaurants which are dominated by small and medium enterprises that are typically undercapitalized, with low profit margins and high rates of business failure. These firms lack the resources to afford the matching employer premiums that would be required of a comprehensive or much more generous CPP. Moreover, the low income employees of SMEs could not afford the much larger pension premiums that would be associated with a comprehensive CPP.

For these reasons, it is legitimate to surmise that the Pearson pension planners deliberately made OAS non-contributory and supplemented by a non-contributory GIS while ensuring a modest universal CPP plan. Restated, the intent was not to develop a *comprehensive public* retirement income system that addressed the needs of middle and upper income Canadians - who were deliberately left to rely mostly on what is now characterized as the third pillar (employer pension plans and individual savings such as RRSPs) and the fourth pillar (all investments outside of registered pension plans). Restated, the Pearson government cleverly created a de facto targeted public pension system in the first and second pillars for the bottom



two quintiles wrapped in the cloak of universality in the hybrid Canadian retirement system they designed, while leaving the remaining quintiles to rely on the third and four pillars.

We now turn to the 2014 election promise in Ontario to establish an Ontario pension due to the alleged inadequacies analyzed above.

## INTRODUCTION OF THE ONTARIO RETIREMENT PENSION PLAN (ORPP)

In May, 2014, the Government of Ontario called a provincial election. Liberal leader Kathleen Wynne decided to focus on pension reform as a critical issue and promised to create the Ontario Retirement Pension Plan (ORPP). On June 2, 2014, the Ontario Liberals won a decisive majority government and Premier Wynne continued her calls for an expansion of CPP at a premier's meeting in Charlottetown, PEI in August, 2014. She released a government-backed Ekos survey that showed that only 15% of Canadians felt that they had enough to retire comfortably. Premier Wynne called on Premiers to take the lead on this issue instead of waiting for the Federal Government. In the absence of a positive announcement from the federal government, the Province of Ontario introduced Bill 56, *The Ontario Retirement Pension Plan Act* on December 8, 2014 which received Royal Assent May 5, 2015.

### *Structure of the ORPP*

The ORPP was designed to supplement CPP for workers who either do not have a workplace pension or who have a pension that is not, at the very least, comparable to ORPP. The Ontario Government will “only exempt defined contribution plans if they have a minimum annual contribution rate equal to 8% of employee pay and if the employer matches at least half of all employee contributions” (McFarlane 2015). When it is fully phased in, workers will contribute 1.9 per cent of their income to the plan, and employers will match the contribution. Contributions

will stop at a maximum income of \$90,000 a year whereas CPP contributions max out at an income of \$53,600.

There was significant criticism of the ORPP from scholars and think tanks in addition to sustained criticism from the business community, large, medium and small. The analysis by Mintz (2015) highlighted 10 reasons why the ORPP was a bad policy decision. Most importantly, he argued the plan would be expensive and complicated to administer with Ontario employees moving between employers exempt from ORPP and those not exempt, and even possibly, moving out of Ontario. He also argued it would distort labour markets with some firms swapping private pension plans for the ORPP if it meant saving on contributions (Ibid).

Mintz pointed out as well that the plan extended to many upper-income households with up to \$180,000 in income when two-earners retire. He also noted that the plan actually hurt the middle class as many middle-class individuals would be subject to much higher tax rates on plan benefits, especially in the \$73,000 to \$90,000 range as Old Age Security payments are clawed back. He also argued that the timing was bad. Ontario was facing a weak economy with a falling employment rate. The ORPP was essentially a new tax on business and... “much of it will be shifted back in lower wages over time. In the short run, companies facing international competition will face higher costs along with higher Ontario energy costs, property taxes and new levies to pay for infrastructure” (Ibid).

Analysis by Milligan (2016) also highlighted the inefficiencies of one Province acting on its own noting that: “the lack of co-operation between the federal and Ontario governments means that vital tax changes to accommodate the ORPP aren’t being made. This denies Ontario residents fair tax treatment of their pension contributions.” Milligan also recognized the mismatch with the actual current pension problems as it covered low earners who currently

receive Old Age Security and the income-tested Guaranteed Income Supplement which often is greater than their working salaries. Therefore, an expanded ORPP would take money from low income earners when they are struggling in their working years. Worse yet, they will pay full ORPP premiums on their earnings, but lose up to half the value of their ORPP benefits once received due to income testing required of GIS benefits (Ibid).

A study by Vaillancourt et.al (2015) for the Fraser Institute also criticized the ORPP, noting that "...past increases in the compulsory CPP contribution rate were followed by decreases in the private savings rate of Canadian households...Our results suggest that overall retirement savings won't increase to the extent of the increase in compulsory savings, and perhaps won't increase at all. In the end, there will be a reshuffling of retirement savings, with more money going to forced savings and less to voluntary savings" (Ibid).

In summary, the criticisms aimed at the ORPP ranged from the poor economic state of Ontario, the complexity and cost of administering the ORPP, the mismatching of the solution with the current pension problems and finally, the financial impact on businesses.

#### THE CPP AGREEMENT OF JUNE 2016

On June 20, 2016, the provincial Finance Ministers met with Liberal federal finance minister Bill Morneau and, to the surprise of many (including this author), it was announced they had reached an agreement in principle to expand the CPP (Department of Finance 2016). All provinces, with the exception of Quebec and Manitoba, supported the proposed agreement. The 2016 CPP reforms establish a new, separate tier which will be phased in over 7 years. The reform expands the upper earnings cap from today's \$54,900 up to \$82,700. To pay for this, the contribution rate will go up by 1 per cent for both employers and employees. The 7-year phase-in that will

commence January 1, 2019 – 2 years later than the ORPP was supposed to launch. It calls for a gradual 7-year phase-in beginning on January 1, 2019 consisting of a 5-year contribution rate phase-in below the Yearly Maximum Pensionable Earnings (YMPE), followed by a 2-year phase-in of the upper earnings limit. The maximum amount of earnings subject to CPP will be increased by 14% and the income replacement level will be increased to one-third of income with an upper earnings limit of \$82,700 upon full implementation in 2025.

It is noteworthy that since: “the CPP enhancement will be fully funded, each year of contributing to the enhanced CPP will allow workers to accrue partial additional benefits. In general, full enhanced CPP benefits will be available after about 40 years of making contributions. Partial benefits will be available sooner and will be based on years of contributions.” (Department of Finance, *Ibid*). The agreement also called for an increase in the Working Income Tax Benefit in order to offset the increased CPP contributions of eligible low-income workers. The Government expects that additional annual spending of \$250 million will achieve this objective (based on the full implementation of the higher contribution rate on earnings below the YMPE). Employee contributions to the enhanced portion of the CPP will be deductible however; a tax credit will continue to apply to existing employee CPP contributions.

The Federal Government’s rationale is that providing a tax deduction for employee contributions associated with the enhanced portion of CPP will avoid increasing the after-tax cost of saving for Canadians (*Ibid*). Finance Canada announced, however, that it will not release a detailed report until later this fall that will reveal how changes to the CPP and Old Age Security will affect Ottawa’s long-term financial health (Curry 2016a).

It was widely reported that the agreement was achieved after British Columbia suggested that the phase-in take place over an extended period of time to soften the economic blow (caused by the mandatory premium increases) to those provinces who were concerned about the impact on their already weak economies. This delay allowed Saskatchewan and Alberta to support the agreement. (Manitoba's Finance Minister did not initially comment. His government had only been recently elected in May, 2016).

One of the major debates concerning the proposed CPP expansion dealt with the impact on lower income Canadians due to a claw back of the Guaranteed Income Supplement. To alleviate these concerns, it was proposed that the federal Working Income Tax Benefit be increased to assist low-income earners. It was for this reason the Federal Government also allowed the provinces to make province-specific changes to the design of the Working Income Tax Benefit to better harmonize with their own programs. To that end, the Federal Government will be consulting with the provinces and territories before implementing the final design of the enhanced Working Income Tax Benefit.

At the request of Ontario, Ottawa and all participating provincial cabinets agreed to individually approve the Agreement no later than July 15<sup>th</sup>. With that agreement, the Ontario Finance Minister confirmed that Ontario would not proceed with the ORPP (Curry and Dhillon 2016). Quebec Finance Minister Leitaio criticized the agreement for being too costly and going too far. Consequently, Quebec announced it would propose an alternative expansion of the QPP that would exempt the new premiums from income ranging from \$3,500 to approximately \$27,000 which will produce a targeted approach. B.C. Finance Minister de Jong stated that: "I think we have reached a balanced approach to satisfying the objectives that were set out. That is,

a modest enhancement that is fully funded, that is affordable; affordable from the perspective of the employees who will be asked eventually to contribute a little bit more to enhance their ultimate benefits, and affordable, importantly, from the point of view of employers.” (Ibid).

Most interestingly, Ontario Premier Kathleen Wynne claimed credit publicly for the final CPP agreement asserting that "quite frankly, I was a thorn in the side of many of my colleagues," she said. "I kept bringing this up. I kept making it clear that we were moving ahead, and I kept making it clear that we all knew that there was a national problem." (Leslie 2016). Premier Wynne’s claim seemed to be supported by Premier Wall of Saskatchewan when he stated that “Saskatchewan had a choice to make the CPP changes better by going slower with an extended implementation period, or sitting it out and risking that a more aggressive plan like the Province of Ontario’s would be implemented nationally.” (Curry and Taber 2016).

All the stars seemed to have lined up for CPP reform until the province of British Columbia announced that it would not meet the July 15<sup>th</sup> deadline as it would be launching on-line public consultations. Without the agreement of British Columbia, the CPP reforms could not be ratified by the Federal Government as B.C. is the 3<sup>rd</sup> most populous province and Quebec had not agreed to sign on. Federal Finance Minister Morneau appeared relaxed in his response, stating: “The process remains on track for the government to table federal legislation in the fall, as planned.” (Curry 2016).

Before we examine the impact of the CPP reforms, it is critical to remember which Canadians are struggling in retirement. Firstly, although Canada enjoys one of the lowest levels of elder poverty in the entire OECD, as shown above, there are approximately 7.2% of elders who are below the poverty line. Secondly, approximately 20% of Canadians are at risk of a

substantial decline in their standard of living when they retire. Most of those households are not in the bottom two quintiles but rather in the middle quintile and upper middle quintile. This identified minority of middle and upper middle income individuals who will experience a significant decline in income in retirement have the common profile noted earlier: 1. do not own their home; 2. are not members of employer pension plans and 3. do not contribute to RRSPs or TFSAs.

Do the announced reforms help these two groups? Certainly not current elders due to the Paul Martin reforms of the late 1990s that codified the rule that CPP benefits cannot be paid before the premium and investment returns have been earned. As described earlier, the enhancements to the CPP must be first fully funded, although each year of contributions allow payees to realize partial payouts. For this reason, it will require 40 years before the full benefits of the new CPP agreement will be achieved. These reforms, moreover, are being phased in over the next 9 years to 2025, ensuring there will be no relief for current elders.

The approximately 20% of Canadians near retirement that are not pension ready will receive limited benefits due to the requirement that benefits must be funded before payouts can be made. For low to middle earners who are currently at or under the earnings cap, the reformed CPP will boost their pension by about one-third. Whereas the old CPP replaced just 25 per cent of their earnings, the new CPP will expand that up to 33.3 per cent. For those earning more than today's \$54,900 earnings cap, the upward expansion of the earnings cap toward \$82,700 means they are now covered at 33.3 per cent over earnings in the \$54,900 to \$82,700 range that were previously not covered at all. Because of this extra coverage, middle-to-high earners will eventually see a substantial increase in their CPP cheques—paid for by much heavier CPP premiums when they are working. (Milligan 2016).

## CONCLUSIONS

A review of the evidence reveals a consensus amongst most pension scholars that Canada is not experiencing a pension crisis. Indeed, then pensions business CEO Bill Morneau (and now Finance Minister in the Trudeau Government), and his Chief Economist Fred Vettese in their book (Vettese and Morneau 2013) specifically debunked the idea of a pension crisis or a savings crisis in Canada based on the empirical data and the evidence. There is an emerging, belated recognition that elder poverty has been vastly reduced in Canada during the past 50 years subsequent to the Pearson Government pension reforms of the 1960s.

Moreover, there is an increasing recognition that the bottom quintiles in Canada experience a substantial increase in income upon retirement due to the combined impact of CPP, OAS and GIS, in contrast to the low incomes earned by the two bottom quintiles during their working years. At the same time, there is an increasing recognition that most but not all Canadians near retirement are pension ready. Based on the foregoing empirical evidence and analysis, we can conclude that the CPP reform agreement of 2016 was not designed to help existing retirees nor those near retirement.

Due to the long phase in to 2025 and the requirement for benefits to be funded before being paid, the evidence suggests that the new CPP reforms were designed primarily to benefit millennials and Gen X people who will be retiring many years in the future. Unfortunately, public debate mostly ignored the unprecedented intergenerational wealth transfer that will take place over the next 10 to 30 years as the parents of the boomers pass on followed by the boomers. It has been estimated that in the next 5 to 10 years, \$750 billion in assets will be



inherited by the boomers who possess very substantial wealth themselves that will in turn be passed to Gen X and millennials. In the fullness of time, it may yet be realized that the CPP reforms were superfluous. However, the fundamental flaw in the CPP agreement of June 2016 was to fail to follow the recommendation of the Quebec Finance Minister and target the reforms to exempt those in the bottom quintiles, who will experience higher CPP premiums deducted from their meagre incomes to receive benefits far in the future that will be partially clawed back from GIS received. For these reasons, the Canada Pension Plan remains a work in progress.

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