

6 Distributional Issues and the Future of the Welfare State

Lars Osberg

Any discussion of distributional issues must begin by defining: "distribution of what?," "distribution among whom?," and "distribution how measured?" Given answers to these queries, one often hears the practical question "but what should we *do* about it?" Since there is more than one answer to each of these questions, this essay presents not one but two "visions" of the future and discusses the choice between these visions.

In one perspective, all distributional issues boil down to a single crucial issue, the distribution of lifetime income among individuals. In this view, the crucial issue for policy purposes is the total lifetime income received by the poor, or the rich, from which individuals will allocate their expenditures. Those averse to risk will purchase insurance, those who wish to consume in their old age will save for their retirement, and those who wish to leave something for the next generation will include a bequest in their plans. If informed, utility-maximizing individuals face competitive markets in an economy which grows steadily along a known turnpike growth path and which has complete markets in all commodities (e.g., future markets), then it will be feasible for individuals to allocate optimally their expenditures. In this vision of how an economy functions, *the* distributional issue is the distribution of lifetime income, and *the* equity issue is how much governments should intervene to redistribute income to the lifetime income poor.

However, in a second vision of the economy, distribution is a more complex issue. If growth in modern capitalist economies is Schumpeterian characterized by a series of technological innovations, shifts in trade patterns, and the unpredictable rise and decline of industrial sectors, then individuals will face great uncertainty in their future incomes. If financial markets are incomplete (e.g., in commodity futures) or very costly (e.g., annuities), individuals will find it difficult to insure privately against the risks of structural change. If the macroeconomy is characterized by cyclical instability and labour markets are

often imperfect, involuntary unemployment may create inequalities in access to employment.

In this second perspective, one cannot reduce all distributional issues to a single issue, since expectations of the future are subject to great uncertainty. This perspective therefore addresses a number of issues whose importance depends on the problem at hand. For the classical economists such as Ricardo, the "principle problem of political economy" is the distribution of income between labour and capital. However, political debates in Canada have traditionally been very sensitive to interregional inequalities in average income levels, unemployment rates, and economic growth, as well as to the distribution of income between social classes. The distribution of wages and employment opportunities among individuals is the focus of anti-discrimination legislation, while the distribution of total income among families and the prevention of poverty are the focus of much social policy. Certainly the distribution of lifetime income is an important concept, but in a world of uncertain incomes and imperfect capital markets, distribution over the life cycle, between older and younger workers and between the dependent and the working generations, is also very important. Finally, environmentalists have argued that our policies should consider the needs of future generations, in addition to those of the current generation.

Since discussion of future trends must start from somewhere, the first section of this essay, "The Point of Departure - Canada in the 1980s," adopts the second perspective and describes briefly the state of the Canadian economy in the late 1980s, with reference to the various dimensions of income distribution - between labour and capital, between regions, between individuals and/or families, between phases of the life cycle, and between different generations. The section "Forces for Change" then outlines the distributional implications of some predictable forces for change in the Canadian economy - technology, increasing international trade, demographic shifts, and environmental pressures.

There is very little that Canadian governments can do about these forces for change in the Canadian economy, but we do have choices to make in how Canada adapts to change. In the 1950s and 1960s, Canadian policy on distributional issues was formed within a broad vision of a

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mixed capitalist society with an activist government and a redistributive (and generally expanding) welfare state. The 1970s and 1980s have seen increased emphasis on a strategy of "providing a framework of price stability, reducing government spending and deficits, and improving incentives for the efficient allocation of resources" [IMF, 1988, p. 24]. The section "Visions of Canada" therefore presents two alternative "visions" of the future of the welfare state in Canada, with differing interpretations of existing events, differing predictions for the future, and different policy prescriptions. The section "Issues of Disagreement" concludes with a discussion of the issues of fact and values which we need to resolve if we are to choose intelligently between these alternative visions.

The Point of Departure – Canada in the 1980s

From the perspective of classical political economy, one would stress the fact that in recent years the distribution of national income between labour and capital has shifted in favour of capital. In 1970, labour's share of national income was 72.6 per cent; in 1980, it was 69.4 per cent; and in 1987, 69.0 per cent. Since 1980, the level of real wages in Canada has fallen – a trend that has been particularly evident in the years following the 1981-82 recession.

Falling real wages are what one would expect to observe in a period when the supply of labour exceeds the demand for it – and an excess supply of labour has been characteristic of Canadian labour markets throughout the 1980s [Morrissette and Solvas-Bronsard, 1988; and Kapsalis, 1988]. The severity of the 1981-82 recession was unprecedented in the postwar period and recovery has been slow.¹ As many commentators have noted [e.g., Lipsey, 1984], the 1981-82 recession was "policy-induced," and since the enormous costs of the 1981-82 recession were incurred in order to bring inflation under control, monetary and fiscal authorities have been extremely wary of rekindling the fires of inflation. Even in June 1988, the percentage of the working-age population in full-time employment in Canada had not yet recovered to the level of August 1981.² Notwithstanding a national unemployment rate of 7.8 per cent for the first three quarters, in 1988 macroeconomic policy was restrictive.

Higher unemployment rates in the 1980s have affected the inequality of earnings among workers as well as the distribution of national income between labour and capital. Dooley [1987] has argued that inequality in annual earnings among cohorts of Canadian males of similar age and education increased over the 1970s, reflecting the increased

variation in weeks and hours of work brought about by rising joblessness. Unlike the United States, in Canadian data there is no evidence of secular growth in earnings inequality within cohorts, *if* one controls for the unemployment rate. However, in Canada, the United States, and the United Kingdom, there is strong evidence that higher unemployment is associated with greater inequality in earnings and family income, both between and within cohorts [Dooley, 1987; Blank and Blinder, 1986; and Nolan, 1987].

Over the 1980s, access to employment has become more unequally distributed in Canada. The incidence of long duration unemployment has increased (although not to the extent found in European countries) and has spread west from Atlantic Canada to become a feature of the labour markets of Northern Ontario/Quebec, the Prairies, and British Columbia. Since recovery has been centred in Southern Ontario, regional disparities in unemployment have increased considerably – in 1979 the unemployment rate of Newfoundland was 3.1 times that of Toronto, but in 1987 it was 4.1 times as high.³

However, high unemployment rates have now become characteristic of Northern Ontario/Quebec, the Prairies, and interior British Columbia – as well as Atlantic Canada. Indeed, since 1981, the unemployment rate in Halifax has been substantially less than that in Vancouver (in 1987, 8.9 per cent in Halifax and 11.4 per cent in Vancouver). The "Atlantic syndrome" of depressed local labour markets and dependence on unemployment insurance has become, in the 1980s, a general characteristic of much of Canada's resource hinterland.

Petroleum, potash, and grain in the Prairies, like timber and mining in British Columbia and Northern Ontario/Quebec, have considerably decreased employment. Between 1981 and 1986, employment in natural resource-based industries in Canada shrank by roughly one fifth.⁴ Since this has traditionally been a relatively high-wage sector in Canada, the disappearance of these well-paid blue-collar jobs affects both the aggregate national distribution of income and the regional distribution of employment opportunities. Over the same period, employment in service industries grew from 66.1 per cent of full-time equivalent jobs to 70 per cent, twice the rate of growth of service sector jobs in the 1970s. Job creation in the service sector has accounted for all the employment growth of the 1980s – between 1980 and 1987 employment in the goods sector fell by 0.5 per cent.

Since service-sector growth has been concentrated at opposite ends of the spectrum of wages – in personal serv-

ice and retail sales jobs and in the professional/technical/managerial occupations – there has been an increasing concern with possible polarization in the distribution of earnings. If relatively highly paid blue-collar jobs are disappearing, while the new jobs being created are either in the low-skilled, low-credential sector or in highly paid professional occupations, then the adjustment problems of displaced workers (especially older workers with poorer education) are likely to be severe. Inequality of opportunity is likely to become even more closely tied to the inequalities of the school system and inequalities of income are likely to increase.

However, the debate on whether there has been a general “disappearance” of middle-class jobs is still inconclusive. Leckie [1988] examines trends in the share of *earnings* going to the middle third of the Canadian population, as well as trends in the aggregate inequality of earnings, over the period 1971-84. He concludes that there has been little change in aggregate earnings inequality, because changes in sex, age, education, part-time/full-time status, industry, and occupation of the labour force have largely balanced out. Although this aggregate picture of balancing changes is cold comfort to those who face personally the costs of such changes (e.g., the laid-off steel worker who is now working at McDonald's), this analysis argues there is little structural trend to increased earnings inequality in Canada.

On the other hand, Myles, et al. [1988] argue that: 1) a middle-class job should be thought of in terms of hourly wages, not earnings, since the distribution of hours worked may change over time; 2) the idea of “middle class” is best captured by examining the proportion of workers with jobs whose wages are close to the median rather than aggregate inequality; and 3) the pace of structural change in Canada has accelerated considerably in the early 1980s, relative to previous decades. These authors find qualified support for the idea of an increasing differentiation of the labour force due to shifts in the distribution of wages paid to different age groups (shifts in the occupation/industry structure have balancing impacts on the wage distribution). In the early 1980s, it was more common in the United States than in Canada to see explicit “two-tiered” wage structures with lower wages for new entrants. However, in both countries high unemployment has depressed entry-level wages, accentuating inequality in earnings between younger and older workers.

American studies, as those in Canada, do not reveal a consensus on the “disappearance” of middle-class jobs. As always, slightly different questions generate slightly different answers – and researchers have asked a variety of questions of the data. Although there is general agreement that

trends in the distribution of earnings and wages in the 1980s have been shaped by *both* accelerating secular trends and an exceptionally severe business cycle, the relative importance of each is hotly debated.

In examining distributional trends, sociologists have tended to emphasize individual wages and earnings due to their importance for relative social status and social cohesion. Economists, on the other hand, have traditionally tended to emphasize family income due to its importance for personal consumption. Trends in the distribution of family income can be quite different from trends in the distribution of individual earnings, since family income is greatly affected by trends in family composition (especially in divorce and household formation), trends in labour force participation (especially increased female and youth labour force participation), changes in transfer payments, and movements in the distribution and magnitude of capital income. Although there has been substantial variation in all of these, Wolfson [1986] argues that their effects on the aggregate inequality of family income have been offsetting – at least for the period 1965-83.

In the 1970s, the Canadian labour force grew by 38 per cent (the most rapid rate of increase in the western world) as female labour force participation rates increased and as the postwar baby-boom generation entered the Canadian labour market. For the decade of the 1980s, labour force increase is expected to be less than half as great (approximately 16 per cent), and the 1990s will likely see a further slowing in labour force growth to about 10 per cent [Seward, 1987]. Since the baby-boom generation has been the best educated cohort to enter the labour force in Canadian history, their movement into the peak earning years of the life cycle creates some tendency to a shrinkage in aggregate disparities in annual earnings. At the same time, however, the relative wages of younger workers have been declining during the 1980s [Myles, 1988], implying a tendency to greater inequality in annual earnings.

Over the 1980s, the incidence of poverty has risen and fallen in parallel with the rate of unemployment, increasing from 1981 to 1984 and decreasing gradually with the subsequent decline in unemployment rates. Indeed, for the period 1970-85, Perron and Vaillancourt [1988, p. 52] emphasize “the importance of cyclical variations in GNP in explaining variations in poverty rates.” However, an enduring legacy of the recession has been an increase in social assistance case loads and the increasing percentage of welfare recipients deemed to be employable.⁵ The social assistance system, however, generally does not reach the working poor (less than 10 per cent of whom receive supplementary welfare payments) and the majority (55 per cent) of poor

Canadian families have a family head with at least some labour force participation in the previous year. Indeed, roughly one quarter of poor Canadian families had, in 1985, a family head who worked full-time, full-year [Statistics Canada, Cat. 13-207, annual].

The high incidence of poverty among groups such as single parents or native Indian/Inuit Canadians and the increasing size of these groups, imply that their poverty is fairly visible to the politic body. The low wages and unemployment of the working poor are less visibly evident as causes of poverty, but their effect spreads over more families. Least visible of all are the functionally illiterate of Canada, whom the Southam Literacy Study [Southam News, 1987] estimated to comprise 24 per cent of the adult Canadian population in 1987.

In all these distributional issues, the Canadian state intervenes on a massive scale. Macroeconomic policy is a crucial determinant of the aggregate demand for labour and, therefore, of unemployment and the trend of real wages and returns to capital – which returns are deferentially treated by the tax system. Macroeconomic policy, especially exchange rate policy, also impinges deferentially on Canada's economic regions. The interregional distribution of employment opportunities and income is affected indirectly by macro policy and directly by regional development incentives, equalization payments to the provinces, and the substantial interregional transfers which are built into programs such as unemployment insurance.

Canadian governments alter the distribution of annual income between families through transfer payments, whose magnitude has grown from 1.8 per cent of personal income in 1947 to 11.7 per cent in 1966 and 14.3 per cent in 1986. Government attempts to influence directly the distribution of wages and earnings among individuals through minimum wage legislation and antidiscrimination policies such as "equal pay for work of equal value." Government redistributes income between generations and between different years of the same person's life, in a very visible way, through programs such as the Canada Pension Plan and Old Age Security. Much less visibly, the "hidden welfare state" of government tax expenditures redistributes income to favoured classes of individuals and corporations. With programs such as Medicare and unemployment insurance, the state redistributes the costs of contingencies such as illness or unemployment. Training programs, mobility grants, and subsidies to education attempt to influence the distribution of human capital among persons.

The short name for this blur of policies, programs, and legislation is "the welfare state." Over the 1980s, there has

been an ongoing debate on whether it is cause or cure for the ailments which it addresses. Certainly transfer payments have grown in aggregate volume, but cutbacks in transfer programs have often been advocated, both from the perspective that the welfare state may have created disincentives to the efficient operation of market forces and in order to reduce the financial deficit of the federal government.

However, from the left the welfare state has been criticized because its expansion over the postwar period in Canada has been accompanied by remarkable stability in the distribution of annual income among family units. In part, the stability of the income distribution arises from its susceptibility to so many conflicting social trends. In part, the limited impact of the state in decreasing inequality of annual income stems from the fact that most of the expenditures of the Canadian welfare state do not have this as their objective. The welfare state in Canada is dominated by "social insurance" programs such as UI or the CPP, whose objective is to redistribute risk or to even out income flows over the life cycle, *not* primarily to redistribute income from rich to poor.

Nevertheless, transfer payments do have a significant impact on poverty. Messinger and Fedyk [1988] calculate that in 1984, transfer payments filled about 70 per cent of the aggregate income gap between the low-income cutoff and pre-transfer incomes and moved about 60 per cent of the pre-transfer poor above the poverty line. The success of the Canadian welfare state is particularly evident for the elderly population – over 90 per cent of the pre-transfer elderly poor are moved above the poverty line by transfer payments. The failures of the Canadian welfare state show up, however, in the increasing incidence of poverty among Canadian children and in the stubborn persistence of regional disparities in average incomes and employment opportunities.

The controversies surrounding the welfare state stem, in part, from basic design dilemmas that have never been fully resolved – for example, the trade-off between income adequacy and the possible loss of jobs involved in setting the minimum wage, or the balance to be struck between incentives and insurance in UI or Medicare. In part, the challenges faced by the welfare state are those of the shifting relative importance of traditional issues, such as pension adequacy for senior citizens or support for single parents. However, the Canadian welfare state has also had to accommodate the issues raised by some fairly new trends, such as the labour force participation of the *majority* of the mothers of young children and the simultaneous distress of Canada's resource hinterland. And the Canadian welfare state has had to do all this during a period when the norms and values by

which it is judged have been in a state of flux. It is no longer socially acceptable, as it once was, to assume that women are "secondary earners" in households; and it is increasingly difficult, politically, to argue for the use of family income as a way of differentiating the net benefits of social programs (such as UI). Given all these factors, it is easy to predict that the welfare state will remain controversial in Canada.

Forces for Change

Technological Change

Since the Industrial Revolution, capitalist societies have been characterized by continual change in technology and in the relations of production. In the 1980s, the pace of technical change accelerated, and there is no reason to doubt that this trend will continue in the 1990s. As many commentators have noted [e.g., ECC, 1987], technological change in industry has become increasingly science-driven, with an ever-closer link between basic and applied R&D. The sophistication of new technologies increasingly demands that applied technologists should have a strong background in math and science skills if they are to transfer new techniques successfully into the production environment. And the revolution in information processing technology offers the potential for major changes in office occupations, where most Canadians work.

Over half of all Canadian workers are now employed in occupations whose primary functions are the production, distribution, and analysis of information [see Osberg, 1988b]. Since computers also process information, and their speed, capacity, and cost is changing with dramatic rapidity, it is not difficult to predict that technological change in telecommunications and computers will have a major influence on employment in Canada over the 1990s. In particular, those jobs in information processing which are relatively routine are likely to be very heavily affected by emerging information technologies. As automatic teller machines replace bank tellers, as computerized check-outs reduce the demand for supermarket clerks, and as filing clerks lose their function in the paperless office, labour demand will shift away from occupations which handle purely routine types of informational transactions. However, the more "knowledge-based" occupations, whose work roles are less routine and less amenable to computerization, are likely to continue their trend of increasing relative importance.⁶

Although the changes required by technological forces are likely to imply substantial adjustment costs for many

individuals, it is more difficult to say whether they will entail appreciable changes in the aggregate distribution of income. When one decomposes the aggregate inequality in earnings into that which is due to inequality *within* industries (or occupational categories) and that due to inequality *between* industries (or groups of occupations), one finds that most of the inequality in the distribution of earnings is accounted for by inequality *within* industries (or occupations). Indeed, the importance of such intra-group inequality is the main reason why Myles, et al. [1988] found that the substantial shifts in the industrial and occupational composition of the labour force which have occurred over the period 1981-86 have produced relatively small impacts on the aggregate distribution of wages. Indeed, even if one looks at hypothetically large future shifts in the broad structure of the labour force, such shifts produce relatively small aggregate effects on earnings inequality *if* inequality within occupational groups remains the same [Osberg, 1988a].

The impact of technological change on inequality *within* industries, or *within* occupations, is therefore both crucial and difficult to predict. If the graduated hierarchy of the traditional bureaucracy is replaced by new organizational structures with fewer levels of authority, then the pyramid of earnings is likely to become more unequal.⁷ And, indeed, Myles, et al. [1988] found that the main factor increasing wage dispersion in Canada over the period 1981-86 was an increase in the disparity between younger and older workers *within* industries and occupations.

Rapid technological change, and the shifts in labour demand it causes, may not, therefore, produce large shifts in the aggregate distribution of earnings. However, it is likely to produce a greater "churning" within the income distribution as workers in declining occupations slip down the distribution of relative wages. Rapid technological change is likely to mean that those who can learn new skills easily can expect to do well in the labour market. Indeed, it is increasingly the norm for training to continue throughout one's work life – in 1983, one sixth of those employed full-time, full-year participated in some sort of formal training program [Picot, 1987]. Yet, as noted earlier, 24 per cent of adult Canadians (17 per cent of those aged 18 to 24)⁸ are functionally illiterate, and many of the literate possess only the most rudimentary mathematics or science skills. A relatively large fraction of the Canadian population is, therefore, not well placed to cope with the rapid technological change which we can expect in the 1990s. To put it another way, technological change may not produce much change in the overall inequality of earnings, but the adjustment costs of technological change will be very unequally distributed.

International Trade

Like technological change, rising levels of international trade have long been one of the basic institutional features of the world economy. Traditionally, Canada has typified itself as a "small open economy" whose interests lie in expanding international trade and in the progressive dismantling of world trade barriers. In the 1960s, however, the competition of low-wage foreign producers in the Canadian domestic market was largely restricted to a relatively small number of sectors such as textiles, clothing, or shoes. But in the 1970s and 1980s, the nature of international competition has changed, as the newly industrializing countries of the Pacific Rim have increased their general penetration of world markets and manufactured goods. Canadian industry has found itself competing with Korean and Taiwanese firms in industries such as automobiles or consumer durables, that have traditionally provided relatively high-wage employment.

During the 1990s, it is altogether likely that the locus of low-wage international competition will change. In the same way that Japan has become a relatively high-wage location for some types of assembly operations compared to Korea or Taiwan, it is quite possible that the latter will lose their wage advantage to countries like the Philippines or China. But the uncomfortable fact of aggressive international competition in all sectors of goods production, based on wages much below those in Canada, is very unlikely to disappear.

Furthermore, the very rapid decrease in costs of telecommunications and information storage and retrieval is likely to imply increased international competition in the production and distribution of information. Historically, traditional office technology, with its predictable paper flow and need for face-to-face supervision, has required most office functions to be in the same location as key decision makers. As a result, clerical, administrative, and professional employment has been a sheltered sector, insulated from the international competition characteristic of the production of goods. But rapid declines in the costs of information transfer make this an increasingly footloose employment sector – one whose location cannot be protected by tariffs.

Nor can such employment be protected, in the future, by regulation from American competition. By the terms of the Canada-U.S. Free-Trade Agreement, Canada has bound itself to accord national treatment to service providers, thereby forswearing the possibility of preserving preferred market access for Canadian firms in the domestic production of information services. Since specialized providers of business services (e.g., corporate law firms or the designers

of offshore oil rigs) depend heavily on the reputation and relationship they have built up over many years with major clients, and those clients are often U.S.-based, Canadian firms operate at a disadvantage in this sector – and it may be increasingly difficult to avoid displacement.

The free-trade agreement has been attacked by organized labour on the grounds that it will shift the balance of bargaining power in Canada in favour of capital. The fear is that increased openness of the Canadian market to competition for goods and investment from low-wage states in the United States will shift the distribution of national income and earnings against labour and depress, to the lowest common North American denominator, the "social wage" of transfer payments, government services, and income supports.

However, even with a free-trade agreement, these competitive pressures within North America will be superimposed on a long-run trend to greater global competition. And one must remember that a profit-maximizing firm is not concerned with labour cost per hour; rather it is concerned with labour cost *per unit of output*. To the extent that Canadian industry can achieve increased labour productivity, Canadian workers will be able to avoid downward pressure on their real wages and increased inequality in the distribution of income. But the general moral to be drawn is the interdependence between national policies of international trade, education and labour force adjustment, science policy, and income distribution.

The Aging Population

In attempting to improve the rate of growth of labour productivity in the 1990s, Canadian policy makers will confront some of the implications of Canada's demographically uneven population. Since it is relatively easy to change one's mind about one's career at the age of 20, the entry of the baby-boom generation into the labour force in the 1970s and early 1980s brought with it a certain "automatic" flexibility in the supply of labour to different sectors of the economy. In the 1990s, however, labour force growth will be much slower and the demographic bulge of baby boomers will be firmly in their 40s. With settled ties to local communities and with (usually) an employed spouse who may not wish to relocate, there will be much more resistance to geographic mobility than was the case in past years. Traditionally, interregional mobility has been greatest among young adults and has served to ease the pressures created by regional differentials in the rate of economic growth. As the young adult share of the population shrinks, the issue of the interregional distribution of income and

employment opportunities is likely to become even more intractable than it already is.

Over the 1990s, the fraction of the population aged over 65 will increase slightly from just under 11 per cent to just over 12 per cent. In terms of numbers, this shift will be more than balanced by the decreasing fraction of the population aged under 20, hence the "dependency ratio" (the ratio of the total population to those of "working age," between 20 and 64) will fall slightly from its 1986 level of 1.65 per cent to an expected level of 1.64 per cent in the year 2001. In terms of costs, however, the elderly consume substantially more than youth do, hence the distribution of total consumption will shift slightly towards the retired population – a trend accentuated by the tendency to increasingly early retirement evident in the Canadian labour force. Over the 1990s, we can therefore expect to see increasing concern with the issues of old age security, pension indexation, guarantees of private pension plans, and funding of the public pension system, whose common denominator is the issue of an equitable distribution of consumption between generations.

Environmental Decay

The 1970s and 1980s saw an increasing level of environmental consciousness and there is no reason to doubt that this trend will also continue in the 1990s. In part, increasing concern with environmental issues arises from the perception of new, and very general, environmental issues such as the "greenhouse effect" and the consequent possibility of increasing average temperatures worldwide. As well, many well-known environmental issues have simply not been satisfactorily resolved, despite years of concern. And with all environmental hazards, one confronts the yawning gulf between ascertainable hazards, with their range of genuine scientific uncertainty, and the much greater variability of popular perceptions of hazards.

Although the acid rain, nuclear waste, and hazardous chemicals issues involve somewhat different types of environmental hazard, issues like these involve specific environmental contaminants whose impact is felt on a particular ecological system. Canadians are particularly concerned about acid rain, since we are downwind of so much of it and since forests are so important to our hinterland economies; but, in general, such hazards have their effects on definable localities and regions. Rising levels of carbon dioxide in the world's atmosphere, and the possibility of a warming of the world's climate, raise issues of an altogether different order of magnitude. If the world climate gets warmer by between 2.5 and 4.5°C over the next 40 years, the consequences for

Canada's agriculture and forest-based industries will be immense. Massive investments will be required in coastal provinces to cope with rising ocean levels and the international environment will be characterized by far greater economic and political instability due to the massive effects which climate warming will have on the agriculture of Third World nations.

Environmental issues are distributional issues in the basic sense that the costs of action to deal with environmental issues are borne by the current generation while the costs of inaction will be borne by future generations. The present generation of Canadian taxpayers/consumers will be able to consume more if nothing is done to clean up hazardous chemical wastes or to decrease the consumption of hydrocarbons by Canadian society. Future generations will, however, pay a heavy price for such inaction. The attention we pay to environmental issues is, therefore, another dimension to the basic issue of the appropriate distribution of potential consumption between generations.

Predictable Problems

Economic policy makers have always faced the problems of balancing their concerns with inflation and unemployment and of finding a way to achieve an equitable distribution of rising real incomes. As we have already noted, these issues are intimately interconnected, since both the inequality of earnings and the rate of growth of real incomes are heavily affected by the rate of unemployment. The inequality of family incomes is, of course, also heavily influenced by government taxation and transfer policies. In a global environment characterized by rapid technical change and an ever-increasing exposure of Canadian employment to international competitive pressures, the achievement of rising real incomes is likely to depend on increasing our capacity for productivity improvement within firms and on a greater ability to cope with structural adjustments between firms.

Structural adjustment is, however, not likely to become easier in the coming decade. If Canada is to achieve higher rates of growth of labour productivity, we will first have to resolve the issue of the distribution of adjustment costs within the Canadian economy. The social policies of the welfare state affect both the distribution of income among persons, families, regions, and the distribution of risk which rapid change entails.

Changes in the age/wage relationship also raise the issue of equity in the distribution of earnings between different generations of the labour force, while the debate on pension policy is driven by the issue of an equitable distribution of

consumption between the employed and the retired generations. Environmental issues force us to consider the implications of our current decisions for generations far into the future. Decisions of some sort on a wide range of issues – even decisions to do nothing – are inescapable. If the aggregation of such decisions is to fit together in a reasonable way, we need some sort of “vision” of the appropriate role of the state in distributional issues – a subject to which we now turn.

Visions of Canada

In thinking about the future, forecasts of where society *will be* are inevitably driven by a perception of where society *is* and an analysis of the direction in which it is currently going. A “vision” of Canadian society in the year 2000 is also, therefore, both a description of current reality and an analysis of current economic and social trends. Implicit in such an analysis is a menu of possible policy alternatives and a set of presuppositions as to their implications.

However, although the description of the Canadian economy in the first section and the outline of forces for change in the second section may command wide agreement, there is profound disagreement about how this should all be interpreted. There are many analyses of social trends and many shades of opinion, but to sharpen the discussion, this section presents two alternative visions of the future role of the welfare state. The first vision presents an interpretation of events which is consistent with much recent writing on social policy issues [e.g., Blomqvist, 1985]. The second presents an alternative interpretation of events more consistent with the postwar consensus on the welfare state. Both visions begin with a discussion of macroeconomic policy because the priority attached to full employment is central to all other distributional issues. The “visions” differ in their perception of feasible macroeconomic policy and they differ also in the relative importance which they ascribe to the social insurance and social assistance roles of the welfare state. This section ends by summarizing the issues of fact and values which differentiate these perspectives.

Over the decade of the 1950s, unemployment in Canada averaged 4.2 per cent, while the 1960s saw an average national unemployment rate of 5.0 per cent. In the 1970s, unemployment averaged 6.7 per cent and there was substantial experimentation with ways of keeping inflation under control while attempting to prevent unemployment from rising to “intolerable” levels, culminating in the controls of the Anti-Inflation Board period. However, over the period 1982-87, the national unemployment rate has

averaged 10.6 per cent, as central bankers and governments in Canada, as elsewhere in the world, have decided that control of inflation is the overriding objective of macroeconomic policy and that restraint of aggregate demand is the only feasible method.

Limiting the Role of the Welfare State

The 1980s shift in emphasis in macroeconomic policy is part of a larger philosophy of limiting the role of the state in economic and social affairs. In part, the decreased importance ascribed to unemployment has been based on the conviction that a stable price level is an essential prerequisite to long-term economic growth. In part, it is also due to a reinterpretation of the nature of unemployment, which authors of academic papers on search theory, labour/leisure choice, and implicit contracts have cast in an essentially “voluntary” light [see Osberg, 1988*d*]. A downward revision in official perceptions of the social cost of unemployment and a benign view of the output costs associated with monetary restraint laid the intellectual foundation for the record-high interest rates of 1981-82 and the unexpectedly severe recession which followed. Since then, monetary authorities have laid great emphasis on microeconomic, “structural” explanations of aggregate unemployment. Despite shifts in the minimum wage, the age structure, and the union density of the labour force which would be expected to decrease the NAIRU (the rate of unemployment at which inflation can be expected to accelerate), Bank of Canada statements in 1988 indicate that it believes that the NAIRU has *risen* over the 1980s, to somewhere in the area of 8 per cent on a national basis.

A macroeconomic policy which accepts such historically high unemployment rates as unavoidable has enormous implications for distributional issues. As already noted, high unemployment produces a labour market with greater inequality in the distribution of individual annual earnings and a higher incidence of poverty among families. High unemployment also entails an increased role for transfer payments, such as UI or social assistance, in the distribution of family income and an increasing separation between employment and the distribution of consumption. Indeed, a chorus of “futurist” writings [e.g., Handy, 1985; and CEIC, 1986] have declared the obsolescence of “full employment” and the traditional full-time job.

High unemployment also increases the demands made on the services which the welfare state provides. As Ketso [1988], Stern [1983], and others have documented, for example, unemployment causes illness, whose costs are a burden to the health-care sector. While high unemployment

places increasing demands on the welfare state, it also implies lower rates of growth of the aggregate output which finances the welfare state. A high unemployment economy therefore produces continual pressure to "refocus" or "reform" or otherwise reduce the programs of the welfare state. And much of this discussion emphasizes the fact that most transfer payments (57 per cent according to Messinger and Fedyk [1988]) do not go to poor families.

The social costs of transfer programs are partly composed of the administrative cost of program delivery (although these are relatively low for universal programs, such as family allowances or old age pension) and partly due to the incentives which particular conditional programs (such as UI) may create. But the cost stressed by Blomqvist [1985, p. 119] and others is the marginal excess burden of raising taxes – i.e., the value of the output lost as individuals readjust their behaviour when confronted with the higher tax rates required to finance welfare-state expenditures.⁹

If one estimates the social costs of welfare-state expenditure to be high and if one believes that the social insurance role of the welfare state in programs such as the Canada Pension Plan or Medicare could be adequately replaced by such substitutes as private health insurance or employer-paid pension plans, then an argument for reduction in the social insurance role of the welfare state follows. One vision of reform of the welfare state, therefore, advocates disentangling income-redistribution programs and social insurance programs. The recommended route for social insurance programs is privatization or behaviour, which mimics the private sector, such as the adoption of actuarially fair premiums or user-cost financing [e.g., Blomqvist, 1985].

Advocates of such policies feel aggrieved by the suggestion that they are advocating policies which might hurt the poor. Their language is one of greater selectivity, of improving the target efficiency of social welfare programs by a better targeting of a given volume of transfers on the "deserving poor." The implicit political hypothesis is that the same, or more, resources would be available to programs clearly labelled "for poor people only" as now actually gets to the poor via more general programs.

In this vision of a reduced, more closely focused welfare state, the redistributive policy usually suggested is some variant of a two-tiered negative income-tax scheme. The Lalonde proposals of the early 1970s and the Universal Income Security Plan (UISP) advocated by the Macdonald Commission in the early 1980s had in common the idea that much of the expenditure now absorbed by income support programs could be rolled into a negative income-tax scheme, in which unemployable recipients qualify for a

high basic guarantee level, coupled with a relatively high rate of taxation on earnings, while employable participants receive a relatively low basic guarantee level, combined with a lower rate of taxation on additional earnings. This program design is motivated by recognition of the trade-off between the guarantee level for basic income support and the tax rate on additional earnings which is inherent in all negative income-tax programs. Setting a low basic guarantee level for employables implies that those who have to depend on it alone will live in poverty, but this is combined with a relatively low tax-back rate on earnings, in order to preserve incentives to accept employment – on the presumption that employment is available.

This vision of the future generally takes as given a monetary policy oriented to the control of inflation and a fiscal policy whose objective is a gradual decrease in the federal deficit. Hence there is no appeal to stimulative aggregate-demand policy to justify the assumption that employment opportunities are available. Rather the emphasis is on reducing the influence of policies which are seen as decreasing the demand for labour by firms at the micro level, such as minimum wages or payroll taxation. There is little sympathy here for the union movement, or for legislation which constrains firm behaviour on such issues as layoffs or severance pay. And although a limited role for government is seen in retraining and mobility assistance, the presumption is that government can best stimulate the effective supply of labour by reducing the disincentives to labour supply implicit in particular programs – e.g., in the so-called "welfare trap" created by high rates of benefit reduction for those social assistance recipients who accept employment [Fortin and Rousseau, 1985; and Fortin, 1987].

From a bureaucratic point of view, one of the main advantages of this vision is tidiness. Each individual bureaucracy can proceed in isolation. The Bank of Canada is to concentrate on the control of inflation while the Department of Finance focuses on deficit reduction and simplicity and horizontal equity in the tax system. External Affairs Canada takes care of trade, while the role of Employment and Immigration Canada is to assist, to a limited degree, in human-capital augmentation and labour market mobility. Subsidy programs to regional employment are to disappear, as far as is politically feasible. While everyone else concentrates on economic efficiency, Health and Welfare Canada is to take care of equity, through a negative income tax. Social insurance programs (Medicare, UI, CPP, or Workers' Compensation) may not be formally privatized, but they should behave as much as possible as if they were, and finance themselves by actuarially fair premiums or by user-pay charges. The important question, of course, is whether such a tidy blueprint for the future will generate better results.

The Welfare State and the Social Contract

Although unemployment has increased in the 1980s in all the OECD nations, it remains very low in some. In 1986, when Canadian unemployment averaged 9.5 per cent, Austria had an unemployment rate of 3.1 per cent, Norway's was 1.9 per cent, and Sweden's was 2.7 per cent.¹⁰ These same countries are characterized by lower levels of inequality in the distribution of income and sharply lower rates of poverty, however one chooses to measure these concepts [Sawyer, 1976; Smeeding, et al., 1985]. With rates of growth of income and labour productivity at least as great as Canada's, these small open economies are case studies in the proposition that it is possible to do things differently.

These national economies are also examples of a broader conception of the welfare state. In them, the welfare state is only partially concerned with redistribution of money income between those who are rich and those who are poor in a lifetime income sense. The provision of common public services outside the marketplace is an important theme, and income is redistributed over the life cycle and between different cohorts of individuals to ensure that different generations of individuals keep pace, on average, with contemporary standards of living. Within this framework, there is also a very substantial degree of risk-pooling in which the state absorbs much of the cost of contingencies such as unemployment or illness.

The political conception underlying this vision of the welfare state is that of a "community." As Tawney [1952, p. 43] put it:

What a community requires, as the word itself suggests, is a common culture, because, without it, it is not a community at all. . . . But a common culture cannot be created merely by desiring it. It must rest upon practical foundations of social organization. It is incompatible with the existence of sharp contrasts between the economic standards and educational opportunities of different classes, for such contrasts have as their result not a common culture, but servility or resentment, on the one hand, and patronage or arrogance, on the other. It involves, in short, a large measure of economic equality – not necessarily in the sense of an identical level of pecuniary incomes, but of equality of environment, of access to education and the means of civilization, of security and independence, and of the social consideration which equality in these matters usually carries with it.

The economic rationale for fostering a sense of community is that of coalition formation, or what athletic types know as "team building." In a rapidly changing world, individuals at the micro level, or relatively small groups at the

national level, may find themselves threatened by change and possessed of some power to impede it.¹¹ If individuals must bear all the costs of change, yet have, in practice, some power to impede change, it may be in their immediate self-interest to block change to the maximum extent feasible. But if everyone acts only in their immediate self-interest, societally desirable change will be impeded. By offering something to just about everybody, the welfare state embodies a social contract which says that, since economic adjustment is socially necessary, adjustment costs will be socially shared.

This vision does not, therefore, see the problem facing the welfare state as one of "adjustment versus security" [Courchene, 1987, p. 20]. Given that individuals want security, the issue is rather how they are going to try to get it. If the costs of change, to an individual, are large, then individuals achieve security by avoiding change, to the maximum extent feasible – for example, by quiet non-cooperation in the implementation of new technology within firms or by assiduous use of the political mechanism to prevent the demise of firms. The fact that such behaviour imposes costs on the larger society is not part of any individual's calculation. The strategy underlying the broader view of the welfare state, however, is to offer a social contract in which everyone expects continuous change, but also expects that the costs of change borne by any individual at any given time will be relatively small.

Myles [1988], however, distinguishes between welfare states with a commitment to full employment, such as Sweden, Norway, or Austria and the "stop/go" welfare state of countries such as Canada, where the state has historically been willing to use unemployment as a device to contain wage increases. Full employment¹² aggregate demand policies are crucial because they create the fiscal dividend which eases the financing of income-redistribution programs, and because they imply that there are always jobs available for those displaced by change. In a full employment environment, employable individuals are not generally dependent on transfer payments, hence social insurance programs (such as UI) do not mutate, *de facto*, into income maintenance programs. Full employment is, therefore, a crucial ingredient in the traditional welfare state – and the achievement of full employment without price inflation is its most severe test. Over long periods, this system has succeeded in offering labour full employment and a rising social wage in return for wage restraint and institutionalized wage setting – but the bargain is not easy or automatic.

Redistribution of income between cohorts of individuals, or over the individual life cycle and the replacement of income lost under specified contingencies, is generally

termed the "social insurance" role of the welfare state. Redistribution of income between those who are rich and those who are poor in expected lifetime family income is generally labelled the "social assistance" role of the welfare state. Within the broad conception of the welfare state there is continual debate over the relative size of social assistance programs and over the details of social insurance programs (such as the income ceiling on CPP coverage) whose implication may be to favour, or to disadvantage, the lifetime income poor. But this view of the welfare state does not attempt rigorously to disentangle the insurance and income redistribution functions of the welfare state, precisely because the idea of community at which it aims requires that it offer something for almost everybody. Furthermore, in this perspective, there is no reluctance to offer some services as in-kind benefits to all citizens – in part because it is common shared experiences (as in the public school system) which help to define a community.

Analysts of the welfare state such as Rainwater, et al. [1986, p. 200] do not think it to be an accident that poverty and inequality are notably greater in the United States than in Sweden, despite the fact that "target efficiency" (the percentage of all transfer payments received by poor families) is considerably greater in the United States than in Sweden, due to the much greater relative importance of Swedish social insurance programs. They argue that it is precisely where the poor benefit from a variety of programs in which the non-poor also share (from subsidized day-care and mass transit to family allowances and unemployment insurance) that pre-transfer income differentials are lower and aggregate transfers to the poor are greater. Wilson [1987, p. 155] has likewise argued that the agenda for the liberals in the United States is "to improve the life chances of truly disadvantaged groups such as the ghetto underclass by emphasizing programs to which the more advantaged groups of all races and class backgrounds can positively relate."

Periods of substantial expansion of the welfare state (e.g., the 1930s and 1960s in the United States or the late 1940s in the United Kingdom)¹³ have often been periods when the institutions of capitalism were under severe scrutiny. In this environment, the welfare state was not necessarily loved by capitalists, but it was preferable to more extreme alternatives. Furthermore, the social democratic welfare state, with its emphasis on full-employment aggregate demand policies and activist manpower retraining and relocation programs, offered business relative stability in the demand for output and a skilled, adaptable labour force. With a large (but limited) role for government and a productive (but acquiescent) labour force, business has been able to make money securely in the modern welfare state. Government has also shared in the risks of doing business with tax expenditures,

concessionary financing, and grants for specific projects, from Hibernia Oil in the East to Northeast B.C. Coal in the West. In short, when one thinks of revisions to the social contract which the welfare state embodies, one should not forget that the welfare state offered something to business too.

Of course, even within a given country, the social contract of the welfare state is ambiguous, unwritten, and subject to a range of interpretations. It also differs appreciably between countries. Part of the bargain of full employment is acceptance of wage restraint and a probability of relocation and/or retraining, but in some countries (e.g., Sweden) relocation is far more socially acceptable than in others (e.g., Norway). Moreover, the idea that insecure people tend to resist change is not unique to the welfare state. Where the welfare state is small, a roughly similar deal appears to be considered desirable by large organizations, such as IBM or the Zaibatsu of Japan, which need to adapt quickly to unpredictable changes in technology and trade patterns. In these examples of "corporate welfarism," the organization offers job security, good pay, and fair treatment; and workers respond with loyalty, adaptability, and effort.

However, the feasibility of what the labour economics literature calls a "primary labour market" strategy depends on whether the corporation can cope with change through internal reallocation of labour alone. When change is more rapid than the organization's ability to adapt, corporate welfarism cannot honour its promises. As ex-employees of companies such as U.S. Steel can attest, the moderately affluent can become the lifetime poor, where the welfare state is limited in extent.

Moreover, national societies are far more complex than even the largest corporation and, as a consequence, the welfare state is more extensive than its corporate alternatives. To make the deal work, the welfare state must be consistent with a widely accepted ethical framework, hence "fairness" is a central concern. But what is a "fair" system? Rawls [1971] argues (as do many explicitly religious statements [e.g., the Canadian Conference of Catholic Bishops, 1982]), that if we did not know how fate would treat us, we would want social arrangements that ensured that the worst case we might experience would not be too awful. A fair society is, by these conceptions, one which maximizes the well-being of those who otherwise would have the lowest lifetime income. We already know how luck turned out in the accident of our own births, but a fair-minded person will admit its role and will argue for some redistribution by the state to ensure against the poverty that bad luck at birth would otherwise entail.

But justice is a concept with more than one dimension and the Rawls criterion is only part of what most people think of as "fairness." Nozick [1974] emphasizes the point that it is "unfair" to deprive individuals of what they have legitimately acquired. In a static or a perfectly foreseeable world, this might not happen, but in a rapidly changing world accidents happen all the time. We do not know, and cannot predict, how the accidents of technological change or trade dislocations or environmental hazard will impinge on us personally – and private insurance markets in these risks do not exist. Hence the welfare state tries to generate a "fair" set of outcomes over a wide range of interrelated issues, with no very clear dividing line between those hazards whose remedies are labelled "redistributional" and those with remedies labelled "insurance."

For many proponents of the welfare state, the ideal of community is an objective worth striving for, in itself. For the more economically oriented, it is an instrumental objective, whose value is that it creates the possibility of cooperative behaviour and a reduction in the obstructionism that might otherwise impede technical and structural change. Although few proponents would disagree that the welfare state may create regulations and disincentives that have economic costs, they would argue that the static allocative costs of sub-optimal price incentives are typically small relative to the cumulative output losses associated with high unemployment and low rates of increase of labour productivity.

For proponents of this view, a return to full employment requires both political will and institutional change. Political will is required because the generals of the war against inflation, like all generals, are ever-prone to want to take "one more hill" and to refight the last war – but a goal of zero price inflation promises war without end [see Crow, 1988]. Institutional change is required because the costs of maintaining enough excess capacity in the economic system to prevent price inflation are simply too high. After the experience of the 1970s, few would argue that consultation, controls or co-determination are costless methods of limiting wage and price inflation, but many would argue that there has to be a cheaper way than the billions of dollars of lost output, which are the costs of a policy of aggregate-demand restraint.¹⁴

Within this vision of the welfare state, there is continuous debate over the balance to be struck between distributional issues. Over time, the relative importance of distributional issues changes as society itself changes. It has always been the case that old age, disability, or single-parent status increases one's chances of poverty, but programs aimed at these issues acquire more urgency as their fraction of the population increases. As the average age of the population

increases, the benefits of the pension system produce an increasing financial pressure on the welfare state and, to the extent that the welfare state attempts to deliver "people-oriented" services whose productivity is difficult to increase, it is exposed to the problem of increasing relative costs raised by Baumol [1967]. The welfare state will therefore always have to face choices in where to allocate resources, and such choices are not made easier by the moving targets which modern social values present.

Since, in practice, many distributional issues must be solved simultaneously, the continual redesign of the modern welfare state is not a trivial problem. The notion of "equity" in the solution of each issue, and the balance between issues, is central to the idea of community at which the welfare state aims. This section has also tried to argue that it can be an efficient adaptation to the world of rapid structural change which we now face. Indeed, the need for structural change is a major motivation for the general risk-pooling of the welfare state, and the difficulty of predicting lifetime incomes in an uncertain world is a major motivation for its refusal to draw a clear line between its "social assistance" and "social insurance" roles.¹⁵

Issues of Disagreement

The idea of "visions" of the future implies some projection of a direction of change and a coherent image of that change. In order to sharpen the discussion, this essay has distinguished two "visions" of the future welfare state, but one must recognize that changes in the welfare state occur slowly at the margins. Even with three terms in office, the Thatcher administration in the United Kingdom has still left many of the structures of the welfare state in place. Despite a clear ideological stance, the buffer of North Sea oil revenues and a parliamentary majority in a unitary state with no written constitution, the welfare state has been amended, not abolished. In Canada, the necessity for provincial agreement imposes much greater constraints on reform of the welfare state, even for the most determined federal government.¹⁶ Reform of the welfare state will, therefore, necessarily be incremental – but the direction of change is still important.

The structure of this essay presumes that discussion of the amount and type of redistribution in modern capitalist societies is basically a discussion of "whither the welfare state?" The vision outlined in the section "Limiting the Role of the Welfare State" argues that issues of redistribution from the lifetime-income rich to the lifetime-income poor can and should be separated from other distributional issues. The argument of the section "The Welfare State and

the Social Contract" is that attempts to disentangle the components of the welfare state will unravel the social contract which the welfare state embodies. The disagreements between these viewpoints are many, but four particularly important issues are: 1) the relationship between unemployment and inflation; 2) the size of the public sector; 3) the importance of the incentive structure of social welfare programs; and 4) the problem of policy coordination. It would be nice if each of these issues could be settled by appeal to dispassionate research, but such research is rendered more difficult by the intertwining of these issues with each other and with basic issues of values.

In macro policy, there is always a debate on the relative cost in the short run of inflation and unemployment and some technical disagreement on the level of unemployment which is consistent in the long run with a stable rate of price inflation. Those who believe that the costs of inflation are high and the NAIRU is around 8 per cent will see current macroeconomic policy as appropriate, but those who think that unemployment is very costly and the NAIRU is around 6 per cent will argue that current macroeconomic policy is stupidly misguided, *even with our present labour market institutions*.

However, the more important question for the long term is whether institutional change can produce a more appetizing choice between inflation and unemployment. Proponents of Vision I tend to argue that the NAIRU can only be reduced if the skills of the work force are enhanced or if labour market flexibility is improved. Proponents of Vision II believe, however, that in a high-unemployment labour market, training programs tend to be ineffective and workers try to avoid the risks associated with job change, hence strong labour market demand is a precondition for the structural changes which can improve the inflation/unemployment trade-off. Since structural changes in the labour market occur fairly slowly, an emphasis on full employment runs the risk of sparking a short-run rise in inflation, but advocates of Vision II are quite willing to contemplate the use of selective wage and price controls to prevent inflation from accelerating during the period it takes for structural change to occur.

These two visions of the welfare state differ, therefore, on the issue of whether activist manpower policies, such as retraining or assistance for job search or relocation, should be complementary to high aggregate demand policies or substitutes for stimulative macro policy. And there is an important issue of fact separating these two visions of distributional issues – the hypothesis that the only way Canada can achieve satisfactory performance with respect to price inflation is by tolerating perpetually high unemployment.

The second set of factual issues which separates adherents to these two visions is the question of the responsiveness of individuals to the incentive structures of social welfare programs. Proponents of the welfare state tend to downplay the incentive effects of particular social programs, but critics have long voiced the suspicion that ingrates might "work the system" (see report of the Poor Law Commissioners, 1834). The 1970s' discussion of the problem of "moral hazard" in social insurance was not, therefore, new. Nevertheless, the debate on incentives is so intertwined with larger visions of the economy as to be almost intractable.

Analysis of unemployment insurance provides an example. If one views unemployment as primarily involuntary, then the UI system represents a form of compensation for the risks of structural change and for the failures of macro demand policy (which is seen as the main determinant of aggregate unemployment). If unemployment is sometimes voluntary, then unemployment insurance may create incentives to longer durations of unemployment spells, hence higher aggregate rates of unemployment. The debate on whether, in fact, UI benefits have significant impacts on the incidence or duration of unemployment is, on one level, an example of the uncertainty surrounding econometric estimates of behavioural response – one can contrast the certainty expressed by Cousineau [1985] with the skepticism of Atkinson, et al. [1984] and the agnosticism of Ham and Rea [1987]. On another level, however, the debate on unemployment insurance quickly becomes a far broader debate about the nature of unemployment itself and the appropriate degree of generosity for social insurance programs.¹⁷

The debate on the marginal welfare cost of taxation depends crucially on a few key empirical parameters, notably those concerning the supply of labour. And the econometric debates on the magnitude of the compensated elasticity of labour supply have created a mini industry which analyses male and female behaviour (singly and within households of different types), with and without stable preferences (over one year or over a lifetime), in labour markets with nonlinear tax structures where individual labour supply may (or may not) be quantity constrained. But the subtleties and uncertainties of econometric estimates of labour supply do not penetrate very far into the debate on marginal welfare costs, which is really a modern version of the old issue "how large should the public sector be?"

Values are, therefore, crucial in this debate and values are crucial, in a different sense, in the problem of policy coordination. The vision of the welfare state as embodying the social contract of a national community entails an

untidy balancing of "economic" and "social" concerns, of "insurance" and "redistribution" functions. Policy concerning day-care must, for example, be framed with an eye to the distribution of financing between rich and poor parents and the distribution of the benefits/costs of program quality between children and taxpayers. It must also consider the efficiency with which it frees up mothers' labour for employment and reduces the need of single parents to depend on transfer payments, as well as the social desirability of its impact on family life. The more limited version of the welfare state is much simpler to administer. Since a negative income tax is presumed to take care of distributional issues, the framers of day-care policy need only consider which program design generates the most day-care spaces at the least financial cost to government.

Coordination between bureaucracies in program design is, therefore, massively simplified in the more limited welfare state – a considerable advantage. The broader vision of the welfare state requires a high degree of policy coordination, which is far more difficult if a consensus does not in fact exist on the desirable future form of the welfare state. And to take a specific, crucial issue, the two visions of the welfare state differ fundamentally in the role which they envision for organized labour. For proponents of the more limited view of the welfare state, unions may have a limited role in the workplace, but the views of organized labour on macroeconomic policy or the design of the welfare state do not count for much. Proponents of the broader view argue, however, that it is stupid to ignore the opinions of the workers who are supposed to implement change and that organized labour legitimately represents their interests.

This essay rejects the view that there is only one possible future evolution of the welfare state.¹⁸ Indeed, it has presented not one, but two visions of distributional issues in Canada in the year 2000, and the choice between the two is clearly important.

In one vision, despair over alternative methods of controlling price inflation produces a policy decision to tolerate high unemployment for the indefinite future. Lower rates of output growth magnify existing pressures on the financing of the welfare state, which progressively retreats from its insurance functions. In an increasingly insecure environment, individuals try to minimize the probability that they personally will have to face the adjustment costs of a changing society, which in turn decreases the rate of growth of labour productivity. The labour movement is under continual pressure to defend its existence and the industrial relations system is typified by a continual conflict over job security and technological change. Individual bureaucracies myopically pursue cost effectiveness and, in a general at-

mosphere of "things we cannot afford," income redistribution programs do not escape. In this picture, there is an increasing separation between the employed and the transfer dependent, and increased inequality in individual earnings, family incomes, and distribution of employment opportunities.

Having painted this picture, readers will not be surprised that I prefer the second vision, in which high employment takes priority, complemented by activist manpower policies and selective intervention to reduce inflationary pressures. This vision has lots of problems, since the social insurance and social assistance functions of the welfare state always compete for emphasis and, in a changing world, no program is ever quite perfect in design. It is a vision of a society in which change is not a threat to be avoided but a fact of life whose costs and benefits are broadly shared. It is not a vision of absolute equality, but it is a vision of lessened inequality and a greater sense of national community.

Postscript

When I accepted the invitation to write this paper, I had no idea that the Perspective 2000 Conference would occur just after the conclusion of one of the most fascinating political debates this country has ever witnessed. My experience has been that, normally, interest in elections is very diffuse and, for most people, pretty minimal – for most people, politics is a distant affair, something which only comes into clear focus a week or less before voting day. But the 1988 election in Canada was different – there was a single major issue on which almost everyone focused, there was a positive thirst for information, and people really did try to *think* about a major national choice.

Of course, the free-trade debate went on at several interacting levels. At one level, it was a debate about the connection between economic, political, and social life – a debate epitomized by the conflicting assertions that the free-trade deal was "just a commercial agreement, cancellable on six months' notice" and the assertion that loss of control over economic events inevitably entails eventual loss of political sovereignty and cultural distinctiveness. At another level, the debate was about the proper role for governments and markets in economic life. Since many of the proponents of the deal did not believe that Canadian governments *should* attempt to control foreign investment or energy export pricing, they were quite sincere in stating that Canada "gave up nothing" in surrendering those rights. But others saw this as a disastrously costly surrender of sovereignty.

My point in mentioning these issues is that the same disagreements, on the connection between economic and social life and the proper role of the state, have very strong echoes in the debate on social policy. But the free-trade debate acquired most of its bite when it focused *directly* on social policy and when Canadians faced the issue, "What is it, *specifically*, which makes our polity different from that of the United States? What is special about us? What do we want to keep and what are we willing to trade away?"

Of course, not everyone saw it this way. Québécois tend to take their distinctiveness for granted and Albertans still remember the National Energy Policy, but in the rest of the country, the free-trade debate became inextricably intertwined with social policy.

And the interesting thing about the debate on free trade is the consensus it presented on some themes of social policy. Proponents of free trade did *not* argue for changes in social policy, for greater selectivity, or for the "harmonization" of Canadian and U.S. policies. Rather, they argued that part of Canadian distinctiveness was Canada's set of universal social programs, that this was *not* threatened by the Canada-U.S. Free-Trade Agreement (FTA) and that, indeed, the deal would create the wealth which would strengthen social policy in the future. Opponents of free trade argued that this was not true – that market pressures would compel "harmonization," while the services provisions of the deal would allow the penetration of the market mechanism into areas of social policy, like the administration of the health-care system from which it has, up to now, been excluded. Supporters of the FTA denied this. *But* the important point is that opponents and supporters of the FTA alike *agreed* that this sort of extension of the market mechanism was *not* desirable and that greater selectivity and "harmonization" was *not*, in principle, a good thing. Similarly, the deal's opponents claimed that subsidies to industries in poor regions were in danger because of the FTA, while supporters said they were not – nobody argued that they really were a bad idea anyhow.

To my mind, therefore, one of the most fascinating aspects of the free-trade debate is the consensus it presented in English Canada on the social democratic perspective, as epitomized in the saying, "The market is a good servant, but a poor master." Or, to put it another way, the market can tell you what something costs, but it does not tell you what you should buy. And there was a pretty widespread perception that this perspective is *not* characteristic of U.S. political and economic life, that placing *limits* on the role of market forces is one of the essential distinctions to be drawn between American and Canadian societies. Even though there was an undercurrent of mistrust that the supporters of free

trade were not really sincere in their sudden support of the welfare state, still the *stated objective* of all three political parties was the maintenance of a substantial federal government involvement in universal social programs.

Of course, some of the public mistrust of the free-trade deal was surely due to the fact that many of the individuals who advocated free trade had earlier been observed commenting on the overextension of the Canadian welfare state and advocating retrenchment and greater selectivity. And a major failure of free-trade advocates was their omission to specify, in advance, a set of initiatives which would mitigate the losses some sectors of society could expect. Since no specific compensation programs were identified, and with advocates whose current defence of social programs seems incongruous with their earlier criticisms, the free-trade deal attracted widespread mistrust.

Hence, the free-trade debate illustrates three aspects of the argument I wanted to make in my paper:

- 1 When it is unclear how the losers from change will be compensated for their loss, they often try to block change – sometimes they succeed, sometimes not, but the struggle is always expensive.
 - 2 The welfare state in Canada represents a social contract which has both redistributive and insurance aspects. In a world of unpredictable change, it offers the citizenry an element of personal security which private markets cannot provide.
 - 3 The debate on free trade acquired much of its passion, on both sides, because it quickly became a debate where the issues of Canadian distinctiveness and the role of the market in Canadian life were mingled. Proponents of free trade did not dispute the desirability of universal social programs and an extensive welfare state – but the deal they proposed to the Canadian people was an historic one. As I read it, the Canadian people were offered "free trade *plus* the broad welfare state" – i.e., they were offered the assurance that the greater uncertainties of a more open economy would be balanced by an undiminished insurance role for the welfare state.
- Since *both sides* of the trade debate identified social policy as an essential aspect of Canadian distinctiveness, the term "sell-out" acquired the *twin* meanings that the interests of middle-income Canadians were put at risk *and* the distinctiveness of Canadian life was endangered. Any future attempts to reduce the universal character of the welfare state in Canada will, I believe, be seen as *welching* on a very important deal and will be greeted with outrage

by those directly affected *and* by those who perceive an erosion of Canada's distinctive nature. To my mind, an enduring legacy of this election is that it has aligned, more clearly than *ever* before, nationalist sentiment with class interests.

So I tend to think that future debates on social policy in Canada will not use the bland and colourless language which I used in my paper, where I contrasted "Vision I – The Limited Welfare State" with "Vision II – The Broader Welfare State" – rather I think that our future debates will refer to the "American" and the "Canadian" visions of the welfare state.

Because the American vision of the welfare state *is*, in many ways, unique among developed nations.

In international comparisons of economic inequality, of poverty rates, social expenditures and social security institutions, the United States stands out as quite different from other OECD countries. Australia and Canada stand out as quite similar to each other and intermediate between the United States and European nations. As new societies with a strong communitarian tradition, both have had an ideal of the welfare state which has been more ambitious than the American model, but less encompassing than the European example. The 1988 election clearly identified universal social programs as a promise of the federal government *and* a distinctive aspect of Canadian national identity. By injecting nationalism into the social policy debate, it has, in my view, fundamentally changed the terms of that debate.

Commentary by Thomas J. Courchene

The paper by Lars Osberg has clearly succeeded in providing the appropriate perspectives within which fruitful analysis of the evolution of the welfare state, and more generally social policy, can proceed. I want to begin my own analysis by attempting to summarize and on occasion to rephrase Osberg's paper. While the intent here is to be objective, subjectivity may well creep in since my own views on the appropriate relationship between the citizen and the state no doubt differ from Osberg's in that I tend to place more emphasis on markets, on incentives, and on individual initiative. To argue that I also place more emphasis on adjustment would probably not be correct: What is correct is that our conceptions of the appropriate *processes* of adjustment diverge.

In the rest of the paper, I take full advantage of the discussant's role: absolved from the Osberg mandate of

ensuring that all bases are touched, I shall rely on a mixture of positive and normative economics to focus on my own view of the likely evolution of the welfare state. To anticipate this analysis somewhat, the principal point of departure from the Osberg paper rests in the interpretation of the status quo. Not surprisingly, a different starting point implies a different evolutionary path. The paper concludes with an attempt to reconcile our two views, or more correctly, to isolate those factors on which our views differ.

Osberg's Perspectives: An Annotated Review

Osberg's first approach is to cast the issue in the context of the life-cycle-income framework – "*the* distributional issue is the distribution of lifetime income and *the* equity issue is how much governments should intervene to redistribute income to the lifetime-income poor." This is a potentially powerful framework and while it is implicit in much of Osberg's analysis, one might have wished that he had made it more explicit. For example, the Rawls principle – "that if we did not know how fate would treat us, we would want social arrangements that ensured that the worst case we might experience would not be too awful" – can conveniently be viewed as ensuring that, *ex ante*, these expected lifetime-income streams are narrowed or, rather, as maximizing the anticipated income stream of those who would otherwise have the lowest lifetime incomes. Policies towards this end would essentially fall under the "equality of opportunity" umbrella and would include, among others, education, health, and the elimination of discrimination of all sorts. While progress in some of these areas has admittedly been slow, I think that societal consensus with respect to these equality-of-opportunity aspects of the overall social envelope is easier to attain than is the case for other aspects of social policy. A large part of the reason for this is that measures that ensure equality of opportunity are fully consistent with, indeed essential to, enhancing a nation's economic potential. In other words, these are positive-sum exercises so that one does not run up against the societal version of the "paradox of thrift" – what is possible for one is not possible for all.

Nonetheless, lifetime-income streams will differ. Here societies have intervened via social assistance and social insurance. Along lines roughly similar to Osberg's, I would define social assistance as redistribution designed to raise lifetime income up to some societal norm and social insurance as redistribution designed to account for contingencies that reduce a person's or family's income below their potential. In either case, the issue here is more along the lines of "equality of result" rather than equality of opportunity.

That this should generate less societal consensus is hardly surprising. At one level of concern are matters relating to the social policy per se – e.g., on the analytical side the degree of moral hazard and the issue of universal rather than selective programs, and on the more practical side the tendency to load social assistance onto social insurance programs and the fact that for most purposes social assistance is based on people's situations at a point in time, quite irrespective of their overall lifetime income. However, what makes equality of result such a contentious issue is that, unlike equality of opportunity, it is generally viewed as impinging in greater or lesser degree on the economic potential of economy, i.e., the manner in which the pie is sliced today affects the size of the pie to be redistributed tomorrow. More on this later, particularly in the context of the need to integrate social and economic policy.

Osberg's second perspective relates to intertemporal or intergenerational distribution, e.g., issues relating to aging, technical change, increasing globalization, and the environment. Osberg might have drawn from the environmental literature (more particularly the Brundtland report) and couched all of this in the context of "sustainable development." On this intergenerational front, the challenge to our generation of Canadians is to avail themselves of existing resources for their production, consumption, and distribution in a manner that ensures that the next generation is bequeathed a bundle of physical and human capital, resources, and quality of environment *at least* on par with that which we enjoy. Osberg's discussion of "environmental decay" is effectively along these lines.

However, despite the very substantial emphasis in Osberg's paper on the macro-policy stance and its interaction with social policy, the impact of government debt and deficits on future generations is not even mentioned. This is an important issue, even apart from the financial and real (lower capital stock) burden that is being transferred to the next generation. Effectively, Canadians and citizens of most industrial nations are increasingly valuing current consumption over future consumption. Why we are discounting the future to this degree is not clear (nuclear concern? impending environmental threat? a belief that debt and deficits are irrelevant?), but what is clear is that future generations are not likely to be bequeathed a healthy environment either if this same rate of time preference exists across the board.

Osberg's remaining perspectives relate to the two visions of Canada he proffers – the "limited welfare state," on the one hand, and the "welfare state as the embodiment of the social contract," on the other. Among the factors that Osberg uses to distinguish between these two visions are: (a) the relationship between unemployment and inflation;

(b) the size of the public sector; (c) the importance of incentives in the social welfare system; and (d) the problem of policy coordination. The proponents of the limited welfare state (LWS) are deemed to place a high value on curbing inflation and are quite prepared to tolerate a reserve army of the unemployed, as it were, to achieve this end. Social contractarians (SC), on the other hand, place emphasis on full employment. LWS focuses a great deal on the incentives in the transfer system but frequently, Osberg argues, this is merely a clever guise for "questioning the nature of unemployment itself (that it is voluntary) and the appropriate degree of generosity for social insurance programs." For the latter, read: government is too large. Under SC, part of the full-employment bargain is the acceptance of wage restraint and a probability of relocation and/or retraining. In addition, for SC "the ideal of community . . . is an instrumental objective . . . whose value is that it creates the possibility of cooperative behaviour and a reduction in the obstructionism that might otherwise impede technical and structural change." Although there are "static allocative costs of inappropriate incentives, these are small relative to the cumulative output losses associated with high unemployment and low rates of increase in labour productivity." In terms of (d) above, LWS strives for disentanglement which takes the form, among others, of keeping "the labour movement . . . under continual pressure to defend its existence" and of opting for some version of a negative income tax which disassociates the welfare issue from the overall socio-economic structure by hiving it off into a self-contained subsystem which will "myopically pursue cost effectiveness." In contrast, SC requires a high degree of policy coordination – an overarching social contract in which "everyone expects continuous change, but also expects that the costs of the change borne by any individual at any given time will be relatively small." So as not to leave much doubt, the LWS vision is seen as generating "an increasing separation between the employed and the transfer dependent, and increased inequality in individual earnings, in family incomes and in the distribution of employment opportunities."

This is an incredibly stark portrayal of the alternative futures. Most of the Canadian economics profession would, by default, find themselves in the LWS vision and some, like myself, are explicitly placed there by Osberg's references and/or footnotes. Part, but only part, of the problem with Osberg's preferred version of the welfare state evolution is that "you can't get there from here." Frankly, the comparison with Sweden is wearing rather thin. Sweden has assumed a more central role in Canadian social democratic thinking now that the perennial co-favourite, West Germany, has decided to tolerate a dramatic escalation in unemployment and has seen its overall employment rate

(employment as a percentage of population aged 15 to 64) fall 7 percentage points below Canada's (i.e., 67.2 per cent for Canada and 60.3 per cent for West Germany), from a position a decade ago where West Germany had the higher rate (OECD, *Historical Statistics 1960-86*). However, Sweden is not a particularly useful role model. First of all, the Swedes are incredibly homogeneous relative to Canadians – linguistically, ethnic-wise, religious background, and so on. Second, Sweden is a unitary state rather than a decentralized federalism and indeed a federalism where linguistic and industrial/economic differences are substantially heightened by where we have drawn our provincial boundaries. Third, and related to the previous points, Sweden has a very different set of institutions. Principal among these is Mancur Olson's observation that special interest groups in Sweden tend to be "broad" (societal) rather than "narrow." Thus collective bargaining in Sweden is basically nationwide in nature.¹⁹ This means that unions have to internalize any negative consequences arising from the wage-bargaining process since there is nobody else in society to pass these costs on to. Hence, retraining, migration, and acceptance of technical change come naturally in this environment. Narrow-interest groups, however, need not be worried about these externalities since they can be foisted upon the rest of the system to deal with. One of Olson's principal conclusions is that, despite roughly similar interventions in the market system, Sweden has generally outperformed Britain on the economic front precisely because of its "encompassing" special interests and distribution coalitions.

The litany of Canadian-Swedish differences can be extended further, but the above three are probably sufficient to make the essential point that Osberg's preferred vision is not merely about the evolution of the welfare system. Rather it is an implicit, if not explicit, call for a wholesale rethinking of Canada – from a multicultural to a melting-pot philosophy, from federalism to unitary state, and from our adversarial collective-bargaining tradition to one embracing of some or another version of corporatism. Within this "vision" of Canada, social contractarianism no doubt makes good sense. Recall, however, that it was essentially the attempt to implement a version of this approach in Britain that got the United Kingdom into trouble and led to the Thatcher counter-revolution. And Britain is much closer to Sweden in terms of the above norms than is Canada.

Nonetheless, Osberg's contrasting futures do highlight two key features that must play centre-stage in the evolution of the welfare state. The first is the thrust of the macro stance, particularly the inflation-unemployment trade-off. The second related to the burden of adjustment: the challenge is to respond to the changing world economic order

without relegating selective groups of Canadians to transfer-dependency, even if the transfers are deemed to be generous. Since, by default, Canada must contemplate its welfare state future, at least its short-term future, within some version of what Osberg refers to as LWS, the rest of the paper will highlight those features that are most likely to determine the nature of this evolution. The analysis discussion begins with a restating of the essence of the status quo.

An Alternative Vision of the Future of the Welfare State

I think that Osberg underestimates significantly the forces for change, on both the real and the social policy fronts, that are incorporated in what passes for the status quo. The combination of globalization and the computational/telecommunications revolution (henceforth referred to as the information society) is going to have major implications for small open economies, particularly resource-based economies. Here, Peter Drucker's [1986, p. 5] trilogy of "uncouplings" is relevant. The first is the uncoupling of the primary products sector from the industrial products sector. The Club of Rome's "running out" hypothesis has been turned on its head: the world is awash in primary products. "By early 1986 raw material prices were at their lowest levels in recorded history in relationship to manufactured goods and services – in general as low as the depths of the Great Depression." Thus much of what Osberg refers to as the spreading of the "Atlantic syndrome" to the resource hinterland has more to do with resource prices globally, rather than the nature of our social contract, or with the ongoing macro stance (although I will comment on the Bank of Canada policy later). One may not agree with Drucker's view that resources are likely to remain in "permanent oversupply," but it nonetheless remains the case that the challenge for Canadians is to make the transition from a resource-based economy to a human-capital or knowledge-based economy. Social policy is front and centre here, both in terms of human-capital formation or reformation and in terms of providing transitional support.

Drucker's second point is that employment is being uncoupled from industrial output. Again Drucker may go too far when he claims that what is being de-industrialized is not the industrial sector but rather blue-collar labour. But this is clearly occurring and the bulk of new jobs are in the service sector. This again has dramatic social policy implications because the stability of "middle-class" labour is diminishing and, with it, the traditional core strength of private-sector unions.

Drucker's third observation is that the "symbol economy" – capital movements, exchange rates, and credit

flows – is replacing the flow of goods and services as the flywheel of the world economy. The traditional conception that differential rates of inflation and rates of productivity drive competitiveness across nations has been thrust on its head as massive exchange rate movements confer comparative advantage across nations. In particular, the combination of flexible exchange rates and near-perfect capital mobility has altered the manner in which world economies are linked. The U.S. government deficit fed rapidly into a dramatic appreciation of the U.S. dollar, the devastation of the U.S. exportables sector, and a record current-account deficit that remains stubbornly persistent. The Canadian deficit is much higher (as a proportion of GNP) than the U.S. deficit but we were spared resort to the foreign sector through most of the 1980s because Canadian private-sector savings were much higher than U.S. private-sector savings. Over the last couple of years, however, our private-sector savings have plummeted and we too are now running a balance-of-payments deficit. Fiscal deficits and debt do not play well electorally but in light of the massive electoral spending promises, Canada faces the likelihood of falling into the U.S. exchange-rate roller coaster.

This brings me to Osberg's concern with the ongoing macro thrust. It is difficult to make the case that fiscal policy has been anything but expansionary. But monetary policy has been too tight. What Canada needs (and what the world's capital markets will likely force on Canada) is a change in the policy mix – towards tighter fiscal policy and easier monetary policy.

All told, this picture is one of a status quo embodying eroding roots to the past and growing forces for change. In terms of the overall economy, the realization is increasingly that the rewards are going to go to those nations that can adjust quickly and efficiently to the changing world order. As enterprises embody more flexible production processes, the pressures on individual Canadians intensify. Osberg's observation that the aggregate share of labour in GNP has fallen reflects this pressure – in a world that increasingly rewards incentive and initiative, the returns to capital (both physical and human) will likely increase and more and more Canadians will shift from workers to entrepreneurs.

It is in this context that one must assess the adequacy of our social policy framework and programs. Basically, we are attempting to address the challenges of the 1990s with a social policy framework designed to meet the challenges of the 1960s. Those were the good old days as it were – we utilized the cushion of resource-based growth to mount a comprehensive set of transfers to persons, enterprises, and even governments. Canadians were so rich and the external environment was so accommodating that we were able to

design social policy largely in terms of social parameters without much concern for how the transfer system interacted with the production system. The shoe is now on the other foot: the challenge is now to reintegrate social and economic policy in order to feed the flailing engines of economic growth, and to ensure that the framework is able to meet the new needs on the social front (day-care, aging, an enhanced emphasis on human capital). Moreover, in the process we have also "rediscovered" inequality concerns. Combined with the domestic, let alone the external, pressures on the deficit, it seems to me rather inevitable that social policy will have to move in the direction of embodying greater incentives relating to labour force reentry and initiative, of enhanced targeting of benefits, of an increased use of user fees (adjusted for ability to pay) for a broader range of public services (e.g., education) and, more generally, of reintegrating social and economic policy. Had we the institutions, the political structure, and the degree of consensus that exist in some other countries, our range of choices would presumably be broader. For better or for worse, we do not have this luxury. While it is undoubtedly true that the best "social policy" is a job, it is also the case that there is only Pyrrhic security on the social policy front in the context of an economy that fails to adjust. Moreover, in the context of a resilient economy, the macro levers can be more safely deployed in the direction of lending more emphasis to full employment than to inflation.

All of this probably leaves me well within Osberg's conception of the LWS. However, I would argue that over the near term the principal avenue for undermining Canada's hard-won gains on the social policy front is, as already noted, to face the 1990s with a framework designed to address the challenges of the 1960s. There is, however, a range of further challenges on the horizon, and the way that some of these get played out may tilt the system more in the direction of Osberg's view of social contractarianism. The first relate to income distribution (i.e., inequality as distinct from poverty).

Emerging Social Policy Issues

Income Distribution

Societal consensus in favour of a market economy reflects that, among other things, free markets have proven themselves in terms of generating high-average incomes and that the resulting distribution of income reflects, to a large degree, relative social products. However, the arbitrary windfalls associated with the inflation roller coaster, the energy-shock-related recessions, and the generalized uncertainty relating to the emerging economic order make

the existing distribution of income more difficult to rationalize in terms of social productivities. This is exacerbated by the fact that some of us collect rents because we have protected niches, whether they go by the name of tenure or seniority or whatever. It is complicated further when industrial leaders' salaries are now extending into the seven-figure range while their workers are expected to confront automation and technical change often without salary, let alone job, guarantees. Presumably, much of what is driving Osberg's contractarian vision of the future welfare state is rooted in these concerns. And his view of the future will become increasingly appealing, unless Canadians find an acceptable way to address these underlying concerns.

While this is not the venue for outlining solutions, it is appropriate to emphasize one critical aspect – human capital. If knowledge-intensive industries are indeed the new cutting edge in terms of international competitiveness, then educational opportunity will be the major criterion of the income class in the 21st century. The challenge here is enormous, ranging from rethinking the whole educational system to ensuring that access to the new information technology is not a function of income class. Intriguingly enough, one of the reasons why Canada has fallen so low in international educational comparisons relates to our elitist immigration policy. The German approach is to bring in low-wage guest workers. This serves to depress low-skilled entry wages and provides an incentive for Germans to build their own human capital. The Swedes have a rather strict immigration policy so they too must invest in their own if they wish to be world class. For much of the postwar period our immigration, via the point system, sought the best and the brightest. This depressed the high-skilled wage relative to the unskilled thereby providing perverse incentives vis-à-vis human-capital formation. This is not an argument against immigration. Rather, it is a comment to the effect that since we do not “pay” for the human capital that other countries invest in our immigrants, we tend to underinvest in our own citizens. This is another part of the reason why the transition from a resource-based culture to a human-capital-based culture is likely to be a difficult one for Canadians.

The Nature of the Public Sector

The conception of the public sector or more generally the relationship between the citizen and the state is undergoing quite dramatic change. Some of this is ideologically driven and, therefore, not very amenable to reason, either way. Some, however, is driven by efficiency – private production of publicly funded goods and services (e.g., contracting out

or vouchers) or private funding of publicly provided goods and services (tuition fees or user charges), although the latter is sometimes also argued on distributional (ability to pay) grounds. Technology is also blurring the line between the private and public sectors; Teleglobe may have made sense as a Crown-owned natural monopoly prior to the telecommunications revolution, but no longer, given the avenues for by-pass.

But it is the social policy area where the role of the state has undergone its largest transformation.²⁰ Once relegated to the provision of *collective* goods such as defence, justice, research, and culture, the state is now in the forefront of providing *private* goods and, in particular, household consumption. In the recent debate over child care, the essence of the issue was whether the state rather than the family has the comparative advantage in the provision of day-care: the fact that day-care would be largely publicly funded was already decided. Some of this reflects the fact that the state has come to be viewed as the leader in social policy – maternity benefits for the work force, equal pay for work of equal value. Given, however, that there is a limit on the public purse, these additional social policy roles undertaken by the state are, intriguingly, leading to the “privatization” of many of the traditional collective goods – police, research, and so on.

The Charter and Social Policy

The assumption in the Osberg paper and in the above analysis is that Canadians through their legislators have a free hand in the design of our social policy framework. This assumption is highly questionable now that, via the Charter, the courts have a potentially powerful role in the social policy arena. Already, the Supreme Court has pronounced on a wide range of social programs and this represents only the tip of the iceberg in terms of cases that are already before the courts. For example, if age discrimination for such programs as Old Age Security, UI and the Guaranteed Income Supplement were to come under fire from the courts, this would usher in a virtual revolution in terms of social policy architecture. In this particular case, the result would be to increase substantially the attractiveness of some version of a negative income tax applicable to all Canadians. Relatedly, the Charter may come to be viewed as preferable to legislatures or unions as a route for pressing for social reform. Speculation as to what the courts may or may not do is not particularly fruitful. However, what is clear is that the potential exists for powerful “external” influences on the evolution of our social programs and more generally the nature of the welfare state.

Federalism and Social Policy

The literature on the relationship between federalism and social policy appears to suggest that federalism has imparted a conservative bias in the evolution, to date, of our social policies. Notwithstanding that this bias may also carry over to the future, I want to focus on three aspects of the current federal-provincial scene that are likely to have a substantial impact on social policy evolution. The first is that our social programs, perhaps especially Medicare, are about to become much more varied across provinces. All the provinces are under tremendous fiscal pressure. For example, with health care accounting for roughly 35 cents of each provincial spending dollar and with the challenges posed by an aging population, the provinces will be scrambling to find more cost-efficient ways of delivering not only health care, but the full range of social programs under their purview. Indeed, this experimentation is already well under way, but it will surely intensify, particularly as technology opens up new avenues for experimentation. On the health-care side, the combination of interactive telecommunication and the "smart card" technology implies that the "home as hospital" becomes almost inevitable, given the rising costs of hospital care. In general, what federalism has to offer here, whether in terms of health care, social assistance, or work incentives, is the possibility for 10 simultaneous experiments relating to the design and delivery of social programs. If "winners" appear, they will quickly be copied by the remaining provinces. Although many Canadians may take a dim view of all of this, it is my own opinion that the decentralized nature of social program delivery is probably the most important asset Canada has in terms of the future evolution of these programs. Lest one downplays this aspect, recall that it was Saskatchewan's postwar experimentation that gave us Medicare.

The second aspect of the federal-provincial social policy scene is that for the first time in the postwar period, and perhaps much further back, Ontario is emerging as the social policy leader. Elsewhere [1988] I have attempted to document why this is the case. For present purposes, it will suffice to note that much of the recent Ontario agenda is a social policy agenda (e.g., equal pay for work of equal value). This dramatically alters the nature of the social policy dynamic in Canada. If Saskatchewan innovates, New Brunswick will likely react by weighing citizen demand against projected costs. However, if Ontario innovates, then the issue is likely to become one of "regional disparities" and almost immediately the pressures will come to rest on Ottawa. This is particularly the case if the Meech Lake Accord is successful, since Ottawa can, under the guise of a shared-cost program, walk into any area of exclusive provincial jurisdiction.

The Meech Lake Accord, itself, is the third element in the federal-provincial arena that is likely to influence the evolution of social policy. At present, it is virtually impossible to conceive a fully coordinated approach to the transfer system as it affects, say, the elderly. Some of the programs here are federal (OAS and GIS). Some are provincial (Medicare, drug plans, and housing subsidies) and some are federal-provincial (CPP/QPP). Constitutional challenges would be flying every which way if Ottawa attempted to rationalize all of this. Meech Lake cuts through all of this. Ottawa can propose an overarching shared-cost program encompassing all aspects of the social policy envelope as it affects the elderly. To be sure, some provinces (e.g., Quebec) may exercise their ability to opt out, but most would not. This *process* dimension of Meech Lake effectively means that Canada has found a clever, even ingenious, way around any jurisdictional problems that might stand in the way of implementing an otherwise efficient and/or equitable set of social programs.

The FTA and Mulroney's Social Contract

I have long argued that we need to alter major aspects of our social programs. For example, once Canadians pass the 65-year-old threshold, the treasury bestows on them a tax or transfer gift of roughly \$6,000, *regardless of income class*. Surely, this does not make sense on equity grounds since increasingly the upper-income elderly have already availed themselves of tax-assisted occupational pensions and RRSPs. In my view, there is ample scope for more selectivity here, where most of the benefits would flow to the lower-income elderly, an increasing proportion of which are single women.

Enter the free-trade agreement and Mulroney's commitment that social programs will not be affected. What does this mean? – that changes Canadians may have ushered in *without* the FTA will now be precluded? Phrased in Osberg's terms, what precisely is the nature of the "social contract" that the Prime Minister has made with Canadians? In my view, it is essentially that Canada will not "Americanize" its social policy. This is not much of a constraint because Canadians have no desire to adopt U.S.-style social policy. Beyond this, however, the thrust of this paper is that social policy, like other aspects of policy, must be brought in line with the forces and challenges of the emerging global order. This does not mean that the politics of social policy change will be easy.

Conclusion

This has been a rather broad-ranging discussion triggered by Osberg's paper. I have been somewhat unfair in that I have focused on several issues that were not highlighted in

his paper. In part this is because I do not have a satisfactory answer to the principal challenge of the Osberg paper, namely, how does LWS evolve in a manner that incorpo-

rates some of the crucial features of SC? Unless those in my camp can provide appropriate alternatives, Osberg's preferred vision may become Canada's evolving reality.