

**THE EVOLUTION OF GOVERNMENT AS
RISK MANAGER IN CANADA**

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Introduction

The key to understanding the continuing growth of government in Canada is to understand government's role in managing risks. Over the course of the 20th Century, Canadian governments managed an increasing number of risks that had formerly been left to the market. These include risks to individuals from unemployment, sickness and aging, risks to the environment, health and safety and economic risks to business (such as from anti-competitive behaviour). Governments' involvement in risk management ensured that governments grew in size in the post-War period and seen a resurgence of growth in recent years despite attempts to limit their size.

This paper examines how the role of government as risk manager developed in Canada in the 20th Century and the impact of this risk management role on the size of government and the boundary between government action and market ordering. It argues that there have been three principal stages in the development of government's role as risk manager in Canada in the 20th Century. In the first stage (1900 – 1940), government played only a minor role in risk management. Its primary risk management activity was reducing the economic risk to business in order to promote economic growth. In the second period (1940 – 1975), Canadians demanded action in response to the severe economic and social dislocation of the Depression. Governments, and in particular the federal government, responded by developing programs to manage economic risks to individuals such as the risks of unemployment, health costs and poverty. Success with these programs and strong economic growth led governments to introduce programs to address broader social risks in the latter part of this second period. These social risks included risks to the environment, health and safety, to consumers and to human rights.

These first two periods established the risk management role of government in Canada. This paper argues that the nature of this risk management role constrained the ability of governments to significantly limit the growth of the size of government in the most recent period from 1975 to 2000. Further, government's role as risk manager shaped the methods used by governments to decrease their size and role. These methods have led in recent years to an increased emphasis on the need for government to act as risk manager.

Part I of this paper discusses the scope of government's role in managing risks, why government may wish to address risks arising from market ordering and the ways in which they address those risks. Part II sets out general overall measures of the size and role of government and how these relate to government's role as risk manager. Part III then discusses the period from 1900 to 1940, illustrating the primary focus on market ordering, risks to businesses and decentralized government. Part IV discusses the period from 1940 to the 1975, during which there was a shift to greater government risk management in the form of the growth of the welfare state and regulation of social risks. Part V addresses attempts by governments to reduce their role in managing risk in the

period 1975 to 2000. Finally, Part V argues that the types of risks that have arisen over the past few decades along with the manner in which the recent shift towards the market occurred in Canada is creating a shift back to greater risk management by governments.

I Risk and Government Action

A. Government as Risk Manager

Governments manage a broad array of risks. Readily apparent examples include government management of the risk of crime or traffic hazards (through policing), of pollution and workplace injury (through environmental, health and safety laws) and of injury from consumer products (through fraud and consumer protection legislation). Yet many of the other activities governments undertake also involve risk management. Government-managed unemployment insurance, health insurance and old age pensions ameliorate the impact to individuals from job loss, illness and aging by distributing the impact across a wider range of people – that is, they “spread” these economic risks facing individuals. Governments use tariffs, subsidies, price and entry controls and the tax system along with limited liability and bankruptcy legislation to manage the risk facing domestic business.

Moss has recently examined the role of the government in the U.S. as risk manager, in particular its role in reallocating risk.¹ He argues that the U.S. economy would be unrecognizable and possibly not function without the government managing risks. According to Moss, the U.S. has experienced three phases in government’s role as regulator of risks that the market could not adequately address. The first phase (prior to 1900) saw governments address economic risks to business through limited liability, bankruptcy, monetary and banking laws. In the second phase (1900 to 1960), governments addressed risks to workers, in particular through worker’s compensation legislation, unemployment insurance and old age pensions. In the final phase (since 1960), governments have expanded their focus to address risks to everyone, such as through consumer protection legislation, environmental regulation and disaster relief programs.

This paper uses Moss’s emphasis on public risk management to examine the growth of government in Canada but, in contrast to Moss, discusses both risk reduction and risk reallocation measures by governments. Moreover, as will be seen, this paper argues that the development of government as risk manager has not been one of monotonic growth (as implied by Moss) but of a trend to growth in risk management by government with long cycles in the boundary between government action and the markets.

¹ David A. Moss, *When All Else Fails: Government as the Ultimate Risk Manager* (Cambridge, MA: Harvard University Press, 2002).

To understand this changing role of government, this paper will examine gross spending and revenue measures as well as discuss in more detail three, often overlapping, areas of government risk management:²

- Economic regulation: Regulation of economic risks posed by the market to companies and consumers encompassing controls over price, rate of return, entry, exit, rate of output and conditions of service for industries;
- Social regulation: Regulation of largely non-economic risks including the risk of physical harm to individuals (such as from occupational health and safety hazards or defective products) or the environment, pecuniary risks (such as damage to property from pollution), risk to basic human rights (such as from discrimination) and risk to broader, non-economic social goals (such as social cohesion);³
- Welfare: Regulation or mitigation of economic risks to individuals such as from sickness, unemployment, poverty and aging, and encompassing income transfers, health care, education and food, housing and similar goods.⁴

Risk management is one goal of government and is important in understanding the role and the growth of the state in Canada. The state can be viewed as having other goals such as redistribution or social cohesion rather than risk management. However, even these goals may be viewed through the lens of risk management at one level and, as a result, risk management covers a wider range of policies than might at first appear to be the case. For example, the welfare state can be notionally seen as an ex ante insurance contract voluntarily entered into by citizens from behind a Rawlsian “veil of ignorance”.⁵ Individuals not knowing their situation at birth could voluntarily demand a form of welfare state as insurance against, for example, the risk of being born poor (and its impacts on health, life and opportunities). While obviously not descriptively accurate, this view of the welfare state can aid in evaluating changes in the role of government over time.

Further, public education can also in part be thought of as a form of risk management for business and individuals. Public education has provided a higher quality labour force for business since its inception, reducing the risk from an undersupply of such labour in the labour market. Moreover, it has reduced the risk of unemployment and poverty for individuals. This reduction in risk to business and individuals in part lies behind recent calls for increased investments in, and government focus on, human capital. For example, Courchene argues that global economic integration and the

² Governments also manage risk through such mechanisms as monetary policy. This type of risk management mechanism is not directly the subject of this paper.

³ Peter Nemetz, W.T. Stanbury and Fred Thompson, “Social Regulation in Canada: An Overview and Comparison with the U.S. Model” (1986) 14 *Policy Studies J.* 580.

⁴ N. Barr, “Economic Theory and the Welfare State: A Survey and Interpretation” (1992) 30 *J. Econ. Lit.* 741; A. Weale, “Equality, Social Security and the Welfare State” (1990) 100 *Ethics* 473.

⁵ Barr (1992).

knowledge/information revolution give rise to a need to increase human capital to allow Canadian businesses to compete internationally and Canadians to obtain jobs in the “New Economy”.⁶ Governments could therefore use education and training programs to address the risks to business and individuals in this new environment.

Before discussing the nature of risks, it is important to address briefly the distinction between public and private action. Often the debate concerning the role of government assumes that there is a bright line demarcating the public sector (government) from the private sector (markets or private ordering). However, in reality there is no such line. Markets or private ordering require government rules and institutions (such as the creation and enforcement of property rights). They could not exist without them and these rules determine the nature of the markets. Conversely, governments have always to one extent or another relied on private actors to help formulate and implement public policies.⁷ Therefore, discussion of the role of the public and private sectors necessarily refers to the mix at a particular time – and not to a clear demarcation between “public” and “private” spheres. This paper maintains the language of the public/private divide but focuses on the changing mix of public and private action over time.

B. Risk and Perceived Risk

(a) Markets, Risk and Information

The relevant risks for the purposes of this paper are pecuniary and non-pecuniary risks arising from market ordering. For example, there are safety risks to workers from manufacturing and other industrial activity such as mining, even in companies which take extensive safety precautions. Investors face the risk that a company will fail. All employed individuals face some risk that they will be laid off. Businesses face the risk that their competitors will use anti-competitive methods to succeed. Individuals face the risk of having to pay for health care. As will be seen below, some of the current risks have been in existence since 1900 while others have developed over time.

When markets are functioning properly, they provide enormous benefits in terms of efficient production of goods and services and economic growth. Further, markets facilitate a degree of individual liberty by allowing market actors to make personal choices. In many cases, markets deal well with risks through creation of insurance markets or premiums for accepting risk.

⁶ T.J. Courchene, *A State of Minds: Toward a Human Capital Future for Canadians* (Montreal: Institute for Research in Public Policy, 2001).

⁷ Jody Freeman, “The Private Role in Public Governance” (2000) 75 *N.Y.U.L.R.* 543; Lester Salamon, *The Tools of Government: A Guide to the New Governance* (Cambridge: Oxford University Press, 2002).

However, for markets to work optimally there are a number of very important pre-conditions. If these pre-conditions do not exist, market ordering will not adequately address risks. These are “market failures”. A key source of market failure is inadequate information. If no one knows there is a risk, then the markets cannot adjust for the risk. An example is the case of a substance (such as asbestos) or a production method that is used for many years before evidence arises that it causes health hazards to workers.

Moreover, informational asymmetries can also give rise to market failure. For example, if workers do not know they are facing a workplace risk, they will not be able to make informed decisions (such as to refuse to work or demand compensation for the risk), even though the employer knew at the time of exposure that there was a risk. Information asymmetries arise in a wide range of risk situations from consumer products to investment opportunities to environmental hazards. Private insurers may not insure some individuals or some risks in the face of informational asymmetries. This will occur where there are, for example, adverse selection or moral hazard problems.⁸

In addition, individuals may take inappropriate decisions concerning risk because they misperceive the risk they are facing. Individuals’ perception of risk may differ from the actual risk because of mental shortcuts or irrationalities. For example, over-optimism concerning the risk of a workplace injury may mean that a worker will not insure him or herself against a substantial risk.⁹ In the face of such perceptions, insurance markets will not function optimally.

Finally, an important source of risk from market ordering arises from externalities where one party is able to impose a risk on another and avoid paying the cost of creating the risk. The most obvious example is a polluter who can impose a cost or risk of pollution on another party without paying a cost.¹⁰ The polluter will produce too much pollution and the other party will be exposed to risk for which he or she is not, and possibly could not be, compensated.

Governments may address risks that the market cannot adequately address due to market failure. However, governments may also address risks which markets could efficiently address. In some cases, this may be because individuals care about the

⁸ Adverse selection arises where those seeking insurance have better information about the risk they pose than does the insurance company. Those with above average risk are more likely to obtain insurance and therefore where the insurance company must base its premiums on average risks, it will lose money. The moral hazard problem arises due to the incentive effects of insurance. Absent insurance, an individual may take certain precautions to avoid a risk (such as a car accident). However, once the individual is insured, he or she will have less incentive to take the precaution and insurers will be faced with higher claims. For a full discussion of the nature of risk and the failure of markets to provide insurance, see Moss (2002).

⁹ Moss (2002).

¹⁰ Robert Cooter and Thomas Ulen, *Law and Economics* (3d) (Reading, MA: Addison-Wesley, 2000). See Ronald Coase, “The Problem of Social Cost” (1960) 3 *Journal of Law and Economics* 1 as to the reciprocal nature of externalities.

fairness of outcomes, both for themselves and for others.¹¹ Therefore while a market may generate an “efficient” risk allocation, individuals may prefer government intervention to ensure what they believe is a fair allocation. In other cases, those bearing the risk may be able to use their political influence to ensure that the government manages the risk (through shifting or spreading the risk) so that they do not bear part or any of the costs.¹²

(b) Perceived Risk

As mentioned above, individuals do not always accurately estimate the probability of certain events – that is, they may over or underestimate the probability of a particular event occurring.¹³ One of the main reasons for such misperceptions is the use of “heuristics” or mental shortcuts by people thinking about events. In addition, people have certain tendencies when considering risks that, while not irrational, have important impacts on their perception of risk. Some of the most important heuristics and tendencies for the purposes of this paper are:

- **Availability:** People tend to over-estimate the probability of an event when a similar event comes readily to their minds (that is, the event is “available” to them). For example, if an individual has just seen a car accident, he or she is more likely to overestimate the probability of another car accident occurring. Factors affecting availability include the observed frequency of the hazard (that is, the more recently the individual experienced the event, the more likely he or she is to estimate it will occur) and the salience of the event (that is, the more salient (memorable, tragic, dreaded) is the event, the more likely it is to be available). Salience can be increased by the degree of media attention concerning the event.¹⁴
- **Over-optimism:** Individuals tend to be unrealistically optimistic that bad things will not happen to them. For example, people tend to believe that other individuals are more likely to be in a car accident or lose a job than they are. This

¹¹ Christine Jolls, Cass R. Sunstein and Richard Thaler, “A Behavioral Approach to Law and Economics” in Cass R. Sunstein, ed., *Behavioral Law and Economics* (Cambridge, MA: Cambridge University Press, 2000). For example, experiments have found that individuals will sacrifice their own self-interest in order to achieve a result which is fair or to punish those who they believe have acted unfairly. See also Matthew Rabin, “A Perspective on Psychology and Economics” (University of California – Berkley Working Paper, November 23, 2001).

¹² Interest groups may pressure governments for regulation providing the groups with rents (that is, some benefit). Public choice theory holds that legislators and bureaucrats respond to such pressure out of self-interest. Other models of legislation and regulation, such as civic republicanism and pluralistic models, also warn of the danger of interest group pressure. Freeman (2000).

¹³ For an overview of risk perception issues, see Cass R. Sunstein, ed., *Behavioral Law and Economics* (Cambridge, MA: Cambridge University Press, 2000).

¹⁴ Jolls, Sunstein and Thaler (2000).

can lead to individuals failing to buy insurance for a risk because they do not believe it is likely to occur to them.¹⁵

- **Loss Aversion:** Individuals are much more averse to losses than they are happy with equivalent gains. This makes the individual's sense of the status quo very important as losses from this status quo are treated differently than gains. It may be possible to change the reference point for the status quo in some cases to make what looks like a gain (or loss) into a loss (gain) and therefore change individuals' feelings about the change.¹⁶

The public's perception of a risk of an event (such as job loss or pollution) and its probability of occurring will therefore depend on a range of factors such as whether the event has occurred to them or someone they knew recently or was particularly salient. Individuals may overreact to some risks or under react to others depending on the timing and framing of the event. As will be discussed below, changes in risk perception are an important factor in the timing of government action on certain risks.

C. How Does Government Deal with Risk?

When government decides to take action on a particular risk, there are three basic ways in which it may do so¹⁷:

- **Risk shifting:** One method for dealing with risk is to shift it from one party to another. An important example is a liability rule – that is, a rule that specifically places the liability for the cost of a particular harm on one party. For example, a liability rule can shift the risk of harm from an unsafe product from the consumer to the producer of the good. This may not only effect who will pay the cost of any harm, it can also reduce the level of risk by providing incentives for a party to take action to limit liability (for example, create safer products).
- **Risk spreading (or pooling):** Risk spreading takes the risk from one party and imposes it on a wider range of other parties. For example, absent insurance, each individual bears the complete risk that he or she will become unemployed. State-provided unemployment insurance spreads this risk across all workers by providing each worker with a payment if he or she is unemployed in exchange for the worker paying a premium (in the form of income taxes or a payroll tax).

¹⁵ Christine Jolls, "Behavioral Economic Analysis of Redistributive Legal Rules" in Cass R. Sunstein, ed., *Behavioral Law and Economics* (Cambridge, MA: Cambridge University Press, 2000); Moss (2002).

¹⁶ Cass R. Sunstein, "Behavioural Analysis of Law" (1997) 64 *U. Chicago L.R.* 1175.

¹⁷ Moss (2002) discusses the three methods of managing risk, although the focus of Moss' study is on risk reallocation (spreading and shifting).

However, in some ways government provision of insurance is also “risk shifting” from the individual to the government (which undertakes to pay the individual). The government then spreads the risk across taxpayers and/or workers. This is important to bear in mind as it has an impact on jurisdictional disputes between levels of government over providing the insurance. For example, governments may attempt to avoid responsibility for a particular type of insurance system (such as covering the costs of health care) in order to avoid the political costs of raising taxes.

- Risk reduction: The government may take actions which will decrease the probability that a risk will occur. For example, the government can impose prohibitions on the use or release of a particular substance or on certain behaviour such as fraud or provisions of false or misleading information. The goal is to stop the risk from occurring or reduce its probability.

However, in some ways this also is a form of risk shifting. Parties can (and do) still undertake the activity. They are merely faced with an increased potential cost from the activity – that is, the cost of being caught, prosecuted and convicted. Regulatory action aimed at reducing risk through standards and regulations are therefore really a method of shifting risk from one party (for example, the worker exposed to the unsafe practice) to firms or other private actors. Whether or not the cost will actually arise depends on a variety of factors such as the size of the potential fine or liability, the probability non-compliance with law will be detected and the probability that the party will be prosecuted and convicted if the non-compliance is detected.

Governments use these three methods to address risk arising from market ordering. As will be seen, governments have used different mechanisms at various times to address economic risks to business and to individuals as well as social risks. The risk management mechanism used has an impact on the size of government and the options open to government in reducing its role as risk manager.

II Risk and the Size of Government

Government has grown dramatically over the post-war period. This section describes the trends in the growth of government and its relation to risk management. It first sets out broad measures of the growth of government expenditures and revenue.¹⁸ It

¹⁸ This discussion focuses on actual expenditures by governments such as on transfers, wages and goods and services. It does not explicitly consider expenditure programs run through the tax system which can play an important role in meeting public goals such redistribution and subsidization. Moreover, it principally relies on spending as a percent of GDP, although this may tend to overemphasize the growth of government because of the higher costs of providing government as opposed to private goods and services: L. Imbeau et al, “Measuring Government Growth in Canadian Provinces: Decomposing Real Growth and Deflator Effects” (2001) XXVII *Canadian Public Policy* 39.

then discusses the composition of government expenditures and its relation to risk management.

A. Government Expenditure and Revenue

(a) Total Government Expenditure

The period from the 1930s to the present has seen a remarkable increase in government spending in most developed countries. As shown in table 1, government expenditure as a percentage of GDP nearly doubled in 14 developed countries over the period 1937 to 1996, from an average of 23.8 percent in 1937 to 45 percent in 1996. Canada was slightly above the average in spending in 1937 (at 25 percent) and slightly below the average by 1996 (at 44.7 percent). Apart from spending during World War II, the peak of government spending in Canada was in 1992 when government spending topped 50 percent.

Table 1: Growth of General Government Expenditure, 1920 – 1996 (Percent of GDP)

<i>General government for all years</i>	Post World War I	Pre World War II	Post World War II			
	1920	1937	1960	1980	1990	1996
Australia	19.3	14.8	21.2	34.1	34.9	35.9
Austria	14.7	20.6	35.7	48.1	38.6	51.6
Canada	16.7	25.0	28.6	38.8	46.0	44.7
France ^a	27.6	29.0	34.6	46.1	49.8	55.0
Germany	25.0	34.1	32.4	47.9	45.1	49.1
Italy	30.1	31.1	30.1	42.1	53.4	52.7
Ireland ^b	18.8	25.5	28.0	48.9	41.2	42.0
Japan	14.8	25.4	17.5	32.0	31.3	35.9
New Zealand ^c	24.6	25.3	26.9	38.1	41.3	34.7
Norway ^b	16.0	11.8	29.9	43.8	54.9	49.2
Sweden ^a	10.9	16.5	31.0	60.1	59.1	64.2
Switzerland	17.0	24.1	17.2	32.8	33.5	39.4
United Kingdom	26.2	30.0	32.2	43.0	39.9	43.0
United States	12.1	19.7	27.0	31.4	32.8	32.4
Average	19.6	23.8	28.0	41.9	43.0	45.0

- a. 1996 data; calculations are based on the Maastricht definition, and are smaller than that published by the INSEE, the national statistical agency.
- b. 1995 instead of 1996, because of break in data calculation.
- c. Central government data for this year, New Zealand: 1960 = 1970, and 1994-5 = 1996.

Source: Vito Tanzi and Ludger Schuknecht, *Public Spending in the 20th Century: A Global Perspective* (Cambridge: Cambridge University Press, 2000).

The level of total expenditures by all Canadian governments as a percentage of GDP and in real per capita terms also illustrates the growth of government in Canada (Figures 1 and 2, respectively). Government expenditures in the 20th Century can be broken down into the following time periods:

- 1900 to World War II:

Governments in most Western countries were relatively small before the Great Depression. In 1920, Canadian governments as a whole spent slightly below average at approximately 16.7 percent of GDP (Table 1). Spending was closer to the U.S. level of government expenditure (12.1 percent) than that of the U.K. (26.2 percent). Spending in all countries except Norway rose in the 1930s. This reflected both an increase in government expenditure because of the impacts of the Depression and a lower level of GDP.¹⁹ By 1937 expenditures by Canadian governments had grown sufficiently fast that they were slightly above the average at 25 percent of GDP. They continued to exceed those in the U.S (19.7 percent) but were lower than expenditures in the U.K. (30 percent). Not surprisingly, government expenditures during World War II increased dramatically in most Western countries, peaking at 50 percent of GDP in 1944 in Canada.²⁰

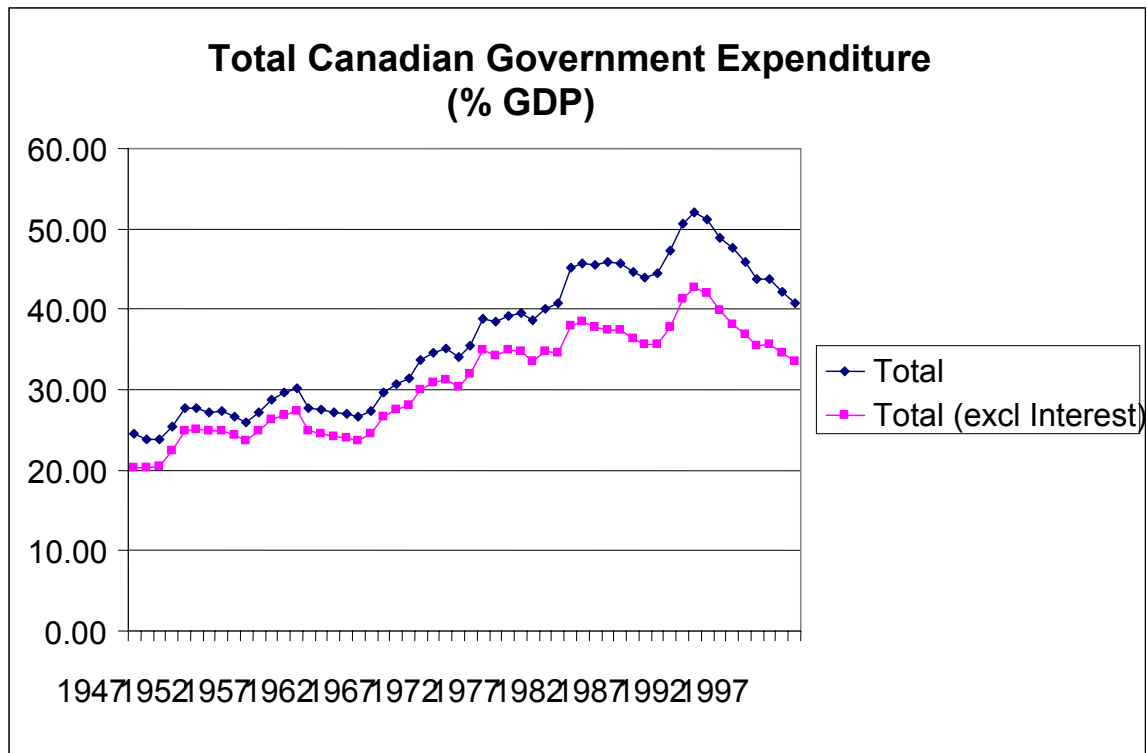
- Modest Growth: 1940s to mid-1960s

There was a modest increase in public spending in the immediate aftermath of World War II. Surprisingly the U.S. had one of the larger increases in spending, with spending rising from 19.7 percent of GDP in 1937 to 27 percent of GDP in 1960 (Table 1). The U.K. had a very modest two percent increase in spending (from 30 to 32.2 percent). Canadian governments also increased spending modestly (less than four percent) (Figures 1 and 2).

²⁰ David Cameron “The Growth of Government Spending: The Canadian Experience in Comparative Perspective” in *State and Society: Canada in Comparative Perspective – Royal Commission on the Economic Union and Development Prospects for Canada, Vol. 32* (Ottawa: University of Toronto Press, 1986).

²¹ Canadian Tax Foundation, *The National Finances, 1990* (Toronto: Canadian Tax Foundation, 1990); Cameron (1986).

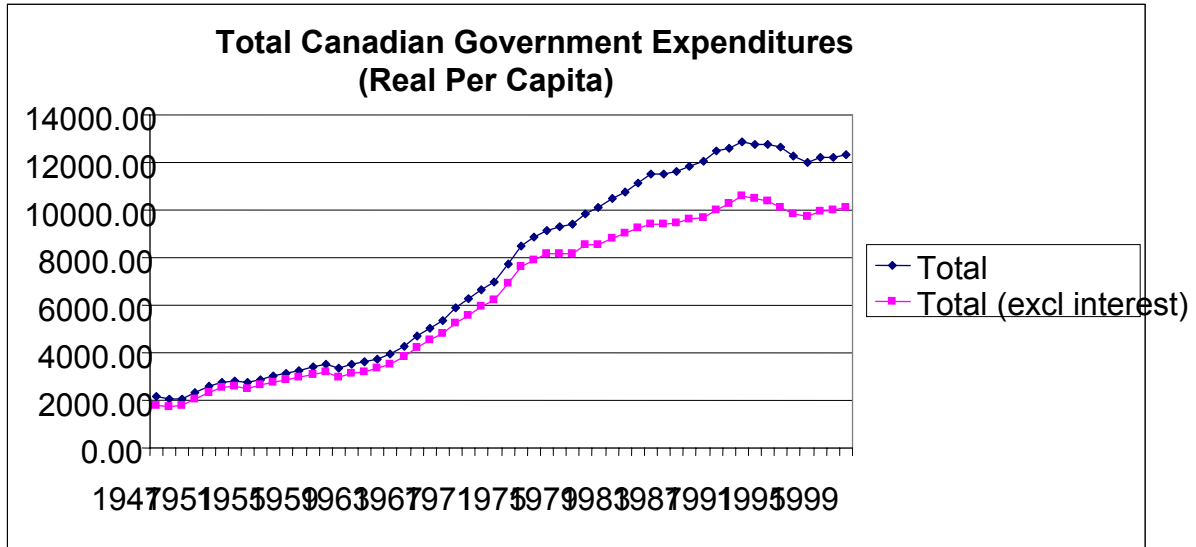
Figure 1



Sources: M.C. Urquhart, ed., *Historical Statistics of Canada* (Ottawa: Statistics Canada, 1982); CANSIM; Perry (1989) and Department of Finance (2001).

- Rapid Expansion: 1960s to 1980

The greatest overall increase in government spending in most countries occurred between 1960 and 1980 when average government expenditure rose from 28 percent of GDP to 41.9 percent (Table 1). As in earlier periods, there were large differences between countries. U.S. government spending grew by a relatively modest 4.4 percent of GDP while government spending in the U.K. grew by over 10 percent of GDP. Total government spending in Canada grew from 28.6 percent to 38.8 percent of GDP. The increase in government spending in Canada of approximately 10 percent of GDP was dramatic (from 28.6 percent to 38.8 percent (Figure 1)) but was less than the average of the other countries (Table 1).

Figure 2

Sources: CANSIM; Urquhart (1982); Perry (1989) and Department of Finance (2001).

- Slow Growth and Retraction: 1980-2000

In the period after 1980, many countries began to address the size of government expenditures. However, the overall average spending of all countries in Table 1 continued to increase. Spending in the U.K. dropped from 43 percent in 1980 to 39.9 percent in 1990 before rising again to 43 percent in 1996. Spending in the U.S. increased slightly between 1980 and 1990 before declining by 1996.

Canada did not begin to decrease the overall size of its government spending until after the U.S. and the U.K. Growth in government spending as a percentage of GDP slowed in the early 1980s before rising rapidly from the late 1980s until 1992 when it hit a peak of 52 percent of GDP, levels not seen since the middle of World War II (Figure 1). However, once governments began addressing the level of government spending in Canada, the level of spending fell quite rapidly to approximately 40 percent of GDP in 2000. This represented a return to the spending levels of 1980. There was also a continued increase in real per capita government spending between 1980 and 1992, although the increases were slightly less than those of the prior period, particularly when interest payments are excluded (Figure 2). Interestingly, real per capita spending fell in the mid-1990s before increasing in the last few years of the 1990s. The decline in government spending as a percent of GDP continued in the last few years of the 1990s but at a much slower rate.

(b) Spending by Level of Government

In addition to changes in the overall size of government since the Great Depression, there has been a dramatic shift in which level of government is spending the funds in Canada. In the 1920s and 1930s, local governments had the highest expenditures followed by the federal government, with the provincial governments spending the least.²¹ However, this pattern changed dramatically following World War II. Not surprisingly, during World War II federal government expenditures dominated total government spending in Canada.²² This dominance of federal government spending continued in the immediate post-War years.

However, government expenditure grew much more rapidly at the provincial level than the federal level after the war, with the provinces accounting for most of the dramatic growth in government spending between 1965 and 1980. Provincial expenditures matched federal expenditures by the early 1970s and overtook them by the late 1970s. This pattern of relatively greater growth in provincial spending held for the period from 1980 to the peak of government spending in 1992. Moreover, the largest share of the decline in total government spending in Canada between 1992 and 2000 was at the federal level.²³ Government expenditures in Ontario followed this pattern of low growth up to the 1950s and rapid growth in the 1960s. Spending in Ontario leveled off in the 1970s before rising sharply in the late 1980s and early 1990s and then falling in the late 1990s.²⁴

The municipalities did not regain their prominence in spending following World War II. In fact, while the spending at the other two levels of government rose dramatically in the post-war period, spending at the local level increased only slightly. Municipalities also cut their expenditures following 1992 but less than the decline at the federal and provincial levels. Local governments' share of total expenditures fell over the post-war period from a peak of 26 percent in 1965 to approximately 19 percent in 2000.

²¹ In 1926, local government spending was 6.4 percent of GDP, federal government spending was 5.7 percent of GDP and provincial government spending was approximately 3.1 percent of GDP. In 1933, local government spending was 9.3 percent of GDP, federal government spending was 8.7 percent and provincial spending was 7.7 percent. Canadian Tax Foundation (1990), Table 3.14. These figures are expenditures excluding intergovernmental grants (that is, the amount directly spent on programs and goods and services by a level of government).

²² Canadian Tax Foundation (1990), Table 3.14. In 1943, federal government spending excluding grants was 37.8 percent with provincial and local governments spending 3.4 and 3.3 percent of GDP respectively.

²³ The federal government decreased spending as a percent of GDP by 5 percent between 1992 and 2000. At the provincial level, spending decreased 4 percent. Department of Finance, *Fiscal Reference Tables, 2001* (Ottawa: Department of Finance, 2001).

²⁴ As a percent of GDP, Ontario government spending was 1.7 percent in 1951-52, 2.6 percent in 1961-62, 6.2 percent in 1971-72, 5.7 percent in 1981-82, 7.6 percent in 1991-92 and 5.8 percent in 2001-02 (CANSIM, Graham White, "Change in the Ontario State: 1952-2002" (Draft Paper for the Panel on the Role of Government, July 2002)).

Intergovernmental transfers constitute a large source of expenditures for the federal and provincial governments. The level of transfers by the federal and provincial governments to other governments has been similar. Such transfers rose sharply in the post-war period and leveled off in the 1970s and 1980s before dropping in the late 1990s as governments sought to reduce spending.²⁵

There has, therefore, been a significant change in the location of government spending in the post-war period. The provinces have become the most significant source of spending. As we will see, this corresponds to the increasing role of the provinces as risk manager over the century.

(c) Government Revenue and Debt

As Western governments increased expenditures in the Depression and after World War II, they also increased their revenues. Canada had above average revenues in the immediate post-war period, with revenue at approximately the same percent of GDP as the U.K. and higher than the U.S.²⁶ However, by 1960 Canadian government revenues had fallen below those in the U.S., the U.K. and the average. Canadian government revenues increased significantly over the next 30 years, surpassing the U.S. and the U.K. and approached the average by 1990. Canada's revenues continued to climb further during the 1990s, reaching a peak of 43.5 percent of GDP in 1998, compared to 37.8 percent in the U.K. and 32.1 percent in the U.S. As a result, over the period 1966 to 1998, the ratio of tax revenue to GDP grew much more rapidly in Canada than in the U.K. and the U.S.²⁷

While total government revenues expanded over the whole post-war period in Canada, the federal government revenues remained between 15 and 20 percent of GDP and local government revenues remained at approximately 5 or 6 percent of GDP. Provincial revenues, however, changed most dramatically, particularly following 1960 when provincial revenues increased from approximately 5 percent of GDP to almost 20 percent of GDP.²⁸

There are two factors relating to revenue which are important to the changing role of government as risk manager over time. First, governments financed much of the increase in expenditures through increases in personal income taxes. Both provincial and federal governments tended to collect about equal amounts of revenue through personal

²⁵ Department of Finance (2001).

²⁶ Tanzi and Schuknecht (2000). The average is over the same group of countries as Table 1.

²⁷ Jack Mintz, *Most Favoured Nation* (Toronto: C.D. Howe Institute, 2001).

²⁸ Canadian Tax Foundation, *Finances of the Nation, 2001* (Toronto: Canadian Tax Foundation, 2001).

income tax and corporate income tax in 1947. However, by 1970 the increase in the collections from personal income tax far outstripped those of corporate income tax – with personal income tax revenue becoming greater than three times the amount of corporate income tax revenue by 1987 and 2000. Most of the growth in such taxes was at the provincial level. The cost of the growth in government spending has therefore increasingly been borne by individuals through personal income taxes along with increased consumption taxes.²⁹

Second, although revenues have increased, Western countries (and in particular Canada) have financed part of the increase in expenditures in the post-War period through debt. Canadian governments were in a deficit position from 1976 to 1996. Deficits in Canada were higher than the OECD median for most of the period between 1982 and 1996 and were in the highest quartile for the OECD in the early 1990s.³⁰ In fact, for much of the 1980s, Canadian deficits as a percentage of GDP were close to or over twice the average for G-7 countries.³¹ Both federal and provincial levels of government experienced deficits, with the federal government and the Ontario, Saskatchewan and Alberta governments having the worst deficits in the 1990s.³² However, Canada was the first of the G-7 countries to return to a surplus position, which it did in 1997. The expenditure restraint started in the Prairie provinces in 1992/93, followed by the federal government in 1995/96 with government returning to a surplus by the end of the 1990s.³³ Local governments, conversely, went through this period with very few deficits and those deficits that existed were very small.³⁴

Most OECD countries experienced an increase in public debt in recent decades due to deficit financing. Up to the 1970s, debt (largely incurred during the Second World War) declined in most countries because of strong economic growth. However, by 1997

²⁹ J.H. Perry, *A Fiscal History of Canada: The Post-War Years* (Toronto: Canada Tax Foundation, 1989). There has also been a slight increase in the use of consumption taxes by both levels of government (Richard Bird and D. Chen, “Federal Finance and Fiscal Federalism: the Worlds of Canadian Public Finance” (1998) 14(1) *Canadian Public Administration* 51). In 2000, Canada collected more from personal income taxes and less from payroll taxes than other OECD countries, including the U.S. However, it relied less on sales and excise taxes than average but more than the U.S. (Mintz (2001)). Municipal governments have traditionally been the only government to rely on property taxes (subject to strict provincial limits) and such taxes have been their main source of income. However, municipalities have increased the use of other taxes over time (such as user fees) (Bird and Chen (1998)).

³⁰ John Richards, *Now that the Coat Fits the Cloth: Spending Wisely in a Trimmed-Down Age* (Toronto: C.D. Howe Institute, 2000).

³¹ Department of Finance (2001).

³² Richards (2000).

³³ Department of Finance (2001); Richards (2000).

³⁴ Canadian Tax Foundation (2001). Municipalities have tended to rely very little on borrowing to finance spending, probably because of strict provincial limits on local borrowing and the requirements for provincial approval of borrowing (Bird and Chen (1998)).

the debt levels of most countries had increased significantly. Canadian government debt levels increased more rapidly than average for most industrial countries over this period and were much higher than levels in the U.K. or the U.S.³⁵ When the Canadian debt to GDP ratio peaked in 1996, it was the fourth highest in the OECD.³⁶

B. Composition of Government Expenditures

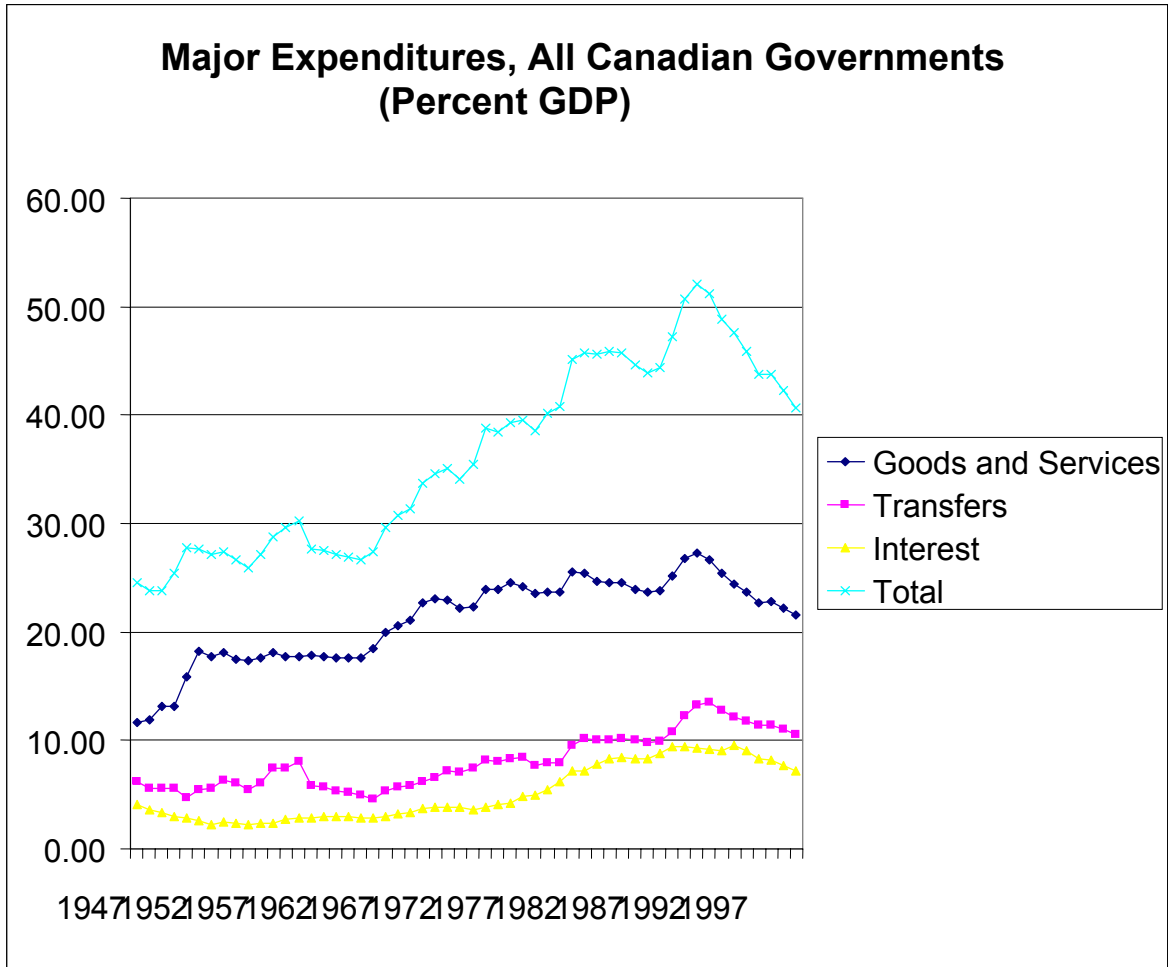
Governments have therefore grown significantly over the post-War period. To examine how this growth relates to the risk management role of government, Figures 3 and 4 set out the growth in the three main categories of expenditures by governments in Canada by percent of GDP and on a real per capita basis, respectively. These figures illustrate the following:

- Government spending on goods and services (including direct purchases of goods by governments as well as spending on wages and salaries) made up the bulk of government spending over the whole period. Moreover, the increase in goods and services drove the spending increases over the post-War period up to 1980. There was a sharp increase in government spending on goods and services in the 1950s when spending on transfers and interest on the debt largely declined. During the period of largest growth in total expenditures in 1965 to 1980, spending on both goods and services and transfers increased, although the increase in spending on goods and services was larger than the increase in transfers. Moreover, when governments began reducing their spending after 1992, they reduced their spending on goods and services by the largest amount. Spending on goods and services as a percentage of GDP was reduced to approximately 1970 levels. In real per capita terms, spending on goods and services declined to 1987 levels before rising again. Spending on goods and services includes much of governments' risk management expenditures including spending on health care, regulatory programs, education and other risk management programs, although it would also include general government employment.

³⁵ Tanzi and Schuknecht (2000). The average was taken from 17 developed countries. This does not include "implicit" government liabilities such as in the form of increases in pensions in the future due to the aging population.

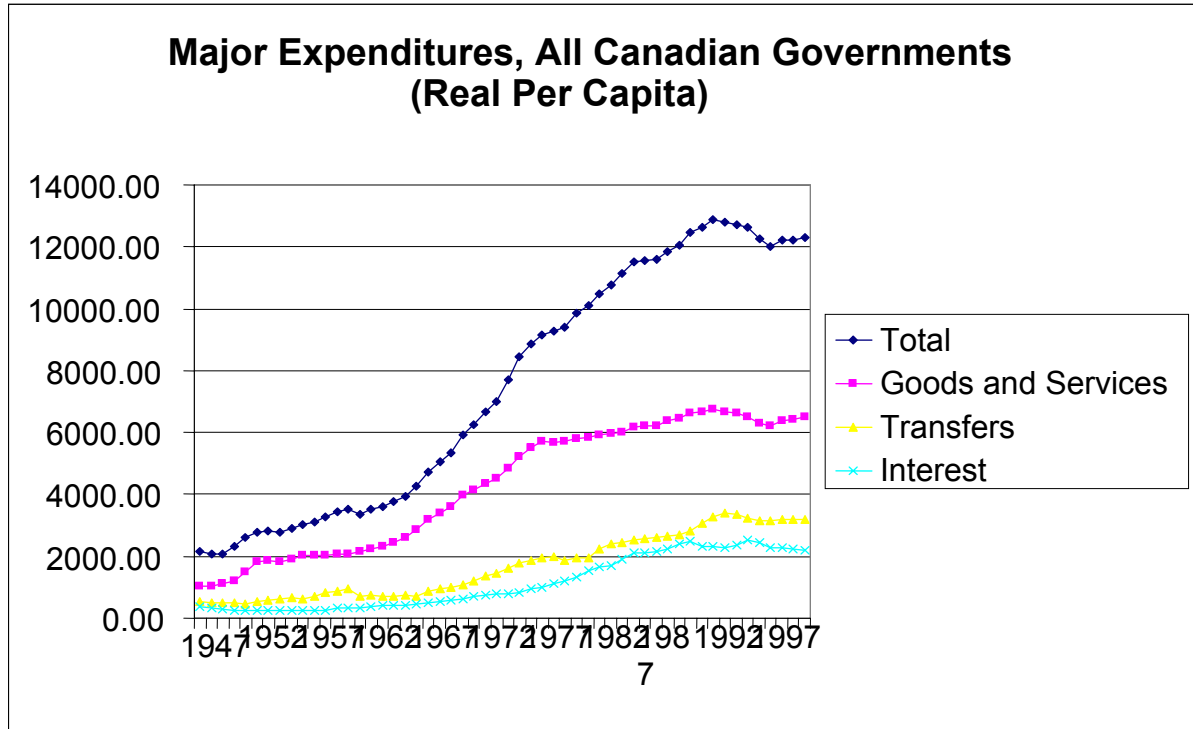
³⁶ Richards (2000).

Figure 3



Sources: Urquhart (1982); CANSIM, Department of Finance (2001) and R. Bird, *Financing Canadian Government: A Quantitative Overview* (Toronto: Canadian Tax Foundation, 1979).

Figure 4



Sources: Department of Finance (2001); CANSIM; Urquhart (1982) and Bird (1979).

- Spending on transfers to individuals can most closely be aligned with the risk management role of government as it largely consists of risk pooling programs such as unemployment insurance, pensions and social security. Transfer spending constituted a significant but relatively constant proportion of spending in the post-War period until 1970 when it began to rise. Spending then rose gradually before increasing sharply between 1980 and 1992. When governments began to reduce spending in 1992, spending on transfers as a percent of GDP fell to 1990 levels while on a real per capita level spending fell only to 1991 levels before rising again.³⁷
- As would be expected from the increase in deficit financing after 1975, interest on the debt played a much greater role in the increase in government spending over time. It accounted for almost a third of spending by 1992. Very little of the

³⁷ A study of government expenditures only examines the inputs to government programs, not the impacts on social and economic measures of the quality of life in Canada. For example, while family income inequality (income after taxes and transfers) remained mostly stable over the past 30 years, there was an increase in inequality at the end of the 1990s. This is contrast to the U.S. where family income inequality grew in the 1970s through the 1990s. (A. Heisz, A. Jackson and G. Picot, "Distributional Outcomes in Canada in the 1990s" in Keith Banting, Andrew Sharpe and France Hilaire, eds., *The Review of Economic Performance and Social Progress: The Longest Decade: Canada in the 1990s* (Montreal: Institute for Research on Public Policy, 2001)).

decrease in expenditures following 1992 was in the form of reduced interest payments.

Therefore, Canada has spent a significant and growing amount on transfers to individuals over time but has spent the most on goods and services.³⁸ However, gross levels of spending on goods and services and transfers does not specifically address whether the spending was on risk management activities. To examine risk management, spending needs to be broken down by function.³⁹ Examining government spending by function for the period 1947 to 1980, the main cause of the increase in government expenditures was the increase in expenditures on health, education and social services. Spending in these areas by all governments in Canada increased from about one-third of the budget in 1947 to almost one-half of the budget by 1980. There was also a significant increase in expenditures on the environment, community development and housing concerns following 1966. The growth in spending between 1980 and 1992 was also largely driven by increases in spending on education, health and social services, particularly in the late 1980s and early 1990s (with spending on these items increasing to over 50 percent of the budget).⁴⁰ Since 1992, spending in each of these functions has declined (as a percent of GDP) but they continue to constitute the major share of the budget.

The dominance of spending on health, education and social services was also the case in Ontario over this period. Health expenditures rose from approximately 12 percent of the budget from 1950 through the mid-1960s to almost 30 percent by 1980 and almost 40 percent by 2001. Education expenditures rose sharply in the 1960s and 1970s to become approximately 30 percent of the budget before dropping to below 20 percent by the 1990s. Finally, spending on welfare was less than 10 percent from the 1950s through the mid-1980s before rising to 16 percent in the early 1990s and falling to 12.6 percent of the budget by 2001. Interestingly, spending on debt interest was approximately 15 percent of the budget through the 1950s. It fell to below 10 percent of the budget in the 1970s and 1980s but rose back to its previous levels of 14 or 15 percent by the end of the 1990s.⁴¹

³⁸ This was also true in the U.S., the U.K. and some European nations. However, during the period of the largest increase in spending from 1960 to 1980, government spending in Canada was driven more by spending on goods and services while the spending in the U.S. and the U.K. was dominated by growth in transfers and subsidies. In fact, only Canada and Germany increased their spending on goods and services more than their spending on transfers and subsidies over this period – in all other countries in the survey transfers and subsidies were the main source of growth in government spending and in many, the difference was very large. All countries experienced an increase in spending in interest payments, particularly in the 1980s and 1990s. Tanzi and Schuknecht (2000); Mintz (2001).

³⁹ Data on spending by function does not directly correspond to spending on goods and services or transfers.

⁴⁰ Perry (1989); Mintz (2001).

⁴¹ White (2002).

As a result, spending increased dramatically over the post-War period. Much of this spending increase was in the form of risk management activities including managing risks of illness (health care), poverty (welfare programs, pensions and education) and environmental and related issues. The spending cuts that occurred in the 1990s mainly took the form of decreases in spending on goods and services (including wages), although there were some cuts to transfers to individuals. As we will see, the risk management role of government can in part explain this pattern of growth and contraction.

III Markets and Economic Risk to Business: 1900-1940

Part II described the increase in the size of government in Canada since the early 1900s, particularly in the 1960s and 1970s. The next two parts briefly discuss the periods from 1900 to 1940 and 1940 to 1975. The role of government as risk manager was established in Canada in these periods.

A. 1900-1930: Markets and Business Risk

As has been seen, government in Canada was comparatively small prior to the Great Depression in terms of expenditures. This corresponded to a significant reliance on market ordering. Markets at this time were taken as natural and any movement from markets was suspect and required justification. This was particularly true in the U.S.⁴²

As in the U.S.⁴³, Canadian governments at this time primarily focused on managing economic risks to business. The emphasis was on using the markets to promote growth, with government interfering as little as possible to ensure the market

⁴² Sunstein (1990). However, this was also true in Canada. For example, there were judicial decisions in this period upholding market freedoms even in the face of discrimination. See *Loew's Theatres v. Reynolds*, (1921) Q.R. 30 (Quebec C.A. upholding right of theatre owner to exclude a Black person from a theatre) and *Franklin v. Evans* (1924), 550 L.R. 349 (Ontario Court upholding right of a restaurant owner not to serve a Black person).

⁴³ Moss (2002). In the U.S. the federal government undertook significant economic regulation prior to the Depression. Moss includes limited liability protection for investors, bankruptcy laws, deposit insurance and monetary protection in the pre-1900 period. However, the federal government also created the Interstate Commerce Commission to ensure reasonable and just rates and guard against rate discrimination or price fixing, as well as the Federal Reserve in 1913 to deal with economic issues, the Federal Trade Commission, the Commodities Exchange Authority and the Federal Radio Commission. This pre-New Deal period can be seen as government addressing risks to companies from anti-competitive behaviour. (Morton Keller, "The Pluralist State: American Economic Regulation in Comparative Perspective, 1900-1930" in Thomas K. McCraw, ed., *Regulation in Perspective: Historical Essays* (Cambridge, MA: Harvard University Press, 1981); Sunstein (1990)).

could work.⁴⁴ The need for a relatively new country to develop economically made the risks from the market which impeded this growth particularly salient.

In general, federal regulation in Canada prior to 1920 focused on fraud in marketing food and drink, ensuring the adequate capitalization of banks and insurance companies, providing assistance to agricultural producers and regulating weights and measures⁴⁵. In addition, the federal government regulated railway rates to make them compatible with growth in the agricultural, mineral and lumber areas.⁴⁶ Most of this regulation was designed to promote economic growth.

Provincial regulation during the early part of the 20th century was also primarily designed to facilitate economic growth largely through promotion of natural resource industries.⁴⁷ Provinces granted mineral rights, set limits on logging, provided financial assistance and built infrastructure to support industry. Provinces generally were not involved in ownership of natural resources. An exception was the hydro-electric industry. Ontario, for example, created a Crown corporation (which was to become Ontario Hydro) to produce electricity.⁴⁸

There was little government regulation of economic risks to individuals or social risks such to the environment, health and safety during this period. In terms of economic risk to individuals, such risks were not salient for two principal reasons. First, economic disadvantage was seen as the result of moral failings, lack of self-motivation and poor education and it was felt there was little the state could do to rectify these problems.⁴⁹

⁴⁴ Michael Bliss, "Canada in the Age of the Visible Hand" in Tom Kent, ed., *In Pursuit of the Public Good* (Montreal: McGill-Queen's University Press, 1997). This emphasis on risks to business may also have been a function of the nature of the governmental institutions at the time which allowed business greater access to legislative power.

⁴⁵ For example, Acts such as the *General Inspection Act* of 1873 set out regulations for the inspection of many agricultural goods. In response to the lack of competition among grain elevator operators, as well as certain monopolistic policies of the railways, the *Manitoba Grain Act* was passed in 1900, which licensed grain elevators, warehouses and commission merchants and regulated elevator rates. However, dissatisfaction continued and led to the government purchase of grain elevators. Regulation was also seen in other sectors including dairy legislation passed to protect producers from American competition. Carman Baggaley, *The Emergence of the Regulatory State in Canada, 1867-1939* (Ottawa: Economic Council of Canada, 1981).

⁴⁶ Economic Council of Canada, *Reforming Regulation* (Ottawa: Supply and Services, 1981).

⁴⁷ Baggaley (1981).

⁴⁸ In contrast, in Quebec the provincial government chose regulation of the hydro-electric industry rather than ownership and in the Prairies there was a mix of municipal ownership and regulated private ownership. The federal government attempted to assert some control in the hydro-electric area through its power over navigation and shipping. However, it had relinquished its power in this area to the provinces by the end of the 1930s. Baggaley (1981).

⁴⁹ Doug Owram, "Economic Thought in the 1930s: The Prelude to Keynesianism" in Raymond B. Blake and Jeff Keshen, eds., *Social Welfare Policy in Canada: Historical Readings* (Toronto: Copp Clark Ltd., 1995).

The general public therefore had little sense of risks to themselves or of any unfairness resulting from economic risk to individuals. Second, markets were seen as self-correcting, not requiring government intervention. As a result, the delivery of social services was largely left to local parishes, townships or counties or, in the case of Lower Canada, the church and its related institutions without regularized government funding.⁵⁰

However, economic risk to individuals was increasing in the period leading up to the Depression. Industrialization and urbanization were breaking down the family and community support ties that formerly helped deal with economic risks.⁵¹ As a result, governments developed some limited welfare programs in Canada in this time period. An early provincial program was Mother's Allowance (compensation for "fit" biological mothers) which was introduced in many provinces by 1920.⁵² Provincial governments also began introducing minimum wage legislation in the inter-war years.⁵³ The federal government's major social program was the means-tested Old Age Pension program for people over 70 years old established in 1927. This was a shared cost program with the provinces - with some provinces, such as Ontario, devolving administration of the program to local governments.⁵⁴

⁵⁰ Raymond B. Blake and Jeff Keshen, "Introduction" in Raymond B. Blake and Jeff Keshen, eds., *Social Welfare Policy in Canada: Historical Readings* (Toronto: Copp Clark Ltd., 1995); Allan Moscovitch and Glenn Drover, "Social Expenditures and the Welfare State: The Canadian Experience in Historical Perspective" in Allan Moscovitch and Jim Alberts, eds., *The "Benevolent" State: The Growth of Welfare in Canada* (Toronto: Garamond Press, 1987); Bliss (1997).

⁵¹ Judith Maxwell, "The Social Role of the State in a Knowledge-Based Economy," in P. Grady, R. Howse and J. Maxwell, *Redefining Social Security* (Kingston: Queen's University School of Policy Studies, 1995); Moss (2002). Governments in Europe began dealing with the issues of poverty and unemployment much earlier than those in North America, perhaps because of more advanced stage of industrialization and urbanization. For example, in the U.K. the pre-Depression 1900s saw the emergence of a significant role for the state. The national government introduced legislation providing medical and nutritional services to children (1906 and 1907) as well as a means tested old age pension (1908). A minimum wage for those in unorganized trades was introduced in 1909 and health and unemployment insurance were introduced in 1911. Geoffrey Finlayson, *Citizen, State and Social Welfare in Britain: 1830-1990* (Oxford: Clarendon Press, 1994). Germany began this move to welfare in the late 1800s (Moss (2002)).

⁵² Because expenditures were higher than expected, provinces tried to delegate these programs to the local level. Veronica Strong-Boag, "Wages for Housework: Mothers' Allowances and the Beginnings of Social Security in Canada" in Raymond B. Blake and Jeff Keshen, eds., *Social Welfare Policy in Canada: Historical Readings* (Toronto: Copp Clark Ltd., 1995); Keith Banting, *The Welfare State and Canadian Federalism* (2d) (Montreal: McGill-Queen's University Press, 1987).

⁵³ Dennis Guest, *The Emergence of Social Security in Canada* (2d) (Vancouver: UBC Press, 1985).

⁵⁴ Costs were somewhat constrained by stringent income qualifications and caps on benefits. James Struthers, *The Limits of Affluence: Welfare in Ontario 1920 - 1970* (Toronto: UTP, 1994). The U.S. had similar programs in this period including state programs relating to pensions, the blind and disabled, old age assistance and limited unemployment insurance. Phyllis J. Day, *A New History of Social Welfare* (2d) (Boston: Allyn and Bacon, 1997).

There was also little government regulation of social risks in the early 1900s. What regulation there was dealt primarily with immediately salient risks. In the occupational health and safety area, for example, work-related injuries and deaths, child labour, sanitation and long hours were issues which impacted large numbers of workers and were sufficiently salient to focus public and government attention.⁵⁵ Governments undertook management of these risks in two ways. First, all provinces except P.E.I. enacted risk reduction legislation (setting health and safety standards) by 1917.⁵⁶ Second, Canada, the U.S. and Britain enacted laws relating to compensation of workers for work-related injuries. Such laws spread the risk of injury across all workers. These laws arose in response to the difficulty of workers obtaining compensation for such injuries from the courts as workers had to prove fault on the part of the employer. Workers compensation legislation involved a trade-off under which the employees obtained compensation for occupationally-related injuries on a “no-fault” basis in exchange for giving up the right to sue employers.⁵⁷ This legislation began in the U.K. and Europe in the late 1800s. Ontario became the first Canadian jurisdiction to adopt a full no-fault system in 1914.⁵⁸

In addition, there was little environmental legislation in the early part of the Century. The level of regulation was low in part because the risk from some types of pollutants was not recognized at that time or was not as prevalent (because of assimilation by the environment or a lower level of industrial development). The legislation that did exist dealt with obvious risks such as dust and smoke in the air and sewage in drinking water. These issues constantly arose and the health impacts would have a high degree of salience to the public. They therefore would create high public

⁵⁵ Moss (2002).

⁵⁶ Similarly, by 1920 nearly all states had industrial safety laws. The origins of health and safety law were largely in the British Factory Acts of the 1800s. M. Dewis, *The Law on Health and Safety at Work* (London: MacDonald and Evans, 1978); Norman Keith, *Canadian Health and Safety Law* (Aurora, Ontario: Canada Law Book, 2001). The first such legislation was enacted in Ontario in 1884 and prohibited child labour, provided the government with inspection powers, established some standards relating to sanitation, restricted hours of work and limited some types of work for women. Pran Manda, Robert Broyles and Gil Reschenthaler, *Occupational Health and Safety: Issues and Alternatives* (Ottawa: Economic Council of Canada Technical Report No. 6, 1981). The little federal regulation there was related to federal powers such as railways. (Keith (2001)).

⁵⁷ Keith (2001).

⁵⁸ The original workmen’s compensation legislation in Canada was the *Workmans’ Compensation for Injuries Act* of 1897 in Ontario under which the workman shared the cost of the accident where the worker was contributorily negligent. This placed the emphasis on blame which was not eliminated until Ontario’s *Workmen’s Compensation Act* enacted in 1914. B.J. Legge, *The Canadian System of Workmen’s Compensation* (unpublished, Toronto, 1972). The timing was similar in the U.S. By 1921, almost all states had workmen’s compensation legislation. Rothstein (1978). According to Asford and Caldart (1996), companies feared an increase in lawsuits as a result of the early state laws and therefore pushed for the workmen’s compensation legislation. If so, workers compensation legislation could be viewed also as managing economic risks to business.

concern and pressure for government action. Responsibility for these issues was largely left to local governments.⁵⁹

B. The Great Depression: The Shift to Government

During the Pre-Depression period, therefore, Canadian governments principally relied on markets to address risk, while their main risk management role was addressing economic risks to business and obvious risks to individuals. However, the Depression shattered public faith in markets and exposed their potential to impose large costs. The severe economic and social disruption of the Depression, following the recessions of 1907, 1912-13 and 1919-20, refuted the classical economic view that the economy was essentially stable and capable of self-correction, with a natural equilibrium point of full production and employment. The risk to businesses and individuals from economic downturns which had always been present now became clearly evident. Additionally, the increasing influence of Keynesian economics led away from the view that state intervention should be minimized.⁶⁰

The Great Depression had two principal impacts on public risk management in the 1930s. First, governments increased regulation of economic risks to business. Industry and investors were harmed by the economic downturn. The government responded to a public and industry demand for greater protection against the risks inherent in such downturns.⁶¹ The Canadian federal government regulated in the areas of financial

⁵⁹ Peter N. Nemetz, "Federal Regulation in Canada" (1986) 26 *Natural Resources J.* 551; Jamie Benedickson, "The Development of Water Supply and Sewage Infrastructure in Ontario, 1880-1990s: Legal and Institutional Aspects of Public Health and Environmental History" (Draft unpublished discussion paper for the Walkerton Inquiry, February 2001); A.W. Bryant, "An Analysis of the Ontario Water Resources Act" in P.S. Elder, ed., *Environmental Management and Public Participation* (Toronto: Canadian Environmental Law Research Foundation, 1975); David Estrin, "The Legal and Administrative Management of Ontario's Air Resources 1967-1974" in P.S. Elder, ed., *Environmental Management and Public Participation* (Toronto: Canadian Environmental Law and Research Foundation, 1975). Regulation of environmental issues was similar in the U.S. at this time. J. Clarence Davies III. *The Politics of Pollution* (New York: Pegasus, 1970); Peter S. Menell and Richard B. Stewart, *Environmental Law and Policy* (Boston: Little, Brown and Company, 1994).

⁶⁰ Owram (1995); W.C. Clark, "Business Cycles and the Depression of 1920-1" *Queen's University Bulletin of the Departments of History and Political and Economic Science* 40 (August 1921).

⁶¹ In the U.S., Roosevelt supported a Second Bill of Rights in the Depression including the right of business to be free of unfair competition and domination by monopolies. The New Deal reformers saw the states and the courts as inadequate for regulating the economy. The federal government therefore established new authorities for creating jobs through public infrastructure projects (such as the Civil Works Administration and the Tennessee Valley Authority) and for pooling risk (such as the Farm Security Administration and the Federal Deposit Insurance Corporation). It also increased its regulatory powers in the areas of labour law (National Labour Relations Act), securities (the Securities and Exchange Commission), ocean commerce (Maritime Administration), airlines (Civil Aeronautics Authority), communications (Federal Communications Commission) and financial institutions (Banking Act of 1933). Sunstein (1990); James McKie, "U.S. Regulatory Policy" in Kenneth Button and Dennis Swann, eds., *The Age of Regulatory Reform* (Oxford: Clarendon Press, 1989).

markets and institutions, fisheries, transportation and agricultural information and standards.⁶² Regulation in the agricultural area was focused on supporting the industry through marketing boards. In addition, the federal government passed legislation to protect against anti-competitive activity⁶³ and to help the railways deal with the effects of the Depression.⁶⁴ It also established the Bank of Canada in 1934 to provide a tool for control of the business cycle through the regulation of interest rates and price levels.⁶⁵ The provinces also enacted economic regulation in the areas of agriculture, business licensing and resource management.⁶⁶ In addition both the federal and provincial governments used Crown corporations to control economic risks.⁶⁷

The second impact of the Depression on public risk management was an increasing recognition of a need for government management of economic risks to individuals. The Depression shattered the belief that markets were inherently self-correcting and provided the public with evidence that everyone was potentially at risk. No longer were unemployment and poverty seen as the fault solely of the individual. This made economic risks to individuals (such as unemployment and not having funds for health care or retirement) available to a much broader range of people and led to a growing demand for protection against these risks. The public demand also likely arose in part because individuals were not only concerned that they would be unemployed or destitute but that others would be so and that such outcomes arose, not because of moral failings but because of market risks. A sense of fairness led the general public to push government to ensure that the social and economic effects of the Depression would not happen again.⁶⁸

⁶² Margot Priest and Aron Wohl, "The Growth of Federal and Provincial Regulation of Economic Activity, 1967-1978" in W.T. Stanbury, ed., *Government Regulation: Scope, Growth, Process* (Montreal: The Institute for Research on Public Policy, 1980).

⁶³ Baggeley (1981). However, many measures passed by the federal government including the *Natural Products Marketing Act* and aspects of the anti-competitive legislation were struck down as unconstitutional.

⁶⁴ Baggeley (1981).

⁶⁵ Owram (1995).

⁶⁶ Priest and Wohl (1980).

⁶⁷ Provinces used Crown corporations in the areas of marketing, power, telephones, transportation systems, liquor, banking, research and agriculture. At the federal level, four of the most important Crown corporations were Canadian National Railways, Bank of Canada, Canadian Broadcasting Corporation and the Canadian Wheat Board. Aidan Vining and Robert Botterell, "An Overview of the Origins, Growth, Size and Functions of Provincial Crown Corporations" in J. Robert S. Prichard, ed., *Crown Corporations in Canada: The Calculus of Instrument Choice* (Toronto: Butterworths, 1983). See also C.A. Ashley and R.G.H. Smalls, *Canadian Crown Corporations: Some Aspects of their Administration and Control* (Toronto: MacMillan, 1965).

⁶⁸ Simeon (1994).

In Canada⁶⁹, the federal government's response to the Depression was to counter the downturn through government works projects, manpower training and federally backed mortgages for home owners.⁷⁰ These were all in part forms of spreading a perceived increase in economic risks across all taxpayers (who funded these programs). The Constitution, however, acted as a constraint on federal government action in this period. As part of a "Canadian New Deal" the Bennett government introduced unemployment insurance legislation in 1935. This New Deal package recognized a national government role in ameliorating economic disadvantage. However, the unemployment insurance legislation was struck down by the courts in 1937 as being outside the constitutional jurisdiction of the federal government.⁷¹

In summary, the Depression ended the overriding faith in the market's ability to address risks. It led governments to manage the most salient risks at the time – economic risks to business and to individuals, although action by the Federal government was constrained by the Constitution. Other risks such as to the environment or health and safety were not as salient because of the overwhelming nature of the economic impacts of the Depression.⁷² This risk management role accords with the levels of government expenditures before and during the Depression as noted in Part II. Government expenditures were low prior to the Depression and increased slightly during the Depression, reflecting the increased risk management role. Many of the actions of government were relatively inexpensive. For example, increased economic regulation imposed costs on industry with relatively lower costs for government (such as in the form of enforcement budgets). Other actions, however, were more costly. Interventions in wheat markets, for example, were very expensive. Further, public insurance programs (such as unemployment insurance or pension plans) were not extensive, limiting the shifting of the risk to individuals of economic downturn onto the government (and therefore onto taxpayers). Finally, most of the expenditures continued to arise at the local

⁶⁹ The U.S. took more significant steps than Canada in the 1930s. Roosevelt's New Deal pushed a relatively broad framework of national state programs which pooled economic risks to individuals. After an initial program was held to be unconstitutional, in 1935 the federal government introduced a federal social insurance program for those in the workforce including Old Age Insurance and Unemployment Compensation. It also established a federal-state program of public assistance partly financed by the federal government and administered at the state and local level. Programs included Aid for Dependant Children, Aid for the Blind and Old Age Assistance. There was also minimum wage, maximum hour legislation and low interest loans for construction of public housing. Bruce Jansson, *The Reluctant Welfare State* (Belmont, CA: Wadsworth, 1988).

⁷⁰ Struthers (1994); Owram (1995).

⁷¹ Struthers (1994); Guest (1985); Banting (1987).

⁷² The federal government in the U.S. began to take a role in occupational health and safety during the Depression. (Asford and Caldart (1996), Rothstein (1978)). In addition, there were some changes in human rights protection in Canada, primarily related to the economic effects of the market. However, there continued to be explicitly discriminatory public action (such as B.C.'s *Provincial Elections Act* of 1939 (prohibiting certain races from voting) and judicial decisions (such as *Christie v. York*, [1940] S.C.R. 139 (in order to facilitate commerce, business owners must be able to deal with whom they wished and therefore a tavern owner could refuse to serve a Black person)).

level during this period (as seen in Part II) because local governments bore the main responsibility for poverty and illness programs.

IV The Growth of the Welfare State and Social Regulation: 1940 – 1975

The Great Depression made most Canadians fearful of economic harm from markets. In addition, the federal government was perceived to have successfully intervened in the economy during the Second World War. These factors, along with the growing influence of Keynesian thinking, pushed the federal government to take a greater role in the lives of Canadians over the subsequent few decades.⁷³

This increased role of the state can be loosely divided into two stages. In the first stage (1940-1965), Canadian governments took a much greater role in addressing economic risk to individuals such as the risk of unemployment or of being unable to afford health care. In the second stage (1965-1975), Canadian governments significantly increased their role in the regulation of social risks including risks to the environment, health and safety, to human rights and to consumers.

A. The Rise of the Welfare State (1940-1965)

The second period of risk management began in Canada with the federal government enacting unemployment insurance legislation in 1941. Unemployment insurance came about in part as the result of the rise of the political left and the report of the Royal Commission on Dominion-Provincial Relations in 1940 (the Rowell-Sirois Report).⁷⁴ The Rowell-Sirois report helped the provinces overcome their reluctance to greater federal control and agree to a constitutional amendment permitting federal unemployment insurance legislation.⁷⁵ Government-provided unemployment insurance manages the risk of unemployment by spreading the risk across all workers. This risk-spreading overcomes the failure of the market to provide private insurance for other than workers with a low risk of unemployment. Private unemployment insurance does not exist for all workers in large part because of the “moral hazard” problem (once an individual is insured, he or she has less incentive to continue being employed or seek new employment if laid off) as well as difficulties due to adverse selection.⁷⁶

⁷³ Bliss (1997).

⁷⁴ The Rowell-Sirois Report recommended greater national control of measures to deal with unemployment and regional disparities. It argued that only the federal government could deal with large scale economic issues like unemployment and that federal control promoted national unity.

⁷⁵ Struthers (1994).

⁷⁶ Barr (1992).

An important influence on the growth of welfare programs in Western countries was the 1942 report of Sir William Beveridge in the U.K. The Beveridge Report focused on income security. It recommended provision of sickness, disability, unemployment and old age benefits through a program of comprehensive and universal social insurance as well as a system of children's allowances, maternity grants and funeral grants. Beveridge argued for universal coverage of these programs to offset the fact that employees in particular industries were at a greater risk of unemployment than others and to distribute the risk across all sectors. In addition, the Beveridge Report recommended that means-testing be replaced with a national minimum level of benefits.⁷⁷ The focus was not on greater equality but protection against misfortune as evident from the minimal level of benefits recommended.⁷⁸ The themes in the Beveridge Report were amplified in Canada by Leonard Marsh and Harry Cassidy in the early 1940s.⁷⁹

As a result of the Beveridge report and similar Canadian reports, the federal government in Canada advocated new welfare programs in the 1940s. However, the Canadian constitutional structure again operated as a constraint on federal government initiatives. Most issues relating to economic risk to individuals (such as pensions, health care, education and welfare) were constitutionally under provincial jurisdiction. The provinces did not all support national programs; in particular, Ontario and Quebec refused to agree to federal taxing proposals which would allow the federal government to implement its programs. In addition, apart from increasing Mothers Allowance benefits, Ontario made no effective reforms to social programs, partly because of cost concerns.⁸⁰

However, the 1950s and 1960s saw an increasing role for the federal government in the provision of welfare programs. The federal government used two techniques to overcome constitutional barriers to such a role. First, in the early 1950s, the federal government was able to obtain a constitutional amendment from the provinces permitting it to legislate in the pension field. However, to obtain Quebec's support, the federal government had to agree that any federal plan could be superceded by a provincial plan.⁸¹

⁷⁷ Howard Glennerster, *British Social Policy Since 1945* (Oxford: Blackwell, 1995); Guest (1985).

⁷⁸ Weale (1990).

⁷⁹ Allan Irving, "Canadian Fabians: The Work and Thought of Harry Cassidy and Leonard Marsh" in Raymond B. Blake and Jeff Keshen, eds., *Social Welfare Policy in Canada: Historical Readings* (Toronto: Copp Clark Ltd., 1995). Marsh's most influential work was the Report on Social Security for Canada published in 1943 for the federal government. It recommended a comprehensive national social insurance program which would provide for a social minimum including benefits for those who had been in the labour market (such as unemployment insurance and compensation for illness, death, disability and maternity) and for those who were employed (including retirement benefits, permanent disability insurance and death benefits). Guest (1985).

⁸⁰ Struthers (1994). The Ontario government did propose the *Welfare Units Act* in 1948 in an attempt to reform provision of social services but because of administrative and cost issues it was never proclaimed.

⁸¹ The result was the passage of the *Old Age Security Act* (flat rate pension for all Canadians over 70 years old) and the *Old Age Assistance Act* (a means tested program for pensions for those between the ages of 65

Second, the federal government began using cost-sharing programs in which it would pay part of the funds of a provincially-implemented program.⁸² Most provinces encouraged these programs as the programs increased the funds available to meet social concerns. However, in the 1960s, Quebec shifted from not accepting a state role in social services to wanting to create its own programs. This shift led to conflicts between Quebec and Ottawa over programs including the Canadian Pension Plan and Medicare programs.⁸³

In the 1950s and 1960s, Canadian governments also began a shift in social programs from means-tested provision (the “residual” approach to welfare programs) to universal programs in which all Canadians were covered.⁸⁴ By spreading risk across all Canadians, universality permitted a pooling of risk that would not occur in private insurance markets. This pooling allowed all Canadians to have coverage for the risk managed through the particular program. For example, in 1966, the federal government introduced the *Medical Care Act* which was a federal cost-sharing program providing a comprehensive universal health care program. Private medical insurance would not cover all individuals or all medical issues as medical insurance gives rise to both moral hazard and adverse selection problems. Adverse selection arises because often only individuals know their true health risk (such as from family history), and as the highest risk individuals will be more likely seek out insurance, private companies will be unwilling to supply insurance (for fear of high costs of a biased pool of insurees) or will charge a very high premium (effectively limiting the number of people who can afford insurance). Private medical insurance therefore could lead to inequitable coverage as

and 69). A.W. Johnson, “Social Policy in Canada: The Past as it Conditions the Present” in Shirley B. Seward, ed., *The Future of Social Welfare Systems in Canada and the United Kingdom* (Halifax: The Institute for Research on Public Policy, 1987).

⁸² It used cost-sharing in this period to implement means-tested allowances for the blind (*Blind Persons Act* (1951)) and the disabled (*Disabled Persons Act* (1954)) and universal hospital insurance and funding for certain in-patient care (*Hospital Insurance and Diagnostic Services Act* (1957)). Guest (1985).

⁸³ Banting (1987).

⁸⁴ The Saskatchewan government introduced a comprehensive medicare program in 1962. The federal government instituted the Canada Pension Plan (with Quebec creating the Quebec Pension Plan) in 1965. This provided a universal indexed pension to those over 65, supplemented by the Guaranteed Income Supplement in 1966. Also in 1966, the federal government introduced the Canada Assistance Plan which was a 50/50 cost sharing plan between the federal and provincial governments under which the provinces could consolidate their social programs and replace means-tested programs with universal coverage. Johnson (1987). The developments in Canada lagged behind those in the U.K. In the U.K. the main growth of social programs was in the mid to late 1940s following the release of the Beveridge Report. The welfare legislation generally embodied the principle of universal and equal provision of services based on a common minimum standard of income, housing, public health and education and reinforced the state’s role in centralized administration of social services. (Finlayson (1994); Glennerster (1995)). Canada also lagged behind developments in the U.S. in some ways. There were few social programs introduced in the late 1940s in the U.S. However, there were also few cuts as President Eisenhower had made a deal with Democrats, who controlled Congress, to preserve the New Deal Programs. There was a flurry of legislative developments in the 1960s in the U.S., first under Kennedy then as part of President Johnson’s “War on Poverty”. Jansson (1998). However, there was less emphasis on universality in the U.S. than in Canada.

certain individuals (those at high risk) would not be able to obtain coverage and the insurance that did exist would not cover all health concerns. Public health insurance overcomes these problems through pooling of risks.⁸⁵

In summary, the period following the Second World War saw a rapid expansion of the government's management of the economic risk to individuals. This risk was readily available (or salient) to most, if not all, of the public because of the severe dislocation of the Depression. Moreover, the resulting effects of economic dislocation were no longer seen as fairly distributed based on lack of motivation or choice. This wide spread sense of vulnerability led to programs that covered a broad range of Canadians from the risks from unemployment, poverty and illness.⁸⁶ As discussed in Part I, however, the period did not see a significant growth in expenditures. This lack of growth was likely because the programs instituted in this period were phased in over this time and the costs did not really begin to accrue until the mid-1960s.⁸⁷

B. The Growth of Social Regulation (1960s to early 1970s)

The next stage in the growth of governments as risk managers was the significant increase of management of social risks by Canadian governments in the 1960s and early 1970s. The U.S. and many European countries also increased regulation of social risks at this time. In terms of environmental, health and safety risks, both the federal and the provincial governments in Canada began increasing regulation in the 1950s, although the

⁸⁵ Public pension plans also overcome gaps in the private insurance market (such as the uninsurability of unanticipated inflation). In addition, they overcome the lack of foresight by individuals in preparing for retirement. Barr (1992).

⁸⁶ This was a period of relatively little new regulation of economic risks to business. In Canada, the area of greatest activity for the federal government during the 1950s was the fisheries. (Priest and Wohl (1980) and Baggaley (1981)). The federal government also liberalized regulation in the banking and financial sectors to increase competition. W.T. Stanbury and Fred Thompson, *Regulatory Reform in Canada* (Montreal: Institute for Research on Public Policy, 1982). The federal government did not, however, regulate interprovincial trucking, despite a Supreme Court of Canada ruling that it was within federal jurisdiction, as the government did not feel it had the resources to regulate the industry. (Michael J. Trebilcock, "Lurching Around Chicago: The Positive Challenge of Explaining the Recent Regulatory Reform Agenda" in Richard M. Bird, Michael J. Trebilcock and Thomas A. Wilson, eds., *Rationality in Public Policy: Retrospect and Prospect, A Tribute to Douglas G. Hartle* (Toronto: Canadian Tax Foundation, 1999)). The provincial governments introduced some legislation relating to professional and vocational licensing, food product standards and agriculture. (Priest and Wohl (1980)). There was also an increase in provincial Crown corporations dealing with such areas as forestry, mining, auto insurance, transportation and municipal finance. Vining and Botterell (1983).

There was also little economic regulation in the U.S. or the U.K. at this time, although there was some increase in the regulation of monopolies and mergers in the U.K. By contrast to Canada and the U.S., however, Labour governments in the U.K. engaged in significant nationalization of industries after the Second World War in order to ensure the provision of essential social services and to promote industry. Clarke (1993).

⁸⁷ Cameron (1986).

primary actors were the provinces.⁸⁸ For example, the Ontario government increased its ability to control water pollution.⁸⁹ This took some control away from municipalities in response to concerns that municipalities were not adequately treating sewage or regulating industry.⁹⁰ Conversely, the Ontario government also protected parties creating social risks in the 1950s such as through legislative action to protect municipalities and to limited liability of private parties from civil actions.⁹¹

However, the most significant expansion of the public risk management role in the area of the environment, health and safety occurred in the 1960s and early 1970s. Increased industrialization, population growth and urbanization had increased the range of environmental, health and safety risks. Industry began using new and more chemicals and the air and water increasingly became degraded giving rise to “acute environmental stresses.”⁹² Further, more information was available about the actual effects of pollution and toxic substances. This information provided the public and government with an increased understanding of the social risks underlying economic activity. Finally, there were events that made these risks particularly salient and available to the public, such as the publication of Rachel Carson’s *Silent Spring* in 1962 (warning of the danger of pesticides) and deadly, widely publicized mining accidents in the U.S. These all led to a heightened concern for environmental, health and safety issues. For example, in 1970 polls showed Canadians ranked pollution first among issues on which the government should focus more attention.⁹³

⁸⁸ The federal government did not play a significant role at this time in the control of air pollution. In terms of water pollution, the federal government made some amendments to the *Fisheries Act* in 1960 to provide greater ability to control the discharges from specific industries. It used this power to control discharges from the pulp and paper, mining and petroleum sectors. Webb (1988).

⁸⁹ *Ontario Water Resources Commission Act*, S.O. 1957, c. 88. Bryant (1975).

⁹⁰ Benidickson (2001). Ontario also enacted its first air pollution legislation in 1958 but, in contrast to water pollution, delegated power to control air pollution to municipalities. Estrin (1975).

⁹¹ Bryant (1975) and Benidickson (2001). In the late 1940s, the Ontario government attempted to pass legislation which would require courts to take into account the benefit of mills to the local community in considering whether to grant an injunction against water pollution. However, this failed to avoid an injunction against a pulp mill, resulting in the province passing legislation which allowed the plaintiffs in that case to obtain damages but dissolved the injunction. Similarly, following a number of actions for injunctions against municipal sewage treatment plants, the province enacted legislation which dissolved injunctions against two municipalities and deemed all municipal works constructed by statutory authority.

In the U.S., by contrast, it was the federal government that began to take greater action in the area of air and water pollution and waste disposal in the 1950s in face of a concern over the ability of the states to deal with these issues. Davies (1970); Menell and Stewart (1994).

⁹² Edward A. Parson, “Environmental Trends: A Challenge to Canadian Governance” in Edward A. Parson, ed., *Governing the Environment: Persistent Challenges, Uncertain Innovations* (Toronto: University of Toronto Press, 2001) at 13.

⁹³ Kathryn Harrison, *Passing the Buck: Federalism and Canadian Environmental Policy* (Vancouver: UBC Press, 1996).

Both the U.S. and Canada saw an explosion of statutes and regulations in the late 1960s and early 1970s relating to air and water pollution, waste handling and disposal, toxic substances and environmental assessment. In Canada, the provinces took primary responsibility for air and water pollution and waste disposal.⁹⁴ While the federal government did take a limited role in environmental regulation in Canada at this time, most of its actions were unused or weak.⁹⁵ This new environmental legislation largely involved risk reduction such as prohibitions on certain types of pollution (that is, on creating certain externalities which impose risks on individuals). These prohibitions, however, were also a form of risk shifting from individuals to firms as they increased the potential liability for firms of creating the externality. One innovation which was more narrowly risk reduction-focused was the increased emphasis on pre-approval by the government before the production of externalities.⁹⁶ This in theory prevents the externality from arising.

As with environmental law, governments in Canada and the U.S. significantly increased regulation of occupational health and safety risks in the late 1960s and early 1970s. Interestingly, the U.S. and Canada managed the risk differently. As in the environmental area, the U.S. increased the strength of its occupational health and safety laws with an emphasis on the government setting standards backed by strong enforcement action by the newly created Occupational Safety and Health Administration. This new regime used risk reduction prohibitions to limit creation of externalities, although as with environmental legislation it also shifted risk to companies from individuals.⁹⁷ In Ontario the provincial government revised its occupational health and

⁹⁴ Estrin (1975). For example, the Ontario government took greater control over environmental issues in the late 1960s through strengthening of the *Ontario Water Resources Commission Act*, the enactment of the *Waste Management Act* in 1967 and the enactment of the *Air Pollution Control Act* in 1967. This continued into the 1970s with the enactment of the *Environmental Protection Act* and the *Ontario Water Resources Act*. Canadian governments also increased legislation in the area of product safety at this time.

⁹⁵ For example, the federal government enacted the *Clean Water Act* in 1970 which allowed for water quality management areas and effluent charges. However, it was essentially unused by the federal government. Similarly, the federal *Clean Air Act* enacted in 1971 provided the federal government with the power to take strong action in the area of air pollution but it largely limited its role to information collection and analysis. Air pollution control remained largely in provincial hands. (Nemetz (1986)). By contrast, the federal government took the lead role in the U.S. during this period. The U.S. federal government assumed greater control over environmental issues from the states in the areas of air and water pollution. The federal government attempted to continue to have the states play a role but took stronger action over time where states failed to act (Menell and Stewart (1994)).

⁹⁶ For example, in addition to requiring approval of new sources of air and water pollution, governments began requiring environmental assessments in this period. Environmental assessment legislation requires projects undergo assessment of their possible environmental impacts before they are commenced so that the adverse impacts can be mitigated before they occur. This began in the U.S. with the federal *National Environmental Policy Act* in 1970. (Menell and Stewart (1994)) Environmental assessment requirements were also put in place in Canada in the 1970s. Ontario enacted the *Environmental Assessment Act* in 1975. The federal government also had environmental assessment provisions in place in the 1970s although they were only guidelines.

⁹⁷ Sunstein (1990).

safety legislation in the mid-1970s.⁹⁸ However, unlike the U.S., this new legislation emphasized the responsibility of workplace parties rather than the government to recognize and address workplace hazards.⁹⁹ The management of risk was therefore in part focused on improving the communication between the parties, leaving greater risk on workers to monitor the company. The Canadian approach assumes workers will be protected through the bargaining process whereas in the U.S. the emphasis is on the government regulator's responsibility to set and monitor protective requirements.¹⁰⁰

Governments in Canada and the U.S. also increased regulation related to human rights in the 1950s and 1960s. Governments were increasingly unwilling to allow private ordering and/or the common law (based on private ordering principles) to control or manage the risk to individuals that human rights would be violated (for example, the risk that individuals would be unemployed because of discrimination). In Canada, the 1940s and 1950s saw legislative developments in three principal areas: discrimination in employment generally, equal pay for women and discrimination in accommodation and government services.¹⁰¹ The 1960s and 1970s saw the expansion of general human rights legislation at both the provincial and federal level.¹⁰²

While the main focus of the late 1960s and early 1970s was on regulation of social risks such as to the environment, health, safety and human rights, there was some

⁹⁸ Keith (2001) and Manda et al. (1981).

⁹⁹ At the federal level, the federal government enacted with Canada Labour Code in 1968 governing federal workplaces. Part II of the Code sets requirements for health and safety. The federal legislation dealt only with workers in federal works or undertakings (the federal government along with industries under federal jurisdiction such as railways and banks). The provincial legislation governed all other workers.

¹⁰⁰ R. Rabinowitz and M. Hager, "Designing Health and Safety: Workplace Hazard Regulation in the United States and Canada" (2000) 33(2) *Cornell International L.J.* 373.

¹⁰¹ For example, in 1951 Ontario enacted the *Fair Employment Practices Act* (S.O. 1951, c. 24) which sought to end discrimination based on race, creed, colour, nationality, ancestry or place of origin. It also enacted the *Fair Accommodation Practices Act* (S.O. 1954, c. 28) providing for equal access to public accommodation, services and facilities (extended to residential and commercial tenancies in 1961). W. Tarnopolsky, *Discrimination and the Law in Canada* (Toronto: R. De Boo, 1982), Robert J. Sharpe and Catherine E. Swinton, *The Charter of Rights and Freedoms* (Toronto: Irwin, 1998) and P. Hogg, *Constitutional Law of Canada* (4th) (Toronto: Thomson Canada, 1997).

¹⁰² Ontario enacted a broad *Ontario Human Rights Code* in 1962 to deal with human rights in private relationships, especially employment and accommodation. Subsequently in the 1960s, Nova Scotia, Alberta, New Brunswick, P.E.I., B.C. and Newfoundland passed general human rights legislation. The federal government's principal legislation in the 1960s was the Canadian Bill of Rights enacted in 1960. The Bill of Rights was general legislation which set out a number of protected civil rights which could not be infringed by federal law. It did not apply to provincial law. The protected rights include freedom of religion, speech, assembly and association, certain procedural criminal law rights, equality and a limited property right. The 1950s and 1960s also saw the growth of the civil rights movement in the U.S. Sunstein (1990).

government management of economic risks to individuals and business. For example, the federal government in Canada reformed the unemployment insurance program in 1971. These reforms allowed the federal government to increasingly manage the risk of unemployment to a wider group of individuals and to regions.¹⁰³ The federal government also undertook a review of its social program with a view to significant reform in 1973.¹⁰⁴ However, the fiscal crisis of the 1970s meant this review could not be fully implemented.¹⁰⁵

As noted in Part II, starting in 1965, government expenditures began increasing significantly. These increases were driven by health, education and welfare expenditures, resulting from the introduction of the welfare state programs in the post-war period. In addition, the increases were driven by an increase in government spending on goods and services (including wages for employees in the newly expanded regulatory areas). As noted in Part II, growth in provincial government expenditure accounted for a large share of total growth in spending in this period. This growth in provincial spending was caused by the costs to provincial governments of the new federal cost-sharing programs as well as the lead regulatory role played by the provinces in the area of social risks. It is important to note, however, that one of the large costs of government risk regulation, increased costs to businesses, is not captured by government expenditure data.

V The Contracting State? (1975 – 2000)¹⁰⁶

A. *From Government to Market*

By the 1970s, the principal role of government as risk manager was in place in Canada. Governments took a significant role in dealing with economic risks to

¹⁰³ The *Unemployment Insurance Act* of 1971 expanded coverage of unemployment insurance (making it essentially universal), increasing the benefits and easing qualification requirements. In particular, the minimum contribution period and the maximum benefits period were made to vary based on regional unemployment rates. Banting (1987).

¹⁰⁴ Guest (1985); Johnson (1987).

¹⁰⁵ Guest (1985). The 1970s also saw the preparations for expansion of the social security system in the U.S., although there were no large scale reforms. Nixon attempted to broaden social programs with the introduction of the Family Assistance Plan in 1969. However, the Bill was defeated in 1972. Neither Presidents Nixon nor President Ford attempted large scale reform again. Moreover, there were some restrictions placed on program eligibility in the early 1970s. However, there was an expansion of the Food Stamp Program, indexing of social security benefits and increased federal funding for job training and to local governments for the administration of social programs (Jansson (1998); Christopher Leman, *The Collapse of Welfare Reform: Political Institutions, Policy and the Poor in Canada and the United States* (Cambridge, MA: MIT Press, 1980)). The U.K., on the other hand, started the 1970s with cut backs to social programs. Glennerster (1995).

¹⁰⁶ Freeman (2000) adopts the term the “contracting state”, as it has a double meaning, to reflect a shrinking state and an emphasis by the state on contracting out services.

businesses and individuals and social risks such as environmental and health and safety risks. However, in the late 1970s governments in most Western countries, including Canada, began focusing on the need for severe cuts in government spending and government involvement in the economy. This focus obviously was best characterized by the Reagan and Thatcher administrations of the 1980s. It, however, continued through the 1990s with severe cuts in spending by most governments.

One reason for this shift away from government action was a dramatic increase in the actual costs of the risk management role of government over the period. The programs that had been developed in the post-War period were expensive. They required extensive bureaucracies to administer the regulatory programs and substantial funds for the public insurance programs. As was seen in Part II, the main run up in costs began in the late 1960s and increased rapidly in the 1980s. Governments increased revenue collections, but not enough to offset the rise in cost. The resulting deficits led to increased costs of financing the debt (interest payments) which added considerable extra burden on government action and financing. These cost implications came to head in the 1990s with international markets expressing concern about the level of government debt in Canada (and other countries). The dramatic growth in government spending was a main cause of the growing concern with the scope of the role of government by some groups.

At the same time (and relatedly), there was an increase in the perceived costs of government. The economy was hit hard during the 1970s with oil price shocks and “stagnation.” This severe downturn led to a growing skepticism of the Keynesian view that government could successfully manage the economy. It also raised concerns about the cost impacts of the risk management programs on business and its competitiveness and an emphasis on supply-side economics.¹⁰⁷ This concern about competitiveness was exacerbated by the subsequent shift in Canada to the “new knowledge” economy and greater global economic integration.¹⁰⁸ Costs to businesses became seen as a central factor in the ability of Canada (and other countries) to compete for jobs and growth.¹⁰⁹

Further, interest groups and political parties played a role in changing the perception of the costs of government. Industry groups and political parties acted as

¹⁰⁷ Michael Trebilcock, “Journeys Across the Divides” (Manuscript, April 5, 2001).

¹⁰⁸ Increasing global economic integration has been argued to have led to a decrease in the ability of governments to maintain distinct social programs or regulatory regimes. Social programs, it is argued, must promote international competitiveness through providing the skills needed for businesses and by ensuring low costs for businesses through lower taxes. However, the differences in the current size and scope of social programs indicate that governments continue to have some freedom to set independent social policy (Keith Banting, *What’s a Country For? The Social Contract in the Global Era* (Queen’s University, School of Policy Studies Working Paper 11, 2000)). While there may be some additional constraint on regulatory action (such as the expropriation provisions under the North American Free Trade Agreement) governments appear to have some room to make independent policy in the environmental and health and safety areas as well.

¹⁰⁹ Mintz (2001); Maxwell (1995).

“availability entrepreneurs”¹¹⁰, emphasizing the cost impacts of growing debt and taxes thereby increasing the public’s perception of the risk of government action. This helped shape public acceptance of the shift away from government action.

A. Risk and Limiting the Size of Government

Governments reacted to changes in the actual and perceived costs and benefits of government action by attempting to shift the emphasis in risk management to the use of the markets beginning in the late 1970s. However, as was seen in Part II, the impact of this change on the role of government was not as significant as might have been expected, at least in terms of actual expenditures. There were two factors related to risk management impacting the size and role of government between the mid-1970s and 2000. First, the risk management role adopted by government up to 1975 constrained its ability to reduce the size and relative role of government in certain areas. Second, governments faced changes in risks and perceived risks over this period.

(a) Constraints on Reducing Public Risk Management

Governments reacted in five main ways to public and interest group pressure for a reduced government role as risk manager. They cut programs, deregulated or privatized industries, contracted out services, off-loaded their role as risk manager and reduced the adverse incentive effects of their regulatory programs.

Cuts to Programs: Governments made significant cuts to a number of different programs in the 1980s and 1990s, either through cuts to payments to individuals or cuts to ministry budgets. Governments tended to make fewer explicit cuts to income transfer programs, although there were some outright cuts to such programs in Canada (most notably in welfare benefits in Ontario in the mid-1990s). Cuts to income transfer programs were mostly made through relatively hidden changes in programs such as changes in qualification levels and indexation. Deindexation and similar more technical changes allow reductions in benefit payments without a large immediate political backlash because such changes are more difficult for recipients to understand.¹¹¹ Canada

¹¹⁰ “Availability entrepreneurs” in the private or public sectors focus attention on an event or situation to make it available or salient to members of the public (Jolls, Sunstein and Thaler (2000)).

¹¹¹ For example, there was de-indexation of the Old Age Security program which impacted the value of benefits throughout the 1990s. There was also partial de-indexation of the Child Tax Benefit, which replaced the Family Allowance in 1993, reducing the number of eligible families. However, the Liberals, with the introduction of the Canada Child Tax Benefit, restored full indexation of Old Age Security and of the Child Tax Benefit in 1998. At the provincial level, on the other hand, there were some clear cuts to welfare benefits in the 1990s (such as in Ontario) and provinces refused to index welfare payments. Ken Battle, “Relentless Incrementalism: Deconstructing and Reconstructing Canadian Income Security Policy” in Keith Banting, Andrew Sharpe and France St.-Hilaire, eds., *The Review of Economic Performance and Social Progress: The Longest Decade: Canada in the 1990s* (Montreal: Institute for Research on Public Policy, 2001).

in the 1990s also experienced an increase in the shift from universal programs to targeted or residual programs¹¹². These cuts in and changes to transfer programs increased the emphasis on market ordering and shifted the economic risk (such as from unemployment or poverty) back onto individuals.

Expenditures on health and education grew over the 1980s and early 1990s and remained a major element of provincial budgets throughout the post-war period. However, in the mid-1990s, there were significant cuts to health and education.¹¹³ In addition, governments made explicit and implicit cuts to the regulation of social risks and economic risks. For example, there were significant cuts to enforcement budgets of environmental ministries or agencies at both the federal and provincial levels in Canada.¹¹⁴

These budgetary cuts increased the emphasis on market or private ordering of risks. The cuts to health and education shifted the costs in these areas onto individuals, such as through increased waiting periods for health care, parental payments for educational expenses or burdens on families (such as having to care for elderly

¹¹² The Mulroney years (1984-1993) saw an emphasis on “targeted funding” of social programs. For example, beginning in 1985 indexation of child and elderly benefits was limited, although a strong lobby of senior citizens reversed this decision for the elderly. Patricia Evans, “Eroding Social Welfare: The Mulroney Legacy, 1984 – 1993” in (1994) 28(2) *Social Policy and Administration* 107. There was also an income test introduced for Old Age Security in 1989 and the Child Tax Benefit introduced in 1993 employed income-testing based on family income. The impact of these changes, however, may not have been overly significant as changes to the Old Age Security in 1996 meant only 2 percent of seniors receive no benefits and 3 percent receive partial benefits. Similarly, the new Canada Child Tax Benefit increased eligibility such that an estimated 95 percent of Canadian families will receive the benefit in 2004. Battle (2001).

¹¹³ Overall expenditures on education (in terms of percent of GDP) declined in Canada and the U.S. between 1975 and 1987. Education increased in both countries between the late 1980s and the early 1990s, with Canada having a much sharper increase in expenditures. Expenditures on education began to decline in both countries in the mid-1990s. Health expenditures experienced a slightly different pattern. They increased, in both the U.S. and Canada (as a percent of the GDP), at a gradual rate over 1975 to the late 1980s when, as with education, they experienced a large increase until the early 1990s. At that point expenditures began to decline in Canada, although they continued to increase in the U.S. The decline was partially caused by the decrease in the levels of federal-provincial transfers over the 1990s. (Mintz (2001) As with transfers to individuals, this decline in spending appears to have leveled off as a percentage of GDP or turned around on a real per capita basis by 2000.

¹¹⁴ In Ontario, the budget of the Ministry of the Environment increased in the early 1970s. In the mid-1970s, the total budget stabilized and even declined slightly through the late 1980s. In the late 1980s environmental issues became salient to the public, as seen by the significant increase in the importance of environmental issues in public polling. This increase in public concern corresponded to a sharp increase spending by the Ontario government on environmental issues through 1991. However, environmental issues again declined in importance for the public, particularly as economic issues became more pressing in the early 1990s. As a result, the NDP and then the Conservative governments in Ontario cut the Ministry’s budget significantly. Anita Krajnc, “Wither Ontario’s Environment? Neo-Conservatism and the Decline of the Environment Ministry” (2000) XXVI (1) *Canadian Public Policy* 111.

relatives).¹¹⁵ The cuts to enforcement and operating budgets in the area of social regulation decreased the risk that had been shifted to regulated parties by decreasing the risk that companies or individuals would be caught and prosecuted for any violations of law. This decrease in risk for regulated parties correspondingly increased the risk to individuals from externalities arising from violations of law.

The impact of these cuts was the greatest on spending on goods and services, although transfers to persons were also reduced (see Part II). However, transfers to persons as a percentage of GDP only returned to levels existing in the late 1980s (Figure 3). Moreover, when viewed in real per capita terms, the transfers were only cut to the levels of the early 1990s (Figure 4). It is interesting to consider the composition of these changes. The decrease in expenditures on transfers to persons primarily occurred at the federal level with the most heavily impacted program being unemployment insurance. Federal Old Age Security benefits have stayed largely stable while there has been an increase in child benefits. Provincial transfers to individuals decreased a relatively small amount over the period, with the reductions principally coming from reductions in welfare payments.¹¹⁶

From a theoretical perspective, the pattern of these cuts can in part be explained by the nature of the risk management role played by government. Cuts to programs involving direct payments to individuals are immediately noticeable. All other things being equal, these would likely give rise to political opposition. However, there are two other factors at work. First, individuals' perceptions of a benefit are impacted by the "endowment effect". Once individuals receive the benefit, they tend to place an increased value on the benefit merely because they have it – more so than they would place on the benefit if they were not originally provided with it.¹¹⁷ It is very hard to overcome these increased valuations. People would therefore be expected to react very negatively to even small cuts to their transfers and governments would be unwilling to make such cuts.

This is related to the second factor - path dependency. People dislike losses much more than they dislike gains. As a result, the same benefit level can give rise to different valuations, depending on the sequence of events leading to the benefit level. A valuation of a former benefit level keeps getting worse as the status quo (the current level of

¹¹⁵ Monaghan (2002); Judith Maxwell, "The Great Social Transformation: Implications for the Social Role of Government in Ontario" (Draft Paper for the Panel on the Role of Government, August 6, 2002).

¹¹⁶ Trends based on Cansim data. Part of the explanation for the large drop in employment insurance payments is due to the changes to qualification and benefit levels. However, a significant portion is also due to the upturn in the economy in the late 1990s which reduced unemployment levels. Don Drummond, "Deficit Elimination, Economic Performance and Social Progress in Canada in the 1990s" in Keith Banting, Andrew Sharpe and France Hilaire, eds., *The Review of Economic Performance and Social Progress: The Longest Decade: Canada in the 1990s* (Montreal: Institute for Research on Public Policy, 2001) estimates approximately one-half of the reduction in employment insurance payments over the late 1990s was due to economic growth and reduced unemployment levels.

¹¹⁷ Sunstein (2000).

benefits) increases.¹¹⁸ This may in part explain some of the outcry against government cuts.¹¹⁹ Individuals appear to be better off in absolute terms than they were when the “social contract” was claimed to first have arisen (although they may have become worse off in relative terms over the course of the 1990s¹²⁰), yet the public seems to feel a sense of real loss of support by governments. Because benefits have increased over time, individuals feel they are in a much worse position because of any cuts, even when in fact over time they have become much better off including the cuts. They experience a return to a prior benefit level as a much greater loss than objectively it appears.

Conversely, governments have been able to cut budgets to health, education and social regulation, in part, because risk management has been the victim of its own success. If a risk is successfully reduced, it becomes less available to the public and the public places less pressure on the government for action or pays less attention to reductions in government action. For example, in the environmental, health and safety area, less pollution or fewer dying lakes as a result of successful government regulation allows people to focus on other issues (such as the economy).¹²¹ The successful reduction in risk may lead to a reduction in the public’s valuation of the government action in addressing the risk.

This reduction in the perceived value of government action may also be at work in the area of transfer payments and other social programs. The risk of severe economic harm through prolonged unemployment or lack of funding for health care may have become less available to middle and upper income Canadians in the 1980s and 1990s. In the immediate aftermath of the Depression, all Canadians felt at risk from the market and understood the risks of economic downturn. This was an immediately available risk to Canadians and led to public pressure for government action. In a sense, all or most Canadians were placed behind a ‘veil of ignorance’, not knowing their probability of being unemployed or unable to afford health care.

However, middle and upper income Canadians may have discounted the risk of unemployment or poverty to a larger extent in the 1980s and 1990s. Over time the Depression has become less available. There have been economic downturns but also significant recoveries and economic risk may not seem as large as it did following the Depression. Further, there may be a discounting of the probability of the economic risk

¹¹⁸ Roger G. Noll and James E. Krier, “Some Implications of Cognitive Psychology for Risk Regulation” in Sunstein (2000). See also S. Gächter and A. Riedl, “Moral Property Rights in Bargaining” (Centre for Economic Studies and IFO Institute for Economic Research, Germany, *Working Paper No. 697* (10), April 2002) (results of experimental economics finding that entitlements (such as to benefits, rent control, fixed utility rates) create “moral property rights” or subjectively perceived rights and that the history of a transaction and the status quo will those who have the entitlement to defend it strongly as fair).

¹¹⁹ Simeon (1992).

¹²⁰ As noted above, there was an increase in family income inequality over the 1990s, although little increase in earnings inequality (Heisz, Jackson and Picot (2002)).

¹²¹ Parsons (2001).

by middle and upper income Canadians due to excessive optimism, discussed in Part I. Individuals may now underestimate the risks to themselves of unemployment or poverty – that is, they are overly optimistic about their own probability of success. These changes in risk perception may be a factor in the apparent acquiescence by middle and upper class Canadians in the initial shift from universal social programs to “residual” or targeted programs. Individuals appear to continue to support social programs, however, from a notion of distributive justice even though the risk to themselves is small.¹²²

A further risk-related factor would make these cuts to operating and enforcement budgets, such as in the areas of environment, health and safety, relatively easy to carry out initially. The cuts only increased the risk of some event (environmental pollution or health risk). The impacts of these events often take time to appear. Government can therefore make these cuts while continuing to espouse its role in protecting against the risks – trading off hidden costs to the public (which at the same time has less interest in government action) against benefits to industry.¹²³ The framework is similar for social programs in which the government delivers goods and services such as health and education. To the extent that impacts are delayed, there will be less immediate backlash to cuts. Individuals may not appreciate the true nature of the cuts until faced with the resulting risk (waiting lists, unavailable procedures or lower quality of education).

The pattern of cuts can therefore be explained in part by the nature and extent of the risk management role played by government. This role allowed significant cuts in areas that did not raise current salient risks to the public. It did not, however, allow large direct cuts to income transfer programs. Instead, most of the cuts in this area were either covert or used the lack of salience of major economic risks for the middle income earners to erode the universality provisions of social programs.

Deregulation and Privatization: Governments began to undertake deregulation or privatization of certain industries or regulatory areas in the 1980s and 1990s. In Canada, the economic crisis of the 1970s initially led to economic control by the federal government through the introduction of wage and price controls.¹²⁴ However, Canadian governments began to move to deregulation and privatization in the 1980s.¹²⁵ There was

¹²² Trebilcock (2001).

¹²³ Douglas Hartle, Michael Trebilcock, J.R.S. Pritchard and Don Dewees, *The Choice of Governing Instrument* (Economic Council of Canada, 1982).

¹²⁴ It also froze the price of domestic oil and implemented subsidies to ensure the same price to consumers dependent on foreign oil (Hogg (2001)).

¹²⁵ Trebilcock (1999). This period also saw substantial deregulation in the U.S. Liberalization occurred in the areas of transportation (airlines, trucking, buses and railways), broadcasting and depository institutions in the late 1970s and early 1980s. This continued in the 1980s and 1990s with a detailed regulatory review process in the Reagan and Bush administrations. In addition, the level of regulatory activity was even less under Clinton than had occurred under Bush, partly because of the Republican controlled Congress and carry over from the Reagan administration. McKie (1989). Marc Allen Eisner, Jeff Worsham and Evan Ringquist, *Contemporary Regulatory Policy* (London: Lynne Rienner, 2000).

a rationalization and reduction of regulation in Canada in such fields as airlines, telecommunications, railroads, motor transportation and energy, although little deregulation in the area of agriculture.¹²⁶ There has also been substantial deregulation in the energy sector starting with the natural gas sector in the 1980s. This was extended to the electricity sector in Ontario and Alberta in recent years.¹²⁷

Most of the deregulation or privatization occurred in the area of economic regulation.¹²⁸ Deregulation or privatization in the area of economic regulation is easier to justify to the public compared to the area of social regulation. Economic regulation involves clear trade-offs between government regulation and business competitiveness. The efficiency and competitiveness benefits of deregulation and privatization (such as the internationalization of markets)¹²⁹ are easy to explain to the public while the costs, if any, such as the potential for increased costs of service or unfair distribution of services, tend to be delayed. It is more difficult for the government to justify deregulation in the area of social risks to the public as deregulation appears to reflect a lack of commitment by the government to the health and safety of its citizens (as opposed to government acting to help citizens by fostering economic growth).

Contracting Out: Governments have also sought to reduce the costs consequent on its role as risk manager through increasing the involvement of the private sector in the delivery of services. This may reduce the actual costs of delivery of government services by engaging the benefits of the market for public ends. Governments have increased contracting out and public private partnerships in a wide range of areas from garbage delivery to social services. For example, in the area of social services, there has been an increase in the contracting out of the provision of social programs in the U.S., Canada

The U.K. also saw a shift to deregulation and privatization beginning with the Thatcher administration. For example, British Telecom was privatized in 1984, telephone equipment was deregulated in 1984, British Gas Corporation was privatized in 1986, the British Airports Authority was privatized in 1987 and the securities market was deregulated throughout the 1980s. However, each of these privatizations led to the introduction of new regulatory powers providing government control of these industries. Brian W. Hogwood, "Regulatory Institutions in the United Kingdom: Increasing Regulation in the Shrinking State" in G. Bruce Doern and Stephen Wilks, eds., *Changing Regulatory Institutions in Britain and North America* (Toronto: University of Toronto Press, 1998).

¹²⁶ Ostry and Stanbury (1999).

¹²⁷ Trebilcock (1999).

¹²⁸ There was, however, some deregulation in the social regulation area in Canada, although it mostly took the form of reducing "red tape". In the U.S., the 1980s saw President Reagan enter office with a promise of deregulation. While he was not able to fully carry out this agenda legislatively, President Reagan did delay and weaken regulation through the use of appointments to lead agencies, reductions in budgets and also increased reliance on cost-benefit analysis. Hahn and Sunstein (2002).

¹²⁹ For example, in the transportation area, trucking industry regulation was liberalized due to pressure from a deregulated U.S. trucking industry, airline regulation was lessened to allow greater international competition, and railways were deregulated and in part privatized to respond to competition from trucking and the deregulated U.S. railways. Trebilcock (1999).

and the U.K. Private groups have always provided public social programs but there has been a noticeable increase in recent years.¹³⁰ Although in most cases government retains a significant role in setting policy, contracting out shifts the emphasis in risk management mainly towards markets, reducing the role of government.

Off-loading of Risk Management: Government has also attempted to reduce its costs by reducing its role in managing risk. When governments regulate a risk, they must develop the management framework and implement, monitor and enforce that framework. Governments have attempted to reduce the costs of these development, implementation, monitoring and enforcement functions by delegating these functions to the regulated parties through increased emphasis on self-regulation. Depending on the scope of the self-regulation, the regulated parties themselves may have the power to create the plans for regulating and monitoring themselves, and in some cases even to prosecute violations.¹³¹ Further, governments have attempted to increase the role of the public in managing risk. For example, in the environmental area, there is a trend towards increasing public participation in formulating environmental law and policy¹³² as well as monitoring and enforcing environmental laws.¹³³ This represents a potentially significant reduction in government risk management through delegation of both policy setting and implementation to other parties.

¹³⁰ Trebilcock (1999); Freeman (2000); Salamon (2002); Daniel Guttman, “Public Purpose and Private Service: The 20th Century Culture of Contracting Out and The Evolving Law of Diffused Sovereignty” 52(3) *Administrative Law Review* 858 (2000)

¹³¹ For example, governments have relied on greater voluntary and self-regulatory mechanisms in the area of environmental risks. In the U.S. the Clinton administration instituted programs permitting firms to develop plans for environmental regulation in concert with “stakeholders” (such as environmental groups) rather than have the government set standards (Steinzer (1998); Freeman (2000)). Canadian governments have also moved in this direction such as through allowing companies to develop their own pollution prevention plans under the *Canadian Environmental Protection Act* or enter into “cooperative agreements” with ministries. See, for example, Ministry of Environment and Energy, “Ontario to Reward Businesses with Strong Environmental Track Records” (News Release, April 1, 2002).

¹³² For example, in the early 1990s, Ontario enacted the Environmental Bill of Rights. This Act provides for greater notice and comment procedural rights to citizens during the formation of environment-related Acts, regulations, policies and instruments such as approvals and orders. In addition, it provides citizens with an opportunity to appeal approvals and orders in certain circumstances and with a (weak) ability to request the government to take action against violations of environmental laws or to review its own laws and policies. This increase in public participation was followed by the federal government in 2000.

¹³³ For example, governments have increased requirements for companies to provide information on environmental health and safety risks to the public. This has occurred in Canada and the U.S. through legislation which requires companies to disclose information on waste disposal and emissions. The intention is to provide governments with the information as to whether action is required. However, it is also intended to provide the basis for public pressure to ensure companies take action, such as, for example, from the fear of adverse publicity. Nicholas Ashford and Charles Caldart, *Technology, Law and the Working Environment* (Washington, D.C.: Island Press, 1996) and Sunstein (1996). In Canada, the federal government instituted the National Pollutant Release Inventory in the 1990s requiring companies to report releases and transfers of a number of substances. It is now on-line so that individuals can determine what substances are being released in their area. Ontario has expanded on this concept by requiring companies to monitor or estimate and report on a broader range of substances that they are releasing to the air.

Reducing the Costs of Government Failure: Finally, governments have attempted to reduce the costs of government risk management through addressing various types of “government failure”. In the social welfare area, public insurance programs allow pooling of risks and therefore coverage which would not arise under private insurance. However, insurance for unemployment or health concerns give rise to significant potential costs in terms of moral hazard – for example, people will become dependant on welfare or unemployment insurance and not seek to obtain work.¹³⁴ As a result, over the 1980s and 1990s governments have increasingly altered programs so as to encourage individuals to return to the work force rather than remain in the social programmes. This can be most clearly seen in changes to the federal unemployment scheme, although it also occurred with provincial welfare programs. The federal government raised qualification requirements and reduced benefits for unemployment programs in the early and mid-1990s. The emphasis, signaled by the renaming of the program in 1996 as “Employment Insurance”, was on structuring the benefits such that there was a greater incentive for workers to stay employed or to return quickly to the workforce.¹³⁵ Such requirements reduce the risk to government (and the taxpayers) of unemployment by shifting some risk back onto the individual.

Governments have also attempted to reduce costs of “government failure” in the area of social and economic regulation. For example, governments have increased the use of cost benefit analysis, particularly in the U.S.¹³⁶ In 1978, the federal government in Canada began requiring the preparation and publication of socio-economic impact analysis statements on the likely costs and benefits of new regulations.¹³⁷ There continued to be some guidelines at the federal level that recommended cost-benefit analysis and minimization of impact on the economy during the 1980s and 1990s. Cost-

¹³⁴ Barr (1992); Moss (2002).

¹³⁵ Evans (1994); Battle (2001). This emphasis on return to work requirements also occurred in the U.K. and the U.S., even under the Clinton and Blair governments. Janssen (1998); Mark Bevir and David O’Brien, “New Labour and the Public Sector in Britain,” in *Public Administration Review*, 61:5 (Sept./Oct. 2001), pg. 535.

¹³⁶ Cost-benefit analysis had its origins during the Nixon administration. President Reagan expanded the use of cost-benefit analysis by agencies in 1982 with the requirement that agencies produce cost-benefit analysis as part of a Regulatory Impact Analysis for major rules. This emphasis on costs and benefits was continued under Bush and Clinton. Clinton’s approach was slightly different than Reagan’s as Clinton required agencies to consider both quantitative and qualitative costs and benefits and promoted openness. In addition, Congress in the last few years has increased its emphasis on cost-benefit considerations. There is a continued push for the use of cost-benefit analysis in the U.S., although with accommodations for substitute risks and with an emphasis on its use to promote regulation and to make decisions more transparent. Menell and Stewart (1994) and Robert Hahn and Cass Sunstein, “A New Executive Order for Improving Federal Regulation? Deeper and Wider Cost-Benefit Analysis” (Chicago: University of Chicago, Law School, John M. Olin Law and Economics Working Paper No. 150, 2002).

¹³⁷ G. Bruce Doern, Michael Prince and Garth McNaughton, *Living with Contradictions: Health and Safety Regulation and Implementation in Ontario* (Report for the Royal Commission on Matters of Health and Safety Arising from the Use of Asbestos in Ontario, 1982).

benefit analysis can be used to ensure that the costs of government risk regulation (economic or social) are proportionate to the benefits. However, depending on how it is used, cost-benefit analysis can also be a tool for deregulation by ignoring or minimizing non-economic benefits of regulatory programs.

Another example of an attempt to reduce “government failure” is the use of market mechanisms to further regulatory goals. In theory, the use of market mechanisms, such as marketable pollution permits, allows companies to meet government objectives at a lower cost. Market mechanisms avoid the inefficiencies associated with the government dictating uniform standards covering a wide range of situations and may provide an incentive to companies to actually reduce costs and improve outcomes (reduce pollution or increase safety). Market mechanisms may also have the effect of permitting the government to reduce its monitoring and enforcement costs. However, there are other costs such as the costs of setting permit levels, allocating permits and monitoring compliance, which must be taken into account in assessing actual government costs savings.¹³⁸ Canada has been relatively slow to adopt market mechanisms in the area of social regulation compared to the U.S. and European nations¹³⁹, although it has used market mechanisms in some areas such as fisheries.¹⁴⁰ However, Ontario recently instituted an emission cap and trade system for certain air emissions from utilities, with a view to expansion of the program in the future. Market mechanisms decrease government’s role in determining how risks are to be reduced, although generally governments are still involved in determining the level of permissible risk.

(b) Changes in Risk and Perceived Risk

The cuts to or changes in programs over the 1980s and 1990s discussed in the previous section altered the mix of private and public action in risk management. An

¹³⁸ Robert Stavins, “Lessons from the American Experiment with Market-Based Environmental Policies,” (Kennedy School of Government, Harvard University, Working Paper Series RWP01-032, April, 2002).

¹³⁹ Most Western countries used economic incentives to some extent. Many governments, particularly in Europe, have used either taxes on pollution or resource use or subsidies for reducing pollution. Countries have also attempted to redefine property rights to create market mechanisms for reducing pollution. The most famous pollution rights program originated in the acid rain provisions in the 1990 Clean Air Act Amendments in the U.S. This program provided for an emissions trading regime for utilities, with trading in SO₂ commencing in 1995 and in NO_x in 1999. In the 1990s, the use of economic incentives for economic regulation held wide-spread approval in the U.S. OECD, “Encouraging Environmentally Sustainable Growth: Experience in OECD Countries” (Paris: OECD Economic Outlook No. 69, 2001); Menell and Stewart (1994); Cass Sunstein, “Is Cost-Benefit Analysis for Everyone?” (2001) 53 *Administrative L.R.* 299.

¹⁴⁰ Katrine Wymann, “A Tale of Two Resources: Why Canada has been Slower to use Tradeable Rights to Regulate Air Pollution than Fisheries” (unpublished, December 14, 2001) arguing that Canada has been slower to adopt trading rights in the environmental area because a small number of pollution sources made it partially possible to overcome the information problems that typically undermine the efficiency of conventional regulation. Subsidies and tax incentives have been used in the areas of acid rain emissions, modernization of pulp and paper facilities (Webb (1988)) and redevelopment of contaminated lands.

additional factor impacting the role of government in 1980s and 1990s was a number of changes in the risks or perceived risks facing Canadians. For example, technological innovation led to a decreased need for government management of risks to consumers in certain industries such as communications and financial services. Canadian governments in part responded to the decrease in risk by deregulating these industries or privatizing government corporations.¹⁴¹ On the other hand, some new risks arose as a result of technology and knowledge advances – a case in point is the current debate about genetically modified organisms. The environmental impact of these organisms is not yet known. However, the potential for risk has given rise to demands for government action.

Changes in technology have also imposed significant costs on the government because of its role as insurer and provider of health care. New, expensive technologies and drugs are being continuously developed. The public expects that these will be available through the public health system to improve health outcomes. This public expectation has put pressure on government systems and raised costs of publically-managed health insurance.¹⁴²

Another important factor in the 1980s and 1990s was the increased liberalization of trade. When combined with significant technological changes (such as in communication), the effect has been increased global and North American economic integration.¹⁴³ This economic integration has led to a new set of economic risks to business. National governments have responded by strengthening international rules of competition such as international trade agreements. These rules mitigate some of the risks of international trade, although they also tend to reduce the government's ability to undertake some forms of risk reduction for businesses (such as tariffs). Further, governments have responded to these new risks arising from international competition through deregulation or privatization such as in the areas of trucking and airlines.¹⁴⁴ These new risks therefore changed the focus of government management of economic risks to the international stage. The impact of the changing nature of risk was strengthened by concerns about the effect of domestic regulation and high marginal tax rates on the costs of businesses and the willingness of capital (including mobile human capital) to relocate.

The combination of technological change and increasing liberalization of trade has also been argued to have led to greater economic insecurity for individuals in the

¹⁴¹ Technological changes, however, appear to be less of a factor in deregulation in the areas of airlines, trucking, rail, natural gas and electricity. Trebilcock (1999).

¹⁴² Maxwell et. al. (2002) (citing prescription drugs as the fastest growing component of health care costs; although they have a large impact on government expenditures, drug costs also have led to large private expenditures as well as Medicare does not cover the costs of all such drugs outside of hospitals). As noted in Part II, health care expenses have become a very large proportion of government budgets, constituting 38.6 percent of the Ontario budget in 2001-2 (White (2002)).

¹⁴³ Mintz (2001); Simeon (1994).

¹⁴⁴ Trebilcock (1999).

1980s and 1990s. The shift to the “new knowledge economy” has meant that individuals are losing jobs in the manufacturing sector and are not able to obtain the new jobs that are arising in the knowledge industries.¹⁴⁵ The resulting economic insecurity and unemployment have given rise to calls for an increased role for government in creating human capital through education and training to prepare individuals to obtain the new jobs and provide a trained workforce for business.¹⁴⁶

New social risks also arose over this period. Once governments began to take a significant role in regulating environmental, health and safety risks in the 1960s and 1970s, they were faced over time with regulating new risks that had not been recognized previously. For example, as more information becomes available about substances currently in use, government is pressured to take action to deal with them.¹⁴⁷ An important example is global warming. Concern about global warming grew through the 1990s and led to the signing of the 1997 Kyoto Protocol to the United Nations Framework Convention on Climate Change. The Protocol has the potential to significantly increase the role for government at all levels in regulating air emissions and to lead to significant government and business expenditures.¹⁴⁸

Further, there have been a number of events throughout the 1970s, 1980s and 1990s which made particular risks salient and led to increased public demand for government action. For example, in the environmental area, such events include the contamination at Love Canal, New York (which was an important factor in leading to legislation dealing with hazardous waste disposal in the U.S.)¹⁴⁹, Three Mile Island and Chernobyl (which raised concerns about the nuclear industry). Such events led to a sharp, short increase in public demand for environmental action in the late 1980s and early 1990s.¹⁵⁰

Finally, government’s risk management role adopted in the post-War period has been impacted by a number of structural changes to Canadian society. One important factor is the aging of the population. The aging population has led to increasing

¹⁴⁵ Maxwell (1995).

¹⁴⁶ Courchene (2001).

¹⁴⁷ This has been institutionalized in Canada with the on-going assessment of substances for toxicity by the federal government under the *Canadian Environmental Protection Act*.

¹⁴⁸ The estimated costs of Canada implementing the Kyoto Protocol vary widely. The Alberta government estimates the cost would be in the area of \$23 to \$40 billion (Alberta, *Albertans and Climate Change: An Assessment of the Economic Impacts of the Kyoto Protocol*, (2002)). A recent federal government study estimates the impact to be between 0 and -2% of GDP (approximately \$25 billion) over 10 years (Canada, *A Discussion Paper on Canada’s Contribution to Addressing Climate Change*, (2002)).

¹⁴⁹ Jolls, Sunstein and Thaler (2001).

¹⁵⁰ Harrison (1996).

expenditures on pensions and health care.¹⁵¹ This increase was not a change in the nature of the risk addressed by government, but in the number of individuals requiring aid. This impact of aging is related to other factors impacting the role of the state – the declining birth rate and changes in household structures (including the increase of single parents and two-income earners).¹⁵² These factors cause government expenditures to grow, even absent any change in its risk management role.

(c) Summary

Since the late 1970s, governments in Canada and other Western countries have sought to reduce their role as risk managers in order to cut costs – both the direct costs of government expenditures and the perceived impact on business competitiveness. Governments have directly cut programs but have also revised their role through such means as off-loading functions, deregulation, and reducing the costs of government failure. Each of these actions increases the role of private ordering and private parties in the management of risk either by directly shifting risk on private parties or by decreasing government risk reduction capabilities or responsibilities.

Government expenditures did not decrease as much or as early as would be predicted from the rhetoric around reducing the size of government, partly because of the nature and extent of the risk management role taken on by the government in the earlier periods. For example, transfers to individuals could not be cut directly to a large extent because of the political ramifications. In addition, government was resistant to reductions in size because of the increase or change in risks and perceived risks in the 1980s and 1990s.

VI The Beginning of the 21st Century: Back to Big Government?

The role of government as risk manager has changed over the course of the past Century. This role grew significantly in the post-War period before governments began attempts to reduce their role as risk manager in the 1980s and 1990s. Further, as discussed below, there appears to be a shift back towards an increased risk management role for government in recent years.

This paper has focused on identifying the risk management role played by the state in Canada and the impact this had on changes to government in the 1980s and 1990s. More work needs to be done on why the shifts in the role of government have occurred. However, the discussion in this paper suggests that the shifts may be due in part to the nature of risk and risk perception. An emphasis on either private or public risk

¹⁵¹ David K. Foot, “Demographic Change and Public Policy in Ontario” (Draft Paper for the Panel on the Role of Government, June 2002).

¹⁵² Maxwell (1995).

management appears to have led over time to a swing in the opposite direction – that is, private and public risk management each carry the “seeds of their own destruction”. For example, the focus on the benefits of the market and the costs of government action (such as in the early 1900s and the 1980s and 1990s) has led to an increase in the actual and perceived costs from market ordering and benefits of government action. This perception of the relative costs and benefits of government risk management has led to public demand for government action and an increase in public risk management. Similarly, the emphasis on public risk management leads over time to a shift back to an emphasis on markets.¹⁵³

Briefly examining the 20th Century from this perspective, in the period from 1900 to 1940, government risk management was limited in Canada and principally located at the local level (Table 2). Risks were largely left to the market. To the extent the government did regulate risk, it focused on economic risks to business and economic growth. There was only limited regulation of economic risks to individuals (such as the risks of poverty, unemployment and illness). Moreover, governments regulated only obvious social risks and even then only to a limited extent.

However, the Great Depression shattered the public’s faith in the ability of the markets to be self-correcting and adequately address all risks. It clearly illustrated the cost of market failure. The result was an increase in the government’s role in addressing economic risks to business in the 1930s as well as the beginnings of a government role in managing economic risks to individuals based on public demand for government action.

The period 1940 to 1973 saw the establishment of the foundation of government’s role in addressing risks. In addition to the costs of the market illustrated by the Depression, the federal government’s successful role in active economic intervention during World War II, combined with Keynesian economic thinking, increased the perceived benefits of government action. Canadian governments first addressed the most salient risks from the Depression – economic risks to individuals such as unemployment, poverty and illness. The tremendous economic growth of the period meant that the costs of these actions were not immediately obvious. Government involvement was also extended to a number of new or newly perceived risks at the end of this period –

¹⁵³ This shifting perception is related to the theory of disappointment proposed by Albert O. Hirschman, *Shifting Involvements: Private Interest and Public Action* (Princeton: Princeton University Press, 1982). Hirschman argued that individuals shift between a focus on involvement in public life and on private goals – between pursuing public or private happiness. These shifts occur because of alternating phases of disappointment. Individuals concentrate on private goals but this does not bring them the level of enjoyment or pleasure they had anticipated. They therefore turn to public involvement such as in protest movements or community action. Public involvement, however, also leads to disappointment as public action requires more costs (both in terms of money and time) than anticipated or public action fails to allow individuals to express themselves (similar to the inability to express intensity of preferences through voting). This leads to a shift back to a private focus, especially as individuals tend to forget their earlier disappointment in private action. Simeon has suggested that Hirschman’s analysis may be applied to Canada in the post-war period. Simeon (1994). This connection between the perceived relative costs and benefits of government action and the extent of government’s role as risk manager needs to be explored more fully.

particularly risks to the environment, health and safety. This period also saw an increase in centralization of government functions in reaction to the perceived inability of lower levels of government to deal with some issues.

Table 2: Stages in Risk Regulation

	Risk and Perceived Risk	Institutional Emphasis	Centralization of Government Action
1900-1940	Lack of Economic Growth Economic Risk to Business	Market	Decentralized
1940-1973	Economic Risk to Individuals Social Risks	Government	Centralized
1973-2000	Lack of Economic Growth Globalization New Economy New Social Risks	Market	Decentralized

The period from 1973 to 2000 saw governments attempt to decrease their role in addressing risks. At the beginning of the period, the oil crisis and stagflation shook the faith in the ability of the government to manage the economy. Further, the costs of the government's role in managing risks began to grow (leading to increased deficits, interest payments and debt) as did the actual and perceived costs of government regulation for business. The result was a growing focus on the costs of government risk management. Further, many risks became somewhat less salient in part because of successful public risk management. These factors reduced the perceived benefit of government action in such areas as the environment and social programs. Finally, global economic integration and the 'New Economy' may have increased the perceived benefit of market ordering.

However, governments did not immediately reduce in size, partially because of the nature and style of risk management that governments adopted in the prior period. Many of the programs could not be cut or could only be reduced covertly. Other program changes, such as privatization and shifting to a greater role for private actors, which developed over the 1980s and 1990s did not have a large impact on the size of government. It took most of the period before governments could reduce the deficit and begin fighting the debt, even then the reduction was much less than would otherwise be expected given the rhetoric surrounding the budget cuts.

This emphasis on private market ordering appears to be giving way to a shift back towards the perceived benefits of governments' role as risk manager in recent years. There has been the beginnings of a return to higher government spending (such as the

increased real per capita spending in certain areas and increases in health, education and certain regulatory budgets) as discussed in Part II and in a focus on the importance of government action to deal with environmental risks, economic risks from the market, risks from private delivery of certain services and even risks from terrorism. This shift is the result of a number of factors.

First, the delayed impacts of a number of the earlier cuts are becoming increasingly evident. The significant cuts to health, education and regulation of social risks (such as to the environment) led to an increase in market ordering for certain risks. The costs of these risks are becoming apparent over time (such as the increased burden on individuals from health care costs and a corresponding increasing dissatisfaction with the health care system).¹⁵⁴ These increased risks have focused attention on the costs of shifting back to market ordering for some risks as well as on the benefits of government action. Government action can have positive effects – it can overcome problems with the market (such as lack of complete insurance markets for unemployment risks and insurance for certain medical risks), deal with informational problems and reduce the levels of externalities.¹⁵⁵ By dealing with market failures, government action can make the economy more efficient and fair. It may not do so in all cases but it can do so in some. Cutting government's role has illustrated these benefits and the attendant costs of market ordering. Governments have responded to public demand for government action by increasing spending.¹⁵⁶

Second, there have been a number of specific events which have led to an increase in the perceived risk of market ordering. For example, the Enron scandal and on-going revelations of accounting irregularities at large public companies in the U.S. gave rise to a perceived risk to markets from lack of government regulation of companies and auditors. It has led to a call for much greater action by government to control these

¹⁵⁴ Judith Maxwell, et. al., *Report on Citizens' Dialogue on the Future of Health Care in Canada* (Report prepared for the Commission on the Future of Health Care in Canada, June 2002); Monaghan (2002). See also Canadian Institute for Health Information, *Health Care in Canada, 2002* (Ottawa: Canadian Institute for Health Information, 2002) (by 1997, just under 30% of health care spending was from the private sector – the highest percentage in the past 25 years; it has since fallen to 27% in 2001). As noted above, there was also an increase in family income inequality in the late 1990s.

¹⁵⁵ Barr (1992); Moss (2002); and Heath (2000).

¹⁵⁶ For example, see Canadian Institute for Health Information (2002) (the years 1997-2001 saw public health spending begin to rise again after falling dramatically from 1993 to 1997, with real spending per person by the public sector increasing by 6 percent in 2001 over 2000 compared to a one percent increase for private spending). See also Ontario Ministry of Finance, "Growth and Prosperity: Keeping the Promise" (News Release for 2002 Budget, June 17, 2002) (citing government priorities of, and increased spending on, health care, education and the environment). This spending increase corresponds to polling data indicating that the public wants the federal government to increase its involvement in programs including health and education (Frank Graves, "The Economy Through a Public Lens: Shifting Canadian Views of the Economy" in Keith Banting, Andrew Sharpe and France Hilaire, eds., *The Review of Economic Performance and Social Progress: The Longest Decade: Canada in the 1990s* (Montreal: Institute for Research on Public Policy, 2001)).

risks both in the U.S. and Canada.¹⁵⁷ In the environmental area, the events in Walkerton, Ontario have led to the perception that government cuts contributed to the tragedy. This perception sparked a public demand for government action and a government response in terms of increased government funding and regulation in the environmental area.¹⁵⁸ These events are sufficiently salient (particularly given media coverage) that they focus public attention on the risks from market ordering.

Third, other costs of the shifting emphasis away from government action may be becoming evident. One argument for a universal welfare system is that it eliminates the exit option and ensures that people use voice to improve government action. For example, if the quality of the health care system declines, a readily available exit option (such as to private insurance) allows high quality demanders of health care services and higher income Canadians (which may have a higher percentage of vocal individuals) to leave the system rather than push for change. The government will not then perceive the same demand to increase the quality of the public system.¹⁵⁹ The Canadian public appears to feel a sense of unfairness arising around the cuts to health care and education and have a perception that allowing further reductions in universality will lead to an unfair further decline in the public system.¹⁶⁰

The result appears to be a re-emergence of a public perception of the importance of the government's continued role as risk manager (even absent the continued structural change discussed in Part V). The emphasis in the 1990s on "reinventing government" or a "third way" by the Clinton and Blair governments was touted as an intermediate route between the markets and the state. The state was reduced by allowing market mechanisms to arise where they are more efficient or effective, but the state retained some role in setting public goals. In fact, however, the "third way" (or "reinventing government" movement) focused on shifting government functions to third parties (private actors) without a clear understanding of the effect of such shifts on public goals. These programs aimed at government reform assumed that the third parties share the public goals with the government or at least these programs insufficiently took account of the differences in interests and goals of third parties and the need for government

¹⁵⁷ CBC News, "Bush Signs Corporate Responsibility Legislation," (July 30, 2002); but see New York Times, "Broken System? Tweak It, They Say," (July 28, 2002) (stating that regulation will likely end with the initial bill on corporate responsibility). See also Ontario Securities Commission, "New Independent Public Oversight for Auditors," (July 17, 2002) (announcing agreement to create a new oversight board for auditors of public companies, with an increased role for provincial and federal regulators (although the new body would not be a government agency)).

¹⁵⁸ The Honourable Dennis R. O'Connor, *Report of the Walkerton Inquiry (Parts I and II)* (Toronto: Ministry of the Attorney General, 2002).

¹⁵⁹ Albert O. Hirschman, *Exit, Voice and Loyalty* (Cambridge, MA: Harvard University Press, 1970).

¹⁶⁰ Maxwell et al. (2002) (public "dialogues" in 2002 found that citizens want to preserve the core Medicare values of universal coverage, access based on need and fairness and that citizens believe increased funding is necessary to preserve the health care system in this form).

oversight.¹⁶¹ Self interested, or at least non-public regarding, action by private parties (such as Enron or the environmental labs in the case of Walkerton) has led to calls for new controls over the use of private actors for public purposes.

The challenge for the coming period will be to structure the use of private actors and market ordering in pursuit of public goals in order to allow the government to take advantage of the potential cost and informational benefits of utilizing these actors while controlling the risks from private interests. In fact, this balancing of the opportunities and risks of greater involvement of private actors could require an even stronger role for government in order to set incentives, structure the mix of private and public action and monitor the performance of private actors. Moreover, it will require new methods of ensuring that this new mix of public and private action will promote accountability such that the use of public power will be legitimate and inclusive.¹⁶² Such steps are necessary to avoid or at least mitigate the costs of government failure as risk manager in this period of renewed emphasis on government action.

¹⁶¹ Salamon (2002); New York Times (2002) (quoting Nobel prize-winning economist, George A. Akerlof, as stating, “It is not regulation versus deregulation that is the issue; we should have both...but if you have rules that allow a lot more freedom, then you need much more vigilance and enforcement, and we have starved budgets for enforcement.”).

¹⁶² Salamon (2002); Michael Taggart, ed., *The Province of Administrative Law* (Oxford: Hart Publishing, 1997); Freeman (2000).