

Trade, Equalization and Regional Disparities in Canada

by

Pierre-Marcel Desjardins

Paul A. R. Hobson

and

Donald Savoie

Canadian Institute for Research on Regional Development
University of Moncton
Moncton, New Brunswick
Canada

OVERVIEW

Canada is an economic union, its origins dating back to 1867. The British North America Act, 1867 provided for free mobility of goods within the economic union and conferred authority for external trade policy on the federal government. Trade policy has had a defining influence on the pattern of regional development, dating back to the National Policy of the late 19th century to the North American Free Trade Agreement on 1997.

Canada is also a federation, comprising 10 provincial governments and 3 territorial governments as well as the federal government.¹ The Constitution Act, 1982

¹ Going from east to west, the 10 Canadian provinces are Newfoundland, Prince Edward Island, Nova Scotia, New Brunswick, Quebec, Ontario, Manitoba, Saskatchewan, Alberta and British Columbia. There are, in addition, 3 Territories—Nunavut, Northwest Territories, and Yukon. There is no definitive regional separation. For some purposes it is useful to think of the East (or Atlantic Canada)—Newfoundland, Prince Edward Island, Nova Scotia and New Brunswick, the Centre—Quebec and Ontario, and the West—Manitoba, Saskatchewan, Alberta and British Columbia. For other purposes the country may be split into Newfoundland, the Maritimes—Prince Edward Island, Nova Scotia and New Brunswick, Quebec, Ontario, the Prairies—Manitoba, Saskatchewan and Alberta, and British Columbia. Because data is collected at the provincial level, it is often convenient to define individual provinces as regions.

mandates both levels of government to promote equality of opportunity and the provision of comparable levels of public services in all regions. The pursuit of these goals has also had a defining influence on the pattern of regional development.

The purpose of this paper is to place regional development in Canada in its historical context, to explore both the successes and failures in regional development policy and to consider the implications for intergovernmental transfers. We begin by reviewing types of economic and social integration. This is followed by a consideration of the evolution of external trade patterns and trade policy. Consideration is also given to issues of internal trade and factor mobility, especially to related constitutional proposals and the recently signed Agreement on Internal Trade. Next, we explore some measures of economic and fiscal disparity across provinces, as well as constitutional recognition of policies designed to alleviate their symptoms. In this light, we review the evolution of regional development policy since its inception in the 1960s. Finally, we review the policy response to economic disparity as it impacts on the fiscal capacities of provincial (and territorial) governments.

TYPES OF ECONOMIC AND SOCIAL INTEGRATION

There are many degrees of integration, both economic and social, between that of a system of unrelated state economies and the unitary national state economy. Previously unrelated state economies may enter into trading relationships with other economies. Such relationships may or may not include trade barriers such as tariffs, but, typically, would include barriers to factor mobility, especially labour mobility. A customs union

would ensure the elimination of tariffs and other forms of trade barriers among member states, although allowing for a common tariff policy with regard to non-member states and barriers to labour mobility among member states.²

An economic union would extend the customs union to include free mobility of factors, especially labour, among member states.³ Economic union brings with it pressures for both monetary and social union. A monetary union would, for example, eliminate problems of exchange rates among member states, especially those associated with transactions costs and exchange rate risk. Currency union would, therefore, be a next step in integration, not necessarily *the* next step. Currency union, by definition, requires that member states forfeit independence in monetary policy, in favour of a common monetary policy.

Prior to currency union, a system of fixed exchange rates, or exchange rate bands, may preserve some degree of monetary independence among member states. The European case has demonstrated that this will necessitate some degree of fiscal harmonization among member states. In particular, it will require that member states achieve a degree of common fiscal balance so as to mitigate pressures for exchange rate adjustment.

Factor mobility brings with it pressures for fiscal harmonization. Capital mobility, for example, creates pressure for harmonization of capital taxation, including corporation

² The post-war European Union would be a case in point.

³ The European Economic Community (EEC) would be a case in point.

tax rates. Labour mobility creates pressures for harmonization of net fiscal benefits—the difference between benefits derived by residents from government services and taxes paid.

A confederal union brings together member states in an economic and monetary union, but without any commitment to fiscal (or other) transfers among member states. A federal system is different: It brings with it the commitment to a central government role in making inter-state fiscal transfers. Specifically, a role can be identified for interstate transfers which promote the dual goals of fiscal efficiency and fiscal equity. Indeed, monetary union brings with it the requirement of some degree of fiscal harmonization, since member states will no longer have the relief-valve of exchange rate adjustment. In the absence of exchange rate flexibility and in the presence of labour mobility, member states may be seriously compromised by fiscal disparity.

A federal system of government is, therefore, characterized by both monetary union and fiscal harmonization. To the extent that fiscal systems are not fully harmonized, there is a case for intergovernmental transfers in order to promote goals of fiscal equity and efficiency. Federalism may dominate the unitary national state where it can be shown that differences in preferences can be better accommodated in a decentralized system than in a fully-centralized system.

If only for historical reasons, Canada can be characterized as a federal system of government. Among provinces, both economic and fiscal disparity is a defining

characteristic.

EXTERNAL TRADE AND THE ECONOMIC UNION

Trade has always played an important role in Canada's economic development and, arguably, in its political development. In this section, we provide an overview of the contribution of trade to the economic development of Canada's region. Second we attempt to answer the question: what role has trade policy played in Canada's development. Third, we reflect upon Canada's future prospects given its new trade structure.

The Genesis of Trade Policy in Canada

For the first century and a half after the conquest by Great Britain, Canada managed to maintain privileged economic links with the *la mère patrie*. In fact, up until the repeal of the Corn Laws in 1846, British colonies in what is now Canada had a two-pronged economic strategy: to secure entry into Britain for Canadian grain under a preferential treatment system (no or very low tariffs) and to establish the Great Lakes-St. Lawrence route as the principal route for grain exports originating in the American midwest (Easterbrook and Aitken. 1958. 281). These privileged links with Great Britain should have benefited economic development in Eastern Canada (Atlantic Canada and Québec), if we take distance as a key variable. History teaches us that up to a point, it did not. Why?

One possible explanation might be found in trade trends: as we will discuss later,

one of the most important economic characteristic in Canada's economic history has been the ever decreasing importance of Great Britain as a destination for Canada's export while the United States' importance constantly grew (Polèse. 1996. 286). This does not explain why eastern Canada has not benefited more from its strategic location with respect to trade with Great Britain, but it confirms one of regional economics' key precepts: distance matters! Another element to take into account is that even if Canada had preferential access to British markets for its grain exports, actual exports fluctuated significantly. In fact, fluctuating British prices for grain meant that for several years, low prices lead to no Canadian grain exports to Great Britain (Easterbrook and Aitken. 1958. 281).

The repeal of the Corn Laws in 1846 in effect eliminated preferential access for Canadian grain. There was also a reduction in preferential access for timber in 1845 and 1846. Furthermore, Europe suffered an economic depression in 1847. Consequently, facing important market losses, many in Canada favoured amalgamation with the United States. (Easterbrook and Aitken. 1958. 293). This movement failed, but a trade agreement with the United States was ultimately signed.

Free Trade, Round 1

In 1854, the United States and United Canada signed a free trade deal, the Reciprocity Treaty (Hébert. 1988. 78; Trudel. 1968). For Canada, this was as much a defensive gesture to compensate for the loss of preferential access to Great Britain's markets as it was an attempt to have increased access to the U.S. markets.

In the years that followed, the trade agreement between Canada and the United States increased significantly. Export from Canada's maritime colonies (Nova Scotia, Prince Edward Island and New Brunswick) to the U.S. doubled between 1854 and 1855 (Desjardins, Deslierres and LeBlanc. 1995. 214). One factor that could explain – at least partly – this surge in demand may be the American Civil War. In western Canada, and this fact remained true even after the end of the Reciprocity Treaty, north-south trade was significantly more important than east-west trade, in part as a result of better transportation networks (Easterbrook and Aitken. 1958. 344).

During this period, an ambitious project was launched to complete the St. Lawrence canals. As mentioned earlier, the goal of this policy was to develop the St. Lawrence route as the preferred itinerary for American exports to Europe. Simultaneously, and again to foster Central Canada's development, railway construction projects were put in place with government support (Easterbrook and Aitken. 1958. 294-319).

One must note that this government policy to stimulate economic development was not geographically neutral. It was concentrated in central Canada: “when the decade of the 1850's closed there was still no railway in existence between the colony on the St. Lawrence and the maritime colonies of New Brunswick and Nova Scotia. Nor was there any railway in existence or even seriously considered [...] between Canada and the struggling British colony on the Pacific coast” (Easterbrook and Aitken. 1958. 318).

A Protectionist Canada: the National Policy

The American Civil War, which was a source of increased demand for Canadian products, also became one of the reasons why the United States chose not to renew the Reciprocity Treaty. At the end of the war, the new government favoured a policy committed to high tariffs and industrial expansion (Easterbrook and Aitken. 1958. 361). Furthermore, some in the United States suspected Canadians to have favoured the South during the war.

When the United States put an end to the period of free trade in 1864, the various British Colonies, in some analysts' opinion, chose Confederation as a Second Best solution. North-South links were more natural and the development of an east-west Canadian economy was an exercise against the tide (Hébert. 1988. 78-79). An illustration of this is the fact that during the infancy stage of Canada, it attempted on various occasions to negotiate a new free trade deal with the United States, only to meet an unwilling partner.

It is in this context that in 1879, Canada finally went forth with its "National Policy" which substantially increased tariffs on semi-finished goods, industrial materials, manufactured equipment and finished consumer goods (Gunderson. 1998. 212-213; Pomfret. 1993. 97; Hébert. 1988. 79). It is noteworthy to point out that this movement towards a high tariff policy originated in what was – and is still – Canada's industrial heartland: the Toronto-Hamilton region. (Easterbrook and Aitken. 1958. 372).

The period between 1879 and 1887 saw a refinement and extension of the National Policy tariff. To further promote the development of this east-west economy, the completion of a transcontinental railway and a policy of colonisation in western Canada then became national objectives.

The Maritimes seem to have gained initially from Confederation. Its manufacturing sector (e.g. processing wood, leather, textiles, etc.) experienced rapid expansion for approximately 20 years. Unfortunately, the region did not manage to maintain this trend. Some argue that this poor economic performance is the result of the loss of comparative advantage in natural resources coupled with the great distance to important markets and the concentration of the financial sector in central Canada (Desjardins, Deslierres and LeBlanc. 1995. 219). In central Canada, the National Policy was becoming an attempt to protect infant manufacturing industries from U.S. competition (Anderson. 1998. 161)

The 20th Century

As second period of protectionist trade policy corresponds to the Great Depression. Between 1930 and 1933, what became known as Bennett tariffs were put in place as much as a reaction to U.S. protectionism as a formula to fight high levels of unemployment in Canada (Pomfret. 1993. 97).

After World War II, Canada has been a consistent participant to GATT and the WTO. Through the successive GATT rounds (Kennedy, Tokyo and Uruguay) Canada has

gradually reduced its level of trade protection (Brown. 1998. 296). Before the recent wave of bilateral trade agreements (FTA and NAFTA), only in 1965 did Canada modify this strategy.

A defining moment in Canada's contemporary economic development was the bilateral sectoral trade agreement signed, in 1965, with the United States. It became commonly known as the Auto Pact (Anderson. 1998. 161; Polèse. 1996. 285; Pomfret. 1993. 103). Its ultimate impact was to rationalise the North American automobile production sector: the objective was to generate economies of scale for the big three U.S. automobile manufacturers by creating for them a single Canada-U.S. market. This policy became a tremendous stimulus for central Canada's economy.

Free Trade, Round 2

In 1989, Canada entered a bilateral trade pact with the United States (Canada-U.S. Free Trade Agreement – FTA) which arguably had as much a psychological as a direct economic impact on the country. It was a firm break from the longstanding policy of trying to benefit from the United States proximity while at the same time maintaining barriers between the two countries.

Later, Canada and the United States extended the FTA to include Mexico. Canada's decision to take part in the North American Free Trade Agreement (NAFTA) was as much a defensive action as anything else. The alternative would have been a situation often characterised as “hub and spoke” where the United States would have

negotiated bilateral agreements and in effect built itself a comparative advantage by having free access to markets not as open to its other partners (Britton. 1998. 171).

The NAFTA per se did not impede national governments from having in place regional development programs. In fact, it did directly put in place neither new rights nor obligations concerning subsidies in general. As far as regional development initiatives were concerned, NAFTA stipulated that national governments remained free to support economic activities to achieve objectives such as those pertaining to regional development. This being said, any government measure which causes significant damages to other country's producers is countervailable (Affaires extérieures et Commerce extérieur Canada. 1993. 17).

Note in closing that Canada has always had an array of non tariff barriers (NTB), although these were usually used for reasons other than protection and, generally, were less important than in other countries (Pomfret. 1993. 97).

The Political Economy of Trade

Today's Canadian economy is the direct result of protectionist policies. It was fostered by the National Policy. In fact, the industrialisation of central Canada was supported both by protectionist policies and the conscious stimulation of east-west trade flows. The development of Canada's industrial heartland also benefited from several other measures to contribute to its development, including infrastructure development and policies supporting R&D and the adoption of new process technology (Britton. 1998. 178).

As mentioned earlier, railways have constituted a tool to foster trade, both internationally and interprovincially. For the Maritime provinces, this transportation infrastructure developed in the later part of the 19th century constituted a means of reducing the cost of transporting resources like coal and lumber to markets in central Canada. For central Canada, not only did these rail links enable it to sell part of its manufacturing production on Maritimes markets, it enabled its industries to access international markets through the port of Halifax, for example, when the St. Lawrence seaway was frozen in the winter, as well as to suffocate potential competitors from the Maritimes by exposing them to harsh competition from central Canada (Pomfret. 1993. 136).

For western Canada, whose economy arguably was the most ill served by Canada's protectionist policy during the second part of the 19th century, the Crow's Nest Pass Agreement of 1897 became a key government tool to help the region transport its grain production eastward. This was achieved when federal government gave the Canadian Pacific Railway (CPR) subsidies in return for lower rates for grain transportation (Pomfret. 1993. 144).

The data

Historical trade data prior to 1926 is unreliable at best. Starting our quantitative analysis at that point, we see that Canada's trade was adversely affected by the Great Depression, as can be expected (Polèse. 1996. 284). In 1931, international trade –measured as a

percentage of GDP – fell to 10% before increasing to approximately 20% in the 1940s, a direct consequence of World War II. The situation remained relatively stable during the 1950s, with even a slightly decreasing trend over the period. But since the early 1960s, a very clear and constant trend has emerged: international trade accounts for more and more of Canada's economic activity. Notwithstanding a slight shortfall during the 1988-1992 recession, international trade as a percentage of GDP has consistently increase to generate over a third of the country's economic activity by 1995.

A very important characteristic of trade data is the place occupied by the United States in Canada's trade. The United States are now the destination of over 80% of Canada's exports (Polèse. 1996. 286). It has not always been the case. The United States only became Canada's principle trading partner after World War II. Before 1939, the United States represented at most 40% of Canada's exports destination. As we indicated earlier, Canada's southern neighbour was omnipresent throughout Canada's development. Data shows that notwithstanding the various trade policies undertaking by Canada, the United States relative importance grew constantly.

What has in fact happened since 1945 is the continentalisation of the Canadian economy. Ontario has greatly benefited from this trend, with its strategic location, close to United States' mid-west. This trend accelerated even before the FTA and NAFTA. For example, Ontario's share of national exports has increased from 50% in 1979 to 58% in 1990. At the same time, Atlantic Canada's share of national exports has decreased from 6,6% to 4% (Polèse. 1996. 294).

What might be an even more significant trend, especially in the context of a federation like Canada, is the decreasing importance of interprovincial trade (Polèse. 1996. 296-297). Canada's two most populous provinces, Ontario and Québec, have seen the relative importance of interprovincial trade for their respective economy decrease significantly over the past few decades.

In Québec's case, three decades ago, interprovincial manufacturing trade doubled international manufacturing trade measured in dollar value. In 1990, the relative importance was reversed: to use Polèse's expressions, Québec is slowly experiencing a globalisation – or one could say americanisation or continentalisation – of its economy paralleled by the de-canadianisation of that economy.

The trend in Ontario is even stronger: international trade overtook interprovincial trade in importance in the early 1980s. In 1990, international trade had actually more than doubled interprovincial trade in relative importance, the greatest part of the former being trade with the United States.

What we are experiencing is in fact the strengthening of regional cross-border economies (Brown and Anderson. 1999; Brown. 1998; Gunderson. 1998). There is a trend for every Canadian region to be more or less integrated with neighbouring U.S. regions: Atlantic Canada and New England; Québec and New England; Ontario with the Great Lakes, Mid Atlantic and South Atlantic states; the Prairies with the Plains;

Alberta/BC with the Rocky Mountains and the West. This is not a one way relationship: U.S. regions are also integrated with neighbouring Canadian regions, although the level of integration from a U.S. perspective is smaller. This may very well be a reflection of the relative size of the national economies.

All this being said, the Canada-U.S. border is still an important factor. McCallum (1995) has estimated that for 1988, in a borderless Canada, interprovincial (east-west) trade would account for 4% of shipments rather than the 23% found. Trade destined to the United States should account for 43% of shipments instead of 24%! McCallum recognises that his data predates both FTA and NAFTA, but argues that “it is not a foregone conclusion that NAFTA will lead to a radical shift in Canadian trade patterns over the next decade or so” (McCallum. 1995. 622).

McCallum is correct to say that Canadian trade patterns will not experience a dramatic shift in the short term, but there does seem to be a definite trend towards relatively greater north south trade (Britton. 1998. 179; Polèse. 1996). Using the international shift-share technique to compare the geographical engines of growth of provincial economies we find that this trend towards the continentalisation of Canada’s economy is far from homogeneous (please see Tables 1-5 in the Appendix).

Dividing the traditional components into sub-components, we went on to analyze the impact of U.S. imports and exports, non-U.S. imports and exports and of the national domestic demand for the three traditional components: national, industry-mix and

regional shifts.⁴ We found that overall, the national shift sub-components suggested a weakening of east-west trade, a strengthening of north-south trade and a weakening of trade with countries other than the U.S.

The results for the sub-components of the industrial-mix shift were less conclusive. Overall, only two provinces seemed to perform better on the U.S. market in the second period than in the first. No province performed better on international markets other than the U.S. Finally, only three provinces (Quebec, Ontario and British Columbia) experienced a decline in the relative importance of the domestic demand shift.

The results for the regional shift component were relatively similar to those for the industry-mix component. Three provinces fared better in the second period than in the first on the U.S. market. For non-U.S. international markets, six provinces performed better. Finally, all provinces but New Brunswick, Quebec and Ontario saw the value of their domestic demand shift increase.

Given these contradictory results, we had to look at alternative aggregates, which we present in Tables 4 and 5. Isolating the import, export and domestic demand shifts, we found that indeed four provinces experienced an overall decrease in the relative value of their domestic demand shift. These are New Brunswick, Quebec, Ontario and British Columbia. All but three provinces experienced a relative increase of the export shift, while two had a relative increase of their import shift.

⁴The following section presents a summary of the results found in Chapter 11 of

The final piece of the puzzle is offered by Table 5. We find that eight of Canada's ten provinces have the greatest share of growth resulting from domestic demand shift. The two exceptions are Ontario, with U.S. trade as its principal source of growth, and New Brunswick, with non-U.S. trade as its principal source of growth.

Six provinces had the relative importance of their U.S. trade shift increase. There also were six provinces with relatively greater non-U.S. trade shifts. Finally, four provinces had the relative importance of domestic demand decrease. These four provinces have demonstrated a weakening of east-west links while strengthening their north-south trade. These provinces are Quebec, Ontario, British Columbia and New Brunswick. New Brunswick's situation is peculiar in that the relative increase of its non-U.S. trade shift is much greater than that for U.S. trade.

We can conclude that the U.S. economy is increasingly important for Canada's economic development, but significantly more so for Canada's biggest provincial economies.

INTERNAL TRADE AND THE ECONOMIC UNION

Section 121 of the Constitution Act, 1982 guaranteed the free flow of goods within the economic union. It did not, however, make explicit reference to the free flow of capital

Desjardins, 1997. 199-239.

and labour within the economic union.

Federal-provincial negotiations directed at enhancing internal free trade repeatedly met with failure. The Federal government adopted an alternative tack to intergovernmental negotiations in 19** , incorporating language about free trade as part of its proposals for constitutional reform.

First, it was proposed that the common market clause (section 121 of the Constitution Act, 1867) be broadened. Second, it was proposed that the federal government be given a specific mandate to manage the economic union. This proposal would have required an extension of the existing section 91. Third, it was proposed that existing areas of provincial jurisdiction be respected and, in some cases, extended. In particular, any future use of the spending power would be restricted.

With regard to the common market clause, the existing prohibition on barriers to the free trade of goods among provinces would be broadened to include the free movement of services, capital, and labour. Exceptions would be allowed for reasons of national interest, for regional development, and, notably, for any federal legislation enacted to further the principle of equalization. Specifically, proposal 14 to extend the existing section 121 stated:

- (1) Canada is an economic union within which persons, goods, services and capital may move freely without barriers or restrictions based on provincial or territorial boundaries.

(2) Neither the Parliament or Government of Canada nor the legislatures or governments of the provinces shall by law or practice contravene the principle expressed in subsection (1).

An important qualification was, however, provided in subsection (3) of the proposal:

- (3) Subsection (2) does not render invalid
- (a) a law of the Parliament of Canada enacted to further the principles of equalization or regional development;
 - (b) a law of provincial legislatures enacted in relation to the reduction of economic disparities between regions wholly within a province that does not create barriers or restrictions that are more onerous in relation to persons, goods, services or capital from outside the province than it does in relation to persons, goods, services or capital from a region within the province; or
 - (c) a law of the Parliament of Canada or the legislature of a province that has been declared by Parliament to be in the national interest.

Finally, there was an important provision directed at ensuring provincial agreement:

- (4) A declaration referred to in paragraph (3)(c) shall have no effect unless it is approved by the governments of at least two-thirds of the provinces that have, in aggregate, according to the then latest general census, at least 50 percent of the population of all the provinces.

With regard to the management of the economic union, this area was recognized to be one of necessarily joint responsibility, requiring provincial concurrence and some provision for opting out. Legislation affecting the economic union would be voted on in a proposed Council of the Federation. Specifically, proposal 15 was to add new section 91a to the Constitution Act, 1867, which would read as follows:

- (1) Without altering any other authority of the Parliament of Canada to make laws, the Parliament of Canada may exclusively make laws in relation to any matter that it declares to be for the efficient functioning of the economic union.
- (2) An Act of the Parliament of Canada made under this section shall have no effect unless it is approved by the governments of at least two-thirds of the provinces that have, in the aggregate, according to the then latest general census, at least 50 percent of the population of all the provinces.
- (3) The legislative assembly of any province that is not among the provinces that have approved an Act of the Parliament of Canada under subsection (2) may expressly declare by resolution supported by 60 percent of its members that

the Act of Parliament does not apply in that province.

- (4) A declaration made under subsection (3) shall cease to have effect three years after it is made or on such earlier date as may be specified in the declaration.²¹

One interpretation of the proposals is that as long as the federal government could ensure the integrity of the economic union through section 91a and the amendment to section 121, it would be willing to transfer explicit jurisdiction to the provinces in other areas. Within this framework, it was argued that labour market training could be recognized explicitly as an area of exclusive provincial jurisdiction, and that federal spending could be withdrawn from that and other areas that are most appropriately viewed as being areas of provincial jurisdiction, such as tourism, forestry, mining, recreation, housing, and municipal affairs. Of course, the withdrawal of federal spending would not preclude the establishment of future federal-provincial cost-sharing agreements and other legislation in areas that are aimed at enhancing the functioning of the economic union.

With regard to the use of the spending power in areas of exclusive provincial jurisdiction, it was proposed that no new shared-cost programs or other forms of conditional transfers that affect areas of exclusive provincial jurisdiction be introduced without the agreement of at least seven of the provinces representing 50 percent of the population. In addition, “reasonable compensation” would be made to those provinces

(up to three) that choose to opt out, provided that they establish their own programs consistent with national objectives. This proposal appears to weaken the spending power as an instrument of federal policy. In contrast to the Meech Lake provision that allowed for opting out only, this proposal would require the federal government to gain the prior consent of the necessary number of provinces to establish new shared-cost programs. Again, the form of the compensation for opting out was not spelled out.

The aim of proposal 14 was so-called negative integration--the elimination of barriers that interfere with the efficient functioning of the economic union--and the aim of proposal 15 was so-called positive integration--the pursuit of policies that enhance the efficient functioning of the economic union. In this regard, the exception made for federal laws that further the principles of equalization and regional development deserves comment.

First, it can be argued that a fully effective equalization system is an instrument of positive integration: it enhances the efficient functioning of the economic union. Indeed, a central thesis of this study is that a variety of federal-provincial redistributive programs enhance efficiency. In this light, no exception is needed for “equalization” in the economic union proposals.²² Furthermore, since the power to make equalization payments appears to fall well within the federal government’s existing constitutional authority, it would not be affected by the provisions of proposed section 91a.

Second, the exceptions for federal laws enacted to further the principles of

equalization and regional development and for provincial laws aimed at the reduction of intraprovincial regional disparities mesh proposed section 121 with existing section 36 of the Constitution Act, 1982. Section 36 defines equalization as the promotion of equality of opportunity as a commitment of both levels of government, including the furthering of economic development to reduce disparities in opportunities and the provision of essential public services of reasonable quality to all Canadians. It might be argued that this meshing of the efficiency-oriented economic union clause with the equity-oriented equality of opportunity clause would provide some guidance to the courts in the event of a challenge under proposed section 121 to some aspect of federal or provincial social policies. The implication is that equity considerations may take precedence over efficiency considerations in the application of common market principles.²³

The Internal Trade Agreement

Ultimately, constitutional change eluded policy makers. Instead, renewed efforts were made at achieving intergovernmental agreement. The Agreement on Internal Trade (AIT). The goal of the AIT is to eliminate barriers to trade, investment and mobility within Canada. It came into force on July 1, 1995. Being an evolutionary process, it is regularly updated.

The Agreement on Internal Trade six general rules are: (Internal Trade Secretariat)

- *Non-discrimination*: establish equal treatment for all Canadian persons, goods, services and investments.
- *Right of entry and exit*: prohibiting measures that restrict the movement of

- persons, goods, services or investments across provincial or territorial boundaries.
- *No obstacles*: ensuring provincial/territorial government policies and practices do not create obstacles to trade.
 - *Legitimate objectives*: ensuring provincial/territorial non-trade objectives which may cause some deviation from the above guidelines have a minimal adverse impact on interprovincial trade.
 - *Reconciliation*: providing the basis for eliminating trade barriers caused by differences in standards and regulations across Canada.
 - *Transparency*: ensuring information is fully accessible to interested businesses, individuals and governments.

Note that under article 508 of the Agreement, a party may under exceptional circumstances exclude a procurement for regional and economic development purposes. Furthermore, article 1801 states that: “the Parties recognize that measures adopted or maintained by the Federal Government or any other Party that are part of a general framework of regional economic development can play an important role in encouraging long-term job creation, economic growth or industrial competitiveness or in reducing economic disparities.” Consequently, several components of the Agreement do not apply to measures adopted or maintained by the Federal Government or any other Party that is part of a general framework of regional development. (Internal Trade Secretariat. 1999).

MEASURES OF ECONOMIC AND FISCAL INEQUALITY

Economic Indicators by Province

Table 1 lists data by province on (i) GDP per capita, (ii) GDP per worker, (iii) unemployment rates, and (iv) labour force participation rates. These data reveal a wide dispersion in GDP per capita, ranging from 73% of the average to 140% of the average. All four Atlantic provinces (Newfoundland, Prince Edward Island, Nova Scotia, and New Brunswick) are below average; all Western provinces are above average. Nonetheless, there is some indication of convergence over time.

Table 1
Economic Indicators by Province, 1996
(Ratio to All Province Average of 100)

	Nominal GDP per capita	Nominal GDP per worker	Unemployment Rate	Labour Force Participation Rate
Newfoundland	73	96	178	84
Prince Edward Island	82	83	134	104
Nova Scotia	82	89	115	95
New Brunswick	86	93	107	95
Québec	99	101	108	101
Ontario	119	111	82	106
Manitoba	100	95	69	101
Saskatchewan	107	105	60	98
Alberta	140	122	65	111
British Columbia	112	106	81	105

Source: Adapted from Coulombe⁵

There is less dispersion in GDP per worker, ranging from 83% of the national average to 122%. The Atlantic provinces remain below average, but are closer to that average. Again, there appears to be evidence of convergence over time.

There is wide dispersion in unemployment rates, ranging from 60% of the national average in Saskatchewan to 178% of the national average in Newfoundland. All Atlantic provinces are above average; all Western provinces are below average. There is no indication of convergence over time.

Finally, labour force participation rates range from 84% of average to 111% of

⁵ Serge Coulombe, "Economic Growth and Provincial Disparity: A New View of an Old Canadian Problem", C.D. Howe Institute Commentary (Toronto: C. D. Howe Institute, 1999).

average. There does appear to be some convergence over time.

Table 2 presents data on provincial shares in population and GDP for 1996. The Atlantic provinces as a whole account for roughly 6% of national GDP. This is, however, less than the region's population share of roughly 8%.

Table 2
Shares of Population and GDP by Province, 1996
(per cent)

	Population Share	GDP Share
Newfoundland	2	1
Prince Edward Island	.5	.3
Nova Scotia	3	2
New Brunswick	3	2
Québec	25	22
Ontario	38	40
Manitoba	4	3
Saskatchewan	3	3
Alberta	9	12
British Columbia	13	13

Source: Author's calculations based on data provided by the Federal-Provincial Fiscal Relations Division, Finance Canada.

Fiscal Indicators by Province

At a crude level, Table 2 would suggest that the Atlantic region's share of total provincial revenues based on GDP would be less than its share based on population—a measure of fiscal disparity, where the standard is equal per capita revenues.

Fiscal disparity is to some extent a symptom of economic disparity. It is more

than this, however, since fiscal disparity can reflect as much differences in the *composition* of provincial GDP per capita as differences in the *size* of provincial GDP per capita.

Table 3 provides detail on provincial fiscal capacities.⁶ The first column shows that own-source revenue generating capacity ranges from 66% of average to 141%--a high/low ratio of 2.13. All Atlantic provinces are below average; also Manitoba and Saskatchewan; also Quebec. These are the, so-designated, have-not provinces.

Table 3
Indices of Fiscal Capacity,
Fiscal year 1996/97

	Own Revenues (Standardized)		Own Revenues plus Equalization		Own Revenues plus Equalization and CHST	
	(\$ per capita)	(% of national average)	(\$ per capita)	(% of national average)	(\$ per capita)	(% of national average)
Newfoundland	3,480	66	5,278	95	5,895	97
Prince Edward Island	3,751	71	5,258	95	5,785	96
Nova Scotia	3,942	75	5,199	95	5,748	95
New Brunswick	3,956	75	5,269	95	5,804	96
Québec	4,622	88	5,181	95	5,805	96
Notario	5,408	103	5,408	97	5,846	97
Manitoba	4,218	80	5,212	95	5,742	95
Saskatchewan	5,067	96	5,287	95	5,783	96
Alberta	7,407	141	7,407	133	7,816	129
British Columbia	5,681	108	5,681	102	6,155	102
All provinces	5,254	100	5,551	100	6,052	100
High/low		2.13		1.43		1.36

⁶ Fiscal capacities are measured in terms of per capita revenue generating capacities, based on the Representative Tax System (RTS). The RTS defines a set of standardized provincial tax bases and assesses revenue generating capacity relative to a national average tax rate.

Source: Author's calculations based on data provided by the Federal-Provincial Fiscal Relations Division, Finance Canada

The Equalization program reduces the degree of fiscal disparity. Equalization transfers to have-not provinces, designed to raise their per capita revenues to a defined standard, result in fiscal capacities that range from 95% of the national average to 133% of the national average. If cash transfers under the Canada Health and Social Transfer (CHST) are taken into account, fiscal capacities vary between 95% of the national average and 129% of the national average.

REGIONAL DISPARITY AND THE CONSTITUTION ACT, 1982

Section 36 of the Constitution Act, 1982, entitled "Equalization and Regional Disparities", is of particular relevance here. It contains two parts, which read as follows:

- (1) Without altering the legislative authority of Parliament or of the provincial legislatures, or the rights of any of them with respect to the exercise of their legislative authority, Parliament and the legislatures, together with the government of Canada and the provincial governments, are committed to
 - (a) promoting equal opportunities for the well-being of Canadians;
 - (b) furthering economic development to reduce disparity in opportunities; and
 - (c) providing essential public services of reasonable quality to all Canadians.
- (2) Parliament and the government of Canada are committed to the principle of making equalization payments to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation.

These provisions seem to have two sorts of effects on federal responsibilities and obligations. First, section 36(1) explicitly recognizes the pursuit of equity as a national

objective that is the joint responsibility of the federal government and the provinces. This is important since much of what both the federal and provincial levels of governments do has a significant equity dimension. Thus, to the extent that the federal government has an interest in the equitable delivery of provincial programs, section 36(1) could be used to justify federal involvement in provincial programs through the spending power. Section 36(1) also enshrines equality of opportunity as an added dimension of equity. That is, it goes beyond a commitment to the provision of reasonably comparable public services at reasonably comparable levels of taxation; it commits also to equality of economic opportunity through regional development policy.

Second, section 36(2) imposes an obligation on the federal government to pursue equalization objectives, or at least commits it to the principle of making equalization payments. The section does not restrict what is meant by an equalization payment; it could include any sort of federal-provincial transfer that has equalizing consequences. As discussed later, Canada's Equalization system, that provides for payments from the federal government to the poorer provinces, contributes explicitly to this objective. Other transfer schemes, however, do so implicitly. If taken literally, section 36(2) could have serious implications not only for the structure of the formal Equalization scheme itself, but for other major federal-provincial transfers as well. It should be noted that it is not clear to what extent section 36(2) is legally binding, or justiciable, on the federal government—it is stated as a general principle rather than as a specific obligation.

THE POLICY RESPONSE

Appropriately, Canada has developed two strands of policy response in the face of regional inequality: Regional development policies and policies directed at equalizing provincial fiscal capacities. Regional economic development policies have, typically, had their origins in the policy “objective of equality of opportunity”—that Canadian’s have the right to live and work in the location of their choice. Policies directed at equalizing provincial fiscal capacities have had their origins in the notion of fiscal equity—that Canadian’s have the right to comparable levels of public services at comparable levels of taxation, regardless of province of residence.

Regional Development Policy

Regional development remains a relatively new policy field in Canada. Indeed, the federal government had no explicit policy of regional development from Confederation to the late 1950s. It has since, however, made up for lost time. From its modest beginnings, regional development policy has seen many dramatic twists and turns over the past thirty years.

Rarely have political leaders been satisfied for very long with the various new approaches introduced. To be sure, the search for a panacea, for a quick fix, has been a factor, as has the need to update the policy to reflect changing economic circumstances. But the desire by Ottawa to secure "visibility" and "due credit" for federal money spent has been equally important - if not more so - in defining and redefining Canadian regional development policy. The point is that federal regional development efforts have been as much about politics as they have been about economics.

The purpose of this section is to review briefly the historical evolution of Canada's regional development policy, how intergovernmental relations in the field have developed and to report on their success or lack of success. It seeks to provide a broad perspective by looking not only at the substance of the policy but also at the forces that have shaped regional development efforts. Finally, it identifies "lessons learned" from past efforts.

An Alphabet Soup

Though the matter had been debated many times in royal commission reports and at federal-provincial meetings, it was the 1960 budget speech that unveiled the first of the many measures Ottawa has developed to combat regional disparities.⁷ The budget permitted firms to obtain double the normal rate of capital-cost allowances on most of the assets they required to produce new products -if they located in designated regions.⁸ The thinking behind this initiative was that "footloose" industries could be attracted to slow growth regions. However, the thinking neglected to note the fact that well-run "footloose" industries can locate anywhere they like, but "where they like" is usually where they are now.⁹ Shortly after, Parliament passed the Agriculture Rehabilitation Act (ARDA) in an attempt to rebuild the country's depressed rural economy.¹⁰ ARDA was a federal-

7. See James P. Bickerton, *Nova Scotia, Ottawa and Politics of Regional Development* (Toronto: University of Toronto Press, 1990) and Donald J. Savoie, *Regional Economic Development: Canada's Search for Solutions* (Toronto: University of Toronto Press, 2nd edition, 1992).

8. See, among others, Anthony Careless, *Initiative and Response: The Adaptation of Canadian Federalism to Regional Economic Development* (Montreal: McGill-Queen's University Press, 1977).

9. See, for example, Benjamin Higgins, *Entrepreneurship and Economic Development: Moncton and Cape Breton* (Moncton: Canadian Institute for Research on Regional Development, 1992), p. 28.

10. Ibid.

provincial effort designed to increase the productivity of small farmers by providing assistance for alternative use of marginal land, developing water and soil resources and setting up projects to support people in non agriculture natural-resources industries. The initiative was soon found wanting, largely because it was not sufficiently flexible and lacked a clear geographical focus.

ARDA thus beget FRED (Fund for Regional Economic Development) in 1966. FRED did have a clear geographical focus. It was concentrated in five designated regions with widespread low incomes and major problems of economic adjustment. Typically, a FRED plan provided for industrial development measures, employment-development activities and industrial infrastructure. Soon, however, FRED was found wanting from both a technocratic and political perspective. As for the technocratic view, senior government officials felt that FRED made little provision for coordinating a growing number of federal and federal-provincial initiatives in the economic development field. They were also convinced that in concentrating as it did on some of the poorest regions in the country, FRED was far too restrictive to meet the challenges of the 1970s.¹¹

FRED thus gave way to the Department of Regional Economic Expansion (DREE). Established in 1969, it introduced two major new programs. One was designed to attract private sector investment to slow growth regions through cash grants. The other - labelled the Special Areas Program - was designed to promote faster industrial growth. In the case

11. T.N. Brewis, "Regional Development in Canada in Historical Perspective," in H. Lithwick (ed.), *Regional Economic Policy: The Canadian Experience* (Toronto: McGraw-Hill Ryerson, 1978), p. 220.

of the latter, twenty-three areas were designated and each became the subject of a federal-provincial agreement. DREE borrowed from François Perroux's growth pole concept - or at least thought it did - to give life to its Special Areas Program. Perroux had argued that economic activity tends to concentrate around certain focal points. Growth, he wrote: "does not appear everywhere and all at once, it reveals itself in certain points or poles, with different degrees of intensity; it spreads through diverse channels."¹² The federal government embraced Perroux's views mainly because it seemed to describe Canada's situation well. For senior DREE officials, the main difference between Ontario and the Maritimes was that Ontario had major urban centres with vigorous economic growth to which people from northern Ontario could move. The Maritimes had few cities capable of strong growth and providing employment; consequently, many people remained in economically depressed rural areas. The growth pole concept, it was believed, would create new opportunities at selected urban centres. Economic growth would take place through movement and change within regions, rather than between regions.

Within a few short years, DREE decided to scrap its Special Areas Program. The reason given was that the approach was too "restrictive," that its concentration on a limited number of areas incurred the risk of overlooking economic development opportunities elsewhere. Henceforth, DREE would "pursue viable" opportunities whether they were in urban or rural areas, though it would be preferable if they were located in slow growth regions, and priority status would still be given to these. In 1973, the department

12. François Perroux, *L'Économie du XXe siècle* (Paris: Presses universitaires de France, 1969), p. 179.

introduced a new approach - the General Development Agreement (GDA).¹³ It was remarkably flexible, capable of supporting virtually any imaginable type of government activity. Negotiated by Ottawa with all provinces except Prince Edward Island (which was already covered by the fifteen year FRED plan), a GDA provided a broad statement of goals for both levels of government to pursue, outlined the priority areas, and described how joint decisions would be taken. GDAs were enabling documents only and did not in themselves provide for specific action; projects and precise cost-sharing arrangements were instead presented in subsidiary agreements that were attached to the umbrella-type GDAs.

From a strictly administrative point of view, all nine GDAs were basically similar. Each had a ten-year life span; each stipulated that DREE and the provincial government in question would, on a continuing basis, review the socio-economic circumstances of the province; and each outlined a similar process for joint federal-provincial decision-making. They differed only in cost-sharing for subsidiary agreements. Under the GDA approach, DREE was granted the following authority to share the cost of a subsidiary agreement: up to 90 percent for Newfoundland, 80 percent for Nova Scotia and New Brunswick, 60 percent for Quebec, Manitoba, and Saskatchewan, and 50 percent for Ontario, Alberta, and British Columbia.¹⁴ The variety of projects supported under the various GDAs was truly remarkable. Virtually every economic sector was covered, particularly in the Atlantic provinces. GDAs sponsored, among *many* others, projects in tourism, urban development, the fishery, recreation, mineral development, rural development, agriculture, forestry,

13. See Donald J. Savoie, *Federal-Provincial Collaboration: The Canada-New Brunswick General Development Agreement* (Montreal: McGill-Queen's University Press, 1981).

industrial development, communications, cultural infrastructure, and ocean-related industries.¹⁵

By the late 1970s, however, DREE was being assailed from a number of quarters, but particularly from central agencies in Ottawa. For one thing, the country's economic picture had changed since DREE was first established. The term stagflation had crept into the economic vocabulary and Canada's industrial heartland - that is, the economy of southern Ontario and Montreal - was getting "soft."¹⁶ The Liberals lost the 1979 election and the Conservative Clark government's tenure in office was too short lived to reform regional development policy in any meaningful way. Returned to office in 1980, the Trudeau government quickly set out to revamp Ottawa's economic development policies, in particular those related to regional development. Underpinning the new economic thinking was the view that "regional balance was changing as a result of buoyancy in the West, optimism in the East and unprecedented softness in key economic sectors in central Canada."¹⁷ The economic prospects associated with resource-based megaprojects in Atlantic Canada (Sable Island and Hibernia) and the West, at least in part, gave rise to the new thinking. The solution was to encourage a "good" investment climate and market access in the West and East where large investments were bound to take place and to put in

14. Ibid.

15. Ibid. See also Savoie, *Regional Economic Development*, 1992, chapter 5.

16. Ottawa, Department of Finance, *Economic Development for Canada in the 1980s*, November 1981.

17. Ibid.

place measures to draw resources from declining industries and move them into growth sectors in central Canada.

So DREE beget MSERD and DRIE. Both new departments were established in 1982 with MSERD (Ministry of State for Economic and Regional Development) designed to play a central agency role coordinating line department activities and DRIE (Department of Regional Industrial Expansion) designed to deliver a regional industrial program based on a "development" index.¹⁸ The index established the needs of individual regions, as far down as a single census district, with all regions arranged in four tiers of need. The first tier, which covered 58 percent of the population, covered the most developed regions of the country while the fourth, which included 5 percent of the population, covered the regions with the greatest need (based on level of employment, personal income, and provincial fiscal capacity). The thinking behind this initiative was that the private sector *everywhere* in Canada needed government assistance to locate, to expand or to modernize. MSERD became responsible for the GDAs and quickly began replacing them with a "new and simpler set of agreements with the provinces, involving a wider range of federal departments."¹⁹ The agreements were labelled "Economic and Regional Development Agreements" (ERDAs), but in time came to resemble very closely the GDAs they replaced. The one important difference was a provision that would allow the federal government to deliver directly certain programs and initiatives rather than always having the provincial governments deliver them, as was the case with the GDAs.

18. Ottawa, DRIE, "Speaking Notes - the Honourable Ed Lumley to the House of Commons on the Industrial and Regional Development Program," 27 June 1983, pp. 1-2.

19. Ottawa, Office of the Prime Minister, "Reorganization for Economic Development," (News Release), 12 January 1982.

During his brief tenure as prime minister, John Turner declared his intention to streamline federal government operations which, in his opinion, had become "too elaborate, too complex, too slow and too expensive."²⁰ He abolished two central agencies, including MSERD and turned responsibility for the ERDAs over to DRIE.

Brian Mulroney came to office in 1984 determined to "inflict prosperity on Atlantic Canada."²¹ Though slow off the mark, the government tried after several months in office to redirect more DRIE funding to slower growth regions. Within a few years, however, it became clear that the government would have to overhaul its regional development policy completely. The four Atlantic premiers, as well as many business groups in the Atlantic region, became extremely vocal in their criticism of Ottawa's regional policy. DRIE was accused of being extremely "bureaucratic" and not sufficiently concerned with the economic difficulties of the Atlantic provinces. In addition, the resource-based megaprojects never materialized in Atlantic Canada and in the West and the "unprecedented softness" in central Canada suddenly disappeared. Indeed, by the mid to late 1980s, the Ontario economy, if anything, was overheating. Atlantic premiers made the case that DRIE, by focusing many of its efforts in central Canada, was exacerbating the "regional disparities" problem. They argued that it was "better to have no federal regional programming at all than to have DRIE [and] DRIE programs favouring central Canada."²²

20. "Trudeau-Pitfield Bureaucracy First Item on Turner's Overhaul," *Globe and Mail*, 2 July 1984, p. 5.

21. Quoted in Savoie, *Regional Economic Development*, 1992, p. 98.

In any event, Mulroney - as politicians are wont to do - wanted to put his own personal stamp on government policy, particularly on regional development which is a high profile and particularly popular policy field in slow growth regions.

DRIE thus beget three new agencies. In unveiling the Atlantic Canada Opportunities Agency (ACOA), Mulroney declared: "We begin with new money, a new mission and a new opportunity. The Agency will succeed where others have failed."²³ He gave ACOA \$1.05 billion of new money over 5 years and also transferred part of DRIE's budget - about \$1 billion - over 5 years. The newly appointed ministers and deputy ministers of ACOA declared early on that the agency would have "no Ottawa bureaucracy to answer to."²⁴ They designed a new program labelled ACTION which was essentially a continuation of incentives programs to the private sector first introduced as early as the pre-DREE days. ACOA also took over the ERDA agreements and renamed them Cooperation agreements. They, too, are remarkably similar to earlier agreements, whether the ERDAs or GDAs.

Mulroney's powerful Alberta minister, Don Mazankowski, also saw little prospect in working with DRIE, which was no more popular in the West than in Atlantic Canada. Mazankowski was determined to bring to the national agenda the need to diversify the western economy and pressured the government to announce an ACOA-type agency for

22. See Donald J. Savoie, *Establishing the Atlantic Canada Opportunities Agency - A report prepared for the Prime Minister* (Ottawa: Office of the Prime Minister, May 1987), p. 20.

23. See, among others, "PM Launches New Agency for Atlantic Canada," *Sunday Herald* (Halifax), 7 June 1987, p. 1.

western Canada. Several weeks after he had unveiled ACOA, Mulroney went to Edmonton to announce a new Western Diversification (WD) department.²⁵ This time, he announced that the new department would be allocated \$1.2 billion of new money, as well as responsibility for DRIE's budget in western Canada and the western ERDAs. Like ACOA, WD looked to modify an existing government program to launch its Western Diversification initiative.²⁶

On 15 July, 1987, yet another special agency was created to promote economic development - this time in Northern Ontario. The Federal Economic Development for Northern Ontario (FEDNOR) launched three new programs shortly after it was established, all of which were designed to support private sector investment in the region.²⁷

A new "national" industry department - the Department of Industry, Science and Technology (DIST) - was established to replace DRIE. DIST would retain regional development responsibilities for Ontario and Quebec and assume "sectoral" responsibility for Canadian industry. The department's focus, much to the delight of many of its senior officials, would become "national" and "sectoral" in scope rather than "regional."

24. "Two Maritimers Will Be in Control," *Daily Gleaner* (Fredericton), 8 June 1987, p. 3.

25. Ottawa, Office of the Prime Minister, Western Diversification Initiative - News Release, 4 August 1987.

26. See Savoie, *Regional Economic Development*, 1992, chapter 10.

27. Ottawa, Department of Industry, Science and Technology, *The FEDNOR Review*, 1989, p. 6.

Still, DIST was being asked to assume responsibility for federal regional development programs in Quebec. Ottawa decided to replace *Le Plan de l'Est*, a program dating back to DREE days, but which was scheduled to expire in March 1988, with a new province-wide agreement to develop Quebec's regions. It signed a five-year \$820 million ERDA subsidiary agreement with the Quebec government. Ottawa agreed to contribute \$440 million and Quebec \$380 million. With DIST having federal responsibility for the agreement, the funding was increased by an additional \$283 million in 1989. The agreement divides Quebec's regions into two broad categories: the central regions and the peripheral or resource regions. The central regions were awarded a larger share of the funds - \$486 million. The resource regions consist of eastern Quebec (Bas-St-Laurent, Gaspésie), the North Shore, the North-Centre (Lac St-Jean), the western region (Rouyn-Noranda), and the northern region (Abitibi). The central regions cover the rest of Quebec.²⁸

By the time the Chrétien government came to power in 1993, regional development had lost its political appeal. Chrétien had made firm commitments to strengthen Ottawa's regional development efforts in one of his five major policy statements in his successful attempt to become leader of the Liberal party. But he quickly lost interest in regional development when he became prime minister in 1993 and never acted on his commitment. Dealing with the country's difficult fiscal situation dominated the government's agenda for several years and one of Chrétien's most important legacy was his program review exercise.

28. See Ottawa, Department of Industry, Science and Technology, *Canada-Quebec Subsidiary Agreement on the Economic Development of the Regions of Quebec*, 9 June 1988, schedules B, C, and D.

The exercise, it will be recalled, eliminated 50,000 positions in the federal government, cut \$30 million in program spending and by 1997 program spending was reduced to 13 percent of GDP, the lowest level since 1951.²⁹ All areas of government activities were reviewed and regional development programs were certainly no exception. In the case of the Atlantic Canada Opportunities Agency, for example, the program review exercise cut about 40 percent of the agency program budget and made all assistance program to the private sector repayable.³⁰

But things changed in the year 2000. The Chrétien government had eliminated the deficit problem and it had to call a general election within 24 months. With public opinion surveys suggesting that the federal government had modest support in Canada, Chrétien went to Halifax on 29 June, 2000 to unveil a new approach to regional development. He gave ACOA \$700 million of new money to be invested in research and development, training and community economic development. However, Chrétien had precious little to say about the role of the provinces in his new approach. He spoke about several new partnerships with the private sector and established a new "Advisory Board" to guide federal government spending in the new economy. The role of the provinces, it appears, would be determined on an ad hoc or on an as needed basis.³¹

29. See, among others, Peter Aucoin and Donald J. Savoie, *Managing Strategic Change* (Ottawa: CCMD, 1998).

30. Donald J. Savoie, *Rethinking Canada's Regional Development Policy* (Moncton: Canadian Institute for Research on Regional Development, 1997).

31. See Background documents,

Evaluating the Alphabet Soup

Have the various federal government programs described above worked? It is not possible to produce an ironclad answer. In fact, it seems that the answer depends very much on who is asking the question and on who is providing the answer.

The reasons for this are varied. For one thing, federal government spending in regional development is very modest in the general scheme of things. There are a number of forces that invariably have a far greater impact on the health of Canada's regions than federal government regional development efforts. These include economic circumstances in the United States and Ontario, monetary policy, and fiscal policy. Accordingly, it is not possible to isolate regional development spending and make the case that it is directly responsible for new growth or new net jobs.

The goals and objectives of the GDAs, and the ERDAs and the Cooperation agreements were and remain extremely broad and of little benefit even as a checklist against which to assess proposed projects. New Brunswick's GDA did not, for example, prevent DREE from providing assistance for the construction of a marina for local pleasure-boat owners, highway construction, the establishment of a community college, and a new golf course. Such a variety of theoretical and policy frameworks makes it impossible to evaluate the effect of expenditures. Even evaluating the impact of individual federal-provincial agreements is very difficult, if at all possible.

The frequent changes of policy and organizational direction have posed yet another difficulty. Before a thorough assessment of one approach could be initiated, a new one would take its place. Insufficient time had elapsed to determine the effect of a particular program on a given sector. With a new policy announced, officials had little interest in assessing a program that was now history. For this reason alone, we will never know, for example, if the "growth pole" concept ever had much of an impact when it was applied to Atlantic Canada.

In addition, new policies and new approaches have been introduced for a number of reasons, not simply because existing ones were no longer effective. In fact, federal-provincial competition appears to have been largely responsible for at least two of the three major policy reviews. In 1973, the federal government sought to establish closer links with provincial governments by introducing the GDAs. By 1981, Ottawa concluded that it was not getting the credit to which it was entitled and decided to scrap these agreements. Since the principal motive behind two major policy reviews was federal-provincial tension, it may well be more appropriate to assess them from this perspective rather than from one of regional development. Certainly, the 1973 policy review placed the provinces in a favoured position in shaping new regional development initiatives. The 1982 review appears to have made it much more difficult for provinces to do so, with the federal government retaining the option of delivering certain projects directly. The establishment of ACOA, WD, and DIST, meanwhile, appears to have resulted from an urgent desire to deal with a crisis of confidence in DRIE, with strong pressure from the Atlantic region and the West to deal with their economies, which were not rebounding from the recession of the early 1980s,

and with a strongly held desire to chart a new course in regional development different from that followed by the Trudeau government. Chrétien's recent announcement also appears to be designed to enable him to put his own stamp on federal government efforts, to establish distance between the Mulroney years and his own time in office, and to win seats in Atlantic Canada in the upcoming general election.

Notwithstanding the above, there have been attempts to evaluate the effect of GDA- and ERDA-sponsored initiatives. The evaluations were incomplete — almost all concluded that more time was required — and were carried out either by federal-provincial committees of officials or by outside consultants.

Consultants and outside critics have also conducted numerous evaluations of regional development programs designed for the private sector. These programs in the past provided cash grants to businesses to locate or expand economic activities, but now provide loan guarantees or low interest loans. Evaluations have led to a variety of conclusions, favourable and unfavourable.

The Economic Council of Canada found that the incrementality of projects under one program to be between 25 and 59 percent and that of jobs between 35 and 68 percent. An investment project is considered incremental if the firm, without assistance, would not have undertaken the project or would have undertaken it outside the designated region. The lower rates, 25 and 35 percent, represent, according to the Council, a very conservative estimate of success. On the whole, the Council found the program beneficial, with a

benefit-to-costs ratio of between 3 and 19 to 1. The Council concluded: "The subsidies seem successful enough to be a paying proposition. The value of the jobs created appears to outweigh the inefficiency involved in locating production inappropriately."³²

However, incrementality is a controversial issue. The lack of consensus about it may well stem from the difficulty of measuring it reliably. Dan Usher explained the difficulty: "Normally one is taxed or subsidized for doing something regardless of whether one would do it or not in the absence of the tax or subsidy. It is as though the family allowances were restricted to children who would not have been conceived. In its absence, or Crow's Nest Pass rates restricted to grain that would not have been grown if freight rates were higher."³³

But what about the state of regional disparities in Canada. Have we witnessed progress on this front since Ottawa first began to introduce regional development measures? Again, there is no clear cut answer.

There has been some progress in reducing regional disparities in per capita income during the past forty years. The largest reduction in income disparities in average family disposable income while the least reduction was with respect to earned income per capita. What this may suggest is that federal transfer payments of one kind or another to the slow-growth provinces had a greater impact than measures to promote economic growth.

32. Economic Council of Canada, *Living Together: A Study of Regional Disparities*, Ottawa, 1977, p. 160, 215.

33. D. Usher, "Some Questions about RDIA," *Canadian Public Policy* (Fall 1975), p. 560.

There are signs, however, that regional development measures may not have worked as well as it was first envisaged. Regional disparities are as persistent today as they always have been in unemployment levels, population growth, and research and development activities and they favour the same provinces, notably the four Atlantic provinces.

Some Lessons Learned

We learned a number of things from forty years of regional development measures in Atlantic Canada. The first is that there is no quick fix or silver bullet. There are reasons why some regions do not grow as quickly as others and the challenges are not easily overcome. Some are historical, others are cultural and still others have to do with the existing urban structure. There are more such factors.

We also learned that politics matters. There are many forces that motivate political leaders to act and some do not always correspond to the requirements of proper economic planning. In addition, things that matter a great deal to politicians like visibility are not very relevant to community leaders or to permanent government officials.

We learned that in regional economic development, as in other things, success breeds success, but failure also breeds failure. It is important for government programs to give rise to tangible success stories from which to build momentum.

Notwithstanding the views of neo-conservative economists, market forces can never dictate where people will live. People do develop strong loyalties and attachments to place. Family, friends, institutions, landscapes, climates, a general sense of belonging and of knowing how to behave in a particular society — these exercise a very strong pull on most people. And this pull means that mobility could never be without cost in terms of pain, even if transport were free, and if houses, churches, hospitals, schools, power plants, and so on could be transported along with the people. Many people have a passionate desire to go on living and earning their living where they are; and that desire must be given its proper weight in the calculation of the impact of any policy on the welfare of a particular society. Moreover, most people do not think of "welfare" in terms of nation-states. They may have enough national pride to be pleased when they read that the per capita income of their country has surpassed that of a neighbouring country; but their pleasure in that fact is not likely to be strong if they live in a retarded region. It seems clear that when social welfare is concerned, much smaller spaces than the nation-state must be used as the criterion.

People will push politicians to intervene and in the end the politicians will intervene and launch new measures to promote regional or community economic development. To have any chance of success, the government will need to tailor the effort to local circumstances. Measures that are national in scope require a far different administrative capacity than measures designed for a small, rural community.

The Canadian experience suggests that flexibility in organization and program design has its advantages. What works in one region may not work in another and one organizational model may be particularly well suited for one community but not another (e.g. urban versus rural). But the Canadian experience also suggests that there are important limits to flexibility. One can make a policy or even a program so flexible and open ended that in the end it means very little. As the Canadian experience shows, a program can be so flexible that it actually means very little even as a guide for action. Some Canadian regional programs have been little more than enabling programs simply clearing the way for officials to design and implement virtually any conceivable activity.

Flexibility in regional development efforts comes with a price. While it enables officials to pursue virtually any opportunity, it also means that governments will never know if their efforts are successful. Having a capacity to evaluate ongoing efforts enables governments to adjust their efforts, to learn from past efforts about what works and what does not. It also gives government officials the capacity to explain and sell their efforts to citizens.

What about the substance of the efforts. To be sure, it depends on a region's economic circumstances. But one can never get it wrong by investing in the "people factor," in education, training and research and development. Institution building is also important if only to empower communities and community leaders to plan and to act.

Lastly, we have learned in Canada that it is very important for governments to limit the application of their regional development programs to designated regions. The most important failure of past and present regional development efforts in Canada has been and continues to be the lack of political will to limit their application of the programs to carefully selected regions.

EQUALIZING PROVINCIAL FISCAL CAPACITIES

Canada's Equalization program provides for unconditional transfers from the federal government to the have-not provinces—those with revenue generating capacities below the national average. These transfers raise per capita revenues in recipient provinces to the standard—an average across the so-called five representative provinces (Ontario, Quebec, Manitoba, Saskatchewan, and British Columbia).

In addition, the federal government makes significant cash transfers to the provinces in the form of a block-grant for health, post-secondary education and welfare through the Canada Health and Social Transfer (CHST). Total CHST entitlements by province are equal per capita, based on the combined value of CHST cash and that of a set number of income tax points transferred to the provinces in 1977. Each province's per capita entitlement to CHST cash is computed as a residual—the difference between its per capita total entitlement and the (equalized) value of the transferred tax points. Thus per capita cash transfers embody an element of super-equalization: The (equalized) value of the tax points is equalized up to a top province standard (Ontario) in all provinces;

beyond this, the remainder of the cash transfer to provinces may be thought of as an equal per capita transfer. Thus, the distribution of CHST cash further contributes to the equalization goal.

CONCLUSION

Trade has indeed played an integral part in Canada's development. One could argue that the Federation was built against the tide. Bucking the north-south forces, Canada has developed on an east-west axis. As McCallum (1995) has demonstrated, the Canada-U.S. border does matter with respect to trade.

Simultaneously, Canada has experienced over the better part of the 20th century, if not longer, a slow but constant trend toward the continentalisation of its economy. Regional cross-border economies are taking strength. East-west trade, though not decreasing, is losing relative importance to north-south trade.

During the second part of the 20th century – up until the FTA – Canada had in fact constructed a *golden triangle*, at least from Ontario's perspective. Through fiscal equalisation schemes, Ontario's dollars were sent to the federal government which in turn sent these to less developed and prosperous regions of the country. In turn, these regions' consumers would spend these dollars on goods manufactured in Ontario... thus the *golden triangle*. Today, these equalisation schemes have seen their importance decreased significantly.

The end of this “Golden Triangle” also corresponds to a period where the federal government drastically reduced the relative importance of regional development programs. With the trend towards the relative weakening of east-west links in Canada and the strengthening of regional economies with north-south linkages, what future remains for Canada, a country built against the odds on a foundation contradicting basic regional economic premises?

Additional pressure to limit government intervention in the field of regional development may come from another direction (Gunderson. 1998. 213-214). Several have argued that trade agreements like FTA and NAFTA are likely to complicate the adoption of policies where government intervenes directly or indirectly to support economic development. Some of these policies may indeed be considered unfair subsidies, thus becoming countervailable. Furthermore, pressures will increase on both provincial and the federal government to level the playing field to ensure that existing Canadian businesses are not overly burdened by taxes, regulation, etc. The 1994 Internal Free Trade Agreement, with its elimination of barriers to internal trade is a concrete example of the trend to harmonise policy.

Finally, even if government wanted to generously support regional development efforts – as well as any other expenditure program for that matter – it will have to balance these with the understanding that capital, including human capital, which becomes much more mobile with trade liberalisation, may exit the country if it is too highly taxed to

finance the various expenditure programs.

It would be farfetched to forecast Canada's demise based on these trends. Furthermore, one could arguably predict that the regional balance in Canada will never be the same. The Golden Triangle is broken. The regional solidarity which is still embodied in Canada's Constitution may slowly become a faint memory. More and more, provinces will have to sink or swim by themselves. In that context, as Brown (1998. 295) suggested, trade policy becomes a regional development policy.

Both economic disparity and fiscal disparity are characteristics of the Canadian federation. Perhaps in spite of regional policy, there is some evidence that the degree of economic disparity has lessened over time although it is still significant. For example, in 1996 GDP per capita ranged from a low of 73% of the national average to a high of 140% of the national average.

Policies directed at alleviating fiscal disparity, however, have been more evidently successful. Disparity in own-source revenue generating capacities in 1996/97, ranging from 66% of the national average to 141% of the national average, is substantially reduced by Canada's Equalization program, now ranging from 95% of the national average to 133% of the national average (129% if cash transfers under CHST are taken into account).

Regional disparity was given constitutional recognition in Canada's Constitution

Act, 1982. What is significant about this is that it enshrines the policy goal of regional equity—both regional economic equity (equality of opportunity) and regional fiscal equity (equality of access to public services)—as well as policy measures directed at achieving this goal—regional development policy, the use of the federal spending power and fiscal equalization.

APPENDIX

Table 1: Results of the International Shift-Share Technique - National Shift Component, Canadian Provinces, 1985-1989 and 1989-1993 (percentage of total shift)

Province and Period	U.S. Exports	NUS Exports	U.S. Imports	NUS Imports	Nat. Dom. D'd Shift
NFLD 85- 89	6.6	5.8	11.5	8.8	111.15
89-93	77.4	0.4	46.4	18.9	137.7
PEI 85-89	5.6	4.8	9.6	7.3	93.0
89-93	37.3	0.2	22.3	8.1	66.4
NS 85-89	7.5	6.5	13.0	9.8	124.9
89-93	42.1	0.2	25.2	9.2	74.9
NB 85-89	5.4	4.7	9.4	7.2	91.0
89-93	48.8	0.2	29.2	10.6	86.8
Qc 85-89	5.8	5.0	10.0	7.6	96.3
89-93	59.5	0.3	35.6	13.0	105.8
ONT 85-89	4.6	4.0	8.0	6.1	77.6
89-93	96.4	0.5	57.7	21.0	171.5
MAN 85-89	8.8	7.6	15.2	11.6	147.0
89-93	71.5	0.4	42.9	15.6	127.1
SASK 85-89	37.2	32.3	64.7	49.2	623.8

89-93	34.0	0.2	20.4	7.4	60.5
ALTA 85-89	-56.7 ³⁴	-49.2 ²	-98.5 ²	-74.9 ²	-950.5 ²
89-93	19.1	0.1	11.5	4.2	34.0
BC 85-89	5.0	5.5	8.4	8.0	88.7
89-93	31.8	-0.4	19.6	7.1	55.9

Source: Desjardins. 1997. 215.

³⁴ Between 1985 and 1989, Alberta's GDP decreased. A negative percentage is thus a positive contribution.

Table 2: Results of the International Shift-Share Technique - Industrial-Mix Shift Component, Canadian Provinces, 1985-1989 and 1989-1993 (percentage of total shift)

Province and Period	U.S. Exports	NUS Exports	U.S. Imports	NUS Imports	Nat. Dom. D'd Shift
NFLD 85-89	-1.9	1.6	-9.6	-5.7	-17.3
89-93	-37.1	1.5	-23.7	-6.2	21.7
PEI 85-89	0.8	4.1	-4.8	-5.8	-11.5
89-93	-24.5	1.5	-12.9	-3.2	11.5
NS 85-89	-1.6	0.9	-11.5	-4.7	-7.7
89-93	-14.8	0.7	-11.7	-3.6	-0.5
NB 85-89	-0.2	2.2	-4.6	-5.1	-5.3
89-93	-13.5	-0.5	-11.3	-4.9	-2.5
Qc 85-89	-0.2	0.4	-0.4	3.4	8.4
89-93	-2.5	-0.4	3.2	0.7	3.2
ONT 85-89	2.0	-3.4	1.4	1.4	8.4
89-93	22.1	1.9	19.9	5.7	-5.0
MAN 85-89	-2.3	1.6	-3.2	-3.7	-9.2
89-93	-23.2	1.0	-8.6	-2.6	20.3
SASK 85-89	-15.2	50.4	-14.4	-29.5	-179.8
89-93	-16.8	-1.7	-9.9	-3.2	15.7
ALTA 85-89	38.8 ³⁵	-39.9 ³	-6.1 ³	17.5 ³	241.9 ³
89-93	-4.1	-1.1	-4.7	-1.2	5.3
BC 85-89	-0.0	3.0	-0.8	-5.1	-1.7
89-93	-6.3	0.5	-8.3	-2.9	-8.0

Source: Desjardins. 1997. 222.

³⁵ Between 1985 and 1989, Alberta's GDP decreased. A positive percentage is thus a negative contribution and vice-versa.

Table 3: Results of the International Shift-Share Technique - Regional Shift Component, Canadian Provinces, 1985-1989 and 1989-1993 (percentage of total)

Province and Period	U.S. Exports	NUS Exports	Nat. Dom. D'd Shift
NFLD 85-89	21.4	6.7	-29.1
89-93	-70.0	21.5	-19.9
PEI 85-89	-3.0	-6.5	19
89-93	-5.4	-1.4	28.8
NS 85-89	2.5	-3.1	-23.2
89-93	-15.1	-31.3	63.4
NB 85-89	6.8	4.4	-2.2
89-93	-3.1	111.3	-103.9
Qc 85-89	2.1	-9.3	12.1
89-93	-11.1	11.5	-13.8
ONT 85-89	0.3	3.2	20.2
89-93	12.2	31.3	-127.1
MAN 85-89	7.0	6.0	-46.5
89-93	-23.3	6.0	-32.5
SASK 85-89	-69.9	148.3	-457.3
89-93	12.3	8.4	2.1
ALTA 85-89	57.8 ³⁶	29.3 ⁴	666.5 ⁴
89-93	10.8	6.2	39.4
BC 85-89	-2.6	-1.9	14.6
89-93	-7.0	11.0	38.0

Source: Desjardins. 1997. 227.

³⁶ Between 1985 and 1989, Alberta's GDP decreased. A positive percentage is thus a negative contribution.

Table 4: Results of the International Shift-Share Technique - Export, Import and Domestic Demand, Canadian Provinces, 1985-1989 and 1989-1993 (percentage of total shift)

Province and Period	Export Shift	Import Shift	Dom. D'd Shift
NFLD 85-89	40.1	-5.0	64.8
89-93	-6.3	-33.3	139.6
PEI 85-89	5.85	-6.4	100.57
89-93	7.72	-14.4	106.7
NS 85-89	12.6	-6.6	94.0
89-93	-18.2	-19.5	137.8
NB 85-89	23.4	-6.9	83.5
89-93	143.2	-23.7	-19.5
Qc 85-89	3.8	-20.5	116.8
89-93	57.3	-52.4	95.1
ONT 85-89	10.73	-16.9	106.1
89-93	164.4	-103.7	39.3
MAN 85-89	28.7	-19.9	91.2
89-93	32.3	-47.1	114.8
SASK 85-89	183.1	-69.9	-13.3
89-93	36.4	-14.7	78.3
ALTA 85-89	-20.0 ³⁷	162.1 ⁵	-42.1 ⁵
89-93	31.0	-9.7	78.7
BC 85-89	8.9	-10.5	101.6
89-93	29.6	-15.6	86.0

Source: Desjardins. 1997. 230.

³⁷ Between 1985 and 1989, Alberta's GDP decreased. A positive percentage is thus a negative contribution and vice-versa.

Table 5: Results of the International Shift-Share Technique - U.S. Trade, Non-U.S. Trade and Domestic Demand, Canadian Provinces, 1985-1989 and 1989-1993 (percentage of total shift)

Province and Period	U.S. Trade Shift	NUS Trade Shift	Dom. D'd Shift
NFLD 85-89	24.2	11.0	64.8
89-93	-52.4	12.8	139.6
PEI 85-89	-1.5	1.0	100.6
89-93	-2.0	-4.7	106.7
NS 85-89	6.9	-0.9	94.0
89-93	-1.4	-36.4	137.8
NB 85-89	7.2	9.3	83.5
89-93	14.2	105.3	-19.5
Qc 85-89	-1.9	-14.9	116.8
89-93	-2.2	7.1	95.1
ONT 85-89	-2.5	-3.7	106.1
89-93	53.7	6.9	39.3
MAN 85-89	1.5	7.3	91.2
89-93	-9.2	-5.6	114.8
SASK 85-89	-98.1	211.4	-13.3
89-93	19.1	2.6	78.3
ALTA 85-89	144.5 ³⁸	-2.5 ⁶	-42.1 ⁶
89-93	19.0	2.3	78.7
BC 85-89	-5.3	3.6	101.6
89-93	7.3	6.8	86.0

Source: Desjardins. 1997. 235.

³⁸ Between 1985 and 1989, Alberta's GDP decreased. A positive percentage is thus a negative contribution and vice-versa.