Appendix A
Other Views

My earlier book *Looking the Gift Horse in the Mouth* (1996) argued that federal transfers and economic-development programs had done Atlantic Canada more harm than good. As I've travelled around the region, I've found that several odd interpretations of the claims made in that book—and of Atlantic Canadian history—have gained currency. To clear the air for future debate, this appendix takes a quick look at some views that have appeared in print.

Government Spending Patterns

An odd phenomenon in recent years has been some Atlantic Canadian economists' denial that government policy was responsible for the increase in transfers to the region in the 1970s. This attitude may reflect an increasing understanding that the 1970s were a disastrous decade for Atlantic Canada. But several people argue that the increase had nothing to do with normal federal program policy.

The claim is that transfer increases were driven by bad economic times in Atlantic Canada. *Gift Horse* argues that increasing federal transfers actively harmed the Atlantic economy in the 1970s. In reviewing that book, Pierre-Marcel Desjardins, of the Canadian Institute for Research on Regional Development, argued the logic was all wrong: "In economics 101 we learn that the function of government expenditures is that of stabilizing the economy. When the economy slows down, expenditures (unemployment insurance, equalization, etc.) increase and vice versa. Could the author have his rationale upside down?" (Saint John *Telegraph Journal*, November 11, 1996)

Desjardins seems unaware of the policy changes in the late 1960s and early 1970s that boosted regional transfers and of the fact that Atlantic Canada was enjoying a period of strong economic growth as federal transfers to it went up. Unemployment insurance, for example, was made more generous on a regional basis at exactly the time the gap between regional and national unemployment rates was narrowing. Economic-development programs were launched when Atlantic Canada's economy was growing faster than the national economy. As Bickerton notes, increases in wealth transfers to Atlantic Canada, far from being driven by bad times, were actually motivated by the region's strong economic performance (1990, 175).

Other economists argue that, while policy had something to do with transfer increases in the early 1970s, the policy in question was outside the normal policy realm. Instead, they say, increases in transfers were "driven by petroleum-related subsidies" (Lynch, Locke, and Hobson 1997, 22).

The subsidies they are talking about came in two policy packages, separated in time. Shortly after the first oil crisis in late 1973, the federal government launched a subsidy program meant to equalize oil prices across the nation. Oil produced in western Canada had to be sold to Canadian consumers at prices below world prices. Oil landed in eastern Canada was purchased at world prices, and the federal government then provided subsidies to reduce the consumer price to the pan-Canadian level. These subsidies were recorded where the oil was landed; a considerable amount of it was imported through New Brunswick, Nova Scotia, and, to a lesser extent, Newfoundland, inflating the federal spending recorded in this provinces.

In the early 1980s, Ottawa launched another petroleum-related subsidy program, the Petroleum Incentive Program, designed to encourage petrochemical exploration and development. Much of the funding was directed to petrochemical finds off the Atlantic coast. This again inflated federal spending, particularly in Nova Scotia and Newfoundland.

Lynch, Locke, and Hobson argue that "policies surrounding the federal government's response to the two energy shocks [were] programs that were massive in terms of federal spending and, together, dwarfed other aspects of policy spending" (*Ibid.*, 19). However, federal-spending patterns don't bear out this claim.[1] Even at their peak, petroleum-related subsidies formed only a small fraction of the total amount of federal transfers to Atlantic Canada (look back at Chart 2-2). From

1. I have been unable to obtain information on the data or calculations on which Lynch, Locke, and Hobson base this claim.

their start in the mid-1970s through their complete elimination in 1989, net petroleum-related subsidies were responsible for just 7 per cent of overall net transfers. Gross petroleum-related subsidies formed just 10 per cent of gross federal spending in the region through this period.

The size of the programs can be seen by comparing Chart 2-7, which shows total government spending as a percentage of GDP, and Chart 2-3, which shows total government spending minus petroleum-related subsidies as a percentage of GDP, presenting a comparison of Atlantic Canada with the rest of the country. Chart 2-3, like Chart 2-4, reveals the rapid rise of government spending in Atlantic Canada through the late 1960s and 1970s. Far from dwarfing other aspects of government spending, petroleum-related spending had only a small part of the overall growth.

This pattern can also be seen in Charts 2-8 and 2-9, which track transfers to persons. These data obviously do not include petroleum-related expenditures.

Other economists argue that since wealth transfers are a common part of any federation, the wealth transfers to Atlantic Canada are simply business as usual. Yet the magnitude of the transfers are clearly well outside the range to be expected in a federation. Military spending, which is unusually high in Atlantic Canada, has been used to explain this anomaly. Military spending is particularly high in Nova Scotia, which has a long military tradition.[2]

Military pay forms the bulk of military spending, particularly in Atlantic Canada, which receives few military contacts. Chart 2-6 shows the pattern of net transfers minus petroleum-related subsidies and minus gross and net military pay. (The choice of net or gross makes little difference to the pattern of wealth transfers.) Because of the federal government's reductions in real terms in military expenditures beginning in the late 1960s, data on transfers with military pay netted out show a rapid increase in net transfers to Atlantic Canada through the late 1960s and early 1970s. Chart 2-5 traces the decline in per capita military spending.

2. Halifax, founded as a military citadel against the French in the 18th century, hosts Canada's Atlantic Command headquarters. During World War II, the great Atlantic conveys assembled in Bedford Basin, at the end of Halifax harbour.

One surprising aspect to these recent attempts to explain away increases in wealth transfers to Atlantic Canada in the 1970s is the fact that, as noted in the main text, economists at the time and until fairly recently had understood the policy changes that had boosted these transfers.

Impact of Government Spending

When economists study the macro-impact of a fiscal stimulus on economic activity and inflation, they first examine the level of and change in overall government spending. Increased spending fuels inflation. If the additional spending is funded by borrowing, particularly external borrowing, the inflationary impact becomes stronger, since the government is injecting additional money into the economy, not merely taxing it away on one hand and spending in on the other. The inflationary impact is also likely to be greater if government is spending transferred money, which does not have to be paid back. Many economists believe that large government borrowings suppress consumer expenditures—and thus inflationary pressure—since individuals tend to save more knowing that they, as taxpayers, will ultimately be responsible for making good on the debt.

Accordingly, in *Gift Horse*, I examine the overall basket of government spending in Atlantic Canada and the size of the wealth transfers to the region. As I note, in line with economic theory and evidence, "from a macro-economic viewpoint all components of the net flow will have similar macro-economic impacts unless the funds are directed away from consumption into productive investment" (p. 16, emphasis added). I also repeatedly stress the benefits of investment spending (as opposed to government consumption) and of current spending in areas like education and health care. These, I note, have strong positive effects on equity and at least partially offset the impact of any inflationary stimulus by their positive impact on health, on skills, and, in the case of investment in areas like transportation, on business costs.

Rather puzzlingly, Lynch, Locke, and Hobson claim I argue that government spending had *identical* effects, all of them negative: "McMahon's claim that the macro-economic impacts of these programs are identical is, of course, false" (1997, 32). I specifically note that investment spending—on things like roads and harbours—has an inflationary effect different from that of consumption spending, and that the effect of investment spending, provided it is not solely political, is positive. Yet these authors write, "McMahon's analysis [is] that improvements to roads, harbours, education and health care have the same negative effect on relative GDP performance" (*Ibid.*, 83).

Curiously, despite Lynch, Locke, and Hobson's focus on the nature of government spending, they do not closely examine its composition. I had hoped my discussion in *Gift Horse* would spark further debate and research on how government spends money in Atlantic Canada. Although differing consumption expenditures have similar effects on wage and cost pressure, the inflationary effects are not identical. Some programs—unemployment insurance, for instance—creates strong pressure; other programs—spending on education, for example—have a much smaller impact. Policy analysis would be aided by a more in-depth examination of spending patterns in Atlantic Canada. I've taken a first step toward that in this book; I hope other researchers will further this work.

Labour Market

Another curious misinterpretation of Atlantic history involves the labour-market and wage patterns in the region. After the appearance of Gift Horse, several economists argued that wages had never risen in Atlantic Canada in comparison to the rest of the nation. Desjardins' comments are typical: "The Atlantic economy has never been close to full employment. And economic theory tells us that a higher demand for labour should not increase wages if unemployment exists" (Saint John *Telegraph Journal*, November 11, 1996). If this statement means that wages did not inflate in Atlantic Canada in the early 1970s, then it conflicts with Statistics Canada data, with reports of the Atlantic Provinces Economic Council through the 1970s, and with evidence that the labour market was quite tight in Atlantic Canada—given the problem employers had recruiting workers—due to UI-related distortions.

Lynch, Locke, and Hobson accepted the Statistics Canada data on wages but have another take on the question: "[W]e find no evidence that increases in net federal spending (driven by petroleum related subsidies) have driven up relative wages in any of the Atlantic Provinces" (1997, 22). This is hardly surprising. Wages started soaring in 1969 and had pretty much stabilized by the time petroleum subsidies started in late 1973.

The Future

By any measure, Atlantic Canada's economic performance has been disappointing, particularly when compared to that of other once-lagging economies. A purgative to the disappointments of the past would be a lively, no-holds-barred debate on the impact of past policy and an examination of policy elsewhere as we seek to develop successful policies for the future. But to move forward, we need to be honest about the past and each other's views, not matter how great the disagreement.