Chapter 1
Introduction and Overview

The 1960s were a time of incredible economic hope in Atlantic Canada. Regional commentators dubbed the era the time of "the Atlantic Revolution". The region's economy was converging toward the national level of affluence at a rate never experienced before. Then, in the opening years of the 1970s, Atlantic Canada's trek toward prosperity came to an abrupt halt. It would be many years before anyone realized how great the reversal of fortune had been.

This book examines the factors that nourished strong regional growth in the 1960s and those that knocked Atlantic Canada off this path. The goal is to explore the conditions needed to invigorate the economy of Atlantic Canada once again, to push it into the kinds of economic turnarounds described in the preceding volume, *Road to Growth* (McMahon 2000).

Although many of the policies examined here were developed in the late 1960s and early 1970s and have been more or less reformed in the years since, the economic problems they created remain embedded in the Atlantic economic and political systems. This book frequently cites recent problems arising out of the policy mix to show the continuing need both for an understanding of the impact of these policies and for reform. The book also attempts to bring into play the experience of other once-lagging jurisdictions and the solutions they found to their economic problems.

The Problem

Few now remember Atlantic Canada's well-founded economic optimism of the 1960s. The region's prosperity was increasing at a faster rate than in the rest of Canada, and its other entrenched economic problems were fading away.

Unemployment had long been the most painful aspect of the region's economic malaise. But, by 1970, unemployment in Atlantic

Canada was virtually at the same level as it was in the rest of the nation. Unemployment was typically lower in Prince Edward Island than in the rest of Canada through the late 1960s and early 1970s. Nova Scotia's unemployment rate dipped below the national average in 1970. New Brunswick's did the same in 1971. Only Newfoundland had an unemployment rate significantly above the national average.

The same optimistic story was reflected in private-sector investment, which is key to generating growth, jobs, and prosperity. It was soaring in Atlantic Canada—from about $1400 per capita in 1961 to about $3500 per capita in 1971.[1] That put investment in Atlantic Canada at virtually the same level it was elsewhere in Canada. The investment gap had closed.

Then everything halted. After 1971, investment in Atlantic Canada just stopped growing, while it continued to expand in the rest of the nation. The per capita difference in investment between Atlantic Canada and the rest of the nation went from about zero in 1971 to about $1000 per person annually in the years since.

Atlantic Canada's economy didn't simply cease converging with the rest of the nation; it lost ground in many of the years after 1970. The region's gross domestic product (GDP) per capita actually declined relative to Canada's. This happened despite massive amounts of evidence from the developed world that lagging regions, except in bad policy regimes, grow faster than advanced regions.

The news was even worse on the unemployment front. Before 1970, the Canadian and Atlantic Canadian unemployment rates were converging. Even before actual convergence (in the middle to late 1960s), Atlantic Canada's unemployment rate had typically been less than two percentage points above the national average.

After 1970, however, unemployment grew much more rapidly in Atlantic Canada than in the rest of the nation. Since the mid-1970s, the unemployment rate in Atlantic Canada has consistently been in double digits. The gap between unemployment in Canada and Atlantic Canada doubled to four percentage points and stayed there.

Many regional commentators blame the oil crisis of the 1970s for

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1. Unless otherwise stated, amounts of money throughout the text and charts of this book are in constant 1997 dollars.

Atlantic Canada's reversal of fortune. The actual timing of events dispels this stubborn myth. Atlantic Canada's growth started to stumble in 1971, about three years before the onset of the first oil crisis: investment stopped growing and unemployment began to rise much more rapidly than in the rest of the nation. And the unemployment and investment gaps between Atlantic Canada and the rest of the nation remain consistently high, even though the oil crises have long faded into the past.

Lagging Even Other Lagging Regions

Atlantic Canada doesn't simply present a puzzle over time—what changed in or about 1970—but also a puzzle over space. Why does it do so much less well than other similar economies? It's not just a lagging economy; it has consistently failed to keep pace even with other lagging regions. Whether Japanese prefectures, U.S. states, or the vastly different regions of Europe, lagging economies consistently close the gap with advanced regions by 2 to 3 per cent a year.[2] Atlantic Canada doesn't even come close. Since 1961, even including the good years of the 1960s, it has closed the gap with the rest of Canada by only 1.3 per cent a year, about half the rate found elsewhere.

Atlantic Canadian policymakers have tried to find reasons for this dismal economic record by utilizing a number of explanations from traditional regional-development theory, the intellectual foundation of policy in Atlantic Canada for the past 30 years. Although that theory has shifted considerably over the past three decades as its predictions and remedies have failed, the core concepts of most of its variants centre on the economic disadvantages of peripheral regions and resource-poor regions.[3]

Yet it has become increasingly clear such concepts are inadequate to explain Atlantic Canada's economic performance. Ireland is every bit as much of a resource-poor, peripheral region as is Atlantic Canada. Yet Ireland has become a star economic performer.

Just 15 years ago, Canada's per capita GDP was two and a half times

2. This evidence is reviewed in *Road to Growth* (McMahon 2000).

3. See Arndt (1987) for a history of the constantly changing theories used to justify activist economic development and the often tragic consequences of these theories in action.

Ireland's. Now, remarkably, Irish per capita GDP exceeds Canada's. Being on the periphery doesn't seem to have hurt the Emerald Isle. In fact, in both Europe and the United States, peripheral regions have been growing faster than core economic regions for some years. Peripheral regions, as Jacques Delors pointed out a decade ago in his review of the progress achieved by lagging regions, seem to be doing well most everywhere:

> [T]he United States economy has...seen pronounced economic growth at its geographic edges rather than favouring any dominant centre. There have also been striking changes in the relative economic performance of certain regions: the emergence of much of the south of the United States from economic backwardness, and the recovery of New England.... Within Europe, much of the periphery has been growing faster in recent years than the geographic core of the E.C.... [N]ew centres of growth have emerged such as Bavaria and the Rhone. Within Italy the problems of the Mezzogiorno have been gradually changing, with prosperity spreading down the Adriatic coast.... Within the United Kingdom, one has seen parts of Wales and Scotland...make rather striking recoveries. (Delors 1989, 83–84.)[4]

Similarly, economic research has now shown that resource wealth is more of an economic curse than a blessing. Resource-rich regions typically grow less strongly than resource-poor regions, in part because they remain focused on primary industries and in part because resource wealth is often funnelled into consumption, particularly government consumption, rather than investment. This bloats costs elsewhere in the economy and impedes the growth of other economic activity.

At first sight, the policy regime in Canada seems to deepen the puzzle about Atlantic Canada's weak economic performance. Canadian policymakers have launched heroic and expensive regional-development measures to help Atlantic Canada catch up with the rest of the nation. The net wealth transfers have been immense—typically

4. Rosenfeld provides interesting insights on developments in Italian regions (1992, 160–205).

equalling 20 to 40 per cent of Atlantic Canada's GDP in any given year—above and beyond what would be expected in a normal federal structure. In fact, their magnitude and duration are rare, perhaps unique, for any region or nation.[5]

Yet, even with this immense effort and wealth transfer, Atlantic Canada's convergence with the rest of Canada compares very unfavourably with convergence across the border in the United States, which lacks large interregional wealth transfers and where regional-development programs are virtually nonexistent. Atlantic Canada's performance also compares poorly with the performance of peripheral regions in Japan and Europe. Europe does have regional programs, but, for the most part, they are minute compared to Canada's. For example, Ireland has been one of the largest recipients of European Union transfers, yet these transfers typically equalled only about 4 per cent of Irish GDP. If transfers were important for growth, then surely Atlantic Canada, not Ireland, would be the star economic performer.

Still, even outside Canada, not all lagging regions share in the full measure of success. That applies to Atlantic Canada's next-door neighbour, the state of Maine. As discussed in *Road to Growth* (McMahon 2000), Maine's rate of convergence with the rest of the United States has been anemic. In the past 20 years, Maine's per capita GDP has closed the gap with the United States' by less than 1 per cent a year, rising from just over 75 per cent of the national average in 1977 to just over 80 per cent in 1996.[6]

Sadly, these statistics underline the economic failure of Atlantic Canada. It not only lags other lagging regions; it even lags behind jurisdictions, like Maine, that themselves lag other lagging regions. Atlantic

5. On a per capita basis, they would dwarf transfers to Israel, the world's largest recipient of foreign aid. Corsica and parts of southern Italy are the only regions I know of that receive transfers that may be of equivalent size. Interestingly, both of these areas have received large transfers for many years, and both have stagnated, like Atlantic Canada but unlike other lagging regions of Europe.

6. The numbers inevitably get confusing. Here it is important to keep in mind the difference between per cent and percentage points. For example, consider a lagging economy with a per capita GDP of 60 per cent of the leading economy. If the lagging economy grows to 70 per cent of the advanced economy, saying it has closed the gap by 10 *percentage points* is equivalent to saying it closed by the gap by 25 *per cent* (the gap was 40 per cent, and 10 per cent is a quarter of that).

Canada's per capita GDP was 77 per cent of Maine's in 1977. By 1996, Atlantic Canada's per capita GDP was just 63 per cent of Maine's. (The fluctuations in this number are large because of exchange-rate movements, but the long-term trend is consistently down.)

Maine's success relative to Atlantic Canada is also found in a comparison of unemployment rates. In recent years, Maine's has been around 4 per cent, while across the border, in New Brunswick and the rest of Atlantic Canada, double-digit unemployment has been the rule.

Strategies for Growth

What can we do that a generation of hard-working, well-meaning bureaucrats and policymakers has not done? We can look to success stories from other once-lagging regions, as I do in the companion volume, *Road to Growth* (McMahon 2000). But to apply the lessons of other jurisdictions' policies, we need to look more deeply at what the past 30 years have done to Atlantic Canada, economically and psychologically.

Accordingly, this book is structured as follows. The next chapter gives a brief history of Atlantic Canada, emphasizing the development of what can best be described as a negative-sum view of its economy.

Chapter 3 examines the region's government structure and how the fiscal structure of Confederation has deepened some of the incentive problems discussed in public-choice theory. Chapter 4 follows up by weighing the effects of wealth transfers and regional-development programs.

Chapters 5 and 6 consider respectively labour-market structure and the business sector. Chapter 7 turns to two of Atlantic Canada's most pervasive problems: the lack of balance in rural and urban growth, and the tragedy of the fisheries.

The Conclusion summarizes the argument and offers policy recommendations.