Chapter 6
Policy and the Business Sector

If you can't compete without grants, you can't compete with them.
British engineer after viewing Atlantic Canadian goods

The policy failures of the past three decades have had a devastating effect on Atlantic Canada's business structure. The pressure of rising wages has choked investment. The determination to "save" jobs in outmoded industries warped the industrial structure, crowding out more productive uses of assets, dangerously politicizing decisions, and undercutting competitiveness.

Investment

Economic theory and consistent empirical evidence show that relatively low wages are the magnet that draws investment to lagging regions—if other government policies are sensible and members of the work force have enough skills and education to make their labour valuable compared to their rate of pay.

Lagging regions are typified by relatively low skill levels among workers and by a low capital/labour ratio. These characteristics result in low wages. But in an economy that is functioning normally, such a combination creates attractive business opportunities. This begins an upward cycle that raises wages due to skill improvement and an increased capital/labour ratio.

This process has been key to the convergence between lagging regions and advanced regions in Europe, the United States, and Japan. Moderate wages were the key strategy in the economic turnarounds in Ireland and the Netherlands (see McMahon 2000).

But, theory and experience tell us, any government-induced distortion in the economy that puts upward pressure on wages unjustified by fundamental conditions has a significant negative effect on private-sector investment. That's exactly what happened in Atlantic Canada as wages rose, particularly after the introduction of regionally extended unemployment insurance (UI) in 1971.

Investment growth in Atlantic Canada abruptly halted, while it continued to grow strongly in the rest of Canada (see Chart 6-1). This opened a large investment gap between Atlantic Canada and the rest of the nation, a gap that continues today.

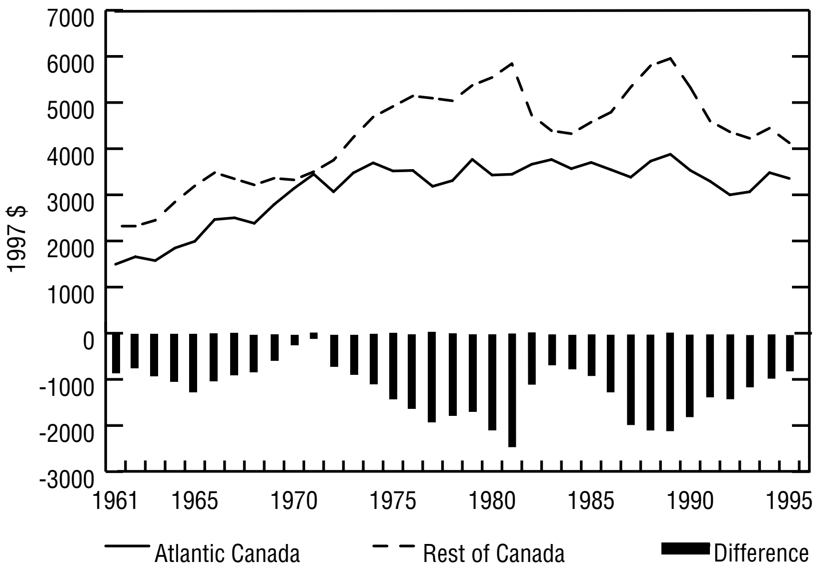
This process was occurring in Atlantic Canada during the 1960s. Through most of that time, wages in the region were well under the Canadian average. And by the end of the period, investment in Atlantic Canada had risen to the national level and unemployment had fallen to the same level.

Interestingly, Atlantic Canada's weakening ability to bring in new private-sector investment was well understood in the 1970s. For example, the Atlantic Provinces Economic Council (APEC), in its April 1972 *Atlantic Report*, called attention to the problem: "The disconcerting aspect of investment intentions for 1972 is the forecast behaviour of capital spending by business. The expected decline in this aspect of investment is concentrated mainly in manufacturing" (p. 3).

Even earlier than this, the *Atlantic Report* had tied rising wages to falling investment, saying "[n]arrowing profit margins caused by escalating costs of labour" were the major factor that had "forced dramatic cut-backs in the optimistic capital spending plans of the business sector in 1970 in the Atlantic region" (January 1971, 9). APEC had previously projected investment to increase in the 1970s in Atlantic Canada (as it had done through the 1960s and would continue to do in the rest of Canada). Instead, escalating wage costs led to dramatic reductions in investment.

Nonetheless, many policymakers in Atlantic Canada applauded federal policy that they correctly believed was responsible for inflating regional wages. They often seemed unaware of the negative economic implications of government-distorted wages. Even the October 1975 *Atlantic Report* congratulates government's boosting wages in Atlantic Canada, though it complains about inability to establish price stability or to achieve full employment: "Although governments have failed to maintain their objectives of either price stability or full employment,

Chart 6–1: Business Investment, per Capita



Source: CANSIM.

progress has been made on yet a third objective. Average wages and salaries throughout the region have been catching up with the rest of the country" (p. 1).

The losses Atlantic Canada has suffered in private-sector investment have dwarfed any positive impact from increased government investment. The negative gap on the private-sector side has been in hundreds of dollars per person. The gain on the government side has been, at best, in tens of dollars per person.

Moreover, the numbers on private-sector investment almost certainly overstate the *useful* investment in the region. At least some part of the investment came in to reap the rich subsidies being offered by government and left when they ran out. The post-1970 period has been the era of winged cars in New Brunswick and redundant fish plants wherever a politician or business person was politically powerful enough to land the subsidy. (See the next chapter for more on fish plants.)

Some of this government-subsidized investment destroyed, rather than built, capital. As already noted, this damaging situation occurs whenever a subsidized company forces an unsubsidized firm out of business.

Industrial Structure

Some of the problems that afflicted Atlantic Canada arose out of the negative-sum view of the economy, that had developed in the region. It had policymakers and government to try to protect the old ways. This strategy is horrible. A recent article in *The Economist* describes the opposite tack:

> By...1950, the third wave [based on electricity, chemicals, and the internal combustion engine] of...successive industrial revolutions had already run its course. The fourth, powered by oil, electronics, aviation and mass production, is now rapidly winding down, if it has not gone already. All the evidence suggests that a fifth industrial revolution—based on semiconductors, fibre optics, genetics and software—is not only well under way but even approaching its maturity. This may explain why America [the United States] shrugged off its lethargy in the early 1990s and started bounding ahead again, leaving behind countries too preoccupied with preserving their fourth-wave industries. (February 20–26, 1999, p. 8)

If only Atlantic Canada were one of the jurisdictions intent on protecting fourth-wave industries. Instead, the region has been intent on protecting industries from the 19th century's *third* wave—coal, rail, and steel—and on expanding resource industries, mainly fishing, that predate even the first industrial revolution of the 18th century. The old industrial complex in Cape Breton is not alone. For example, New Brunswick subsidizes an inefficient coal mine in Minto that produces the most-polluting coal still mined in North America.

Such policies reflect the negative-sum view of the economy—if any job or any activity disappears, nothing will ever replace it. Thus, all market change is seen as a threat, not an opportunity. This outlook has led to a policy of protecting existing activities and, through government involvement and subsidies, of bloating traditional sectors. In the negative-sum view of the market economy, government, an outside player in the market, is the only source of positive sums. This view has had particularly damaging consequences in the fishery (see Chapter 7). Overall, it has left Atlantic Canada far too dependent on economic activities that led to fewer and fewer jobs:

> [E]mployment in high-technology, high-wage and science-based manufacturing industries has expanded since 1970, in sharp contrast to the stagnation in employment in medium-technology sectors and job losses in low-technology, low-wage and labour-intensive industries. (OECD, 1996, vol. 2, 59)

Yet Atlantic Canadian policymakers continued to support outmoded industries and even fight new technology, particularly in the fisheries, that could move a sector away from labour intensity.

Politicization of the Business Sector

Government's activity also lead to further politicization of the economy. It limits the growth of self-sustaining industries that have to compete with subsidized industries for resources, particularly labour. And it creates a dangerous conflict of interest in government's crucial policing role in the economy. Government is hardly a disinterested observer when its own creatures are involved.

Government involvement in the mining industry, for example, led to a great tragedy. In the late 1980s, the Nova Scotia government promoted and subsidized, along with the federal government, a new coal mine in Westray, a community in the constituency of senior provincial cabinet minister Donald Cameron, who later briefly became premier.

The Westray tragedy demonstrates not only the conflict of interest in government responsibilities but also how politicized the economy has become. Investment decisions are no longer seen as investment decisions, but rather as part of the political process. The Pictou area, where Westray is located, is a Progressive Conservative stronghold, and Conservative federal and provincial governments pumped nearly $100 million in loans and guarantees into the mine.[1]

---

1. Cape Breton, which was then predominately Liberal, saw the Westray mine as a move on the part of the provincial and federal Conservative governments to undermine Cape Breton coal and reward a Conservative area of the province. Federal Liberals from Cape Breton used parliamentary procedure to drag out federal approval for the new mine for 14 months.

The Westray mine never made economic sense, as later reports make clear. The issue was viewed through the prism of politics, not economics. Federal and provincial Conservative governments succeeded in pushing through the project. Safety regulators were hardly diligent, and the company operating the mine took many short cuts. Later reports pointed to many obvious warnings of safety problems and lack of appropriate government diligence in enforcing regulations, but all those warnings were ignored at the time. The inevitable tragedy happened, a preventable underground explosion that killed 26 men in May 1992.

The Westray tragedy highlights the conflict of interest that can entrap government too involved in an economy. From the beginning, the mine was seen as a political deal that closely involved Nova Scotia's government, top bureaucrats, and leading politicians. This clearly created a conflict of interest for the hardly arms-length department charged with policing and enforcing safety regulations.

These conflicts are common. It is difficult, for example, to believe the pollution produced by the government-owned Sydney industrial complex would ever be permitted from a private company. Cape Breton's steel industry and coal industry, both government owned and subsidized, have produced unacceptable levels of local and air-borne pollution for decades. The cleanup will cost many hundreds of millions of dollars. In fact, the provincial government cited the costs of cleanup as a reason for continuing to subsidize Sysco, the steel company. "We'd take a hit that we could never afford," then Economic Development Minister Manning MacDonald said in justification of keeping Sysco open, rather than shutting it down and facing the closure costs (Halifax *Daily News*, March 17, 1997).[2]

So far, efforts to control local pollution in Cape Breton have been caught up in political considerations, as well as efforts to maximize payments from unemployment insurance by cycling employees involved in the cleanup. Sydney-area residents suffer disproportionately from a variety of medical conditions, and health experts believe the high level of local pollution is partly responsible. These problems suppress the possibility of indigenous economic growth in Cape Breton.

2. However, the Progressive Conservative government elected in 1999 has pledged to sell or close Sysco.

Local pollution, the outmoded industrial structure, the militant stance of old-time unions, and distortions introduced by the UI/EI system all discourage investment, and they reflect the conflict of interest between government as regulator and government as operator.

The coal mines have also suppressed economic growth and job creation throughout the province. Nova Scotia Power was forced to buy its coal from the Cape Breton Development Corporation (Devco) at prices well above world levels. Energy costs are one of the most important factors in economic development. Yet Devco so overcharged for its coal that "the president of the Nova Scotia Power Corporation and the president of Devco would not even talk to each other," according to testimony before the Senate committee studying Devco in 1996. Devco sold its dirtiest coal to Nova Scotia Power. It exported its best at a lower price—and at a loss. In one recent year, according to Senate testimony, Devco export sales were about $45 million; the company lost $20 million on these sales. Had Devco been able to sell this good coal at the same price it charged Nova Scotians for bad coal, the corporation would have made $3 million, as reported in the Senate testimony (Canada 1996, 1:25).

All this points up how politicized the regional economy has become. No one on the left or right of the political spectrum could believe that it was a wise use of government resources to spend more than $10 billion (in 1997 dollars) to keep outmoded, heavily polluting industries that create dangerous, unhealthy jobs. Yet the money kept coming for generations.

Projects are not judged on their economic viability, as they would be in a market economy, but on their political merits. And if the political rewards are great enough, government is happy to use its resources, even if the use of public funds damages the overall economy. Thus, subsidized Cape Breton coal weakened the overall economy of Nova Scotia, while subsidized Westray coal, in a Tory voting area, might well have further weakened it, leading to demands for further subsidies for Cape Breton.

As already pointed out, McNiven and Plumstead (1996) used the measures developed for the world-competitiveness report to compare Atlantic Canada with a variety of other economies in the developed and developing world. It fared badly on many criteria.

Category	Rank out of 49
Government and involvement in investment decisions	48
Government control of enterprises distorting fair competition	38
State control of industry	36
Politicization of business	37
Transparency of government decisions	37

The results of this ACOA-sponsored study are even more interesting when viewed in comparison with other nations. In state control of industry, Atlantic Canada rates lower than China, Indonesia, Mexico, and Egypt. Only Russia scores lower on government involvement in investment decisions.

This study, which is based on a combination of objective criteria and a survey of business attitudes, presents an international comparison in what can be described only as an impressionistic way. Clearly, the expectations of government by business people in, say, Indonesia, differ greatly from those in more developed nations. What is fascinating, however, is that business people in Atlantic Canada, using the standard of advanced nations, judge government intervention and politicization in their region to be so much larger above the norm found in developed nations.

COMPETITIVENESS

Competitiveness is at the heart of survival for private-sector firms. How does Atlantic Canada score on this scale? To investigate the question, this section focuses on an outstanding 1990 study by P. N. O'Farrell of the Heriot-Watt Business School, Edinburgh, comparing the competitiveness of matched pairs of Nova Scotia and New England firms.[3]

O'Farrell concentrates on both the quality and price of the output of these firms and examines their microfunctioning to explain differences in quality and price.

This methodology helps O'Farrell avoid the weakness of many

3. The study cannot be accused of bias against the government. It was financed by the Nova Scotia Department of Industry, Trade and Technology, and by the Atlantic Canada Opportunities Agency (ACOA).

competitive studies: a focus only on the raw price of homogenius inputs, which can ignore quality (a computer engineer whose experience is mostly with a 1970-era mainframe is, other things being equal, worth less than an engineer up on the latest software) and thus lead the analyst to fail to note misallocation.

Although O'Farrell focuses on Nova Scotia, economic conditions similar to those he reports are found in all four Atlantic provinces.

Government Presence in the Economy

O'Farrell isolates large distortions and inefficiencies in Nova Scotia that he attributes to government activities and, more generally, to an overly large government presence in the economy.

O'Farrell finds that Nova Scotia firms typically offered poorer quality products at higher prices than New England firms (as well as British firms, which he examines in an addendum to the paper). Weak productivity was endemic, even though Nova Scotian firms often had newer equipment, subsidized by government money. O'Farrell notes that New England producers can end up buying secondhand equipment from their Canadian neighbours—equipment first purchased in Nova Scotia with government assistance and being replaced there by subsidized purchases of even newer equipment.

Noting that many Nova Scotian firms depend on government assistance and government contracts to maintain profits, rather than on efficient market-oriented production, O'Farrell explores "major factors explaining the apparent paradox of the Nova Scotia companies sampled being profitable and yet manufacturing much more expensive and, on average, lower quality products than the matched companies in New England and the U.K." Government-induced distortions in the marketplace are key to understanding this paradox, O'Farrell says:

> [A] significant proportion of the Nova Scotia firms visited were partially dependent either directly upon provincial or other forms of public purchasing or indirectly through subcontracting to larger firms which are in turn reliant upon government spending for their survival and profitability.... *Public policy appears inadvertently to have reinforced market failure to some extent by cushioning profits via grants, subsidies and preferential purchasing thereby reducing the incentive to change....* The heavy

> reliance upon Federal transfers has indirectly promoted a dependency culture in the province...a culture, as one owner manager said of "a whole region being on the dole." (*Ibid.*, p. 24–25, emphasis in the original)

The dependence both on subsidies and on government contracts, at the expense of developing competitive products, is hardly surprising in a region where government spending is equal to two-thirds of gross domestic product (GDP), and government expenditure on goods and services alone equals between a quarter and a third of GDP.

The type of "grantrepreneurship" O'Farrell is discussing is something much in the consciousness of policymakers in jurisdictions, such as Ireleand, that have recently and dramatically turned their economics around. For example, in a passage that could be a warning to Atlantic Canada, rather than Ireland, Ó Gráda and O'Rourke write:

> A key issue…[about] economic institutions is the extent to which they promote or hinder rent-seeking behaviour.… Rent-seeking can lower a country's growth for several reasons. First, it can directly hinder innovation (in the case where potential losers lobby successfully to get the innovation blocked). Second rent-seeking involves a waste of resources. Such behavior can benefit an individual firm, but only by making others worse off; it does not benefit society as a whole. The resources devoted to such lobbying would thus be better employed, from society's point of view, in alternative activities. In a country like Ireland, where entrepreneurship may have been a scarce resource at various points in time, the diversion of that resource to "grantrepreneurship" could be particularly harmful. (1995, 206)

Effects on Marketing

O'Farrell notes that dependence on government, rather than the market, has also adversely affected the firms' market research and their marketing and selling efforts. When a firm's biggest customer is government, the effort to find out what other customers want, to design and adapt for niche markets, and to develop a marketing campaign may seem of little relevance:

> Selling is characterized by a casual and rudimentary approach. Price is often the major marketing platform used by too many firms, especially as this research has conclusively demonstrated that, on average, products manufactured in the province are not price competitive. (1990, 28–29)

Of course, this rent-seeking behaviour has been "particularly harmful" to Atlantic Canada, as O'Farrell and other researchers show. All the problems Ó Gráda and O'Rourke isolate and more are to be found in Atlantic Canada because of the huge government presence.

The weak management that O'Farrell reports reflects findings in other studies. Attempting to place Atlantic Canada on a competitiveness scale with 48 nations, McNiven and Plumstead say, "[C]ompetitivity of the Region's companies is low (40th). On the criterion of managers' sense of entrepreneurship and innovation, the U.S. ranks seventh, Canada 32nd and Atlantic Canada 46th (1996, 49). Not surprisingly, given the region's dependence on government, research and development were short-changed:

> Because of [Atlantic Canada's] small population, it is not surprising that the two criteria about total R&D personnel employed has this region ranked 46th and 47th. However, when these numbers are converted to the proportion of R&D personnel per 1000 of the labour force, the situation only marginally improves to 44th for total R&D employment. (*Ibid.*, 49–50)

Overall, in this ranking, the quality of management in Atlantic Canada placed 37th, behind Peru, the Philippines, Columbia, and Argentina.

The lack of interest in developing new markets has a dangerous side effect on economic growth and the attractiveness of the region as a place to invest. In surveys of what business finds important in selecting a site for investment, the quality and cost of labour is inevitably first, but many surveys report as second the availability of qualified, dependable, price-competitive, quality-conscious subcontractors. Yet a large government presence and the availability of government work undermine the willingness and ability of regional firms to form relationships with outside firms. This has both the immediately negative impact of discouraging investment and the secondary effect of holding back regional firms from developing world-class expertise that would fuel growth. O'Farrell tells a cautionary tale about

> a large multinational enterprise (MNE) which recently located a branch plant in Nova Scotia. They attempted to set up sub-contract relationships with precision engineers.... The purchasing officer approached six Nova Scotia firms for quotations; several replied they were too busy; another said they would not be "comfortable" quoting "because of the tolerances and finish required"; and one firm delivered the parts 6 weeks late and 10 per cent of their components were rejected. The MNE now subcontracts the work to Ontario. None of the Nova Scotia machine shops has approached this large multinational seeking a share of their sub-contract business; and when the MNE contacted the suppliers many were still reluctant to tender for contracts. (*Ibid.*, 8)

The poor quality of local suppliers is frequently noted in the literature on the Atlantic economy. For instance, a survey of 20 exporting firms in Nova Scotia and Prince Edward Island, "[T]he problem of poor quality at the supplier level was cited by over half the firms as being an obstacle. Companies deal with this by badgering and complaining until something changes. Occasionally they go elsewhere to access key services, even including printing" (DRM Advisory Group 1994, 10).

Effects on Labour

On the labour side of the equation, O'Farrell finds that the UI system creates additional problems for the competitiveness of Nova Scotian firms. His findings reflect many of the problems discussed in the preceding chapters of this book:

> In high unemployment regions, where U.I. is a mainstay of incomes, it also has undesirable side effects by creating incentives in favour of short-term employment, maximization of unemployment benefits, and disincentives to long-term re-employment. It affects the supply side of the labour market by influencing work attitudes where workers may wish to work the minimum number of weeks necessary to obtain stamps; it

> rewards conformity to the system rather than initiative. For employers, it discourages training investment and the creation of [a] suitable workforce; and it contributes to a high labour turnover and increased training costs. (O'Farrell 1990, 25)

Effects on Capital

One reason frequently put forward for the large economic-development effort in Atlantic Canada is based on the assumption that Canadian capital markets are imperfect and that regional firms thus need grants to help them buy the equipment and make investments if they are to be competitive.

In other words, government is providing financing and subsidies to solve a problem that doesn't exist, and, in so doing, it creates another problem, which weakens regional companies.

O'Farrell's microanalysis also finds perverse results from such programs:

> *The more modern machinery found everywhere in Nova Scotian firms seems to be related to the more generous levels of assistance available rather than to commercial success. The "grantrepreneur" mentality…appears to be widespread* [emphasis in the original]. Yet the American firms did not complain that they were undercapitalized .... As one precision engineer in Bristol stated succinctly when I showed him the U.S. and Canadian samples, "[I]f you can't compete without grants, you won't compete with them." Any shortfall in Canadian competitiveness [productivity and quality] cannot be traced to the vintage of machinery. (1990, 16)

Precision engineering is the sector most dependent on new equipment. Here, O'Farrell finds that over a third of the equipment used by Nova Scotian firms was under five years old, and three-quarters under ten years. In contrast, less than a tenth of the equipment used in New England firms was under five years old, and more than half was over ten years old. But the New England firms produced superior quality products at lower prices, even though they also paid higher wages and did not typically receive government help like Nova Scotian firms.

The industry in Atlantic Canada that has received the most government attention is the fishing industry, and it is here government-induced distortions are most visible. O'Farrell's analysis of the fishing industry was prepared before the extent of the environmental crisis became clear, and his comments focus only on the economic distortions created by government. The emphasis on landing government support, rather than fish of competitive quality and price, distorted the industry's competitive orientation. This is, of course, exactly what has been found by others who examined government's role in the fishery, but O'Farrell's microanalysis is worth quoting to bring the discussion down to the boat deck and the plant floor:

> Canadian groundfish sell at a lower price in New England than groundfish landed in Maine. Fish are generally not gutted on the Canadian boats and are apparently less well handled.… As one Maine fish proprietor stated succinctly: "I can buy in Canada at half the price and half the quality"; while another said: "Unless I'm there, I wouldn't buy from Canada." Even allowing for a degree of American chauvinism in such comment[s], there are obviously problems with the quality of Canadian fish sold on the New England market....The Canadian boats are subsidized (many Maine fishermen purchase the Canadian vessels second hand), the processing plants are eligible for financial assistance, and the resulting products compete on price at the lower quality end of the U.S. market. Conversely the New England boatmen with no grants and similarly unassisted fish processors compete on price at the high value added quality end of the market.... *Clearly the large scale subsidies provided to the sector have not been used to enhance productivity, quality and product development.* (*Ibid.*, 13–14, emphasis in the original)

Government activity was designed to maximize employment, though this is almost always at the cost of productivity and even quality, since labour-intensive handling methods often produce lower quality fish. Government's insistence on a seasonal fishery increased capital costs (since capital was utilized for only part of the year), raised training and recruitment costs, and lowered quality due to high labour turnover and relative lack of continuous experience. In this area, O'Farrell blames the UI system for considerable economic damage in the fisheries.

In other words, in the fishery, as in other Atlantic Canadian industries, disaster has arisen from government "correction" of a failure in capital markets that doesn't exist. Even data collected by government-sponsored research show that "considerable financing is available for business which will come as a surprise for many people" (Plumstead and McNiven 1996, 8). The substitution of government finance for private-sector finance has produced perverse results, again according to a government-sponsored study:

> First entrepreneurs become accustomed to the notion of raising money without making relationships with investors; [s]econd business people are often required to "adapt" their business plans in order to fit into the requirement of government programs; and [t]hird, the fact that government financing is an option means that private investors tend to stand on the sidelines. The result is that companies generally miss out on the benefits of receiving "intelligent money"—money which brings with it the support, advice and discipline demanded by a private-sector view. The best investors work to support the success of companies in which they are involved. (DRM Advisory Group 1994, 11–12)

Overall

The overall findings of O'Farrell's study are startling. In virtually all industries, New England firms paid their employees much more than Nova Scotian firms: a third to two-fifths more. And in the *low-skill* industries New England wages were most notably higher than Nova Scotia wages. Yet the prices of goods produced in New England were much lower than the prices of goods produced in Nova Scotia—a fifth to a third lower. Of course, as argued earlier, a good economic environment and skill development in the longer term justify higher wages. The problem with Atlantic Canadian wages was that they were inflated by government activities unrelated to efficiency improvements and to developments in markets.

There was also a marked difference in the quality of New Engand and Nova Scotian goods. British buyers were asked to judge the quality of products from both regions in a blind test. In all sectors examined, the quality of the Nova Scotian goods was judged inferior. For example, in precision engineering, where new equipment should have given Nova Scotia firms a particular advantage, the British buyers found three in five Nova Scotian samples unacceptable but only one in five of the New England samples. In brief, Nova Scotia producers paid their employees less, had new equipment, and yet produced higher-priced products of mostly unacceptable quality.

O'Farrell's study was done in 1990 and has had no equivalent followup. If a sequel were commissioned, I believe it would find a much more competitive private sector in Atlantic Canada today. A number of business people have told me that when government pulled back in the 1990s, they assumed they would be devastated. Instead, many say, they forced themselves to become more competitive and to pay attention to markets, quality, and price—and they are now doing better than ever before. This anecdotal evidence cries out for a followup to O'Farrell's study.

Oddly enough, one of O'Farrell's most damning passages provides more than a glimmer of hope when viewed from today's perspective:

> The U.S. matched plants visited, in contrast to their Canadian counterparts, process fish all year by buying in supplies from the west coast, California and the Gulf of Mexico in winter. This enables them to spread their fixed costs over a larger output than the Canadian companies. This situation is partly a consequence of a lack of entrepreneurship by Canadian proprietors and partly due to the Unemployment Insurance syndrome. (1990)

The description of U.S. plants would now apply to many Canadian fish plants, which process year-round. As government money ran out, fish companies realized they needed to turn to the private sector and markets to increase revenues. Thanks to the shift of focus to markets, the value of fish landed and processed in Atlantic Canada is increasing—despite the collapse of the northern cod stock. The region is again establishing a reputation for fish quality.

The "lack of entrepreneurship" O'Farrell found in Atlantic Canada is hardly innate. When government money was the best source of income, regional business people became successful "grantrepreneurs", to use O'Farrell's term. This is something Canadian economist Thomas Courchene describes as a rational response to irrational policies. Now, with many of those policies diminished in Atlantic Canada, businesses throughout the region are turning their attention to the market.

Conclusion

Investment is the motor of economic growth. It leads to increased prosperity, higher wages, and employment generation. When nations like Ireland or the Netherlands finally faced their economic problems, their key goal was to make their nations attractive for investment. To do this, they strove to get costs, particularly wages and taxes, under control (see McMahon 2000 for details).

Atlantic Canada's economic-development strategy took the exact opposite approach. During the period of the greatest policy concentration on government-directed economic development, taxes grew and severe distortions in the labour market put upward pressure on wages and decreased the market's flexibility. Atlantic Canada became a much more expensive place to do business. Not surprisingly, investment stagnated, opening a persistent gap in per capita investment between the Atlantic provinces and the rest of Canada.

Moreover, the data on regional investment doubtless overstate the amount of *useful* investment. Much undoubtedly came in to take advantage of subsidies. This list of failures—a waste of both private-sector investment and government-subsidy dollars—is immense in Atlantic Canada.

Government also moved to protect old industries. Billions of dollars of government money was used to keep polluting, uneconomical, and dangerous industries alive, crowding out other, self-sustaining economic activity. The policies government pursued in the fisheries (to be examined in the next chapter) were the most economically and environmentally perverse.

Policies also warped attitudes and incentives in the business sector, dramatically weakening the competitiveness of Atlantic firms. As the O'Farrell study shows, Nova Scotian businesses paid considerably lower wages and had more modern equipment than their New England counterparts yet produced goods of considerably higher price and all too often unacceptable quality.

The disconnects that government policies created between management and the work force and between management and their product need to be touched on here only briefly. They parallel the similar disconnects between workers and the firm discussed in the last chapter. Some of these perversities appear to be disappearing, which offers a ray of optimism for the future.

Once again, a jurisdiction seeking the worst possible mix of business policies would do well to examine Atlantic Canada. Government policies introduced distortions that caused private sector investment—an all-important ingredient for economic growth—to stagnate. Government protected outmoded industries at the expense of other activities, instead of creating a level playing field which would have allowed greater development of new high-growth industries. Government activity politicized the economy and turned business incentives away from market opportunities and toward rent-seeking opportunities. All of this has impeded growth and the development of new opportunities.