

# Foreword

Regional policies have been an important component of government policy in many countries since the end of World War II. The post-war period was a time of unprecedented growth in developed countries, a growth that was often characterized by a shift out of low-productivity rural sectors to high-productivity urban sectors and by an outward migration from declining areas. But the outmigration, usually of the most skilled and educated young people, came to be a serious concern in rural and poor areas, where residents wanted to share in the new national wealth without moving to the city. Regional policies were born in countries where geography and political boundaries coincided with rural, primary-resource producing, and low-income areas.

By their very nature, regional policies involve government intervention and—often, but not necessarily—interference with the market. The case for intervention must be based on the need for public goods or market failure. But it is not always easy to distinguish between market failure and often-painful-but-necessary adjustment processes. A region becomes poor for a variety of reasons that might include a collapse of demand for its export products; unstable monetary or fiscal policies in the currency area of which it is a part, inefficient taxation or regulation, and demographic factors. Each of these problems requires different policies. Quite often, government is the problem, not the solution.

*Retreat from Growth* provides a valuable addition to the Canadian and international literature on regional policies. The book focuses on Canada's four easternmost provinces, known collectively as "Atlantic Canada" and comprised of the Maritime provinces of Nova Scotia, New Brunswick, and Prince Edward Island, plus Newfoundland after it joined Canada in 1949. In it, Fred McMahon delivers a devastating critique of regional policies with respect to Atlantic Canada after World War II.

More than a century ago, McMahon reminds us, it was the Maritime provinces—not the inland provinces of Ontario and Quebec—that were

Canada's stars in economic performance and industry: the locale of Canada's steel mills and much other industry, and the home of two of Canada's "big-five" financial institutions, the Bank of Nova Scotia and the Royal Bank. This early success was heavily contingent on free trade. With the subsequent worldwide trend toward protectionism, however, and Canada's own "National Policy" (championed by Canada's first Prime Minister, Sir John A. Macdonald), the Maritimes lost much of their international markets and had to shift their exports—with the help of large rail subsidies—toward the far-off central provinces. Once those provinces caught up, however, the federal transportation subsidies were slashed and the Maritimes were left in the cold, sinking into a decline from which they never recovered. One could say that regional policies in Canada started in the last century, favouring the central provinces, in the wake creating the regional problems of the eastern provinces.

In the early part of this century, regional policies took the form of subsidizing employment in declining industries; McMahon mentions the Glace Bay mine (where, incidentally, in an explosion in the 1920s, my grandfather was killed) in Cape Breton Island. Regional policies in Canada received a boost in the 1950s with the publication, as part of the Gordon Commission's *Report on Canada's Economic Prospects*, of R. Howland's "Study of Some Regional Aspects of Canada's Economic Development." This study revealed the size of the economic gap between Atlantic Canada and the rest of the nation, pointed out the "shabby" treatment the Maritimes had experienced in Confederation, and gave intellectual "heft and legitimacy to calls for more regional fairness."

Starting with John Diefenbaker's minority government in 1957, and continuing through the 1960s, Canada's federal government began to create cost-sharing programs that allowed Atlantic Canada to benefit from them. At first, things seemed to go well: the policies seemed not only to serve a valuable social function, but also to spur economic growth.

McMahon shows that the apparent success created a case of government hubris and greatly increased the scope and direction of the regional transfers. The role of government in Atlantic Canada shifted away from providing traditional services to managing regional growth! There was at this time no proof that such policies would have much chance to work. Only later would it be understood that "providing quality basic services and infrastructure was associated with economic growth, but that increas-

ing government consumption and intervention have a negative effect on economic growth and job creation.”

Economic theory tends to predict convergence between lagging and leading regions, and there is a considerable body of literature on the subject. McMahon suggests that lagging regions tend to close the per capita gap with advanced regions by 2–3 per cent a year, whether in Europe, the United States, or Japan. “But it is not true with Atlantic Canada, despite, or because of, all the heroic efforts at government-directed economic development.” The rate of convergence of Atlantic Canada with the rest of Canada is only half the expected rate of convergence. “In 1961 Atlantic Canada’s per capita GDP was just under 60 per cent of the national average; in 1997, it was just under 73 per cent of the national average.”

In the 1960s, Atlantic Canada’s rate of convergence was about equal to the international average despite relatively high transfers. In the 1970s, these provinces actually lost some ground, but regained it in the 1980s and 1990s, when government spending was cut back! The curious negative correlation between federal transfers and GDP could be partly explained by the effect of transfers on costs.

This book ends with a number of policy recommendations that certainly demand close attention from economists and policymakers in government. Government spending and taxation should be brought into a “normal” range from their current inflated levels. “Diverting federal transfers from wasteful spending to tax cuts would create a magnet for investment in Atlantic Canada,” although McMahon realizes that this reform would be fought by federal politicians: sending money earns more votes than tax cuts.

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