

The Prospects for Regional Development Policy in Canada

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The accession of a new federal government in Canada brings with it an important opportunity to establish innovative directions in a multitude of policy endeavours. Although the Liberal government, elected in October of 1993, has had limited time to put their own stamp on government operations, the publication of their election platform under the title *Creating Opportunity* (more commonly known as the 'Red Book') as well as their first budget and the early statements of ministers, provide an opportunity to assess a variety of policy initiatives.

Canadian regional development policy is one area which seems to be in perennial need of reform. Condemnations of past policies transcend party politics: governments of all persuasions have been unable to meet the demands of critics. Indeed, many of these criticisms are contradictory. Those who support the use of regional development programs (RDPs) point to persistent regional disparities as evidence of inadequate policies and insufficient effort. Opponents of RDPs suggest that these endeavours are a waste of scarce resources: convergence should occur naturally through mechanisms such as migration, and the use of policy simply introduces economic distortions that will impoverish the rest of the country.¹

Rather than dwell on the vexatious normative question of whether the government should continue to implement RDPs, this paper examines the operational problems of current policies. The paper is divided into three sec-

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1. See Courchene and Melvin (1986) and Savoie (1986) for an earlier debate about the merits of regional development policy.

tions, dealing with the choice of targets, the instruments deployed, and the administrative structure used to deliver regional policy. In each of these sections, the current system of RDPs is reviewed within the context of lessons drawn from past efforts, and the key problems of the current programs are identified.² Finally, the current Liberal government's election platform, first budget, and statements are examined to determine the likelihood and direction of RDP reform.

It is worth emphasizing that regional development programs are not a major budgetary item. The total of all business subsidies and capital assistance (\$6.7 billion) amounted to 5.5% of the federal government's non-interest expenditures in 1992 (Statistics Canada CANSIM matrix 6671 and Government of Canada, 1969-94). The budgets of the four regional development agencies amounted to approximately 0.7% in the same year. The explicit combination of redistribution, market intervention, and regionalism, however, makes regional development programming an interesting microcosm of the major policy questions which have traditionally faced Canadian governments. With the political composition of the current parliament magnifying both regional and ideological differences, these policy questions are arguably going to take on greater significance.

Regional Development Policy Targets

There are numerous ways of targeting regional development assistance. The key characteristics generally used to define RDP targets are geography, sector, firm size, production activity, and factors of production. Canadian government agencies have used a variety of targeting strategies in the past. Current regional development programmes are available throughout Canada, and the provision of assistance to small and medium sized firms has become a dominant theme. Furthermore, special attention is paid to firms involved in research and development (R&D) and trade. The administration of the government's infrastructure program has also been assigned to the regional development agencies (Government of Canada, 1969-94). Factor targeting has become more difficult to characterize, as RDPs have begun to focus on specific aspects of the production process as opposed to simply granting assistance on the basis of jobs created or capital investments undertaken. The evolution of regional program targeting into this current structure reflects past lessons, but has left some problems unaddressed.

Geographic targeting in Canada has gone through distinct phases. Early efforts such as the Agricultural Rehabilitation and Development Act (ARDA) and the Fund for Rural Economic Development (FRED) focused on depressed

2. For a more detailed examination of some of these issues, see May and Rowlands (1993).

rural areas, reflecting the spatial focus of the development literature and the sectoral concerns caused by declining agriculture. But these early programs (and the later Area Development Agency (ADA)) suffered from political disputes concerning which rural areas qualified for support and which did not (Brewis 1969: 142). The focused geographic approach was initially continued by the Department of Regional Economic Expansion (DREE) after its establishment in 1969. Three years later, however, there was an abrupt shift to geographic universality, as all regions became eligible for assistance. This shift was also traced to political pressure, with a minority federal government seeking to shore up its regional profile after the 1972 election (Savoie 1992: 53).

Under the new policy, the federal government negotiated a separate General Development Agreement (GDA) with each province. The poorer regions were given priority by providing relatively larger subsidies for projects located in poor provinces. Under DREE's successor, the Department of Regional Industrial Expansion (DRIE), provinces were broken down into smaller regions, each categorized under a four-tier system of graduated subsidy levels. This gradual dilution of regional development funds was feared by the poorer provinces, though generally approved by the richer ones (Savoie 1992: 96-97). The trend, therefore, has generally been to extend the geographic coverage of RDPs and restrict direct inter-jurisdictional competition and comparison regarding relative funding. The current system of regionally separate agencies providing virtually universal coverage, therefore, is partly a reflection of political necessity.³

With respect to sectoral targets, earlier federal RDPs tended to concentrate on individual sectors such as manufacturing or resources, to the exclusion of others such as the service sector. Evaluating sectoral bias, however, is problematic due to the simultaneous existence of multiple regional and business development agencies in the 1960s. Thus ARDA focused initially on agriculture, while FRED targeted research, infrastructure, and rural businesses. There were also jurisdictional divisions which affected RDP sectoral targeting, both between levels of government and between government departments. Development policies for the resource sector, for example, were often considered the prerogative of provincial governments or a specific federal department such as Fisheries and Oceans or Energy, Mines, and Resources.

Subsequent programs also tended to be more narrowly focused, with DREE's early program focusing largely on manufacturing (Savoie 1992: 33).

3. The four formal agencies are the Atlantic Canada Opportunities Agency (ACOA), Western Economic Diversification Canada (WEDC), Federal Office of Regional Development for Quebec (FORD-Q), and the Northern Ontario program (FEDNOR). The two areas without formal regional development agencies are the Territories and southern Ontario. The former are covered by northern and aboriginal development programs, however, and the latter is the recipient of many benefits from Industry Canada's industrial programs. Thus, development assistance is effectively available to all areas of the country.

Under the flexible GDAs, which DREE adopted subsequently, however, virtually all sectors were eligible for assistance within the single GDA program. The regional agencies have continued this flexible approach, although a tendency to focus on the manufacturing sector may still exist. For example, contributions to manufacturing from ACOA's Action Program have consistently been close to one-half of total contributions (Savoie 1991: 96). The same data, however, indicate that business services, other services, and tourism have become significant recipients of ACOA funding. With services becoming a prominent recipient of current RDP funding, and with the elimination of agencies with sectorally restricted mandates (such as FRED), sectoral targeting appears to have followed geographic targeting in the sense of becoming available to virtually all sectors.

Targeting on the basis of firm size has been adjusted to reflect many of the lessons derived from previous business assistance programs. One of these lessons is that smaller firms are generally believed to have a more difficult time dealing with government bureaucracies than larger firms, and are thus at a disadvantage when both types of firms compete for resources under the same program (Young and Wiltshire 1990: 69). 'Automatic' programs such as special tax incentives, however, often do not provide the immediate financial assistance which is of greater use to smaller and newer firms. The use of established programs designed specifically for small businesses, therefore, seems necessary to prevent larger firms from monopolizing RDPs. Among the approaches adopted by government programs are assistance for market development and facilitating access to lending, obstacles of particular concern for small and medium sized firms.

Large firms, however, still receive assistance, although this is often provided by Industry Canada programs, not just the regional agencies. The use of *ad hoc* arrangements to meet extraordinary funding requirements, often bail-outs, does occur. Examples of *ad hoc* arrangements would include the loan guarantees or subsidies paid to firms such as Chrysler and de Havilland; there are \$10 million still listed in Industry Canada's 1994-1995 estimates for contributions to Bombardier-de Havilland. These are generally high profile cases in which the employment effects of a firm's closure would be extensive. Regional considerations can affect these cases. While having the federal (or, on occasion, the provincial) government handle large firm assistance may equalize negotiating skills and bargaining strength, the apparent absence of a general framework for such assistance (such as industry wide negotiations and capacity limitations) can lead to non-uniform results. The *ad hoc* arrangements, however, have not proved effective in practice; the history of firm-specific grants has been dominated by spectacular and expensive failures (McGee 1992: 183-184).

The type of activity undertaken by a firm may also be a target for RDPs. R&D and trade assistance and promotion have frequently been important elements of business development programs. These persist in programs offered

by the regional development agencies in Canada, although Industry Canada and the Department of Foreign Affairs and International Trade run programs as well. Innovativeness and international competitiveness are seen as important aspects of healthy business development, the focus of current regional development policy.

The final main targeting category for RDPs is factors of production. For many observers, regional disparities were undesirable because of the accompanying differentials in living standards. Furthermore, the presence of regional differences in unemployment rates was seen as a key reason for inter-regional income disparities. Labour subsidization appeared to be an appropriate policy if the goal of RDPs was to alleviate the immediate problems of low employment and out-migration.

Such an approach, however, did not promote the accumulation of capital (human and physical) which is arguably the only sure route to long-term economic development. Encouraging labour intensive activities and production techniques would condemn poorer regions to perpetual relative poverty, as their wealthier counterparts accumulated the capital necessary for high productivity and high wages. In practice, the capital subsidy approach seemed to win. Early programs by the government often used investment tax credits, capital cost allowance incentives, and funding based on capital investment as the means to deliver industrial and regional development assistance. Subsequent analyses indicated that this approach may have led to relative decreases in employment (see, for example, May 1979). While there were some explicit programs to assist labour, these tended to be directed towards encouraging adjustment in the case of structural decline in a sector or industry.

Subsequent programs have often provided funding on the basis of both capital investment and employment generation, although capital investment still dominates the funding practices of agencies like ACOA. According to ACOA, "[c]apital investments (establishment, expansion and modernization) still represent the largest percentage of projects and investments", although "support to operational projects and innovation and marketing activities is steadily gaining importance" (ACOA 1994: 20). The funding of other business activities such as marketing studies and business plans has reduced the traditional pro-capital bias of regional development programs. Labour subsidies often occur in the form of training assistance.

By reducing the relative factor bias of RDPs, regional development programs may actually converge with theories of economic development which emphasize the role of entrepreneurs.⁴ Specifically, the subsidization of all direct factors of production may encourage entrepreneurs. In this sense, entrepreneurship may not be a 'typical' factor of production in that at the margin it may act as a complement rather than a substitute for other factors.

4. For example, the theories associated with Schumpeter.

The traditional focus of RDPs on subsidizing capital for relatively larger projects is being supplanted with a balance in factor subsidies and emphasis on smaller projects, bringing the practice of RDPs into line with the stated objectives of fostering entrepreneurs. Evidence of this shift may be found in ACOA's funding activities, where there has been a marked shift towards smaller projects, with contributions to projects over \$1 million falling from 51% in the period prior to 1989, to 22% in the period from April 1989 to March 1993 (ACOA 1994: 17).

What is the Liberal government's approach to RDP targeting? In terms of the geographic coverage of RDPs, the explicit differentiation between poorer and richer regions is not likely to be resurrected. Universal geographic coverage seems to be necessary for political reasons, and to help portray regional development policy as the encouragement of profitable economic activity rather than simply inter-regional redistribution. Thus, it seems that the earlier debates about the geographic targeting of RDPs has been settled in favour of universality with funding directed primarily towards poorer areas. The Liberal Party's statement that it sees "strong regional economies as the building blocks of Canada" (Liberal Party 1993: 59) attests to their view that regional development programs should not be geographically restricted.

During the election campaign, the business development plans of the Liberals focused on small and medium sized business (Liberal Party 1993: 44-54), a focus repeated in their statement on regional development (Liberal Party 1993: 59). Subsequent statements by federal ministers, such as Paul Martin (FORD-Q News Release, March 28, 1994), have also emphasized the role of small and medium-sized business. The priority assigned to these firms by the Liberals is consistent with the evolution of RDPs in the last decade.

The Liberal Party's stated aim of simplifying business regulation and providing business services to promote trade and innovation are consistent with the changing focus of RDPs from capital subsidization to the provision of a 'pro-entrepreneurial' environment. This trend in RDPs indicates that policies may move beyond encouraging entrepreneurs implicitly because of the need to maintain a degree of 'neutrality' in other factor markets, to encouraging entrepreneurs explicitly by removing obstacles to their activities.

What targeting problems remain for the Liberals to address? The first question is how absolute and relative funding between the regions will evolve. Figure 1 shows how the funding for the agencies delivering RDPs evolved from 1969-1990. Aside from the expenditure spike in 1994 (due to the infrastructure program), regional agency budgets have certainly not been increasing in real terms. Fiscal restraint, at the federal level, will likely result in declines in federal spending on regional programs.

In addition to the level of funding, the regional distribution of subsidies may also signal the government's dedication to economic convergence. Figure 2 shows federal non-oil and non-agricultural subsidies and capital assistance for the Atlantic provinces, Quebec, and the four Western Provinces. The share of

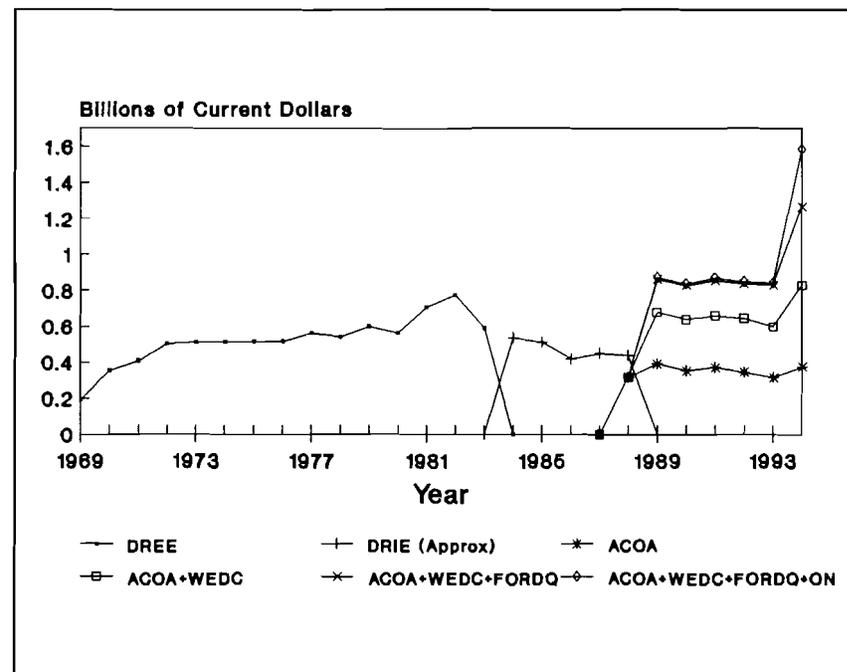


FIGURE 1 Regional Development Spending, 1969-1994

Note: The figures presented for (1984-1991) are approximations, since the regional and industrial components were not reported separately for DRIE, and FORD-Q was not a separate reporting entity until 1991. Note that 'ON' represents FEDNOR.

Source: Government of Canada, *Expenditure Estimates, 1969-94*.

federal business subsidies received by the Atlantic provinces has declined over the past 30 years. The share of subsidies received by Quebec and the four western provinces has been more volatile, but the latter group appears to be gaining, partially at the expense of Quebec.⁵ The initial motivation of regional development policy, the reduction of inter-regional economic disparities, implies that poorer regions should be funded relatively more. The recent em-

5. Ontario's share of business transfers has been fairly stable. Note that the West's share of federal business subsidies increased by almost 50% from 1961-1992, while its share of population and GDP increased by approximately 10%. The share of federal business transfers received by Quebec and the Atlantic provinces declined from 1961 to 1992 by 21% and 27% respectively, while their population shares declined by 12% and 19% respectively, and their shares of GDP declined by 12% and 16% respectively. Part of the decline in relative funding, therefore, reflects population and GDP shares. (Source: Statistics Canada, Cat. No. 11-210).

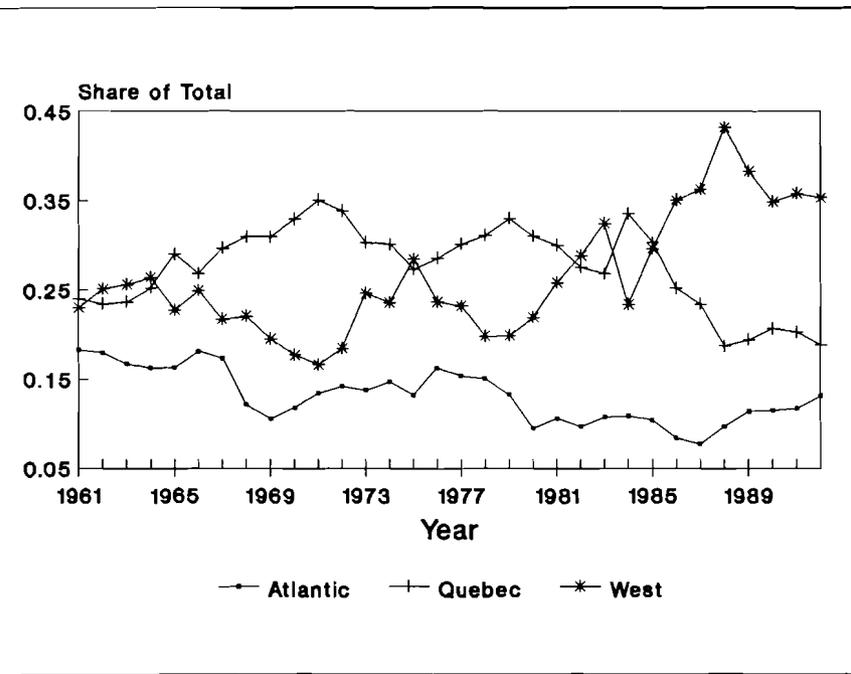


FIGURE 2 Federal Transfers to Business, Subsidies and Capital Assistance

Source: Statistics Canada, CANSIM 6814-6825. Oil and agricultural related payments are not included.

phasis on encouraging viable business enterprises suggests that the economic potential of each region should also be an important determinant of relative funding. How these two elements are balanced in the funding decisions has not been debated publicly. For political reasons, such a debate is not likely to be forthcoming.

The government has also not indicated how it intends to deal with large firms; the mechanisms by which a government can precommit to not assisting large firms are weak. Subsidies to large firms by Industry Canada remain in the first budget of the Liberals. This case represents an inherited government obligation, however, and may not be indicative of Liberal policy towards large firm subsidies. There may be some cause for concern, however, since -- despite critical comments by Finance Minister Paul Martin about bailing out large firms -- the new government has signalled its interest in the fate of the Hyundai automobile plant in Bromont, Quebec. While it may be politically difficult to establish a standardized program by which large companies may receive government assistance, the dangers of allowing assistance to be decided case

by case are also considerable.

Finally, the evolution of RDPs towards small businesses and entrepreneurship has led to a problem of program duplication. For instance, it is not clear whether small business will be able to make just one application at one government office to be eligible for a coordinated assistance package which encompasses all government programs. Although the Liberals have called for the creation of 'one-stop' centres to deal with all small business programs, they have not specified exactly which programs will be available from these centres. Some federal-provincial coordination for the centres does seem forthcoming. Finance Minister Martin announced that an integrated information and service 'counter' will be opened which will be jointly sponsored by the Quebec and Federal governments (FORD-Q 1994). There still are, however, some inter-departmental jurisdictional issues at the federal level. For example, will a regional agency such as WEDC administer applications and assistance from the Federal Business Development Bank (FBDB), Industry Canada's programs (such as the Defence Industry Productivity Program, DIPP), R&D incentives, and marketing information from the Department of External Affairs and Foreign Trade? The multitude of targets has led to a multitude of programs, and the degree to which the various programs will be integrated has not been clarified.

Regional Development Program Instruments

Tax expenditures such as investment tax credits and accelerated capital cost allowances were featured prominently in many early regional and industrial development programs administered by agencies such as ADA and DREE. These programs were easy to administer through the established tax collecting bureaucracy, and were generally cost effective in terms of the associated effects on investment, especially investment tax credits (Bird 1980). Tax incentives for regional and industrial development, however, are now less common. Regionally differentiated federal tax rules have been politically unpopular, as they are a highly visible method of discrimination which affects international as well as inter-regional investment decisions. Tax credits are also harder to target, and typically violate the requirements of incrementality. Finally, tax credits are generally less useful to new and small businesses -- particularly those involved in research and development or innovation -- the primary targets of established RDPs.

Direct government grants seem to be the preferred manner of assisting new and small firms. Grants can be used to provide up-front financing for businesses with initial cash flow problems. The problem with using grants is that the administration of them tends to be more expensive. Ensuring that governments do not give money to undeserving enterprises requires fairly detailed grant applications. The firms most capable of enduring complex ad-

ministrative requirements are the larger and more established ones, the same firms which probably require grants the least and are not the primary targets of current RDPs. This type of administrative barrier can dissuade smaller firms from applying for assistance (Savoie 1987: 41-42).⁶

The continuing focus on small, innovative, and new firms means that grants will continue to be a relatively more effective instrument than tax measures, as they help meet initial financing requirements. Fiscal and administrative responsibility, however, entails the maintenance of relatively complex procedures to ensure that funds are used appropriately. The provision of other business services is an appropriate way of reducing the relative administrative burdens of grant programs. In these integrated programs, the firm can obtain access to a range of services and assistance without having to make several separate applications. The current RDPs have already moved in this direction. Grants from ACOA, for example, are geared towards defraying the costs of a range of activities essential for business development, from market studies to capital investment.

An alternative approach to make grant assistance less of a fiscal burden is to require repayment. WEDC uses repayable assistance extensively, and ACOA requires repayment from successful commercial firms which have received in excess of \$100,000. Unfortunately, the success of many of these programs has not been assessed in detail because past assistance has not yet come due in most cases. According to the 1994-1995 budget estimates, nearly 80% of repayable contributions administered by WEDC have not yet reached the repayment phase, although the "majority of projects already in the repayment phase were on schedule" (Government of Canada estimates for WEDC 1994-1995: 20).⁷ Past programs which required repayment were frequently cited by the Auditor General as having failed to collect the money owed (see, for example, Auditor General 1983, 1985, 1989). Recent Auditor General Reports have not identified any similar problems at WEDC. As long as repayment does not emerge as a problem for current programs, then the resource costs of RDPs may be reduced. Since repayable financial support can provide quick financing in the same way as grants, it remains a useful instrument for financing new investments, although it does reduce the level of assistance to the recipients. Finally, repayable assistance does act as a tax on success, and thus the incentives for the firm may be altered. Standard economic theory shows that financial payments which are contingent on profitability may lead the firm to adopt riskier business strategies. This potentially undesirable effect is mitigated by requiring entrepreneurs to contribute their own resources to a project, which is standard practice in Canadian RDPs. Despite these minor

complications, repayable assistance seems to have become a favourite option for fiscally strapped governments.

An alternative program similar to repayable grant assistance is to make credit more readily available to firms, a method which also provides initial funding at low cost. There have been frequent demands by small businesses for greater access to capital markets. Again, it is the small and new firms which seem to face the greatest difficulty in attracting loans from private institutions, though the magnitude of the problem may not be as severe as is widely thought (Economic Council of Canada 1982: 27). At any rate, the government has correctly targeted the group most disadvantaged by the current lending market.

One way of enhancing the ability of targeted firms to borrow is to provide loan guarantees. This approach reduces program costs by relying partially on the administrative structure of established lending institutions. Providing loan guarantees, however, may generate inappropriate behaviour. In this case, commercial lenders may lend to riskier ventures with the knowledge that the government is providing a guarantee of full or partial repayment.

An alternative to loan guarantees is the direct provision of government loans without relying on private intermediaries. The establishment of the Federal Business Development Bank was motivated by the desire to correct the perceived imbalances of the current financial system. The presence of government lending institutions, however, may also have a number of undesirable effects. If the government institution supplies loans at concessional rates, then commercial lenders will be priced out of the market and the burden on the government lender will be accordingly enlarged. If non-concessional lending is provided, then the government institution may be stuck with the businesses which commercial banks considered unworthy. This adverse selection would put government resources at greater risk. While funding riskier projects may well be the *raison d'être* of government lending institutions, what needs to be shown is why the government institution's evaluation of the tradeoff between risk and the rate-of-return is closer to the 'social optimum' than the commercial sector's, or why the government institution is more capable of evaluating risk than its private counterparts.

It should be noted that loans may not always be the most appropriate means of assistance. In particular, the provision of loans will affect the debt-equity ratios of firms, which may lead to undesirable consequences. The most obvious cost of having a relatively small equity base is the vulnerability of the firm to interest rate fluctuations and the business cycle. The absence of adequate equity appears to be a more serious deficiency for small businesses than the absence of credit (Economic Council of Canada 1982: 27). Thus the financial structure of the firms need to be examined before deciding on the propriety of loans (Economic Council of Canada 1982: 14).

The two themes which seem to have dominated the evolution of RDP instruments are target choice and cost effectiveness. In terms of targeting, the increased reliance on grants relative to tax incentives is consistent with the

6. For a review of the relative merits of grants and tax incentives, see Savoie (1985).

7. To date, the Ottawa office of WEDC confirmed that no detailed study on repayment was available.

targeting of small business and specific activities, while the use of loans targets a perceived market failure. Repayable assistance and loans can also reduce the government's fiscal burden.

The Liberal's Red Book identified the absence of capital availability as a key constraint on the development of small and medium sized businesses. (Liberal Party 1993: 48). Among the proposed changes was the elimination of personal guarantees for loans made under the Small Business Loans Act. Such a change would presumably lead to an increase in the number of persons or businesses qualifying for loans under the Act. Unfortunately, eliminating personal guarantees also changes the incentives of firms, and may either lead banks to become more cautious in their lending (in the case of government guarantees which do not cover the full costs of loan default), or increase the financial costs to the government. Although Bill C-99 raised the portion of loans guaranteed under the Small Business Loans Act from 85% to 90%, the private lender still bears part of the risk of their loan.

The Liberal plan also called for the development of alternative capital sources, such as community or regional investment pools, cooperatives, and credit unions (Liberal Party 1993: 49). A Canada Investment Fund was to be established to act as a venture fund for leading edge and emerging industries, with lending to be proactive rather than just reactive.⁸ While these types of programs may have some potential use, it is important to ask why private lenders and investors (and the Federal Business Development Bank) have, apparently, not performed these tasks in a satisfactory manner. Furthermore, the effect of these proposed institutions on the current market have not been identified. Will the government's investment fund end up separating the market into high and low risk ventures, with the government holding the risky portfolio? Will community and regional investment pools lead to capital market segregation, with inefficient resource allocation? The Liberal election platform identifies a number of institutions to be created or encouraged, but does not provide any analysis of how these institutions are supposed to affect the current market outcomes, or interact with each other.

One key aspect of the Liberal Party proposal is the apparent emphasis on providing equity financing as opposed to credit. Enhancing access to equity capital does address some of the concerns raised by the Economic Council of Canada (Economic Council of Canada 1982: 27). More detail will have to be provided about how the government equity shareholder will manage its portfolio. Presumably there will have to be provisions for disposing of shares in order to free up finances for further investments.

8. The Liberal Party proposal called for the investment corporation to have staff "whose mandate would be to seek out projects and technologies in which to invest" (Liberal Party of Canada 1993: 49). This approach would presumably be in contrast to simply receiving and evaluating proposals. However, to date, the Canada Investment Fund has not been established.

The Administration of Regional Development Programs

The current administrative structure for RDP delivery was initiated in 1987 with the creation of ACOA, WEDC, and FEDNOR. The creation of the separate regional development agencies occurred under the previous Progressive Conservative government after the reorganization of departments and the removal of regional programs from the industry portfolio. The Department of Regional and Industrial Expansion was eliminated by this change. As far as regional development programs was concerned, the move was probably advantageous: the forced integration of the DREE and Industry, Trade and Commerce (ITC) which created DRIE had led to administrative disharmony, and a reduced emphasis on DREE's regional development objectives in the amalgamated Industrial and Regional Development Program (IRDP) (Young and Wiltshire 1990: 68-69).

The optimal degree of decentralization for regional development program administration is difficult to determine. There are two key arguments in favour of greater decentralization: cost and flexibility. On the cost side, some observers believe that lower levels of government are capable of delivering comparable services with lower administrative costs (Savoie 1987: 63). Decentralization and local discretion permit programs to be tailored more closely to the idiosyncrasies of local economies (Savoie 1987: 43). Program flexibility can lead not only to administrative sensitivity to local conditions, it may also generate useful innovation and experimentation with programs.

There are also several disadvantages to decentralized administration, and the optimal RDP administrative structure must reflect these as well. Local discretion and experimentation may make RDPs more vulnerable to abuse, especially if local interests 'capture' the administrators, although Savoie suggests that local bias may not be a significant problem (Savoie 1987: 56). The ability of lower level bureaucrats to deal with relatively large clients is also open to question, and, at the least, may lead to considerable variation in the application of RDPs depending on the relative skills of local administrators. The use of graduated levels of discretion, that is, the requirement for more senior bureaucrats to approve funding above certain predetermined levels is useful in avoiding these types of problems, and were common under the old DREE administrative structure.

There are other advantages to having federal government involvement in the administration of RDPs. First of all, untied federal funding of locally administered programs may introduce unfavourable incentives. For example, untied transfers weighted towards the poorest regions implies that relatively successful development will reduce subsequent funding. This argument about incentives can also be used to justify regional and economic development programs as a whole. In a state where there are substantial federal transfers to individuals, generating opportunities for these people to contribute economical-

ly will be of particular interest to the federal government. The transfers to individuals may discourage local or individual initiatives to generate employment. Under these conditions, it may seem preferable to a local agency to finance projects which essentially increase current consumption as opposed to investment.

The involvement of the federal government may also make the administration of certain program types more efficient. Programs which use tax incentives (which used to be an important instrument for RDPs) can be more easily administered through Revenue Canada. Programs requiring large amounts of discretionary funding may also be better served by direct federal involvement. The dissemination of program innovations and administrative expertise across jurisdictions is probably easier if the federal government is involved more directly. The benefits of local experimentation may thus be shared more effectively.

The absence of a federal government presence also opens the door to inter-provincial and inter-regional competition. While some competition may be useful in terms of promoting efficiency and encouraging innovation, it is unlikely that the poorer regions will be the ones most able to attract or develop new enterprises.⁹ Competition will also tend to distribute economic rents to firm shareholders and management rather than to the community at large, especially in the case of 'bidding' for firm location. Although smaller firms may themselves compete for business incentives, the bargaining structure will probably be favourable to the businesses rather than to the local communities. There are many communities continuously seeking to attract businesses, providing a constant 'supply' of location incentives. In contrast, there are unlikely to be many firms which are indifferent to location and hence able to compare relative incentive schemes directly. Furthermore, these firms are likely to be larger ones seeking a location for part of its production activities, and larger firms can be formidable negotiators. Thus, the potential for communities to compete on the basis of locational incentives is considerable. The presence of the federal government may help to ensure that this inter-regional and inter-provincial competition is reduced, or at least plays a constructive role.

The data in Figures 3 and 4 provide some tentative evidence of the potential need for federal mediation of RDPs. Figure 3 displays the recent growth in nominal federal and provincial transfers to business. While both have increased substantially over the past 12 years, federal transfers seem to have

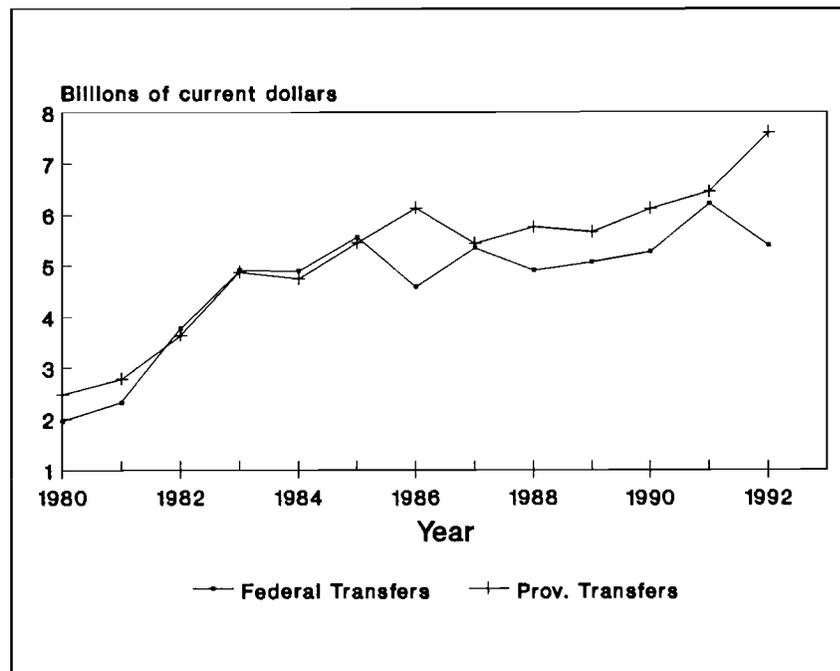


FIGURE 3 Federal and Provincial Transfers, Subsidies and Capital Assistance

levelled off earlier than provincial transfers. The ratio of provincial to federal transfers, shown in Figure 4, seems to indicate that provincial transfers have become relatively larger. This evidence is clearly tentative, but may be indicative of greater provincial influence in RDPs, and the potential for inter-provincial competition to become more important.

Finally, the inclusion of higher levels of government improves the capacity for effective economic planning. Not only will local governments have fewer administrative resources to conduct economic planning, they will be less able to take a wider regional or sectoral view. Focusing on local economies may lead to problems arising from the fallacy of composition. For example, the benefits of subsidizing the forestry sector in one area will depend critically on whether other regions also intend to subsidize their forestry sector. Such competition between regions can be reduced by federal coordination, and inappropriate sectoral investment avoided. In effect, the presence of the federal government is useful to ensure that provincial and regional economic plans are mutually compatible, and consistent with 'national' objectives.

The political arguments in favour of federal involvement and centralization are also very strong, and have frequently proved to be a driving force in the evolution of regional policy in Canada. One of the primary reasons cited for

9. One referee correctly pointed out that New Brunswick has had some recent success in attracting firms away from larger and wealthier provinces. Whether the policy of the New Brunswick government is sustainable, given the costs of providing location incentives, is open to question. More importantly, it is uncertain how much additional job 'poaching' the other provinces will tolerate before aggressively retaliating. In the long run, the ability of Ontario, B.C., Alberta, and Quebec to finance competitive business subsidies exceeds the capacities of the other provinces.

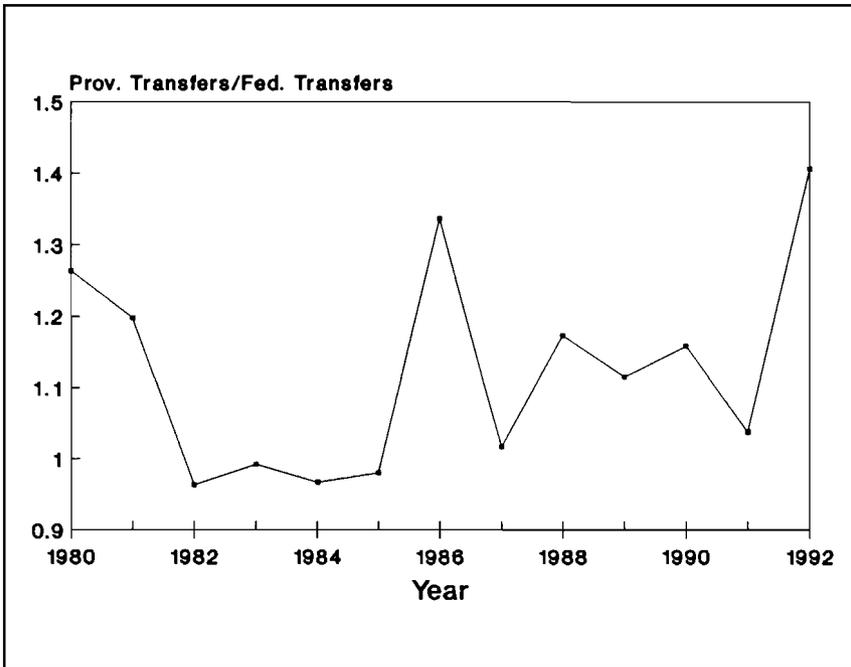


FIGURE 4 Provincial - Federal Transfer Ratio, Subsidies and Capital Assistance

Source: CANSIM Matrix 6814. Federal subsidies were not adjusted on an accrual basis, and do not include agricultural or petroleum related subsidies.

the demise of DREE was the alleged absence of a federal profile (McGee 1992: 115). While the DREE programs were administered jointly with the provinces according to specific agreements (the GDAs), the proximity of the provincial politicians permitted them to become more closely associated with a given development project.

Aside from the question of how decentralized the RDP administration should be, perhaps the most difficult issue in regional or industrial development is program evaluation. Past evaluations have not satisfied program critics, and have often been methodologically inappropriate. The use of questionnaires has been identified as a particularly improper, although widespread, method (Bird 1980: 34). The evaluations performed by independent reviewers have often generated less favourable reviews for RDPs than those conducted by the government (see, for example, May 1979). For an excellent review of some of the issues surrounding RDP evaluation, see Cohen and Legoff (1987).

Part of the difficulty of evaluating RDPs is unavoidable. The process of regional economic development is extremely complex and very slow; RDPs cannot be evaluated in terms of overall regional growth rates or reductions in

regional disparities. The behaviour of an individual firm (its investment activity, for example) is also complicated. The timing of policy effects are difficult to trace, and long-term effects may not be apparent at the time of evaluation. Criticisms of evaluations which fail to take these problems into account will have as much use as the flawed evaluations themselves.

Government evaluations have improved. A recent study of some ACOA programs by Coopers and Lybrand used questionnaires more as a supplement for statistical evidence on issues such as incrementality (Government of Canada Estimates for ACOA 1994-1995: 21). ACOA now compares the success and failure rates between projects given assistance and those denied assistance. Surveys of applicants are then used to verify the results. Methodologically, this approach to measuring incrementality is seriously flawed. What they are actually measuring is their capacity to identify successful projects. Some of the evaluation problems reflect inherent philosophical and practical issues associated with targeting only incremental activities (Usher 1975). While it is comforting to know that ACOA is not throwing money away on unsuccessful ventures, the degree of project incrementality claimed by ACOA on the basis of surveys remains uncorroborated.

The current Liberal government has not expressed any interest in changing the administrative structure for delivering RDPs. The separate agencies are each represented by a separate senior minister from the relevant region. Such a structure explicitly focuses the competition between regions at the cabinet level, a structure which has been present since the demise of DREE and the Ministry of State for Economic and Regional Development (MSERD). While there should be no suggestion that the presence of a separate department eliminates cabinet level competition among regions, the absence of such a department removes one venue for RDP coordination and cooperation.

There is evidence that some of the problems of the administrative structure are recognized by the current government. The Liberal government's election platform called for greater federal-provincial cooperation in regional development, and suggested that inter-governmental competition be avoided by assigning roles to each government. The Liberal election plan suggested that the Federal government should concentrate on infrastructure (including tourism), research and development and its applications, and assistance to small business (Liberal Party 1993: 59). Clear definitions of roles and activities for each government level may be one solution to current problems of duplication. The Liberals also called for greater intra-regional government cooperation. Furthermore, both program administrators and the Liberal government have indicated that they are aware of more fundamental issues in program evaluation, notably that the impact of assistance programs must be examined in terms of the market effect, rather than just in terms of individual firm performance (Liberal Party 1993: 59).

While there is a signal that minor administrative improvements will be forthcoming, some problems still remain. The decentralization inherent in the

regional agency structure has weakened the ability to coordinate and cooperate across regions, and encouraged some forms of inter-regional competition. For example, ACOA and WEDC have both indicated an interest in promoting the interests of their region in the federal government on issues such as procurement. ACOA's Advocacy Program and Procurement Program are specifically designed to promote the interests of Atlantic Canada. WEDC has its own Procurement Initiative, the progress of which is described in annual reports and WEDC newsletters (WEDC 1991). With the end of DRIE and MSERD -- the last RDP coordinating agencies (Savoie 1992: 161) -- inter-regional rivalries may have to be resolved politically at the cabinet level.

While regional differentiation is appropriate, and may lead to greater understanding of RDPs because of the variety of experiments being undertaken in different regions, the absence of stronger central coordination may inhibit some of the sharing of these lessons. While the current structure does permit information to flow across regional agencies, other forms of sharing such as personnel exchange may be reduced by the presence of separate agency structures. There are apparently no plans to have a formal central coordinating body to examine regional plans within the context of national objectives. According to the Privy Council Office (PCO), the responsibilities for formulating regional development policy is shared between itself, the departments of Finance and Industry, Treasury Board, and the regional agencies. These organizations help determine federal policy on regional development by consulting and cooperating amongst themselves, and serve as an important conduit for information to be shared inter-regionally. Officials at PCO indicated that the program review in 1994 resulted in somewhat stronger directions being issued to the regional agencies by the federal government, and that there was recognition of the need to coordinate RDPs at the federal level.

The government has not signalled any intention to open up the process of administering RDPs, institute a more reliable external evaluation procedure, or specify the goals of RDPs in a manner which facilitates evaluation. Although inherent difficulties will always constrain RDP evaluation, improvements are still possible. One of the most enduring evaluative difficulties is the failure of governments to identify clearly the objectives of RDPs and identify quantitative measures of success and failure. This deficiency has been a long standing concern:

"Objectives setting that does not include some form of quantitative targets can make it all-too-easy for programmes to cruise along without 'real overhaul' for years...Conflicting or woolly viewpoints about major 'programme' goals mean that evaluation at the project level must inevitably be an exceedingly unsatisfactory and groping-in-the-dark affair". (McAllister 1974: 94)

An independent reviewing agency, and a more transparent administrative pro-

cess for RDPs, would contribute to an improved evaluation procedure. Improved evaluations, in turn, will permit RDPs to evolve efficiently.

One factor complicating the government's regional development program is the role of the two new parties in Parliament. With the Bloc Québécois representing the desire for greater powers on behalf of Quebec's citizens, and the Reform Party (based primarily in western Canada) arguing for greater spending cuts, the government may be forced to alter their regional development policy. In addition, business groups have also been calling for an end to government business subsidies. One potential strategy may thus be for the government to reduce funding for RDPs substantially, citing fiscal restraint, restoration of market forces, and the acknowledgement of provincial rights as reasons. With the current threat of Quebec separatism, however, a complete withdrawal of federal spending is not likely in the short run. RDPs are a practical manifestation of the fiscal ties that help to unite Canada, and can be used to publicize federal government involvement in encouraging development.

Conclusion

Canada has had twenty-five years of substantial regional development programming. With a new government, now might be an appropriate time to take a close look at the lessons learned from this experience to see where future policy may be headed, and to see which past programs and practices are expendable.

The new Liberal government has acknowledged some of the important elements of the evolving structure of RDPs. Promoting entrepreneurship in all regions has evolved into a key RDP target. Assistance through the provision of government services as opposed to simply providing government subsidies has also been identified as an increasingly important RDP instrument. Instrument choice and targeting have become more compatible. Finally, businesses have called for simplified application procedures, leading to pressure for greater coordination and integration of programs. The new government seems favourably disposed to these developments.

Unfortunately, more detail about a Liberal regional strategy has not been made available, and may not exist. Regional economic development was not a key issue in the last federal election. It is hardly surprising, therefore, that the Liberal government has not given RDPs a high profile since coming to office. The diminished priority of regional development programming can be traced to four factors. First of all is the increased need for fiscal restraint, which restricts program expansion. Secondly, regional development is a politically sensitive issue, and policy changes are likely to simply generate undesired attention. Thirdly, past regional development efforts have arguably been unsuccessful in generating 'substantial' economic convergence amongst the

regions.¹⁰ In the absence of new theories about regional development, the direction of policy reform may not be obvious. Finally, RDPs have evolved through the regional agencies into a business support program consistent with the government's general perspective about economic development. Thus regional development continues to emphasize absolute development within each region as opposed to relative development between regions; regional development and business development are now essentially equivalent.

The regional agencies have gained valuable experience and have initiated improvements. The continued evolution of RDPs, however, requires some difficult political decisions to be taken at the federal level. One problem with the current system is that federal intervention may be necessary to eliminate programs which have not been useful, especially if the regional agencies perceive funding to be tied to the presence of specific programs. Secondly, programs such as small business assistance are now being provided by more than one government agency, and the integration of these programs will require federal coordination. Finally, inter-agency information sharing and cooperation on planning will be facilitated by explicit federal coordination, preferably within the framework of a national strategy.

Ideological concerns have not been a dominant force in determining Canada's RDPs. The gradual evolution of programs seems to have prevailed despite frequent shocks to the administrative structure of regional programming. The evolutionary process, however, has been hampered by an absence of the rigorous evaluations required to improve good programs and eliminate poor ones. The process of evaluation has, in turn, been obstructed by the absence of political direction in terms of identifying program goals and resource tradeoffs. So, while the past evolution of RDPs has led to some important changes, further improvements will require a government which is willing to deal explicitly with the contentious issue of quantifiable RDP goals, and identify explicitly the resource tradeoffs it is prepared to make in pursuit of regional development.

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10. Coulombe and Lee (forthcoming) suggest that convergence has occurred; what constitutes 'substantial convergence' is obviously subjective. Furthermore, it is not clear how much worse the disparities may have become in the absence of RDPs.

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