

Review Essay/Note de lecture

A REAPPRAISAL OF CANADIAN REGIONAL
DEVELOPMENT

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Still Living Together: Recent Trends and Future Directions in Canadian Regional Development. Edited by William J. Coffey and Mario Polèse. Montreal: The Institute for Research on Public Policy, 1987; 459 pages; \$25.00.

The 1977 report of the Economic Council of Canada, which was entitled *Living Together: A Study of Regional Disparities* [3], presented a concise account of Canadian regional disparities. By analyzing regional income and productivity differences, and regional stabilization and development policies, the Council sought to demonstrate modest progress in narrowing long-standing regional disparities. The Council also promised the possibility of much greater progress, at low cost, if some alternative policies that they recommended were implemented. These alternatives put emphasis on narrowing regional productivity differences and advocated some disengagement by the federal government to allow greater provincial, local and individual initiatives. Although this report was the subject of criticism in the following decade, particularly since the narrowing of regional income differences was mainly attributable to greater federal transfer payments, it nevertheless presented a coherent and logical thesis.

Despite its title, *Still Living Together* has no such coherence and logic. On the contrary, it consists of fourteen chapters based on a variety of ideologies and perspectives, it is more descriptive than analytical and, unlike the Economic Council report, it does not lead the reader to a set of policies or alternatives that are a logical extension of the preceding discussion. In short, we are presented with a set of individually interesting but collectively disjointed essays on Canadian

regional development. Given subsequent and recent policy developments in which the Mulroney government has announced a revived federal regional development program (including, for instance, in August 1987, a \$1.2 billion fund to diversify the western Canadian economy), it is most unfortunate that this collection lacks a consistent and comprehensive framework in which one could assess recent policies.

The Domestic Context

The book is organized into four parts, the first of which describes recent Canadian development trends and should, therefore, provide an appropriate point of departure. Polèse summarizes long-term trends in provincial product and per capita income in the opening chapter. This historical material is well known and needed only a brief summary, whereas recent changes, including the late 1970s boom in western Canada and the subsequent decline, are noted but not analyzed. A disaggregation of provincial product into major sectors along the lines of Davis [2] would have added much to Polèse's interpretation, and perhaps helped the author to answer the key question he poses: to what extent are recent changes in provincial economic performance cyclical and temporary, or structural and long-term? Termote's analysis of demographic trends from 1966 to 1981 needs to be connected with the introductory chapter, because economic opportunities are a major factor in migration. It is unfortunate that 1986 census data were not available to Termote, because only in Table 4 does he quantify the dramatic reversals in migration to western Canada that occurred after 1981. This evidence of a major migration reversal suggests that cyclical phenomena are once again fundamental to an understanding of Canadian regional development.

Coffey presents an empirical analysis of changes in employment structure from 1971 to 1981. Parts of the analysis are presented at the regional level but, somewhat anachronistically, most of the discussion is at the urban scale. The author notes the growth of elements within the service sector, particularly consumer services in eastern Canada and producer services in Ontario and western Canada, but it remains unclear whether such services are considered capable of being a leading sector in regional growth. If the service sector is largely nonbasic, then the primary and manufacturing sectors deserve more detailed study. For example, take Coffey's finding that a very significant growth of all three classes of manufacturing occurred in towns of 30-50,000 population. This raises the possibility of (and may indeed be a manifestation of) the decentralization of Canadian manufacturing to non-metropolitan regions. There is a substantial lacuna in our understanding of the process here. And is it not important to such an analy-

sis that the 1971 census coincided with the recovery from a minor recession (1968-70), whereas in 1981 Canada was on the threshold of the worst recession since the 1930s?

Lithwick's brief is an evaluative survey of regional policy in Canada. This is well done, but given available reviews (including the unreferenced paper by Weaver and Gunton [11]), one wishes that the critique had dwelt upon the recent past, beginning with the later DREE (General Development Agreements) period. Explaining why Canada achieved virtually no narrowing of regional incomes, net of transfers, in the 1973-81 period (when regional policy was a serious business) lies at the heart of this book. Lithwick's explanation is that regional development is highly dependent on national development, so regional policy should take cognizance of how a region fits into the national economy. In practice, however, the Canadian economy is unusually fragmented, the regions are poorly articulated, and regional performance is much affected by factors external to Canada. This suggests that Lithwick's solution is partial and would require, in addition, policies to improve the connection between some regions and the national economy.

The Foreign Context

The three essays in Part Two look at international relations in the context of multinationals (Bonin and Verreault), corporation decision-making (Semple), and the likely regional impact of freer trade with the U.S. (Watson). Given that Canada has a very open economy (merchandise exports accounted for 23.6 percent of GDP in 1982) and has high levels of foreign investment in most sectors of the economy, then it is clear that Canadian regional development, as Innis and Macintosh told us years ago, must be examined in the light of external trade and investment relations. Indeed, this reviewer's belief that foreign trade performance is central to an understanding of regional prosperity in Canada gives rise to the main criticism of this section, namely that trade and foreign investment as a whole is not considered. The ability of Canadian regions to export their staples, manufactured goods, or services, and the world prices of those goods and services, played a decisive role in regional economic performance in the 1981-84 recession, influencing both the timing of the downswing and recovery, and the severity of the regional impact [5;6].

Bonin and Verreault examine provincial changes in the distribution of establishments, employment and value-added in foreign-controlled manufacturing firms from 1961 to 1981. Their base is Michael Ray's study [8], which found that Ontario was the major recipient of U.S. foreign investment (the U.S. accounts for approximately 75 percent of all foreign capital invested in Canadian manufacturing). Little

has changed, so that contrary to the experience in many European countries where regional investment incentives have attracted foreign capital to peripheral regions, in Canada it is the heartland that attracts most foreign capital. We are left, however, without a definitive explanation of why this is so.

Despite its title, Semple's paper does not present a regional analysis of corporate decision-making. What it does present in several interesting tables is a breakdown of the location of the headquarters of major corporations by sector and by city. Semple shows that Toronto's dominance as the Canadian centre of corporate headquarters is due largely to foreign corporations; as far as domestic companies are concerned, Montreal ranks a much closer second. Missing is an examination of what these data imply for corporate decision-making and for the resource and peripheral regions served by many of these companies, and the consequences of all this for the theme of this book. Are the regions mutually supportive (living together), or is the relationship between the urban heartland and the periphery a parasitic one?

Watson considers the likely regional effects of freer trade with the U.S., this being a theme crucial to the book and one deserving a fuller treatment, including an empirical study of recent trends. He begins by rejecting the Macdonald Commission's position that free trade will have an insignificant regional impact, and proceeds to examine possible effects, first on the consumption side, and then on production. In the former instance, the expected lowering of consumer prices will have a fairly uniform beneficial effect on all regions. His discussion then focuses on the expected regional impacts of changes in production. Watson examines possible outcomes under various assumptions, favouring a general equilibrium model to a partial one. He concludes by calculating likely regional impacts using the Harris and Cox model with the twin assumptions of imperfect competition and increasing returns to scale. The results indicate that changes to value added and to employment will vary a lot from sector to sector, that the aggregate regional benefit will be to boost GDP by about 15 percent, but that in the Prairies GDP will rise by 22 percent. The analysis poses as many questions as it answers. For example, the free-trade model predicts a 60 percent increase in sectoral GDP in agriculture (which accounts for much of the predicted benefits in the Prairies), a figure that Watson admits is not entirely credible. This is an understatement; free trade would marginalize several segments of Canadian agriculture in which U.S. producers have a comparative advantage. The model also fails to take into account variations in the quality of regional resource endowments or regional variations in transportation costs. The key issue of exchange rates and the associated labour cost advantage that a depreciated dollar gives to Canadian producers is dealt with rather cursorily,

despite the evident mobility of capital. If anything is to be learned from the ebb and flow of the trade balance under the 1965 Auto Pact, it is that Canada attracts manufacturing investment when the Canadian dollar is well below par.

The Role of Resources

Three obvious possibilities for shifting the pattern of regional development in Canada in favour of lagging regions are through the selective pursuit of technological change, through the development of human resources, and through resource exploitation (a peculiarly Canadian solution). These topics are the subject of Part Three, with essays by Mansell on energy policy, De Wolf on offshore resources, Lesser on technology, and Cousineau and Vaillancourt on university education.

Mansell presents a very satisfying assessment of energy policy, rents, and pricing by examining the processes operating to influence Canadian development patterns during the recent Alberta energy boom. This boom, in which the oil and gas industry acted as a classic propulsive industry with Calgary as the major growth pole, had the potential to change the structure of the Albertan economy. Due to (1) artificially low oil and gas prices imposed by the federal government, (2) the National Energy Programme, and (3) equalization payments, a large proportion (perhaps two-thirds) of the total economic rents generated by Alberta's energy boom was transferred to other provinces, largely in reflection of Central Canadian interests. The federal system of low energy prices proved not to be an efficient way of distributing economic rents (it subsidized energy-intensive industries and favoured high income earners), nor did it help the Albertan economy to diversify very much, although some growth of producer services for the energy industry did occur.

Left unexamined by Mansell is the issue of how one deals with regionally-localized industries that are susceptible to a boom-and-bust cycle. Despite the moderating effect of substantial migration to Alberta during the boom, a regional Phillips curve mechanism operated. Wage inflation made it difficult to diversify the Albertan economy and may have contributed to the decline of the food industry. Calgary experienced a real estate boom. This made the bust all the more severe, with a quite startling reversal of migratory trends, a collapse of real estate prices, and high vacancy rates in Calgary office blocks from 1982 to 1986. Despite the billions of dollars of energy rents retained in the province (including the Heritage Fund), and despite a decade of low taxes and high provincial expenditure, by 1987 Alberta begged for and received federal funds to diversify the economy and revive the flagging fortunes of the oil, gas, and agriculture industries.

The development of Atlantic Canada's offshore oil and gas resources—specifically the Hibernia and Venture fields—is the subject of De Wolf's essay. It is predicted that the industrial expenditures to develop these two fields will involve considerable leakage out of the Atlantic provinces and indeed outside Canada (perhaps 50 percent in the case of the larger Hibernia project). The local employment impact will be small, except during a relatively short construction phase. Thereafter, however, they will contribute substantially to the GDP of Newfoundland and Nova Scotia. Being marginal, the economic rents of the Venture field will be quite small, but in any case reduced equalization payments mean that the fiscal capacity of the two provincial governments would remain unchanged were it not for offset provisions offered by the federal government under the Canada-Nova Scotia Offshore Oil and Gas Act and the Atlantic Accord. These are crucial, because the indirect effects of this type of resource development appear to be much more important than the direct regional effects. Needless to say, all these conclusions are based on fairly optimistic assumptions about the world price of oil, which, as recent price fluctuations show, is quite volatile.

Technological change may be expected to affect regional economic disparities not only through changes in productivity in specific industries but also, as Lesser argues (and here he echoes Parr [7]), through the peculiar and particular characteristics of a region's economy. This theme is explored in the context of the expected impact of information technology on the Atlantic economy. Given a large public sector to which questions of regional comparative advantage do not apply, a small manufacturing sector, and a substantial primary sector that can make very limited use of information technology, then the current wave of technological innovation based on microelectronics is likely to have little impact in the Atlantic region and therefore leave it developmentally further behind. In theory, improved telecommunications make it possible to communicate better with the periphery, but in practice, Lesser fears, the reverse may occur and that may have an effect comparable to airline deregulation, with a concentration of service among oligopolistic suppliers on high density connections. He recommends a vigorous policy initiative to prevent such a pattern becoming entrenched.

The paper by Cousineau and Vaillancourt on university education and provincial income disparities is both interesting and contentious. They present a regression model that shows that income levels increase with level of education in each Canadian province. From this stems the proposition that selective additional investment in university education may reduce regional income disparities. This is then tested using a human capital model. The results confound the proposition;

only in New Brunswick, Nova Scotia, Quebec, and Ontario is the public rate of return on university education higher than alternative investments. Moreover, only in Quebec, Alberta, and British Columbia would investment in human capital narrow income disparities. Nationally, university education yields a 13 percent rate of return, so it is in the public interest. But the returns are unlikely to narrow regional disparities and, to the extent that young graduates are highly mobile (with substantial net flows of graduates to Alberta and British Columbia between 1961 and 1981), they may even widen disparities. The contentious issue underlying this line of argument is whether higher investment in human capital is a cause or an effect of higher incomes. If it is the latter, then very probably the marginal returns from further investment will be quite different from the average returns.

Politics and Policy

The final section of this collection presents three essays that deal with broad policy issues—the efficiency of fiscal federalism, the political economy of regional policy, and the efficiency-equity trade-off.

Rabeau uses Quebec and the Atlantic Provinces to examine the asymmetry that exists in the federal transfer payment system, whereby a province is rewarded by increased equalization payments for slow economic growth but punished by reduced payments if it improves its competitive position. Thus the main beneficiary of a marginal increase in GDP in the provinces of eastern Canada would not be the provinces themselves but the federal government. Rabeau recommends a dose of economic Darwinism to solve this problem by making some part of federal transfer payments conditional upon regional performance. Clearly, there have been some unacceptable abuses of equalization and other federal programs by the provinces in the past, but Rabeau does not explain how he can reconcile the proposed changes with the original "nation-building" and politically-based goal of providing comparable levels of public services in each province at comparable levels of taxation.

The much under-represented political dimension is, however, treated by Savoie and Chénier. The importance of the political context can be demonstrated in several ways. In recent years, each change of government has been accompanied by a restructuring of regional programs (and acronyms!): DRIE replaced DREE, ERDAs replaced GDAs, RDIA was superseded by IRDP, and so on. Likewise, the progressive expansion of designated regions (by the end of the DREE era, 93 percent of Canada's land mass was designated for regional assistance) was a response to political pressure. A third political dimension not documented by the authors is the favouritism (pork-barrelling) shown by

successive governments to their own constituencies. Yet another political dimension was revealed by the Canada-U.S. free trade talks, in which the Americans (often under pressure from lobby groups) objected to regional assistance as an unacceptable form of subsidy.

Assessments of the regional incentives programs have been generally critical, although there is evidence of a modest degree of incrementality (that is, the programs have created some new activity rather than merely altering the timing and location of activity that would have been created regardless). The extraordinarily political nature of regional development activities in Canada is demonstrated by the policy cycle of the current Progressive Conservative government. Its election platform included the goal of reduced federal spending, which it began to implement in 1984 with the Nielsen task force and Finance Minister Wilson's review of many programs (in the name of economic efficiency). Yet three years later Prime Minister Mulroney had rediscovered regional development with the Atlantic Enterprise Programme, the Atlantic Canada Opportunities Agency (June 1987), and the Western Diversification Office (August 1987). Once again, politically contrived regional programs came into being without any hard evidence that they met rigorous economic or welfare criteria.

McNiven's paper addresses critically the way the Macdonald Commission's *Report* dealt with regional policy. There is a deep contradiction in the *Report* between the economists' view of a unified and competitive economy trading freely with the United States (mainly discussed in Volume II), and the statements (largely found in Volume III) on social policy and the sharing philosophy that underlies a commonwealth. The two viewpoints—efficiency versus equity—may also be characterized as ideology versus pragmatism. The Commission attempted to resolve the issue by assigning primary responsibility for economic efficiency to the federal government, and "place prosperity" to provincial jurisdictions (in practice, regional policy accounted for a mere twenty-five pages of the total 1700 pages). The obvious problem with this solution is that the provinces lack the funds to take up this initiative without federal support, which the federal Department of Finance is reluctant to provide. The Commission envisages that free trade, by some unspecified mechanism, would help economic activity to disperse, but quite how market forces would achieve this is left unstated. Moreover, equalization payments are currently reduced if a province increases its GDP, so provincial success is penalized. McNiven echoes Rabeau in his proposal to reward provinces that successfully pursue economic development programs.

Towards an Alternative Regional Focus

Canada has two main types of problem regions. First, there are the long-recognized lagging regions characterized by low productivity, low incomes, high unemployment, net out-migration, and high cyclical sensitivity due to staple dependency. Second, and ignored in *Still Living Together*, are regions liable to overheat during a boom. For example, in August 1987 the Toronto economy (which is larger than the total Atlantic economy or the B.C. economy) had an unemployment rate of 4.5 percent, well below the Non-Accelerating Inflation Rate of Unemployment (NAIRU) of 6.5 to 8.0 percent identified by the Macdonald Commission [9]. Moreover, adjustment mechanisms (essentially migration) could not prevent inflationary pressures; the high cost of housing and the near-zero vacancy rate in the rental market deterred in-migration. Any initiatives to increase dramatically Toronto's supply of housing and physical and social overhead capital would take at least three years to come on stream, when the current boom will presumably have petered out. Meanwhile, the unemployment rate in Newfoundland was 15.8 percent, and in New Brunswick and Nova Scotia close to 11 percent. This suggests that adjustment mechanisms alone, because of absorptive limitations, are not capable of balancing out the needs of depressed and overheated regions, and need to be coupled with regional incentive programs of some kind.

What kind of incentive program? Most contributors to *Still Living Together* are mute on the subject, although there are some references to diversification and the creation of a service economy. This ignores a fundamental issue that should have been addressed in this collection: How important is manufacturing in Canada? Bearing in mind Harris's [4] conclusion that manufacturing remains the natural base of regional growth in most theories (growth-pole, cumulative causation, and demand-side), and that in the U.K. manufacturing has *not* been displaced by services as a component of regional output, then there is surely a need to examine the same issue in the Canadian context. To the extent that manufacturing is considered in this collection, a system of incentives to encourage multi-plant (often non-Canadian) firms to locate subsidiaries or branch plants in designated regions is generally assumed.

Also missing is a discussion of locally-based entrepreneurship [10]. There are sufficient examples of entrepreneurship, working through a group of community "animators", being instrumental in regional development to make this a glaring omission, particularly in view of Coffey and Polèse's own recent contribution [1]. Finland, for instance, has arguably achieved the most successful record of economic growth of any nation on earth in the last decade despite having a much smaller domestic market than Canada. Small locally-owned firms that are

innovative in design and in their use of technology have played a major role in this Finnish success. Similarly in Canada, Beauce in Southern Quebec is receiving considerable attention as a region where locally-owned and export-oriented firms have spearheaded development.

It is easy to be over-critical of a collection of essays such as this, which addresses a broad theme. Without almost Draconian editorial control from the beginning, the coverage is bound to be patchy and lack a cohesive argument. Besides, the 1981-84 recession, precisely because of its variable regional impact, made this examination of Canadian regional development a timely one, even though few lessons are drawn from the recession in this collection. However, despite the intrinsic value of many of the essays, this reviewer sees the collection as something of a missed opportunity, because the whole does not exceed the sum of the parts. We do not end up with a convincing critique of recent Canadian regional development. To what extent are recent changes cyclical or long-term structural changes? Is the post-industrial economy a myth or does the emerging service economy herald a new pattern of regional development? Is eastern or western diversification a phantom? Nor, in the final analysis, do we end up with a vigorous assessment of policy alternatives. We have some idea of the limited possibilities of regional incentive policies, less idea of what adjustment policies can do, and only an inkling of what an entrepreneurial policy might achieve. There is still much work to be done on Canadian regional development.

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