



**Stupidity is doing the same thing over and over again,
expecting different results:**

A New Approach to Prosperity and Growth in Atlantic Canada



**Remarks by AIMS President Brian Lee Crowley
In a debate with Jack Layton, leader of the federal New Democratic Party
at the Atlantic Mayors' Congress,
Moncton, NB, 26 March 2004**

Ladies and Gentlemen,

A great historian once observed that the history of the 20th century was of the abandonment of what works in favour of what sounds good. Nowhere is that more true than in the history of economic development policy in this region. We, locally and in Ottawa, have progressively abandoned policies that actually worked, in favour of policies that sounded good, but that not only haven't delivered the goods, they've wasted huge resources while holding back our progress. The good news is that because much of our economic decline has therefore been self-inflicted, we can do better. The bad news is that getting there will not be easy because we have created significant constituencies in this region who find that the status quo has benefited them.

Half a century of economic theory, borne out by real-world experience, confirms that lagging economies naturally catch up with advanced ones. Even if advanced nations or regions are growing quickly, lagging regions should grow more quickly. Each year a lagging region should close the gap with its relevant leading economy by between two and three per cent.¹

Why convergence? Many reasons, but I'll just mention one. Innovation is the source of 2/3 of economic growth, but innovation is costly. Lagging regions get to copy leading regions' innovations for free.

For practical examples of convergence, we could look to Holland, Ireland, Japan, Korea, Georgia, Michigan or a host of other places. For the sake of brevity, let's look at just one example: Ireland. Just a few years ago, the Irish economy was among the walking dead of Europe. Now, it has become one of the most successful economies in the developed world. This turn-around did not come accidentally or because they discovered oil (the Irish have nothing to work with except people), but because of consistent, deep, and widespread policy changes reforming the economy from top to bottom.²

The extent of the Irish turn-around is hard to exaggerate. Its chief export was its desperate, job-hungry people rather than any valued good or service. Just 20 years ago, things were even more desperate than usual. Unemployment was soaring and nearly one in five were without work. Ireland's deficit through the early 1980s averaged more than 12 per cent of Gross Domestic Product (GDP), which was about *eight times* the average rate of economic growth. The national debt soared.

Today, Ireland faces a labour shortage, and Irish recruiters scour the globe luring expatriates back home. As a share of GDP, the nation's debt ebbs away each year. Government revenues have increased despite huge tax cuts. In the mid-1980s, Canada's per capita GDP was two and a half times the size of Ireland's. Now Irish per capita GDP exceeds Canada's. Ireland's economic purgatory, just like its subsequent remarkable recovery, was policy-induced. Getting the policy framework right made the difference between productivity and prosperity on the one hand, and unemployment and decline on the other. The right policy has been summed up as follows:

[The Irish] saw that trying to prop up dying industries was a mug's game. Public debt needed to be brought under control, taxes lowered, and excellent value offered in public services when measured against the taxes paid. Politics needed to be banished from decisions about where and how to invest, whether in public infrastructure or private industry. Work incentives needed to be improved by reforming social welfare. Profitability in the private sector needed to be improved. And costs, including labour costs, needed to be kept keenly competitive. The sum of these measures was a policy environment in which business had every reason to invest and build productive capacity, while workers had every reason to work hard and build their job skills. As the capital investment grew and workers became more skillful, real wages rose along with tax revenues, and a virtuous circle was created. Growth bred more growth, success bred more success.³

Ireland's turn-around cannot be attributed to government spending, transfers from the EU, or an activist "economic development policy".⁴ Indeed, government-driven strategies are far less successful at achieving convergence than ones that rely on getting policy right and then letting employers, investors and workers respond to the signals of the marketplace. One recent World Bank report came to the conclusion that "regional development policies have failed in almost all countries – federal and unitary alike". Where there has been some reduction in regional inequality, such as in the United States, the convergence in regional income seems to be an outcome of policies that have eliminated barriers to the movement of people and capital rather than the success of any specialized regional development policy. And note that the US doesn't have national regional development programmes, unemployment insurance or equalisation, yet they have been more successful than we have in closing the disparities between developed and less developed regions.

Yet much “economic development policy” aimed at Atlantic Canada has been based on the government-driven model. This goes some considerable way to explaining why, despite heroic efforts by the federal government to encourage economic growth, Atlantic Canada has failed to converge with the “have” provinces of Canada.

And when I say “heroic efforts”, I am not exaggerating. If you took the net transfers from Ottawa into Atlantic Canada (that’s total federal spending in the region, *minus* federal taxes paid in the region), and instead of spending that money as we have done, you had put that money in US 90-day T-bills, does anyone know how much money would be in the account today? Over \$1-trillion dollars, or enough to pay off the entire national debt of Canada twice over. Or we could put \$400,000 in the RRSP of each and every Atlantic Canadian, man, woman and child.

No wonder that former New Brunswick premier Frank McKenna, in his 1997 farewell speech, observed that dependency has become a narcotic to which Atlantic Canadians have become addicted.

So what did we get for the vast sums of money that I’ve just mentioned? Well, we got an economy that closed the gap with places like Ontario and Alberta at less than half the rate that economists would expect to see *if we had done nothing at all*.

Let me make the further point that it is not as if we have no evidence of convergence working right here at home in this region. It is not that convergence wasn’t working, and regional development programmes were instituted here to fill this gap. In fact, convergence was working very nicely thank you in the years leading up to the 1970s. By the sixties, for instance, our regional unemployment rates had nicely converged with the national ones. Then in 1971 the federal government “liberalised” UI, and made it widely available to seasonal workers. The wide differential between this region’s unemployment and the national rate emerged quickly thereafter and we have traditionally floated somewhere between 2 and 4 percentage points higher than the national rate ever since. That is just one example of how well meaning national policy actually short-circuited our natural efforts to leave old industries and professions behind and move into the modern economy. So Ireland and all these other examples are directly relevant to us, because *we’ve already shown in the past that we can do what it takes*.

But of course this notion that markets and the economy don’t work for us and that therefore government has to rush in and fill the gap, by, for example, making financing available for business, is a theme that we hear repeated here every day. If it were true, it might well justify some kind of government

intervention. But is it true? Is there, say, a shortage of capital in the region that government must make good.

Nonsense. Just yesterday I got an e-mail from a businessman in St. John's, who had seen an interview with me in the Toronto Star in which I said this region was full of brilliant entrepreneurs. He wrote to say "The inferiority complex that persists in Atlantic Canada, relative to the rest of the country and world, is our biggest challenge...and that's ours to fix. I fully endorse what was said [in the article] regarding capital availability. No matter where you're based you still have to get off your a*s* and go get it. I run a public company from a head office in St. John's where we have no disadvantage whatsoever communicating with or attracting investors throughout North America and Europe."

In fact what we have is a culture in which bureaucratically controlled and directed money is preferred by many companies to private capital because the money can be made to flow for political reasons and not business and economic ones. Yet not only does that mean that the money too often flows for the wrong reasons to the wrong places at the wrong times, but that genuine new companies don't get what they most need. What they most need is not just money; they need smart money, they need the kind of money that comes with business acumen, not bureaucratic strings, attached. There is too little of such money here because it has been to a large extent crowded out.

And lest anyone object to my claim that a great deal of government money in support of business flows for political reasons rather than economic ones, I refer you to the recent paper by Jack Mintz and one of his colleagues at the C.D. Howe Institute on the politicisation of ACOA spending. Not only did the spending on business support follow, to a surprising extent, the electoral rather than the business cycle, but government constituencies were favoured with more spending over opposition ones, and constituencies where the sitting government member had a low margin of victory in the previous election were the most favoured of all. But that means that much business decision-making in the region is based on political benefits to the government rather than the business case for investors. And when you don't invest on the business case, you get more business failures than you would otherwise, because you get a lot of political ventures masquerading as business ventures.

Now let's talk about another common view about Atlantic Canada, namely that our biggest public policy challenge is unemployment, and therefore all public policy must be bent towards the goal of withdrawing as many people as possible from the labour force by, for example, paying them via our thinly disguised workfare scheme known as EI not to work for much of the year.

Demographic trends are such that most of the industrialized world⁵ faces very significant labour shortages today and in the future. That, and not unemployment, is the public policy challenge of the future.

Atlantic Canada has not been spared these trends. The last census showed that the depopulation of the region is occurring faster than most knowledgeable observers had predicted, and this is supplemented by an aging of the population that is more pronounced than anywhere else in the country.⁶

Using conservative assumptions, in 15 years there will be 32,000 fewer workers in Newfoundland, 11,000 fewer in Nova Scotia, 35,000 fewer in New Brunswick and little change in PEI.⁷ Most industries, including the fishery, are forecasting increasingly significant challenges finding workers, and employers regularly report to pollsters that they have significant difficulties finding people with the proper skills willing to work at prevailing wages. For an entire week this summer, the front page of the business section in the Halifax Herald was devoted to industry after industry facing labour shortages around the region, including in many blue-collar occupations. Some of our most promising industries, such as aerospace and biotech and IT are begging for permission to bring in skilled immigrants. So we have the incredible irony here of significant labour shortages co-existing with massive unemployment. This is policy-induced madness. But better policy can fix it.

The region's labour shortage is real; it is driven by poorly designed social programmes and a mismatch between the skills that workers possess and those that employers need. For convergence to work, it must be possible for workers to be shifted off dependence on social programmes and out of low-value work and into higher value-added occupations. It must be possible to attract and keep immigrants as well as our own young people. This flies in the face of a political culture that still clings to the outmoded idea that unemployment is our most significant challenge, that there is too little work and that every person put to work is preventing someone else from working.



AIMS' Brian Lee Crowley shares ideas with Mayor Lorne Mitton of Moncton (left), and Cape Breton Regional Municipality Deputy Mayor Jim MacLeod (right)

So let's talk concretely about the incentives we've created and how they affect the behaviour of people and governments around the region. I'm going to talk about three things: equalisation, EI and taxes.

Equalisation: Equalisation, as we all know, is the programme by which the federal government ensures that Canadians living in less developed provinces can still get access to reasonable levels of public services without having to tax themselves to death. This is a worthy objective, but it has turned out to be a curse for this region because it rewards bad policy by provincial governments, policies that discourage economic development, and rewards policies that deepen dependence on transfers from Ottawa. I could go into a long explanation of how this works, but let me summarise in a way that I think will resonate with the elected people in this room.

There are three ways that a government can get a dollar to spend on public services: they can impose a dollar in taxation on their own population, they can be given a dollar in transfers by Ottawa, or they can borrow a dollar. Now, in an equalisation-receiving province, if the government collects an extra dollar in taxation, they get a dollar's worth of unpopularity (because no one likes to pay taxes), but they only get an extra 10 cents in revenue to spend on public services, because Ottawa claws back 90 cents of the new revenue under equalisation. In fact, in the case of some tax bases, Ottawa, claws back **more than a dollar** for each new dollar in local taxes, so that increased local tax revenue leaves the province **absolutely worse off**.

On the other hand, if you can squeeze a new dollar in transfers out of Ottawa, that whole dollar is available to be spent on public services, and another level of government had to incur the disapproval that raising that dollar causes, *and* the taxes were largely paid by people who don't even live in your province. Alternatively, you can borrow the dollar; that leaves your transfers unaffected, *and* you can pass the cost in taxation on to future taxpayers, who will not be annoyed at you at the next election, but will be annoyed at some other bunch of politicians in 10 or 20 years' time when the bill falls due.

Now, given that set of incentives, what would you expect to see happen? How about high levels of dependence on transfers, the predominant political activity pressing Ottawa for more transfers in preference to pursuing genuine sustainable economic growth, and high levels of public debt. And I would submit that that is a pretty fair description of where we have got in this region, and it's not easy to climb out, in spite of the best will in the world.

EI: What are the incentives for a kid in a fishing family? If you're 18 years old and your dad fishes a high value species like crab or shrimp, you can go out with him in the boat and with a few days fishing – perhaps even just one day's fishing – you can get the maximum entitlement to EI. Then the federal government offers you the following choice: either you can go home and do nothing for months at a time, in which case Ottawa will give you \$10,000, or else you can go to university, in which case Ottawa will give you nothing (students don't qualify for EI), and you'll probably have to get into debt. We talk a good game about the knowledge economy and the importance of education and all the rest, but talk is cheap. Actions count, and these actions are signalling in very concrete terms that what our society values most is a life of bouts of seasonal work, propped up by EI financed in part by waitresses and chambermaids and cooks working full time full year at minimum wage in Toronto and Moncton, and who never claim EI.

Taxes: I recently tried to hire a young professional from Ontario to work for my Institute. When he compared Nova Scotia income taxes to Ontario's, he saw that on an income of \$52,000, he'd pay \$2160 more in income and related taxes than in Ottawa, where he now lives. His wife, an expat Maritimer, earns an equivalent salary, so moving here they'd run the risk of her getting a lower salary, because salaries *are* lower here, or maybe not finding work at all. If she did find equivalent work, you can double the tax penalty I've mentioned, a penalty, I hardly need to remind you, that is repeated annually, and becomes more onerous as you become more successful. And they'd also pay more for gasoline, wine, electricity and a whole host of other things. Apartments are just as expensive as many parts of Ottawa, and houses on the Halifax peninsula are no bargain. So he and his wife preferred to stay in Ottawa, putting their

brains and productivity to work for the Ontario economy and paying taxes to Queens Park. Taxes aren't the only factor, but they matter, a lot.

LOOKING FORWARD: REVIVING CONVERGENCE

The dependency and weakness of Atlantic Canada's economic performance, then, is chiefly the result of bad policy. Atlantic Canada's failure to sustain convergence at the normal rate, its high unemployment, and its low levels of private investment indicate that the net negative effect of policy has much outweighed any benefits resulting from increased government spending.

The argument for government intervention is based on the idea of market failure, that a region like Atlantic Canada is a loser that cannot attract investment or create innovation on its own. This view gives Ottawa its justification for direct intervention in the economy, enabling it to "solve" market failure either by investing itself or by bribing private investors into the lagging region through subsidies. The entire edifice of regional development policy, including the activities of agencies such as ACOA, has been based on exactly this understanding of the operation of lagging economies.

Unfortunately for Atlantic Canadians, and for the taxpayers of Canada as a whole, this vision of how to achieve growth and convergence is wrong. The evidence indicates that success comes from focusing relentlessly on productivity, private investment, competitiveness, welfare and EI reform, the removal of the disincentives within equalization and the freeing up of labour markets, so that the region's unemployment can be absorbed and labour shortages eliminated. Politicization of decision making in what are essentially business endeavours has to be eliminated.

It is perfectly clear -- to me, at any rate, -- that there is a key role for government (including municipal governments) in promoting economic growth, but the policy options available to governments include a great many destructive possibilities, such as the ones I've laid out here, as well as a more limited range of positive helpful ones, such as good quality training and education, top flight infrastructure built for the right reasons, a light regulatory burden, and a competitive tax regime, so that we reward companies and individuals who are successful, rather than punishing them by taxing them too hard, and then transferring the results to their less successful competitors. I would point out that there was a positive correlation between federal transfers and growth before the 1970s, when transfers were at a much more modest level. The relationship only turned negative when we ramped the transfers up hugely in the 1970s and 1980s. The trick is to distinguish good policy from bad. We have a poor record of doing just that.

Let me conclude by saying that I believe that what I have laid out here is a very optimistic view of Atlantic Canada, not a negative or depressing one. It is certainly not the paternalistic and dismissive one so prevalent in Ottawa and some other parts of the country that sees Atlantic Canadians as people with no jobs, no drive and no hope, fit only to be bought off with transparent bribes of transfer payments to business, government and individuals. I believe that it is liberating, not depressing, to have the real causes of our economic underperformance laid bare. Knowledge is power — by understanding what has held us back, we can and will overcome it. There is nothing Atlantic Canadians cannot do, if only the rest of the country will stop doing us these favours. They mean well, but they don't understand us, and they don't understand how their interventions have made worse the problems that they sincerely wanted to contribute to solving.

It is not that this region lacks the entrepreneurial skills and energy that could make the policy package I've described work. I don't believe that for a moment. On the contrary. Any people that can convince taxpayers in other parts of the country to pay for gull wing sports car plants, giant cucumber greenhouses, Clairtone factories, heavy water plants, gravity-based structures, massive subsidies to seasonal work, obsolete coal mines and failing steel mills and to fork over 40% of the cost of their provincial governments year after year – these people are **brilliant** entrepreneurs, absolutely **brilliant**.

The only hitch is that they have been taught to direct their entrepreneurial energies to capturing a share of the wealth of the rest of the country through politics. There is lots of evidence that if we could re-focus that energy on making goods and services that people actually want to buy, at prices that people actually want to pay, there would be no stopping us. Moncton's great prosperity in recent years is proof of that. And we've already shown that we can do it, historically, and right up to the present day around the region, including in rural areas. Corporate leaders like the McCains the Sobeys and the Irvings have proven that business can succeed, as have more recent success stories with growing national aspirations like Moncton's Bernard Imbeault. Political leaders like Frank McKenna have proven that strong leadership can help governments make significant progress in achieving the self-reliance that is the keystone of pride and progress. And the vast bulk of Atlantic Canadians, who work hard every day of the year, pay their taxes and expect to be responsible for themselves, proves that there is nothing wrong with our work ethic or our energy. If we could eliminate the self-inflicted wounds of bad public policy, there would be no stopping us.

Thank you.

¹ Barro, Robert, and Xavier Sala-I-Martin. 1995. *Economic Growth*. New York: McGraw-Hill.

² These policy changes are fully examined in *Road to Growth* (McMahon, 2000).

³ McMahon, Fred. 2000. *Road to Growth: How Lagging Economies Become Prosperous*. Pp. 10-11. Halifax: Atlantic Institute for Market Studies.

⁴ McMahon, Fred. 2000. *Road to Growth: How Lagging Economies Become Prosperous*. Halifax: Atlantic Institute for Market Studies.

⁵ Evidence from the Centre for Strategic and International Studies (CSIS) Commission on Global Aging suggests that industrialized countries face an unparalleled transition brought about by rising old-age dependency and a shrinking working-age population. Not only will the care infrastructure for supporting dependent elders need to be improved, but also societal aging could have sweeping implications for global growth. A decreased labour force and a decreased overall national population, which will in turn effects the tax base for national economies, will all threaten global financial stability. For details please visit the CSIS website, < <http://www.csis.org> >, accessed on July 2002.

⁶ See *The Future of Work in our Coastal Communities*, <<http://www.aims.ca/commentary/fcc.htm>>, accessed on July 2002 and *Population Change in Atlantic Canada*, <<http://www.aims.ca/Archive/1998/praug1198.htm>>, accessed on July 2002.

⁷ Denton Frank T., Christine H. Feaver, and Byron G. Spencer. 1998. *Population Change in Atlantic Canada: Looking at the Past, Thinking about the Future*. Halifax: Atlantic Institute for Market Studies.