Chapter 7

The Long and Winding Detour to Prosperity

Since Confederation, we have never been as close to 1866 [in Atlantic Canada's ability to trade freely with the rest of the world] as we are right now. - Former Nova Scotia Finance Minister Bernie Boudreau

Prior to Confederation in 1867, the Maritimes boasted a robust, trading economy - a world-class trading economy, with all the features of such an economy, including a dynamic and growing financial sector, which later spawned many of Canada's major financial institutions, such as the Royal Bank and the Bank of Nova Scotia, as well as major insurers. The need for letters of credit, money changing, financing, deposit taking and so on always created powerful financial centres in trading centres, whether in Antwerp, Amsterdam, London, New York or, on a smaller scale, Halifax and Saint John.

The Maritime economy was not one-dimensional as is often thought today, dependent on cheap lumber and crude means of shipbuilding, run by a conservative business class that was unable to adjust to changes in shipbuilding techniques. Along with shipbuilding and the Maritimes' financial sector muscle, the region had major iron, steel, and textiles sectors, with strong secondary industries in sugar, rope and glass, not to mention more primary industries like coal and lumber. All this had been built primarily on trade. Yet, within two generations (40 years) after Confederation, the region was well on its way to becoming the basket case of Confederation, and, about 10-15 years later (roughly 1920), it was an economic basket case.

The most significant economic change wrought by Confederation concerned trade patterns. The National Policy cut the Maritimes off from the markets it could reach most efficiently, those accessible by water-borne transportation, and the region was left to trade with a distant hinterland. It was as if the Maritimes was dropped into a distant Prairie, unserved by rivers, and told to send the goods - once loaded on ships - on an expensive 1,000-mile overland trek. It should be noted, however, that U.S. protectionism by itself would have similarly isolated Atlantic Canada from the U.S. market.

Now, as Bernie Boudreau notes (see quote at the beginning of this chapter), markets long cut off from Atlantic Canada because of trade and tariff policies have opened again, due to the CanadaU.S. Free Trade Agreement, the North American Free Trade Agreement, and the worldwide movement to freer trade. If the history of this region demonstrates anything, it is that we do well when we have open access to markets and disastrously when access to markets is shut off. It also shows that we have done poorly by our alphabet soup of regional development programs - Area Development Agency (ADA), Atlantic Development Board (ADB), Cape Breton Development Corporation (Devco), Department of Regional Economic Expansion (DREE), Department of Regional Industrial Expansion (DRIE), Economic and Regional Development Agreement (ERDA), Fund for Rural Economic Development (FRED), Industrial Estates Limited (IEL), Maritime Coal Production Assistance Act (MCPAA), Maritimes Freight Rates Act (MFRA), and Regional Development Incentives Act (RDIA) - to name a few. McNiven (pg. 9, 1988) calculates a policy change every 40 months since 1961, while Lithwick, (1986, pg. 113) identifies six major policy regimes between 1947 and the early 1980s, and it should be noted that various subsidies were directed to the Maritimes from the beginning of Confederation.

The Maritimes actually prospered for a while after Confederation, despite (or perhaps because of) the National Policy which threw tariff walls up around Canada. By 1885, with less than 20 per cent of Canada's population, the region boasted eight of the nation's 23 cotton mills, three of five sugar refineries, two of seven rope factories, one of three glass works, both Canadian steel mills, and six of 12 rolling mills. In 1890, 24 per cent of Canada's manufacturing enterprises were located in the Maritimes, which represented only 18 per cent of the nation's population. (Brodie, 1990, pg. 109)

The reasons for the Maritimes rise to economic power and its subsequent fall are controversial and poorly understood. Several schools have arisen to try to explain the phenomenon. Nonetheless, the region's industrial growth after Confederation was probably based on three factors: abundant coal unlike the rest of Canada, the relatively strong Maritime industrial base upon which to build, and the National Policy which forced the rest of the rest of Canada to buy from its strongest industrial base.

But, as so often happens, short-term gain leads to long-term pain. Overland transportation is almost always more costly than water-borne transportation, and the gap was larger in the 19th century than today. Protectionism in large measure deprived the Maritimes of the trading advantages related to water-borne transportation. The Maritimes were left with but one large market to serve, Central Canada, instead of several. Given the costs of transportation to that market, the economics of locating the industrial structure within that market area soon overcame the initial advantages of the Maritimes' existing industrial structure.

Towards the end of the 19th century, two trends severely damaged the Maritime economy. First, large interests from Central Canada began to buy out Maritime businesses. These businesses were not immediately shut down; many remained in operation for years. But, new investment in these businesses was stifled. Ultimately, they were shut down and the parent company would serve the region with production in Central Canada. Second, the National Policy forced U.S. companies to establish branch plants in Canada. Not surprisingly, these were located in the country's largest market, Central Canada; almost none were built in the Maritimes.

This type of process is virtually inevitable for a small region allowed to sell to only one large market; business, unable to use natural transportation advantages to serve several markets, simply packs up and moves to the remaining large market area. The loss was huge: in 1890, the region represented 16 per cent of the nation's gross value added, by 1910, that had dropped to 10 per cent and then to six per cent by 1929. The deterioration of the region's industrial base was accompanied by the deterioration of its once-vibrant financial sector. At the turn of the century, the region had 13 banks, but only three in 1910. (Brodie, 1990, p. 110, 112)

Worse was to come. Shortly after the Great War, the remaining trade-oriented Maritime businesses were in effect cut off from their remaining large market, and the dirty thirties arrived a decade early in the Maritimes. How did this happen? Rail rates in the Maritimes and between the Maritimes and Central Canada more than doubled compared to the rest of the nation over four years. "It was almost as though Maritime manufacturers had suddenly been pushed another thousand miles out to sea." (Forbes, pg. 17)

Again, limits on trade sent the Maritimes into an economic nosedive. Economic failure sparked much agitation: the Maritime Rights movement was formed, Maritime unity was bandied about, and greater resources from Ottawa were demanded.

In an eerie echo of recent policy, government in the 1920s attempted to protect employment in the fisheries by limiting competition and banning new technology - in this case, mechanized trawlers. This and related moves may have drastically limited the long-term potential of the fishery by excluding foreign capital, cutting off markets, and halting an attempt to internationalize the Nova Scotia fishery.

> *Opposition to such technology [mechanized trawlers] came from an impressive political coalition of inshore fishermen, large-schooner owners, and fish merchants, all of whom saw the introduction of this 'industrial' technology as contrary to their interests. This coalition had been successful in forcing the government as early as 1908 to pass restrictive legislation on the use of trawlers, and it reached the peak of its influence in 1929 with state actions ... to severely restrict trawler competition. The resulting government legislation ... reversed the trend towards the increasing use of this technology in Nova Scotia, effectively reducing the number of trawlers in use from ten in 1927 to three in 1939.*

The ability of this political coalition in the region to 'fend off' the threat of capitalist competition employing new technology is further evidenced by the failed attempt in the late 1920s by American capital – utilizing American-owned quick freeze technology, cheap second-hand English steam trawlers, and purchased Nova Scotia fish-processing facilities – to follow through with a plan to turn Nova Scotia into the 'Fish Pier of America.' (Bickerton, 1990, p. 69-70)

It is hard to imagine the potential by-passed here to fend off competition. Another problem soon surfaced for the Maritime economy – the cost of building the physical infrastructure required by the automobile. This is the case of government investment serving a crucial economic function. Yet, the Maritime provinces were cash strapped, and Ottawa's funding formula only hurt the region. The central government, which controlled most of the nation's tax revenues, agreed to cost share, but at 50 percent or less. The rich provinces usually had the extra 50 cents or so; the poor struggled to find the funds, and the region's infrastructure lagged.

The Second World War created more regional disadvantages. One of the few times government economic action is consistently successful in market economies is during war years. Economic action is narrowly focused on production: Consumption is suppressed and investment poured into the industrial structure, which can produce guns and tanks during the war, and ploughshares and cars after.

Investment was funnelled into Central Canada even when this made little economic or war-planning sense and ignored easier, year-round water transportation from the Maritimes to the European war front. "British technical advisors in Canada ventured the opinion that decisions to locate industry, including shipbuilding and ship repair, in distant metropolises cut off from the North Atlantic by ice for four or five months of the year, were politically motivated." (Forbes, pg. 22) By the spring of 1941, the Maritimes had received less than two per cent of federal monies for industrial expansion although the region had 10 per cent of the nation's population, obvious locational advantages, and a traditional skill base in crucial war industries. By the end of the war, the region had received well under five per cent of federal industrial investment. (Brodie, 1990, p. 146-7). After the war, the Maritimes relationship with the centre reverted to form, although Newfoundland joined Canada and the term "Atlantic Canada" came into use to indicate the Maritimes plus Newfoundland. However, in the late 1950s, Ottawa moved more forcefully than before to address some of the region's historical grievances. A pattern would emerge. The region would gain influence during times of minority government when constituencies in the periphery could take on a tremendous political importance. Three factors focused attention on regional problems in the late 1950s: a deep recession after 1956 which had a particularly strong impact on Atlantic Canada, the minority government of John Diefenbaker, and a study by R. Howland, *Some Regional Aspects of Canada's Economic Development*, published as part of the Gordon Royal Commission on Canada's Economic Prospects. This study focused policy-makers on regional problems and provided data to show the gap between rich and poor provinces. Through a process that largely began with Diefenbaker's 1957 minority government, equalization payments were established, regional economic development became a strong focus, and a number of shared-cost programs, now designed so that the Atlantic Provinces could afford them, were launched both by the Diefenbaker government and by the minority governments of the mid1960s. These programs included the *Hospital Insurance and Diagnostic Services Act* (1958), *Established Program (Interim Agreements) Act* (1964), post-secondary cost sharing agreement (1967), the *Canada Assistance Plan* (1966), and Medical Care (1968).

Government spending can be beneficial when expenditures are funnelled into building economically essential infrastructure and providing services which reduce business costs, such as health care and training. Probably in part because of these federal transfers, regional economic growth was buoyant through the 1960s, and this period of revived economic success was hailed as the "Atlantic Revolution."

In 1972, the government of Pierre Trudeau was re-elected but with a minority in Parliament. This emphasized the importance the winning seats in Atlantic Canada. The region's increased electoral importance was magnified by several factors: Ministers from the region had already assumed positions of great influence; the Atlantic region was already growing strongly and it was thought just a little more effort could put it over the top; and Keynesian economics, with its view that government could manage economic growth, was at its peak of influence. Regional subsidies exploded. Growth was concentrated in economic development programs and UI.

This growth of regional subsidies went well beyond the provision of important services and infrastructure, and instead created huge economic distortions in the region which, as argued elsewhere in this book, created inefficiencies and shifted demand to outside the region, stifling the development of the region's industrial base.

Recognition that these regional subsidies, particularly economic development programs, were not producing the expected results came within a decade of the escalation of transfer payments. Even those who sometimes sympathize with government intervention in the economy acknowledged that "the benefits of these programs have been less than their costs." (Bradfield, 1981, pg. 53) Bradfield notes that his evaluation of regional programs left him

> *...sceptical of the efficiency of these significant efforts. The macro data tend to be erratic and show little clear evidence that the massive expenditures to overcome regional disparities have achieved their intended goals... [T]here is little doubt that [key economic development] programs lack economic viability.*

The recognition that regional subsidies were not working as hoped led to dramatic policy swings to find an approach that worked. A review of the debate shows policy makers repeatedly claiming to have recognized why past approaches failed and why some new approach would succeed, only to have the "new" approach similarly criticized and replaced a few years down the road. Savoie, (1992 , pg. 207) describes this policy merry-go-round:

> *The various departments and agencies have not been very clear about their objectives and keep changing their policy framework. At one point, the growth pole concept held sway. Then DREE sought to tie its efforts to a development opportunities concept. This, in turn, was followed by an attempt to assess initiatives in terms of their relevance to a region's natural economic strength. Toward the end [of DREE's existence], senior DREE officials frequently spoke of about local or community development concepts. ACOA now talks about promoting entrepreneurship .... Even when a particular approach is in vogue, it seems that it does not prevent the department from sponsoring a variety of initiatives that do not really fit in with that theory.*

In the early 1980s, the recognition that transfer programs were failing combined with fiscal pressures led Ottawa to begin a retrenchment process with regional subsidies. (See Appendix A.) Predictions of doom abounded and, as noted previously, some analysts still appear to believe these reductions were a body blow to the Atlantic economy. In fact, relative economic growth in Atlantic Canada boomed while and after regional subsidies were cut. This book has argued that the reason the programs failed were not their specific structure, but rather the whole approach. This is why the constant retooling of the programs failed to produce the hoped-for results. The approach was flawed at its base.

The massive inflow of transfer money distorted the reaction of the region's economy to changing economic circumstances through the mechanisms described in the main body of this book, and led to a misallocation of resources by crippling the natural functioning of the market. The same problem lies at the root of efforts to protect the fishery and other industries through protective regulations. These efforts freeze inefficient production methods in place and only result in increased hardship when government decides it can no longer support the antiquated structures it has created.