

Chapter 8

Conclusions and Policy Implications

This research has examined the impact of large regional subsidies on the region from several perspectives. In other nations, large net inflows of funds, unrelated to the nation's core economic activity, stifle export growth and soften economic growth, largely through a currency appreciation unconnected to either price or productivity performance. The research examined the mechanisms through which such an impact would be transmitted to the Atlantic Canadian economy, and found support for the contention this phenomenon has been at work in the regional economy. This *appreciation-effect* can also be viewed as a demand shift away from the region's high value products.

The research also examined the market distortions large regional subsidies would cause in the allocation of resources from an economy-wide level down to the level of the firm. O'Farrell's empirical study of the competitiveness of Nova Scotian firms found the expected type of distortions. If anything, the fact that O'Farrell's study was sponsored by two key players in regional subsidy programs, ACOA and the Nova Scotia Department of Industry Trade and Technology, adds credibility to the conclusions.

These distortions might be labelled the *depreciation-effect*. The depreciation of a nation's currency, unrelated to either price or productivity movements, creates a bonanza for firms and allows them to continue making profits with even low-productivity methods of production. It slows the reallocation of resources to more productive uses and an increasingly aging economic structure gets locked into place. This, in effect, is what O'Farrell found in Nova Scotia. Ironically then, government policy blessed Atlantic Canada with the worst effects of an *appreciation* and a *depreciation* and none of their benefits.

A review of two analogous situations, foreign aid and fiscal impulse/restraint, suggested similar conclusions.

The policy implications are straightforward. The winding down of the transfer programs does not, as the Cassandras would have it, spell doom for the Atlantic economy. Instead, the ongoing reduction, combined with the new world of increasing free trade, provides an opportunity to grow through the utilization of market forces. It means we must bend our efforts to removing distortions in the Atlantic economy as quickly as possible and open our own markets to competition (rather than protect producers through trade frictions or subsidies) as the only way to increase the competitiveness of our own firms.

Atlantic Canadians should be under no illusion that this will be a painless process. In any economic adjustment, real people do become displaced and hurt, and companies fail. It's what Schumpeter called "creative destruction". One alternative would be to expect the rest of Canada to maintain large regional subsidies, and that's no alternative at all. Another alternative, adopted by some Atlantic leaders, is to try to maintain the status quo as long as possible. That only makes the reckoning that much harder when it comes, and leaves the

economy less flexibility and less time to adjust.

Fortunately, most in Atlantic Canada (including the provincial governments), accept the need to leave behind an economy based on the "whole region being on the dole," to quote the comments of a Nova Scotian entrepreneur as noted by O'Farrell. Individuals, governments and firms seem to be moving to embrace a new era of market-driven growth in the region.

Hopefully, what this study has done is firm up the analytical basis for what many in the region intuitively now understand - that the economic policy of large gift money for the region has been a failure.

This work has examined only the impact of regional subsidies in a single bundle; it did not attempt to distinguish between their overall negative impact and the possibility that some level of carefully directed support could be helpful. It is likely, though far from certain, that regional subsidies which support key services such as health and education provide benefits. But these, too, create distortions and should be wound down as we gain in our ability to pay our own way.