Introduction

There is probably no other field of government expenditure in which so much public money is committed but so little is known about the success of the policy. There exist very few objective research studies of regional development efforts in Canada.

Donald Savoie, Executive Director
Canadian Institute for Research on Regional Development
Université de Moncton. [1]

One central factor dominates economic life in Atlantic Canada — government. Government expenditure equals about two-thirds of regional GDP, and it has reached as high as four-fifths of GDP. Key to government expenditures is another highly unusual aspect of Atlantic Canada's economy — massive regional subsidies from the rest of Canada equal 20-to-25 per cent of regional GDP, and it has reached about 40 per cent. (See box on page 16 for an explanation of regional subsidies.) The size of these regional subsidies makes the Atlantic economy highly unusual and possibly unique worldwide, save for some very small, very poor developing nations. [2] The sums are staggering. Had Ottawa invested these regional subsidies in 3-month U.S. Treasury bills, the nation would have built up a nest egg of about US$700 billion since 1971--- about $1 trillion Canadian. [3]

That's nearly twice the size of our national debt, or a gift of about $400,000 Ottawa could put in an RRSP account for every Atlantic Canadian. To form an idea of the opportunity cost, consider that no national debt would mean significantly lower real interest rates for all Canadians while the surplus over the debt — and lack of the punitive debt servicing charges which eat up a third of all federal revenues — would mean much-reduced taxes for the same level of services. This would have translated into an incalculable boost to economic growth across Canada and in Atlantic Canada.

Such counterfactual comparisons, of course, have little economic meaning in a quantitative sense. There are too many interconnections among economic forces for such simple accounting to predict the way things would have been. But it does provide a qualitative sense of opportunity cost.

The question becomes: What was bought for this massive effort? The central thesis of this research is that large increases in regional subsidies to Atlantic Canada have had a perverse effect, retarding economic growth rather than spurring it. On the other hand, the regional economy has responded with renewed vigour to cutbacks in regional subsidies. While the result may be unconventional political reasoning, it is strikingly consistent with economic theory, with the facts of Atlantic Canada's economic evolution, and with international experience.

Organization of the book

This research examines the impact of regional subsidies from a number of theoretical and empirical angles to see if these differing perspectives support or cast doubt on the central finding of the research.

The first chapter, "Overview: Atlantic Canada’s 35 Years of Growth", introduces and explores key elements of this research, and then provides an overview of the important arguments, with references to the chapters where they are more fully explored. Chapter 1 examines the macro impact of the inflow of large regional subsidies, and looks at the impact on wages, unemployment, net exports, investment and hours worked. From this, several labour market questions arise which are examined in Chapter 3.

Chapters 4 and 5 are more speculative. They examine the types of micro distortions regional subsidies and a huge government presence might be expected to create, and the effect of such distortions on economic growth. Chapter 4 mainly takes a neo-classical perspective while Chapter 5 views some of the same questions from a more Keynesian perspective.

Chapter 6 looks at the international evidence relevant to the situation in Atlantic Canada. Among other issues, it examines the impact of foreign aid — a situation analogous to regional subsidies though at the national level — and finds that the international experience with foreign aid is consistent with Atlantic Canada’s experience with regional subsidies.

Chapter 7 provides an overview of the region’s economic history to get some perspective on when the region has been successful economically and when it has faced economic problems and why.

Appendix A looks in more detail at the history of transfer payments and what motivated them; Appendix B presents some econometric tests; and Appendix C briefly explores the differing reactions to regional subsidies of, on one hand, Nova Scotia and New Brunswick, and, on the other hand, Newfoundland and Prince Edward Island.

Appendix D briefly examines the question of whether regional subsidies have had enough of an impact on regional population to distort the per capita numbers used in this report. The appendix reaches no conclusion on the controversial issue of whether regional subsidies have affected population or migration, but, based on the muddiness of the evidence and the relatively low estimates for any impact on population, it does find that any change in population caused by regional subsidies would not have been large enough to alter significantly the per capita results presented in the volume.

BOX: Regional subsidies: calculation and importance