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# Careless Intentions: Regional Consequences of National Policies

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Policies have consequences. That's the good news. If they didn't, responsible and responsive governments would have no capacity to change the status quo—damning us to our inherited status in the global economy. The bad news is that policies can often involve unintended or unanticipated tradeoffs. At the worst extreme, policy makers can be so remote from those impacted by their decisions that they become essentially disinterested in the consequences. Atlantic Canada is a case in point. Since the region has never existed as a separate political entity, administrative decisions have often been made by outsiders. The outcomes have not always been beneficial.

Throughout much of its post-Confederation history, Canada's Atlantic region has experienced less vigorous economic performance than other parts of the country. Newfoundland and Labrador's recent energy-based ascension into the class of better-off provinces notwithstanding, per-capita income and gross domestic product in the other provinces remain below par. That has not always been the case—neither need it represent an enduring circumstance.

Despite the wishful ambitions of administrators, real-world conditions are only impacted by policy at the margin, so an explanation of why Atlantic Canada appears to under-perform its potential cannot be entirely laid at the feet of the federal government. That said, throughout its modern economic history Atlantic Canada has frequently been a casualty of inappropriate federal policy—mostly well-intentioned; some arising through indifference.

This is not a grumbling complaint nor necessarily a plea for more favourable treatment—just a commentary on the inevitable consequence of being geographically remote from central decision making and having a population base too small to threaten commercial or military interests and insufficient to reward political attention.

**Swapping Imperial Priorities for National Priorities**

In the century before Confederation, Atlantic Canada—at least the commercial provinces of New Brunswick and Nova Scotia were among the fastest growing economies of North America, and during the 1800s sustained one of the more vibrant industrial sectors on the continent—augmented by mineral extraction, shipping, finance and, of course, the fisheries that first attracted Europeans to the maritime shores.

Although historians like to speak with authority, it is a matter of speculation as to what caused the erosion of the region's economic clout. Without doubt the transportation revolution played a major role. It was an era when railroads spread out across the continent—at first serving to bring the agricultural riches to the eastern watershed but

ultimately to enable the establishment of the "industrial heartland". Other city-regions in the American northeast experienced similar declines—the most notable exception being New York, bolstered by its financial importance and its role as Europe's shipping gateway to the Americas.

That said, from their inception, railways played a central role in Canadian policy—so it can be argued that Atlantic Canada's eclipse was at least in part policy-driven. That policy, of course, was of greater benefit to central Canada and eventually the west than it was to Atlantic Canada.

Of greater immediate pertinence was the shifting trade environment in which East coast interests were largely overlooked as policy direction gradually (even subtly) shifted from Imperial to colonial determination. The first serious foray into continental free trade happened in 1854, less than a decade after the loss of preferential access to British markets with the repeal of the Corn Laws. The experiment lasted only two years, but in exchange for free entry of natural products and drastically reduced tariffs on manufactured goods entering US markets the British colonies ceded East coast fishing rights to the Americans. Central Canada benefited at a cost to the Maritimes.

When reciprocity collapsed, the Americans retained access to Atlantic fisheries and under the Caley-Galt act, Canada (the Union of Upper and Lower Canada) imposed steep protective tariffs on manufacturing imports—from both the United States and the Maritime colonies.

It was during this period that the decline of East coast manufacturing accelerated. It would be a hard case to make, that the intentions of either the Imperial government or the Canadian Union were deliberately aimed at destabilizing Maritime industry—it was more likely that the waning influence of a small, albeit vibrant, economy seemed of little import when measured against the explosive incursions railways were making into the continent.

Between the turn-of-the-century and Confederation the population of Upper Canada grew 10-fold. Ironically, in the effort to attract the Maritimes into political union with the Canadas, in addition to the prospect of a common tariff, one of the inducements was the promise of a railway connection that would enable the region's manufacturing access to the growth markets in the interior.

It was too late. The momentum had already shifted. Not for the first time, policies respecting Atlantic Canada became subservient to other interests. It cannot be said that, given the Westward drift of commerce, policies could have been devised that would have arrested the outcome. But there is scant evidence that policy makers either in London or Canada—or probably even in Halifax—appreciated the impact their grand schemes would have on the Maritime economy. Their intentions were likely neither good nor bad—just incidental.

**Good Intentions Gone Bad**

When decision makers are situated at some distance from the communities they oversee, theory often trumps local wisdom. Policies can be formulated to accomplish "expert" professional objectives without a full understanding of their effect on regional economies. The intentions may be well meant—but the outcome can be counterproductive. Canada's equalization program is a prime example.

The acknowledged "father of equalization" is Nobel-prize-winning economist James Buchanan. At a luncheon in 2001 (sponsored by AIMS and its sister institutes the Montreal Economics Institute and the Frontier Centre for Public Policy) he observed: "A full half century has gone by since my early involvement in analyses of fiscal equalization in federal political settings. Indeed, this subject matter was my first research concentration. I advanced arguments for policies aimed at fiscal equalization among the states or provinces of a federalism in situations where there are disparities in fiscal capacities. My arguments were analytically

abstract and they were developed independent of reference to the fiscal or political structure of any existing country. My defence of fiscal equalization was grounded in considerations of both equity and efficiency."

Buchanan (with appropriate professional reserve) went on to say towards the conclusion of his address: "But I now recognize that the practical difficulties, politically, involved in implementing any equalization scheme may be such as to negate any potential net gains. The final judgment here must be pragmatic and must take into account the facts on the ground in particular settings."

In a 2002 interview conducted by the Frontier Centre, former New Brunswick Premier Frank McKenna was rather less diffident in his assessment of the program's success: "I think it is fair to say that the programmes [Federal transfers] are well intentioned, have had minor to modest success but, generally speaking, aren't transformational". That is the nub—effective policies should not be mandated by intent but by effect.

Many outside Atlantic Canada are of the view that equalization payments are one of several initiatives the federal government has undertaken to compensate economically less-advantaged provinces/regions of the country. That is not the purpose.

Since individual provinces may, from time to time, experience differing rates of economic performance—which, in consequence, affects the ability of those governments to raise revenue—equalization payments are intended to restore the "fiscal capacity" of those provinces. Recipient provinces are not be compensated if they simply reduce their tax rates—it is only in circumstances when their revenues would slide if they exert a tax effort equivalent to a formula-driven norm—that the system kicks-in. The program (of which the principle is part of constitutional law) is not designed to permanently support any particular province or region and is not explicitly aimed at achieving economic convergence.

The federal government also participates in several other transfer programs—notably in support of joint federal-provincial initiatives in healthcare, social support and higher education. These programs are, however, on a per-capita basis—intended to have equivalent impact on all provinces (although some argue that regions with older average populations, such as Atlantic Canada, are less-than-adequately compensated on a needs basis).

Over the past decade, or more, AIMS authors have consistently noted that the general effect of federal transfers—and the equalization program, in particular, have been to encourage higher government wage bills in Atlantic Canada—that is either higher per-capita levels of public service than in other parts of the country or higher than average public service salaries; or both.

Research in Canada and other countries has shown that such transfers from one level of government to another encourages reduced fiscal accountability on the part of recipient governments—who tend to be less responsive to taxpayer pressure. (See, for example, Brian Lee Crowley and Bobby O'Keefe "The Flypaper Effect" AIMS June 2006)

No one would be tempted to conclude that the objective of federal-provincial transfer programs is to reduce regional competitiveness. Nevertheless, to the extent that they encourage above average levels of government service, they actually diminish effective market operation. That is a prime example of how policy—even the best-intended policy—can, and has performed a disservice to Atlantic Canada.

**Sorry—Didn't Notice You There**

Policies like equalization explicitly recognize the existence and perceived needs of regions in a federal jurisdiction. Other national policies simply materialize because particular regions represent too insignificant a portion of the wider interest to

warrant special attention to unique circumstances. An example was cited earlier of how maritime fisheries territories were treated as a sacrificial component in a deal that bought greater trade benefits to Canada—and that was at a time when Atlantic Canada's voice carried greater clout.

A more contemporary example is the evolution of rules governing electricity transmission in Canada. AIMS' author Gordon L. Weil argues in Freeing the Flow: Proposals for Reform of Canadian Electric Industry Regulation (AIMS November 2010): "The current system of regulation unfairly discriminates between three provinces – Newfoundland and Labrador, P.E.I. and Nova Scotia – and the other provinces."

The situation that gives rise to Weil's assertion is a prime example of how simply regional interests (especially when that region is as small as Atlantic Canada is) can be overwhelmed by preponderant circumstances in much larger jurisdictions. It also provides an interesting history lesson on how regulatory policies come into being.

As Weil points out, leaving constitutional authority for electricity generation and transmission effectively in provincial hands works well for Canada's large provinces—whose size makes them among the largest power authorities on the continent (such as Quebec, Ontario, BC, Alberta and Manitoba). When electricity interests in those jurisdictions choose to exchange transmissions with neighbouring grids, all that is required is a simple bilateral agreement that satisfies both parties. The same is true if they wish to interconnect with US power grids—since they share an international boundary. In that case, however, the arrangement must obtain approval from the US regulator: Federal Energy Regulatory Commission FERC.

Where the three "locked-in" eastern provinces are disadvantaged is that, in the event they wish to export excess power to the United States market, they must do so via transmission facilities owned in neighbouring provinces—and Canada has no comprehensive national regulatory equivalent to the US FERC. There is the clear potential for beggar-thy-neighbour obstruction. Many in Atlantic Canada consider the long-standing agreement that allows Hydro Quebec to export power from Churchill Falls in Labrador to represent just such a condition—that a more effective national policy, or joint provincial initiative, could have prevented.

To understand how and why the Canadian and US systems have evolved so differently, one must take into account both the historical development of electrical power and the relatively larger size of Canadian political jurisdictions.

Initially, residential electricity distribution was a purely local concern. Because of the obvious futility of stringing lines from competing companies, the early systems were granted municipal monopolies and placed under administrative boards to prevent price gouging.

With relatively abundant hydro-electric capacity available at Niagara Falls, the Ontario Hydro Commission developed a publically-owned generation and transmission model that was widely emulated in other Canadian jurisdictions. The preponderance of public ownership and large geography in Canada made self-contained systems viable. When there was advantage to grid sharing it could be easily facilitated through bilateral arrangements. There was little need for, and no defined constitutional role for, federal regulation.

In contrast, the proliferation of smaller, frequently private, electricity companies in the United States along with the explicit inter-state commerce regulatory powers of the federal government resulted in a much greater degree of centralized control in that country.

As Weil points out in his article, the energy crises of the 70s introduced some new imperatives—initially in the United States, but subsequently in Canada. These have been manifest in "open access" practices that separate traditional generation and

transmission roles, allowing cogeneration and the establishment of market pricing.

As foreign to the traditional model as the ability to feed in electricity to one part of the grid and have it extracted remotely in a different grid may seem—the subsequent emergence of financial energy futures based on nothing more than a bet-based promise to deliver electricity at a specified future date must appear even more revolutionary.

The point is that the electricity marketplace has dramatically altered over recent decades and the Canadian regulatory environment has remained the same. That might constitute a nuisance to Canadian systems in general—but to the three "locked-in" Atlantic Canada provinces, the absence of a coherent cross-boundary regulatory framework poses a decided drawback. That deficiency needs to be addressed—especially in light of the proposed regional distribution of power from the lower Churchill Falls.

Despite the constitutional issues that might arise in its implementation, there are cogent reasons favouring an expanded role for the National Energy Board. That agency does have some permitting authority for international transmissions and enjoys some conceptual rationale for oversight of inter-provincial connectivity. A joint provincial agreement could serve in place of federal regulation, but only in the unlikely event that all jurisdictions opted-in. Without a comprehensive regulatory framework, however, regional agreement would only likely prove a stop-gap—and sooner or later even greater market sophistication and system interconnectedness would again test the rules. One of the key drivers of this evolution will almost certainly be the "clean energy" imperative.

Now that the arrangement has fallen through, the consequences of the acquisition of all or part of New Brunswick Power by Hydro Quebec must be a matter of speculation. It shouldn't be. The electricity marketplace in Atlantic Canada should be as transparent and predictable as it is in most other parts of the country. There has been no deliberate intent. Regulation has simply evolved without taking the needs of the affected provinces into account, in large measure because their influence has been modest—and perhaps because there has been little common purpose in raising protest.

**Conclusion—But Not the End**

So long as there are multiple levels of government and widely diverse geographies, such as characterize a country like Canada, there will be inevitable policy shortcomings. One size will—categorically—not fit all. Atlantic Canada's voice will not magically take on greater standing in the larger debate. National policy makers will not independently dedicate more attention to locally significant impacts. Over recent decades, the emergence of more interprovincial and federal-provincial councils has provided greater opportunities to resolve such issues.

Since many of the inadvertent policy shortcomings have been poorly recognized even within the Atlantic Canada, it is unrealistic to expect the impetus for change to come from elsewhere. The onus is clearly on regional governments to more completely understand and promote local interests so as to negotiate from a position of greater strength.

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