THE POLITICAL ECONOMY
OF REGIONAL DEVELOPMENT
WITH PARTICULAR REFERENCE
TO CANADIAN POLICIES

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ABSTRACT

There are inherent difficulties in the field of regional development policy. The overlapping jurisdictional responsibilities of different levels of government in terms of both function and geographic area, necessitates the close co-ordination of governmental activity. The conflict between economic and non-economic goals requires resolution through the political process.

If the optimal governmental decisions are to be reached, policy-makers must possess a clear conception of what regional development entails, the cost of its attainment and the price the populace is willing to pay to achieve this end. Since such clear conceptions are lacking in practice, and also because such variables tend to change with the passage of time, the measures undertaken by the federal government in pursuit of the ultimate equalisation of regional opportunity represent a 'trial-and-error' approach to the problem.

On the basis of certain indicators, it seems reasonable to expect that the Government of Canada considers the ultimate elimination of regional economic disparities an increasingly high priority. In its pursuit of this objective, two important trends are discernible: the first is the growth of the inter-departmental committee as an administrative apparatus for coping with regional development problems, while the second is the increased awareness within all federal departments of the regional dimensions of national policies. If these trends continue, they might well bring about important institutional innovations having a marked impact upon regional development.

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CHAPTER 1

INTRODUCTION

The Consistency of National Economic, Political, Social and Cultural Goals With Respect to Regional Development Programs

In the past several decades, the Government of Canada has demonstrated a growing concern over the uneven regional diffusion of economic activity in Canada. One manifestation of this increased concern in the federal government was the establishment of The Royal Commission on Dominion-Provincial Relations on August 14, 1937, with instructions to undertake "a re-examination of the economic and financial basis of Confederation and of the distribution of legislative powers in the light of the economic and social developments of the last seventy years."[1] Not until the present decade, however, have federal programs designed to tackle problems of regional development in a systematic way been initiated.

The impetus for the regional development programs which have arisen has stemmed from economic as well as political, social and cultural considerations. Although it has been recognized that accepted economic, political, social and cultural goals are, in general, not simultaneously attainable, the precise nature of the 'trade-off' between the goals in these different arenas remains an unresolved issue. The major source of inconsistency between these diverse goals appears to derive from the different policy directions suggested by the economic and the non-economic goals; of course, the onus is upon policy-makers to effect the most desirable reconciliation between the divergent policy implications of economic and non-economic goals. The conflict between the economic goal of maximizing per capita income and non-economic goals appears to exist only to the extent that the realization of this economic objective necessitates massive out-migration from the relatively stagnant to the relatively prosperous regions in Canada.

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[1] Report of the Royal Commission on Dominion-Provincial Relations (Ottawa: Queen's Printer, 1954 printing), Book 1, p. 13.

For example, a pre-eminent national political goal is the fostering of national unity. An implication of this goal for regional economic policy might well be the preclusion of the massive out-migration of manpower from the lagging regions, to regions offering superior employment opportunities. In fact, the impetus for a regional development programme might derive largely from the need to instill in all regions of the country a sense of belonging and participation in the mainstream of economic life.

The extension of economic assistance by the more prosperous regions to the less developed regions is a reflection of the social obligations which nationhood entails. Nevertheless, transfer payments to the unemployed, however humane their motivation, have the effect of hampering labour mobility out of relatively depressed regions, since the incentive of the unemployed to emigrate to a region promising greater opportunity is thereby diminished.

Finally, the goal of preserving a region's cultural identity, particularly where cultural homogeneity is the basis upon which the region is demarcated, clearly is inconsistent with those solutions, proposed to cure the region's economic ills, which entail a substantial exodus of manpower from this region.

Thus, the national acceptance of the political, social and cultural aims and obligations cited above seems to militate against the tendency towards the increasing concentration of economic activity. On the other hand, market forces seem to induce an increasing concentration of economic activity, and to the extent that the government adopts the goal of per capita income maximization, the underlying pressures which promote economic concentration will be accentuated.

It seems plausible to expect that the key factor which largely determines the spatial distribution of economic activity is the initial distribution of a country's national resources. However, a regionally unbalanced distribution of resources is not regarded by some economic analysts as being a necessary precondition for the concentration of economic activity to occur. To further analyse this problem, consider the hypothetical case wherein all the regions of a country enjoy equivalent resource endowments. Suppose that a socio-political goal of the country is to perpetuate this state of regional "egalitarianism". It appears unlikely that such a state of affairs can obtain indefinitely without the conscious involvement of the government, since once any of the regions advances relatively, for whatever fortuitous reason, such as, for example, the birth in its midst of an entrepreneurial genius, the disparity between this region and the others might indeed continue to widen. Moreover, "it would pay to concentrate development in relatively few places, because of the economies of geographical concentration."[1] If the economic goal of the state were to maximize the per capita income of its citizens in all regions, a conflict emerges between this objective and that of maintaining the country's regional equality. That is, efficiency dictates that economic activity be concentrated whereas regional egalitarianism suggests the equal disbursement of economic activity.

The prospects for reconciling the economic goal of per capita income maximization with the political, social and cultural goals posited above will now be considered.

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1 W.A. Lewis, Development Planning: The Essentials of Economic Policy, (New York: Harper and Row, Publishers, 1966), p. 69.

Reconciling Economic Goals with Particular Regional Economic Policies

One possible reconciliation between these competing ends lies in a reinterpretation of the goal of regional balance. Rather than advocating equal levels of per capita income in all regions, policymakers might promote equality of opportunity for all citizens by facilitating labour mobility to the areas having the highest growth potential. Essentially, such a reorientation in respect of the concept of "regional balance" is tantamount to advocating measures whose purpose it is to facilitate the integration of the country. In this connection, W. Arther Lewis puts forward the following argument:

> If the country is fully integrated, it is in the general interest that resources be invested where they are likely to prove most productive. Full integration means a right to participate equally in economic activities in any part of one's country. If the savings of citizens of county B are to be used to develop county C, on the ground that they will be most productive there, the citizens of B must be allowed to enjoy the new opportunities which their savings will be creating in C: to seek work there... and to enjoy any facilities (schools, hospitals, etc.) which are going to be financed out of taxes collected as a result of such development. Resistance to the proposition that resources be invested where they are most productive derives from the expectation that those who live where the resources are invested are going to benefit most. Such resistance... can be minimized by furthering the country's integration...[1]

One might fairly ask whether efforts directed along the lines indicated by Lewis can indeed reconcile the economic goal of maximizing per capita income with the policitcal, social and cultural aims posited above. It certainly seems that the political goal of national unity would be facilitated by "integration" in Lewis' sense. Moreover, the need for transfer payments to the country's disadvantaged areas might in due course be diminished and perhaps ultimately obviated.

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1 Ibid.

However, the goal of preserving a region's cultural identity appears to be rendered difficult, if not impossible, by measures whose purpose it is to absorb the region's inhabitants into the mainstream of economic activity which happens to be in other regions. Nevertheless, a solution to this dilemma does seem possible; for if the culture of the economically floundering region can be successfully extended to the country's prosperous regions, thereby enriching in a cultural sense the rest of the country, the transfer of people from the disadvantaged area would not entail the demise of the culture which had hitherto been rooted in the lagging region.

Some people (for example, Quebec separatists) contend that such a vision, wherein the best of all possible worlds is envisaged, is unattainable. Others claim the opposite and strive vigorously for the realization of their own vision. The validity of these opposing views can only be determined <u>ex post</u>.

An alternative reconciliation between the economic, political, social and cultural objectives which were stated above, which appears to be more feasible politically is based upon the belief that a prerequisite for the long-run prosperity of the nation is the full participation of all of the nation's component geographic regions in the economic life of the country. Thus, this school of thought argues that even though massive out-migration from the lagging regions might result in higher per capita incomes than before, such a result will be short-lived. It would thus be argued that over a time horizon of sufficient length, the per capita income will <u>not</u> be maximized by a policy which entails the absorption of the lagging region's population into the economic activity of the prosperous regions.

In effect, then, the possible inconsistency between the economic, political, social and cultural goals is eliminated by assumption, since massive out-migration from a lagging region is deemed to be ultimately deleterious to the national interest. The validity of the contention that prosperity in the long-term requires the full economic participation of all regions of the country can also be ascertained only ex post.

An extension of this last attempt to harmonize the alleged incompatibility between the economic goal of per capita income maximization and the political, social and cultural goals stated above involves the adoption of a new interpretation with respect to the nature of the concentration of economic activity which must obtain in order to permit and facilitate the realization of the inherent "economies of geographical concentration." It is the view of some that intra-regional labour mobility is sufficient to secure the economic advantages of geographical concentration. Therefore, the prescription for the optimal path to national economic prosperity would call for the efficient utilization of resources within each region, and would de-emphasize large-scale inter-regional transfers of manpower. The credibility of this view is enhanced when one considers that in general, those who migrate from the lagging to the bouyant regions are younger and often more skilled than those who remain behind. Thus, the likelihood of such an outflow of labour from the lagging regions resulting in an increase in the per capita income of the relatively depressed regions seems rather remote.[1]

The thinking manifested by this view of the development process is essentially that the pursuit by each region of its optimal pattern of development will result in the optimal development of the nation as a whole. As Charles L. Leven notes, this eventuality is really only a happy coincidence of regional and national interests, and is logically necessary only in a world of perfect competition.

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[1] G. Myrdal, Economic Theory and Underdeveloped Regions (London: G. Duckworth, 1957), p. 27.

He states that,

> ... in a world where capital markets are imperfect, capital facilities are durable and immovable, and personal relocation is resisted on social and psychological grounds, the problem is a genuine one.[1]

Leven specified three major reasons why optimization at a national level may conflict with optimization at the level of the region:

> First, where there are multi-dimensional economic goals, the preference patterns of regions may be such that there will not be a consistent ordering of these goals at the national level. Second, even if maximum output were the only goal, each region's share in the relocation cost needed to achieve it may not be equal to their share in the resultant gains. Third, in either case, external economies or diseconomies in production extending across regional boundaries have not been taken into account.[2]

It is obvious that the conflict stemming from inter-regional variations in the priorities attached to accepted goals can only be resolved by some kind of compromise (i.e. at least one of the opposing factions must make some concession).

In the case of the second type of inter-regional friction, a full reconciliation between optimization at both the regional and national levels is possible only under certain circumstances. The following simple examples will serve to illustrate cases in which the complete harmonization of regional and national goals of per capita income maximization are both possible and impossible.

Assume that the country in question is divisible into three distinct regions, which we designate A, B and C. Assume also that policy-makers must select one of the three policy alternatives confronting them. In addition,

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1 C.L. Leven, "Establishing Goals for Regional Economic Development", in _Regional Development and Planning: A Reader_, ed. by John Friedmann and William Alonso (Cambridge: M.I.T. Press, 1964), p. 586.

2 _Ibid._, p. 596.

we make the simplifying assumption that the populations of the three regions are independent of the policy alternative chosen. The outcome of each of the policy alternatives is known for all three regions by the policy-makers, and is summarized in the following table[1]:

Policy Alternative \ Region	A	B	C
1	10	6	4
2	6	6	5
3	5	8	3

Clearly, from the national persepctive, policy one yields the best result since output would be twenty billion dollars, whereas it would be only seventeen and sixteen billion dollars under policies two and three respectively. From the perspectives of three regions, policy one is optimal for A while B would prefer policy three and C would prefer policy two.

Using a principle of compensation somewhat analogous to that devised by Nicholas Kaldor and John Hicks, one can demonstrate that if policy one is adopted, A could purchase the acquiescence of (i.e. bribe) B and C by transferring two billion dollars to B and one billion to C. Such a transfer will create conditions in B and C which are as favourable, in terms of realizing the goal of per capita income maximization, as would the adoption of the other policy alternatives. Moreover, even A, with the remaining seven billion dollars, would be better off than under any other policy. Thus, the choice of policy one is seen to permit the full reconciliation of regional and national aspirations (which in this example, encompass only output levels).

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[1] The units of the table are in billions of dollars.

Consider next a slightly different array of outcomes:

Policy Alternative \ Region	A	B	C
1	10	6	4
2	8	6	5
3	5	8	3

Once again, policy one is optimal from the national perspective, since it permits the production of twenty billion dollars, while policies two and three allow only nineteen and sixteen billion dollar output levels respectively. In this example if A were to "fully" compensate B and C by restoring the latter regions to income levels which equal their respective optima, A would pay two billion dollars to B and one billion dollars to C (just as in the previous example). However, the balance remaining for A, namely seven billion dollars, would be less than A could achieve under policy alternative two. Therefore, A would be unwilling to pay more in compensation to B and C than a total of two billion dollars. If the total transfer from A were to exceed two billion dollars, A would clearly opt for policy two, which is undesirable from the national perspective. Therefore, this latter example is an illustration of a case wherein it is impossible for all regions of a country to simultaneously achieve their optima. The best solution under these circumstances would entail the adoption of policy one with A only partially compensating B and C for the opportunity costs which they incur by foregoing their respective optimal policy alternatives. Thus, at least one of the regions must accept a financial settlement which involves the attainment of an income level below that achievable under an alternative policy.

If regional governments act in a manner which seeks to maximize the welfare of only the area under their respective jurisdictions, then the existence of external economies and diseconomies between regions would necessitate the delegation of responsibility in these spheres to a supra-regional authority in order to ensure the efficient allocation of resources from the national viewpoint. It is thus argued that "any time a non-resident could or does benefit from, but must pay for, a provincial service that costs nothing extra to provide, resources are allocated inefficiently and this inefficiency provides an opportunity for arguing that the federal government should take over responsibility for the service."[1] Therefore, the conflict respecting the division of powers and responsibilities between the three levels of government may be resolved by opting for the maximum degree of decentralization in the decision-making units in those spheres in which externalities are inconsequential and by moving responsibility for a service up one level of government where significant inter-regional externalities exist.

Theoretical Approaches to Goal Formulation by Government

In general terms, there are four types of formulations expressing national objectives:

> First, there may be some single objective. An example would be "the maximization of economic growth."
>
> Second, there may be several objectives competing for scarce resources and arranged in the form of a national indifference map. This would enable

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[1] D.M. Nowlan, "The Economics Component of Canadian Federalism," in Public Finance in Canada: Selected Readings, ed. by A.J. Robinson and James Cutt (Toronto: Methuen Publications, 1968), p. 146.

the government to state, for example, that the nation is indifferent between a bundle of a 2 per cent rate of growth of GNP, 4 per cent unemployment, and 1 per cent inflation, and one of 2.5 per cent rate of growth, 3 per cent unemployment, and 3 per cent inflation, but prefers both to a bundle of 3 per cent growth, 2 per cent unemployment and 7 per cent inflation.

Third, the national objective function may consist of the maximization of one objective, or weighted combination of objectives, subject to constraints in terms of other desirable goals.

Fourth, we may imagine the set of objectives to be somewhat imprecise statements of desirable events and hinted-at priorities.[1]

T. King dismisses the first type of formulation because it is "implausible" in terms of the normal behaviour of governments. He considers the second type of formulation to be "the most conceptually satisfying way of dealing with these various conflicting objectives...but as an operational device this would, at least at present, appear to be unobtainable." The third type of formulation is, according to King, "conceptually much less satisfactory than the indifference map, but it offers more hope that it can be applied." Nevertheless, the weighting of conflicting objectives is meaningless[2] unless their marginal rates of transformation are known; however, where these are ascertained, all objectives other than tangible output are slighted.[3]

King's conclusion is as follows:

> We can either attempt to construct some maximizable objective function whose precision will be in part spurious and may therefore mislead those who base decisions on it, but which will facilitate a choice between alternatives, or we can let decisions be made on some ad hoc basis. We would then leave our objectives in the fourth form, and the result would be decisions made...on a "satisficing" basis rather than on a maximizing one.[4]

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1 Timothy King, "Development Strategy and Investment Criteria: Complementary or Competitive?" Quarterly Journal of Economics, LXXX, (May, 1966), 112.

2 It is meaningless at least insofar as it is completely arbitrary.

3 See Otto Eckestein, "A Survey of the Theory of Public Expenditure Criteria," in Public Finances: Needs, Sources and Utilization, (Princeton: Princeton University Press, 1961), as quoted op. cit., p. 114.

4 T. King, op. cit., p. 114.

Approaches to Governmental Goal Formulation In the Canadian Experience

A basic problem arises when one attempts to ascertain what Canada's national goals are. The problem is that the objectives of the departments which collectively comprise "the government" are in themselves too narrow to express concisely which ends the government is seeking to attain in some specified time horizon. Is there, then, some department or agency within the governmental structure whose perspective is sufficiently broad to enable it to formulate the national goals? Probably the closest approximation to such an agency is the Economic Council of Canada, a quasi-autonomous body whose terms of reference direct it "to study how national economic policies can best foster the balanced economic development of all areas of Canada."[1] The Council's interpretation of "regionally balanced economic development" consists of two components: (a) a reduction in the present levels of inter-regional per capita income disparities, and (b) ensuring that each region utilizes its material and human resources in the optimal manner, in order to contribute most effectively to national output and to sustained, long-run growth of that output.[2]

The Council enunciates the following five basic economic and social goals in the Canadian economy in the medium term future:

(1) "full employment" defined as 97% employment of the labour force;

(2) "a high rate of economic growth" defined as "an average annual rate of potential growth in output of 5.5 per cent";

(3) "reasonable stability of prices" defined as "moderate" annual fluctuations around the 1953-63 average annual increase in consumer prices and in prices of all goods and services produced in Canada of 1.4% and 2%, respectively;

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1 Towards Sustained and Balanced Economic Growth (Ottawa: Queen's Printer, 1965), p. 97.

2 Ibid., p. 99

(4) "a viable balance of payments" defined as an improvement (i.e. a decline) in the ratio between current account deficit and total output by 1970; and

(5) "an equitable distribution of rising incomes" defined as the sharing by all Canadians "in rising living standards associated with the attainment of a high and consistent rate of growth."[1]

Canada's national goals, as enunciated by the Economic Council of Canada, appear to be most appropriately classified somewhere between T. King's second and fourth formulation categories.

A fundamental question confronting policy-makers is whether a high rate of growth and an equitable distribution of income are competitive goals, and if so, to what extent. Once the nature of the trade-off alternatives available between growth and equity become discernible, the judgement of the policy-makers must ultimately form the basis of their choice in the same way that an acceptable level of employment and inflation is selected.

In the conclusion of his study on Canada's inter-regional income disparities, S.E. Chernick reached the following conclusion:

> If it can be established that high levels of economic activity go hand in hand with its widespread regional diffusion, then the guidelines for a regional development policy might not be very different than those for national economic growth. If the contrary is true, it would imply that a high rate of national growth is not in itself a sufficient condition for securing an increased degree of regional participation. The data examined above, while far from conclusive, would tend to support the latter hypothesis, at least for the post-war period. Under these circumstances, the formulation of special policies aimed at specific regions may be called for.[2]

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1 Ibid., pp. 7-8

2 S.E. Chernick, Interregional Dispasrities in Income, Staff study No. 14, E.C.C.. August 1966. p. 65.
In its Third Annual Review, the E.C.C. concluded that "the growth of the economy at the national level provides a necessary and favourable environment, but it is not in itself sufficient to secure major improvements in regionally balanced economic development. This is clearly a long-term objective to be sought on the basis of deliberate integrated public policy." Prices, Productivity and Employment, (Ottawa: Queen's Printer, 1966).

Conclusion

While the Economic Council did reach a consensus on the national ends to be sought in the medium-term, an unequivocal endorsement of the means to be employed has to date, not been forthcoming. In advocating the optimal utilization all regions of their material and human resources "in order to contribute most effectively to national output and to sustained, long-run growth of that output," the Council is sufficiently non-commital as to provide no guide to the appropriate policies to effect a regional balance in Canada. The Council fails to explicitly recognize the potential conflicts between regional and national optimization policies and thus fails to indicate measures which might reconcile such conflicts.

It is important to note that even though a theoretical reconciliation between economic and non-economic goals may be possible, in practice, a strong popular fear of such an alternative often necessitates its rejection. Thus, although one may argue on a theoretical plane that the culture of a region may be preserved even though its inhabitants are 'transferred' en masse to other regions, the very fear of losing their cultural identity may well lead to a rejection of this theoretically possible 'solution'. In the Canadian context, the reluctance of inhabitants in lagging regions to abandon their way of life imposes upon the different levels of government the burden of fostering economic opportunity in these regions, irrespective of whether such policies promote long-term national economic efficiency as measured in terms of market values.

THE CONCEPT OF A REGION: A CONSIDERATION OF ALTERNATIVE CATEGORIZATION CRITERIA

The Subjective Nature of the Concept of "Region"

The motivation for agreeing upon an acceptable definition of "region" is obvious: in order to discuss any issues pertaining to regional economic development in any meaningful sense, one must be able to specify what is meant by the entities called "regions". Similarly, in order to measure the impact of certain policies upon "regional development", the area comprising a particular region must be known, and there should be some rationale for this demarcation of the region.

A number of alternative criteria for the delimitation of regions have been proposed. It seems that the basis for regional demarcation which is ultimately adopted is largely a function of the intended application of the analysis. As Caves and Holton have noted, regions are delineated in economic research only to help in the analysis of some particular problem.[1] Moreover, as Prof. T.N. Brewis has pointed out, "boundaries which may be appropriate for one purpose may be inappropriate for another, and precision is essential when administrative action is involved."[2]

In emphasizing the subjectivity of the concept of a region, Prof. Brewis cites the following definition of the American Association of Geographers:

> A region is not an object either self-determined or nature given. It is an intellectual concept, an entity for the purposes of thought, created by the selection of certain features that are relevant to a real interest or problem, and by the disregard of all features that are considered to be irrelevant.[3]

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1 R.E. Caves and R.H. Holton, The Canadian Economy: Prospect and Retrospect, (Cambridge: Harvard University Press, 1961), p. 144.

2 T.N. Brewis, Regional Economic Policies in Canada, (Toronto: The Macmillan Company of Canada Ltd., 1969), p.43.

3 Ibid., P.45.

In the same vein, Friedmann and Alonso offer the following remarks concerning the difficulty in defining an objective set of workable planning regions:

> Since every regional definition is, of necessity, bound to a purpose derived from a national delineation of problems and goals, the definition is generally more mindful of what is socially valuable and politically significant than of scientific accuracy. Planning regions are best defined to be congruent in space with the socioeconomic functions to be carried out.[1]

Finally, the opinion expressed by R. Vining is that "the spatial structure of a human economy should be regarded conceptually as virtually a continuum. As in other studies of phenomena having volume or spatial extension, empirical observations must be made upon the contents of finite and arbitrary spatial units, these empirical units being viewed as providing an approximate conception of what would be viewed were the spatial units made arbitrarily smaller while the contents were being made more dense."[2]

Despite the high degree of arbitrariness involved in specifying which common properties will be adopted as the defining characteristic of a region, the bases for regional demarcation can be classified into three types of criteria:

> The first stresses homogeneity with respect to some one or combination of physical economic, social, or other characteristics; the second emphasizes so-called nodality or polarization, usually around some central urban places; and third is programming - or policy-oriented, concerned mainly with administrative coherence or identity between the area being studied and available political institutions for effectuating policy decisions.[3]

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1 John Friedmann and William Alonso, eds., Regional Development and Planning: A Reader, (Cambridge: M.I.T. Press, 1964), p. 489.

2 R. Vining, "Delimitation of Economic Areas: Statistical Conceptions in the Study of the Spatial Structure of an Economic System," Journal of the American Statistical Society, Volume 48, 1953, p.44.

3 J.R. Meyer, "Regional Economics: A Survey," American Economic Review, Volume 53 (1963), p.22.

It has been noted by J.R. Meyer that "all regional classification schemes are simply variations on the homogeneity criterion and it is somewhat misleading to suggest otherwise."[1] Thus, although "homogeneity with respect to some one or combination of physical economic, social or other characteristics"[2] has traditionally been one of several proposed alternative criteria for regional delimitation, the homogeneity criterion can encompass the others if the distinguishing common characteristics used to define the region are of sufficient breadth.

For example, a region which has been demarcated on the basis of political-administrative considerations displays a homogeneity with respect to the jurisdiction of the responsible administrative unit. A region delineated on functional gounds is homogeneous to the extent that the areas which depend in some trade or functional sense upon a specific centre are combined. The most obvious case of homogeneity is with respect to physical characteristics such as natural resourse endowment, although other economic or social characteristics might be the basis for a regional demarcation based upon homogeneity.[3]

Administrative Units for Policy-making

The fundamental consideration in the adoption of a political-administrative criterion for demarcating regions is the institutional framework within which policies are formulated and implemented. Although political boundaries often include areas which fail to comprise "meaningful" economic units, such a regional demarcation may well be the most relevant one for purposes of policy action. One reason for this is that the existing distribution of jurisdiction between different governmental bodies might necessitate a complex inter-governmental co-ordination

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1 *Ibid.*

2 *Ibid.*

3 *Ibid.*

for programmes designed for regions which are not demarcated on a strictly political-administrative basis, and the various governments might lack the machinery to successfully effectuate joint inter-governmental programmes. A further factor in opting for the political-administrative criterion is the fact that such a regional delineation might be the only geographic area about which data for most economically significant variables are available or can easily be made available. This latter factor has led J.L. Fischer to describe a region whose delineation is largely motivated by data availability as 'the "data" region of convenience.'[1]

One problem which attends the political-administrative demaraction of regions arises when different governments are responsible for similar functions in a particular geographic area. In such circumstances, a co-ordinated approach to economic development programming becomes unavoidable. Some examples of overlapping jurisdictions cited by Prof. Brewis are administrative responsibility for roads, education, industrial development, employment services, or local taxes.

A further problem arises when the rationale for the existing administrative boundaries has disappeared. For example, townships and municipalities of "uneconomic" size probably encounter difficulties in providing adequate services, not to mention the obstacles which must be faced in framing and executing development plans.[2]

A variant of the political-administrative region is the "planning region" or "programme region" which has as its main emphasis "the development of policies, programmes and actions to move the region from where it is economically toward

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1 J.L. Fischer, "Concepts in Regional Economic Development," Regional Science Association Papers and Proceedings, Volume 1, 1955, p.W-6.

2 Brewis, Regional Economic Policies in Canada, p.47.

predetermined economic objectives."[1] Thus, the government whose jurisdiction encompasses a particular distress area may attempt to delimit a region within this area in a manner which best facilitates the solution of the area's problem. J.R. Boudeville has described a "programme region" as follows:

> ...a decision-making model involving the spatial notion in both its forms: price effect (transport and production costs), and income effects (multiplier, agglomeration effect, nodal attraction). The aims differ according to the problem confronting the policy-maker... The particular aim does not matter, the main point being to build the appropriate model and use it for determining the optimum area.[2]

The advantages of a planning regional demarcation are clearly manifested in the following description of the nature of planning regions:

> The planning region must be one in which effective action can be taken, and will therefore tend to coincide with existing spatial definitions of authority, such as provinces, states or counties. It must also be one for which information is available and, since data are normally tabulated according to the traditional governmental divisions of space, the planning region is seldom drawn freely over a map, but is rather composed of predefined building blocks. Except in cases where the function is very narrowly defined, experience has shown the wisdom of emphasizing effectiveness over scholarly nicety in the defining of a region.[3]

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1 Fisher, "Concepts in Regional Economic Development," p. W-6.

2 J.R. Boudeville, "A Survey of Recent Techniques for Regional Economic Analysis," in Regional Economic Planning: Techniques of Analysis for Less Developed Areas, ed. by W. Isard and J.H. Cumberland (Paris: European Productivity Agency of the Organization for European Economic Co-Operation, 1960), p. 380.

3 Friedmann and Alonso, Regional Development and Planning, p. 490.

Homogeneous Regions

The area comprising a homogeneous region has at least one significant characteristic in common. For example, some similarity of geographic features may distinguish a region from the rest of the country. As Fisher notes, "This kind of region is useful particularly when the common geographic characteristic which unites and organizes the region is of prime importance."[1]

An alternative type of homogeneity is with respect to one or more economic and social indices. For example, such indicators in an area as per capita income, the rate of unemployment, the standard of industrialization, the standard of literacy, the growth rate, as well as indices on land use, level of living, population characteristics, type of farm composition, and so on may serve as the basis for delineating a region. Where more than one index is utilized, the need to assign these relative weights arises.

A fundamental limitation of employing socio-economic indices for regional demarcation is their essentially static nature. As Prof. Brewis points out, "In a dynamic context, moreover, a region may have high incomes which are declining, or be depressed economically but be growing rapidly."[2] However, the inclusion of dynamic indices such as the growth rate in the development of a composite index of homogeneity can overcome this particular shortcoming of the homogeneity criterion.

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1 Fisher, "Concepts in Regional Economic Development," p. W-5.

2 Brewis, Regional Economic Policies in Canada, p. 46.

One type of homogeneity which appears to be quite independent of the economic nature of space is that based on culture. An example cited by Friedmann is of the U.S. South, which was considered by many to be:

> ...the archetype of a "true" region. It was identified with a distinctive "folk culture," the region being an expression of the folk who occupy it and who give it a distinctive character through their 'natural' extra-organized, extra-technological, and unrationalized ways of life."[1]

Friedmann hastens, however, to issue the following warning concerning an inordinately high reliance upon culture as the basis for regional demarcation:

> Folk culture, no doubt, was the cohesive bond that held a region together. But it was not sufficient for a definition. The region was also a distinctive area because it possessed "the largest possible degree of homogeneity measured by the largest possible number of economic, cultural, administrative and functional indices, for the largest possible number of objectives."[2]

Whereas homogeneity is essentially a 'stock' concept,[3] the notion of "nodality" is really a type of 'flow' concept. Thus, homogeneity deals with <u>physical patterns</u> while nodality is concerned with <u>activity patterns</u>. As Friedmann and Alonso point out,

> In studying the spatial structure of economic development, both physical and activity patterns must be considered as two aspects of the same reality. The first refers to the arrangement in space of human settlements, productive

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1 Harry E. Moore, <u>What Is Regionalism</u> (Chapel Hill: The University of North Carolina Press, 1937), p.13, cited in J. Friedmann, "The Concept of A Planning Region," in Friedmann and Alonso, <u>Regional Development and Planning</u>, p.505.

2 <u>Ibid</u>. and Walter J. Matherly, "The Urban Development of the South," <u>The Southern Economic Journal</u>, February, 1935, pp.3-26, as cited <u>ibid</u>.

3 As was noted above, however, dynamic elements may be introduced through the inclusion of such indices as growth.

facilities, transport routes, land uses and the like. Activity patterns consist of the flows of capital, labour, commodities, and communications which link the physical elements in space.[1]

Friedmann and Alonso theorize that "The spatial structure of an economy comes into being from the interaction of physical and activity patterns. It may be described and studied with reference to such phenomena as growth poles, development axes, functional urban hierarchies, trade areas, and intermetropolitan peripheries."[2]

Nodal Regions

The basis upon which a nodal or functional or polarized region is demarcated is the itensity and regularity of the interaction and interdependence between the region's focal point (i.e. its 'nodal point' or 'growth pole') and the rest of the region's area. The boundary of the nodal region is determined fairly mechanically once the researcher has decided upon the type of economic flow which is of primary interest. Since there are as many different boundaries as there are economic flows, these flows (for example, those related to trade, labour supply or finance) are often combined in order to delineate the boundary of the most general economic activity area.

To simplify the analysis, suppose that we single out trade (i.e. commodity flows) as being of determining importance in the definition of a nodal region. "Each area has its trading centre and its hinterland within which trading is carried on in much greater volume than it is with outside areas. Lines of

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1 Friedmann and Alonso, Regional Development and Planning, p.9.

2 Ibid.

communication and transportation are the sinews which hold this type of region together.[1] One method of regional delineation may be that a particular area be included in the regional boundary of a nodal point if that area conducts the major part of its trade with the nodal point. Employing this same technique at a higher level of sophistication, indicators which show the intensity of trade with a nodal point may be developed. The magnitude of the indicator will generally vary inversely with the distance between the nodal point and the area under consideration. Districts whose index of intensity of trade with reference to the same nodal point are equal are then interconnected. A particular district may well be involved in trade relations with more than one nodal point. Therefore, several interconnected lines, each line consisting of points which experience equal levels of trade activity with a particular nodal point, may pass through some arbitrarily chosen district. This district would then fall within the boundary of the region whose nodal point exerts the strongest influence, and this would be indicated by the interconnected line depicting the maximum trade level.

The term "nodal region" appears to be applicable to several different kinds of economic regions. One classic variety of nodal region in the metropolitan-hinterland area. According to Donald J. Bogue,

> a metropolitan community is an organization of many . . . communities, distributed in a definite pattern about a dominant city, and bound together in a territorial division of labor through a dependence upon the activities

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1 J.L. Fischer, "Concepts in Regional Economic Development," p. W-4.

> of the dominant city . . . . The metropolitan community is not independent of the physical environment, but is, rather, an adaptation to the environment. It utilizes the techniques of production and exchange which are common to populations with industrial commercial cultures in order to exploit environmental resources and maintain maximum security against catastrophy...The complete structure of the metropolitan community may include the functions of finance, government, education, religion, and innumerable other aspects of the institutional composition of the individual hinterland community. . . .The metropolitan community has come to be a characteristic pattern by which at least one urbanized commercial-industrial society, the United States, is organized.[1]

A second approach focuses upon the export base as the fundamental determinant of a regional structure whose basis is the pattern of trade flows. R. Vining describes the "economic community" as the fundamental entity which appears to be organized around its 'export' industry,

> . . .this being the source of the flows which this community injects into the larger interdependent system and which act as a balance for the flows diverted from the larger system and channelled into this community. . . . the region, then, is the area including this primary unit, and it corresponds approximately to the familiar primary trade area.[2]

The nodal point of Vining's "economic community" would likely be a site having strategic transfer advantages in reference to procurement and distribution costs and might also be a processing centre in virtue of these factors. An explanation for the evolution of an urban centre (i.e. a nodal point) in the midst of an area which possesses an easily marketable export commodity is the following:

> Since the transfer advantages of these [nodal] points rests partly on large-volume traffic and frequent and flexible service, there is evidently a cumulative pressure toward concentration of transfer advantage . . .

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1 Donald J. Bogue, The Structure of the Metropolitan Community (Ann Arbor, Michigan: University of Michigan Press, 1949), pp. 61-63.

2 R. Vining, "The Region as an Economic Entity and Certain Variations to be Observed in the Study of Systems of Regions," Papers and Proceedings of the American Economic Association, Vol. 39, May 1949, pp. 90-92.

In addition there are many kinds of auxiliary services catering to business in general -- banks, utilities, fire and police protection, and others -- which can do a more effective job in larger communities. Interest, property insurance, and utility rates are generally lower in larger cities.[1]

It should be noted that although a nodal region which is characterized by an export base and a homogeneous region characterized by the homogeneity of its resource endowment might comprise the same area, the nodal demarcation derived by examining the relationships between various economic activities furnishes much greater insight into the nature of economic processes than does the latter approach which merely examines geographic conditions. The difference in approach is similar to that between economic analysis and descriptive economics.

The final aspect of "nodal regions" which will be considered is the relationships between contiguous nodal regions and their implications for regional delineation. From the perspective of national policy action, the validity of the nodal delineation of regions appears to be inversely related to the degree of factor mobility or commodity mobility between various regions. Under conditions of 'perfect labour mobility', for example, regional disparities in the rates of unemployment could not exist. Similarly, "The larger the market area for products produced in regions of high unemployment, the less necessary and desirable may be pinpointed policies, and the more these regions benefit from expenditure changes occurring in other regions."[2]

Thus, if a high priority of policy-makers were the elimination of inter-regional disparities in the cyclical fluctuations of business activity, this problem could be tackled by measures facilitating factor and commodity mobility, for the boundaries separating the delineated nodal regions would then become increasingly blurred.

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1 E.M. Hoover, The Location of Economic Activity (New York: McGraw-Hill Book Company, Inc., 1963), p. 120.

2 S. Engerman, "Regional Aspects of Stabilization Policy," in Regional Analysis, ed. by L. Needleman (Middlesex, England: Penguin Books Ltd., 1968), p. 279.

The Canadian Experience in Regional Delineation

Canada's regions have traditionally been delineated on the basis of a combined political and homogeneity criterion. The most common subdivision of Canada is into five major regions. The Maritime provinces together with Newfoundland comprise the 'Atlantic Region'; Quebec and Ontario constitute 'Central Canada'; Manitoba, Saskatchewan and Alberta are grouped together to form the 'Prairie Region'; British Columbia is generally classified as a distinct region; and the North is taken to include the two federal territories--the Yukon and the Northwest Territories.

The rationale for such a regional delineation is quite obvious. As R.D. Howland notes:

> One basic factor in any definition of a region, where policy considerations are germane to the study, is that the area, either by itself or in combination with other areas, must be able to take political action on its own behalf. This is probably the overriding factor in the choice of regions in the present study...[It is appropriate,] in the light of the Canadian Constitution, under which the provincial governments have substantial responsibilities in economic development...that the definition of regions should conform to the realities of political action. In this study, therefore, regions are taken to be either individual provinces or groups of provinces. The one exception to this is the treatment of the North as one region.[1]

A further justification for the above regional classification is in connection with explanations for the economic growth of Canada. If this growth can indeed be traced to the development of Canada's staple exports, then a logical regional demarcation would be based upon the homogeneity of productive resources. Some contiguous provinces having in common a comparative advantage

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1 R.D. Howland, Some Regional Aspects of Canada's Economic Development (Ottawa: Queen's Printer, 1957), p.2.

in certain significant goods would then be grouped into one region. Thus, the Maritimes and Newfoundland are similar "in that the role of the fisheries and the Atlantic trade has been of overwhelming importance"[1] for both.

In the same vein, Ontario and Quebec are clearly similar with respect to economic characteristics: both provinces followed identical phases of fur booms and timber development. Moreover, their patterns of agricultural development have been parallel. Both provinces exported mostly to the rest of Canada rather than abroad. They collectively comprise "the industrial heart of Canada" and their post-war mineral booms have followed similar paths.[2] The differences between their prosperity stem more from differences in the degree and emphasis of their respective economic developments than from a difference in kind.

Historically, the provinces of Manitoba, Saskatchewan and Alberta have comprised one region, for the following reasons:

> ...all three provinces were opened up by the construction of the Canadian Pacific Railway in 1885; all three concentrated initially on wheat production for export; and all have been dependent on distant urban cities for the bulk of their manufactured goods.[3]

The geographic isolation of British Columbia, as well as the fact that the impetus for its development stemmed initially from gold mining, distinguish this province regionally from other parts of Canada.

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1 Caves and Holton, The Canadian Economy, p.145.

2 Ibid.

3 Ibid., p.146.

Finally, according to Caves and Holton, "The Yukon and Northwest Territories can be lumped into a single region because the resources are largely unknown rather than because they are known to be similar."[1]

The preoccupation with regional demarcation in the Canadian context is certainly warranted as the following comments of Howland convincingly argue:

> ...the division of Canada into regions is a basic factor in the political and economic life of the country. It is not a matter of choice but a basic reality of the economy. If it can be said that Canada represents a political triumph over geography, that victory has not eliminated geography in any economic sense. Regionalism is in fact a built-in feature of the Canadian economy; a phenomenon which stems even from the constitution of the country, which is, in itself, sensitive to regional interests and special characteristics.[2]

The pioneering effort in regionally demarcating Canada by means of a synthesis of four delineation criteria was initiated by Pierre Camu, E. P. Weeks and Z. W. Sametz.[3] They subdivided Canada into 68 individual regions on the basis of the composite criterion which they developed. Their composite criterion, which they designated 'SFPM formula', was designed:

> for general analysis because it considers basic structural (S) factors, such as the physiographic bases and the population and capital structure; functional (F) factors, such as the transportation and communications network and the flow of other servicing functions; productive (P) factors

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1. Ibid.

2. Howland, Some Regional Aspects of Canada's Economic Development, p.1.

3. P. Camu, E.P. Weeks and Z.W. Sametz, Economic Geography of Canada (Toronto: The MacMillan Company of Canada Limited, 1964).

(both in respect of their homogeneity and of their relationship to one another); and marketing (M) patterns.[1]

In their own assessment of the utility of their 'SFPM' demarcation, the authors state the following:

> It is suitable for general theoretical area analysis such as studies of area income and expenditure because of the provision for both production and marketing factors, and for area input - output analysis because of the attention paid to industrial relationships. It is also directly suitable for various practical purposes such as marketing analysis.[2]

There are inherent difficulties in attempting to combine homogeneity of structure with a consideration of functional relationships in devising a composite regional classification criterion. As Prof. Brewis points out, "Functional regions necessarily comprise heterogeneous sub-regions as where, for example, a rural area provides the argricultural produce for a market town, which in turn provides recreational facilities for the rural population."[3]

In a study prepared at the invitation of the Area Development Agency, R.S. Thoman and M.H. Yeates dealt with "delimitation in terms of alleviation

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1 Ibid., p.265. A detailed description of this system is found ibid., Chapter 10. The system's weaknesses are discussed by D.M. Ray and J.L. Berry, "Multivariate Socio-Economic Regionalization: A Pilot Study in Central Canada," in Papers on Regional Statistical Studies (Canadian Political Science Association Conference on Statistics, 1964), eds. Sylvia Ostry and T.K. Rymes (Toronto: University of Toronto Press, 1966).

2 Ibid.

3 Brewis, Regional Economic Policies in Canada, p.51

rather than identification"[1] of distressed areas. It can fairly be stated that their study did not yield any major breakthroughs in the field of regional demarcation.

In the Canadian context, then, regional demarcations based on functional and apolitical grounds are really still in an infancy stage of development.

Conclusion

In the Canadian context, then, regional demarcations based on functional and apolitical grounds are really still in an infancy stage of development. In terms of regional delineation for purposes of economic analysis, the major constraint is imposed by the availability of statistical data. The Dominion Bureau of Statistics has, in general, failed to publish data which is disaggregated below the level of the provinces. Moreover, confidentiality requirements continue to militate against the prospects of regional delineation at a sub-provincial level. However, to some extent, the inadequacy of data at even the provincial level reflects the absence of a regional orientation in the past in the federal government.

Therefore, in view of present statistical limitation, the evaluation of alternative definitions of 'region' can initially serve no purpose beyond indicating the direction which future statistical compilation would most usefully take with respect to the level of disaggregation.

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1 R.S. Thoman and M.H. Yeates, "Delimitation of Development Regions in Canada (with Special Attention to the Georgian Bay Vicinity)", a report submitted to the Area Development Agency, Department of Industry, Ottawa, 1966, p. 12.

CHAPTER III

MARKET FORCES AND ECONOMIC ACTIVITY

Introduction

When conflicting explanations for the persistence of regional economic disparities in Canada are offered, what is often at issue is the relevance of the factor price equalisation theorem to the Canadian setting. This theorem specifies certain sufficient conditions which result in the elimination of geographic differences in the returns to factor inputs through an equilibrating process. The historical failure of the Canadian economy to respond to these (alleged) equilibrating forces and equalize the returns to resources in all regions has inspired two alternative explanations. Some economists argue that the interregional differences in returns to factor inputs have not been eliminated (or even significantly reduced) in Canada because the sufficiency conditions of the factor price equalisation model were not fulfilled. That is, it is claimed that since those conditions which are sufficient to bring about factor price equalisation did not obtain, regional differences in returns to factor inputs were not eliminated (or perhaps not even diminished). On the other hand, some economists contend that even where the conditions which allegedly cause factor price equalisation were fulfilled, the expected conclusions have not materialized historically.

In order to bring the issue of factor price equalisation into sharp focus, it is necessary to digress briefly into the economic theory which predicts such results.

The Tendency for Diminishing Regional Disparities

The first point to bear in mind is that the result of factor price equalisation has been predicted by the "mainstream" of economic thinkers under sets of assumptions which may contradict each other on the matter of factor mobility. As P.A. Samuelson has noted,

> Classical trade theory always took it for granted that free mobility of factors of production would tend to equalise the relative and absolute prices of productive services in the different regions.[1]

It was held that differentials in the returns to equivalent factor inputs between two regions would, assuming free mobility of factors, result in a voluntary flow of productive factors from the region of lower to that of higher returns. The influx of new factors to the higher yielding region would tend to depress the returns, since the marginal product of the factor being attracted to the region would decline according to the law of diminishing returns. On the other hand, as the interregional transfer of factors occurs, the marginal productivity of the factor which has moved from the low to the high return region will rise in the region of low returns. This process of interregional factor input flows "would cease only when absolute and relative factor prices had been finally equalised."[2]

A neo-classical variant of the factor price equalisation theorem, pioneered by Prof. E.F. Heckscher and B. Ohlin and refined by Paul Samuelson assumes complete factor immobility between regions.[3] Ohlin's conclusion was that:

> (1) Free mobility of commodities in international trade can serve as a partial substitute for factor mobility and
>
> (2) will lead to a partial equalisation of relative (and absolute) factor prices.[4]

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1 P.A. Samuelson, "International Trade and the Equalisation of Factor Prices," The Economic Journal, LVIII (June, 1948), 163.

2 Ibid.

3 The theorem actually assumes factor immobility between "countries" but because free trade is assumed, "countries" and "regions" may be used interchangeably.

4 Quoted by Samuelson, ibid.

Heckscher and Ohlin argued that although free trade between regions created a tendency for factor returns to be equalised between the regions, full price equalisation would not result in practice for various reasons. Samuelson extended their analysis to demonstrate the conditions under which full factor price equalisation would occur in the two factor, two commodity case. Samuelson then proceeded to extend the analysis to the general case of 'n' goods and 'r' factors, again formulating the set of assumptions which were sufficient to result in complete factor price equalisation.[1]

The underlying assumptions of the Classical model which render full factor price equalisation inevitable are the following:

> (1) The total supply of labor to all regions taken together is fixed. The only way in which one region may employ more labor is through migration from other regions. (2) A single homogeneous output is produced in each region. (3) There are zero transport costs between regions so that the price of output is regionally uniform. (4) The same production function exists in each region, being homogeneous of degree one in the inputs labor and capital. (5) There are zero costs of converting output into capital goods.[2]

G. H. Borts points out that, "Whether or not labor migrates, capital movements would produce an eventual elimination of regional differences in resource endowment, in the real wage and in the marginal product of capital."[3] He notes, moreover, that the model's implications will be contradicted if certain of the assumptions do not hold. For example, consider the following case:

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1 P.A. Samuelson, "Prices of Factors and Goods in General Equilibrium," The Review of Economic Studies, XXI (1) (1953-54), 1-21.

2 G.H. Borts, "The Equalization of Returns and Regional Economic Growth," The American Economic Review, 50 (1960), 320

3 Ibid.

If the supply of labor grows faster in low-wage regions and if labor is insensitive to regional wage differentials, different conclusions are suggested. Low-wage regions will still experience the highest rate of growth of capital, but they may not experience the highest rate of increase of wages; for the growth of the labor supply would prevent a rise in the ratio of capital to labor.[1]

Borts also demonstrates that without the assumption of complete specialization in production for each region, the growth rate of a high-wage region may exceed that of a low-wage region.

Turning to the neo-classical model in which factor price equalisation is effected through the internal reallocation of a region's resources rather through inter-regional factor transfers, the following conditions were specified by Paul A. Samuelson as being sufficient for full factor price equalisation in the simple two-factor, two-product case:

(1) linear homogeneous production functions in each good;
(2) diminishing returns along isoquants for each good;
(3) non-reversible and different factor-intensities of the two goods at all (relevant) factor prices:
(4) indentity of production functions for each good between countries [or regions];
(5) perfect competition and valuation of factors according to marginal value productivity;
(6) incomplete specialisation in production in each country; and
(7) absence of transport costs.[2]

Bhagwati's observations concerning the role of each of these assumptions are as follows:

The last assumption ensures commodity price equalisation, under free trade, between countries. The first five assumptions ensure a unique relationship between commodity and factor prices, under incomplete specialisation in

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1 Ibid., 321.

2 J. Bhagwati, "The Pure Theory of Internation Trade: A Survey," in Surveys of Economic Theory: Volume II, ed. by the American Economic Association and the Royal Economic Society (New York: St. Martin's Press, 1968), p.186.

production, which obtains identically between countries. With assumption (6), ruling out complete specialisation, therefore, commodity price equalisation necessarily entails factor price equalisation.[1]

The great limitations of the neo-classical model are certainly obvious. Samuelson himself is actuely aware of these, as his qualifications serve to demonstrate:

> In the first place, goods do not move without transport costs, and to the extent that commodity prices are not equalised it of course follows that factor prices will not tend to be fully equalised...there are many reasons to doubt the usefulness of assuming identical production functions and categories of inputs in the two countries; and consequently, it is dangerous to draw sweeping practical conclusions concerning factor-price equalisation...Where scale is important it is obviously possible for real wages to differ greatly between large free-trade areas and small ones, even with the same relative endowments of productive factors...
>
> There is no iron-clad a priori necessity for the law of diminishing marginal productivity to be valid for either or both commodities...
>
> In conclusion, some of these qualifications help us to reconcile results of abstract analysis with the obvious facts of life concerning the extreme diversity of productivity and factor prices in different regions of the world.[2]

The Tendency For Increasing Regional Disparities

Gunnar Myrdal contends that "the play of forces in the market normally tends to increase, rather than to decrease, the inequalities between regions."[3] Myrdal elaborates his thesis in the following way:

> If things were left to market forces unhampered by any policy interferences, industrial production, commerce, banking, insurance, shipping and, indeed, almost all those economic activities which in a developing economy tend to give a bigger than average return...would cluster in certain localities and regions, leaving the rest of the country more or less in a backwater.[4]

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1 Ibid.

2 P.A. Samuelson, "International Factor-Price Equalisation Once Again," The Economic Journal, LIX (June 1949), 195-6.

3 Myrdal, Economic Theory and Underdeveloped Regions, p.10.

4 Ibid.

Since Myrdal conceives of the economic process as being "cumulative because of circular causation," he claims that "the role of international trade becomes...one of being one of the media through which the market forces tend to result in increased inequalities when...the spread effects are weak."[1] Myrdal criticizes economic theory for its failure to focus "on the problems connected with big differences between techniques of production and, indeed, between the productivity functions themselves, corresponding to very great differences in the relative scarcity of factors of production and to immense differences in standards of living and the entire cultural setting."[2]

The process whereby the operation of market forces tends to aggravate regional disparities is depicted by Brewis:

> The more extensive the growth of a particular region, the more likely it is to attract migrants from other parts of the country. Such migration, moreover, is selective and tends to draw workers, generally the younger and more competent ones, out of the lagging regions. If, in addition to such migration, the growing region also attracts capital from the less promising regions, the inequalities between the regions become even greater, and once this trend becomes marked the situation is still further aggravated by the tendency of industry to locate in areas promising the greatest rate of growth and to avoid the depressed areas.[3]

Albert O. Hirschman has designated the unfavourable repercussions of the growth of the buoyant regions upon that of the lagging regions as "polarization effects." He argues that the internal migration of skilled people from the lagging to the buoyant regions may be undesirable from the national perspective because the pay differentials which induce such migration may well "overstate

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1 Ibid., pp.151-2.

2 Ibid.

3 Brewis, Regional Economic Policies in Canada, p.57.

considerably the real productivity differentials in the most productive and skilled grades."[1]

A Resolution of Conflicting Market Forces

Lest the prospects for depressed regions be regarded with undue pessimism, it must be noted that the growth effects of a booming region upon its lagging neighbour region need not be unfavourable. In fact, where the growth of one region stimulates growth in the lagging region, such a phenomenon has been characterised by Hirschman as a "trickling down" effect.[2]

The "polarization" and "trickling down" effects may be viewed as two conflicting vectors, each pulling the lagging region in an opposite direction. Thus, the direction of the resultant vector is a function of the relative magnitude of these opposing forces.

To illustrate the possible interplay over time between the "polarization" and "trickling down" effects, consider the following example given by Hirschman. We designate the buoyant region 'B' and the lagging region 'L'. Assume B specialises in manufactures and L in primary production. One would expect B's economic expansion to stimulate growth in L. However, if, as is likely, the short-run supply elasticity of L is low, the terms of trade move against B, leading to three possible results. In the best of circumstances, L could adjust successfully to meet B's increased demand for its primary products.

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1 A.O. Hirschman, The Strategy of Economic Development (New Haven: Yale University Press, 1958), p.188.

2 The terminology employed by Myrdal which corresponds exactly to Hirschman's "polarization" and "trickling down" effects is, respectively, "backwash" and "spread" effects.

A more pessimistic eventuality would be for L's rising prices charged B for raw materials to dampen B's growth, thereby leading to a decline in L's exports to B. The third possibility would be for B to substitute cheaper foreign exports for exports from L, or to diversify its own economy and supply its own raw material requirements. If this third eventuality came to pass, region L would be "largely cut off from beneficial contact with [region B]...while remaining exposed to the adverse polarization effects. Under these conditions... the stage would be set for a prolonged split of the country into a progressive and a depressed area."[1]

The Canadian Experience in Historical Perspective

> Over the period 1926 to 1962 taken as a whole, the level of variability of relative per capita income among the regions has been approximately constant. Furthermore, over the long term, there has been little change in the relative positions of the individual regions. On the basis of this evidence the trend of regional income differentials in Canada appears to have been roughly a constant; there has been neither convergence nor divergence.[2]

The same conclusion was reached by S. E. Chernick in his staff study for the Economic Council of Canada:

> While the degree of income disparity in relative terms has varied with changing levels of economic activity, the longer-run tendency, over a period of roughly forty years, has been one of little or no change. The long-run persistence in the extent of interregional income disparity, moreover, has been accompanied by a fairly fixed ranking among regions.[3]

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[1] Hirschman, The Strategy of Economic Development, p.189.

[2] M. McInnis, "The Trend of Regional Income Differentials in Canada," Canadian Journal of Economics, I, no.2 (May, 1968), 441.

[3] Chernick, Interregional Disparities in Income, p.64.

Not surprisingly, Chernick's results merely confirm the more preliminary findings of the Economic Council of Canada, which were as follows:

> Despite variations in personal income per capita from region to region, the feature which emerges most strikingly from the record of the past four decades is the essential persistence of income disparity among the regions of Canada...[The data of the Dominion Bureau of Statistics indicates that] the position of each region relative to the average... was virtually the same in 1926 as in 1964.[1]

Finally, the research of Jeffrey G. Williamson led him to conclude that "Canada does not reveal any significant trend towards either divergence or convergence during the thirty-five year period, 1926-60, for which regional income data are available."[2] His findings were not as simple as this conclusion might lead one to expect. Williamson's empirical investigations really constitute an attempt to test his hypothesis concerning the relationship between regional income disparities and the level of a nation's economic development. Therefore, we now turn to a consideration of his hypothesis and an examination of its applicability to Canada. According to Williamson,

> ...the early stages of national development generate increasingly large... [interregional] income differentials. Somewhere during the course of development, some or all of the disequilibrating tendencies diminish, causing a reversal in the pattern of interregional inequality. Instead of divergence in interregional levels of development, convergence becomes the rule, with the backward regions closing the development gap between themselves and the already industrialzed areas. The expected result is that a statistic describing regional inequality will trace out an inverted 'U' over the national growth path; the historical timing of the peak level of spatial income differentials is left somewhat vague and may vary considerably with the resource endowment and institutional environment of each developing nation.[3]

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[1] Towards Sustained and Balanced Economic Growth (Ottawa: Queen's Printer, 1965), p.102.

[2] J.G. Williamson, "Regional Inequality and the Process of National Development: A Description of the Patterns," in Regional Analysis, ed. by L. Needleman (Middlesex, England: Penguin Books Ltd., 1968), p.136.

[3] Ibid., p.108.

In order to calculate secular trends in regional income disparities, Williamson divided Canada in eleven regions: namely, the ten provinces and the North, the latter comprising the Yukon and Northwest Territories. He first derived 'V_W', "a weighted coefficient of variation which measures the dispersion of the regional income per capita levels relative to the national average while each regional deviation is weighted by its share in the national population."[1] In mathematical terms,[2]

$$V_W = \frac{\sqrt{\sum_i (y_i - \bar{y})^2 \frac{f_i}{n}}}{\bar{y}}$$

where f_i = population of the i^{th} region,
n = national population,
y_i = income per capita of the i^{th} region, and
$\bar{y}$ = national income per capita.

This size of geographic income differentials varies directly with the magnitude of V_W. Williamson's findings for the 1926-60 period were as follows[3]:

Year	V_W
1926	0.176
1930	0.221
1935	0.237
1940	0.220
1945	0.189
1950	0.199
1955	0.192
1960	0.175

1 Ibid., p.111.

2 Ibid., n.14.

3 Ibid., p.130.

Williamson's interpretation of these results was that:

> ....apart from the interlude of the 1930's, stability in V_W has been the rule, with Quebec and the Maritime provinces barely maintaining growth rates equivalent to those of Ontario and British Columbia, while the Prairie provinces reveal extreme instability producing fluctuations around the national average.[1]

The increase in V_W between 1930 and 1935 is a reflection of the strong impact of the depression on the Prairie provinces, while the decline in V_W between 1935 and 1940 reflects a reversal of these relatively short-run conditions. Thereafter, Williamson fails to explain the rise in V_W between 1945 and 1950, but it seems that he would consider this event to be a short-run aberration. In terms of testing Williamson's "inverted 'U' " hypothesis, the peak level of regional inequality cannot be ascertained from his data on V_W, partly because of the distortions caused by the depression and the Second World War, but most importantly because the data does not extend back far enough into time. Since the existing data did not permit Williamson to extend his time series for V_W backward, he developed a 'proxy' variable designed to approximate regional income per capita or level of development. His substitute index, Δw, equalled "the square of the differences between regional shares of agricultural employment in the labour force (hereafter termed A/L) and that of the nation as a whole,"[2] In mathematical terms,[3]

$$\Delta_W = \sqrt{\sum_i [(A/L)_i - (A/L)]^2 \cdot \frac{fi}{n}} \times 100$$

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[1] Ibid., p.137

[2] Ibid., p.140

[3] Ibid., n.34

where $(A/L)_i$ = share of agricultural labour in the total labour force of the i^{th} region,
(A/L) = share for the nation as a whole,
f_i = population of the i^{th} region, and
n = national population.

Williamson derived the following time series for Canada[1]:

Year	Δ_W
1901	7.14
1911	9.88
1921	12.35
1931	12.68
1941	12.60
1951	10.19

Williamson claims that this table "appears to support" his hypothesis. He interprets the results in the following manner:

> Δ_W increased rapidly during a very impressive period of Canadian growth, from 1901 to World War I (or more accurately, to 1921). Stability in regional inequality was indeed the case from 1921 to 1941, and the decline since World War II does appear to be part of a secular trend, rather than a short-term movement.[2]

If 'time' is plotted on the abscissa and 'regional income disparities on the ordinate axis', it seems that Williamson would project a continuing diminution in regional income disparities until the level of 1901 is attained. Such a prediction is only as strong as is the substituitability of Δ_W for V_W. However, if one wishes to determine the coefficient of correlation between these two variables, one can legitimately compare them for only three observations. Thus, correlating the values of V_W for the years 1930, 1940 and 1950 with the

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1 *Ibid.*, p.142.

2 *Ibid.*, p.143.

respective values of Δ_W for the years 1931, 1941 and 1951, we found that the coefficient of correlation , 'r', equalled 0.8109.[1] Since the coefficient of correlation must have a value of at least 0.8054 when only three ovservations are employed in order to yield a minimum confidence level of ninety per cent, it must be conceded that Williamson's 'proxy' variable was justifiably used. From the computation, one may infer that 66% [i.e. $(100 \cdot r^2)$ %] of the variation in V_W may be accounted for (or explained by) the linear influence of Δ_W. Nonetheless, since most economists would be extremely wary of drawing inferences on the basis of three observations, it appears that an attitude of scepticism towards Williamson's hypothesis is warranted.

Theordore W. Schultz developed a model which depicts the pattern of economic development in the new world and focuses upon the emergence of regional income disparities.[2] Without doing violence to Schultz's model, it appears possible to fit it into an outline which is very similar to that of Williamson's hypothesis. It might be noted, in passing, that C. Lemelin of Laval University contends that Schultz's model "applies perfectly to Canadian economic development."[3]

Schultz's analysis begins with the basic assumption, (which he claims is supported by empirical evidence), that the communities of early settlers in

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1 Let $Y=V_W$, $X=\Delta_W$, and N=3.

Then $r = \sqrt{\dfrac{3\ (7.602) - 35.47\ (.640)}{[3\ (423.38) - (35.47)^2]\ [3\ (.137) - (.64)^2]}}$

$= 0.8109$

2 T.W. Schultz, "Reflections on Poverty Within Agriculture," <u>The Journal of Political Economy</u>, (February, 1950), 1-15.

3 C. Lemelin, "Comment on Professor McInnis' Paper," <u>Canadian Journal of Economics</u>, I, no.2 (May, 1968), 472.

the United States possessed about the same distribution of wealth ('capital') and natural endowments ('talents'). He seeks to explain the origins of the regional disparities in per capita income which exist today by means of the following hypothesis:

> These gaps, consisting of differences in level of living, are basically consequences of the way in which the economy of the United States has developed and not primarily the results of any original defferences in the cultural values or capabilities of the people themselves.[1]

According to Schultz, the very process of industrialization results in the unequal regional distribution of productive assets, with a disproportionately high percentage of those who own large volumes of capital assets locating in the nation's dynamic regions. Schultz cites three categories of conditions which generate regional income disparities:

> (1) those that alter the proportion of the population engaged in productive work in one community relative to that of another; (2) those that change the abilities of a population to produce, of one community relative to another; and (3) those that impede factor-price equalization of comparable human agents between communities.[2]

The statistical investigations of the Economic Council of Canada strongly corroborate the significance of Schultz's conditions (1) and (2) as factors contributing to interregional income disparity. Chernick's findings were:

> that the interregional dispersion in earned income per employed person is significantly below that based upon the total population in each of the regions...[reflecting] interregional differences in the availability

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1 Schultz, "Reflections," p.5.

2 Ibid., p.9

> and utilization of labour...In other words variations among the five major regions in the age structure of the population, labour force participation and unemployment rates are significant and account for roughly two fifths of the interregional dispersion in earned income per capita.[1]

With respect to condition (1), the 1960-64 average index of employment percentage for each region, (i.e. the percentage of the population employed in the labour force), taking the Canadian average as 100, was 80 for the Atlantic region, 95 for Quebec, 109 for Ontario, 104 for Manitoba, 100 for Saskatchewan, 104 for Alberta, and 97 for B.C.[2] Only 47% of the Atlantic Region's adult civilian population was in its labour force, compared to 57% in Ontario. The E.E.C. concludes that, "Differences in the utilization of available manpower... [account for] roughly half of the gap between the Atlantic region and the national average..."[3]

The E.C.C. attributes the low participation rates largely to a lack of employment opportunities. Thus, "the high unemployment rate and the low participation rate are symptoms [and not causes] of a substantial underutilization of manpower resources..."[4]

Condition (2) as outlined by Schultz is important in several respects. For one thing, the productivity of a region's labour force is closely correlated with the average level of educational attainment. Also, the low level of educational training prevents a region's population from earning high personal incomes, and this direct effect hampers the region's prospects of achieving prosperity.

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1 Chernick, Interregional Disparities in Income, p.26.
2 The figure for B.C. may be largely explained by this province's popularity amongst those who retire.
3 Towards Sustained and Balanced Economic Growth, pp. 113-7.
4 Ibid., p. 116.

Furthermore, the shortage of a skilled labour force may be the decisive factor in the decision of a firm not to invest in a region. In addition, the cumulative processes towards regional inequality are also at work in the realm of education. Because a region is poor, it can ill-afford to sustain the heavy burden which would be imposed by an educational system matching that of its richer counterpart (unless external aid of sufficient magnitude were forthcoming from federal authorities in the form of equalization payments). Yet if its educational services were inferior to those of richer regions, the difficulty of narrowing the gap in income disparity would be compounded.

Schultz's third category of the conditions which forestall a narrowing in interregional income differentials consists of factors inhibiting the "factor-price equalization of comparable human agents between communities." An enormous volume of literature has appeared which deals with the labour mobility aspect of this issue. Setting the debate concerning labour mobility in the Canadian context raises more questions than it answers. Turning first to the facts:

> At the decennial census in 1871, over twenty per cent of the Canadian population lived in the three Maritime Provinces of Nova Scotia, New Brunswick and Prince Edward Island. By 1961, the percentage had dropped to less than eight. Between 1881 and 1931, net out-migration from the Maritime Provinces is estimated to have averaged some 90,000 per decade...[1]

Given conditions which sufficiently approximate those postulated in the various factor price equalisation models, the conclusions of the model could reasonably be expected to obtain. However, in fitting these models to the

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1 T.N. Brewis, et al., Canadian Economic Policy (Toronto: Macmillan Company of Canada Ltd., 1965), p.322.

historical experience of Canada, there are certain factors which seem to reverse their predictions of diminishing regional income disparities. In addition to the inherent limitations of the model, which were indicated above and which are obviously reflected in the lack of realism of some of the assumptions, there is a further critical difference between the theory and Canada's experience. The Classical model which assumes free labour mobility posits the existence of higher rates of return to factor inputs in the lagging regions, so that these factors, seeking their maximum earnings, flow from the prosperous to the relatively depressed regions. To recapitulate the balance of the theorem, the law of diminishing returns results in the marginal productivity of the factor input which migrates from the prosperous region to rise there while simultaneously causing the marginal productivity to decline in the relatively depressed region as it experiences this influx of the factor input. Thus, the disparities between the marginal productivity of a particular factor input in different regions is eliminated and consequently, the rates of return to the factor becomes equalised for all regions. In Canada, this phenomenon with respect to the labour input appears to have occurred in reverse; that is, the higher returns of the prosperous region have effectuated a 'brain drain' from the poorer regions. In neither of its two versions does the factor price equalisation theorem appear to make any allowance for the direction of the factor flow. Yet whether factor inputs are attracted from the prosperous to the lagging regions or vice versa seems to be a key consideration, as the following observations of Brewis indicate:

> In so far as the rewards to labour and capital are higher in central Canada than in the Atlantic provinces, labour and capital will tend to flow to the former from the latter. This will tend to greater equality of rewards, but this an offsetting consideration. The increased investment in central Canada will further stimulate employment and income there, and if the increased income is largely spent in central Canada, as is likely, this will have a multiplier effect, increasing incomes still further in central Canada. The expenditure of this income is likely, moreover, to have an

> accelerator effect, inducing new investment that in turn will lead to increased incomes and employment. The cycle thus continues, and is accentuated by the external economies that result from a growing industrial complex. The converse could be true of the Atlantic provinces. As a result there may be less gain in reducing the income gaps than one would expect [on the basis of the factor price equalisation theorem].[1]

A further fallacy is found in the argument that the extent to which interregional income disparities are reduced is directly proportional to the extent to which labour is mobile. However, when one considers that "labour is not a homogeneous stock, but is composed of persons of different ages, stregths, marital and family states, skills, training, risk-taking propensities, and propensities to participate in local institutions and governments,"[2] and moreover, that "people with these valuable characteristics are likely to be the first lured away when local opportunites falter, and their departure is likely to impose the greatest per capita loss,"[3] then one must conclude that if labour migration fails to proceed beyond the stage of this initial outflow, the economic conditions in the lagging region will most assuredly deteriorate. Furthermore, the factors which impede labour mobility are felt most acutely by the older, less educated, less skilled, and consequently, less adaptable segment of the population. Thus, the obstacles to labour mobility militate strongly against out-migration continuing beyond the initial stage. Despite the absence of legal barriers to labour mobility within Canada, there do exist obvious social, economic, and cultural constraints, not the least of which may be the 'psychic income' which is

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1 Ibid., pp.322-3

2 A.D. Scott, "Policy for Declining Regions: A Theoretical Approach," in Areas of Economic Stress, ed. by W.D. Wood and R.S. Thoman (Kingston, Ontario: Industrial Relations Centre, Queen's University, 1965), p.86.

3 Ibid.

derived from life in the lagging regions, and these obstacles appear to be of greatest significance amongst those individuals whose economic contribution yields the lowest market value.

Turning finally to differing explanations of Canada's persistent regional income disparities for a period exceeding four decades, Mr. McInnis claims that "the over-all constancy...will probably be best explained as a historical development which fortuitously has maintained a precarious balance between convergence and divergence over a relatively long period of time."[1]

Lemelin challenges McInnis' description of constant regional income differentials as "fortuitous," pointing out that the model which he accepts, namely that of Schultz, predicts that "the market mechanism will contribute to perpetuate and increase" any initial gap between the per capita income of two regions. This approach would therefore "point to constancy of income differentials over time if, and only if, government intervention is effective in complementing market forces."[2]

Scott, on the other hand, argues that government expenditures, both at the local and federal level, which ignore the fundamental lack of viability of a region and seek to defy (or least offset) market forces, merely serve to prolong the agony and ultimately perpetuate regional income inequality. According to Scott,

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1 McInnis, "The Trend of Regional Income Differentials in Canada," 448.

2 <u>Ibid</u>., 472.

> ...the government programs endorsed are deficient in that they usually contain many more provisions for the attraction and holding of industry than for the embodiment in the labour force not only of skills and abilities, but also of an adaptability, a capacity to adjust to the techniques, languages, customs or laws of other regions.[1]

The final verdict concerning the relative merits of the two approaches to effectuating a narrowing of regional income disparities must be reached by the responsible politicians. The policy chosen can only be optimal in terms of a particular set of values, and the values of the populace will be reflected by their political choices.

Location Theory

At the root of regional income disparities are the location decisions of the individual producing units. "Location Theory" is the branch of economic theory which attempts to systematically formulate those principles which largely govern the choice of an individual firm locating at a particular site

It is generally assumed that firms seek to maximize their profits. In the event that a firm fails to select its optimal production location, it will also fail to attain its highest profit level. Various factors will weigh more or less heavily in the deliberations of the firm in search of its optimal plant location; a key consideration is the nature of the firm's product.

E.M. Hoover divides the activities of a productive enterprise into three stages "which are always present, though sometimes one or another may be unimportant":

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1 Scott, "Policy For Declining Regions," p.89

a. Procurement: purchasing and bringing the necessary materials and supplies to the site of processing
b. Processing: transforming the materials into more valuable forms (products)
c. Distribution: selling and delivering the products[1]

If a firm faces a perfectly elastic demand curve, its preoccupation will be with minimizing its cost of production. Since transportation expenses comprise an important element in a firm's cost structure, the relative advantages of various location options will be considered by the firm in terms of minimizing transfer costs. Hoover observes that "the distribution and procurement advantages of sites vary...rather systematically according to distance from customers and suppliers."[2] Industries are classified into one of three categories, depending upon whether total transportation costs are minimized by locating close to the material inputs, close to the consumer market or whether the location is a matter of indifference to the firm: the categories are 'materials-oriented', 'market-oriented' and 'foot-loose' industries respectively.

According to Hoover,

> ...a process entailing a larger volume of materials than of products is likely to be more influenced by considerations of nearness to materials sources. Thus, processes in which there is considerable loss of weight through combustion or waste of part of the material are likely to be located close to the source of the material...[3]
>
> Analogously, orientation to markets may be based either on a "weight gain" in the process or on higher transfer costs per ton-mile on products than on materials.[4]

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1 Hoover, The Location of Economic Activity, p.7.

2 Ibid., p.8.

3 Ibid., p.31.

4 Ibid., p.35.

As a rough generalization, one can say that early stages of production are material-oriented and late stages are market-oriented while intermediate stages are relatively "foot-loose" as to transfer considerations.[1]

Since the foregoing analysis considered the case in which the firm's demand curve was perfectly elastic, it abstracted from such considerations on the revenue side as variation in the price to consumers which could be realized or the quantity of output which the firm could successfully market. Where the firm faces a tilted demand curve, it enjoys some monopolistic power. In a situation such as this, it is not sufficient for the firm to minimize costs in order to maximize profits. In fact, the firm seeking its most suitable location under monopolistic competition conditions must adopt a two-prong strategy: it must favour a market area whose demand allows the firm to operate at (or near) its optimum scale of production, and it must seek a location such that it can realize external economies (e.g. from proximity to producers of inputs required by the firm). Where locational discrepancies alter the firm's possible production function and demand curve, the profit maximizing firm would select a site which offered the most promising net returns based on its combined prospective production function and demand schedule.

The Element of Chance in Location Decisions

There are, broadly speaking, two schools of thought concerning the location pattern of economic activity which evolves. Representative of the deterministic view that location patterns are not the results of historical accident is the following:

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[1] Ibid., p.46.

> Human activities are distributed over the national territories in certain rhythms and patterns that are neither arbitrary nor the workings of chance. They result rather from the interdependencies that give form to economic space. The economic and social development of the nation is reflected in [not caused by] its patterns of settlement; its systems of flow and exchange of commodities, money, and information; its patterns of commuting and migration; and its reticulation of areas of urban influence.[1]

In sharp contrast is the following account of Myrdal's explanation of the national distribution of industry:

> ...within broad limits, the power of attraction today of a centre has its origin mainly in the historical accident that something was once started there, and not in a number of other places where it could equally well or better have been started, and that the start met with success. Thereafter the ever-increasing internal and external economies--interpreted in the widest sense of the word to include, for instance, a working population trained in various crafts, easy communications, the feeling of growth and elbow room and the spirit of new enterprise--fortified and sustained their continuous growth at the expense of other localities and regions where instead relative stagnation or regression became the pattern.[2]

Prof. Barber seems to share Myrdal's viewpoint as exemplified by his following comment:

> While the location of some industries can be explained quite simply in terms of their resource orientation there are other industries whose location is partly due to the chance of history. Watches in Switzerland, diamond cutting in Amsterdam, optical equipment in Germany, are examples that come to mind. That both foot-loose and market-oriented industries are located where they are today, is the outcome of a long series of interacting decisions made in the past.[3]

Yet another manifestation of "chance" in the location decision of a firm would be in the psychological disposition of its management with respect to location. L. Needleman has pointed to situations wherein personal predilections

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1 Friedmann and Alonso, Regional Development and Planning, p.2.

2 Myrdal, Economic Theory and Underdeveloped Regions, pp.26-7 [my underlining].

3 C.L. Barber, "Comments," in Areas of Economic Stress in Canada, ed. by Wood and Thoman, p.93.

weigh more heavily with management than do the "best interests" of the firm:

> A number of studies stress personal factors as influencing the choice of particular sites for new branches. A businessman, in his choice of location, may not always be concerned with maximizing the profits of the company. He may have other criteria: one place may appeal to him more than another, social life may be rich here and meagre there. There is no necessity for all these aims to coincide, and the likelihood of their doing so is decreasing as the divorce between ownership and management in business becomes more widespread. It appears to be not uncommon for potential sites to be rejected because the prospective manager of the new plant would not like to make his home in the district.[1]

Conclusion

The realization of inter-regional factor price equalization is not in itself sufficient to eliminate economic disparities in view of inter-regional differences in the occupational labor force's distribution and the level of participation of the populations of different regions in the labor force. Therefore, policies which seek merely to equalize returns to homogeneous factors of production in all regions may be inadequate for the task of reducing inter-regional disparities in per capita income. To achieve this latter end, special measures designed to encourage economic development in the lagging regions may be warranted. If the location incentive grant is the instrument for this purpose, it appears to offer the most promise in the case of foot-loose industries or of industries which, at best, offered the firm a marginal advantage at the site where it intended to locate prior to the government's offer of a location incentive.

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[1] L. Needleman, "What Are We To Do About the Regional Problem," Lloyds Bank Review, No. 75 (January, 1965), 50.

CHAPTER IV

AN EXAMINATION OF SELECTED FEDERAL REGIONAL AGENCIES

Introduction

Prior to their consolidation into the new "Department of Regional Economic Expansion" on March 24, 1969,[1] a substantial array of programmes and agencies existed at the federal level, each designed to cope with particular aspects of the regional economic disparity problem. The status of the agencies ranged from autonomous and quasi-antonomous to fully integrated subdivisions of the various departments.

Since one cannot hope to grasp the essential philosophy and orientation of the very recently constituted Department of Regional Economic Expansion, the most fruitful course appears to involve an examination of selected components of this department with a view to ascertaining, for each agency, its objectives, its terms of reference, and perhaps even its underlying philosophy (where this has been more or less clearly articulated). Where the goals of certain agencies incorporated into the new department are found to be, to some extent, competitive rather than complementary, the department's overall developmental philosophy and priorities will be called upon to resolve the conflict in some way. It is probably fair to say that the Department of Regional Economic Expansion lacks, at the present time, a clear philosophy concerning the optimal approach to regional development. However, an increasingly clear philosophy is likely to evolve through a process of trial-and-error as the relative merits of different approaches are assessed.

In the following section, the orientation of some of these agencies towards the problem of regional development will be briefly sketched. Largely on the basis

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[1] Bill C-173.

of discussions with government officials having expertise with respect to certain regional development agencies or programmes, the fundamental strengths and weaknesses of these agencies and programmes and the potential and actual conflicts in their objectives and measures adopted will be indicated. The terms of reference of the new Department of Regional Economic Expansion, the general approach of this Department and the manner in which the components which comprise the new Department are being gradually rendered fairly consistent will be examined in the final chapter.

'Area Development Agency' (ADA)

In Part II of the Department of Industry Act (which Act received assent in July, 1963), the Governor in Council is empowered to designate "any district or locality in Canada that is determined to require special measures to permit economic development or industrial adjustment by reason of the exceptional nature or degree of unemployment in that area" as "a designated area."[1]

The "Area Development Agency" (ADA) was established under the direction of a Commissioner for Area Development whose responsibility is now to the Minister of Industry, Trade and Commerce. The Minister's responsibility was to analyse "the means of increasing employment and income in designated areas" and to this end, to initiate and execute programs and projects which "cannot suitably be undertaken by other departments, branches or agencies of the Government of Canada." The Act allowed the Minister to "enter into agreements with the government of any province or any agency thereof for the carrying out of programs for which he is responsible."

The preoccupation of ADA was initially with the relief of the very high unemployment experienced by certain areas in Canada through the incentives offered

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1 Statutes of Canada, 12 Elizabeth II, Chapter 3, Sec. 9, p.61.

to industry to locate in these areas. ADA adopted what might be described as a "non-discretionary approach" in its designation of areas eligible for federal assistance in the form of incentives to industry to loate there. That is, it adopted a set of criteria which, although arbitrary, are nevertheless adhered to in order to ascertain whether or not a given area qualifies for 'designation' and its ancillary benefits. One may take issue with the criteria adopted for designating areas; however, once such criteria have been established, the process of determining the status of an area is strictly mechanical.

In 1963, ADA's primary concern was the alleviation of high unemployment in certain areas of Canada. Thus, areas were designated on the basis of National Employment Service information on labour surpluses. By 1965, with the adoption of additional criteria for designating areas -- namely, income level and growth of employment in an area, as well as provision for the inclusion of continguous counties in the N.E.S. areas if they qualified -- a shift in emphasis occurred from the single unemployment criterion to greater reliance on a complement of symptoms portraying areas of stress.

The ADA program offers the following incentives to firms locating in designated areas:

(1) A Development Grant in the form of cash or an equivalent tax credit of up to one-third of the capital cost of new machinery and equipment and new buildings. The Development Grant is exempt from federal income tax and does not reduce the amount of capital cost which may be used for tax purposes.

(2) Accelerated Capital Cost Allowances of up to 50% per annum, straight line, on new production machinery and equipment.

(3) Accelerated Capital Cost Allowances of up to 20% per annum, straight line, on new buildings and significant extensions to existing buildings.[1]

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1. Area Development Agency (Ottawa: Queen's Printer, 1967), p.5.

In a publicity brochure, ADA explains the motivation for its area incentives program as follows:

> In spite of its prosperity, there are certain areas in Canada which have marked time in terms of population, employment and economic growth. In order that these areas may also share in the nation's growth, a large number have been designated for assistance through special programs administered by the Area Development Agency of the Department of Industry.[1]

There are some obvious strengths and weaknesses in the ADA incentives program. With respect to a non-discretionary approach, an obvious advantage is that of political expendiency. Once the criteria for designating areas have been chosen, the decision regarding the classification of a given area is, in a sense, 'objective'. It should be recognized, however, that value judgements are made in establishing a set of area designation criteria. Furthermore, greater flexibility may be allowed by scheduling periodic review of the criteria adopted and of special areas which fail to comply with the established criteria but which may still require special governmental assistance. Yet another advantage of the non-discretionary approach is that it clarifies the "ground rules" leaving entrepreneurs in a more favourable position to interpret their best interests. The stability of the criteria facilitates a smoother adjustment by industry to the government incentives program. The basic weakness of a non-discretionary approach is that it might prove to be overly rigid and prevent administrators of the programme from fully exercising their judgement. Because the criteria will have been formulated with a view to being sufficiently general to encompass depressed regions of varying types throughout the country, the special problem areas may not satisfy the general conditions and the program administrators may find themselves in a bind if they try to broaden the interpretation of an explicit set of criteria.

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1 Ibid., p.3.

It seems, however, that a more telling weakness in the non-discretionary approach is its failure to examine the long-run economic prospects of firms which locate in certain designated areas. There is the ever-present danger that industries will be induced to locate in an area for a short-term benefits even though there are only poor prospects for long-term survival.

Furthermore, a non-discretionary approach is fundamentally incompatible with an integrated regional development strategy. The essence of a non-discretionary approach is the establishment of a set of rules and regulations which form the framework within which businessmen must operate. This legal system imposes the only constraint on business behaviour; apart from the legal constraint, businessmen have complete freedom to manoeuver in the manner which they interpret to be in their best interest. The ADA legislation offers a grant to businessmen who locate in certain designated areas. The reason that a grant was offered was that government officials had decided that private and social accounting methods would yield significantly different investment allocation patterns. They realized that if the market mechanism were not consciously influenced by the government, the volume of investment in "depressed areas" would be further from optimal than would be the case if investors were induced by monetary incentives to invest in such areas. That is, without government intervention, the volume of investment in lagging regions would be less than is socially desirable. However, it must be recognized that government subsidies, grants, higher depreciation allowances, or tax exemptions do not really represent an unequivocal commitment to the promotion of the economic development of lagging regions. For the real root causes of underdevelopment are not attacked. Although it is conceivable, that the attraction of a sufficiently large volume of external capital to a lagging region may fortuitously solve some real barriers to the region's development, developmental strategy cannot be based on such remote possibilities. What is required is an honest appraisal of a region's assets and liabilities, followed by an educated evaluation of the region's development potential, assessing its prospects from a national perspective. It is because a system of grants and subsidies leaves development to chance that the above claim that a non-discretionary approach is incompatible with a comprehensive regional development plan was made.

In his discussion of discriminatory grants, one ADA official pointed out that if, in the logically extreme case, equal grants were offered to all areas of Canada, the government objective of diverting investment funds from prosperous to lagging regions could not hope to succeed. However, the further governmental goal of optimally allocating investment among the designated areas must fail for the same reason if a grant system is non-discriminatory between the various designated areas; for in offering uniform grants to all designated areas, the government foregoes the opportunity of distributing the investment fund in the manner most propitious in terms of economic growth and development, relying instead on the invisible hand whose past performance has left much to be desired.

Concerning the principle of industrial location incentives, Lionel Needleman states that:

> It has been argued that measures that restrain industrial expansion in the prosperous areas are ill-advised, first, because businessmen know better than any civil servant how to choose the most efficient least-cost location, and second, that if they have to set up plant at other locations the loss in efficiency may be substantial. The findings of the empirical studies cast doubt on both these assumptions. It seems that, within fairly broad limits, the government need not worry too much about the effect of its intervention on costs of production and can concentrate on the problem of how industry may be steered most effectively to the regions where resources are under-utilized.
>
> The inducements offered by the public authorities can, in principle, sway firms in their choices between alternative locations. The extent to

which firms actually do move to the places where the government would like them to move depends partly on the degree to which the firms' original choices and those of the government coincide and partly on the nature and scale of the government's inducements.[1]

A very senior government official who was instrumental in the establishment of ADA's location incentives program, described the thinking of the policy-makers in terms which de-emphasize the social equity principle as a factor of importance in the formulation of the program. The policy-makers' goal, according to this official, was to induce the firms' managements to base their location decisions more on the profit maximizing principle than on their personal tastes in cities or other utility maximizing considerations. This official explained that the essential role of locational incentive grants was the promotion of 'economic rationality'. In other words, the grants were designed to cause management to pause and reflect upon the real advantages of locating in lagging regions. As Needleman notes, "Higher transport costs in the peripheral region may well be more than offset by other costs being lower, particularly lower rents, rates and labour costs".[2] The government official felt that more often than not, the management of firms fail to even consider locating in lagging regions. L. Needleman concurs with this view insofar as Britain is concerned:

> Location decisions within British manufacturing industry appear often to be unsystematic, if not casual. In their search for sites, firms seldom attempt to obtain any technical advice. In general, firms do not seem to be looking for the best site but for a site that is satisfactory. Once they have found two or three that meet their minimum requirements they stop looking for further sites, and choose from among the short list that they have collected. Decisions to locate in one place rather than another seem rarely to be based on detailed calculations of the costs of operating at the different sites involved. Indeed, the most thorough survey of manufacturing location yet published in Britain states: "We should have liked to have given an example of a classic case of location choice in which operating cost estimates

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[1] Needleman, "What Are We To Do About the Regional Problem," 51.

[2] *Ibid.*, 50

> were made for two or more possible places, all imponderables or non-cost factors assessed, and then a way found of comparing the good and bad points of one place with those of the other. Unfortunately, we have not been able to find such a case.[1]

Viewed in a less positive light, locational incentive grants may be seen to offer <u>compensation</u> to firms locating in lagging regions -- possibly for the higher risk or for higher transportation and communication costs incurred in transactions with central markets, or for adjustment costs resulting from shortages in the availability of manpower having the requisite skills.

Speaking before the Standing Committee on Regional Development respecting "An Act to provide Regional Development Incentives, Etc."[2] Mr. J. Marchand, Minister of the Department of Regional Economic Expansion, adopted this latter rationale for location incentives. He stated that:

> The only thing we are trying to do with [location incentives]...is to put the companies which accept to go into those underdeveloped regions or slow-growth regions on exactly the same footing, from a competition point of view, as companies which establish themselves in large centres such as Montreal, Toronto, Calgary, Vancouver and so forth. We say, "You are away from the markets, you have transportation problems. We are going to give you a grant so that you are on exactly the same footing."[3]

One final issue centering about ADA's choice of criteria in designating areas to be eligible for incentives was the following:

> that of development versus relief. The extension of government stimuli and aids to private investment, if restricted only to areas of high unemployment, aimed really at relief. Since industrial development would be most attracted to larger growth centers which offered better labor and product markets and the advantages of some external economies, the denial of incentives to firms desirous of locating in such centers was -- and remains -- inimical to economic development objectives for the region.[4]

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1 <u>Ibid.</u>

2 Bill C-202.

3 Canada, House of Commons, Standing Committee on <u>Regional Development</u>, Twenty-eighth Parliament, First Session, No. 16, June 16, 1969, p.390.

4 L.J. Walinsky, <u>Evaluation of Economic Research Relating to the Atlantic Region</u> (Fredericton: Atlantic Provinces Research Board, June 1967), p.33.

One government official (not working for ADA but having expertise in the field of Federal region development policies) described ADA as mainly an "operational apparatus" to administer the Act. He claimed that there was no continuous review of the rules; he stated that instead, ADA, the Department of Finance and Treasury Board are attempting to assess the effect of the locational incentive grants. According to this official, ADA has not really evolved, since its basic objective remains the alleviation of high unemployment rates. He pointed to the announcement by the Prime Minister, that the same incentives offered by ADA to designated areas would be made available by the ADB for investments in Halifax, Dartmouth, St. John and Frederiction, as evidence of an implicit recognition of the fact that the Atlantic region's long-term growth prospects were being hampered by the diversion of investment funds from the region's major growth centres to areas having no real prospects because of the rigid ADA criteria for area designation. It is the contention of proponents of the "growth pole theory" of economic development that the maximum linkage effect from investment is realized by the concentration of investment funds in a few key growth centres; under such circumstances, it is claimed that the surrounding region will also prosper through a favourable "trickling down effect." Therefore, this school of thought claims that the decentralized proliferation of investment funds will dissipate their potential developmental impact with the result that the rate of growth and development of the region will be unnecessarily low. That is, when the volume of investment in a region is given, it is claimed that its optimal distribution would involve its concentration in dynamic growth poles. This view is held by the Atlantic Development Board, among others.

In defence of ADA's area designation criteria, one ADA official pointed out that there is a heirarchy of growth poles competing for the same funds, and that if Halifax had been in a designated area, it might have diverted funds from, say, Syndey, Nova Scotia.

This official conceded that ADA's perspective was narrower than that of the ADB, and this fact accounted for their policy conflict with respect to the growth pole theory. He admitted that there was a strong possibility that the total volume of investment in the Atlantic region would have been greater had the Atlantic growth centres of Halifax, Dartmouth, St. John and Fredericton not been excluded from designation for locational incentive grants by ADA. Thus, although Halifax might have attracted some funds that were originally destined for Sydney, there was a good possibility that the designation of the complete Atlantic region would have channelled additional funds from, say, Toronto. However, this official did note that the growth pole theory might well indicate that the investment pattern facilitating the highest national rate of growth would require the concentration of investment in the Toronto area if Toronto is indeed at the apex of the growth pole hierarchy.

This official also took issue with the claim that ADA's grant system was more of a relief measure than a development program. He emphasized the fact that ADA merely offered "a one shot subsidy -- not a continuing subsidy." Therefore, the onus was on the firm to determine the economic viability of its location in a designated area. The ADA program was, according to this official, designed to maintain a market-type economy with the minimal amount of government interference (except where absolutely necessary). He claimed that ADA's location incentives program was complementary to expenditures by other federal agencies on social overhead capital in the lagging regions, since both measures were designed to lower the risk of, or raise the return to, prospective investors in the region.

'Atlantic Development Board' (ADB)

The Atlantic Development Board is unique in that it is the only federal agency whose sole concern is the economy of the Atlantic region. As such, it reflects the government's recognition that the Atlantic region needs a special agency to supplement the efforts of other agencies and departments concerned with the problems of the region.[1]

The Atlantic Development Board, consisting of eleven members, was established in December, 1962 by an Act of Parliament which was amended in 1963 with the establishment of a $100 million Atlantic Development Fund and in 1966 when this Fund was increased to $150 million.The ADB's terms of reference direct it to:

...prepare, in consultation with the Economic Council of Canada, an overall co-ordinated plan for the promotion of the economic growth of the Atlantic region[2]...

as well as to:

...enter into agreements with the government of any province comprised in the Atlantic region...providing for the undertaking by the Board of any programs or projects that, in the opinion of the Board, will contribute to the growth and development of the economy of the Atlantic region and for which satisfactory financing arrangements are not otherwise available.[3]

According to the ADB Annual Report 1966-7,

Although there is no formal procedure for bringing projects to the attention of the Board, the Board follows the practice of consulting the provincial government concerned before taking action on specific projects. Moreover, the provinces share in the cost of many of the Board's projects, and completed works are turned over to the provinces for operation, maintenance and assessment of user charges, where applicable. Provincial governments make their own arrangements with municipalities.[4]

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1 ADB Annual Report 1966-67, (Ottawa: Queen's Printer, 1967), p.9.

2 Statutes of Canada, 1962, ADB Act, Sec.9.(1) (a).

3 Ibid., Sec.9.(1), (d), (i).

4 ADB Annual Report 1966-67, p.13

Since its inception, the ADB has contributed more than $60 million to power production and distribution facilites. The source for more than half of this sum was the Atlantic Development Fund. To the extent that the expenditures of the ADB reflect the priorities of the Board, it can fairly be said that the preoccupation of ADB has been the Atlantic region's infrastructure. For example, as of March 31, 1967, the ADB approved $98,714,237 worth of projects for power, transportation, and "other basic services to industry." Of this amount, $54,068,658 have already been spent, leaving an outstanding commitment of $44,645,579. In addition, $30,000,000 was approved for the Trunk Highway Program, of which $10,652,259 have been disbursed. These figures make the expenditures by ADB on "technical and economic surveys and studies" of $1,253,875 in 1967 and $456,306, in 1966, seem almost trivial by comparison.

In its Annual Report, the ADB explains the rationale for their concentration upon infrastructure in the following way:

> One of the obvious factors responsible for the continuing lag in the economic growth of the Atlantic region has been the inadequacy of the basic infrastructure essential for economic growth - power, transportation, water, serviced industrial land, facilities for research. This has been largely the result of inadequate financial resources on the part of the provinces and municipalities, but also the consequence of a dispersed population entailing high costs of servicing. The lack of adequate facilities is not only a deterrent to new industries; it can also retard the expansion of existing industries. If the essential services were to be improved, the Board would need to fill the gap by supplementing existing federal and provincial programs.
> Consequently, during its first four years, the Board has concentrated upon infrastructure...[1]

Not until 1965 was the 'Planning Division' established at ADB. This division undertook a diagnosis of the problems of various sectors of the Atlantic economy by means of a wide range of studies and surveys. The purpose of these

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1 Ibid., p.14.

studies was to indicate the range of development potential of each of these sectors, given the present state of technology. It might be added that with the passage of time, as technological advances are made, the assessment of a lagging region's development potential tends to become increasingly optimistic.

The developmental philosophy of ADB is, according to one official of its Planning Division, characterized by an acute awareness of the inadequacy of an approach which seeks to buoy up an economic structure which cannot produce goods which are competitive in world markets and even lacks the potential to do so. Rather than propping up old industries, the concern of ADB is with revitalizing the structure of the Atlantic region. From the ADB perspective, welfare-oriented assistance to lagging regions is not a tenable solution. Thus, even though subsidies to inefficient industries in the Atlantic region and transfer payments could provide residents in the area with incomes equal to the average national level, such a policy is unacceptable.

The Planning Division has interpreted its terms of reference with respect to "the promotion of the economic growth of the Atlantic region" to mean "the narrowing of the per capita income gap between the region and the rest of the country and the reduction of the rate of unemployment in the region".[1] The ADB recognizes that a prerequisite to the creation of a comprehensive development plan for the Atlantic region is an accurate appraisal of the region's development potential, given its present structural limitations. The tentative conclusion of the ADB's Planning Division is as follows:

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[1] Policy Issues in Planning the Economic Development of Canada's Atlantic Region, p.1. This memorandum is not an official document of the ADB but rather 'a confidential staff document'.

> The evidence from our studies to date suggests that the traditional economic activities, even after allowing for fuller utilization of the resources than at present and more efficient organization of the production processes, may not, be themselves, significantly narrow the income gap or reduce the level of unemployment.[1]

Therefore, some fundamental structural change in the Atlantic region's economy is required. In this connection, the ADB tentatively proposes such measures as the much fuller utilization of natural resources such as the region's deep harbours and

> the engendering in the region's labour force - from the factory worker - those qualities which will permit itself to seek out more aggressively, and capitalize on, sources of new activity and growth.[2]

In this memorandum, a policy of promoting out-migration is relegated to the status of a last resort measure, to be seriously considered "only if the scope for such a transformation [of the economy's structure] appears inadequate to meet the goals set for regional development policy..."[3]

The basis for ADB's tentative appraisal of the Atlantic region's developmental potential consisted of an input-output table for the Atlantic region and for each of the four Atlantic provinces,[4] as well as a number of sectoral studies which explored the problems and capabilities of the Atlantic region's industries (i.e. fish processing, forestry, mining and agriculture) and broader sociological studies which sought to isolate non-economic factors which are partially responsible for the region's lag in development.

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1 Ibid., p.2.

2 Ibid., p.2.

3 Ibid.

4 These tables were developed by K. Levitt through the offices of the Dominion Bureau of Statistics, and were financed jointly by D.B.S. and ADB.

ADB intends to use the input-output tables as a tool facilitating policy decisions. Once the updating of the input-output tables of the Atlantic region from its 1961 basis to a 1965 basis has been completed, these tables will serve as a predictive guide on the implications of various policy measures, for the tables will enable policy-makers to ascertain the probable ramifications of different policy alternatives. By utilizing the tables in this manner and by combining these results with the sectoral and sociological studies, the optimal development strategy can be determined. According to an official of ADB, once a comprehensive development program for the whole Atlantic region is finalized, it will subsume the current allocations by ADB on the region's infrastructure. As this official pointed out, the problem of making a comprehensive plan operational involves the formulation of an acceptable federal-provincial agreement which explicitly covers the financial aggrangements; also, there is the further problem of whether the financial agreements should be uniform for all the Atlantic provinces.[1]

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[1] In his submission to the Federal-Provincial Tax Structure Committee, the Hon. M.W. Sharp, then Minister of Finance, stated the following:

> ...while the provincial governments undoubtedly have an interest in stable and balanced economic growth, and are increasingly embarking upon their own programmes for this purpose, and while it is certainly true that the provinces have control over their own resources, the Federal Government must continue to accept an over-riding responsibility for employment, economic stability, and economic development in Canada. It follows that it should continue to be free to engage in federal-provincial measures as well as its own tax, expenditure and credit measures, in order to accomplish this general objective. The Federal Government proposes, therefore, to continue to employ shared-cost programmes for economic purposes, and to offer them on the same basis to all provinces,"

Federal-Provincial Tax Structure Committee (Ottawa: Queen's Printer, September 14-15, 1966), p.22, [my underlining].

<u>'Agricultural and Rural Development Act'</u> and <u>'Fund for Rural Economic Development'</u> (ARDA and FRED)

The Agricultural and Rural Development Act (ARDA) of 1960-61, as amended in 1966-67[1] provides for federal-provincial agreements on the joint undertaking and financing of:

> ...projects for the more efficient use and economic development of rural lands specified in the agreement...[and] programmes of research and investigation respecting the more effective use and economic development of rural lands in that province.[2]

as well as:

> ...projects for the development of income and employment opportunities in rural areas specified in the agreement and for improving standards of living in those areas...[and] programmes of research and investigation [to this end]...[3]

and also:

> ...projects for the development and conservation of water supplies for agricultural or other rural purposes, and projects for soil improvement and conservation of rural lands in that province or in any area thereof specified in the agreement...[and] programmes of research and investigation for the development and conservation of water supplies and for soil improvement and conservation in that province.[4]

The federal-provincial agreements must specify the proportions of the cost of and revenues from any projects undertaken to be paid by the federal and provincial governments, as well as specifying "the authority that shall be responsible for the undertaking, operation and maintenance of any project" in the agreement; also, where charges are levied against the beneficiaries of a project,

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1 <u>Statutes of Canada</u>, 9-10 Elizabeth II, 1960-61, Chapt. 30, as amended by 1966-67, Chapter 11.

2 <u>Ibid.</u>, Section 2, subsections (1) and (2).

3 <u>Ibid.</u>, Section 3, subsections (1) and (2).

4 <u>Ibid.</u>, Section 4, Subsections (a) and (b).

the terms and conditions of such charges must be specified.[1]

In July, 1966, assent was given to the Fund for Rural Economic Development Act (FRED). The Act was designed "to provide for the establishment of a fund for the economic and social development of special rural development areas."[2] The ceiling imposed on the fund's magnitude was $300 million. The Act provides for a cost-sharing federal-provincial "comprehensive rural development program" agreement for a "special rural development area." The Act defines a 'comprehensive rural development program' as:

> a program consisting of several development projects, that is designed to promote the social and economic development of a special rural development area and to increase income and employment opportunities and raise living standards in the area, and that makes provision for participation by residents of the area in the carrying out of the program.[3]

The Act defines 'a special rural development area' as being

> a predominantly rural area within a province that is designated in an agreement between the province and [hitherto, the Forestry] Minister...to be an area of widespread low incomes resulting from economic and social adjustment problems and that, in the opinion of the Board[4] based on information submitted by the province with respect to physical, economic and social conditions in the area, has a reasonable potential for economic and soical development.[5]

The provisions which must be included in FRED agreements are identical to those of the ARDA agreements as cited above.

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1 Ibid., Section 5.

2 Statutes of Canada, 14-15 Elizabeth II, Chapter 41, as amended by 1966-67, Chapter 80.

3 Ibid., Section 5(a).

4 The Advisory Board consists of ten Deputy or Assitant Deputy Ministers represent ten departments named to the Board, to advise the Minister in charge of Regional Development (which has hitherto been the Minister of Forestry and Rural Development) on the policy implications of proposed plans.

5 Ibid., Section 5(b).

In a speech delivered by the Minister of Forestry and Rural Development to the annual meeting of the Atlantic Provinces Economic Council (APEC) at Halifax in October, 1967, the Minister discussed the framework, which had started to evolve within ARDA in its efforts to come to grips with problems of regional development, in the following terms:

> When first established by legislation in 1961, ARDA...was oriented towards a more rational use of resources in marginal agricultural activity. The second stage came with the acceptance of the fact, that in many areas of Canada the problems of marginal agriculture could not be solved by programs limited to the agricultural sector alone, and that ARDA must be directed therefore to rural, not exclusively agricultural problems. A third stage in the evolution of the objectives and operations of the ARDA program is embodied in the legislation, passed in June 1966, known as the...FRED Act. This legislation recognizes that in a number of large, depressed, essentially rural regions of Canada, the problems of development and adjustment, are so difficult that significant results can only be achieved through full co-ordination of federal and provincial government activities in the region supplemented by special programs directed to the particular needs of each region. Only through detailed and comprehensive regional planning is it possible to achieve the objective of increasing the income and economic and social opportunities for the people of these regions.[1]

In the same speech, the Minister explains the rationale for the ARDA and FRED developmental philosophy with respect to the Atlantic Region as follows:

> Our studies of rural areas in eastern Canada indicate that improvement of the levels of rural income can be obtained through structural adjustment and modernization in agriculture, fishing, forestry and rural service activities. However, the structural adjustment and modernization in those sectors, which is required to increase incomes, would also result in reduced employment. This diminishing number of rural jobs is likely to be further complicated by weakness and obsolescence in certain parts of the manufacturing and mining sectors of the economy.
>
> The unemployed surplus of population in these regions could either emigrate out of the region, or be supported in the region on welfare basis, or through subsidies designed to prop up low productivity activities. The alternative is to absorb this surplus population in urban-oriented industrial development in the region. Since a large scale de-population of the region is not acceptable, the only real alternatives are either to maintain the surplus population on welfare, or to synchronize and integrate the process of

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1 Hon. M. Sauvé, Halifax, Oct. 24, 1967, p.2.

rural development with the process of urban-oriented industrial development.

> The necessity of synchronizing rural adjustment and modernization with urban-oriented development has been stressed in practically all rural development studies in Eastern Canada as the only practical type of economic development. Only this approach provides a solution to the low level of economic development in Eastern Canada where, because of a low rate of urbanization, rural-areas constitute the key low income and high unemployment problem. These problems cannot be solved by independently organized and separate rural and urban-oriented development programmes. Rural development, to be successful under the conditions that exist in Eastern Canada, must be synchronized with the urban economic development.
>
> Only in this way do we feel that it is possible to move towards the objective of increasing the economic and social opportunities of the people living in these regions.[1]

The dilemma confronting regional development policymakers was articulated by a Director of an ARDA Branch in the following manner:

> On the one had, large areas in Canada are unresponsive or marginally responsive to national and province-wide policies and programs directed to various sectors but on the other hand, to gear such national policies and programs to the special needs of depressed areas would be tantamount to economic suicide [since it would undermine the nation's competitive position].[2]

According to this same government official, the key to ARDA's present role:

> ...can be found in the close relationships developed as a matter of basic policy with the (provincial) governments in the regions. As a result the whole ARDA program has developed in a manner which is more sensitive to individual regional needs than are most national programs.[3]

The emergence of the FRED Act reflected the (understandable) reluctance of the Federal authorities "to undertake major regional development programs in the

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1 Ibid., pp.2-3.

2 L. Poetschke, Director, Policy and Planning Division, Rural Development Branch, Dept. of Forestry and Rural Development, "Regional Planning for Depressed Rural Areas -- The Canadian Experience," Paper Presented to the Regional Science Association Far East Conference (Tokyo: Sept. 15, 1967), p.3.

3 Ibid., p.4.

absence of a national framework for allocating resources:"[1] therefore, the approach was adjustment-oriented and the comprehensive plan for development was confined to rural regions suffering from a serious poverty problem. The prerequisites of an area seeking special assistance in the form of a comprehensive development program are:

(i) that this area be subject to widespread low income;

(ii) that this area possess major adjustment problems;

(iii) that this area have recognized development potential; and

(iv) that this area be jointly designated by the federal and provincial governments.

These are essentially three phrases in the formulation of a comprehensive development program:

> First, physical, economic and social studies and investigations of all sectors of the region to determine its development problems and potentials.
>
> Second, the participation of local people through the establishment of rural development committees or similar bodies.
>
> Finally, the preparation of comprehensive development plans incorporating a broad range of projects whose purpose is to increase income and employment opportunities and to raise standards of living.[2]

These three stages in the development of a comprehensive plan are collectively reprsentative of an approach which is in a sense diametrically opposed to the strategy of ADA.

According to one ARDA official, assuming that a lagging region has development potential in terms of its physical resources, the essence of its problem is the lack of an entrepreneurial spirit among the native population, as well as a lack of

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[1] Ibid.

[2] Mr. M. Sauvé, Halifax, p.3.

institutions to enhance any emerging enterpreneurship. Thus, this official argued, a program of locational investment incentives does not come to grips with the problem of regional development, for the inflow of external capital fails to realize a substantial proportion of the potential linkage effects because an internal (i.e. to the region) dynamism is not thereby created. This thinking explains the rationale for the second stage of the planning process as outlined above. Furthermore, the inflexible non-discretionary type of program which is made available to all who satisfy the stipulated preconditions, was rejected by an ARDA official on the following grounds:

> If they [the programs] fail to work in the conditions of particular areas, it is difficult to make the adaptations necessary to fit that special case. Such action, in the present framework, would set a precedent which could distort and abuse the programme as a whole. Since such a programme can deal with only one, or at most a few of the aspects of the problem it is not possible to allow the programme to vary, as the problem varies, from area to area or group to group.[1]

The discretionary approach of ARDA, as embodied in its comprehensive rural development program, entails an objective appraisal of an areas economic assets and liabilities. On the basis of this information, the area's economic and social development potential is guaged, and a strategy is tentatively evolved. Next, the tentative development strategy is critically examined from a national perspective. If the proposed strategy is found to conflict with national priorities or if it would be significantly undermined by planned developments in other regions of the country, the strategy would then be accordingly altered. It is important to note that each comprehensive development plan is catered to the specific needs of the area for which it is designed. Yet there are problems in the formulation of such a plan. As was mentioned above, the research phase examines "all sectors of the region to

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[1] Poetschke, ARDA and Poverty - Lessons in Developmental Planning, p.6.

determine its developmental problems and potentials." The development strategy then would be to focus government assistance in those sectors holding the most promise in terms of economic development. However, as Poetschke asserts,

> Government administration is organized along sectoral and jurisdictional lines while almost all problems or bottlenecks to development cross these lines and there is no permanent machinery to assist these crossovers. Once a problem has reached serious proportions, some special organizational arrangement is usually made. Its terms of reference, however, are usually too narrow to allow consideration of all alternatives, and it arrives on the scene so late that the build up of social pressure tends to restrict its choice of alternatives which in turn tends to result in defensive programming.[1]

The establishment of the inter-departmental FRED Advisory Board appears to have been motivated by the obvious need to set up some governmental apparatus which could permit a broad inter-sectoral approach to solve the problems of lagging regions. A broad integrated plan of development in the Atlantic Region might require a simultaneous attack upon several factors which impede development. For example, it is conceivable that the plan might call for a rationalization of its fishing and forestry industries, for a modification in the existing manpower training and mobility programs, for measures to transform the inoperative credit market into a dynamic instrument of growth, for measures to largely increase the equity capital available to the lagging region's population, for improvements in the transportation network and an expansion in the region's power capacity. Clearly, a plan of such breadth could not be effective without an inter-departmental co-ordinating mechanism; indeed, the plan might well involve the Department of Fisheries, the Department of Forestry and Regional Development, the Department of Manpower and Immigration, the Department of Finance, the Department of Public Works, the Atlantic Development Board, and Treasury Board, among others.[2]

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1 Ibid., p.8.

2 Following the recent restructuring of departments, Fisheries and Forestry now comprise one department while the Department of Regional Economic Expansion now subsumes the ADB.

One official predicted the demise of the "General Agreement" type of federal-provincial joint undertaking, since it was necessary to couch such agreements in terms sufficiently general to be applicable to the specific needs of any particular region. In other words, the general agreement's options really consisted of the composite of options which would satisfy the special needs of each particular region in Canada, since geographic differences between regions would govern their choice of different option.[1] The most recent "Federal-Provincial Rural Development Agreement" covers the years 1965-70. Therefore, assuming that ARDA is not radically transformed in the organization of the new department responsible for regional development, this official expected the post-1970 federal-provincial agreements to be tailored to the specific needs of each region.

The type of research being conducted under ARDA and FRED is essentially of two varieties. The first type deals with specific problems, involving: feasibility studies, undertaken on a cost-sharing basis with the provinces, on particular projects; research on the factors which are relevant to labour mobility (i.e. which group of people are mobile and what is the result of their movement); research on Indian problems, examining barriers to their integration; analysis examining legal, sociological and economic factors which present problems in terms of development. The second type of research undertaken is classified as "action programs". This involves the formulation of a comprehensive development strategy for a particular region, and demands an examination of the problems and potentials of the region, both within a regional and a national framework. Thus, the region would be carefully scrutinized in order to determine which sectors appear to offer the most promise in terms of development potential, whereupon these seemingly

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[1] In this context, "options" refers to those programmes with which ARDA is empowered to deal.

favourable sectors would be examined in the light of the national interest and the original program might be revised to be made more consistent with national objectives and priorities.

It might be of interest to note that under the ARDA agreement of 1965 to 1970, all projects whose projected total cost exceeds $100,000 must be subjected to a benefit-cost analysis. The methodology for these analyses was agreed upon by Treasury Board and ARDA officials.[1]

Department of Manpower and Immigration

As previously stated, the most mobile segment of a region's labour force consists of a disproportionately large number of people, (in relation to the composition of the region's total population), in the working age group and having higher than average levels of formal training. Often, those remaining in a stagnant region are the seasonally unemployed who subsist in the off-season on welfare payment (i.e. unemployment insurance transfer payment). If a programme of regional development based on transferring manpower out of the depressed area, is able to productively employ those who were unemployed in the off-season, then to calculate the net benefits of such an out-migration policy, one must deduct the

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1 An important study which clearly articulates the methodological problems of benefit-cost analysis is that of W.R.D. Sewell, et. al., A Guide to Benefit-Cost Analysis, (Ottawa: Queen's Printer, 1962), prepared for the Resources for Tomorrow Conference, Montreal, October, 1961. For a document which has been instrumental in the efforts of Treasury Board to standardize benefit-cost analyses, see A.D. Scott and W.R.D. Sewell, The Use of Benefit Cost Analysis By Canadian Federal Government Agencies, a report prepared under contract with the Department of Mines and Technical Surveys, August, 1966.

welfare expenses which society would have had to bear in the absence of this program.

In his statement of March 3, 1967, the Minister of the Department of Manpower and Immigration explained the objective of the manpower mobility program:

> Generally speaking, we will be helping workers to move to the nearest community where there are jobs. It is not our intention to divert manpower from emerging employment in nearby areas or elsewhere in a province, but rather to make it possible for people to move to such employment and thus strengthen regional and provincial development programs.[1]

The Manpower Mobility Program provides outright grants to "any man who is unemployed, or has been notified of his permanent lay-off...if there is little prospect of suitable employment in his home community and there is a definite job for him to go to in another area."[2] In addition, an exploratory grant covering the return transportation costs to the nearest area offering suitable employment would be offered to unemployed workers seeking jobs.

A further measure of this program to facilitate labour mobility is a $500 grant to be awarded to a worker, to be applied either to the sale of his home in the old location or to the purchase of a home in his new location. It should be noted that workers who, on their own initiative, arrange for jobs farther from their original home than the nearest area suitable in terms of employment opportunities "could still be eligible for transportation, moving and resettlement grants."[3]

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1 Statement in the House of Commons [my underlining].

2 Ibid.

3 Revised 'Manpower Mobility Program Fact Sheet', March 3, 1967, p.2.

The Department of Manpower and Immigration administers the Adult Occupational Training Act and Training Allowance Act. Both Acts were designed to upgrade the level of skills of a given region's manpower supply. The eligibility for the Adult Occupational Training is specified by the Act in the following way:

> A manpower officer shall arrange for the enrolment of an adult [who has not attended school on a regular basis for at least twelve months and wishes to undertake occupational training] only in an occupational training course that is operated by the province in which that adult resides or by a provincial or municipal authority in the province, unless there is no such course suitable for that adult being offered at or in the vicinity of the place of residence of that adult, in which he may be enrolled.[1]

The Department of Manpower and Immigration is authorized to enter into agreement with any province to pay the costs incurred by the province in providing and operating an occupational training course. The federal government is authorized to pay to the province the student's tuition fee. The federal government may also enter into agreement with a private employer to sponsor the occupational training of his adult employees. In addition, the federal-provincial agreement may specify the payment of funds by the Department of Manpower and Immigration to the province to offset the costs incurred by the province in undertaking the following:

> ...research in respect of occupational training, including research in respect of the changing needs of the economy for trained workers and the relationship between occupational training and the needs of the economy.[2]

The Department of Manpower and Immigration, under its 'Program Development Service', has a "Pilot Projects Branch" which was established "to develop pilot training projects, in co-operation with the provinces, as part of special

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[1] Statutes of Canada, 14-15-16 Elizabeth II, Chapter. 94, 4.(2).

[2] Ibid., 10.(1).

programs aimed at improved utilization of manpower and at the reduction of poverty."[1]

To enhance their flexibility of action, and speed their response to special needs, the "pilot projects are to be carried out by corporations formed under provincial companies' legislation. Although the federal government will make grants to finance each company's operation, the federal and provincial governments will share control of the company."[2] Four provinces[3] have hitherto agreed to the establishment of pilot project corporations, while negotiations are proceeding with other provinces. It is the function of these "New Start" corporations to develop "new methods for the motivation, training, placement and mobility of adults who are disadvantaged, particularly as to their education and training."[4]

Despite the fact that the Minister of Manpower and Immigration stated that the objective of his Department with respect to labour mobility is to facilitate the transfer of the unemployed worker to the <u>nearest</u> location offering suitable employment prospects, it does not seem that this statement offers convincing evidence that the emphasis of the Department on <u>intra-regional</u> labour mobility is motivated by more than cost minimization considerations and/or perhaps by a desire to allay the fears of the lagging provinces that the federal manpower mobility programme was designed to deplete the pools of available manpower in their regions thereby diminishing the area's attractiveness to potential investors.

Judging by the Department of Manpower and Immigration's list of goals, it does not appear to be particularly oriented towards regional economic development.

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1 <u>Annual Report: Dept. of Manpower and Immigration, 66-67</u> (Ottawa: Queen's Printer 1967), p.28.

2 <u>Ibid.</u>, p.28-9.

3 These are: Saskatchewan, Alberta, Newfoundland and P.E.I.

4 <u>Ibid.</u>, p.29.

According to a senior official of the department, it would be naive to think that jobs would be created in a lagging region and that these employment opportunities would remain vacant until such time as members of the indigenous population could be trained to fill these positions; similarly, he claimed that once people are trained, it is quite unlikely that they will await the arrival of newly created employment opportunities. Since a successful regional development policy must clearly combine simultaneously a manpower training programme with a programme involving job-creation in the lagging region, the implication is that the Department of Manpower and Immigration, whose jurisdiction extends to only one side of the coin, is not in a position to undertake and execute regional economic development plans. At best, the Department must seek to harmonize its programme with those of other departments and agencies concerned with various aspects of regional development.

The orientation of the Department of Manpower and Immigration can, perhaps, best be illustrated by quoting a few of the avowed goals of the Department:

(a) To improve the efficiency of the labour market. This means <u>shortening the time for which jobs are vacant</u> by referring suitable people to the job.

(b) To assist the individual worker to respond to the employment opportunities that are attrative to him and that offer him the best lifetime earnings prospects, by...
helping him, if he is unemployed or underemployed and is in an area where his continuing prospects are poor, to move to employment in another area; (and)
purchasing training for him, and when qualified paying training allowances to him, if his earnings prospects will be substantially improved by training for which he is eligible.

(c) To facilitate productive economic changes by the specially intensive application of manpower measures, on the basis of advance planning with management and workers, in situations of major industrial change.

(d) To minimize the underutilization of manpower arising from seasonal fluctuations in employment.

(e) To participate, by the specially intensive application of manpower measures, in any federal or federal-provincial projects for regional economic development.

Conclusion

To ensure consistency in objectives and to avoid unnecessary duplication of effort, the need for an administrative apparatus designed to co-ordinate the regional activities of various agnecies and departments became obvious. The nature of the responses to this need were of two varieties. One response entailed the consolidation of several agencies possessing regional mandates into a newly constituted department--the Department of Regional Economic Expansion--since this department would seek to function in an internally consistent manner. The second response involved the establishment of inter-departmental committees having as their terms of reference the formulation of policy directives with respect to regional problems.

In view of the enormous complexity of regional development problems, it seems likely that the machinery of the inter-departmental committee will be an increasingly important element in the evolution of regional development strategies in Canada.

CHAPTER IV

THE POTENTIAL USEFULNESS OF SELECTED INSTRUMENTS OF FEDERAL ECONOMIC POLICY FOR REGIONAL DEVELOPMENT

Introduction

In contrast to 'structural' policies, the impetus for which may derive from the intention of policymakers to affect specific regions (or industries), 'cyclical' stabilization policies are in general conceived to be national in scope and orientation. Nonetheless, despite the uniformity of their regional application, cyclical policies may well bring about quite 'uneven' repercussions in different regions, in terms of the relative and absolute magnitude of their impact as well as in terms of the time path of the changes wrought in various regions.

Several factors suggest themselves as partial explanations for such regional variations. For example, differences in the industrial composition of each region. As Isard states, "Cycles of a regional economy are simple composites of the cyclical movement of the economy's industries, appropriately weighted."[1] This explanation abstracts from possible differences in the percentage fluctations in the economic activity of a given industry between regions, in response to a particular stabilization measure -- an assumption of dubious plausibility. A further hypothesis is that the sensitivity of one region in response to economic fluctuations in other regions is a function of the extent to which the national economy is integrated. Two indicators of national economic integration are the level of inter-regional trade and the degree of factor (particularly labour) mobility between regions.

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[1] W. Isard, "The Value of the Regional Approach in Economic Analysis," in Regional Income: Studies in Income and Wealth, Volume 21 (Princeton: Princeton University Press, 1957), pp. 69-78.

Whereas structural measures have traditionally sought to eliminate regional variations in the response to stabilization policies, the preoccupation of federal cyclical measures has been with influencing aggregates with little attention being focused on the regional distribution of the aggregate effects. The following sections in this chapter will examine the potential and the limitations of utilizing federal monetary, fiscal and investment measures in a manner which is consciously discriminatory between regions.

Monetary Policy

> If monetary policy is conceived of simply in terms of action on the money supply and if money flows freely between one Province and another, it is difficult to see how there can be a "regional monetary policy." On the other hand, if one understands by monetary policy -- as I do -- any action by the monetary authorities calculated to affect the cost or availability of credit, one may visualize action intended to make certain forms of credit cheaper or more abundant in particular Provinces.[1]

The latter definition of 'monetary policy' is more suitable for our purposes. Thus, accepting this broader sphere of activity as the legitimate realm of monetary policy, the question arises why the Bank of Canada or other federal authorities have consistently chosen in the past not to undertake monetary policies which explicitly discriminate in favour of the lagging regions. In fact, the failure of the Central Bank and of the federal government to discriminate in favour of the lagging provinces has resulted in these provinces being discriminated against by 'market forces'. For example, borrowers in the Atlantic Provinces must pay a premium in comparison with borrowers from Ontario. Moreover, the interest rates paid by the poorer provinces on provincial debentures exceeds that paid by the wealthier provinces. Therefore, even if the federal authorities did no more than offer credit to the poorer regions at terms which

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[1] A.K. Cairncross, Economic Development and the Atlantic Provinces(Fredericton: Atlantic Provinces Research Board, February 1961), p.3.

matched those enjoyed by the wealthiest region, the federal government would be discriminating in favour of the lagging regions.

It should be recognized at the outset that the Central Bank or the Department of Finance could discriminate in favour of some regions of Canada in respect of credit availability; that is, such discrimination is technically feasible. To illustrate how such a policy might be effectuated, consider the following measures for eliminating the premium paid (a) by private borrowers in the Atlantic and (b) by the Atlantic Provinces in the international money markets.

To overcome the former problem, the Department of Finance (or some other federal agency) could offer to pay a premium to the chartered banks for loans issued in the Atlantic region, where these funds were earmarked for use in the Atlantic region. Thus, if the chartered banks were extending credit in Toronto at an average interest rate of 8% but were charging 10% in the Atlantic for equivalent loans, the federal authorities could offer to more than recompense the chartered banks for extending credit in the Atlantic at 8% as well. For example, the federal authorities might offer to pay 3% to the chartered banks for every 8% loan issued in the Atlantic region for use there.

To tackle the latter problem, one possible scheme would involve the federal government's role as an agent acting on behalf of all provinces to secure funds for their long-term financing. Thus, the Department of Finance could conceivably act on behalf of the provinces to secure funds in the money market on equal terms to all provinces, either by guaranteeing the provincial bonds, or by issuing federal bonds and then channelling the moneys raised thereby into the coffers of the various provinces in exchange for provincial bonds. For short-term financing, the Bank of Canada may do the following:

> make loans or advances for periods not exceeding six months to ... the government of any province on the pledge or hypothecation of readily marketable securities issued or guaranteed by ... any province.[1]

In examining the feasibility of these hypothetical responses of the federal authorities to the difficulties confronting individuals in, and governments of the lagging provinces, a number of obstacles -- some political, others economic in nature -- present themselves. Consider first the case of federal compensation to lending institutions for providing credit to individuals and corporations located in lagging regions at an interest rate below that in the market. If such a scheme were implemented, the federal authorities would have to assume a <u>policing function</u> in order to ensure that funds earmarked for a particular lagging region would, in fact, be used in that region. This regulatory role would certainly be <u>objectionable to the lagging provinces to the extent that their political autonomy became diminished</u> by the increased (and conspicuous) presence of the federal government. Moreover, this policing function might, in certain circumstances, prove to be an impossible role for the federal authorities. To illustrate such a case, suppose that an interest rate differential which <u>favoured</u> the lagging regions were created by the central government. Suppose, further, that an enterprising individual had sufficient funds to undertake all his investment plans without any borrowing. Such an individual might still borrow, at a discounted rate, an amount equal in magnitude to his investment intentions and then re-lend this sum at a rate below that of the market to an entrepreneur who was planning to invest in a wealthy region; since the individual in the lagging region would proceed to invest in his region a sum equal to his discounted loan, he might quite easily escape detection. Assuming that both entrepreneurs would have undertaken the same investments even in the absence of interest rate differentials favouring the

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1 <u>Statutes of Canada</u>, 1966-67, <u>Bank of Canada Act</u>, Sec. 18 (1)(i) .

lagging regions, the net result of such measures would be simply for the federal government to incur the cost of subsidizing investment activity in the wealthy region and to bring about a haphazard income redistribution within the nation.[1]

With respect to federal government measures designed to furnish funds to the poorer provinces at a rates below those available in the money markets, the proposed solutions create political and economic problems. First, the greater the reliance of a province on the federal government for assistance in its financial (i.e. debt) management, the less autonomy will that province possess. Thus, if the Department of Finance acts as monetary agent of a provincial government, the influence of the federal government on that province will inevitably be enhanced. Similarly, if the mechanism for reducing the interest rates paid by governments in the poorer provinces entailed the issue of Government of Canada bonds, with the federal government utilizing the funds raised thereby in order to purchase provincial bonds at a price exceeding what the money market would have paid, the federal government seems to acquire an inordinately great leverage in its dealings with the provinces. Moreover, once the provincial governments accept this state of dependency upon the federal government for monetary operations, they appear to pass a 'point of no return'; acceptance of such a status by a provincial government is a tacit confession that it lacks confidence in its own "marketability" and should such a province wish, at a later date, to re-assert its independence and act as its own monetary agent, it might well find that the securities which it issues or guarantees are no longer "readily marketable." In such circumstances, this province could not ever count upon the Bank of Canada to "make loans or advances for periods not exceeding six months ..." and the province would find itself in an inextricable relationship of dependence upon the federal government.

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[1] This example is one variant of the potential difficulty encountered in controlling the end use of funds.

An additional factor must be borne in mind when considering the implications of the assumption by the federal government of monetary responsibility for a provincial government. It is most unlikely that the federal government would acquiesce to raising funds for a province without carefully scrutinizing that province's budget and its financial solvency. Again, such scrutiny would represent a serious erosion in provincial autonomy.[1]

Problems of an intricately legalistic nature would arise respecting the status of the Bank of Canada vis-a-vis a province which had the Government of Canada acting as its monetary agent, since the Bank of Canada is required by law to "act as fiscal agent of the Government of Canada ..."[2] In fact, in the "Act to incorporate the Bank of Canada," which Act was assented to 3rd July, 1934, the following provision was enacted:

> The Bank shall act as fiscal agent of the Government of Canada without charge and, subject to the provisions of this Act, by agreement, may also act as banker or fiscal agent of the government of any province.[3]

No provinces chose to make use of the clause which would have permitted them to engage the services of the central bank "as banker or fiscal agent," probably because of the likely diminution in their autonomy as a consequence of such action. Moreover, the Bank of Canada would have been reluctant to assume such a responsibility since the Bank of Canada has sought, fairly consistently[4] to remain aloof of political issues. The role of the Bank of Canada has been essentially a 'residual' one with respect to the regulation of Canada's money

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[1] According to Louis-Phillipe Pigeon, "autonomy means for a province the priviledge of defining its own policies." See L.-P. Pigeon, "The Meaning of Provincial Autonomy" in The Courts and the Canadian Constitution, ed. by W.R. Lederman (Toronto: McClelland and Stwart Ltd., The Carleton Library No. 16, 1964), p. 43.

[2] Statutes of Canada, 1966-7, Bank of Canada Act, Sec. 20(1).

[3] Statutes of Canada, 1934, Bank of Canada Act, Chapter 43, Sec. 23(1).

[4] This has been especially the case since the departure of Mr. James Coyne.

supply. That is, the provinces and municipalities, as well as the corporate sector, all influence the supply of money by means of issuing and retiring bonds. The Bank of Canada must then determine whether the money supply is at the level which it deems to be appropriate and undertakes "open market operations" and other measures to adjust the money supply. Since its function is largely one of adjustment and reaction to the actions of others, its role may be characterised as being residual or compensatory.

A further point ought to be noted in connection with co-operative federalism as it applies to long-term financing by the provinces in Canada. In the event that a province (or municipality) becomes entagled in indomitable financial difficulties and even greatly risks defaulting on its debt payments or its outstanding principal, the federal government would still be most reluctant to intercede on behalf of the province. If a precedent were set in this regard, the provincial governments might expect that in the future, they would be exempt from the discipline imposed by the market. Furthermore, intervention by the federal authorities would prevent the market from disciplining the purchasers of provincial securities, so that these prospective buyers might relax the standards of sound financial management which they demand of the provinces. It is interesting to recall that during the depression, the federal government did not intercede to prevent the Province of Alberta from defaulting on its debt commitments. One can well imagine the problems which a province, which had recently failed to honour its financial obligations, would encounter in attempting to restore the market's confidence in its financial capability. Therefore, the refusal of the federal government to intervene may be viewed as a most stern measure indeed.

Finally, it is of interest to consider the most recent position of the Bank of Canada in respect of several of the issues raised above, as evidenced by the recent testimony of Mr. L. Rasminsky before the House of Commons Standing Committee on Finance, Trade and Economic Affairs.

First, the Bank of Canada is explicitly cognizant of the fact that monetary policy does not affect all regions in Canada uniformly and has taken measures to somewhat alleviate this problem:

> ...the Bank of Canada is well aware that tight credit conditions can have quite uneven impacts in an economy such as ours. For this reason, at recent meetings with executives of the chartered banks the Bank of Canada has expressed the view, as it has in earlier periods of tight credit conditions, that these institutions should have special regard [sic] for borrowers in less prosperous areas of the country and for small businesses that do not have alternative sources of credit.[1]

Mr. Rasminsky noted that the chartered banks "have indicated they are complying with the other requests that I have made as regards the regional distribution of credit and the small business loans."[2]

The Governor points out that, "right now, the Bank does not have any powers with regard to the allocation of credit, except the power of moral suasion -- the power of influencing or trying to influence the behaviour of the banks."[3] Moreover, the Bank of Canada's influence upon provincially incorporated financial institutions is circumscribed by constitutional difficulties.[4]

Fiscal Policy

When one undertakes to ascertain the possibilities inherent in the federal government's fiscal policy in effecting regionally discretionary impacts, several aspects warrant examination.

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1 House of Commons, Standing Committee on Finance Trade and Economic Affairs, No. 55 (Ottawa: Queen's Printer, 1969), pp.2744-5, Mr. Rasminsky testifying on July 3, 1969.

2 Ibid., p.2764.

3 Ibid., p.2784.

4 Ibid., p.2788.

The possibilities of fiscal stabilization measures as a regionally discriminatory instrument are just beginning to be explored. The latest federal budget contains measures which are explicitly selective in their intended regional impact. In order to dampen the inflationary pressure emanating from some types of construction activity[1], the Minister of Finance proposed that depreciation allowances should be deferred for a two-year period on commercial buildings "put in place" until the end of 1970. The following qualificaion appearing in the Minister's budget speech must be deemed to be most significant, since it establishes a precedent in the sphere of regionally selective stabilization policy:

> Having in mind the disparity of regional conditions, however, this measure will not apply in those provinces where unemployment remains relatively high, or where employment growth has been slower than the national average. Buildings in rural areas and in smaller towns and cities, which bear the effects of inflationary pressures but scarcely contribute to them, will also be totally exempt. The cut-off point will be a population size of 50,000 as recorded in the last census, and the boundaries of the areas affected will be those defined in the 1966 census. The measure, therefore, will apply to major urban centres and census metropolitan areas in Ontario, Alberta and British Columbia...It should help to divert more funds and resources to essential housing, schools, and municipal works, and to the industrial plants and factories needed to produce the increasing flow of goods and commodities which remain the basis of our prosperity. The beneficial effects of this action will also spread to all parts of the country. At the same time it is the intention of the government so far as possible to defer major new construction for its purposes in the same areas.[2]

The innovation in this measure lies in non-uniformity of its application by region. However, in its selectivity, the measure has a <u>sectorial</u> as well as regional dimension. The sectoral dimension to fiscal selectivity (or discrimination) is certainly not a new budgetary phenomenon. Moreover,

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1 Exempted was construction for housing, industrial plants, utilities and public institutions.

2 <u>House of Commons Debates</u>, Vol. 113, No. 162, 1st Session, 28th. Parliament (Ottawa: Queen's Printer, June 3, 1969), pp. 9419-20.

it must be recognized that a subsidy or special tax concession to a particular sector, even though it be applied to all regions on an equal basis, is nevertheless a regionally discriminatory measure in view of the fact that regions differ in terms of their industrial compositions. Thus, a subsidy to all wheat producers in the country clearly favours Saskatchewan more than it favours Quebec, notwithstanding the uniformity of its application by region. Similarly, the special federal assistance to the coal industry, or its special tax concessions to the oil industry, or federally subsidized freight rates for wheat producers, or even the protective tariff umbrella enjoyed by manufacturers concentrated in central Canada are all measures which are regionally selective in their import. Historically, these measures have comprised important elements in the regional development strategy of the federal government. Therefore, only the decision taken by the Minister of Finance to apply a particular measure in a manner which discriminates in favour of Canada's lagging regions really represents a new approach by the Government of Canada.

The two cornerstones upon which the fiscal policies of the federal government are founded are firstly, the responsibility of the Government of Canada for fostering desirable economic conditions in the country, and secondly, its responsibility for ensuring that individuals throughout the country enjoy (approximate)equality of opportunity. In order to discharge its first responsibility successfully, it is necessary that the Government of Canada possess an adequate level of fiscal capability, either directly, in terms of its taxing and spending powers, or indirectly, in terms of the influence it is capable of exercising over the junior levels of government in guiding their fiscal policies. The measures which the federal government has adopted to fulfil its second responsibility have operated at three complementary levels: at the level of redistributing income (in an egalitarian direction) between individuals, at the level of equalizing the public services provided by all provinces by means of inter-regional equalization grants, and at the level of initiating regional development programs in disadvantaged regions of the country.

Perhaps the most fundamental challenge to the federal government in respect of these responsibilities which it assumes is the need to reconcile the attainment of these objectives with the realization of provincial autonomy as first envisaged by the Fathers of Confederation and the provincial fiscal capacity which the latter concept entails.

In connection with the approach of the federal government to the equalization of provincial public services across Canada, the record indicates an increasing flexibility as well as an increasing commitment on the part of the Government of Canada. In the years immediately following Confederation, the Government of Canada provided small annual fixed grants to the provinces which just enabled the latter to balance their budgets; these subsidies were to be in "full and final" settlement of all claims of the provinces on the federal government. However, in 1907, the Laurier government enacted a further adjustment -- also "final" -- in recognition of the special requirements of the Western and Maritime provinces. The advent of the Great Depression and World War II elicited emergency responses by the federal government to the exigencies of the times, with emergency assistance to provinces being largely of an _ad hoc_ nature. Not until 1957 did inter-provincial redistribution of fiscal capacity assume "the form of a quasi-scientific equalization formula by which the federal government agreed to make supplementary payments in amounts necessary to bring every province's per capita yield from the uniform provincial share of the three standard taxes up to the average level in the two wealthiest or highest-yielding provinces."[1] This formula was modified in 1961 by including provincial natural resource revenues in the tax base and by raising the minimum tolerable level of provincial revenue to the average national level prevailing prior to inter-regional fiscal transfers. Then in 1963, the formula was again altered, with equalization grants being calculated on the basis of the average yield in the two richest provinces from the standard revenue sources (exactly as in 1957) but with the additional provision that retained resource revenue be included in adjustment payments. In 1967, all main tax sources were included in the base and interprovincial transfers were calculated in relation to the national average. It should be noted that such a formula does not bespeak an uncompromising commitment by the federal government to the cause of regional equality in fiscal capacity. For one thing, raising all provincial revenues falling below the national average to the level of the national average does not eliminate inter-regional per capita revenue differentials. In fact, such a measure is tantamount to ensuring a minimum of opportunity (stemming from the provision of provincial public services) for all provinces; inter-regional equality of opportunity cannot be attained by means of such a formula, even if one assumes that inter-provincial revenue transfers are sufficient to secure this end, and this is certainly a dubious assumption. Forthermore, even in terms of the calibre of public services provided, the existence of externalities as well as the likelihood that outlays on public services do not yield constant returns to scale seem to

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[1] A.M. Moore, J.H. Perry and D.I. Beach, The Financing of Canadian Federation: The First Hundred Years, Canadian Tax Paper No. 43 (Toronto: Canadian Tax Foundation, 1966) p. 105.

suggest that the quality of public services would probably differ between provinces of unequal size even if their expenditures on a per capita basis were identical. Inasmuch as the acceptable limit on interprovincial revenue transfers falls short of complete equality in per capita fiscal capacity, (the protests against increased equalization grants emanating, of course, from the richest provinces), it is quite conceivable that potential for diminishing inter-regional economic disparities through this mechanism has been fully exhausted. If this is indeed the case, greater reliance will have to be placed upon regional development programs and upon regionally selective stabilization measures.

The efficacy of stabilization measures as regionally selective instruments depends upon the relative magnitude of the federal government's discretionary budget in comparison with the discretionary portion of the budgets of all the provinces, as well as on the absolute magnitude of the federal government's discretionary budget. To illustrate the importance of the federal government's fiscal strength vis-à-vis the provinces as a key determinant of the success of programs designed to narrow inter-regional economic disparities, consider a situation wherein the role of the federal government became minimal. In this event, there would be a cumulative tendency for inter-regional income disparities to increase, since the greater wealth of the prosperous provinces would, other things being equal, permit them to devote more resources per capita to such growth-inducing activities as 'investment in human capital'. Similarly, unless the absolute size of the discretionary component in the federal budget is of a significant order of magnitude, regionally selective stabilization measures would influence events to only an insignificant extent.

The federal share of total income tax revenues has declined from virtually the whole amount in 1955 to 91 per cent in 1960, 81 per cent in 1963 and 75 per cent in 1966.[1] Moreover, a "dominating proportion is devoted to... statutory payments that cannot be easily or quickly cut back in response to short-run changes in the economic situation"[2] greatly diminishing fiscal flexibility. If the federal government could successfully coördinate the counter-cyclical fiscal policies of the provinces, Canada's stabilization capability would not suffer from a continued decline in the federal government's fiscal strength. The need for federal leadership is dictated by the breadth of its perspective in comparison with that of the provinces:

> The Government of Canada is guided...by its judgement as to the total demands which are likely to be placed upon the supply of resources and capital in the economy as a whole, including those by the provinces and municipalities, the desirable balance between fiscal and monetary policy, and other related considerations.[3]

However, it is generally felt that the influence of the federal government varies directly with its fiscal leverage; and while the urgency of bringing a national perspective to the attention of the provinces would increase as greater reliance comes to be placed upon the provinces to adopt a counter-cyclical stabilization policy, the relative decline in the fiscal strength of the federal government would undermine its ability to enforce its viewpoint. Moreover, if capital markets were not receptive towards provincial debentures in deflationary periods, major provincial investments might be so timed as to

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[1] T.R. Robinson and T.J. Courchene, "Fiscal Federalism and Economic Stability: An Examination of Multi-Level Public Finances in Canada, 1952-1965, "Canadian Journal of Economics, II, no. 2 (May, 1969), pp. 166-7.

[2] The Challenge of Growth and Change (Ottawa:Queen's Printer, 1968), p. 148.

[3] P.E. Trudeau, Federal-Provincial Grants and the Spending Power of Parliament (Ottawa: Queen's Printer, 1969), p. 24.

have a destabilizing impact on the economy. Similarly, since the lack of acceptance of provincial and municipal debentures during a deflationary period might well induce these levels of government to defer such expenditures, the opportunity of contributing towards a national policy of economic stability is foregone by these levels of government. Since the marketability of the debt issues of the lagging provinces appears to be most sensitive to economic fluctuations, there are natural market forces inducing more marked fluctuations in the economic activity of (say) the Atlantic Provinces than of Ontario. That is, one would expect the patterns of provincial fiscal policy to be more pro-cyclical in the lagging provinces than in the more prosperous ones.

An examination of fiscal federalism within the context of Canada's constitution will be undertaken in the following chapter. However, in the next section, the possibilities of selectively distributing federal expenditures by region will be considered from both a theoretical and practical perspective.

The Regional Distribution of Federal Expenditures[1]

It has been noted above that "provincial and municipal governments now ... have greater expenditures than the federal government itself." The Economic Council of Canada points out that in 1967, "Direct federal expenditures on goods and services ... amounted to only $4.3 billion or about one-third of expenditures on goods and services in Canada by all levels of government ..."[2] The scope of the federal government for redistributing its expenditures to favour the lagging regions is constrained by more than the relative diminution in the magnitude of federal expenditures. As the Council notes,

> ... there is no readily available information on the allocation of all federal expenditures among the regions. It is true that some federal departments maintain records of regional allocation. But regional allocation of the whole range of federal expenditures are extremely difficult, and necessarily arbitrary ... a far more comprehensive and systematic reporting system would be required if a reasonably

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1 In this section, 'federal expenditures' will be taken to exclude transfer payments.

2 The Challenge of Growth and Change, p. 148.

> good regionally oriented stabilisation program were to be contemplated... [However] Because of "leakages" or " spillovers", the full impact of an expenditure program is not likely to be confined to the region in which it it initially located.[1]

In his memorandum concerning "National Defence and Regional Development", R.D. Howland reached the following conclusion:

> It is true to say that... a policy which pays no serious attention to the regional implication of defence spending, amount[s], in fact to a strengthening of the forces which are making for regional disparity.

A generalization which extends Howland's statement to include all federal expenditures does not appear to be unwarranted. In order to inform one's judgement concerning the appropriate regional allocation of federal government expenditures, due consideration of the following theoretical model seems desirable.

M.A. Rahman developed a model[3] for the optimal regional allocation of investment in a two-region economy, given the following (simultaneously operative) conditions:

(1) the objective of the central investment allocators is to maximize the rate of growth over the defined time-horizon (planning period); that is, to maximize national income at the end of the planning period;

(2) a political and/or social equity constraint that any level of growth which results in wide disparities in standards of living is sub-optimal and as such is to be rejected as unacceptable;

(3) the productivity of investment and the rate of saving both differ in the two regions.

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1 *Ibid.*, p. 149

2 R.D. Howland, *Some Regional Aspects of Canada's Economic Development* (Ottawa: Queen's Printer, 1957), p. 292, prepared for the Royal Commission on Canada's Economic Prospects.

3 M.A. Rahman, "Regional Allocation of Investment," *Quarterly Journal of Economics*, LXXVII (February, 1963), 26-39.

Further assumptions are that the economy is closed, that its instantaneous consumption and one-year lag investment functions are both linear and homogeneous and that planned saving equals planned investment at a satisfactory level of employment.

Rahman states that "The main finding of the analysis is that, in the presence of differential regional rates of saving, the rate of growth of total national income is not necessarily maximized [given the regional income disparity constraint] by concentrating investment in the more productive region throughout the planning period."[2]

If region A is both more productive and has a higher rate of savings than region B, then of course the less productive region [namely B] has no economic claim to turn investment allocation policy in its favour.[3] However, if region A is more productive but its rate of savings is lower than that of region B, then according to Rahman's findings, if the time horizon (i.e. planning period) is sufficiently large, the opportunity cost incurred by temporarily foregoing the larger return on investment (i.e. by concentrating investment for a number of initial years in region B - the region of lower productivity), can be recouped, since region B's higher rate of saving implies a higher 'internal rate of growth'.[4] Rahman's conclusion is as follows:

> If the less productive region has a higher internal rate of growth, then optimality would require investment to be concentrated in this region for a number of initial years of the plan, after which the policy should switch in favour of the more productive region. How many initial years would comprise the first phase of such a "switching" program depends, given the length of the planning period, on how high the "internal rate of growth" in the less productive region is in relation to that in the other region and on how narrow are the political tolerance limits to regional income disparity.[5]

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1 The central authorities utilize fiscal, monetary and foreign exchange control instruments to regulate 'planned saving' and 'planned investment'.

2 Rahman, "Regional Allocation of Investment", 27.

3 Ibid.

4 Internal rate of growth of a region is defined as the rate at which its income would grow if it were a closed region so that its income grew out of its own saving only. Ibid.

5 Rahman, "Regional Allocation of Investment," 27.

Rahman extends his analysis to n-regions and, abstracting from the regional income distribution constraint, claims that "the maximum number of switches that may occur equals the number of regions, if any whose 'internal rate of growth' exceed the internal rate of growth of the most productive region".

Rahman states and then proves the following five propositions. where 'S_i' is defined as the marginal propensity to save (i.e.$\Delta S/\Delta Y$) for the i^{th} region and 'k_i' is defined as the incremental capital/output ratio (i.e.$\Delta K/\Delta Y$) for the i^{th} region:[1]

> (1) In general, the optimum income combination... lies at an extreme every year.
>
> (2) If $s_2/k_2\ s_1/k_1$, then the optimum program favors the more productive region, A, throughout the entire planning period.
>
> (3) If order that the optimum program may favor the less productive region, B, in any year at all, s_2/k_2 must exceed s_1/k_1.
>
> (4) If in any particular year the optimum position favors the less productive region, then in all earlier years, if any, the same region must be favored.
>
> (5) Given $s_2/k_2\ s_1/k_1$, and a plan period sufficiently large, the optimum program must favor the less productive region in a number of initial years.

Rahman's preoccupation was with the formulation of a development policy in a country which would maintain a reasonable balance among the rates of progress in its different regions. Robert Dorfman tackles an analogous problem but he is able to abstract from the constraint of some allocational equity for investment funds by considering the "allocation of investment <u>among different industrial sectors</u> of an underdeveloped country so as to attain a maximum over-all rate of growth in a specified planning period. In this version of the problem the rates of progress of the different sectors need not be kept in balance if doing so interferes with the basic goal, namely attaining maximal wealth at the end of the planning period."[2] Dorfman assumes that the sources of investment in each year are saving and reinvestible surplus.

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1 Subscript 1 denotes region A and subscript 2 denotes region B.

2 R. Dorfman, "Regional Allocation of Investment: Comment," <u>Quarterly Journal of Economics</u>, LXXVII (February, 1963), 162 [emphasis added].

He describes the plan which will emerge in the following terms:

> The resultant plan will be a little outrageous though suggestive, and should not be taken literally. It will recommend, in particular, that in each year all investment be concentrated in one or a few sectors (linear programming solutions are always like that; linearity drives one to extremes) and that the favored sectors be changed abruptly from time to time. One or two of the implications, however, are entirely believable... [Namely], that if you follow the plan backward through time, a sector in which investment is taking place can be displaced only by a sector with higher reinvestible surplus;... that once a sector has been displaced it will never again be eligible for investment... [and] that in the long-run planning period any sector with less than the highest re-investment factor will eventually be displace.[1]

Dorfman infers from his argument an allegedly significant, albeit not unexpected, conclusion.

> ...a twenty-year plan will lead to a different investment program than a sequence of four five-year plans, in general, and will yield superior results as of year 20 though, in all probability, not as of intermediate years.[2]

Michael D. Intriligator extends Rahman's analysis by the method of "optimal control".[3] He develops a two-region economy which may be generalized to n-regions without substantively altering the findings. As Intriligator notes, "Because neither diminishing nor increasing returns are considered it is to be expected that at any time the optimal time path allocates investment to only one region".[4] Intriligator attempts to test the sensitivity of the optimal regional allocation of investment to the planner's choice of objective. He concludes that: "Maximizing terminal income leads to a switching from high growth regions to high output/capital [or low capital/output] ration regions, while maximizing per capita consumption over the planning period leads to a <u>reverse switching</u> from high output/capital ration regions to high growth regions."[5]

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1 <u>Ibid.</u>, p. 164.

2 Ibid. Not withstanding Dorfman's conclusion, based as it is on a 'ceteris paribus' assumption, the high probability that the parameters of the model will not remain constant for a twenty-year time horizon strengthens the case for shorter-term planning.

3 M.D. Intriligator, "Regional Allocation of Investment: Comment," <u>Quarterly Journal of Economics</u>, LXXVIII (November, 1964), 659-62.

4 <u>Ibid.</u>, p. 660.

5 <u>Ibid.</u>, p. 662 [emphasis supplied].

In his rejoinder to Intriligator's analysis, Rahman points out that Intriligator has failed to take into account a political constraint on regional income disparity. Rahman further claims that Intriligator has erred in his solution of two differential equations, so that the part of his result which indicates that a switch in the regional concentration of investment must necessarily always occur is thereby invalidated.[1] And A. Takayama concurs with Rahman:

> ...if the saving rates in both regions are the same, we would obviously invest all the fund in the region where productivity of capital... is higher. Similarly, if the productivities are the same... we should invest all the fund in the region where the saving rate is higher. In this case, there is no switch for our control variable b [where b is the allocation parameter, i.e. the proportion of the investment fund allocated to region A so that (1-b) is the proportion allocated to region B]. Since these cases are intuitively obvious, one may wonder why Intriligator was misled to conclude that there is always a "switch" at the terminal date.[2]

A fundamental weakness of all the variations on the basic theme of Rahman's model is the assumption of constant productivity (i.e. constant average and incremental output/capital ratios) for each region. By the law of diminishing returns, as capital accumulates, and the proportion of capital to other factor inputs increases, the productivity (i.e. output/capital ratio) of capital is expected to fall.[3] As Takayama notes:

> One reason which may prevent this happening is that labour is freely available so that the capital/labor ratio is kept constant. This is impossible in a full-employment economy unless the total labor supply increases at the same rate as capital. Even in an economy where there is an unlimited supply of labour, it is not easy to conceive of a mechanism which decides the number of total employment of labour and allocates this labour to regions such that the capital/labour ratio remains constant.[4]

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1 Rahman held that an insufficiently lengthy planning period would result in no switch occurring for regional investment allocation.

2 A. Takayama, "Regional Allocation of Investment: A Further Analysis," Quarterly Journal of Economics, LXXI (May, 1967), 332.

3 Strictly speaking, the law of diminishing returns assumes more than that the ratio between the factor inputs is altered; it assumes that all but one of the factor inputs are held constant, and as the one variable input increases, the returns accruing to successive incremental units of equal magnitude will eventually diminish.

4 Takayama, "Regional Allocation of Investment", 336.

However, the heart of the problem associated with the model concerns its policy implications. To the extent that reliance is placed upon the favourable "trickling down" effect of the dynamic region rather than upon a higher concentration of investment in the more stagnant region in order to achieve the regionally balanced growth objective, these implications essentially support a version of the growth pole theory. Although Rahman's model does take into account the political constraint with respect to regional income disparities, its policy implications would seem to be hardly palatable to residents in the stagnant region in those cases where the complete concentration of (public) investment funds in the dynamic region is advocated.

Takayama indicates further difficulties with the model:

> If income is growing in region 1, while it is stagnant in region 2, there may be a migration of labour from region 1 to region 2. It is not quite clear whether there should be a mechanism to stop this migration, and whether we should consider the effect of this migration on productivity and the propensity to save of each region. In short, we have to face the question whether we can keep labor implicit in our model.[1]

The prospects of any use being made of suggestive theoretical models such as that of Rahman are contrained by the exigencies of the political process in a democracy which discourage politicians from adopting a time horizon extending much beyond the next election. However, the decisions which are made on the basis of a relatively short time horizon need not be sub-optimal when one considers the great likelihood that the relationships which were assumed to be constant in the theoretical models will change over a lengthened time horizon. The high probability of changes in parameters represents a serious challenge to the alleged superiority of one twenty-year plan over four consecutive five-year plans.

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1 Ibid., 337.

Conclusion

Within the present institutional framework, the scope for federal monetary policy as an instrument of regional development appears rather limited. Nevertheless, the effectiveness of directives from the Bank of Canada to the chartered banks regarding the regional lending practices of the latter remains a mystery since the chartered banks are not required to disclose the regional source and destiny of their funds.

Much greater flexibility appears to exist in the sphere of federal fiscal policy as an instrument of regional development. The most recent innovation in this field has been the introduction of a regionally selective stabilization measure in the 1969 budget. This measure seems to be more significant for the regional orientation in the federal government which is thereby manifested than for the impact on regional development which will result from it. In fact, until recent years, the federal government has displayed very little interest in the regional diffusion of its 'national' expenditures as the paucity of statistical records in this regard indicates.

CHAPTER VI

CURRENT FEDERAL APPROACHES TO REGIONAL DEVELOPMENT PROBLEMS

Introduction

In recent years, there has been a noticeable increase in the regionally-oriented activity of the federal government. Although a system of "co-operative federalism" implies, by its very nature, that the federal government will be involved on a significant scale in issues which are often narrowly regional in scope, it is only within the last several decades that the federal government has begun to grapple systematically with regional development policy. The evolution of a number of formulae governing the transfer of revenues from the federal to the provincial governments is but one manifestation of this phenomenon. Further evidence of the increase in the federal government's attention to regional development is the re-organization of existing departments with the intention of enhancing their regional perspectives, as well as the establishment, in the last decade, of federal agencies and programs with a regionally-oriented mandate. Moreover, the consolidation of these agencies into Department of Regional Economic Expansion this year is further proof of the federal government's efforts to come to grips with regional development problems in a systematic and consistent manner.

In preceding chapters, attention was drawn to a number of possible conflicts which may arise in the formulation of regional development policies. Such conflicts may be inherent in the difficulty or impossibility of attaining several posited goals simultaneously. Furthermore, conflicts may stem from differences in the preference patterns for public services between various provincial governments or between the federal government and some of the provincial governments.

In addition, as the programs of different agencies and departments concerned with regional development were described, some apparent inconsistencies were identified.

The balance of this chapter will deal with the actual approaches being adopted by the federal government in its efforts to overcome the conflicts and inconsistencies confronting it.

Reconciling Conflicts in Goals in Practice

In the first chapter of this thesis, the potential conflict between the economic goal of maximizing per capita income and the political, social and cultural goals of strengthening national unity, ensuring equality of opportunity in all regions, and preserving the cultural identities of the people of Canada was analysed. It was noted that this economic goal might be attainable only through a substantial increase in the concentration of economic activity in Canada, and that this might in turn necessitate large-scale flows of manpower from the lagging to the prosperous provinces. However, as was noted, such inter-regional manpower flows are unacceptable because the pursuit of the political, social and cultural goals which were posited seems to require the regional decentralization of economic activity.

The fundamental approach of the federal government is one of creating self-sustaining opportunity in all provinces in Canada. To this end, measures have been initiated with the intention of stimulating the development of promising growth poles in all provinces. In this manner, the economies of geographical concentration may be tapped at the level of the region, while the political, social and cultural goals posited above are simultaneously fostered.

The Minister of the Department of Manpower and Immigration has publicly emphasised that the intent of the "Manpower Mobility Program" is the strengthening of regional and provincial development programs by fostering intra-regional labour mobility. However, it is often quite difficult to distinguish between the rhetoric of the Minister of a department and the actual policy of that department. In practice, unless a manpower re-training and mobility program is designed to meet the requirements of employment opportunities in a region, the end result can only be one of facilitating inter-regional labour mobility. Nevertheless, if the efforts of the Department of Manpower and Immigration are carefully co-ordinated with the regional programs of other departments, the manpower mobility program could indeed be intra-regional in its impact. In fact, the recent burgeoning of numerous inter-departmental committees possessing a regionally-oriented mandate strengthens the prospects of intra-regional labour mobility surpassing inter-regional labour mobility in importance.

In the light of the policy directions currently being taken by the federal government, it seems fair to conclude that W. Arthur Lewis' concept of national economic integration--namely, "a right to participate equally in economic activities in any part of one's country"--is considered to be insufficient by the federal government. However, this does not mean that all those measures which would have to be undertaken in order to realize the type of economic integration envisaged by Lewis are unacceptable. Thus, even if the federal government completely rejected a policy of promoting inter-regional labour mobility, it is highly unlikely that it would reject the second pillar upon which Lewis' concept of economic integration is founded: namely that of unhampered inter-regional trade. As a matter offact, the Government of Canada insists, in its constitutional negotiations with the provinces that:

> No government...should have the power to erect through its tax system barriers to interprovincial trade, whether intentionally or otherwise, and only Parliament should have the power to impose customs duties.[1]

Despite the firm position taken by the federal government on the matter of free interprovincial trade, it is doubtful that intra-national trade continues to occupy the pre-eminent position as an integrative force which it maintained during the earliest years of Canada's nationhood. During that period, Canada's tariff policy constituted "a definite part of an attempt through national policy to integrate and unify the Dominion economically. Western settlement, all-Canadian transportation, and industrialization by the protective tariff made up a three-fold policy of which the determining lines were set before 1890."[2]

The remarks of the Minsiter of Finance in his budget speech of June 3, 1969, suggest that the Government of Canada's decision to accelerate the schedule for implementing the negotiated tariff reductions of the Kennedy Round was motivated by the expected contribution of this measure "to the overall efficiency of the Canadian economy" as well as by the following consideration:

> ...the burden of adjustment and the pressure of increased competition will fall mainly on producers in the industrial center of Canada. It is here that inflationary pressures are greatest. This is one of the principal

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1 Hon. E.J. Benson, The Taxing Powers and the Constitution of Canada (Ottawa: Queen's Printer, 1969), p. 16.

2 W.A. MacIntosh, The Economic Background of Dominion-Provincial Relations, Appendix III of the Royal Commission on Dominion-Provincial Relations, reprinted in Carleton Library No. 13 (Toronto: McLelland and Stewart Limited, 1967), p. 140.

> reasons why the Government has decided to propose this measure, the burden of which might well have fallen with rather greater weight on those areas of the country where economic activity is still lagging behind central industrial Canada.[1]

Thus, whereas tariff policy served the end of national integration by means of fostering greater inter-dependence between regions during Canada's infancy, it is now called upon to effect regionally discriminatory anti-inflationary pressure. A desirable by-product of this measure may be the induction of regional differentials in the rates of economic growth favouring the lagging provinces. To the extent that inter-regional economic opportunities become more equalized, the tariff reductions will ultimately exert an integrative influence upon the nation. However, there is another side to this coin: it is likely that the balance between Canada's intra-national and internatinal trade will, as a result of these tariff reductions, shift in favour of the latter; to the extent that this occurs, inter-regional economic ties in Canada will be weakened. Therefore, the overall impact of this tariff reduction upon the degree of economic integration within Canada is indeterminate.

Reconciling Regional and National Interests in Practice

As was indicated in the first chapter of this thesis, the sources of friction between federal and provincial levels of government may be inter-regional differences in preference patterns for public services resulting in an inconsistent ordering of priorities at the national level, inter-regional 'spillovers' in connection with outlays on, an returns from the public services provided, as well as inter-regional production externalities. The practical course which the Government of Canada has pursued historically has essentially

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[1] House of Commons Debates, Vol. 113, No. 162, 1st. Session, 28th. Parliament (Ottawa: Queen's Printer, June 3, 1969), p. 9418.

parallelled the theoretical avenues to reconciling confilcting interests which were outlined in Chapter 1. The key to resolving conflicts arising from inter-governmental differences in priorities has been the federal-provincial negotiations wherein a reasonable consensus was sought.

A fundamental problem confronting Canada's variant of co-operative federalism has always involved the determination of the optimal balance between "our constitutional concept of provincial identity and purpose and the fiscal policy role of government in the modern economy."[1] The provincial governments demand a level of revenue which is sufficient for them to adequately discharge their constitutional responsibilities; moreover, they generally fear that a dependence upon Ottawa for fiscal assistance will result in an undue diminution in their autonomy. Therefore, from the perspective of the provinces, the most acceptable mode of transfer of funds from the federal government is the unconditional grant. The attitude of the federal government is that it must possess the tools to maintain a favourable economic environment throughout the nation; that is, the fiscal leverage of the federal authorities must be sufficient to enable it to stimulate economic activity or to restrain it, as the situation dictates. Moreover, the federal government assumes responsibility for ensuring that all regions in the country can provide a minimum national standard of services. Finally, the federal government assumes responsibility for co-ordinating provincial fiscal policy in order to avoid "double taxation" of businesses and individuals as well as to prevent tax barriers to interprovincial trade.

The position of the Government of Canada respecting the division of taxing powers under the constitution is:

...to give both levels of government broad and overlapping powers of taxation,

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[1] Moore, Perry and Beach, <u>The Financing of Canadian Federation</u>, p. 100

with the objective of enabling each to cultivate these fields, as required, to meet changing fiscal responsibilities.[1]

...the general principle, which has been enunciated in one way or another by almost all of the provincial governments--the principle that each legislative body ought to have taxing powers which are consistent with its spending power--is one to which the Government of Canada consistently has subscribed. It is a principle which accords both with federalism and with the functioning of democratic processes: each government ought to have access to tax fields or tax capacity which are adequate to enable it to discharge the responsibilities it assumes under its constitutional powers. How much of these powers the legislature wishes to exercise--how many spending obligations it wishes to assume and which taxes it wants to impose to finance them--is a matter to be decided by the political process, not by the Constitution.[2]

The claim that the federal government has consistently adhered to the principle that the provinces ought to possess taxing powers which match their responsibilities seems somewhat exaggerated. When one recalls that during Canada's earliest years, the federal government preferred to allocate small annual fixed subsidies to the provinces in order to enable them to just balance their budgets rather than extending the power of indirect taxation to the provinces the accuracy of the above claim appears questionable. Through the application of fiscal leverage, the federal government has attempted to exercise leadership in areas which are the constitutional responsibility of the provinces. For example, the institution of the federal instrument of "conditional grants" in the years immediately following the first world war represented the advent of a new era in federal-provincial relations. The essential characteristic of the conditional grant was that the Government of Canada "offered to share the cost of

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[1] Benson, The Taxing Powers and the Constitution of Canada, p. 6.

[2] Ibid., p. 14.

a specified function provided certain standards of performance were met."[1] The provinces would incur up to half the cost of the program provided federal standards were met. Following World War I, conditional grants were offered for such diverse program areas as vocational education, highway construction, provision of employment offices, venereal disease prevention, and in 1926, the old age pension plan.[2]

According to Moore and Perry, "Through the adroit use of conditional grants the federal government has been able to gain and hold the initiative for instituting a wide range of services at the provincial level."[3] Of course, the utilization of this instrument by the federal government to influence the timing and content of provincial programs is not without controversy; as the above authors note:

> Shared-cost programs have been viewed by some as ideal government co-operation--the co-operation of the resources of two government levels for the provision of badly needed services. Others have regarded them only as federal legislation regulating provincial activity in fields that are the provinces' own constitutional responsibility.[4]

The constitutional justification for the use of the conditional grant by the Government of Canada is found in the following ruling of the Supreme Court of Canada:

> ...Parliament, by properly framed legislation may...dispose of its public property in any manner that it sees fit...the Dominion may grant sums of money to individuals or organizations and conditions as Parliament may see fit to enact. It would then be open to the proposed recipient to decline

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[1] Moore, Perry and Beach, The Financing of Canadian Federation, p. 8.

[2] Ibid.

[3] Ibid., p. 113.

[4] Ibid.

the gift or to accept it subject to such conditions.[1]

When this interpretation was appealed, the Privy Council ruled:

> That the Dominion may impose taxation for the purpose of creating a fund for special purposes, and may apply that fund for making contributions in the public interest to individuals, corporations or public authorities, could not as a general proposition be denied...But assuming that the Dominion has collected by means of taxation a fund, it by no means follows that any legislation which disposes of it is necessarily within Dominion competence ...Dominion legislation, even though it deals with Dominion property, may yet be so framed as to invade civil rights, property, may yet be so framed as to invade civil rights within the Province, or encroach upon the classes of subjects which are reserved to Provincial competence.[2]

The qualification contained in the Privy Council's judgement has had the effect of rendering the whole issue of the constitutionality of federal spending in fields of provincial jurisdiction unresolved; therefore, in a sense, the very legality of the conditional grant (or shared-cost program) hangs in the balance.

The motivation of the Government of Canada in employing shared-cost measures has been "to achieve a country-wide priority for certain programmes." The federal government argues "that in the absence of some such vehicle common priorities across Canada would be highly unlikely."[3] In practice, the shared-cost program appears to have been the principal mechanism for effecting a reconciliation between divergent priorities at the regional and national levels.

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[1] In re: Employment and Social Insurance Act, (1936) R.C.S.427--l'honorable juge Duff, p. 457, as cited in Trudeau, Federal-Provincial Grants, n. 7.

[2] [1937] A.C. 355 at 366, as cited ibid., n. 8.

[3] Ibid., p. 18.

The history of financial assistance by the federal government to the financially disadvantaged provinces seems to suggest that regional equalization transfer payments were guided, and indeed motivated, less by moralistic convictions than by the exigencies of the times. Not until recent decades has a rationale for such special assistance been articulated, this rationale being partly economic and partly nationalistic in character. The economic justification for the efforts of the federal government which are directed towards the establishment of certain minimum standards in public service throughout the country is based upon the unfavourable repercussions in the rest of the country which may be expected to result from the provision of inferior public services in a particular region. The argument may be couched in the theoretical phraseology of optimizing resource allocation:

> Even with perfect allocation of resources in accordance with the principle of marginal productivity, average income and other indexes of fiscal capacity would vary from province to province and from locality to locality because of lack of uniformity in the distribution of natural resources, and consequently in occupational distribution. Equalizing transfers would therefore still be necessary to implement the principle of fiscal equity and to prevent distortion from the optimum allocation of resources.[1]

By 'fiscal equity' is meant that "similarly situated individuals in different provinces and localities should receive equal fiscal treatment, taking both benefits from public services and burdens of taxation into account."[2] There would be two sources from which distortions in the allocation of resources would derive if 'fiscal equity' does not obtain. First, the less favourably treated individuals in the poorer provinces may transfer their assets or themselves to richer provinces

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[1] J.F. Graham, "The Fiscal Equity Principle," in Public Finance in Canada, ed. by Robinson and Cutt, p. 133.

[2] Ibid., p. 132.

which offer better fiscal treatment, even though their productivity in the poorer provinces may be higher. Secondly, if a province fails to provide a public service which yields benefits which far outweigh the cost from a national perspective, but not from that particular province's viewpoint, then allocational inefficiency will result if the narrow perspective of the province is permitted to prevail. Therefore, expenditures in one province which have important external or spillover effects in other provinces ought, at the very minimum, to be influenced by the federal government. Examples of expenditures of this sort abound; some cases in point are pollution control and technical education programs:

> The governments of upstream provinces are not likely to be disposed to impose very heavy burdens upon their municipalities and industries where the benefits of pullution control will be felt largely in a neighbouring province. Nor will a largely agricultural province be likely to initiate expensive technical and professional training courses, the graduates of which can only be employed in manufacturing enterprises.[1]

The element of nationalism which underlies regional equalization grants has been identified by the federal government as "the sense of community which moves its residents to contribute to the well-being of residents in other parts of the federation."[2] This sense of community is explained in part by the increasing mobility of Canadians which enhances the populace's awareness of other regions in the country, and the calibre of the public services which they provide. Another factor which has strengthened the case for fiscal equalization transfers to the lagging provinces has been the historical pattern of labour out-migration from the poorer to the richer provinces. Such financial grants may thus be viewed as a form of compensation paid by the richer provinces, since the poorer provinces fail to

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[1] Trudeau, Federal-Provincial Grants, p. 26.

realize any return from their expenditures for the public services provided the migrants who desert their provinces in favour of the richer ones. However, if the equalization grants are of sufficient magnitude, they may represent a serious effort to stem the flow of migrants from poor to rich provinces.

As has been indicated in the third chapter of this thesis, the direction of inter-regional flows of skilled manpower may well have been a decisive factor perpetuating the degree of inter-regional economic disparities in Canada. To recapitulate this point, the failure of the factor price equalization theorem to consider the significance of the direction of inter-regional factor input flows is largely responsible for rendering it irrelevant to a convincing interpretation of Canada's economic history. As Prof. Brewis has noted, the Canadian experience has witnessed a flow of labour and capital from the lagging to the more prosperous regions which, because of multiplier and accelerator effects as well as the external economies which accompany a growing industrial complex, has tended to offset the equalizing influence exerted by inter-regional factor mobility. Therefore, although unimpeded inter-regional factor mobility may contribute towards high levels of economic activity, there is much evidence to suggest that its widespread regional diffusion will not ensue as a matter of course. The impetus for special policies aimed at specific regions may legitimately be attributed, in large part, to this historical fact in Canada.

In order to halt the flows of factors of production from the lagging to the prosperous regions, and perhaps even ultimately to reverse the historical direction of these flows, it has been necessary for the federal government to initiate programs which create conditions in the lagging provinces promising higher returns than those available in the more prosperous regions of the country, or at least which offset the locational disadvantages of the lagging regions. To a greater or lesser extent, the motivation for all programs undertaken under ARDA and FRED, under ADA, and under ADB was the creation of economic opportunities in the lagging regions. However, as was indicated in the fourth chapter of this thesis, certain inconsistencies existed between the fundamental approaches of these agencies. Specifically, the non-discretionary criteria approach of ADA, which approach was really tantamount to a tinkering with the market mechanism, seemed to be clearly at odds with the comprehensive planning approach which ARDA and ADB were opting for in the formulation of their programs. Moreover, the nature of the regionally-oriented programs of the Department of Manpower and Immigration suggested the need to closely co-ordinate these measures with the regionally-oriented activities of other involved departments, and this strengthened the arguements of those who advocated a comprehensive planning approach.

Since ARDA and FRED, ADA and ADB have all been absorbed by the newly constituted Department of Regional Economic Expansion, the structure and terms of reference of this new department will be described in the following section in order to indicate the manner in which these component elements have been organized to foster internal consistency within this department.

Department of Regional Economic Expansion (DREE)

Under Bill 173, "An Act respecting the organization of the Government of Canada and matters related or incident thereto" as passed by the House of Commons on March 24, 1969, the Department of Regional Expansion was established. As is suggested by the new department's name, its preoccupation will be to foster "economic expansion and social adjustment" in those areas deemed to warrant special measures in order to attain these ends. Specifically, those areas which are judged to possess inadequate opportunities for productive employment will receive the attention of this department. The Minister of DREE is empowered to formulate, in co-operation with any province,

> ...a plan of economic expansion and social adjustment in a special area and, with the approval of the Governor in Council and subject to the regulations, enter into an agreement with that province for the joint carrying out of such plan.[1]

The process by which such a plan would be formulated and executed is suggested by the structure of DREE. This department consists of five main branches, four of which come under the responsibility of Assistant Deputy Ministers and one branch being headed by a Director-General. The branches headed by Assistant Deputy Ministers are the Planning Branch, the Programming Branch, the Implementation Branch, the Operations Branch; under a Director-General is the Administration and Program Review and Evaluation Branch. The heart of the Planning Branch appears to be its Economic Analysis Division, the officers of which have been characterized as the 'diagnosticians' of regional ailments. A systematic analysis of the economic difficulties in a region is the initial step taken in the formulation of a developmental plan; the tentative plan which is formulated in the Planning Branch then becomes an input for the Programming Branch, which branch then formulates the appropriate 'program mix'; that is, the Programming Branch decides upon such regional elements as manpower, transportation and industry. The orientation of the Implementation Branch is towards 'field work' in the execution of the plan. The Operations Branch seems to be a complementary adjunct to the other components of DREE, concerning itself with the area of industrial incentives. Finally, the Administration and Program Review and Evaluation Branch has a self-explanatory role which in all likelkihood will become increasingly important as DREE matures and a sufficient amount of time has elapsed for its programs to bear fruit.

The very structure of DREE necessitates a close co-ordination of efforts in all its branches and the response to this requirement has been the establishment of a number of inter-divisional committees. To illustrate the overlap in functions one need only trace through the total process of devising and implementing a plan of regional development. In connection with demarcating the area to be assisted, the Planning Branch, the Implementation Branch and the Operations Branch might all be involved, as well as the officials of the province in question. After the problem area has been demarcated, the tentative plan--the 'output' of the Planning Branch--becomes an input for the Programming Branch; the tentative program for the area then becomes an input for the Operations and Implementation Branches. It is important to realize that the overlapping which is inherent in the structure of DREE is <u>not dysfunctional</u>; it is rather the means of ensuring that the efforts of the department are co-ordinated and that DREE operate in a consistent manner.

The relationship which DREE bears to its subsumed components is perhaps best understood by considering the 'origin' of those who presently head each of its five branches. The head of the Planning Branch was formerly an Assistant Deputy Minister in the Department of Manpower and Immigration; the head of the Programming Branch was formerly an Assistant Deputy Minister responsible for the ARDA program; the head of the Implementation Branch was formerly the Director of the ADB; the head of the Operations Branch formerly was 'Commissioner for Area Development' under the ADA program; and lastly, the Director-General of the Administration and Program Review and Evaluation Branch formerly served as the Deputy Director of ADB.

As has already been noted, the basic source of inconsistency between the regionally-oriented agencies stemmed from the different approaches adopted by ADA and by the others. Within DREE, the most fundamental re-orientation with respect to the approaches of the component agencies appears to have been effected in the realm of industrial incentives. Whereas under ADA, rather rigid non-discretionary criteria were established to determine the eligibility of an applicant firm for a location incentive grant, under the new legislation, a maximum of latitude is allowed the Minister in the designation of 'special areas'. The Act reads as follows:

> The Governor in Council, after consultation with the government of any province, may by order designate as a special area, for the period set out in the order, any area in that province that is determined to require, by reason of the exceptional inadequacy of opportunities for productive employment of the people of that area or of the region of which that area is part, special measures to facilitate economic expansion and social adjustment.[1]

In June 1969, under Bill C-202, "An Act to provide incentives for the development of productive employment opportunities in regions of Canada determined to require special measures to facilitate economic expansion and social adjustment"[2] was passed. This Act succeeds the 1965 Area Devleopment Incentives Act which will have been completely phased out of existence by January, 1970. Under this new Act

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1 Statutes of Canada, 17-18 Elizabeth II, 1968-69, Bill C-173, Sec. 24.

2 Statutes of Canada, 17-18 Elizabeth II, 1968-69, Bill C-202.

a very high emphasis is placed upon Ministerial discretion. Thus, it is specified that:

> A region may be designated pursuant to subsection (1) only if the Governor in Council upon the report of the Minister, is satisfied that
> (a) existing opportunities for productive employment in the region are exceptionally inadequate; and
> (b) the provision of development incentives under this Act for the establishment of new facilities or the expansion or modernization of existing facilities in the region will make a significan contribution to economic expansion and social adjustment within the region.[1]

The exercise of Ministerial judgement is similarly demanded by the following provision:

> Subject to this Act, the Minister may authorize the provision of a development incentive in the maximum amount provided for by this Act or in any lesser amount...[2]

Similarly, the following specification of ineligible facilities calls upon Ministerial discretion in rendering a decision:

> No development incentive may be authorized under this Act for the establishment, expansion or modernization of any facility if, in the opinion of the Minister,
> (a) it is probable that the facility would be established, expanded or modernized without the provision of such an incentive; or
> (b) the establishment, expansion or modernization of the facility would not make a significant contribution to economic expansion and social adjustment within the designated region.[3]

In comparing the Regional Development Incentives Act with its predecessor, the Area Development Incentives Act under ADA, an official of DREE stated that the newer Act was designed to allow room for common sense whereas its predecessor was not. In view of the flexibility built into the Regional Development Incentives Act, the potential for eliminating all inconsistencies within DREE is certainly not lacking.

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[1] Ibid., Sec. 3, (2)(a) and (b).

[2] Ibid., Sec. 6.

[3] Ibid., Sec. 7, (1)(a) and (b).

It was noted in Chapter II of this thesis that "Canada's regions have traditionally been delineated on the basis of a combined political and homogeneity criterion." This state of affairs was attributable to two factors: first, the Government of Canada dealt with the governments of each of the provinces in its fiscal negotiations, and second, the common interests of certain adjacent provinces, such as the Maritimes(and more recently, the Atlantic) provinces, the Prairie provinces and at certain times, the Central provinces, induced them to 'lobby' in concert with the Government of Canada so that groups of provinces came to be identified as regions. The regional concept held by DREE is more complex than one based upon political jurisdiction and homogeneity of resources; in fact, DREE seems to adopt different regional concepts for different occasions, as the situation demands.

Since much of DREE's activities are carried out in consultation with the provinces, the department must be ever-aware of the region in terms of provincial jurisdiction. Moreover, since all five branches in DREE are organized, for administrative convenience, into Eastern,Western and Central components, the region as a combination of geographically adjacent provinces must be a categorization at some level of departmental thinking. In DREE's regulations governing the designation of regions to be eligible for incentive grants, the following provision appears:

> ...the Governor in Council, after consultation with the government of any province or provinces, may for the purposes of this Act by order designate as a designated region, for the period set out in the order, any region, comprising the whole of that province or those provinces or any portion thereof not less than 5,000 square miles in size, that is determined to require special measures to facilitate economic expansion and social adjustment.[1]

The condition concerning the minimum size of the region to be designated was motivated strictly by the consideration of administrative convenience. In fact, the original draft of the Act specified a minimum size of 10,000 square miles.

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[1] Ibid., Sec. 3, (1).

Finally, the concept which DREE must adopt in connection with its plan formulation and program development must be a hybrid of the political-administrative-programming unit and the nodal concept of region. In a word, then, the concept of region adopted by DREE is simply one that is operational.

Apparent Trends in Federal-Provincial Relations and Their Implications For Regional Development in Canada

The position taken by the Government of Canada on a number of fundamental issues in recent years appears to presage the advent of a new era in federal-provincial relations, the key element of which will be substantially greater provincial autonomy. Whether the modified stance of the federal government is a product of both the pressures for increased autonomy emanating from Quebec and the determination of Ottawa to deny 'special status' to Quebec is anybody's guess. At any rate, the role of the Government of Canada seems to be evolving from one of 'initiation' (or leadership) in matters of provincial jurisdiction to one of 'co-ordination'. This evolution manifests itself in the endorsement by the Government of Canada of the principle that both the federal and provincial governments be given broad and overlapping powers of taxation in order to enable each level of government to meet its changing fiscal responsibilities. Furthermore, with respect to conditional grants for joint federal-provincial programs, the Government of Canada proposed the following two principles to govern such grants:

> ...first the existence of a "broad national consensus" in favour of any programme, and secondly the assurance that a "fiscal penalty" would not be imposed upon the people of non-participating provinces.[1]

[1] Trudeau, Federal-Provincial Grants, p. 38.

The rationale for such an 'opting-out' arrangement is stated by the Government of Canada in the following terms:

> No provincial government ought to feel obliged to exercise its constitutional powers in a particular way for the reason that a fiscal penalty would be visited upon its people if it took a contrary view. The objective therefore, clearly must be to keep the people of non-participating provinces from paying a penalty: it follows that any payment must logically be made to them.[1]

Another factor which further enhances provincial autonomy is the Canada Pension Plan, the funds of which substantially diminishes provincial dependence upon capital markets for long-term financing. In 1968, for example, of the total of $1,865 million in provincial bonds which were sold, $704 million or nearly 38 per cent were sold to the Canada Pension Plan. As Prof. Barber has noted, "Perhaps the key factor in determining whether a province can pursue an independent fiscal policy is the nature of the province's borrowing capacity and the extent to which it can increase its debt."[2]

If one accepts the notion that the long-term objective of the federal government is the attainment of the maximum degree of provincial autonomy which is compatible with the efficient operation of a modern nation-state, the implications for present regional development policy seem quite clear. In order to terminate the continued reliance of the disadvantaged provinces upon the federal government for fiscal assistance--a reliance which is ultimately incompatible with genuine provincial autonomy--a long-run regional development program must be vigorously prosecuted.

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[1] Ibid., pp. 46-8.

[2] C.L. Barber, "The Theory of Fiscal Policy from the Point of View of the Province," in Public Finance in Canada, ed. by Robinson and Cutt, p. 320.

CHAPTER VII

CONCLUSION

It will be recalled from the third chapter of this thesis that both A.D. Scott and C. Lemelin attribute the remarkable constancy in Canada's regional economic disparities to the role played by different levels of government; however, their interpretations displayed a critical difference. According to Scott, governmental interference with the market mechanism has hampered the improvement in inter-regional economic disparities which the free play of market forces would have effected; Lemelin (following T.W. Schultz's approach) maintains that the government's involvement has prevented the aggravation of inter-regional economic disparities which would have resulted from the free play of market forces.

It has become increasingly obvious that policy prescriptions based upon Scott's recommendations for policy action entail measures to facilitate the adjustment of the lagging regions to the dictates of the market. Extending this line of thinking to its logically extreme limit, the problems in lagging regions would be eliminated by eliminating the lagging regions--not by fostering their economic development but by facilitating their virtual abandonment. Obviously such an approach is politically unacceptable. However, even on economic grounds Scott's analysis is subject to valid criticism, primarily because of its essentially static nature.

Given the diminishing responsiveness of factors of production to negative pressures to migrate, the federal government's approach must rely ypon positive measures to equalize the returns to the same factors of production in different regions to the same factors of production in different regions in the long-run.

Assuming that the national will exists to eliminate regional disparities in economic opportunities in the long-run, an important question arises: Is there at present enough flexibility in our governmental institutions to effectuate policies which involve funds of sufficient magnitude to seriously challenge persistent inter-regional disparities? The volume of federal resources devoted to regional development is an important indicator of the extent of national commitment to the goal of equalizing regional opportunity. A key determinant of the potential volume of resources which are allocated towards regional development is the relative fiscal capacity of the federal government and the provinces. In the short-run, any strengthening of the relative position of the federal government in this regard enhances the possibilities for commiting adequate resources for regional development. However, if the Constitution were revised in order to facilitate this short-term end, the very success of the regional development programs might well render the Constitution 'obsolete' in the long-run when the provincial demands for greater autonomy would be matched by the provinces' own fiscal resources. Moreover, it is not clear that the present institutional framework is incapable of accomodating the measures necessary to equalize regional opportunities throughout the country; in fact, the federal government has demonstrated considerable imagination in devising measures to promote regional equality. The increasing consciousness within federal departments of the regional dimension of all policy measures may well prove to be the most important development in the area of regional development policy[1], since the absence of a regional orientation has, in the past, resulted in policies which often favour the advanced regions.

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[1] For example, if the operational criteria for Crown Corporations were extended to include a regional dimension, or if the Bank of Canada were reorganized along lines parallelling the geographic decentralization principle of the Federal Reserve system in the U.S., the regional implications of such measures could prove to be extremely significant.

As economic activity in Canada increasingly becomes more evenly diffused by region, the urgency of federal equalization grants will correspondingly diminish, since the ability of the lagging regions to provide nationally acceptable standards in public services without unduly burdening the residents of these regions will, at the same time, be enhanced. Therefore, the nature of the Government of Canada's concept of national integration will probably be one which reflects an increasing awareness and concern over the essential qualities of inter-regional economic ties; the magnitude of such linkages will be only one dimension of national integration, perhaps not even the most important one. If such a view is adopted, then not until there exists a two-way flow of goods and factors of production between a region in Canada and the rest of the country would that region justifiably be considered to be integrated into the mainstream of economic life in Canada.

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