

# Our Place in Canada: Realistic and Restrained, but Lured into Folly by the Seduction of Oil

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WITH A MANDATE to critically analyze Newfoundland and Labrador's strengths and weaknesses, and to recommend "how best to achieve prosperity and self-reliance" within Canada, the Royal Commission on Renewing and Strengthening Our Place in Canada produced a report that is for the most part moderate in tone and modest in ambition. At the same time, it is highly critical of Newfoundland's treatment by the federal government, and the failure to place the province on a more solid economic foundation. The Commission's report has been criticized for, among other things, its failure to provide a comprehensive financial accounting of the costs and benefits of Confederation, and for not developing a clear strategy for recapturing control over the province's natural resources as a basis for future economic prosperity.<sup>1</sup> However, the Commission does provide a realistic and measured analysis of the province's political, economic and fiscal situation and prospects, one which recognizes that there are no quick fixes, ideal strategies, or clear-cut solutions to the problems and challenges that beset the province. It suggests only a general approach to federal-provincial relations, and modified institutional frameworks within which policy problems can be addressed, with the ongoing cooperation of the federal government and the occasional partnership of other provinces. Rather than advocating radical reversals or sweeping changes, the Commission speaks of mitigating problems and readjusting arrangements and programs.

The fact that the report did not generate a sustained discussion after its release, and then failed to attract much attention in the October 2003 provincial election, is perhaps due more to this practical and pragmatic orientation than to any notable shortcomings in analysis or recommendations. With regard to Newfoundland's place in Confederation, there is a clear sense of alienation borne of marginality that infuses the report, but it is not ambivalent or ambiguous about the province's political future. It asserts that Newfoundland and Labrador "wants in" — that the province wants to be able to realize the unfulfilled promise and potential of its union with Canada, achievable only when the province is a fully-participating partner, and not an economic and fiscal supplicant.

In reviewing Newfoundland's 54 years within Confederation, the Commission's figures can be read in two ways: that the province's poor position compared to the Canadian average in key indicators (e.g., unemployment and labour force participation rates) remains unchanged, or that some gaps have been narrowed significantly (e.g., income and earned income per capita, GDP per capita). Moreover, the province continues to exceed the Canadian average in some key social indicators, while its capital city, and more generally the Avalon Peninsula, enjoys a new prosperity that is unparalleled in terms of its stability and the economic diversity upon which it rests.<sup>2</sup> Relations with Ottawa and the federal government, however, have too often been dysfunctional: competitive and combative rather than strategic and cooperative.

## GENERIC PROBLEMS: RURAL DECLINE AND FEDERAL-PROVINCIAL RELATIONS

Some of the problems and challenges identified in the report are unique to Newfoundland and Labrador, some are more generic to the Atlantic region, and some are shared nationally. Such distinctions might have been better drawn in the report itself, since they do have a bearing on the best approaches to addressing problems, as well as the likelihood of partnering to find effective solutions. One generic problem has to do with demographic change, in particular aging, falling birth rates, population decline, and out-migration from rural areas. The province's challenge here seems to be more severe than other provinces in degree, but in kind it is no different than that faced by a number of others, for example Nova Scotia and Saskatchewan, or many other developed countries. For instance, it is anticipated that some European countries will lose population over the next few decades due to their low birth rates (below replacement values) and meagre immigration numbers. This does not remove the policy challenge for Newfoundland and Labrador, but it does suggest the wisdom of an expanded search for remedies, or effective adjustment strategies, both nationally and abroad. Another generic problem is the challenge of social inclusion, whether women, Aboriginals, or other minorities. In this area, the challenge to Newfoundland may not be as great as it is for many other jurisdictions in Canada with significantly larger populations of visible minorities, French-speakers, and Aboriginals. Having noted this, the current political and policy impact of the province's Aboriginal population is very significant. The Labrador Inuit will soon control much of northern Labrador, the Innu land claim is in process, and the Labrador Metis will follow suit. On the island, the Mi'kmaq are fighting their land claim, and the Federation of Newfoundland Indians has launched a lawsuit against the federal and provincial governments alleging neglect of fiduciary duty since 1949.

There are other persistent problem areas targeted in the report that Newfoundland and Labrador shares with several other provinces, including federal-provincial relations, economic development (both generally and in the "hard case" of isolated rural areas), and the chronic and cumulative problem of provincial deficits and debt. Federal-provincial relations have run the gamut, from the cozy, partisan ties of the Smallwood era to the confrontational and combative stand-offs of the Peckford years, when a 'go-it-alone' strategy based on provincial autonomy and control over resources clashed with the Canada-first federalism of Pierre Trudeau. The report recommends building up the intergovernmental affairs capacity of the provincial civil service in order to design and implement a more strategic approach to the relationship with Ottawa (a sensible recommendation that could just as easily be made to the government of Nova Scotia). A second thrust of the recommendations is to increase Newfoundland's presence in federal institutions, which the report pans as wholly inadequate. However, the triple 'E' Senate favoured in the report is unlikely to appear any time soon, blocked by the constitutional trade-offs that would be necessary to make it happen. And a more cooperative tone and approach in the relationship, based on application of the principles of partnership and subsidiarity, while a laudable sentiment, is likely to prove difficult to sustain and embed over the long run, given the wide range of variables that tug at Ottawa's complex and multifaceted relations with the provinces.

The more straightforward and tangible objective of getting more federal offices in Newfoundland and Labrador, and more Newfoundlanders in federal offices, may commend itself as a line of negotiation that the province can pursue with Ottawa over the short-to-medium term. Still, if the federal response to this were to amount to nothing more than a re-juggling of jobs within the region, robbing the Maritime Peter to pay the Newfoundland Paul, there will be inter-provincial frictions and political obstacles. As for more intergovernmental cooperation within the region, the report reflects a traditional suspicion that this tends to yield benefits primarily to New Brunswick and Nova Scotia. Thus any new cooperative initiatives should be considered strictly on a case-by-case basis, with participation based on the potential advantages for Newfoundland and Labrador.<sup>3</sup> This would have the effect of reaffirming the status quo, since the province's traditional role has been as an occasional participant in ongoing efforts to further expand Maritime/Atlantic cooperation, a condition with which all the Atlantic provinces seem comfortable.

## ECONOMIC DEVELOPMENT

The challenge of economic development in a peripheral region is another familiar complaint, as is the particular concern about what the future holds for rural areas, especially those far removed from any urban centre. The Commission's discussion of this topic is paralleled by similar ongoing discussions in every region across Can-

ada, since all are affected by the same problem of rural economic decline and depopulation. The same factors are involved: birth rates that have dropped dramatically, educated young people leaving for better and more diverse opportunities in urban centres, resource industries that require less and less labour, or are shrinking due to resource depletion. The disappearance of the cod fishery is, of course, a particularly stark example of the latter, but the general trends have been well established almost everywhere, and for some time.

The Commission notes that in 1980 the Economic Council of Canada released its "From Bays to Peninsulas" study, advocating a concentration of economic activities in urban centres connected by roads to smaller outports within commuting distance. This was a version of the growth centre strategy that had been pursued by the Department of Regional Economic Expansion elsewhere in the region since the early 1970s. However, the ECC study, which for many in Newfoundland evoked the much-maligned resettlement strategy of the 1960s, was rejected by the provincial government, which proceeded instead to invest in a rural revival strategy based on an expanding fishery.<sup>4</sup> In its recommendations, the Commission appears to have returned to the ECC strategy, by suggesting that the government stop fighting demographic realities and social trends, accept internal migration to larger urban areas, and concentrate on the development of these growth nodes to which at least some rural communities can connect.<sup>5</sup> In short, while the province should sustain as much of rural Newfoundland as feasible, the future for rural dwellers will increasingly lie in moving or commuting to more built-up urban areas. Such a message may be too politically unpalatable to be openly embraced by politicians (and not only in Newfoundland and Labrador), but it is likely that it will shape the basis for a provincial development strategy, much as it has elsewhere. The alternative to this controlled transition is the haphazard disintegration of many rural communities, as out-migration strips them of their population base, with ever-more serious effects and consequences for their continued viability.

The Commission's analysis of provincial economic development prospects, more broadly cast, is fully consistent with the current economic outlooks and strategies of other provinces, with an emphasis on education, skills, research, and the development of human capital as the key to economic prosperity in the twenty-first century. The essential infrastructure required to nurture human capital depends upon public sector spending and, especially in the Atlantic region, federal public spending, on such things as research, student aid, transportation corridors, and broadband internet access. While natural resources will remain important to Newfoundland, they will not be the main source of much employment or economic growth in the future. Investing in people has become the primary task of governments everywhere, and more cooperation in performing this task will be needed, not least because people are a mobile national resource. Simply put, there is no guarantee that a province's investment in raising the education and skills level of its people will not simply add to the quality of the productive workforce of another

province. For a province like Newfoundland and Labrador, or for that matter Nova Scotia, New Brunswick or Saskatchewan, the migration of highly educated individuals can produce direct dividends only if they subsequently remain in or return to their home province with enhanced knowledge, skills, and connections. On the other hand, provinces that are net exporters of human capital can still benefit indirectly — thanks to national social programs and redistributive mechanisms — from the contributions of their former residents to the overall competitiveness and productivity of the national workforce. Clearly, a large federal contribution to building and maintaining the infrastructure needed to produce, sustain, and attract this enhanced human capital is not only warranted by the reality of national mobility, but is also the *sine qua non* for the participation of small, peripheral provinces in the new economy. For Newfoundland and Labrador, as for every other Atlantic province, there is no practical alternative to the task of preparing and adapting its society to participate in this new economy, other than accepting a fate of future stagnation and worsening disparity relative to the metropolitan regions of North America.

Another common problem is the issue of provincial deficits and debt. A fiscal crisis threatens Newfoundland and Labrador's present and future ability to provide the infrastructure and supports needed to participate in the new economy. The level of provincial debt per capita, and the debt-to-GDP ratio, are among the worst in Canada, though it should be noted that the province continues to keep company with Quebec and Nova Scotia. The fiscal outlook for the province is a good news/bad news story, with large projected deficits but also strong revenue projections due to rising oil production. The kicker is the equalization payment losses that accompany these rising oil revenues. With at least 70 percent of new oil revenues offset by a dollar-for-dollar decline in equalization, and oil revenues slated to fall off dramatically after 2010, offshore oil will not be a panacea for the province's fiscal circumstances. Nor will these circumstances be easy to change, with population decline a major contributing factor. This triggers reduced federal transfers for health, education, social services, and equalization; but the cost of providing public services remains high.

## EQUALIZATION

This raises a central issue for the Royal Commission: the need to improve the equalization program. Since 1967, equalization has made up between 25 and 33 percent of provincial budgetary revenues, though it is presently at the lower end of this range. The importance and centrality of equalization to the fiscal position of poorer provinces cannot be overemphasized. However, the gap between fiscal need (the actual cost of providing services) and fiscal capacity, the basis on which provincial revenues are equalized, poses serious difficulties for a province with a sparse, thinly-distributed, and declining population. As well, the present equalization for-

mula, in place since 1982, is based not on national average fiscal capacity, but a five-province average that excludes Canada's richest province, Alberta. There is general agreement amongst the premiers (but not yet the federal government) of the need to reform equalization, including a return to the ten-province standard that was in place before 1982. The Commission also advocates this change in its report, along with the adoption of population floor provisions for both the equalization program and social transfers like the CHST, in order to lessen the fiscal shock of population decline, and an annual escalator for CHST transfers, to reflect rising program costs.

While the Commission devotes the best part of a chapter to equalization, in truth it could have been given even greater prominence. In an era when the development of human capital is at the core of economic performance and competitiveness, equalization is not just a mechanism of fiscal federalism, but also a long-term economic development tool that easily surpasses control over natural resources in its importance. Improving the equalization formula should be the focus of Newfoundland and Labrador's efforts to renegotiate the federal bargain, as it should be for the other Atlantic provinces. Not recognizing and clearly stating that this should be the province's foremost priority is a major miscalculation on the part of the Commission, and exposes the lingering assumption that being a recipient province under the equalization program is a form of penury, something from which the province must somehow find a way to escape. On this point every Atlantic province should be emphatic: equalization is not a form of welfare; it is the mechanism used by Canada to ensure the constitutional right of all its citizens to receive roughly similar levels of public services at roughly similar levels of taxation, regardless of where they live. If the program is not performing this function sufficiently well, then it is the constitutional duty of every government in Canada to reform the program to make it more effective.<sup>6</sup> Nor should equalization be seen as "transitional" in its purposes, designed to "tide a province over" while it moves from relative poverty to the national mean or better in terms of wealth. Rather, it is a permanent mechanism which will always be necessary and always will be used, as long as the federation persists.

The reality is that, barring a dramatic reversal in the economic fortunes of Canada's wealthiest regions, the provinces that are the current recipients of equalization will continue to be, though their economies may grow and prosper, as they have (for the most part) ever since equalization was put in place, in its contemporary form, in 1967. The relevant point is that equalization is a *relative* measure, tied to a standard which has been constantly moving upward. And it seems unlikely that Newfoundland and Labrador — and along with it Nova Scotia, New Brunswick and PEI — will ever surpass the national average fiscal capacity in Canada, irrespective of their economic performance over the next 20 years. In Newfoundland and Labrador, a rising tide of oil may or may not eventually float the provincial economy above the national average fiscal capacity; if it does, it may do so for only a short time. Nevertheless, it would be foolish to expect this to happen, and to use it as

the basis of future economic plans. Even worse, to use the measure of becoming a "have" province as the main criterion for gauging whether Newfoundland has succeeded within Confederation, or even more perversely, whether it has ceased to be "poor," is misguided and nonsensical. While the Commission does not explicitly adopt this line of thinking in its report, neither does it clearly distance itself from this attitude toward equalization and its role in Canada's federation.<sup>7</sup>

## THE FISHERY AND NATURAL RESOURCES

Finally, there are the touchstone issues that appear to be at the core of the province's discontents within Confederation: the exploitation and management of, and control over, the fishery and natural resources. With regard to the fishery, the Commission's recommendations are more or less consistent with positions taken by the province for many years, that there should be joint management of the resource, and that the 200-mile management zone should be extended — unilaterally if last-ditch international negotiations fail — to cover the whole of the continental shelf. It seems likely that the province will continue to pursue these objectives (the first of which Nova Scotia has always opposed), though it appears no closer to attaining them today than it has been over the past 20 years. More to the point, there is no evidence or convincing argument put forward that these proposed changes, had they been in place over the past two decades, would have altered significantly the disastrous history of the groundfishery. The province's own role in ratcheting up fishing and processing capacity after the 1977 declaration of the 200-mile limit, and using the fishery as an employment sector of last resort, does not leave one sanguine about any inherently superior management outlook or abilities. It simply is not clear that the changes proposed by the Commission would improve the situation in the fishery. Indeed, if there are lessons that have been learned from the decimation of what was once the world's greatest fishery, then all governments, as well as all fishers, have learned them. The provincial government has no monopoly on new-found, *ex post facto* wisdom regarding the imperatives of conservation.

With regard to electricity and oil, the most obvious areas in which the potential for significant provincial revenues has either been thwarted (electricity) or not yet fully realized (oil), the Commission makes two rather bold suggestions. The first is that the province should investigate the utility of section 92A(4) of the constitution (provincial taxing power over resources) as leverage in the province's ongoing disagreement with Quebec over the long-term contract governing the sale of electricity from the Upper Churchill to Hydro-Quebec. Simultaneously, however, and perhaps more importantly, the Commission recommends that the bitter disagreement over the Upper Churchill not be allowed to further delay planning, in conjunction with Quebec and the federal government, for development of the hydro potential of the Lower Churchill. This seems an eminently sensible position which

the province would be well advised to adopt. So long as bitterness over the enormous “lost revenues” associated with the disastrous Hydro Quebec contract prevents further cooperation between the provinces, the people of both provinces will be the poorer. In time, the unfair outcome of the first contract will be superceded by new arrangements that should greatly benefit the people of Newfoundland and Labrador after 2041, when the original contract expires, and hopefully well beyond.

On the question of offshore oil, the Commission recommends that the Atlantic Accord be re-opened, with a view to amending the Accord to ensure that the principal-beneficiary objective is met (that is, that Newfoundland and Labrador be the principal beneficiary of the exploitation and development of offshore oil and gas, as stated in the Accord). This recommendation is based on the “loss” of 75 to 80 percent of offshore revenue due to dollar-for-dollar reductions in equalization payments. The Commission drives home its point by stressing that there has been no major discovery of new oil for 17 years, and that peak revenue from current developments will last for only six or seven years (2006-2012), after which they will rapidly decline.<sup>8</sup> The implication is that the province is presented with a “window of opportunity” to amass windfall economic rents that may only be available for a short period of time.

In making this recommendation, the Commission is playing a dangerous game. By its own reasoning, it seeks to gain specific advantages for the province by altering, in what only could be construed as a selective and biased manner, the one national program that no Atlantic province can afford to see impugned or undermined. The logic of the equalization formula should not be altered to allow Newfoundland and Labrador (or Nova Scotia, which seeks a similar change) to escape the implications of the simple calculus that represents equalization’s core principle: that as a province gets richer it should receive proportionately less in equalization payments. It appears that the panic to “cash in” on the current oil projects, while the money is there, is driving this recommendation, rather than a balanced and considered evaluation of the long-term interests of the province. Equalization has made, and will continue to make, a much more important contribution to the general welfare, standard of living, and development prospects of Newfoundlanders and Labradorians than the oil industry. The Commission should have explicitly recognized this, and resisted the temptation to advocate re-opening the Accord with a view to sheltering provincial oil revenues from the equalization program. It should have staunchly defended the logic of the equalization program and its inherent fairness *if effectively implemented*, and the need to reform the program in order to ensure this. The Commission’s failure to do so aptly illustrates the corrupting influence that the prospect of windfall economic rents can exercise on otherwise clear thinking and principled individuals. In the end, the Commission could not resist the siren call of oil money as some kind of development “magic bullet.” Yes, its contribution could yet be significant. But to risk an improved and principled equal-



ization program in order to maximize short-term returns from offshore oil is pure folly.

## Notes

<sup>1</sup>William Marshall, retired Justice and former Newfoundland energy minister, in a presentation to the Atlantic Provinces Political Studies Association, St. John's, NL, September 27, 2003; Brian Peckford, "Brian Peckford condemns royal commission's report," *The Newfoundland Herald* (July 20, 2003).

<sup>2</sup>Our Place in Canada: Report of the Royal Commission on Renewing and Strengthening Our Place in Canada, 28-9.

<sup>3</sup>Report, 84.

<sup>4</sup>Report, 40.

<sup>5</sup>Report, 42-44.

<sup>6</sup>Section 36 of the Constitution Act, 1982, reads as follows: "Parliament and the legislatures, together with the government of Canada and the provincial governments, are committed to a) promoting equal opportunities for the well-being of Canadians; b) furthering economic development to reduce disparities in opportunities; providing essential public services of reasonable quality to all Canadians ... Parliament and the Government of Canada are committed to the principle of making equalization payments to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation."

<sup>7</sup>Arguments about equalization and its place in the federation are reviewed in *Sharing the Wealth: Choices for the Federation*, The CRIC Papers ([www.cric.ca](http://www.cric.ca)), September 2002.

<sup>8</sup>Report, 120.