

# Learning from Studies of Newfoundland's Economic Problems

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THE SUBJECT OF this paper is the interplay of perceptions of economic problems, opinions, and economic analysis in the two most recent reports on Newfoundland economic difficulties. The two are the reports of the Economic Council of Canada (1980) and the Royal Commission on Employment and Unemployment (1986). Both documents are of considerable importance, offering extensive reviews of the economy and far-reaching policy recommendations. Yet economic malaise continues. As Newfoundland enters the 1990s, unacceptably high unemployment and other serious economic problems persist. So is the problem that the medicine has not been applied? Is it the wrong medicine? Are there conflicting prescriptions? Is there no cure? Those questions provide the impetus for this paper. The key aspects of the reports' approaches, opinions and policy recommendations are summarized and compared. In light of those comparisons, some sense of the answers emerges.

## ECONOMIC PROBLEMS

Before delving into the reports themselves, a brief review of the problems that they were set up to study and to provide solutions for is in order. In broad terms, there are two fundamental and intertwined economic problems faced by Newfoundland and Labrador. And the apparently stubborn persistence of both is striking. Those problems are: economic disparity and dependency.

The former refers to the difference in certain economic variables, most notably output and unemployment, between this province and the country as a whole. The disparity problem is illustrated in Figures 1 and 2. Figure 1 shows the unemployment rate in Newfoundland and in Canada for the past twenty years. The province's unemployment rate is obviously correlated with the

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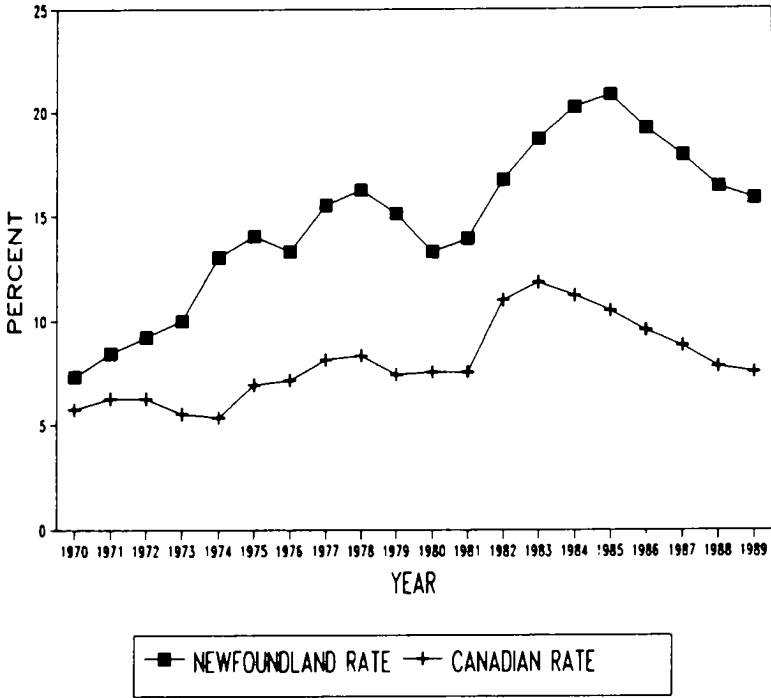


Figure 1. Newfoundland and Canadian Unemployment

Sources: Newfoundland Statistics Agency, *Historical Statistics of Newfoundland*, Government of Newfoundland and Labrador, St. John's.

Bank of Canada, *Bank of Canada Review*, (Various Issues).

Canadian rate and is consistently higher. The Newfoundland rate is approximately double the national figure. The story is much the same in terms of output. Gross Domestic Product (GDP), a measure of the value of incomes generated in an economy, is an indicator of production or output. The gap between Newfoundland GDP per capita and the national level, also on a per capita basis, is illustrated in Figure 2. Clearly Newfoundland lags behind and does not appear to be catching up, at least not over the past twenty years. It is generally accepted that the disadvantageous gaps in these two variables, unemployment and GDP per capita, imply a lower standard of living in Newfoundland, together with associated social problems.<sup>1</sup>

The second fundamental problem is dependence. Specifically, funds from the federal government have been, for some time, crucial to the maintenance of provincial government budgets and personal income levels in Newfoundland. The federal government currently spends, net of taxes collected, in excess of \$2 billion in Newfoundland. That spending is through several avenues: transfers to

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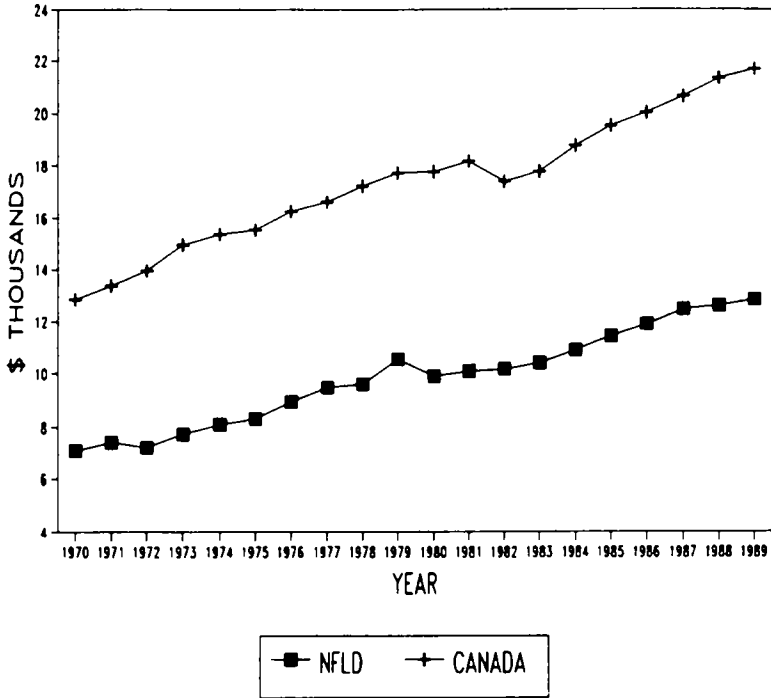


Figure 2. Real GDP per Capita: Nfld. and Canada  
Sources: Statistics Canada, *Provincial Economic Accounts*, 13-213 (Various Issues).

people through programmes such as Unemployment Insurance (UI), transfers to the provincial government as under the Equalization programme, and directly through local procurement and salaries. Of this amount, a growing proportion is UI payments.

The data displayed in Figures 3 and 4 illustrate the extent of Newfoundland's economic dependence on the federal government. In Figure 3, federal government expenditure, net of its tax collections, in this province relative to GDP is shown for the years 1970 to 1989. For that time period net federal expenditure, on the average, has been approximately equal to one third of GDP, with the range going from a low of 21.3% in 1970 to a high of 41.4% in 1985. For the last year for which data are currently available, 1989, net federal expenditures were \$2.6 billion while GDP was \$8.4 billion, leading to a ratio of approximately 31%. Of course, it can be correctly pointed out that not every dollar of federal expenditure translates directly into GDP; depending on the nature of the expenditure, one federal dollar may generate more than a dollar of GDP while another generates less. Still, the ratio of those expenditures to GDP is a

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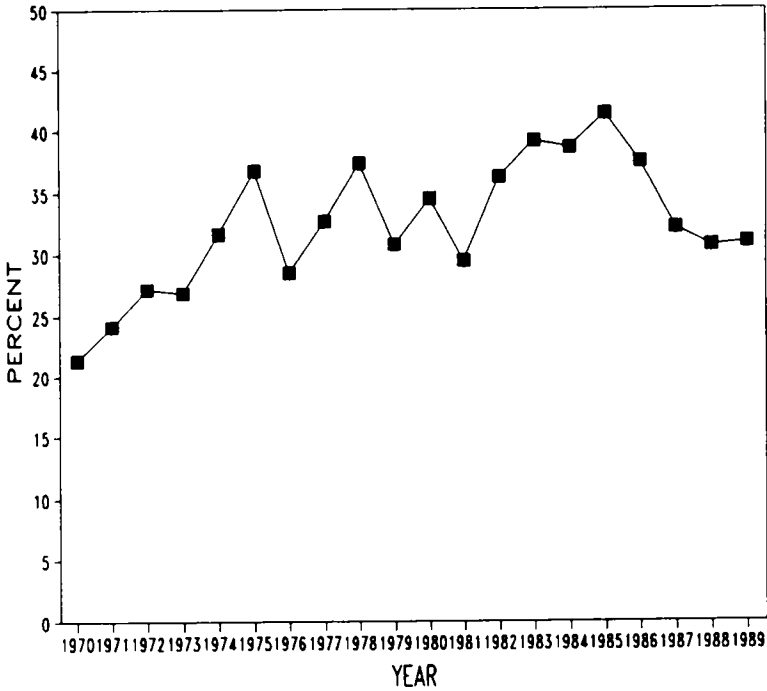


Figure 3. Net Federal Spending as % of Nfld. GDP

Sources: Statistics Canada, *Provincial Economic Accounts*; and Newfoundland Statistics Agency.

very good index of the importance of federal transfers to this economy. Moreover, the dependence on the federal government is not just financial. Federal legislation and international treaty arrangements can be of crucial importance; the best example of this is the province's dependence on federal action to protect and rejuvenate dramatically depleted fish stocks in waters adjacent to Newfoundland.

Figure 4 supports the contention of a trend towards greater reliance on unemployment insurance. In 1970, UI payments constituted only 10% of federal government expenditure in Newfoundland. Within a few years after the 1971 restructuring of the UI programme, which made it more generally available to workers, between 20 and 25% of federal expenditure in Newfoundland was through that programme. In the mid-1980s, despite some modest reforms of the system in earlier years, there was a sharp increase in the UI share of federal spending. By 1989, over 30% of federal spending in Newfoundland was in the form of UI benefits.

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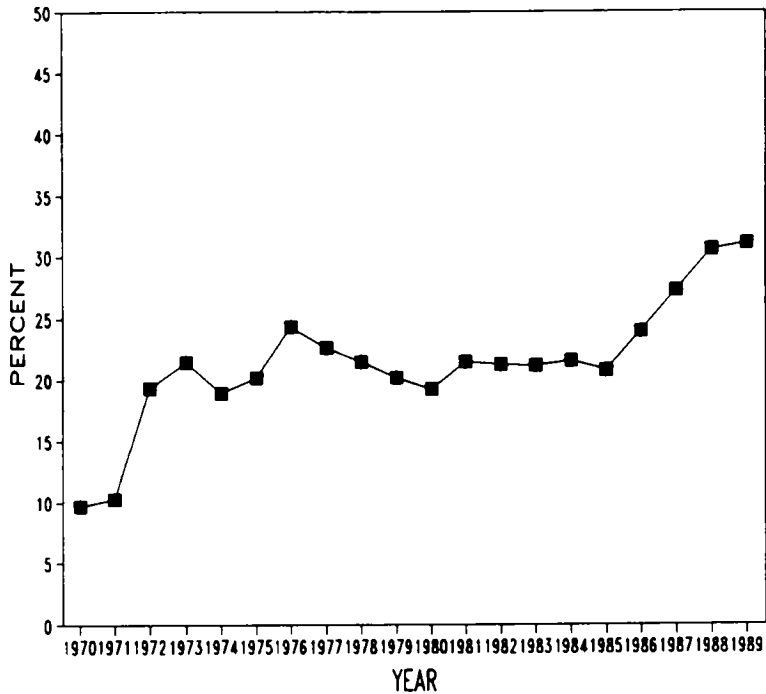


Figure 4. UI as % of Net Federal Spending in Nfld.

Sources: Statistics Canada, Provincial Economic Accounts; (various issues).

These statistics merely provide an aggregate picture of the persistence of disparity and dependence. Many sectoral, public policy and social problems arise as consequences of those fundamental problems. Addressing the fundamental problems and the other difficulties underlying them constitutes the *raison d'être* of the two studies now to be scrutinized.

### THE REPORTS: A SKETCH

It is worthwhile, initially, to gain a sense of the broad thrusts of the two studies. To accomplish this, overviews, according to a variety of criteria, are helpful. In particular, in this section the reports are briefly compared according to the following: terms of reference, the investigators and their approaches, the nature and number of recommendations, and the reactions to them. This sets the stage for the more substantive reviews of the later sections.

First, consider the terms of reference. These were similar. The Economic Council of Canada commenced its two-year study in 1979 at the request of the then Prime Minister of Canada, P. E. Trudeau. The impetus for Prime Minister

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Trudeau's request was a request from the then Premier of Newfoundland, F.D. Moores. The Council was specifically asked to assess the relationship between Newfoundland's persistently high unemployment and its low economic performance, and to provide a long-term economic development strategy for the province.<sup>2</sup> The Royal Commission on Employment and Unemployment, chaired by sociologist Douglas House, received its terms of reference from the provincial government. They, too, focused on the unemployment problem. The Commission was directed to examine and report on the state of employment and unemployment, to document and identify their causes, to examine the trends in these variables, to assess the impacts of training, job creation programmes and the income support system, to consider the impact of offshore oil and gas development and to make appropriate recommendations on these matters.<sup>3</sup>

Secondly, it is interesting to compare the investigators. The work of the Economic Council was carried out almost entirely by economists. As a group, those economists can be described as rather homogeneous. Their approach was highly scientific, drawing on their specialized skills in neoclassical economic theory and econometric analysis. Few were from or resident in Newfoundland. On the other hand, the group involved in the Royal Commission was quite different, both in background and approach. The commissioners were all Newfoundlanders. Most of its staff and consultants were Newfoundlanders or had settled in Newfoundland. In contrast to those involved in the Economic Council study, backgrounds were varied. As well, submissions from the general public and interest groups were called for, and public hearings held. Thus, not surprisingly, the approach of the Royal Commission was essentially multi-disciplinary with input from interested members of the public and interest groups. The earlier Economic Council report did not receive much attention from the Royal Commission.<sup>4</sup>

The two reports also differ markedly in terms of both the nature and number of recommendations. The Economic Council's recommendations are few, just twenty-five, and a large portion seem inordinately lacking in specifics, relative to the research undertaken. The recommendations are also consistent with orthodox economic theory. Within that approach, government intervention in the economy is typically limited to that required to correct "market failure", which may be defined in a narrow sense as the failure of market prices to reflect true benefits, or, in a broader sense, to encompass social matters beyond the realm of markets' functions. Consistent with this approach, almost half the Economic Council's recommendations relate to the fisheries, an industry based on a common property resource. Others relate to the offshore oil, agglomeration economies, transportation policy, and measures designed to make the labour market work more efficiently such as reform of unemployment insurance. In contrast, the Royal Commission makes a large number of recommendations, two hundred and forty-two. Those recommendations covered a wide range of

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issues, from dealing with the details of how government departments are organized, to academic programmes offered by Memorial University, to major items such as calling for a radically different income support system. The recommendations touch on many aspects of society, reflecting a view that government has a pervasive role in facilitating individual and group actions. Overall, the recommendations are consistent with a highly pragmatic approach, notably characterized by a desire to preserve the urban/rural population distribution and a belief in substantial untapped potential in rural Newfoundland.

Finally, the reactions to the two reports could hardly have been more different. The report of the Economic Council was badly received at the political level. When released to government, the then Premier, A.B. Peckford, was very critical. In a speech to the House of Assembly, he stated that "the document as a whole appears fatally flawed, both technically and intellectually" and he attacked its recommendations, particularly those related to urban structure and the fisheries.<sup>5</sup> The opposition members in the House of Assembly were largely in agreement with Peckford's position. Following government's reaction, there was little public debate and, despite some academic opinions to the contrary, e.g., McAllister (1982), no prolonged interest in the Economic Council's report. On the other hand, the Royal Commission's report met with a highly favourable response. The provincial government, opposition members, various interest groups and the public at large were receptive. Little criticism was forthcoming and there was considerable interest in the report both in Newfoundland and nationally.<sup>6</sup> As well, implementation of the report's recommendations appears to be among the rationales for the creation of the province's Economic Recovery Commission.

One may still ask: which report is superior to the other? Or a fairer question is: in what ways is one superior to the other? The next two sections examine the substance of the reports in more detail, looking first at the differences in interpretation of the workings of the labour market and, secondly, comparing the scope of and rationales for their respective policy recommendations.

### LABOUR MARKET VIEWS

The reports reflect very different senses of how the aggregate labour market functions. It is therefore of some interest to compare what they say about the labour market. Admittedly this will not capture the multi-dimensional aspects of the economic problems faced by Newfoundland, but it will set the stage for the subsequent discussion. And it is quite helpful in that it illustrates that there is really no substantive difference in how the two groups see the solution in broad terms. Both argue for policies that increase the demand for labour. That is to say, they want policies that increase productivity of labour.

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The orthodox view of English-speaking economists from the time of Adam Smith to the Great Depression (the Classical economists) was that labour markets were generally competitive and functioned well. The corollary of this view is that unemployment is rare and short-lived. Interestingly, there has been a revival of that hypothesis by the “New Classical school” of economics, which relies on the notion of rational expectations to argue that deviations from full-employment are the result of short-lived errors about perceptions of prices and wages.<sup>7</sup> Both the Classical and the New Classical schools contend that the labour market is typically in equilibrium, which occurs at the wage where the quantity of labour supplied to the market coincides with that being sought by employers. The number of workers sought by employers is the demand for labour and is determined by several considerations, the main ones being the quality and amount of equipment used by the workers, the workers’ productivity, the price of substitutes for labour and the wage that must be paid to attract workers; if other relevant variables are held constant, a higher wage leads to lower demand for labour.

On the supply side, the theory is that as the wage rises, if other considerations remain unchanged, more people choose to enter the labour market, making themselves available for employment. This reflects increasing opportunity cost of labour to the individuals involved, where the term “opportunity cost” refers to the satisfaction or gains that could otherwise have been had. People allocate their time according to many considerations: the desire for leisure, family obligations, education, training, work at home, individual pursuits of all sorts, and the wage available on the market, net of direct costs of earning that wage, e.g., transport cost, union dues, taxes on wages. From these activities, rewards are forthcoming, but as the wage rises relative to those rewards, people will tend to enter the labour market or participate in the labour market more than otherwise, at least up to some limit. For example, if average wages rose sharply, some students would likely choose to cease studies and enter the labour market in search of lucrative employment.

The Economic Council report rejects this classical economics characterization of the labour market as a description of the Newfoundland market. Rather, it proposes a “wage parity” hypothesis.<sup>8</sup> The Council identifies a number of forces that support the view that wages in Newfoundland are downwardly inflexible from a reference level, even in the face of considerable provincial unemployment. That reference level is determined by the Canadian average wage. Workers in Newfoundland, the argument goes, are reluctant to accept a wage markedly lower than the Canadian one. Knowledge of the Canadian market, national unions, the federal government’s common pay structure and access to unemployment insurance all serve to reinforce this view of a socially acceptable wage, a wage based on the Canadian norm. With that wage being above the one associated with the equality of labour supply and



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demand on the market, the result is unemployment, which in turn may discourage some workers from entering the labour force, biasing down the reported unemployment rate.

The Economic Council of Canada's characterization of the labour market implies three options. These are: to cut wages, to reduce the labour supply, or increase the demand for labour. The first could be accomplished by measures such as cuts in unemployment insurance benefits, making eligibility requirements more stringent, adopting labour relations legislation less favourable to trade unions, and having the federal government adopt regional wage differentials according to local market conditions. The second option, reduction in the size of the labour force, entails encouraging out-migration and making non-migration less attractive. This could be accomplished by assistance for relocation costs and elimination of regionally extended UI benefits, respectively.

The Economic Council rejects the first two options. They choose the third, to increase the demand for labour, i.e., increase productivity. Their rejection of wage-cutting and out-migration measures likely reflects, in part, consideration of the adjustment costs. With the former, the wage cuts required could be quite substantial, leading to a lower standard of living and worsening labour-management relations. With out-migration, adjustment costs and social implications are also considerable, and their analysis of migration led them to recommend a neutral stance, recommending that out-migration be neither encouraged nor discouraged. On the other hand, their policy choice, increasing the demand for labour, would entail more employment in the province, with possibly higher, and certainly not lower, wages.

The Royal Commission provides a model of the functioning of the labour market that is quite different. Its main tenets are contained in Chapter 5 of House (1986). They are: there is substantial adjustment taking place in the labour market in the face of market forces; opportunities for non-market production activities, i.e., household production, are substantial in Newfoundland, especially in rural areas, and in light of these opportunities workers need participate in paid employment only for short periods in order to generate sufficient cash (earned and from unemployment insurance) to return to household production; in a sense, unemployment in Newfoundland reflects a "false excess supply"; and withdrawal of UI, without replacement, would be devastating to the rural lifestyle.

Surprisingly, this model is consistent with the classical view of a quickly-adjusting labour market in which the outcome is full employment! In this model, people are simply choosing not to be in the labour force for lengthy periods because of attractive non-market activities and availability of UI. And disruption of UI benefits would jeopardize the standard of living associated with this particular labour market equilibrium.

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Despite this essentially classical full-employment model, the Royal Commission does suggest that unemployment in Newfoundland is of an involuntary nature. This is clear once one proceeds beyond the discussion of the model; e.g., see the chapter entitled the "Human Face of Unemployment," which provides compelling, though anecdotal, evidence on the severe hardship caused by unemployment. In short, the model presented in the report is simply not in accordance with the Commission's true interpretation of the unemployment problem; a problem that, clearly, it sees as severe, persistent and socially damaging.

The Royal Commission report identifies, either explicitly or implicitly, a number of problems associated with the working of Newfoundland's labour market. First, market wages are lower in Newfoundland, compared to the Canadian level. Secondly, at times there are severe difficulties experienced by people leaving the non-market sector to obtain paid employment, which is crucial to the non-market activities. Thirdly, the system is built on access to UI, leading to a dependency syndrome affecting initiative. And as the Royal Commission emphasizes, this is a fragile situation. Removal of UI would force those in the non-market sector to enter the labour market, causing high unemployment at the prevailing wage and leading to a severe fall in living standards, especially for rural Newfoundlanders. The long-term adjustment may entail substantial wage reductions and out-migration. Neither of these is acceptable to the Royal Commission.

Their preferred option is to increase the demand for labour. They forecast limited increases in demand in the future and suggest that job sharing will be desirable but propose a programme of development designed to make the demand for labour higher than otherwise. In short, they, like the Economic Council of Canada, adopt increasing the demand for labour as the broad solution. The effect of this would be to entice people out of non-market activity through rising wages and greater employment opportunities in the market. The question is: how can the demand for labour be increased?

### COMPARISON OF RECOMMENDATIONS

The Royal Commission and the Economic Council adopt a fundamentally common starting point; solving the problems requires policies that increase the demand for labour. What they do not share, however, is a common policy path. Their recommendations, while sharing some elements, differ quite distinctly on a number of important issues. The recommendations of both groups can be conveniently classed into four major categories. These are: actions for general productivity, measures involving existing natural resource industries, reforming the UI system, and offshore oil and gas policy. Using this classification, the recommendations falling into each of these four categories for each of the two reports are now compared.

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Offshore oil and gas policy will be dealt with first. The Economic Council of Canada extensively analyzed offshore oil and gas prospects and development. Their report warns that oil and gas development will not be a panacea for all the province's problems but that it is an important element in the province's path to self-reliance. A comparison with the North Sea experience leads to their conclusion that employment prospects in oil-related activities are quite limited.<sup>9</sup> However, the report emphasizes the revenue potential, while expressing reservations about the desirability of the provincial government's local preference policies. If Newfoundland could capture a reasonable share of royalties, net of concomitant reductions in federal payments to the provincial government under the Equalization program, then those revenues could be used for broad-based development, tax reductions and debt repayment. The report also suggests that decisions on the pace of the development take into account the province's ability to cope. All this was said, it should be remembered, at a time when oil prices were at high levels and rising.

The Royal Commission began its work when oil prices were high. Shortly before the Commission's report was submitted, circumstances had changed drastically. The world price had fallen from almost \$30 U.S. per barrel to levels as low as \$11.00 U.S. This event created considerable uncertainty, as the Royal Commission report acknowledges. But, on the assumption that offshore development would proceed, the Royal Commission makes a number of suggestions. They have much in common with those of the Economic Council. For instance, the Royal Commission argues that as a first principle the provincial government should attempt to maximize its share of any economic rent from the resource, which is the surplus of revenue over costs. There are suggestions for training and education for offshore employment, tempered with an acknowledgement that such employment may not significantly reduce the unemployment rate. Suggestions are made regarding participation of local business in offshore development. Also, the Royal Commission emphasizes that provincial government revenues from offshore production ought not to be used for the benefit of the oil companies or invested in industrial megaprojects. Rather, the funds should be used for other functions such as reducing the provincial deficit and taxes, and diversifying the economy.

This oil and gas strategy is, to a large extent, similar to that developed by the Economic Council of Canada. Goals are the same, priorities are similar and even the suggested means have much in common, aside from the use of local preference regulations. This is the only area of obvious difference. The Royal Commission clearly favours local preference as one of the ways of increasing local participation in offshore development, despite the negative implications for their first principle, rent maximization. The Economic Council, while amenable to local participation, expresses concern about the use of such regulatory means of achieving that goal. Thus even on this point the difference is a matter of degree.

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Secondly, consider the reform of the UI programme, where the Royal Commission and the Economic Council of Canada also have common concerns. Both regard unemployment insurance, as currently structured, as a serious problem. The Economic Council estimated that, at the time of their study, approximately 1 percentage point of the gap between the provincial and national unemployment rate was due to the greater generosity of UI in Newfoundland. The greater generosity arises because of the special benefits for fishermen and the regionally extended benefits of the programme, which provide many more weeks of benefits to regions with high unemployment rates. These benefit arrangements provide workers with more support, tending to increase the opportunity cost of labour, thereby leading to higher wages, with those higher wages reducing the employment offered by employers. The Council is concerned that fishermen's benefits keep and attract more workers to the seasonal, overcrowded inshore fishery and that regionally extended benefits offer similar incentives for seasonal employment generally. The Council suggests a variety of alternatives to these special features of the UI programme. These range from the possibility of a guaranteed annual income to modest changes to the existing system. No precise and detailed plan is given. The Council recommends further study.

The impact of UI is even more alarming to the Royal Commission. In part, this may be due to the considerable increase in reliance on it between 1980 and 1985. In 1979, the year the Economic Council commenced its study, benefits paid to Newfoundlanders totalled \$234.0 million; by the time the Royal Commission was formed, 1985, that figure had more than doubled to \$554.4 million.<sup>10</sup> This trend continued, with benefits reaching in excess of \$800 million in 1989, in an apparently unstoppable trend to the \$1 billion mark. The Report of the Royal Commission expresses grave anxiety over the combined effect of make-work projects, seasonal employment and underemployment in conjunction with unemployment insurance. This UI make-work system is described as the "ten week syndrome". The system creates many problems. House reports eleven.<sup>11</sup> They are: the system undermines the intrinsic value of work; undermines good working habits and discipline; undermines the importance of education; is a disincentive to work; undermines personal and community initiatives; discourages self-employment and small-scale enterprises; encourages political patronage; distorts the efforts of local development groups; has become a bureaucratic nightmare; distorts the role of state officials; and is vulnerable to manipulation. To solve these problems the Commission discusses alternative income security systems. It recommends a prototype system that it believes is not characterized by the undesirable aspects of the current system. A separate plan is suggested for fisheries-related unemployment benefits. It cautions against drastic reduction in the generosity of unemployment insurance. Essentially, then, the Royal Commission is in broad

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agreement with the Economic Council of Canada. That is to say, unemployment insurance distorts behaviour in a manner detrimental to development, and rather than drastically cutting the level of benefits, the system must be replaced by one less damaging, and with more positive incentives.

The third category chosen for comparison is that involving the resource policy, other than offshore oil and gas, which has been treated separately. These natural resource industries are: the fisheries, forestry, mining, agriculture, and hydro-electricity generation. The Economic Council, in reviewing the potential of these sectors, concludes that they offer little in the way of future employment growth and laments the loss to Newfoundland of a reasonable share of economic rent generated by the hydroelectric facilities of the Upper Churchill river. The Council, while even projecting that major hydroelectric power sites on the lower Churchill River would proceed in the 1980s, states that jobs will have to come from elsewhere. The report does, however, separate the fisheries from the other resource-based industries. While little is recommended for the other sectors, much is said about the fisheries and what is said proved to be very contentious.

The common property nature of the fisheries is what separates it from the other resource industries. The Economic Council draws extensively on the economics of common property resources to develop a design for a revamped fishery. The fundamental problem arising from common property resources is over-entry and over-exploitation; this is commonly known as the "tragedy of the commons" by resource economists. This problem afflicts the Newfoundland fishery along with a number of other problems such as technological change, seasonality, the inshore-offshore trade-off, and the fisheries-related UI benefits. The Economic Council devised a scheme that it felt would strengthen the industry and ensure efficient utilization and long-term management of the resource. The main features of this plan involve recommendations for: greater bio-economic research on the fishery, a system of licensing and transferrable stunted landing rights to eventually encompass the offshore and some of the inshore fisheries, elimination of various subsidies to the fisheries (which would have the effect of reducing the inshore), replacement of fisheries-related unemployment insurance with either a compulsory self-financing scheme or private insurance, further control and surveillance of foreign fishing, and creation of an independent board to establish and control quality and grading. The most controversial aspects of this plan are those involving licensing and stunted landing rights. Adoption of these measures, as designed, would severely limit entry and eventually reduce the numbers of workers involved in the fisheries. These measures, plus a bias in favour of the offshore fisheries, led the provincial government to reject these recommendations outright.

For the resource industries other than the fisheries, the Royal Commission takes a similar position to the Economic Council regarding future employment

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prospects. Their outlook is not for significant employment growth. The Royal Commission does, however, offer many recommendations involving these industries as well as other industries not emphasized by the Economic Council, most of which are aimed at strengthening existing activity. One exception is a plan for substantial expansion of agriculture. That industry, defined in broader terms as agri-foods and animal products, is described as being important for employment generation. An "infant industry" argument is advanced for government assisted and subsidized expansion. The rationale for attention to agriculture seems based on a combination of faith and technological feasibility. Economic feasibility is not an obvious consideration. Additionally, the enthusiasm for agriculture is not entirely shared by the Economic Council, which does, however, cautiously suggest that concerted efforts to raise productivity in certain aspects of the industry could result in increased employment.

Fisheries policy is another matter. The Royal Commission, while accepting the importance and progress of the offshore fishery, touts the inshore fishery as not receiving the attention that it deserves and as suffering from policies that lack necessary flexibility. Affinity for the inshore fisheries permeates the Commission's report, despite a recognition of its weaknesses. The rationales for this are three. First, the inshore fishery is an essential element for community-based rural development favoured by the Commission. Secondly, the Commission attempts to argue that the economic benefits of that fishery are greater than studies indicate. Thirdly, with appropriate changes considerable improvements are possible. In short, the Royal Commission argues that there is more than a social case to be made for the inshore fisheries; there is an economic case. Yet the brevity of their argument and its weakness in terms of economics are glaring.

The elements of the Commission's plan for the rejuvenation of the inshore fishery include a recommendation that government assert its faith in the inshore fishery. In addition, there are specific proposals involving a revitalization programme, debt relief to longliner fishermen, a more flexible licensing system, replacement of fishermen's unemployment insurance with an income support programme, and a variety of measures to improve training and policies on fish plants consistent with the community-based approach. Additional recommendations related to other aspects of the fisheries involving government's role, planning, education and technology are also given. There is no apparent emphasis on the importance of the fisheries as a source of economic rent.

The fourth category of recommendations chosen to facilitate the comparisons between the two studies is general productivity. The Economic Council places strong emphasis on this. While the number of recommendations it advances are few, they are broad in scope and have potentially far-reaching implications. It is therefore disturbingly unfortunate that these recommendations

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are both sparse and terse. One can hardly avoid feeling that the extensive theoretical and empirical research undertaken by the Economic Council would have been sufficient basis for more detailed proposals.

The measures formulated by the Economic Council involve: transportation policies designed to facilitate access to urban centres and remove distortions in choice of transportation modes; a recommendation that government favour job creation in more urban areas within commuting distance of outports; programs of apprenticeship and training; the establishment of an advisory council on productivity; and a recommendation that alternatives to the extended benefits provisions of unemployment insurance be sought. These recommendations reflect in part the Economic Council's findings on productivity in Newfoundland. In studying productivity at the firm level, the Council concludes that Newfoundland firms typically lag behind those outside the province by a wide margin. That is to say, with comparable resources such as machinery and numbers of workers, less is produced in Newfoundland. The existence of this gap leads the Council to conclude that productivity gains are possible. The other underlying basis for the Council's recommendations is agglomeration economies. Agglomeration economies may be defined as the increased productivity associated with the more integrated market activity that results from the concentration of economic activity.<sup>12</sup> Hence the emphasis on transport systems that enhance people's ability to commute between rural and urban areas, and the emphasis on employment location in more urban areas where feasible.

A large portion of the Royal Commission's 242 recommendations, approximately half, may be placed in the general productivity category. The many recommendations on education and training perhaps constitute the largest component of these but there are numerous other recommendations which involve support for small enterprise, local preference, labour relations, technology, transportation and, especially, rural development. Particularly noteworthy are the recommendations on rural development. They reflect the Commission's broad vision of a development plan which has as its goal the creation of an economic prosperity in a society characterized by a strong rural economy fostered by community-based government development policy and integrated with the urban structure as well as with national and international markets.<sup>13</sup> Many other recommendations, e.g., those emphasizing the inshore fisheries, are consistent with this objective.

### UNRESOLVED ISSUES

The Royal Commission and Economic Council of Canada have contributed important and informative reports addressing Newfoundland's serious economic problems. Examining their backgrounds and recommendations leads to some interesting insights. Following from the

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preceding discussion, one may conclude that four broad fundamental issues arise and remain to be addressed by policy-makers. These are: how to reform unemployment insurance, the role of government in the economy, the relevance of spatial structure, and how to approach the fisheries. An elaboration together with possible resolutions of these matters follows.

Both reports agree that unemployment insurance, as structured at the time, and which has not changed appreciably since, is a fundamental problem. That programme's design distorts behaviour towards unproductive activities, creates dependency, etc. Both agree on the need to replace the system with one with less negative side-effects. Unfortunately, there may be problems with the schemes suggested by both and no other scheme has been put in place. Unemployment insurance functions now as then, and dependence on it has grown. It is a federal government responsibility, beyond the control and authority of the provincial government. It is therefore at the federal level that action must occur.

One may speculate as to why there has not been reform of the UI system. The proposals put forward by the Royal Commission and the Economic Council were devised with Newfoundland the focus of attention; perhaps the broader implications for the rest of the country are problematic. Still, other reports at the national level, e.g., Forget (1986), have devised reforms which were not adopted either. No doubt part of the problem is political. Proposals for substantive reforms have met with considerable opposition; unemployment insurance is very important to many people and those people are often concentrated sufficiently so as to have considerable potential to affect election results. Also, many citizens and policy-makers are legitimately concerned about the equity aspects of changing the system. Yet somewhat paradoxically, it seems that all those who examine UI conclude that there are serious problems. One could argue that addressing the problems of UI is secondary in that with sufficient employment-oriented policies people could be drawn out of the UI dependency trap. This seems unrealistic and utopian. As the reports imply, the UI system, while initially alleviating the hardship of unemployment, has now evolved into part of the problem.

Given the political constraints and the equity considerations, it is unlikely that far-reaching reform is either feasible or desirable. An approach involving modest, well-defined changes to the system seems the only way of actually achieving any reform. For example, the regionally extended benefits could be curtailed in terms of payments, reducing the percentage of payments from 60% of previous earnings to a smaller percentage, possibly combined with a modest reduction in the number of weeks during which these benefits could be received. To this might be added limitations on eligibility for fisheries-related benefits, the main intent being to keep those affected by the first measure from entering the inshore fisheries. At the same time, the savings to the UI fund could



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be used to further training programmes, to assist worker relocation or to fund infrastructure projects. So as not to create a climate of uncertainty, which would add to opposition to such a plan, there could be a clear commitment that no other aspect of UI would be altered for a specified period, say five years. This not only might stem opposition but allow time to ascertain the impact of the changes and permit an analysis of whether any further changes, in one direction or another, are required.

The second issue remaining to be addressed or reassessed is the role of government in the economy; in particular, the provincial government. Differing views on this matter are apparent in comparing the reports. This was noted earlier. The Economic Council directs the majority of its recommendations towards the fisheries and offshore oil and gas, both of which are sectors where market failure can be expected to arise. In the former, there is the common property problem, while in the latter, government is the mechanism by which society can collect the economic rents from the resource that it owns, a similar problem. Other recommendations relate mostly to transport and training. There is little to suggest that the provincial government ought to become involved in a broader range of activities in which there is no clear evidence of market failure.

The Royal Commission takes a more eclectic approach and one with almost unbridled faith in the public sector. It starts with its vision of the ideal state of Newfoundland society and economy. That ideal is characterized by the modern villages founded on individual, community and cooperative initiatives, self-reliant and integrated with one another and the outside world. The scope of government intervention is then largely defined in terms of any activity that contributes to the realization of that ultimate objective.<sup>14</sup> This criterion is little tempered by considerations of feasibility, cost, or whether the activity would have proceeded regardless of government assistance. Moreover, some of these policies may not be compatible with achieving the stated goals. For instance, if there were dramatic success in increasing education and training of people in rural areas, then that may well lead to a further depopulation of outports as education provides the mobility to engage in other activities and encourages the desire for doing so. The avoidance of the cost issues no doubt contributed to the Royal Commission's political success. Its acceptability rests not only on what some may describe as the sacrosanct notion of the modern village but also on a host of other initiatives favourable to practically all interest groups and opinions, combined with a role for government as a facilitator of those initiatives, thus implying ultimate responsibility lay with government.

There is no easy answer to the philosophical question of the role of government in the economy. No answer is attempted here. But a cautionary note is in order. If the interventionist tack is taken, there are many ways of doing it. One way is through subsidies of various sorts, which are made available to firms as opposed to an entire industry or the entire business sector. Those

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familiar with government assistance to private ventures in Newfoundland are aware of many costly failures. Feehan et al. (1991) elaborate on the arguments against firm-specific subsidies and other forms of assistance provided by the provincial government. In particular, firm-specific subsidies are likely to be unproductive, amounting to little more than a zero-sum game: taxation of some to benefit others. In addition, one could argue that the availability of grants and subsidies of various sorts leads to a waste of resources as firms compete with one another for the limited assistance that is available. This sort of wasteful endeavour is described as “directly unproductive, profit seeking activity” by economists and has received considerable attention in recent years; see, e.g., Krueger (1974), Bhagwati, Brecher and Srinivasan (1984) and Tollison (1982).

Spatial distribution of the population is the third fundamental issue that, it is argued here, remains to be addressed by policy-makers. It is a subject with a history of controversy in Newfoundland, reaching back to the centralization and resettlement programmes. The Economic Council emphasizes the importance of agglomeration economies to future development. Being aware of the political sensitivity of the resettlement schemes in Newfoundland, the Council suggests a compromise, a “from bays to peninsulas” approach. Urban centres along the Trans-Canada highway are preferred centres of job creation, and transportation policy, the Council suggests, should facilitate linkage among those centres with east and west coast ports and with outports from adjacent peninsulas. This strategy in combination with other recommendations, particularly those in the fisheries, went too far in terms of political acceptability. Provincial politicians rejected it. Emphasis on community and rural development, a key feature of the Royal Commission report, proved to be far more popular.

For the rural-urban split of the population, opting for the status quo appears socially appealing and politically adroit. Yet it is not resolved that development based on that status quo offers more in the way of economic growth and employment. Rural areas in Newfoundland suffer even more than urban areas in terms of measured unemployment and population loss. Many outports have been depressed for a long time. The persistent failure of these areas to progress does not provide convincing evidence that the potential is there. The Royal Commission asserts that the potential is indeed present but with little proof. On the other hand, evidence in favour of the agglomeration approach is somewhat stronger but not compelling. Boisvert (1978) cites the strongly positive correlation between income and urban size as well as a similar correlation between urban size and labour force participation rates, with the correlation and unemployment rates being unclear. However, this empirical evidence is certainly not overwhelming nor does it prove anything, nor is it necessarily applicable to Newfoundland. Its only relevance is that it is consistent with the general hypothesis that urbanization and income go hand-in-hand. Nothing can be inferred about causality, which may go either way or be

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two-way. Moreover, there are, no doubt, many other variables that influence a region's economic performance; some areas' characteristics may require a dispersed population. A blanket recommendation of urbanization as the means to raise income in low income regions would be folly.

At the theoretical level there are also two sides to the argument. Economic theory does provide a strong rationale for gains from agglomeration; greater participation in markets improves the performance of the market, leading to greater gains from market exchange than otherwise. Alternatively, one may also argue, equally strongly, that there are economic gains from location close to some types of resource bases, and that that argument is applicable to Newfoundland. The stagnation of many rural areas in this province provides evidence contrary to that logical argument. The choice between population distribution and economic performance (if making such a choice is a legitimate matter of public policy) may well involve a trade-off in Newfoundland's case.

The entire debate over urban structure, though emotional to many, may be superfluous and misplaced. The dependency problem is now more serious than ever. People are leaving the province in greater numbers and immediate prospects for the economy are not bright; even the development of the Hibernia offshore oil field offers little hope.<sup>15</sup> Wherever potential strengths are, rather than where we would like them to be, they ought to be realized. Our resource base, technology, and the structure of prices prevailing on world markets determine economic strengths or, in the jargon of economics, comparative advantages. Building on these strengths may entail success for some rural areas and decline for others, and similarly for the more urban areas. What is needed is public infrastructure and training that enhances mobility potential within the province and across activities. This would permit flexibility and adjustment in the face of changing comparative advantage. Simultaneously, people would exercise their choice of where to live in accordance with their preferences and incentives. The overriding problem for Newfoundland in the 1990s is one of economic survival. The fish stock crisis, the severity of which was not known at the time of the two reports, is perhaps the most immediate and pressing challenge; declining federal transfers and the threat of Quebec separation may turn out to be equally problematic. Thus, whether Newfoundland's population is located in a thousand villages of five hundred or fifty towns of ten thousand is hardly germane when the immediate and pressing challenge is to ensure sufficient economic progress to avert massive out-migration.

Finally, what to do about the fisheries? Both the Royal Commission and the Economic Council of Canada recognized the importance of acquiring greater scientific knowledge of the fisheries resource and ensuring the long-term health of the resource by avoidance of excess harvesting. Neither was in a position to anticipate the severity of the current fish stocks crisis. If the federal authorities fail to achieve an effective international resolution of the problem of

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foreign over-fishing in areas beyond Canada's 200 mile limit, then there may be little hope for the fisheries.

On the assumption that the over-fishing can be halted, many problems remain. The Economic Council and the Royal Commission epitomize the fundamentally different approaches to dealing with those problems. The former emphasizes the common property nature of the resource and, with it, the importance of limiting entry and capturing resource rents. The latter emphasizes the role of the inshore fisheries in rural Newfoundland, both socially and economically. There is no easy resolution as to which position ought to receive greater consideration. In part, this is because benefits and costs of alternative actions are not well known or understood. Resolution of the fisheries problems requires as clear a delineation as possible among what is feasible, what is socially desirable and what is economically efficient.

### CONCLUSION

The strength of the Economic Council Report is in its technical expertise in economics. Its weaknesses are its less-than-adequate understanding of Newfoundland society and its failure to draw on its research findings to offer more recommendations with greater detail. The reverse is true for the Royal Commission's strength and weaknesses. Its relative weakness lies in its less-than-rigorous economic analysis of feasibility. But where it is strong, it is Herculean. The Royal Commission Report is more home-grown, multi-disciplinary, and in touch with society through numerous public hearings and other media. Also, it develops an idealized vision of Newfoundland society, one which possesses something for almost all interest groups and political philosophies, while implicitly absolving individuals and groups of ultimate responsibility by making government the essential element in almost every aspect of its detailed set of proposals.

There is a lesson here for future economic enquiries. Considerations of both societal preferences and economic possibilities are crucial. Technical economic analysis is essential to the latter but can offer little on the former, and economists' preferences often are not synonymous with those of the mainstream of society. A thorough understanding of society is essential in making the choices among alternative economic possibilities. Future studies on Newfoundland's economic problems will hopefully come closer to striking the appropriate balance.

What about economic policy? Certainly the precise solutions to the problems do not emerge from this paper but perhaps, in some cases, the elements of partial solutions do. Reform of unemployment insurance is clearly desirable. On that, the two reports agree. The contention here is that well-defined and very modest change is the most fruitful, and possibly the only feasible, way to proceed. But solving the UI problem, important as it is, is

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neither necessary nor sufficient to remedy all Newfoundland's economic problems. The provincial and federal governments have many other challenges to address. In broad terms, policies should be adopted that ensure the provincial economy performs as best it can, given its resources, technology and the structure of prices. Firm-specific subsidies have no place in achieving that objective. Rather, the policies that are required are those that, among other things, enhance the mobility of resources across industries and geographically, so that people and business may respond to incentives as they believe them to be advantageous. No doubt this involves education, training, transportation and natural resource management; items stressed by both reports. The choice and extent of measures to attain these goals ought to be determined by comparing their economic and social benefits to their costs, rather than by their appeal to an ideal.

### Notes

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<sup>1</sup>Melvin (1987) offers a contentious view on this matter, suggesting that much of the "regional disparity problem" may be illusory.

<sup>2</sup>See Economic Council of Canada (1980), Appendix D.

<sup>3</sup>See House (1986), Appendix 1.

<sup>4</sup>Copithorne (1986) was, however, prepared at the request of the Royal Commission.

<sup>5</sup>See House of Assembly Hansard. Also, a more complete response to the Economic Council was issued by government following Peckford's address, see Government of Newfoundland and Labrador (1981).

<sup>6</sup>One exception to this was S. Antler in S. Antler et al. (1986).

<sup>7</sup>For elaboration on the New Classical school of thought see, e.g., Hall et al. (1990).

<sup>8</sup>See Chapter 4 of Economic Council of Canada (1980) and Swan and Kovacs (1981).

<sup>9</sup>Feehan and Locke (1988) reach similar conclusions about employment prospects.

<sup>10</sup>See Table D-3, Newfoundland Statistics Agency (1990).

<sup>11</sup>See pages 406-409 in House (1986).

<sup>12</sup>Boisvert (1978) and especially Reid (1980) are the Council's relevant background studies.

<sup>13</sup>For further elaboration see chapter 1 of House (1986).

<sup>14</sup>Interestingly, neither group explicitly recognizes the constraints placed on government policy due to the heterogeneity of society. Self-interest of individuals, firms, social organizations, regional groupings, bureaucrats and politicians can lead to obstacles to generally beneficial policies.

<sup>15</sup>See Feehan and Locke (1988) and Locke (1991) for prospects on Hibernia-related employment and revenues, respectively.

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