

A comment on the papers by
Thomas Courchene and Albert Breton

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My comments focus primarily on Tom Courchene's informative analysis of the central role played by the Canadian Economic Union (CEU) issue in the recent constitutional debates. Towards the end of these comments I raise an issue which straddles the concerns of both the Courchene and the Breton papers.

It is possible to come away from Courchene's paper with the impression that balkanization, the regional dimension of the inequality of price and marginal cost, is a recent problem in Canada. In fact, however, balkanization is very deeply seated in the interaction of the political economy of regulation, the federal character of the constitution, and the regional nature of Canadian economic development since Confederation (Paquet and Winer, 1980).

It is well-known that the interests of producers of goods and factor services tend to dominate those of consumers and other relatively larger and harder-to-organize interest groups (e.g., Downs, 1957 and Olson 1965). Mancur Olson (1974) and Jean-Luce Migué (1977) have more recently shown why entry restriction, which is a necessary condition for balkanization in the long run, is the first order of business for any

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producer seeking rents via the political process. Entry restriction is first on the regulation agenda because in a market characterized by a perfectly elastic supply, the benefits of other capture-type policies such as subsidies will simply be competed away by new entrants.

This dominance of producer interests in the political process would not lead to balkanization of the internal common market if these interests did not have a substantial regional dimension, or if governments could not deliver regulation with regionally differentiated effects. As for the latter, however, the dominant feature in the Canadian political system is the fact that the British North America Act of 1867 endowed the provinces with substantial regulatory autonomy and financial independence. At the same time, the BNA Act placed few constraints on the use of provincial legislative and executive powers to impede economic mobility.

In addition to the provincial ability to supply regionally specific policies, moreover, the demand for regulation in Canada has always had an important regional dimension. This is because Canadian economic development, partly for geophysical reasons, has to a significant extent been along provincial lines. For example, manufacturing dominates the economies of Ontario and Quebec, agriculture that of Saskatchewan, resources the economies of Alberta and British Columbia, and so on. Producers in Ontario and Quebec have an interest in preventing the industrialization of the Western and the Atlantic provinces. Industrial labor unions in central Canada have an interest in preventing migration to the relatively high-paying jobs in the auto industry and steel foundries of Ontario, just as organized forestry workers in B.C. will try to prevent the competing away by interprovincial migration of rents they earn in the forest sector. Farmers' co-ops are interested in the subsidization of wheat transport costs, even if this involves cross-subsidization and higher costs for western manufacturers trying to compete in central Canadian markets. So even in the absence of a federal structure in Canada, we would still expect balkanization. Indeed, the original national policy of international tariffs (1879) and the Crow's Nest freight rates (1897) can be seen as an attempt by the federal government to meet the demands of both central Canadian manufacturers and western grain producers.

The political economy of special interests, the regional dimension

in Canadian economic development, and the federal character of the constitution have together produced in Canada a history of regulation which is almost synonymous with the history of federal-provincial competition over regulatory powers and over the servicing of what Anthony Scott (1965) has aptly labelled "regional" interests. Given the deep nature of this regulatory competition in Canada, it is not at all surprising that the CEU issue played an important role in the recent constitutional debates. Recent debates over the CEU can be regarded simply as continuation of the same old federal-provincial struggle for regulatory power to service their respective clienteles. Of course, the old debate has a certain constitutional flavor this time. (I hesitate to describe as constitutional a debate in which governments themselves rather than a constituent assembly decide upon the limits to governmental authority.) This flavor was chosen by a Prime Minister whose primary goal was to increase the legitimacy of central institutions in Quebec, or, in Albert Breton's terms, who was intent on increasing French Canada's belief that national institutions would deliver economic results that are fair and just. Trudeau's strategy called for entrenching French language rights in the constitution to ensure that these rights could not be abrogated by provincial governments, as they have been in the past. To enhance the acceptability of entrenched French language rights, Trudeau proposed to include these rights in a Canadian (i.e., national) Charter of Rights and Freedom. And, to gain the provincial support needed for constitutional reform of any sort, this charter was written to enhance provincial regulatory powers, including the right to indirect taxation in the resource field amongst the other features noted in Tom Courchene's paper.

This is my interpretation of Trudeau's fundamental strategy, the implementation of which culminated in the November 1981 constitutional conference. It is an interpretation which seems to be close to that of Breton and to be somewhat different from that of Courchene. Tom Courchene views the federal attempt to centralize economic power in the guise of protecting the CEU as more than a federal bargaining strategy vis à vis language rights. In my view, however, it was to be expected that the balkanization potential of provincial policies would be increased by the new constitution. Entrenched French-language rights that must be enforced by the provinces in their school systems are likely to

cost those provincial governments politically. Outside of Quebec and parts of New Brunswick, these rights are not popular. In particular, in Manitoba and Ontario, where there are sizable French-speaking minorities, French-language rights have been over the years a source of great emotional and political passion. The entrenched powers of the provinces were required for substantial support of patriation, though there was prolonged conflict over the terms of the federal-provincial agreement (i.e., on the constitutional reform package) as the feds attempted to yield the minimum. The thrusts and parries in this debate are ably documented in Courchene's paper.

The costs of balkanization stem, first, from the static losses due to the divergence of price and marginal cost, and secondly and probably more importantly, from the dynamic costs of an economy in which adjustment to changes in relative prices is slowed by the maintenance of entry barriers. The latter costs have never been measured, as Courchene notes. He argues that a statement about the size of these costs is only weakly related to the federal character of the country. I concur with him that centralization of power at the federal level is not unambiguously efficient, contrary to the widespread belief in Canadian academia and in the Canadian press. This is so for essentially three reasons not clearly noted in the paper. First, as I have already pointed out, the regional character of the demand for regulation will lead the federal authorities to balkanize. Of course, federal intervention will on the whole be more favorably directed towards Ontario and Quebec, whose representatives dominate the House of Commons, than will provincial regulatory activity. Second, centralization of public services often amounts to standardization of services across regions, and this also breaks the link between regional prices and marginal cost. Third, and most important of the reasons why centralization is not unambiguously efficient, is that the federal authorities, unlike provincial regulators, need not worry about interprovincial competition. For this reason centralization can be said to be equivalent to cartellization. I am even tempted to argue that this third reason is dominant and that decentralization is one route to a better economic union. However, I do not see how one could determine either logically or empirically which federal-provincial division of powers is most conducive to integration of the Canadian economy. On the other hand, enhancement of civil liber-

ties via reform of the new Charter of Rights may reasonably be expected to enhance the operation of the CEU by restricting the power of all governments to balkanize the economy. This is the route suggested by Courchene, and I agree that it is the most promising in principle.

Thus it would appear that the most important, if not the only important, recommendations of the newly created Royal Commission on the Canadian Economic Union, of which Albert Breton is a member, will be those directed toward strengthening the Charter of Rights. This poses a dilemma for the Commission and for Canadian society, because a Charter that seriously limits the ability of governments to balkanize the CEU is also likely to alienate French Canadians by threatening the current language legislation of the Quebec government.

The Quebec language legislation imposes a wider use of French in business than is required by the marketplace for profitability. It also limits the ability of international and interprovincial migrants to choose the language of public-school instruction for their children. From an analytical viewpoint, these measures lead to an increase in the price of imported goods and factors, with the relative price increase varying with the linguistic content of the import. A tariff on the interprovincial movement of goods and factors would have the same effect; the language policy is equivalent to a tariff on the import of non-Francophone services.¹ The language legislation is, therefore, incompatible with a strong CEU. Since this legislation is, I believe, widely seen by Francophones as an avenue to a fairer distribution of income and economic opportunity, the serious strengthening of mobility rights that would lead to "debalkanization" of the CEU is not likely to build the trust of Québécois in central institutions.

¹The above analysis of the Quebec-language legislation follows Migué (1979).

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